

T-142



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

## AUDIT REPORT

FINANCIAL STATEMENTS FOR  
FISCAL YEAR 1997 FOR THE  
OFFICE OF THE SPECIAL TRUSTEE FOR  
AMERICAN INDIANS TRIBAL AND  
OTHER SPECIAL TRUST FUNDS AND  
INDIVIDUAL INDIAN MONIES TRUST FUNDS  
MANAGED BY THE OFFICE OF TRUST  
FUNDS MANAGEMENT

REPORT NO. 99-I-372  
MARCH 1999

DOI SOL



# United States Department of the Interior

OFFICE OF INSPECTOR GENERAL  
Washington, D.C. 20240

MAR 26 1999

## Memorandum

To: Special Trustee for American Indians,  
Office of the Special Trustee for American Indians

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

Subject: Audit Report on the Financial Statements for Fiscal Year 1997 for the Office of the Special Trustee for American Indians Tribal and Other Special Trust Funds and Individual Indian Monies Trust Funds Managed by the Office of Trust Funds Management (No. 99-I-372)

The Office of Trust Funds Management contracted with the independent public accounting firm of Griffin and Associates, P.C., to audit the statements of assets and Trust Funds balances and the statements of changes in Trust Funds balances for Tribal and Other Special Trust Funds and for Individual Indian Monies Trust Funds as of and for the year ended September 30, 1997. The Trust Funds, which are managed by the Office of Trust Funds Management, under the Office of the Special Trustee for American Indians, consist of tribal and individual Indian monies and other special appropriated funds. The audit was required by the Chief Financial Officers Act of 1990, as amended. 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."

For the fiscal year 1997 annual financial report, Department of the Interior and Office of Trust Funds Management officials issued two sets of financial statements with accompanying notes: one set for the Tribal and Other Special Trust Funds and the other set for the Individual Indian Monies Trust Funds. The financial statements and notes to the financial statements of the Tribal and Other Special Trust Funds were reported using the cash basis of accounting, and the Individual Indian Monies Trust Funds were reported using a modified cash basis of accounting. Because of changes in reporting methods used in preparing the financial statements for the fiscal year ended September 30, 1997, comparative data for the prior year had not been presented.

In its reports on the financial statements, the independent public accountant issued qualified opinions because cash and overnight investments could not be independently verified, cash balances were materially greater than those reported by the U.S. Treasury, major deficiencies

in the accounting systems' controls and records caused the systems to be unreliable, and certain Trust Funds beneficiaries disagreed with balances recorded by the Office of Trust Funds Management and had filed or were expected to file claims against the Office of Trust Funds Management. These conditions prevented the cash and Trust Funds balances and the receipts and disbursements from being audited. In addition, a potential liability to the Federal Government exists because of lawsuits filed over the Government's fiduciary responsibilities.

The independent public accountant's report on the internal control structure contained 11 recommendations to address 3 material weaknesses, 4 reportable weaknesses, and 4 advisory comments.

The report identified the following three material internal control weaknesses:

- Inadequate management controls hampered management's ability to implement certain policies and procedures.

- Critical information regarding the status of account beneficiaries was missing or could not be obtained for testing.

- Numerous receipts were erroneously coded, which resulted in the inability to provide reasonable assurance as to the type or amounts represented as individual categories of trust receipts.

The report identified the following four reportable internal control weaknesses:

- Funds were accepted from a tribe for deposit into trust accounts without supporting documentation, which resulted in the inability to ascertain that the funds were trust funds.

- The lack of procedures for transfers between Tribal and Individual Indian Monies Trust Funds resulted in a \$6.6 million overdraft and an equal overinvestment in an overnight U.S. Treasury security at September 30, 1997.

- The lack of procedures for making and reviewing manual adjustments to the Omnitrust accounting system and the lack of reconciliation procedures for the carrying values of securities resulted in an incorrect manual adjustment being made to the carrying value of a security.

- The lack of procedures for manually pricing securities resulted in several incorrect market values being recorded in the Omnitrust accounting system.

The report identified the following four advisory internal control comments:

- Policies and procedures did not exist for requiring authorizations, such as tribal resolutions, to support the withdrawal of funds from Tribal Accounts - Proceeds of Labor.

- Errors in the system maintained by the Office of Trust Funds Management's contractor were not corrected in a timely manner.

- The Office of Trust Funds Management may be establishing accounts for non-Trust beneficiaries and accepting non-Trust Funds deposits to these accounts.

- Instances of noncompliance with internal control procedures and trust responsibilities were identified, including unauthorized disbursements; failure to assess interest on late payments from lessees; failure to execute leases timely; the holding of checks beyond the 24-hour Treasury fiscal requirement; original documents being stored in unsecured locations; some allotted lands not being advertised for lease; a lack of segregation of duties between the collections official and the mail clerk; the lack of a backup collections official or the backup collections official not being familiar with the collections process; and personal checks being accepted as a form of payment and occasionally not being honored by the payer's bank, which resulted in overdrafts to Individual Indian Monies Trust Funds accounts.

The independent public accountant's report on compliance with laws and regulations contained a notice that some tribal organizations and individual Indians have filed various claims against the Federal Government for its failure to fulfill fiduciary responsibilities. The report also addressed an immaterial noncompliance issue (No. C.1) relating to the Office of Trust Funds Management's accepting voluntary deposits totaling \$2.5 million to Individual Indian Monies Trust Funds accounts. Although the report contained no recommendations for these issues, the Office of Trust Funds Management responded to No. C.1. The issue concerning potential and actual litigation will be a matter for the Office of Solicitor or the Department of Justice to address.

In addition to the results of the audit of the financial statements as of and for the year ended September 30, 1997, the independent public accountant's report contained information on the minimal progress made by the Office of Trust Funds Management and the Bureau of Indian Affairs in addressing the material weaknesses and reportable conditions (Recommendations 1-30). The status of these prior year recommendations is presented in Appendix 2 of this report. The status of Recommendation 27, which was reported as resolved and implemented in the fiscal year 1996 report, has been changed to resolved but not implemented in the current report.

The independent public accountant's report on compliance with laws and regulations also contains information on the minimal progress made by the Office of Trust Funds

Management and the Bureau of Indian Affairs in addressing the noncompliance issues identified in the audit reports for fiscal years 1995 and 1996.

Based on the response from the Office of Trust Funds Management (which was incorporated into the independent public accountant's report) and the response from the Bureau of Indian Affairs (see Appendix 1) to the 11 recommendations (Nos. 31-41 in the report on internal controls), we consider Recommendations 31, 32, 33, 34, 35, 36, 37, and 40 resolved but not implemented and Recommendations 38 and 39 resolved and implemented. Recommendation 41 was addressed to the Bureau of Indian Affairs, which did not indicate in its response whether or not it concurred. Accordingly, we suggest that the Bureau of Indian Affairs send us a revised response to specify concurrence or nonconcurrence with Recommendation 41. The unimplemented recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation, and no further response from the Office of Trust Funds Management to the Office of Inspector General is required for these unimplemented recommendations (see Appendix 3).

In conjunction with the audit, we reviewed the independent public accountant's report and related working papers. Our review, as differentiated from an audit performed in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not express, opinions on the financial statements of the Office of the Special Trustee for American Indians, on management's assertions about the effectiveness of its internal controls, or on its compliance with applicable laws and regulations. The independent public accountant is responsible for the auditor's report dated June 4, 1998, and the conclusions expressed in the report. However, our review disclosed no instances in which the independent public accountant did not comply in all material respects with generally accepted auditing standards.

In accordance with the Departmental Manual (360 DM 5.3), we are requesting a written response from the Bureau of Indian Affairs regarding Recommendation 41 by April 28, 1999. The response should provide the information requested in Appendix 3.

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.

cc: Assistant Secretary for Indian Affairs

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U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF THE SPECIAL TRUSTEE  
FOR AMERICAN INDIANS  
TRIBAL AND OTHER SPECIAL TRUST FUNDS,  
AND INDIVIDUAL INDIAN MONIES TRUST FUNDS  
MANAGED BY THE  
OFFICE OF TRUST FUNDS MANAGEMENT

FINANCIAL STATEMENTS

SEPTEMBER 30, 1997

WITH REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS  
TRIBAL AND OTHER SPECIAL TRUST FUNDS,  
AND INDIVIDUAL INDIAN MONIES TRUST FUNDS  
MANAGED BY THE  
OFFICE OF TRUST FUNDS MANAGEMENT

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U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS  
TRIBAL AND OTHER SPECIAL TRUST FUNDS,  
AND INDIVIDUAL INDIAN MONIES TRUST FUNDS  
MANAGED BY THE  
OFFICE OF TRUST FUNDS MANAGEMENT

OVERVIEW

MANAGEMENT'S DISCUSSION AND ANALYSIS

SEPTEMBER 30, 1997

## DESIGNATED TRUSTEE

The Secretary of the Interior ("the Secretary") is designated as Trustee of funds held by the federal government for Indian Tribes and individual Indians. The Secretary delegated authority for the management of Indian trust funds to the Assistant Secretary - Indian Affairs. This authority was re-delegated to the Bureau of Indian Affairs ("BIA") and was administered by the BIA's Office of Trust Funds Management ("OTFM").

The Office of the Special Trustee for American Indians ("OST") was established, under authority provided by the American Indian Trust Fund Management Reform Act enacted in 1994 (the "Act"), to oversee all facets of trust management improvement for the Department of Interior ("DOI"). In February 1996, the OTFM was transferred from the BIA to the OST. The Special Trustee has since re-delegated program and administrative authority to the Director, OTFM.

The OTFM manages all trust activities associated with the receipt, accounting, investing, and disbursement of funds for American Indians and Alaska Natives in accordance with public laws, regulations, policies, and procedures. The OTFM is working with the Special Trustee to mitigate deficiencies in all processes, and to make the appropriate improvements to the overall administrative activities while providing efficient and timely service to the account holders.

There is approximately \$2.9 billion (historical unamortized cost basis) held in over 285,000 Tribal and Individual Indian Monies ("IIM") accounts. There is a cash flow including the daily Overnighter money market in excess of \$75 billion annually. In addition, OTFM provides continuous interface with the Tribal and individual Indian account holder community across the nation.

Due to numerous General Accounting Office reports, DOI/Office of Inspector General audits, and DOI and Congressional reports, the management of Indian Trust Funds has been and continues to be a highly visible program and has been under very close scrutiny during the past few years. The creation of the OST in 1994 was an initial step toward improving trust funds management and developing the major reforms necessary to resolve program deficiencies.

## FIDUCIARY RESPONSIBILITY

The U.S. Federal Government holds fiduciary funds on behalf of various entities (for example, individuals and tribes). The U.S. Federal Government has a fiduciary responsibility for several deposit and trust funds. The DOI has responsibility for the assets held in trust on behalf of American Indian Tribes, individuals, and other Special Trust Funds. The fiduciary funds are held in accounts for over 315 tribes, 285,000 individual Indian accounts and other funds, including the Alaska Native Escrow Fund. The assets held in trust for Native Americans are owned by the account holders and are not U.S. Federal Government assets. 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 law, 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."

**Mission Statement of OST/OTM**  
**To assure the highest level of accuracy, responsiveness and service in the receipt, investment and disbursement of all judgement awards, special acts and income from trust resources belonging to Native Americans in accordance with the American Indian Trust Fund Management Reform Act of 1994.**

**TRUST FUND ACCOUNTS**

Indian Tribes and individual Indians trust funds are primarily derived from judgment awards and 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 consist of judgment awards while individual Indian funds realize receipts primarily from royalties on natural resource depletion,

land use agreements, enterprises having a direct relationship to trust fund resources, per capita payments, and investment income. The composition of Indian trust funds, when taken as a whole, in terms of the source of funds has not changed significantly since January 1997; however, the value of the funds and number of accounts have grown.

**APPROPRIATED ACCOUNT**

In the fiscal year ended September 30, 1997 ("FY 97"), the OTM received direct appropriation for operational services. The FY 1997 funds have been utilized for executive direction, program operations, support and improvements, past reconciliation and trust fund improvement initiatives. These appropriated program funds are not American Indian Trust Funds and have not been included in these financial statements. However they are included in the Office of the Secretary's annual financial statement audit.

The FY 1997 funding for Executive Direction supports staffing for the Office of Special Trustee, funding for the Special Trustee's Advisory Board ("the Board") and the Intertribal Monitoring Association ("ITMA"). The Board advises the Special Trustee on all matters pertaining to trust funds operations and management, and the appropriated funding was used to pay travel costs of the Board and related expenses.

The ITMA is a tribal membership organization with a 12-member Board of Directors that provides the Special Trustee and the DOI with tribal views on reconciliation of past trust fund activities, and reform initiatives.

Part of the program operations funding provides for service bureau agreements for administrative support services with the BIA, United States Geological Survey ("USGS"), Washington Administrative Service Center ("WASC"), Bureau of Reclamation ("BOR"), and General Services Administration ("GSA").

Another part of program operations funds staffing and operating costs for the 62 OST field offices located throughout the United States which comprise 11 Area offices, 50 Agency offices and one Division of Field Operations office.

Improvement initiatives funding included the on-going IIM data clean-up project and a requirements analysis/user needs assessment ("the assessment"), which was completed in April 1997. The assessment began in December 1996, was to determine the approximate costs associated with the development of a comprehensive automated records system to support the information needs of the OTFM. The assessment included development of a comprehensive master trust beneficiary accounting system with a master trust and custody function, including supplementary systems necessary to handle assets such as real estate, oil and gas rights, timber and other land management assets. The Special Trustee's comprehensive strategic plan was built on this work.

Other ongoing costs are for improvements to the trust funds management programs such as the annual lease trust system, centralized custodial services and annual financial audits.

#### ANNUAL FINANCIAL AUDITS

In prior year audits (fiscal years ended September 30, 1995 and September 30, 1996), the audit coverage was intended to meet the requirements of the Chief Financial Officers Act of 1990 ("CFO Act"). However, following OTFM management's consultations with the DOI and officials of the office of Management and Budget, the consensus is to account for Tribal and Other Special Trust Funds on a cash basis and IIM Trust Funds on modified cash basis, both of which are an other comprehensive basis of accounting. The basis for this position is that the majority of assets held in trust for Native Americans are owned by the account holders and are not U.S. Federal Government assets.

For the annual financial audit for FY 1997, Departmental and OTFM managers have agreed to issue two sets of financial statements with accompanying notes to the financial statements, a combined report on internal control structure and a combined report on compliance with laws and regulations of the trust funds managed by OTFM.<sup>1</sup>

One set of financial statements will include the Tribal and Other Special Trust Funds. These statements will be presented using the cash basis of accounting, with assets stated at historical cost and at market value. Premiums and discounts will not be amortized or accreted.

The other set of financial statements will include only the Individual Indian Monies. These statements will be presented on a modified cash basis of accounting.

1

The following is excerpted from a letter to the Director, Office of Trust Funds Management, from the Director, Office of Financial Management, United States Department of the Interior:

"From a theoretical standpoint, the 'Tribal Trust Funds' as a reporting entity consists of the sum of the individual accounts, which are measured on the cash basis, plus any assets, liabilities, revenues and expenses of the trust funds which have not been allocated to the account holders. Based on discussions between the Office of Financial Management and OTFM, all cash, assets, and revenues received by the 'Tribal Trust Funds' entity have been distributed to individual account holders. Likewise, there are no liabilities or expenses, which have not been allocated. Given this, a summation of the cost basis of the tribal accounts would constitute a complete presentation of the reporting entity, and would constitute 'an other comprehensive basis of accounting' in accordance with private sector accounting guidance. As with reports to individual account holders, market value could be presented along side the cost basis for informational purposes."

"Regarding Individual Indian Money (IIM) accounts, we concur with the decision to use of modified cash accounting. Due to differences in the underlying nature of the IIM versus Tribal accounts, and the different accounting methodologies applied, separate statements and footnotes should be prepared for each type of trust activity."

Assets will be presented at amortized historical cost. Premiums and discounts will be amortized and accreted.

The audits will encompass all Indian trust funds managed by the OTFM, which includes the funds in the following Treasury account symbols:

Tribal Trust Funds

14X5197	Tribal Economic Recovery Fund
14X8176	Crow Creek Tribe Infrastructure Development Trust Fund
14X8327	Northern Cheyenne Indian Water Rights Settlement Trust Fund
14X8365	Tribal Trust Funds
14X8368	Navajo Rehabilitation Trust Fund

Other Special Trust Funds

14X5166	Cochiti Wetfields Project
14X6140	Deposits of Proceeds of Lands Withdrawn for Native Selection
14X8060	Bequest of George C. Edgeter Fund
14X8366	Papago Cooperative Fund
14X8563	Funds Contributed for the Advancement of the Indian Race

Individual Indian Monies Trust Funds

14X6039	Individual Indian Monies
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OTFM appropriation 14X0120, which is OTFM's program operating fund, is specifically excluded from these financial statements of the American Indian Trust Funds.

OTFM PROGRAM STRUCTURE

The OTFM operates in the following program structure:

Division of Trust Funds Quality Assurance - Responsible for issuing policies and procedures, and records keeping, while establishing a basis for performing internal, financial and compliance reviews.

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 customer services to tribal and individual account holders.

Division of Trust Funds Accounting - Responsible for the day to day operations for all investments, along with 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 and hardware enhancements.

Division of Trust Funds Reporting/Reconciliation - Responsible for financial reconciliation efforts, all financial reporting to the OMB, Department of the Treasury, Department of the Interior and providing other special reports.

Division of Field Operations - Responsible for coordinating the administrative and technical execution of financial trust programs conducted at field offices, providing adequate technical service to guide and support field operations and evaluating the performance of eleven (11) area offices and subordinate agency offices.

**GOVERNMENT PERFORMANCE AND RESULTS ACT  
(GPRA)**

The American Indian Trust Fund Management Reform Act of 1994 directs the OST to consult with Indian Tribes and Indian organizations and to develop a comprehensive strategic plan to reform the trust fund management system. This planning process, by law, is on a separate but parallel track toward developing a results-based strategic plan. The Special Trustee submitted his strategic plan to the Secretary of the Interior and the Congress on April 11, 1997. This plan has identified a mission and goals for improvement and operation of a Trust Fund Management system for the American Indians. It is likely that the Administration and congressional review and final approval of a strategic plan for trust fund management reform could take another year to complete. As a result, while following the intent of GPRA, OST's compliance with some of the time frames of GPRA may be delayed. Once approved, the OST strategic plan will become part of the strategic plan for the Department.

**VISION STATEMENT OF THE U.S. FEDERAL  
GOVERNMENT REGARDING AMERICAN INDIAN  
TRUST FUNDS**

Assume and manage the U.S. Government's trust responsibility to American Indians and American Indian tribes for trust resource management, trust funds management and land title and records management according to the most exacting fiduciary standards and moral obligations of the highest responsibility and trust.

**CUSTOMER SERVICE**

The OTFM has offices that provide intensified trust funds management services to field offices, Tribes, and individual account owners. They are responsible for assisting in planning and recommending policies and procedures governing the management of controlled trust fund accounts. Technical advice and assistance are being provided to American Indian Tribes in developing financial plans and investment strategies for tribal and individual Indian trust funds.

A new toll-free number to improve customer service is in the process of being implemented. Currently, 1-888-OST-OTFM (678-6836) is installed and is being answered by OTFM's Division of Trust Services in Albuquerque, NM. By the end of the first quarter of Fiscal Year 1998, account holders will be able to dial the 1-888 number, enter the first three digits of their account number and be connected with the agency that services their account.

OTFM staff conducted 65 Tribal meetings to discuss investment holdings and/or to provide OmniTrust system training. These visits were mostly on-site at Tribal or Agency offices; however, seven meetings were held with Tribal officials at OTFM's Albuquerque office. Twenty-eight (28) of the Tribes participating in these meetings were from the top 100 Tribes (asset value) for which OTFM provides service. Additionally, meetings were held with BIA staff members at 19 Agency offices during this period. Innumerable contacts are made daily by telephone and telefax, as well as, written communication of information to tribes and their independent auditors regarding tribal funds held in trust.

U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS  
TRIBAL AND OTHER SPECIAL TRUST FUNDS  
MANAGED BY THE  
OFFICE OF TRUST FUNDS MANAGEMENT

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON FINANCIAL STATEMENTS

SEPTEMBER 30, 1997

# GRIFFIN & ASSOCIATES, P.C.

CERTIFIED PUBLIC ACCOUNTANTS

DAN D. GRIFFIN

## REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON FINANCIAL STATEMENTS

To the U.S. Department of the Interior  
Office of the Special Trustee for American Indians:

We have audited the accompanying Statement of Assets and Trust Fund Balances and the related Statement of Changes in Trust Fund Balances for the Tribal and Other Special Trust Funds managed by the U.S. Department of the Interior Office of the Special Trustee for American Indians (the "OST") Office of Trust Funds Management (the "OTFM") as of and for the year ended September 30, 1997. These financial statements are the responsibility of management of the OTFM. Our responsibility is to express an opinion on these financial statements based on our audit. As discussed in Note 2, the OTFM used the cash basis of accounting to prepare these financial statements, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. 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 Statements, (1) cash and overnight investments are maintained by the U.S. Treasury (a related party) and cannot be independently confirmed, (2) cash balances reflected in the accompanying financial statements are materially greater than balances reported by the U.S. Treasury, (3) major inadequacies in various Department of the Interior ("DOI") Indian Trust Fund accounting systems and subsystems, controls and records caused the systems 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 U.S. Federal Government that 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 in the Statement of Assets and Trust Fund Balances and individual categories within the Statement of Changes in Trust Fund Balances are stated.

In our opinion, except for the effect on the financial statements 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 and change in Trust Fund balances of the Tribal and Other Special Trust Funds managed by the U.S. Department of the Interior Office of the Special Trustee for American Indians Office of Trust Funds Management as of September 30, 1997, and for the year then ended in conformity with the comprehensive basis of accounting described in paragraph one above.

4730 TABLE MESA DRIVE, SUITE C100, BOULDER, COLORADO 80303

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*Members of the American Institute of Certified Public Accountants*

We have also issued separate reports dated June 4, 1998, on the OTFM's internal control structure and on its compliance with laws and regulations.

The information in the Overview Section is not a required part of the basic financial statements, but is supplementary information. 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 statements taken as a whole. The Market Value columns, Supplementary Combining Schedule of Assets and Trust Fund Balances, and the related Supplementary Combining Schedule of Changes in Trust Fund Balances as reflected on pages 27 and 28 are presented for purposes of additional analysis and are not a required part of the basic combined financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic combined financial statements, and in our opinion, except for the items set forth above, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Griffin & Associates, P.C., CPAs*

GRIFFIN & ASSOCIATES, P.C.  
Certified Public Accountants

Boulder, Colorado  
June 4, 1998

U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS  
TRIBAL AND OTHER SPECIAL TRUST FUNDS  
MANAGED BY THE  
OFFICE OF TRUST FUNDS MANAGEMENT

FINANCIAL STATEMENTS

SEPTEMBER 30, 1997

U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS  
TRIBAL AND OTHER SPECIAL TRUST FUNDS  
MANAGED BY THE  
OFFICE OF TRUST FUNDS MANAGEMENT

COMBINED STATEMENT OF ASSETS AND TRUST FUND BALANCES - CASH BASIS  
SEPTEMBER 30, 1997

ASSETS	<u>Cash Basis</u>	<u>Market Values - Information Only</u>
Cash (Note 4)	\$ 735,011	\$ 735,011
Investments (Notes 1C,4 and 5):		
Overnight investments	289,848,448	289,848,448
U.S. Treasury and Agency securities	1,995,077,796	2,143,912,994
Certificates of deposit	5,398,670	5,398,670
Equity securities - TVA preferred stock	7,548,750	7,814,213
Mortgage backed securities	105,112,677	105,891,225
Total investments	<u>2,402,986,341</u>	<u>2,552,865,550</u>
 Total assets	 <u>\$ 2,403,721,352</u>	 <u>\$ 2,553,600,561</u>
 TRUST FUND BALANCES, held for Indian Tribes and Other Special Trust Funds (Note 7)	 <u>\$ 2,403,721,352</u>	 <u>\$ 2,553,600,561</u>

The accompanying notes are an integral part of these statements.

U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS  
TRIBAL AND OTHER SPECIAL TRUST FUNDS  
MANAGED BY THE  
OFFICE OF TRUST FUNDS MANAGEMENT

COMBINED STATEMENT OF CHANGES IN TRUST FUND BALANCES - CASH BASIS  
FOR THE YEAR ENDED SEPTEMBER 30, 1997

RECEIPTS:

Interest and dividends earned			
on invested funds (Note 2B)	\$	153,714,298	
Net gain on disposition of investments		9,501,186	
Other receipts (Note 2C and 9)		<u>443,781,192</u>	
		606,996,676	

DISBURSEMENTS:

Payments to and on behalf of			
Indian Tribes and Other			
Special Trust Funds (Note 2D)		108,333,082	
Withdrawal of trust funds			
by Tribes (Note 2D)		<u>330,552,882</u>	
Receipts in excess of disbursements		168,110,712	
TRUST FUND BALANCES, beginning of year		2,297,852,046	
Beginning Trust Fund balances			
adjustment for cash basis (Note 10)		<u>(62,241,406)</u>	
TRUST FUND BALANCES, end of			
year (Note 7)	\$	<u>2,403,721,352</u>	

Market Value - Information Only

TRUST FUND BALANCES, beginning of year			
at Market Value	\$	2,261,723,615	
Receipts in excess of disbursements		168,110,712	
Unrealized Gain (loss)		<u>123,766,234</u>	
TRUST FUND BALANCES, end of year			
at Market Value (Note 7)	\$	<u>2,553,600,561</u>	

The accompanying notes are an integral part of these statements.

U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS  
TRIBAL AND OTHER SPECIAL TRUST FUNDS  
MANAGED BY THE  
OFFICE OF TRUST FUNDS MANAGEMENT

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NOTE 1 -- BACKGROUND AND DESCRIPTION OF THE ORGANIZATION

A. Overview of Trust Funds, the Office of the Special Trustee for American Indians ("OST") and the Office of Trust Funds Management ("OTFM")

Formation of the Trust Funds - The legislation, which authorizes the Secretary of the Interior ("the Secretary") to manage the Tribal Trust Funds ("Trust Funds"), gives formal recognition to the relationship that exists between the Indian Tribes and the U.S. Federal Government. At the time the U.S. Federal Government was founded, Indian sovereignty was recognized. Agreements between the U.S. Federal Government and the various Indian Tribes, therefore, initially took the form of treaties. During the course of the nation's history and the U.S. Federal 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. Federal 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. Federal 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 Bureau of Indian Affairs ("BIA"). The American Indian Trust Fund Management Reform Act of 1994 ("P.L. 103-412") provided for the establishment of the OST. On February 9, 1996, Secretarial Order 3197 ("the Order") transferred the OTFM, and financial trust services performed BIA Area and Agency Offices, from the BIA to the OST.

Organization of the OST - Trust assets are managed under the authority of the OST and the BIA.

- ♦ Agency and Field Offices - The OST and BIA maintain Agency and Field Offices 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. OST personnel located at most of the Agency Offices perform various functions related to trust funds activities.
- ♦ Area Offices - Each of the Agency and Field Offices is organized under one of the Area Offices. The Area Offices provide administrative and operational support for their respective Agency and Field Offices.
- ♦ Office of Trust Funds Management - The OTFM, established October 26, 1989, and located in Albuquerque, New Mexico, has management responsibility over

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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 OTFM management 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 OTFM-wide technical system support.
- ◊ 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, as well as monitoring collections and recording of funds. 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 Trust Funds 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 U.S. Federal Government and for inclusion in various OTFM-wide reports.
- ◊ Division of Field Operations - This division coordinates the administrative and technical execution of financial trust programs conducted at subordinate offices; providing or obtaining adequate technical service to guide and support field operations; and evaluating the performance of field level organizations. The division, through its subordinate branches, is also responsible for the work processes related to receiving, recording, and disbursing general trust and judgement funds collected by the BIA, belonging to tribes, and preparing, maintaining, and reconciling records.

B. Description of the Trust Funds

The Trust Funds are managed by the OTFM on behalf of Tribes and Other Special Trust Funds. Certain of the Tribal and Special Trust Funds are subject to legal,

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regulatory, budgetary, court ordered or other restrictions. A brief description of each Trust Fund follows:

- ♦ Tribal Fund - Approximately 315 Tribes have accounts in the Tribal Fund; however, some Tribes have multiple accounts. As a result, approximately 1,600 separate accounts comprise the Tribal Fund. Approximately 44% of the Tribal Fund assets are held on behalf of six Tribes.

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.

- ♦ Other Special Trust Funds - Other Special Trust Funds represent other trust assets currently managed by the OTFM. Authorization for management of these assets is based on U.S. Congressional Acts establishing such funds. Each of these funds either reverts back to the U.S. Federal Government upon certain conditions, or the corpus of the fund is non-expendable. A brief description of each Fund follows:

- ◊ Alaska Native Escrow Fund - The Alaska Native Escrow Fund was established by U.S. 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. Federal Government.
- ◊ 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.
- ◊ Papago Cooperative Fund - The Tohono O'odham Nation, 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 that 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.
- ◊ Contributed Funds - The OTFM maintains eight (8) contributed funds that were established by donations. The individual funds each have a specific

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use or purpose in some form to better the American Indians by giving assistance for education or Tribal operations.

- o 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.

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 Indian Trust Funds. Trust funds assets are directly invested in U.S. Federal Government securities, including U.S. Treasury and U.S. Federal Government Agency issues, as well as certain other securities that are guaranteed by the U.S. Federal Government. A portion of Indian Trust Funds assets are also invested with financial institutions at which such deposits are covered by Federal depository insurance, or collateralized by U.S. Treasury or U.S. Federal Government Agency securities for amounts deposited in excess of Federal depository insurance limitations.

NOTE 2 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Accounting

The OTFM uses the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles, for the Tribal and Other Special Trust Funds. The cash basis of accounting differs from generally accepted accounting principles in that receivables and payables are not recorded and premiums and discounts are not amortized or accreted for the cash basis of accounting. Investments are stated at historical cost. Interest receipts reported in the Statement of Changes in Trust Fund Balances reflect the interest received during the fiscal year. The financial statements include a market value column for informational purposes. The market value information is integral to the fiduciary responsibilities of the OTFM.

The Trust Funds account for assets held for others in a trust capacity and do not involve measurement of operations. Receipts are recorded when received, because it is not practicable to measure the majority of such items prior to receipt. Accordingly, receivables are not reflected in the accompanying financial statements. The accompanying financial statements include only the balances held in trust by the OST and OTFM for others and do not include (1) the account balances of the OST and OTFM (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.):

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B. Interest Receipts

Tribal Trust and Other Special Trust Funds are invested separately by account with interest recorded based on actual income received from each investment. Interest is received in two ways: (1) directly from investment securities in which the Trust Funds are placed, such as certificates of deposit at financial institutions or U.S. Treasury, Agency or U.S. Federal Government sponsored securities, or (2) from a U.S. Treasury overnight investment ("overnighter"), which earns a rate comparable to "Fed Funds" rates. The interest on the overnighiter investments is calculated daily, compounded, accumulated separately for participating accounts and posted to the separate accounts monthly.

C. Other Receipts

Approximately one-third of other receipts are payments as a result of claims and judgment awards to Tribes and Other Special Trust Funds by the U.S., State and local governments, and private entities and individuals.

Other trust receipts are generated from a variety of assets that are held in trust by the U.S. Federal Government and managed by the various Agencies and the BIA on behalf of Tribes. Payments are received from various leasing activities, mineral royalties, and sales of extracted minerals, timber and forest products. Payments are also derived from related fees and fines, and the granting of easements.

D. Disbursements

Payments disbursed to Tribes and Other Special Trust Funds consist of investment income as well as funds from various income producing activities such as leasing, royalty payments, minerals extraction and timber and forest product sales. Under certain conditions, Tribes disburse per capita payments to their enrolled members from the Trust Funds. Payments are made to Tribes from the proceeds of various judgment awards. Upon submission and approval of the required documentation, Tribes may submit requests for payments in accordance with terms and conditions of the awards.

P.L. 103-412 specifically allows for the voluntary withdrawal from the Trust Funds program. An Indian Tribe may submit a plan to withdraw some or all funds held in trust for the Tribe. The plan must be approved by the Secretary, DOI, and the appropriate Tribal governmental body, and must provide an indication as to the capability and experience of the individuals or institutions managing the Trust Funds.

E. Comparative Data

Comparative data for the prior year has not been presented, because of changes in reporting methods used in preparing the financial statements for the year ended September 30, 1997. These changes are further described in Note 11.

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F. Significant Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates. Management considers the market value of investments one such significant estimate.

NOTE 3 -- ACCOUNTING SYSTEMS AND MATERIAL INTERNAL CONTROL WEAKNESSES

The accounting systems, subsystems and internal control procedures used by the OST 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 policies and procedures 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 OTFM-wide, which has caused accounting errors in the Indian Trust Funds. Standardized documented policies and procedures have not been instituted for some significant 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.
- ◆ There is an unreconciled difference of approximately \$34,000,000 between the total cash balances reflected by the OTFM for Tribal and Other Special Trust Funds, and Individual Indian Monies and the balances held by Treasury. Treasury reports reflect balances 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.
- ◆ Many individual Tribal accounts 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.
- ◆ There is inadequate supervision of field personnel at the Area and Agency Offices.

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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 contract for a new trust asset and accounting management system, and the new oversight authority of the U.S. Department of the Interior Office of the Special Trustee for American Indians.

NOTE 4 -- CASH AND OVERNIGHT INVESTMENTS

The U.S. 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. Starting with fiscal year ending September 30, 1992, 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 that are not negotiated. Cash balances consist of cash deposits to Treasury between the cut-off time for overnight investment, 1:00 p.m., and the end of the business day. Amounts on hand at the Area and Agency Offices waiting for deposit to Treasury are not included in the financial statements.

Overnight investments consist of available cash invested with Treasury.

NOTE 5 -- INVESTMENTS

Investments are recorded at unamortized historical cost.

The Trust Fund assets have a concentration of credit risk in U.S. Federal Government securities as mandated by 25 USC 162.

Certificates of Deposit

Following is an analysis of depository insurance and collateral on certificates of deposit at September 30, 1997:

Deposits covered by depository insurance	<u>\$ 5,398,670</u>
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**Maturities**

Investments with scheduled maturities at September 30, 1997,  
are as follows:

**Fair Market Value**

	Tribal Trust	Other Special Trust Funds	Combined Total
<b>U.S. Treasury and Agency securities:</b>			
Overnight investments	\$ 289,077,794	\$ 770,654	\$ 289,848,448
Less than 1 Year	289,944,929	2,703,752	292,648,681
1 - 5 Years	741,287,707	20,105,364	761,393,071
5 - 10 Years	849,045,566	7,749,566	856,795,132
Greater than 10 Years	216,168,749	16,907,361	233,076,110
	2,385,524,745	48,236,697	2,433,761,442
 <b>Certificates of Deposit:</b>			
Less than 1 Year	4,790,805		4,790,805
1 - 5 Years	607,865		607,865
	5,398,670		5,398,670
 <b>Equities with no scheduled maturities</b>	7,814,213		7,814,213
<b>Mortgage backed securities with varying maturities</b>	105,891,225		105,891,225
	\$ 2,504,628,853	\$ 48,236,697	\$ 2,552,865,550

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NOTE 6 -- COMMITMENTS AND CONTINGENCIES

The Secretary has been designated by the U.S. 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 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. Federal Government funds, and not assets of the Trust Fund. No amounts have been accrued in the accompanying Trust Fund financial statements for potential claims receivable from the U.S. Federal Government.

NOTE 7 -- TRUST FUND BALANCES

Trust Fund balances are the aggregation of monetary assets held in trust and represent the amounts owed to beneficiaries as of September 30, 1997, for which the OTFM has a fiduciary responsibility.

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.

Tribal organizations 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.

NOTE 8 -- SIGNIFICANT TRANSACTIONS WITH OTHER U.S. FEDERAL GOVERNMENT ORGANIZATIONS

Debt Arrangements

The BIA 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

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as manufacturing, hotel/motel facilities, etc.). Individual Tribes are primarily liable for repayment of these loans. Proceeds of Labor Trust Fund accounts may be utilized for repayment of these loans.

Minerals Management Services

The OTFM 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 OTFM upon receipt. At the time the royalty payments are received, MMS provides the OTFM with a breakdown of 100% Tribally owned lease royalties, thus permitting the OTFM to allocate the receipts directly into Tribal accounts. For tribally and individually co-owned leases, the royalty payments are forwarded by MMS and subsequently allocated through the Royalty Distribution Reporting System ("RDRS"). MMS and the Bureau of Land Management both perform verification and other monitoring procedures of mineral assets.

Oil and gas companies sometimes make overpayments to MMS. These are first paid to the OTFM on behalf of Indian Tribes and individuals, and then disbursed by the OTFM 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. Typically, the oil and gas companies recover such overpayments by adjusting future payments. The amount of such overpayments as of September 30, 1997, has not been quantified in these financial statements.

Other

As discussed in Note 4, the Treasury holds cash and overnight investments and acts as a disbursing agent for the OTFM. As discussed in Note 6, the DOI Office of the Solicitor serves as legal counsel for the OST and OTFM.

NOTE 9 -- TRANSFERS

The OTFM receives monies into IIM special deposit accounts for both Tribal and IIM beneficiaries. Funds are subsequently transferred from the IIM system to the appropriate Tribal account. These transfers amounted to approximately \$43,000,000 during the fiscal year ended September 30, 1997. The other receipts category of the Statement of Changes in Trust Fund Balances includes these net transfers. The amount of monies not yet transferred has not been quantified in these financial statements.

NOTE 10 -- RESTATEMENT OF BEGINNING FUND BALANCE

In prior year audits (fiscal year ended September 30, 1995 and September 30, 1996), the audit coverage was intended to meet the requirements of the Chief Financial Officers Act of 1990 (CFO Act) and contained adjustments to reflect accrued interest and dividends, and amortization of premium or accretion of discount. However, following management's consultations with the Department of the Interior and officials of the Office of Management and Budget, a consensus was achieved to account for Tribal and Other Special Trust Funds on a cash basis. The basis for

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this position is that the majority of assets held in trust for Native Americans are owned by the account holders and are not Federal assets. This method of financial statement presentation is consistent with periodic account statements provided to account holders.

The Federal Financial Accounting Standards Advisory Board issued Interpretation Number 1 which indicated that the Indian trust funds were not federal monies, and therefore, superseded the hierarchy of accounting principles, for the Indian trust funds, that were approved by the Secretary of the U.S. Treasury, The Director of the OMB and the U.S. Comptroller General for use by U.S. Federal Government entities. This interpretation no longer required the Indian trust funds to use the reporting requirements as outlined in OMB Bulletins No. 94-01 and 97-01 (Form and Content of Agency Financial Statements). Previous Indian trust fund financial statements (fiscal years ended September 30, 1995 and 1996) were prepared under the requirements of OMB Bulletins No. 94-01 and 97-01.

Beginning with the year ending September 30, 1997, the OTFM used the cash basis of accounting to prepare the annual Tribal and Other Special Trust Funds financial statements. The net accrual and amortization/accretion at September 30, 1996 amounted to \$62,241,406.

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SUPPLEMENTARY COMBINING SCHEDULES

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SUPPLEMENTARY COMBINING  
SCHEDULE OF ASSETS AND TRUST FUND BALANCES - CASH BASIS  
SEPTEMBER 30, 1997

	Tribal Trust	Other Special Trust Funds	Combined Total
<b>ASSETS</b>			
Cash (Note 4)	\$ 787,868	\$ (52,857)	\$ 735,011
Investments (Notes 1C,4 and 5):			
Overnight investments	289,077,794	770,654	289,848,448
U.S. Treasury and Agency securities	1,949,963,852	45,113,944	1,995,077,796
Certificates of deposit	5,398,670		5,398,670
Equity securities - TVA preferred stoc	7,548,750		7,548,750
Mortgage backed securities	105,112,677		105,112,677
Total investments	<u>2,357,101,743</u>	<u>45,884,598</u>	<u>2,402,986,341</u>
 Total assets	 <u>\$2,357,889,611</u>	 <u>\$45,831,741</u>	 <u>\$2,403,721,352</u>
 TRUST FUND BALANCES, held for Indian Tribes and Other Special Trust Funds (Note 7)	 <u>\$2,357,889,611</u>	 <u>\$45,831,741</u>	 <u>\$2,403,721,352</u>

Market Value Information Only

	Tribal Trust	Other Special Trust Funds	Combined Total
<b>ASSETS</b>			
Cash (Note 4)	\$ 787,868	\$ (52,857)	\$ 735,011
Investments (Notes 1C,4 and 5):			
Overnight investments	289,077,794	770,654	289,848,448
U.S. Treasury and Agency securities	2,096,446,951	47,466,043	2,143,912,994
Certificates of deposit	5,398,670		5,398,670
Equity securities - TVA preferred stoc	7,814,213		7,814,213
Mortgage backed securities	105,891,225		105,891,225
Total investments	<u>2,504,628,853</u>	<u>48,236,697</u>	<u>2,552,865,550</u>
 Total assets	 <u>\$2,505,416,721</u>	 <u>\$48,183,840</u>	 <u>\$2,553,600,561</u>
 TRUST FUND BALANCES, held for Indian Tribes and Other Special Trust Funds (Note 7)	 <u>\$2,505,416,721</u>	 <u>\$48,183,840</u>	 <u>\$2,553,600,561</u>

The accompanying notes are an integral part of these schedules.

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SUPPLEMENTARY COMBINING  
SCHEDULE OF CHANGES IN TRUST FUND BALANCES - CASH BASIS  
FOR THE YEAR ENDED SEPTEMBER 30, 1997

	Tribal Trust	Other Special Trust Funds	Combined Total
<b>RECEIPTS:</b>			
Interest and dividends earned on invested funds (Note 2B)	\$ 150,584,151	\$ 3,130,147	\$ 153,714,298
Net gain(loss) on disposition of investments	9,519,888	(18,702)	9,501,186
Other receipts (Notes 2C and 9)	443,590,875	190,317	443,781,192
	<u>603,694,914</u>	<u>3,301,762</u>	<u>606,996,676</u>
<b>DISBURSEMENTS:</b>			
Payments to and on behalf of Indian Tribes and Other Special Trust Funds (Note 2D)	106,472,518	1,860,564	108,333,082
Withdrawal of trust funds by Tribes (Note 2D)	330,387,013	165,869	330,552,882
	<u>166,835,383</u>	<u>1,275,329</u>	<u>168,110,712</u>
Receipts in excess of disbursements	166,835,383	1,275,329	168,110,712
TRUST FUND BALANCES, beginning of year	2,252,345,265	45,506,781	2,297,852,046
Beginning Trust Fund balances adjustment for cash basis (Note 10)	(61,291,037)	(950,369)	(62,241,406)
TRUST FUND BALANCES, end of year (Note 7)	<u>\$2,357,889,611</u>	<u>\$ 45,831,741</u>	<u>\$2,403,721,352</u>

Market Value Information Only

TRUST FUND BALANCES, beginning of year at Market Value	\$2,215,827,831	\$ 45,895,784	\$2,261,723,615
Receipts in excess of disbursements	166,835,383	1,275,329	168,110,712
Unrealized gain (loss)	122,753,507	1,012,727	123,766,234
TRUST FUND BALANCES, end of year at Market Value (Note 7)	<u>\$2,505,416,721</u>	<u>\$ 48,183,840</u>	<u>\$2,553,600,561</u>

The accompanying notes are an integral part of these schedules.

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON FINANCIAL STATEMENTS

SEPTEMBER 30, 1997

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON FINANCIAL STATEMENTS

To the U.S. Department of the Interior  
Office of the Special Trustee for American Indians:

We have audited the accompanying Statement of Assets and Trust Fund Balances and the related Statement of Changes in Trust Fund Balances for the Individual Indian Monies trust funds managed by the U.S. Department of the Interior Office of the Special Trustee for American Indians (the "OST") Office of Trust Funds Management (the "OTFM") as of and for the year ended September 30, 1997. These financial statements are the responsibility of management of the OTFM. Our responsibility is to express an opinion on these financial statements based on our audit. As discussed in Note 2, the OTFM used the cash basis of accounting with certain modifications to prepare these financial statements, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. 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 Statements, (1) cash and overnight investments are maintained by the U.S. Treasury (a related party) and cannot be independently confirmed, (2) cash balances reflected in the accompanying financial statements are materially greater than balances reported by the U.S. Treasury, (3) major inadequacies in various Department of the Interior ("DOI") Indian Trust Fund accounting systems and subsystems, controls and records caused the system to be unreliable, (4) various 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 U.S. Federal Government that 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 in the Statement of Assets and Trust Fund Balances and individual categories within the Statement of Changes in Trust Fund Balances are stated.

In our opinion, except for the effect on the financial statements 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 and change in Trust Fund balances of the Individual Indian Monies trust funds managed by the U.S. Department of the Interior Office of the Special Trustee for American Indians Office of Trust Funds Management as of September 30, 1997, and for the year then ended in conformity with the comprehensive basis of accounting described in paragraph one above.

We have also issued separate reports dated June 4, 1998, on the OTFM's internal control structure and on its compliance with laws and regulations.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The information in the Overview Section is not a required part of the basic financial statements, but is supplementary information. We did not audit this information, and because of the exceptions set forth above, we do not express an opinion on such information.

*Griffin & Associates, P.C., CPAs*

GRIFFIN & ASSOCIATES, P.C.  
Certified Public Accountants

Boulder, Colorado  
June 4, 1998

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STATEMENT OF ASSETS AND TRUST FUND BALANCES - MODIFIED CASH BASIS  
SEPTEMBER 30, 1997

ASSETS

Investments (Note 4 and 5):	
Overnight investments	\$ 36,971,217
U.S. Treasury and Agency securities	366,466,565
Certificates of deposit	96,000
Equity securities - TVA preferred stock	5,000,000
Mortgage backed securities	<u>111,072,484</u>
Total investments	519,606,266
Accrued interest receivable	<u>5,766,870</u>
Total assets	<u>\$ 525,373,136</u>

TRUST FUND BALANCES, held for Individual Indians (Note 7):	519,707,284
Cash overdraft with U.S. Treasury (Note 4):	<u>5,665,852</u>
Total trust fund balances and cash overdraft	<u>\$ 525,373,136</u>

The accompanying notes are an integral part of these statements.

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STATEMENT OF CHANGES IN TRUST FUND BALANCES - MODIFIED CASH BASIS  
FOR THE YEAR ENDED SEPTEMBER 30, 1997

RECEIPTS:

Interest and dividends earned on invested funds (Note 2B)	\$ 34,777,373
Net gain on disposition of investments	3,817,144
Other receipts (Note 2C)	<u>239,059,378</u>
	277,653,895

DISBURSEMENTS:

Payments to and on behalf of account holders	<u>274,708,295</u>
Receipts in excess of disbursements	2,945,600

TRUST FUND BALANCES, beginning of year	<u>516,761,684</u>
TRUST FUND BALANCES, end of year (Note 7)	<u>\$ 519,707,284</u>

The accompanying notes are an integral part of these statements.

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NOTES TO THE FINANCIAL STATEMENTS  
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NOTE 1 -- BACKGROUND AND DESCRIPTION OF THE ORGANIZATION

A. Overview of Trust Funds, the Office of the Special Trustee for American Indians ("OST") and the Office of Trust Funds Management ("OTFM")

Formation of the Trust Funds - The legislation, which authorizes the Secretary of the Interior ("the Secretary") to manage the Individual Indian Monies ("IIM") Trust Funds ("Trust Funds"), gives formal recognition to the relationship that exists between the Indians, Indian Tribes and the U.S. Federal Government. At the time the U.S. Federal Government was founded, Indian sovereignty was recognized. Agreements between the U.S. Federal Government and the various Indian Tribes, therefore, initially took the form of treaties. During the course of the nation's history and the U.S. Federal Government's varying policies toward Indians and 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. Federal 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. Federal 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 Bureau of Indian Affairs ("BIA"). The American Indian Trust Fund Management Reform Act of 1994 ("P.L. 103-412") provided for the establishment of the OST. On February 9, 1996, Secretarial Order 3197 ("the Order") transferred the OTFM, and financial trust services performed at BIA Area and Agency Offices, from the BIA to the OST.

Organization of the OST - Trust assets are managed under the authority of the OST and the BIA.

- ♦ Agency and Field Office - The OST and BIA maintain Agency and Field Offices 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. OST personnel located at most of the Agency offices perform various functions related to trust funds activities.
- ♦ Area Office - Each of the Agency and Field Offices is organized under one of the Area Offices. The Area Offices provide administrative and operational support for their respective Agency and Field Offices.
- ♦ Office of Trust Funds Management - The OTFM, established October 26, 1989, and located in Albuquerque, New Mexico, has management responsibility over

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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 OTFM management 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 OTFM-wide technical system support.
- ◊ 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, as well as monitoring collections and recording of funds. 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 Trust Funds 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 U.S. Federal Government and for inclusion in various OTFM-wide reports.
- ◊ Division of Field Operations - This division coordinates the administrative and technical execution of financial trust programs conducted at subordinate offices; providing or obtaining adequate technical service to guide and support field operations; and evaluating the performance of field level organizations. The division, through its subordinate branches, is also responsible for the work processes related to receiving, recording, and disbursing general trust and judgement funds collected by the BIA, belonging to individual Indian adults, minors, legal incompetents, deceased beneficiaries; examining, verifying, and maintaining accounts and accounting data for IIM accounts; and preparing, maintaining, and reconciling records. It also responds to IIM account holders' questions concerning the status of accounts, receipts, or other related matters.

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B. Description of the Trust Funds

The Trust Funds are managed by the OTFM on behalf of IIM account holders. Certain of the IIM funds described above are subject to legal, regulatory, budgetary, court ordered or other restrictions.

The IIM Fund is primarily a deposit fund for individuals, who may have a fiduciary interest in the Trust Funds. IIM account holders realize receipts primarily from royalties on natural resource 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 entities. Approximately 285,000 accounts are held for participants and Tribal enterprises in the IIM Fund. Approximately 50% of the IIM trust fund assets are held by two Area Offices at September 30, 1997, 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.

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 Indian Trust Funds. Trust fund assets are directly invested in U.S. Federal Government securities, including U.S. Treasury and U.S. Federal Government Agency issues, as well as certain other securities that are guaranteed by the U.S. Federal Government. A portion of Indian Trust Funds assets are also invested with financial institutions at which such deposits are covered by Federal depository insurance.

NOTE 2 -- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Accounting

The OTFM uses the cash basis of accounting for the Individual Indian Monies; however, accrual adjustments were recorded in the accompanying financial statements as of September 30, 1997, to reflect interest and dividends earned, but not received, and to record any applicable accretion of discount/amortization of premium over the terms of the investments. This is a comprehensive basis of accounting other than generally accepted accounting principles. Investments are stated at amortized historical cost. Interest receipts reported in the Statement of Changes in Trust Fund Balances reflect the net of interest earned and amortization expense or accretion income recognized during the fiscal year. Investments have not been adjusted to reflect changes in market value, because it is the OTFM's intent and ability to generally hold these 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

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accrued interest and dividends, are not reflected in the accompanying financial statements. The accompanying financial statements include only the balances held in trust by the OST and OTM for others and do not include (1) the account balances of the OST and OTM (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.).

B. Interest Receipts

IIM Trust Funds are pooled and invested. Interest is received in two ways: (1) directly from investment securities in which the Trust Funds are placed, such as certificates of deposit at financial institutions or U.S. Treasury, Agency or U.S. Federal Government sponsored securities, or (2) from a U.S. Treasury overnight investment ("overnighter"), which earns a rate comparable to "Fed Funds" rates. Interest receipts as reflected in the Statement of Changes in Trust Fund Balances are net of amortization expense/accretion income for the fiscal year.

C. Other Receipts

Other trust receipts are generated from a variety of assets that are held in trust by the U.S. government and managed by the various Agencies and the BIA on behalf of Individual Indians. Payments are received from various leasing activities, mineral royalties, and sales of extracted minerals, timber and forest products. Payments are also derived from related fees and fines, and the granting of easements. Other receipts also contain payments claims and judgment awards to Individual Indians by the U.S., State and local governments, and private entities and individuals.

D. Disbursements

Payments disbursed to Individual Indians consist of investment income, per capita payments, as well as funds from various income-producing activities such as leasing, royalty payments, minerals extraction and timber and forest product sales.

E. Comparative Data

Comparative data for the prior year has not been presented because of changes in reporting methods used in preparing the financial statements for the year ended September 30, 1997. The Individual Indian Monies trust funds were reported on a combined basis with Tribal and Other Special Trust funds for the years ended September 30, 1995 and 1996.

F. Significant Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates. Management considers the market value of investments one such significant estimate.

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NOTE 3 -- ACCOUNTING SYSTEMS AND MATERIAL INTERNAL CONTROL WEAKNESSES

The accounting systems, subsystems and internal control procedures used by the OST 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 policies and procedures 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 OTFM-wide, which has caused accounting errors in the Indian Trust Funds. Standardized documented policies and procedures have not been instituted for some significant 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 generally accepted accounting principles.
- ◆ The IIM detailed subsidiary ledger contains certain accounts with negative balances aggregating approximately \$44,000,000.
- ◆ There is approximately \$151,000,000 held in approximately 27,000 Special Deposit Accounts in the IIM subsidiary ledger. There are inadequate controls and a lack of management reporting and accountability over the use of these accounts.
- ◆ There is an unreconciled difference of approximately \$21,000,000 between the IIM detailed subsidiary ledger and the corresponding general ledger control account.
- ◆ There is an unreconciled difference of approximately \$34,000,000 between the total cash balances reflected by the OTFM for Tribal and Other Special Trust Funds, and Individual Indian Monies and the balances held by Treasury. Treasury reports reflect balances 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.

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- ♦ Many individual Indian accounts 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.
- ♦ There is inadequate supervision of field personnel at the Area and Agency Offices.

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 September 1996 to a new investment accounting system, Bolt II, contracting for a new trust asset and accounting management system, and the new oversight authority of the U.S. Department of the Interior Office of the Special Trustee for American Indians.

NOTE 4 -- CASH AND OVERNIGHT INVESTMENTS

The U.S. 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. Starting with fiscal year ending September 30, 1992, 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 that are not negotiated. Cash balances consist of cash deposits to Treasury between the cut-off time for overnight investment, 1:00 p.m., and the end of the business day. Amounts on hand at the Area and Agency Offices waiting for deposit to Treasury are not included in the financial statements.

Overnight investments consist of available cash invested with Treasury. As of September 30, 1997 the investment in overnight investments exceeded the available cash by \$5,665,852, which resulted in the cash overdraft with U.S. Treasury.

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, as mandated by 25 USC 162.

Certificates of Deposit

Following is an analysis of depository insurance and collateral on certificates of deposit at September 30, 1997:

Deposits covered by depository insurance	<u>\$ 96,000</u>
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Maturities

Investments with scheduled maturities at September 30, 1997,  
are as follows:

Amortized Cost

	Amortized Cost	Fair Market Value
<b>U.S. Treasury and Agency Securities:</b>		
Overnight Investment	\$ 36,971,217	\$ 36,971,217
Less than 1 Year	7,556,052	7,621,390
1 - 5 Years	55,432,551	55,958,413
5 - 10 Years	185,036,859	183,388,095
Greater than 10 Years	118,441,103	119,045,566
	403,437,782	402,984,681
 <b>Certificates of Deposit:</b>		
Less than 1 Year	96,000	96,000
	96,000	96,000
 <b>Equities with no scheduled maturities</b>		
	5,000,000	5,262,600
 <b>Mortgage backed securities with varying maturities</b>		
	111,072,484	113,847,191
	\$ 519,606,266	\$ 522,190,472

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The original cost, net accumulated amortization and accretion, amortized cost and market value of the investments held at September 30, 1997, are as follows:

Individual Indian Monies

<u>Investment Class</u>	<u>Cost</u>	<u>Net Accumulated (Amortization)/ Accretion</u>	<u>Amortized Cost</u>	<u>Market Value</u>
Overnight Investment	\$ 36,971,217	\$ -	\$ 36,971,217	\$ 36,971,217
U.S. Treasury and Agency securities	351,854,494	14,612,071	366,466,565	366,013,464
Certificates of Deposit	96,000	-	96,000	96,000
Equity securities	5,000,000		5,000,000	5,262,600
Mortgage backed securities	112,048,628	(976,144)	111,072,484	113,847,191
	<u>\$ 505,970,339</u>	<u>\$ 13,635,927</u>	<u>\$ 519,606,266</u>	<u>\$ 522,190,472</u>

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NOTE 6 -- COMMITMENTS AND CONTINGENCIES

The Secretary has been designated by U.S. 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.

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. Federal Government funds, and not assets of the Trust Fund. No amounts have been accrued in the accompanying Trust Fund financial statements for potential claims receivable from the U.S. Federal Government.

NOTE 7 -- TRUST FUND BALANCES

Trust Fund balances are the aggregation of monetary assets held in trust and represent the amounts owed to beneficiaries as of September 30, 1997, for which the OTFM has a fiduciary responsibility.

A significant amount of such account balances represent prepayments or deposits on production type leases for which certain Tribes hold an interest (see note 9). Any deposits in excess of production are returned to the depositor. Such account balances as of September 31, 1997 have not been quantified.

A significant number of IIM accounts and balances are held for the benefit of minors and other individuals who have been determined by the BIA to require assistance in managing their trust account activities and balances. It is the practice of the OTFM to not forward statements to minors and other IIM account holders with supervised accounts. The Secretary, DOI, or his authorized representative (typically, Agency Superintendants) must approve withdrawals from these accounts. In addition, some IIM account holders have not furnished the OTFM with their current addresses that would allow the OTFM to forward their account statements. Accordingly, certain account holders do not, or are unable to, agree with the balances reflected in their accounts.

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 approximately \$21,000,000 as of September 30, 1997.

A portion of the monies held in the IIM Trust Fund have not been allocated and distributed by the OTFM because the ultimate account holders are not known. Because

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such amounts were not awarded to a specific individual, there is no independent party (independent of the OTFM) to determine the ownership of these account balances.

NOTE 8 -- SIGNIFICANT TRANSACTIONS WITH OTHER U.S. GOVERNMENT ORGANIZATIONS

Debt Arrangements

The BIA 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 of these loans.

Minerals Management Services

The OTFM receives royalty payments from the U.S. Department of the Interior Minerals Management Service ("MMS") on behalf of individuals holding mineral rights. MMS generally transfers the royalty payments to the OTFM upon receipt. At the time the royalty payments are received, MMS does not provide the OTFM with lease information for IIM account holders until several weeks after the related royalty payments are received. Accordingly, the OTFM holds the royalty receipts until it receives the lease information on how the royalties are to be allocated. Upon receipt of the lease information data from MMS, the royalty receipts are distributed through the Royalty Distribution Reporting System ("RDORS"). IIM account royalty payments are then either paid by check or held in IIM accounts. MMS and the Bureau of Land Management both perform verification and other monitoring procedures of mineral assets.

Oil and gas companies sometimes make overpayments to MMS. These are first paid to the OTFM on behalf of individuals, and then disbursed by the OTFM 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. Typically, the oil and gas companies recover such overpayments by adjusting future payments. IIM account overdrafts are created as a result of netting payments and collections at the lease level and rounding differences. The amount of such overpayments as of September 30, 1997, has not been quantified in these financial statements.

Other

As discussed in Note 4, the Treasury holds cash and overnight investments and acts as a disbursing agent for the OTFM. As discussed in Note 6, the DOI Office of the Solicitor serves as legal counsel for the OST and OTFM.

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NOTE 9 -- TRANSFERS

The OTFM receives monies into IIM special deposit accounts for both Tribal and IIM beneficiaries. Funds are subsequently transferred from the IIM system to the appropriate Tribal account. These transfers amounted to approximately \$43,000,000 during the fiscal year ended September 30, 1997. The payments to and on behalf of account holders category of the Statement of Changes in Trust Fund Balances includes these net transfers. The amount of monies yet to be transferred has not been quantified in these financial statements.

NOTE 10 -- CHANGE IN HIERARCHY OF ACCOUNTING PRINCIPLES

In prior year audits (fiscal year ended September 30, 1995 and September 30, 1996), the audit coverage was intended to meet the requirements of the Chief Financial Officers Act of 1990 (CFO Act). However, following management's consultations with the Department of the Interior and officials of the Office of Management and Budget, the consensus is to account for Tribal and Other Special Trust Funds on a cash basis and IIM Trust Funds on modified cash basis, both of which are an other comprehensive basis of accounting. The basis for this position is that the majority of assets held in trust for Native Americans are owned by the account holders and are not Federal assets. This method of financial statement presentation is consistent with periodic account statements provided to account holders.

The Federal Financial Accounting Standards Advisory Board issued Interpretation Number 1 which indicated that the Indian trust funds were not federal monies, and therefore, superseded the hierarchy of accounting principles, for the Indian trust funds, that were approved by the Secretary of the U.S. Treasury, The Director of the OMB and the U.S. Comptroller General for use by U.S. Federal Government entities. This interpretation no longer required the Indian trust funds to use the reporting requirements as outlined in OMB Bulletins No. 94-01 and 97-01 (Form and Content of Agency Financial Statements). Previous Indian trust fund financial statements (fiscal years ended September 30, 1995 and 1996) were prepared under the requirements of OMB Bulletins No. 94-01 and 97-01.

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON INTERNAL CONTROLS

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON INTERNAL CONTROL STRUCTURE

To the U.S. Department of the Interior  
Office of the Special Trustee for American Indians:

We have audited the Statements of Assets and Trust Fund Balances and the related Statements of Changes in Trust Fund Balances for Tribal and Other Special Trust Funds, and Individual Indian Monies trust funds ("IIM") managed by the U.S. Department of the Interior Office of the Special Trustee for American Indians ("OST") Office of Trust Funds Management ("OTFM") as of and for the year ended September 30, 1997, and have issued our report thereon dated June 4, 1998.

We conducted our audit in accordance with generally accepted auditing standards. 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 the 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 of 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 cash basis of accounting used to prepare the Tribal and Other Special Trust Funds financial statements, and the modified cash basis of accounting used to prepare the Individual Indian Monies Trust Funds 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 and the related Statement of Changes in Trust Fund Balances for the Tribal and Other Special Trust Funds and Individual Indian Monies managed by the OTFM as of and for the year ended September 30, 1997, 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 the related Statement of Changes in Trust Fund Balances and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion. Also, for those significant internal control structure policies and procedures that were properly designed and placed in operation, we performed tests to determine whether such policies and procedures were operating effectively at September 30, 1997.

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. 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.

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.

In the Report of Independent Public Accountants on Internal Control Structure for the years ended September 30, 1995, and September 30, 1996, we noted matters involving the internal control structure and its operation that we considered to be material weaknesses, reportable conditions and other advisory comments. The disposition of these matters is set forth in the sections of this report denoted as "Prior Year."

#### Material Weaknesses

##### Area and Agency Office - Inadequate Management Controls - IIM (31)

There is a lack of policy and procedure or ineffective implementation of certain policies and procedures related to management controls and management's supervision of field personnel. During our field visits, and in our substantive and compliance testing, we noted the following:

- An accounting technician made unauthorized changes to an Integrated Records Management System ("IRMS") account holder master record.
- An accounting technician processed disbursements from beneficiary accounts that were on a credit hold status prior to receiving proper authorization and documentation to remove the hold. In this instance, the beneficiary accounts affected were individuals of close personal relationship to the accounting technician.
- Accounting technicians work in an open, unsecured environment in Bureau of Indian Affairs ("BIA") field offices. This type of work environment lends itself to the possibility of sensitive account holder information being released to non-account holders. This environment also does not prohibit terminated employees from re-accessing their old work station and account holder information.
- An accounting technician has multiple passwords to the IRMS system.
- An accounting technician allows the Authorized Collector access to the IRMS system under the Clerk/Teller's password, and allows the Authorized Collector to process transactions.

The accounting technician has access to the account holder master record within the IRMS system, and also processes cash receipt and disbursement transactions. The accounting technician does not submit address changes, status (hold) changes, new account set ups, etc., to a supervisor for approval prior to processing, and no supervisory review of the change to the master record occurs subsequently. The

IRMS system does not require a supervisor's review and acceptance before changes are processed to the master record.

By allowing an unauthorized individual access to the IRMS system, which also includes access to the IIM account holder master record, unauthorized changes to master records, improper transactions or errors in transaction processing may occur and could potentially be undetected. Using multiple passwords may present difficulty in tracing transactions to the individual responsible for processing them.

No security review of these Agency offices occurred during the last fiscal year. This may have detected the impropriety. Further, there is no daily on-site supervision of the accounting technicians that might have deterred the individual from sharing the password.

Recommendation (31): We recommend that the OTFM develop policies and procedures to strengthen supervision of the field personnel. We feel the following should be given priority in these policies and procedures:

- ♦ The field technician be given inquiry access only to the IIM account holder master records, and processing of master record changes be performed by individuals who are independent of the transaction processing function.
- ♦ A documentation review and approval policy and procedure should be instituted prior to the processing of master record changes.
- ♦ A subsequent review should be made of the actual system updates.
- ♦ A review of IRMS passwords should be undertaken which includes a check for individuals with more than one password and elimination of inactive passwords.
- ♦ A security review of Field Agencies should occur, and the need for password security reinforced. The OTFM maintains a Field Review and Internal Review staff, and, as part of their regular duties, they should perform periodic Agency visits and review system controls.

We recommend the OTFM centralize the accounting processes, master record changes and financial transaction processing. Master record changes should be performed by individuals who are independent of the transaction processing function. We also recommend the OTFM institute a documentation review and approval policy and procedure prior to the processing of master record changes, and a subsequent review of the actual system updates.

Client Response (31): The OTFM has contracted for a feasibility study of the realignment of OTFM trust accounting functions. Based on the study results, realignment is scheduled to begin August 1998, with an anticipated completion date of December 1999. The accounting and data entry function realignment should improve internal controls.

System security is currently under the purview of the BIA. The implementation of TFAS beginning in August 1998, with a target completion date of December 1999 will move system security to the OTFM. The TFAS has imbedded security monitoring capabilities. In the interim, the OTFM System Security Officer will request the OTFM's user ID listing from BIA to review for multiple user ID's assigned to the same individual or other inconsistencies. This review and corrections will be made by September 30, 1998.

Several of these instances occurred at one agency and appeared to be caused by a single individual. The individual in question was reassigned and has subsequently resigned. In the spring of 1998, a mandatory two-day training course on

policy/procedures and customer service was completed for all field staff to address these types of deficiencies.

Area and Agency Offices - Missing Beneficiary Records - IIM (32)

Critical information regarding the status of account beneficiaries is either missing or could not be obtained for our testing. In responding to our requests for documentation to support various transactions in our sample, one Agency stated that a warehouse had been vandalized, and in another instance files were "missing". Often, these files have been established over many years and document requirements may have changed. We also noted numerous instances for which we were unable to obtain the appropriate documentation authorizing IIM accounts as automatically disbursing, and several instances where we were unable to obtain support for a minor reaching the age of majority. Without adequate supporting documentation it is not possible to determine whether transactions, particularly disbursements, are properly authorized and in accordance with the account holder's status.

Inadequate records management and record keeping facilities and ineffective implementation of existing policy and procedures at Area and Agency offices is the cause of this condition. Although the OTFM has taken positive actions that would ordinarily reduce the problem, due to the current de-centralized operating environment and ingrained past practices and past supervisory/employee relationships, progress has been impaired.

Recommendation (32): The OTFM is addressing this issue as part of its IIM clean up project and records management centralization and imaging initiative. The OTFM needs to continue its follow up in ensuring that the records remain "clean" once they are returned to the Area and Agency offices, and that new accounts are being properly documented as they are set up.

Client Response (32): The OTFM concurs with the recommendation. In fiscal year 1998, the OTFM issued policy memorandum POL98-012, Mandatory Documentation Requirements for IIM Account Jacket Folders. After the files are scrubbed and inventoried during the IIM clean-up project, the mandatory documents will be imaged and an effort to gather missing mandatory documentation will be initiated. The centralization of files and the review process benchmarked against established policy requirements will identify additional records required to ensure compliance to the extent possible for future IIM records. The OST/BIA records management objective is to develop and implement a joint records management solution to trust management records, which may include electronic records/imaging technology.

Improper Transaction Coding - Tribal and IIM (33):

We noted numerous receipts encoded to erroneous reference codes within the IIM system, particularly, the use of the "miscellaneous" reference code, or "payment, other" although the items represented agriculture leasing, land sales, etc., for which there are specific reporting codes. We also noted errors in the OmniTrust system, where lease payments are coded as land sales, or transfers between or within appropriations were erroneously recorded. As a result, the OTFM cannot provide reasonable assurances as to the nature or amounts represented as individual categories of trust receipts.

Recommendation (33): The OTFM needs to ensure that personnel who are responsible for transaction coding receive adequate training. Transactions should be reviewed prior and subsequent to processing to the trust systems.

Client Response (33): The OTFM concurs with the recommendation. A significant portion of source documents is generated by the BIA, and, as a result, a cooperative training effort must be taken to provide consistency. The OTFM Division of Trust Funds Accounting in Albuquerque began the practice of reviewing Tribal transaction coding in March 1998, and notifying the field offices of recommended corrections. This has improved the accuracy of Tribal transaction coding. The implementation of the Trust Funds Accounting System ("TFAS") will incorporate both Tribal and IIM codes into one comprehensive list that should allow for consistent application of transaction processing. The implementation of TFAS will also provide pre and post-quality assurance verification of codes utilized. The resolution of this condition will not be complete until the Trust Asset and Accounting Management System ("TAAMS") is totally implemented. The implementation will include training for OTFM, BIA and Tribal staff.

#### Reportable Conditions

##### Funds Accepted into Trust without Supporting Documentation - Tribal and IIM (34)

We noted several Tribal timber-related collections posted to the IIM system which originated with the Tribe and for which there was no supporting documentation. The amounts totaled approximately \$365,000.

Without supporting documentation, the OTFM has no way to ascertain that the funds it is receiving into trust are actually trust funds. The Tribes are entitled to receive the royalty payments or other proceeds of labor income directly and later submit all or some of the revenue to the OTFM for deposit into trust. As administrator, the OTFM needs, and should be able to obtain, supporting documentation and reasonable assurances from the Tribe regarding the nature of the funds it is receiving into trust.

Recommendation (34): The OTFM should define via policy and procedure the documentation it requires to support the collections of proceeds of labor monies by Tribes later deposited to trust.

Client Response (34): The OTFM concurs that policy and procedures should be developed which fully document and support the nature of collections. Our present condition involves the participation of the Bureau of Indian Affairs in the collection process of which the OTFM does not have supervisory control over their collection officers. OTFM plans for lockbox collections requiring identified source documents with the collections. The target date for all areas to implement lockbox collections is projected for September 1999.

##### Cash and Overnight Investments - Lack of Transfer Transaction Procedures - Tribal and IIM (35)

A cash overdraft and over-investment in the Overnighter by approximately \$6.6 million on 9/30/97 occurred, as a result of inadequate procedures related to transfer transactions between IIM and Tribal accounts in OmniTrust system. The items in question were transactions related to Tribal monies within the IIM system that were to be transferred to a Tribal account in the OmniTrust system. Both the IIM subsidiary system and the OmniTrust system were posted on 9/30/97. The Tribal Trust portion of the transaction in the OmniTrust system was posted prior to the Overnighter sweep cut off on 9/30. However, the upload of the offsetting transaction within the IIM subsidiary system did not post to the OmniTrust control account for IIM until after the Overnighter sweep cut off. As a result of the "day out" nature of the IIM upload for overnighter investment purposes, both Tribal

Trust and IIM were invested on 9/30/97 for the \$6.6 million, resulting in both a cash overdraft and over-investment in the Overnighter.

The interest collected by the OTFM for the over-investment was subsequently refunded to the U.S. Treasury. No account holders were affected by the accounting error.

Recommendation (35): Proper procedures should be designed and implemented to ensure that timing of the posting of transfer transactions will properly offset for purposes of the Overnighter investment sweep. Documentation and an approved confirmation of the transaction posting date in IIM before passing the transaction to Tribal accounting should be obtained, and the proper posting date for the OmniTrust system Tribal transaction should be noted. Supervisory review of these transactions prior to and after posting should be incorporated in the procedure.

Client Response (35): The OTFM concurs with the recommendation. Interim procedures were issued to the Division of Trust Funds Accounting to correct this condition on March 13, 1998. We are in the process of realigning data entry for trust accounts; therefore, the unnumbered interim procedures will stay in affect until the realignment is complete. The permanent resolution is anticipated for December 1999 with the TFAS system conversion. As mentioned above in the condition, this timing difference will be eliminated when Tribal and IIM accounts reside on one system.

Investments - Lack of Manual Adjustment Procedures and Lack of Carry Value Reconciliation - Tribal and IIM (36)

We were unable to locate documented procedures for performing manual adjustments (correcting entries) in the OmniTrust system. These procedures should include a review of the transaction before and after the posting to ensure accuracy. In our testing of investment activity, which included several principal pay down transactions, we noted the amount of carry value reduced with a principal pay down did not correspond to the same par/cost relationship as indicated in the original broker's confirmation. In reviewing the history of transactions posted for the security, it was noted that in the previous fiscal year a manual adjustment to carry value was made incorrectly, thus altering the par/cost relationship. Further, we were unable to locate a periodic reconciliation of carry value so the error was undetected until our testing.

Recommendation (36): Procedures should be designed, documented and implemented to ensure adequate control over the review, approval and posting of manual transactions in the OmniTrust system. A periodic reconciliation of carry value should be instituted to ensure timely error detection and correction.

Client Response (36): The OTFM concurs with the recommendation. Manual adjustments are only performed for correcting transactions. OTFM has procedures in draft to ensure that proposed manual carry value adjustments are administratively reviewed and documented prior to being posted. The calculated par/cost relationship per the OmniTrust system will be compared to the original par value/purchase price as listed on the original purchase ticket in the first cycle following the date of the adjustment. This check should ensure that the par/cost relationship did not change. The implementation of the TFAS system should minimize the manual adjustments since the system will provide for automated paydown and automated reversals of transactions.

Investments - Inadequate Procedures relating to Market Pricing and Stated Market Values - Tribal and IIM (37)

In performing our tests related to manually priced securities at 9/30/97, we noted the market value of several securities per the OmniTrust system did not agree to the schedule of manually priced securities prepared by the Branch of Investments for the same period. We also noted several differences in comparing the prices obtained by the Branch of Investments to market values obtained from Bloomberg, a widely used investment information service. In reviewing the process by which the Branch of Investments obtains information to manually price securities, we determined there is no documented procedure for updating and documenting the source of information for manually priced securities.

Recommendation (37): The OTFM needs to implement procedures to ensure adequate control over manual pricing, including review and approval prior to and after the OmniTrust system is updated.

Client Response (37): The OTFM concurs with the recommendation. Appropriate documentation is now accumulated and retained to support each month end pricing effort. This documentation includes a copy of the Unpriced Securities Listing from the OmniTrust system annotated with current prices plus hard copies from each source used, such as Bloomberg, original broker input, Simmons FNB monthly update on mortgage backed securities, etc. This documentation will be provided to the Chief, Division of Trust Funds Services for review, sign off and retention.

The OTFM has procedures in draft to ensure that all manually priced securities are reflected correctly in the OmniTrust System and on Customer Statements. Price updates will be verified to the source document obtained from the Branch of Trust Funds Investments to ensure that the prices agree and that there is no over/understatement of investment market values reported to beneficiaries.

Other Advisory Comments

Inconsistent Practices regarding Disbursements from Tribal Accounts - Tribal (38)

Practices with regard to disbursements from Tribal Accounts - Proceeds of Labor were inconsistent at the Aberdeen Area. In our testing of Tribal disbursements from Proceeds of Labor accounts we noted several instances where no Tribal Resolution was provided to support the disbursement to the Tribe. Per the Area Trust Accountant, we were given the understanding this was the practice at that particular Area office, although we did not note the same practice at other Area offices. We also noted that Tribal Resolutions were provided for some disbursements from Proceeds of Labor Accounts at the Area office in question.

We could not locate any specific requirement, policy or regulation that addresses this practice. The practice at Area offices, in general, appears to require a Tribal Resolution authorizing the disbursement from trust. The Tribal Resolution clearly ensures the Council or governing body has recommended and approved the use and disbursement of the trust funds.

Recommendation (38): We recommend that the OTFM propose policy and procedure to address the documentation standards for withdrawal from Tribal Accounts - Proceeds of Labor.

Client Response (38): The OTFM concurs with the recommendation. On March 19, 1998, guidance was issued to all Area Trust Accountants and Financial Trust Service

Officers, with copies to other appropriate OTFM staff, defining the required documentation for all Tribal disbursements.

Investments - Lack of Contract Compliance - Custodial Reconciliation - Tribal and IIM (39):

Differences exist between Banker's Trust, OTFM's Custodian, and information contained on the OmniTrust system. The differences exist predominately on the Banker's Trust system and include maturity dates, interest rates and differences in par value. Although the OTFM has identified and communicated the differences to the contractor, some differences have aged significantly without resolution. The differences may lead to difficulties in proper settlement when securities mature or are sold if the appropriate party does not resolve them.

Recommendation (39): The OTFM needs to ensure that differences are communicated to the contractor and resolved in a timely fashion.

Client Response (39): The OTFM concurs with the recommendation. The OTFM will address the contractual issues related to the reconciling differences by September 30, 1998.

Fund Balance - Accepting Non-trust Beneficiaries and Non-trust Funds - Tribal and IIM (40)

It appears that accounts may be established and maintained for non-trust beneficiaries and non-trust money may be accepted into these accounts. It does not appear that definitive regulation or legislation exists which specifically addresses the nature of the allowable collections into trust or whether the OTFM may provide trust and/or banking services to organizations other than Tribes or Individual Indians.

During our field visits, and in our substantive and compliance testing, we noted several accounts that appear to be maintained in the IRMS system for various BIA program related activities, including the Ute Mountain Court of Indian offenses and Wapato Irrigation Program. We also noted accounts for various Tribal Credit Programs. The collections to these accounts included court fines and fees, irrigation fees, and loan payments.

We also noted a Special Deposit Account entitled "Southern Ute Severance Fund." The collections deposited into this account are ostensibly severance taxes levied by the Southern Ute Tribe ("the Tribe") on methane gas extracted from tribal coal beds underlying both tribal and non-tribal lands. The funds and the Tribe's right to impose the tax is the subject of a lawsuit. The Tribe collects the payments and then, in the case of the transaction selected in our sample, issues a check to the BIA. However, we were unable to obtain any supporting documentation to determine the source of the funds actually deposited into the account. Further, per an Accommodation Approval dated May 17, 1994, and Solicitor's Opinions M-36935 and M-36970, the Department of the Interior adopted the position that the Tribe does not own the coal bed methane gas that may or may not be associated with the Tribe's coal deposits. The Accommodation Approval also stated the Department of the Interior owes the Tribe no fiduciary responsibility with regard to ownership of the coal bed methane gas.

By accepting these moneys into the trust funds, the OTFM accepts the fiduciary responsibility for maintaining the balances and investing the funds. The OTFM may not be delegated those responsibilities and may be inappropriately utilizing government resources to manage and account for the funds. Additionally, without

proper supporting documentation, it would be impossible to determine the nature of the funds collected as being appropriate.

The accounts were set up at the various field Agencies prior to February 9, 1996, and the accounting technician was not required to obtain a supervisory approval prior to setting up a new account.

Recommendation (40): A clear, definitive policy with regard to allowable trust accounts and allowable types of collections into trust is needed. The OTFM may also wish to obtain an opinion of the Solicitor that addresses these issues.

Further, a procedure is needed whereby a supervisor reviews and approves new account documentation and set up within IRMS. The OTFM has already established a Trust Acceptance Committee for Tribal Trusts, and perhaps a similar policy and procedure may be adapted for account establishment within IRMS.

If "non-trust" funds of the nature described above are to be allowed in trust, policy and procedure with regard to a documentation standard supporting the nature of the funds submitted for collection should be required. Policy and procedure should also address other compliance and reporting issues, e.g., Internal Revenue Service reporting requirements.

Client Response (40): The OTFM concurs with this recommendation. The OTFM requested a Solicitor's Opinion on April 3, 1996, with regard to deposit of funds generated from Tribal activities, and on June 21, 1996, with regard to accepting gaming funds. The OTFM has followed up periodically and re-submitted the issues on March 2, 1998. Upon receipt of an Opinion, the OTFM will pursue a Departmental policy with regard to types of deposits allowed into trust accounts.

Currently, IIM accounts are established at 62 field locations. Under the existing level of field staffing, resources and technology, the OTFM does not have the capability to provide a supervisory review and approval of source documents and new account set ups in the IRMS system. A pre and post-quality assurance review will be piloted in conjunction with the TFAS conversion, imaging initiative and realignment of encoding staff in August 1998 and fully implemented by December 1999.

Area and Agency - Bureau of Indian Affairs Trust Responsibilities - Tribal and IIM (41)

As part of our field visits and substantive and compliance testing, we reviewed the collection process along with supporting documentation for collections posted to IIM and Tribal accounts. In so doing, we noted the following internal control issues and instances of non-compliance as they relate to the trust responsibilities of the BIA:

- Unauthorized disbursements from trust accounts occur. We also noted disbursements from IIM accounts with Social Services holds were "recommended" by a rubber-stamped facsimile of the Superintendent's signature.
- Our testing of lease income revealed that interest is not always collected on late payments. We noted instances where the lessee paid an incorrect amount that was less than the lease amount due. We also noted the Agency was making no attempt at collection of past due amounts.

- The lessee did not execute one lease selected in our upstream sample. We also observed instances of lease payments receipted "pending approval of the lease." The lessee has had use of the land.
- The Agency holds checks in excess of the 24 hour Treasury Fiscal Requirement.
- Files containing original documents were not stored in a locked, secure location.
- Some allotted lands are not being advertised for lease
- There is a lack of segregation of duties when the Agency Authorized Collector simultaneously acts as the Authorized Mail Clerk.
- There is no backup for the Collections officer, or the alternate Collection officer has not had an opportunity to process collections, which may mean they are no longer familiar with the process.
- The Agency accepts personal checks as a form of payment. On occasion personal checks were not honored by the issuing bank, and overdrafts to IIM accounts occurred as a result of the delay between the time the item was returned to the Agency and the distribution to the account holder.

Recommendation (41): The OTFM may wish to share these findings with the BIA for their comments.

Client Response (41): Per an agreement between the OTFM and BIA during the FY 1996 financial audit, these comments were provided to the Office of Inspector General for forwarding to the Office of Audit and Evaluation.

The following sections contain the comments from the September 30, 1996, Report on Internal Controls.

Prior Year - Material Weaknesses - September 30, 1996

Inadequate Internal Financial Reporting - Tribal and IIM (17)

In performing our tests related to the trust fund balances, we noted that the OTFM could not produce a ready analysis of the changes in cumulative trust fund balances. The resulting Statement of Changes in Trust Fund Balances for IIM is a compilation of information derived from three different sources, including OmniTrust data, IIM system data, and manually prepared investment amortization and accretion schedules.

The OTFM does not produce internal consolidated trust fund financial reports or statements in accordance with the appropriate basis of accounting. Financial reporting prepared for management's review contained no Statement of Assets and Trust Fund Balances or Statement of Changes in Trust Fund Balances other than those produced as a part of the annual audited financial statements.

The Statement of Changes in Trust Fund Balances is a generally accepted financial report that provides an analysis of periodic receipt and disbursement activity by source, and, in essence, represents a summary reconciliation of beneficiary accounts at the highest consolidated level.

This condition was concurred and implementation is underway at September 30, 1997. The OTFM did compile a Statement of Changes in Trust Fund Balances at year end, and plans to implement monthly financial reporting in fiscal year 1998.

Area and Agency Offices - Unauthorized Transactions - Tribal and IIM (18)

As part of our receipts and disbursements testing, we reviewed disbursement transactions for proper approvals, in accordance with 25 Code of Federal Regulations ("CFR"), Secretarial Order 3177, and Secretarial Order 3197 (for transactions subsequent to February 9, 1996).

In our sample, we noted that BIA personnel did not approve three Tribal disbursement transactions from the IIM subsidiary system totaling \$850,000. These were disbursed prior to the February 9, 1996 Secretarial Order 3177 which changed policies and procedures relating to disbursement approvals. Also, for two transactions totaling \$70,640, documentation supporting beneficiary approval of disbursements to third parties was not provided.

OTFM and BIA policies and procedures require an appropriate approval be obtained prior to funding tribal disbursements. Without proper approvals, the OTFM may be inappropriately disbursing trust assets. An approval signature indicates that a disbursement has been reviewed and is appropriate based on supporting documentation. Lack of documented approval indicates that these steps may or may not have occurred. Inadequate documentation of approvals may also expose the OTFM to a potential breach of fiduciary responsibility.

The condition was shared with the BIA as related to fiscal year 1996. However, our testing of disbursement transaction for fiscal year 1997 revealed several instances of unauthorized disbursements from both Tribal and Individual Indian Money accounts. This condition is unresolved at September 30, 1997.

Area and Agency Offices - Ineffective Implementation of Policies & Procedures - Tribal and IIM (19)

As part of our audit related to receipts and disbursements transactions, we reviewed prior year internal control questionnaire responses, conducted telephone interviews with Area and Agency staff, and visited Area and Agency offices. It was noted that while authority to supervise financial trust accounting personnel was delegated to the OTFM in February 1996, particular trust functions (i.e., collections) are performed by non-OTFM staff, over which, the OTFM has no control nor authority. As a result, there is an inability to implement existing policies and procedures pertaining to those functions. The following OTFM policies and procedures are inadequately implemented, or are not implemented at Area and Agency offices.

AREA AND AGENCY OFFICE INTERNAL CONTROL WEAKNESSES

- Administrative reviews of the collection process have not been performed within the last year.
- Collections are not processed by Authorized Collectors.
- Incoming mail is opened and receipts are listed by a person having access to cash receipts (BIA).
- The same person who opens mail and lists cash receipts enters cash receipts in books of original entry (BIA).
- Daily deposits are not reconciled to Schedules of Collection.

- The BIAM 42, Illustration 15, Quarterly Collection Review Worksheets are not completed (BIA).
- The Collections Officer is the only individual with the combination to the safe or the combination is not located in a sealed envelope with a third party.
- The Authorized Collector does not have an alternate to perform the function in their absence (BIA).
- The Agency does not have and follow the BIAM 42. (This item was resolved at September 30, 1997.)
- The IIM teller does not have a Desk Operating Procedure Manual to follow. (This items was resolved at September 30, 1997.)
- Administrative review by the Area Accounting Officer or Trust Officer is not performed on the disbursing function. (This item is resolved at September 30, 1997.)
- Receipts are not mailed to the Area Office for deposit on a daily basis.
- When an employee with knowledge of the combination to the safe leaves his/her position, the combination to the safe is not changed (BIA).
- Effective control is not provided over miscellaneous receipts when received at the Area office (BIA).
- Funds are disbursed via Journal Vouchers prior to the funds being deposited. (This item was resolved at September 30, 1997.)
- The key to the cabinet containing the blank check stock is located in the same safe as the signature plate. (This item is resolved at September 30, 1997.)
- The inventory of the blank check stock is not always performed by an individual independent of the disbursing function or is not performed at regular intervals.
- The same individual performs collections and disbursing functions. (This item is resolved at September 30, 1997.)
- The field accounting technicians do not have a trained backup to perform their duties in their absence.
- There is inadequate documentation to support IIM account holds.
- There is inadequate control over cash received. For the year ended September 30, 1997, we noted instances where cash receipts were held in a file drawer rather than in a safe or vault.
- The PC system, also known as the Management Accounting Distribution ("MAD") system, does not have a built in control to stop duplicate disbursements.

Further, the OTFM and the BIA continue to be hampered by a lack of adequate information systems to support various trust related activities, including land

inventory systems, lease management systems, ownership systems, accounts receivable and an adequate trust accounting system for IIM. While the OTFM continues to work towards providing improved regulatory guidance, policies and procedures, consistent implementation of existing guidelines has not been achieved due to the decentralized nature of OTFM operations, lack of personnel, lack of authority over certain trust functions related to OTFM operations and inadequate information systems.

This condition was concurred and implementation is in progress at September 30, 1997. These comments were shared with the BIA for their follow up.

#### Reportable Conditions - Prior Year - September 30, 1996

##### Cash - Failure to Analyze Suspense Accounts - Tribal and IIM (20)

An analysis of the items that comprise several U.S. Treasury ("the Treasury") suspense and budget clearing accounts has not been completed. Therefore, the OTFM's current procedures for researching and proposing adjustments to the cash out of balance condition do not consider whether an offset may already exist within one of these account balances. Funds to cover the adjustments may be in a Treasury suspense or budget clearing account because the original transaction may not have been reported to Treasury, and a Statement of Difference was created. If the Statement of Difference was not resolved, the transaction amount was transferred to one of the Treasury suspense or budget clearing accounts. The Treasury suspense and budget clearing account balances at September 30, 1996, are approximately \$100,500, (\$3,378,000), \$5,957,000 and (\$3,310,000).

As a result, the resolution of reconciling items between the U.S. Treasury and the OTFM may be incorrect without consideration given to the items that comprise prior period suspense balances.

The condition was concurred and implementation is in progress at September 30, 1997. The suspense account balances are unchanged since September 30, 1996.

##### Cash - Lack of Supporting Documentation Prior to Recording Transactions - IIM (21)

Various prior period adjustments have been recorded to the IIM subsidiary system without adequate documentation. Since the appropriate adjustment has not been researched and supported, the items have not been recorded to the OmniTrust system control account for IIM. The adjustments are recognized as new reconciling items in the Daily Cash Reconciliation. A number of these items have existed for a lengthy period of time, but, as yet, the items have not been sufficiently researched so that they may be resolved. As of the end of fieldwork, documents have not been received for approximately 39 line items.

These items represent, in many cases, cash disbursement transactions that have occurred at the IIM subsidiary system level. The potential to create cash transactions without proper substantiation exposes the OTFM to the risk of creating uncollectible overdrafts if the transaction was not properly supported and should be reversed. Also, it is generally more difficult to resolve reconciling items as the items age.

The condition was concurred and resolved as of September 30, 1997.

Investments - Lack of Reliable IIM Balance Available for Investing - IIM (22)

The amount invested on behalf of IIM account holders is based on the OmniTrust system IIM control account balance. The balance per OmniTrust does not agree to the balance per the IIM subsidiary ledger. The OmniTrust control account for IIM exceeds the IIM subsidiary ledger by approximately \$29,000,000. At this point in time, it can not be determined which system has an accurate balance. Consequently, the OTFM may be over or under-investing, because the underlying balance is unreliable.

The \$29,000,000 difference is now reflected at approximately \$21,000,000 as of September 30, 1997. The out of balance condition changes as reconciling items are identified and cleared. The condition was concurred but remains unresolved at September 30, 1997. The balances are likely to remain intact until the U.S. Federal Government and the beneficiaries reach a resolution regarding past activities and balances.

Investments - Accounting System Calculation Errors - IIM (23)

The OTFM contracted with SunGard Systems to utilize its Bolt II investment accounting system to satisfy financial reporting requirements and appropriately calculate and record amortization/accretion of investment discounts or premiums in accordance with generally accepted accounting principles. Several computational errors and/or limitations of the Bolt II investment accounting system relating to amortization/accretion of investment premiums and discounts were noted.

- ♦ The Bolt II system did not calculate any accretion/amortization of premiums or discounts for the accrual classes ("Z-tranche") of Collateralized Mortgage Obligation ("CMO") securities which were still in the accrual phase with the cash flow table method. In discussion with Bolt II personnel, this problem was attributed to a programming error. Based upon calculations provided by OTFM, net result of this error is an understatement of accretion in the amount of \$215,870.
- ♦ Values for Z-tranche holdings were inaccurately converted to the Bolt II system due to incorrect manual postings in the OmniTrust system. This issue, combined with the accretion error, produced incorrect Bolt II system values.
- ♦ The Bolt II system was unable to produce accurate amortization/accretion of CMO's with par values less than \$100,000 due to a programming error. The Bolt II system fully accreted these securities as of September 30, 1996, although these securities had not yet been fully paid down, called or matured. The discounts associated with these securities totaled \$12,952.
- ♦ The cash flow table assumptions for three asset backed securities were not accurate due to Bolt II system programming errors. When Bolt II system values were compared to manually computed values, these investments were under-accreted \$476,734.

The cumulative effect of these errors is an under-accretion of \$679,642. These errors affect the accuracy of financial reporting to individual account holders.

The condition was concurred but the Bolt II system deficiencies remain unresolved at September 30, 1997. The OTFM has instituted various means to work around the limitations of the Bolt system and properly amortize and accrete these security types in order to resolve the issue.

Special Deposit Accounts - Lack of Policies and Procedures and Inconsistent Practices - IIM (24)

Per OTFM management, "Special Deposit" accounts are to be used as suspense accounts to which funds are posted when the distribution is not immediately clear. These accounts are held within the IIM subsidiary system. The funds are then transferred to the account holder when the proper allocations are determined. For receipt and disbursement transactions specifically related to Special Deposit accounts, we noted a number of practices which may be inconsistent with management's defined use of Special Deposit accounts, as well as inadequate policies and procedures governing the use of these accounts.

Among the issues noted were:

- ♦ Special deposit account balances are incompletely allocated (less than 100% of the balance is allocated, leaving a residual Special Deposit account balance) or allocated on an "as-needed" basis (similar to a checking account) to the beneficiary as opposed to being allocated in full.
- ♦ Loan payments to third party financial institutions accumulate in a Special Deposit account, and lump sum payments are made on behalf of beneficiaries. The amounts paid do not equal the amounts contributed by beneficiaries, and it is not known how the payments by individuals were reconciled to the lump sum payments. Further, we were unable to obtain documentation to support approval by the beneficiaries of these payments made to third parties.

These practices noted above may expose the OTFM to unnecessary risk, as in the case of receipt and disbursement of loan payments or payments to third parties without documented beneficiary approval.

- ♦ A Tribal credit program using a Special Deposit account to withdraw funds as necessary to make loans to Tribal members. The source of the deposits to this particular Special Deposit account may be loan repayments, which are not considered proper receipts from trust activities.
- ♦ Past errors that had not been resolved offset to Special Deposit accounts. These include canceled check claims, payments to an incorrect individual for per capita distribution, and historical conversion errors (from manual to automated system in 1977).
- ♦ Special deposit accounts contain judgment award funds.
- ♦ Special deposit accounts were missing supporting documentation for the approval of disbursements to third parties.
- ♦ Disbursements are made directly to beneficiaries from Special Deposit accounts without first being transferred to a beneficiary's IIM or Tribal account. These transactions were not reported on the account holder's statement.

Direct disbursements from Special Deposit accounts pose problems in providing a complete and accurate accounting. Statements of Special Deposit accounts are not routinely sent to beneficiaries, and none of the Special Deposit activity is consolidated with the beneficiary's account statements. Based on our analysis, only 12% of Special Deposit accounts receive statements, and none of the Tribal Special Deposit accounts in our sample received such statements. Approximately

\$33,000,000 was directly disbursed from Special Deposit accounts to third parties (beneficiaries and unrelated third parties combined).

The American Indian Trust Fund Management Reform Act of 1994 ("The Reform Act") requires periodic statements be provided to account holders and that accounts be reconciled. As a result of these practices, the OTFM may be unable to comply with The Reform Act, and incomplete and inaccurate reporting is being provided to account holders.

- ♦ For receipt and disbursement activity, various attributes of specific Special Deposit accounts were tested. These attributes included proper authorization and support for establishing the initial account in the IIM subsidiary system. The OTFM was unable to provide documentation for two of the eleven Special Deposit accounts that were selected for testing. The accounts have been in existence since 1985 and 1993, respectively, and both accounts have negative, overdraft balances.

Lack of standardized procedures and adequate resources to identify and allocate these monies is the primary cause of aged Special Deposit account balances. Further, management lacks financial reports to sufficiently monitor the progress of Area and Agency offices in clearing Special Deposit account balances.

This condition was concurred and implementation is in progress at September 30, 1997.

#### IIM Interest Earnings - Inadequate System, Policies and Procedures - IIM (25)

The distribution of interest earnings to IIM accounts is not performed in a consistent manner. For example, some accounts closed during the month using the Closed Accounts Program ("CAPs") receive interest based on the Overnighter investment only. However, due to limitations of the IIM system, other accounts closed during the month do not use the CAPs program, but receive interest based on the interest factor from the previous month. Other accounts open throughout the month receive interest based upon a calculation that considers the entire IIM investment portfolio earnings. The above inconsistencies may lead to an inequitable distribution between account holders.

The CAPs program was instituted to eliminate overdistribution when closing accounts and to provide an automated calculation reducing errors in manual calculations. However, the CAPs program cannot be used for all accounts. Therefore, some accounts continue to receive incorrect interest allocations.

Written policies and procedures for the various methods of determining the IIM interest earnings calculation and distribution have not been completed. Policy and procedures should address both the CAPs program and monthly processes for assimilating information from the various sources, calculation methodology, due date for completion, and a review checklist. Without a standard to follow, changes or errors in the methodology of the calculation can occur without management's knowledge or approval. An informal review process without formal approval does not properly document that a review was performed, particularly if changes or recalculations were recommended. In addition, the lack of adherence to set deadlines may lead to untimely distributions.

This condition was concurred but remains unresolved at September 30, 1997.

Negative IIM Account Balances Included in Invested Balance - IIM (26)

The IIM subsidiary ledger contains negative account balances approximating \$44,000,000. The OmniTrust control account for IIM is supposed to represent the aggregate net balance of the IIM subsidiary system. However, this is difficult to determine because of the \$29,000,000 out of balance condition between OmniTrust and the IIM subsidiary ledger that is noted in a separate reportable condition. The invested balance for IIM account holders is equal to the OmniTrust balance. If the negative balances are included in both ledgers, IIM account holders with positive balances are being penalized by lower earnings due to the IIM investment pool being reduced by the amount of the negative balances.

In addition to individual overdraft accounts, a large portion of the negative balances are due to negative undistributed interest account balances. These accounts have continued to grow over the past year due to a lack of reconciliation. IIM account holders with positive balances are potentially penalized as a result of investing the net IIM holdings as a pool.

This condition was concurred but remains unresolved at September 30, 1997.

IIM Amortization/Accretion of Mortgage Backed Securities - IIM (27)

The monthly calculation of IIM investment earnings for distribution to the IIM account holders is a manual process which attempts to calculate earnings on an accrued basis for the IIM investment pool. For securities purchased at premiums or discounts other than mortgage backed securities, the amortization or accretion is calculated on a straight line basis, and added to the pool earnings for the period. However, amortization/accretion of mortgage backed securities held on behalf of IIM account holders is not calculated in the monthly IIM earnings calculation of the interest distribution.

Without the amortization/accretion calculation, investment income for mortgage backed securities is recognized on a cash, rather than accrual basis. As a result, the IIM account holders receive monies at a different point in time than they would if the mortgage backed securities were being properly amortized or accreted. This method is inconsistent with the treatment of the balance of the IIM investment earnings calculation.

This condition was concurred and implementation is in progress at September 30, 1997.

Trust Fund Balance Transfers Recorded Inconsistently - Tribal and IIM (28)

There is a lack of policies and procedures in recording transfer transactions, which has resulted in transfer transactions being recorded in an inconsistent manner. To record transactions which represent transfers between and within appropriations, a "BB" transaction type should be utilized within the OmniTrust system and specific codes should be set up to denote these transactions. The net effect to the aggregate fund balance should be zero. However, in some instances we noted that income is being recorded twice as a result of transfer transactions. When trust income is received, it is coded to a specific type (e.g., royalties, lease payments, etc.). At a later date, if the money is transferred to another account, an income type code is again used, rather than a transfer code. This condition resulted in a net inaccurate recording of trust activity of approximately \$4,000,000.

This condition was concurred and implementation is in process at September 30, 1997.

Other Advisory Comments - Prior Year - September 30, 1996

Earnings on Overnight Investments - Tribal and IIM (29)

The OTFM has no formal written policies and procedures to document the method of determining the amount to invest in the Overnight investment, or how to distribute the income earned thereon. During our testing we noted one instance where the OTFM incorrectly calculated the amount to invest as a direct result of a coupon interest payment being late. In instances when the OTFM calculates and invests an amount greater than what is actually available, the OTFM refunds the Treasury for the interest earned on the over-invested amount. When the broker paid the OTFM interest for being late, the OTFM posted the receipt to the account holder instead of refunding the Treasury. An inexperienced employee was performing this function and was unclear how to handle the transaction.

This condition was concurred and implementation of an interim policy was in place at September 30, 1997.

Investment/Bolt II System Implementation - Tribal and IIM (30)

To satisfy financial reporting requirements and to perform an automated calculation of amortization and accretion in accordance with FASB 91 guidelines, the OTFM implemented the Bolt II investment accounting system. The Bolt II system will be used in conjunction with the OmniTrust system, and OmniTrust data was used to populate the Bolt II system data fields. However, the OTFM did not have a formalized, detailed needs assessment and implementation plan in place prior to the selection and data conversion. For example:

- ♦ OTFM personnel performed limited, informal testing as part of its assessment of the Bolt II system to determine if Bolt II would be adequate to meet the OTFM's needs. OTFM personnel submitted seven securities for testing, including FICO strips (principal only securities, with conversion features at various call dates), deep discounts (zero coupon), and mortgage backed securities. However, other security types were not tested, nor was the dollar size of the securities tested in relationship to the entire portfolio considered. Complete and thorough testing may have helped identify potential system weaknesses, limitations or incompatibilities.
- ♦ The OTFM did not utilize outside consultants in order to assess alternative systems, nor was a consultant utilized during the implementation process. OTFM personnel could not allocate sufficient time and resources to the system conversion process.
- ♦ A comprehensive plan to convert data to the Bolt II system should have documented which individuals were to be involved in the process and identified each person's specific responsibilities and deliverables. Implementation phases and time frames for completion should have been documented to gauge progress and timely delivery. A plan would most likely include system testing as an integral phase of the process. The system testing would also be thoroughly documented in computer-generated reports, analytical memoranda and data run scenarios.

- ◆ After converting data to the Bolt II system, OTFM personnel did not agree the market values of securities reported by OmniTrust to those that were reported by the new Bolt II system reports. Also, security descriptions were not verified or compared to those recorded in OmniTrust. We noted several discrepancies in security descriptions and market values between the OmniTrust and Bolt II systems.
- ◆ Bolt II reports transactions based on a calendar year, while the OTFM operates on a 'fiscal' year basis. As a result, the OTFM has to develop alternative procedures to accumulate fiscal year to date activity.
- ◆ The OTFM did not adequately consider system and information requirements for its September 30, 1996, financial statement reporting, including reporting the changes in trust fund balances. Considerable time and manual effort was required to produce the needed information.

This condition was concurred and resolved at September 30, 1997.

The following sections contain the comments from the September 30, 1995, Report on Internal Controls.

Material Weaknesses - Prior Year - September 30, 1995

Cash - Tribal and IIM (1)

Cash balances converted from the prior general ledger to OmniTrust were approximately \$27,000,000 higher than the balance per the Treasury. Cash reconciliation procedures only reconcile current activity from OmniTrust 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 condition was concurred but not resolved during the years ended September 30, 1996 and 1997. Further, the \$27,000,000 difference is now reflected at approximately \$34,000,000 as of September 30, 1997. The out of balance condition changes as reconciling items are identified and cleared.

The balances are likely to remain intact until the U.S. Federal Government and the beneficiaries reach a resolution regarding past activities and balances.

Trust Fund Balances - Tribal and IIM (3)

An "Undistributed Interest Account from TFMS" (the prior general ledger system) exists on OmniTrust with a balance of approximately \$1,800,000 at September 30, 1995. As of September 30, 1997, the balance of this account is approximately \$2,010,000, due to interest being accrued to the balance. This condition was concurred; however, the balance remains unresolved.

There was a difference between the general ledger summary account of IIM on OmniTrust and the total of the balances per the IIM subsidiary ledger detail. The difference was approximately \$30,000,000 at September 30, 1995, with the general ledger carrying the higher balance. Further, the \$30,000,000 difference is now reflected at approximately \$21,000,000 as of September 30, 1997. This condition was concurred; however, the balance remains unresolved.

The balances are likely to remain intact until the U.S. Federal Government and the beneficiaries reach a resolution regarding past activities and balances.

#### Area and Agency Offices - Tribal and IIM (4)

A review of questionnaire responses from the Area and Agency offices indicated that there is no consistency in the application of accounting policies 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 fiscal year ended September 30, 1995, staff in the Area and Agency offices were supervised by the BIA, 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.

This condition was concurred and remains unresolved at September 30, 1997. Until a pre and post-quality assurance review which will be piloted in conjunction with the TFAS conversion, imaging initiative and realignment of encoding staff is fully implemented in December 1999 this condition will remain unresolved.

#### General - Tribal and IIM

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 address these pervasive issues, the OTFM was placed under the direction of the OST, effective February 9, 1996. Since that time, the OTFM began various reform and clean up efforts to address these problems during fiscal year ending September 30, 1997. However, it is not yet possible to ascertain the effectiveness of these initiatives in resolving the issues, given the efforts were not complete at fiscal year end. Therefore, implementation of this condition is in process at September 30, 1997.

Reportable Conditions - Prior Year - September 30, 1995

Cash - Tribal (5)

Negative Cash Balances

There are thirteen (13) cash accounts on OmniTrust 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. Federal Government and the beneficiaries reach a resolution regarding past activities and balances.

This condition is not resolved at September 30, 1997. The negative balances have remained constant.

IIM Investment Earnings - IIM

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.

This condition was concurred and implementation is in process at September 30, 1997.

IIM Special Deposit Accounts - IIM (7)

Through the Area and Agency offices, the BIA 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.

This condition was concurred yet continues unresolved at September 30, 1997. However, clean up efforts began as part of the OTFM's reform initiatives implemented during fiscal year 1997.

Ownership Records - Tribal and IIM (8)

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.

This condition was concurred, but remains unresolved at September 30, 1997. This condition has been shared with the BIA.

General

Policies and Procedures - Tribal and IIM (9)

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.

This condition was concurred and implementation is underway at September 30, 1997.

Accounts Receivable System - Tribal and IIM (10)

The BIA does not have an accounts receivable system in place for trust assets. The GAO, in its report dated April 25, 1994, (GAO/AIMD-94-110R) recommended that the BIA develop an accounts receivable system. Currently, the BIA 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.

This condition was concurred but remains unresolved at September 30, 1997. This comment has been shared with the BIA.

Other Advisory Comments - Prior Year - September 30, 1995

Electronic Data Processing

Disaster Recovery - IIM (12)

Disaster recovery planning over the OmniTrust application is adequate. Our review noted there currently is no formal agreement for disaster recovery pertaining to the Unisys A-17 or the IBM 3090, maintained by the BIA. 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.

This condition was concurred and resolution is in process at September 30, 1997. However, limitations to the current planning should be noted. Our review noted a disaster recovery agreement was implemented and a test of the plan has been successfully completed. Our review also noted the disaster recovery tapes for the Unisys A-17 are not rotated offsite in a timely manner. The current rotation procedure could potentially result in a loss of information.

Password Controls - IIM (13)

Security controls over the Unisys A-17 mainframe maintained by the BIA 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. This condition was concurred but remains unresolved at September 30, 1997.

Application Change Controls - IIM (14)

Our review noted that changes to the 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 the programmer has implemented changes. Review is limited to verification of the output by the requesting party.

This condition was concurred but remains unresolved at September 30, 1997.

1099 Interest Reporting - IIM (16)

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.

This condition was concurred but has not been resolved at September 30, 1997.

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, and 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., CPAs*  
GRIFFIN & ASSOCIATES, P.C.  
Certified Public Accountants

Boulder, Colorado  
June 4, 1998

U.S. DEPARTMENT OF THE INTERIOR  
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS  
TRIBAL AND OTHER SPECIAL TRUST FUNDS,  
AND INDIVIDUAL INDIAN MONIES TRUST FUNDS  
MANAGED BY THE  
OFFICE OF TRUST FUNDS MANAGEMENT

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON COMPLIANCE WITH  
LAWS AND REGULATIONS

SEPTEMBER 30, 1997

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS ON COMPLIANCE WITH LAWS AND REGULATIONS

To the U.S. Department of the Interior  
Office of the Special Trustee for American Indians:

We have audited the Statements of Assets and Trust Fund Balances and the related Statements of Changes in Trust Fund Balances for the Tribal and Other Special Trust Funds, and Individual Indian Monies trust funds ("IIM") managed by the U.S. Department of the Interior Office of the Special Trustee for American Indians ("OST") Office of Trust Funds Management ("the OTFM") as of and for the year ended September 30, 1997, and have issued our reports thereon dated June 4, 1998.

We conducted our audit in accordance with generally accepted auditing standards. 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 statements referred to above are free of material misstatement, we performed tests of OTFM and compliance with certain provisions of laws and regulations. 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 Statements of Assets and Trust Fund Balances and the Statements of Changes in Trust Fund Balances, or that the sensitivity warrants disclosure thereof. The results of our tests disclosed material instances of noncompliance. As communicated to us by the Office of the Solicitor (Solicitor) for the Department of the Interior, tribal organizations and classes of Indian individuals have filed various claims against the U.S. Federal Government for failure of the U.S. Federal Government to fulfill its fiduciary responsibilities and related charges.

We noted an immaterial instance of noncompliance as a result of our testing of receipts and disbursements described below.

Noncompliance with 25 CFR 115.6 - IIM (C1)

- Noncompliance with 25 CFR 115.6 was noted. We noted several instances in which the OTFM accepted voluntary deposits to Individual Indian Money accounts totaling approximately \$2.5 million.

Client Response (C1): The OTFM will conduct an internal review of the voluntary deposits mentioned. Per an agreement between the OTFM and BIA of Indian Affairs ("BIA") during the FY 1996 financial audit, these findings will be provided to the Office of Inspector General for forwarding to the Office of Audit and Evaluation.

The following sections contain comments from the September 30, 1996, Report on Compliance with Laws and Regulations.

Material Noncompliance - September 30, 1996

Lack of Memorandum of Understanding - Tribal and IIM (C2)

The OTFM and BIA have not reached an operating agreement or executed a Memorandum of Understanding that would define the authorities and responsibilities of various OTFM and BIA personnel in performing financial trust services on behalf of Tribes and individual Indians. As a result, lines of authority are unclear and transactions are improperly authorized or, in some cases, processed without authorization.

- ♦ We reviewed disbursement transactions for proper approvals, in accordance with 25 Code of Federal Regulations ("CFR") and Secretarial Order 3177 or Secretarial Order 3197 (for transactions subsequent to February 9, 1996). According to numerous sections of 25 CFR, and Secretarial Order 3177, disbursements from tribal trust accounts require the approval of the Secretary of the Interior or his delegate. This authority was subsequently re-delegated to Agency Superintendents for transactions prior to February 9, 1996.

On February 9, 1996, Secretarial Order 3197 established the Office of the Special Trustee for American Indians within the Department of the Interior and moved the Office of Trust Funds Management from the BIA to the OST. The Secretarial Order issued all delegations of authority for financial trust services to the Special Trustee for American Indians, and rescinded all such delegations to the Assistant Secretary - Indian Affairs. Pursuant to that Order, on February 9, 1996, the Special Trustee for American Indians delegated all program and administrative authorities necessary to perform financial trust services to the Director, OTFM, with the exception to approve withdrawals of tribal funds from trust. This delegation was published as 210 DM 14, Release 3053.

The Director, OTFM, attempted to re-delegate administrative authority within the jurisdiction set forth in 210 DM 14, Release 3053, to OTFM field accounting personnel and BIA Agency Superintendents. This re-delegation was not approved. Therefore, all delegations of authority continue to reside with the Director, OTFM, only.

This condition was concurred but remains unresolved at September 30, 1997. There is an on-going effort to jointly develop an operational responsibilities guide.

Immaterial Non-compliance - September 30, 1996

Instances of noncompliance with 25 CFR were noted during visits to Agency offices as follows:

- ♦ Noncompliance with 25 CFR, Part 114.4 was noted during the receipts and disbursements testing that was conducted for all Agencies. The Agencies have instances where they must calculate interest at an interim period

prior to the month-end interest distributions. The Agencies calculated interest on Special Deposit Accounts using an average daily balance rather than using the month-end balance since the last interest period, as stated in the 25 CFR.

The condition was concurred and remains unresolved at September 30, 1997. A work group was formed in fiscal year 1997 to address the numerous regulatory inconsistencies related to trust activities.

- ♦ It was noted that Agency offices are in violation of the Treasury Fiscal Requirements whereby funds had been accumulated in excess of \$1,000 and a timely deposit was not made.

The condition was concurred but remains unresolved at September 30, 1997. The OTFM's lockbox initiative should address the delays in the deposit of funds.

The following sections contain comments from the September 30, 1995, Report on Compliance with Laws and Regulations.

#### Noncompliance - September 30, 1995

Various instances of noncompliance with 25 CFR, Part 162 were noted during visits to Agency office as part of the fiscal year 1995 audit. These findings have been shared with the BIA, and included instances of immaterial noncompliance, e.g., leases not advertised before award, lack of surety bond guaranteeing payment of the contractual obligation, lack of appraisals, etc.

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

The prior instances of noncompliance were concurred but remain unresolved at September 30, 1997.

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.

Additionally, the objective of our audit of the financial statements was not to determine whether OTFM's systems are Year 2000 compliant. OTFM's management is solely responsible for Year 2000 compliance for its systems and any other systems that impact OTFM's operations, such as those of OTFM's vendors, service providers or other third parties. Accordingly, we have no responsibility to determine, and provide no assurance on, whether OTFM has addressed or will be able to address the affected systems on a timely basis.

This report is intended for the information of the Inspector General, the Assistant Secretary for Indian Affairs, and the Office of Special Trustee for American Indians of the U.S. Department of Interior and management of OTM 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., CPAs*

GRIFFIN & ASSOCIATES, P.C.  
Certified Public Accountants

Boulder, Colorado  
June 4, 1998



# United States Department of the Interior

OFFICE OF THE SECRETARY  
Washington, D.C. 20240

AUG 14 1998

## Memorandum

To: Assistant Inspector General for Audits  
**Acting**

From: Assistant Secretary - Indian Affairs *ESH*

Subject: Draft Audit Report on the Financial Statements for Fiscal Year 1997 of the Tribal, Individual Indian Monies, and Other Special Trust Funds Managed by the Office of the Special Trustee for American Indians (Assignment No. C-IN-BIA-003-98M)

Your memorandum of July 31, 1998, requested a response from this office on one finding considered unresolved from the FY 1996 financial statement audit, and a response to the internal control weaknesses noted in the FY 1997 financial statement audit.

The prior year finding indicated that the Office of Trust Funds Management had made disbursements from tribal IIM accounts which had not been approved by Bureau personnel. Since the unauthorized disbursements were made by OTFM, we request that this recommendation be referred to the Office of the Special Trustee for American Indians.

The internal control deficiencies identified in the FY 1997 audit, Finding 41, cover both Bureau and OST functions. On July 31, 1998, the Secretary approved the Trust Management Improvement Project "High Level Implementation Plan." One of the subprojects contained in the Plan specifically deals with the internal control deficiencies which have been identified "across the entire trust management spectrum." Attached is a copy of that portion of the Plan which discusses the internal control issues and the implementation milestones associated with the Plan. The Bureau of Indian Affairs will work cooperatively with the other responsible offices in the Department to implement the Plan within the time frame established by the Secretary.

Attachment

CC: Office of the Special Trustee for American Indians

## STATUS OF PRIOR AUDIT RECOMMENDATIONS

<u>Recommendation Reference</u>	<u>Status</u>	<u>Action Required</u>
1, 3, 4, 5, 7, 8, 9, 10, 12, 13, 14, 16, 17, 18, 19, 20, 22, 23, 24, 25, 26, 27, 28, and 29	Resolved; not implemented.	No response to the Office of Inspector General is required. The recommendations have been referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.
2, 6, 11, 15, 21, and 30	Implemented.	No further action is required.

## STATUS OF AUDIT REPORT RECOMMENDATIONS

<u>Recommendation Reference</u>	<u>Status</u>	<u>Action Required</u>
41	Unresolved.	The Bureau of Indian Affairs should specify concurrence or nonconcurrence with the recommendation. If concurrence is indicated, a plan of action that identifies a responsible official and a target date for implementation should be provided.
31, 32, 33, 34, 35, 36, 37, and 40	Resolved; not implemented.	No response to the Office of Inspector General is required. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.
38 and 39	Implemented.	No further action is required.

**ILLEGAL OR WASTEFUL ACTIVITIES  
SHOULD BE REPORTED TO  
THE OFFICE OF INSPECTOR GENERAL**

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