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



**ANNUAL REPORT 2002**

AIRR 75-05-0386  
Box 24 "Management Controls Corresp."

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IN REPLY REFER TO:

# United States Department of the Interior

## OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS

Office of Trust Funds Management

505 Marquette N.W. Suite 1000

Albuquerque, New Mexico 87102

### LETTER FROM THE DIRECTOR

#### HISTORY OF OTFM

The Office of Trust Funds Management (OTFM) was first established within the Bureau of Indian Affairs (BIA) in 1989, pursuant to Secretarial Order Number 3187 dated October 26, 1989. This order combined the trust funds accounting and investment functions within the BIA into one office, OTFM.

In October 1994, the U.S. Congress passed the American Indian Trust Fund Management Reform Act (Public Law 103-412). This statute established within the Department of the Interior (the Department) the Office of the Special Trustee for American Indians (OST). The OST is headed by the Special Trustee who reports to the Secretary of the Department of the Interior (the Secretary) and is appointed by the President of the United States of America.

Indian trust funds are managed under the authority delegated to the OST, which is also responsible for the oversight, reform and coordination of all Departmental activities involved in the management of Indian trust assets. In addition to judgment awards and settlements of claims, the management of Indian trust assets produces trust funds which involves the processing of trust related transactions with the accounting systems of the Department, including but not limited to the BIA, Minerals Management Service (MMS), and certain other Departmental agencies. The BIA, MMS, and other Departmental agencies are responsible for managing the trust resources located within the boundaries of Indian reservations and trust lands as well as the processing of data regarding the ownership and lease of Indian lands.

In February 1996, OTFM was transferred intact out of the BIA and placed within the OST. Certain financial trust service employees in region and field offices located throughout the U.S. were also transferred from BIA and made part of OTFM and OST. Today, the Director of OTFM reports to the OST.

The OTFM is responsible for the management of trust funds on behalf of trust beneficiaries and is significantly dependent and reliant upon the receipt of timely and accurate information derived from the records of the ownership and the lease of trust resources maintained by the BIA and other Departmental agencies. In light thereof, OTFM is responsible for the accurate receipt, investment and disbursement of Indian trust funds to tribal account holders and individual beneficiaries. The balances that have accumulated in trust have resulted generally from judgment awards, settlements of claims, land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources and investment income. As presented in the fiscal year 2002 financial statements, American Indian trust fund accounts total approximately \$3.2 billion. Of this amount, about \$400 million is owned by approximately 252,000 individuals, with the remainder owned by over 300 tribes.

Fiscal year 2002 has been another very busy year for the OTFM. We have experienced much progress in various reform projects. The following are some of the special points of interest that have occurred during fiscal year 2002.

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## POINTS OF SPECIAL INTEREST FOR FISCAL YEAR 2002

### ❖ INTERNET SHUTDOWN

On December 5, 2001 in conjunction with Cobell vs. Norton, the U.S. District Court for the District of Columbia issued a temporary restraining order prohibiting internet access by Department of the Interior offices (including MMS, BIA, OTFM, etc). As a result, the MMS was unable to receive, process, and transmit oil and gas distribution information to the BIA (and subsequently to the OTFM). In addition, the BIA was also unable, for a period, to transmit to OTFM transactions involving non-oil and non-gas (i.e., range lease) distributions. (In January 2002, BIA began transmitting non-oil and non-gas distributions to OTFM.)

To assist in alleviating the continued negative financial impacts imposed by the internet shutdown, the OTFM processed estimated oil and gas royalty payments on February 22 and March 22, 2002 totaling approximately \$3.6 million. On March 25, 2002 internet access was restored to MMS and the interfacing of (back-logged) oil and gas information resumed.

### ❖ INTERAGENCY PROCEDURES HANDBOOK & TRAINING

Effective July 8, 2002, the OTFM-BIA Interagency Procedures Handbook was published and issued. The handbook formally delineates respective OTFM and BIA operating and programmatic responsibilities. The handbook is the result of the extensive and joint efforts of OST and BIA personnel in mapping the policies and procedures relating to the administration of trust accounts. Training began in August 2002 and will continue throughout fiscal year 2003.

### ❖ CHANGES IN LEADERSHIP - RESIGNATION OF THE SPECIAL TRUSTEE

On July 30, 2002, Tom Slonaker resigned as the Special Trustee for American Indians. Pursuant to Mr. Slonaker's resignation, Donna Erwin was appointed as Acting Special Trustee and assumed her new duties on July 31, 2002.

Donna Erwin has 33 years of experience in all facets of private and public trust and fiduciary duties, including administration, operations and investments. She has worked for the past 10 years at the Department of the Interior in a series of posts of increasing responsibility, including service as the Director of Trust Funds Management and Deputy Special Trustee for Systems and Projects in the Office of Special Trustee for American Indians.

### ❖ SPECIAL DEPOSIT ACCOUNTS CLEANUP PROJECT

Numerous findings have cited the significant misuse of special deposit accounts (SDAs) for purposes other than those established in 25 CFR Part 115 as temporary "suspense" accounts. Over past years, the number of SDAs that have been opened and remain open has proliferated. The goal of the SDA Cleanup Project is to distribute residual account balances to respective beneficiaries and to prevent the recurrence of similar problems historically associated with the use of SDAs. As of September 30, 2002 there are 20,698 SDAs, representing \$62.3 million, in the TFAS that need to be distributed to individual Indian account holders, tribes, or third party entities. It was decided that a pilot was needed to establish procedures for working the accounts to attain this goal.

The SDA pilot project focus is on identifying the residual makeup of an account balance and preparing a recommendation to the Bureau of Indian Affairs (BIA) for disposition of the balance based on the analysis. The primary objective of the pilot project is to test and refine the procedures/approach

described in the preliminary project work plan and to develop recommended scopes based on stratifications of account data, estimated costs and timelines for the performance of a similar effort for all BIA agency locations and all SDAs. The work plan procedure is a dynamic document that needs to reflect and adapt to changes and will be adapted to changing environments and processes.

The pilot project is being conducted in two phases to develop work plan procedures that delineate the cleanup process in its entirety, from financial transaction research and analysis to distributing residual SDA balances to beneficiaries or other appropriate recipients. Once the pilot project is completed and the work plan procedures finalized, the cleanup process will be implemented on a nation-wide basis during Fiscal Year 2003.

❖ **UPDATE - FOR HANDLING WHEREABOUTS UNKNOWN ACCOUNTS**

Efforts for locating Whereabouts Unknown will be an ongoing process. Given the number and volume of accounts under OTFM management, it is unrealistic to think that, at any given point in time, there will be zero account holders who are whereabouts unknown. Even private sector operations deal with the problem of not having current addresses for their account holders. Regardless, OTFM has performed the following in its efforts to locate whereabouts unknown account holders:

We contracted with the "Lakota Journal", who published a large list of Whereabouts Unknown. On October 25, 2001, 10,000 copies of the publication were sent to subscribers and newsstands within the five state region including South Dakota, North Dakota, Montana, Nebraska, and Wyoming. Based on responses from account holders and comments from OTFM field staff, this publication has been favorable.

On November 15, 2001, OTFM implemented a new, proactive approach to minimize the occurrence of new Whereabouts Unknown accounts by placing all accounts with a valid Social Security Number and/or current or previous valid address on Trans Union's WATCH product. WATCH notifies OTFM when an account holder changes their address within three years of being placed on WATCH.

In January and July 2002, lists of Whereabouts Unknown were sent to tribal officials asking for their assistance in locating their tribal members. Responses have been favorable and are being received daily.

In January 2002, letters were sent to the Internal Revenue Service, BIA Payroll Office, Social Security Administration, Veteran's Administration, and the Indian Health Service requesting assistance and/or the sharing of information for Whereabouts Unknown account holders. Presently, the details pertaining to the sharing of information are being worked out with these organizations.

Each of the initiatives has yielded positive responses, with individuals being "located" daily.

❖ **INVESTMENT PERFORMANCE MEASUREMENT SYSTEM**

Beginning July 2002, using the Trust Funds Accounting System (TFAS), OTFM initiated total return measurements on 200 of the largest and most active tribal accounts and the IIM portfolio. It will take a year to capture data to deliver annual performance measurements. By July 2003, these measurement capabilities will be used on a regular basis to compare OTFM performance with industry benchmark measurements.

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❖ QUALITY SERVICE SURVEY

A Quality Service Survey (QSS card) has been designed and will be made available to account holders at all OTFM servicing locations. The QSS cards were designed to obtain direct feedback from account owners regarding the quality of the services they received. We look forward to obtaining this information for our continuing efforts to provide the highest quality of service to all trust funds account holders.

We look forward to the coming year, remaining optimistic and committed to continued improvements and in providing the highest quality of services to all beneficiaries.



Douglas Lords  
Director, Office of Trust Funds Management

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# INDIAN TRUST FUNDS

## HISTORICAL PERSPECTIVE

The legislation, which authorizes the Secretary of the Interior ("the Secretary") to manage the Tribal and Other Trust Funds, and Individual Indian Monies Trust Funds ("Trust Funds"), recognizes the unique trust relationship that exists between the Indian tribes, individual Indians and the U.S. Federal Government. Agreements between the U.S. Federal Government and the various Indian tribes, many in the form of treaties, recognize the sovereignty of the tribes. During the course of the Nation's history and the U.S. Federal Government's evolving policies toward Indian tribes and individual Indians, the trust relationship has retained characteristics based upon tribal sovereignty.

### *Mission Statement of OST/OTFM*

*To assure the highest level of accuracy, responsiveness and service in the receipt, investment and disbursement of all judgment 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.*

## DESIGNATED TRUSTEE

The Secretary is designated by the U.S. Congress as the primary U.S. Federal Government trustee with fiduciary responsibility for the monetary and non-monetary resources held in trust on behalf of American Indian tribes, individual Indians, and other trust funds. In carrying out the management and oversight of Indian trust assets, the Secretary has fiduciary responsibilities including but not limited to, i) ensure all monies are received for the use of Indian lands and the extraction of natural resources from Indian lands, ii) ensure that trust accounts are properly maintained and balances invested, iii) disburse monies to appropriate beneficiaries, and iv) ensure that accurate and complete reports are provided to trust beneficiaries in accordance with applicable law.

## TRUST FUNDS

The balances that have accumulated in the Trust Funds have resulted generally from judgment awards, settlement of claims, land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources, and investment income.

Many of the Tribal and Other Trust Funds ("Tribal" Trust Funds) are managed based on U.S. Congressional Acts or particular bequests establishing the funds. For Federal budget purposes, the Trust Funds are reported in two trust fund balance categories, *Held for Indian tribes* and *Held by the Department of the Interior and considered to be U.S. Government funds*. The first category represents funds which are considered non-Federal monies held on behalf of Indian tribes. The second category represents funds which are considered Federal monies, some of which will be transferred to the Held for Indian tribes category provided certain conditions are satisfied, and for others the corpus of the fund may be non-expendable. The Individual Indian Monies Trust Funds ("IIM" Trust Funds) are a deposit fund for individuals who have a beneficial interest. The management of the Trust Funds and related trust assets are performed within various offices within the U.S. Department of the Interior ("Department").

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## SPECIAL TRUSTEE

Pursuant to authority provided by The American Indian Trust Fund Management Reform Act of 1994 (Pub.L. 103-412) ("the Reform Act"), Secretarial Order 3197 established the Office of the Special Trustee for American Indians ("OST") and delegated all program and administrative authority necessary to carry out the responsibilities of the OST to the Special Trustee for American Indians ("Special Trustee"). The Office of Trust Funds Management (OTFM) was transferred intact out of the Bureau of Indian Affairs (BIA) and placed within the OST and resulting in the transfer of certain financial trust service employees in region and field offices located throughout the U.S. from BIA to OTFM and OST.

The Special Trustee reports to the Secretary and pursuant to the Reform Act is responsible for the oversight of the Department's reform and coordination efforts of all Departmental activities involving policies, procedures, systems and practices used in managing Indian trust assets by various agencies and offices in the Department - including but not limited to the Office of Trust Funds Management (OTFM), the BIA, Minerals Management Service (MMS), and the Bureau of Land Management (BLM).

## TRUST ASSETS MANAGEMENT AND TRUST FUNDS MANAGEMENT

Indian trust funds are managed under the authority delegated to the OST. The management of the Indian trust assets that produce those funds is a process that is dependent upon the processing of trust-related transactions with the accounting systems of the Department, including but not limited to the OTFM, BIA, MMS, and certain other Departmental agencies. The BIA, MMS, and other Departmental agencies are responsible for managing the trust resources located within the boundaries of Indian reservations and trust lands as well as the processing of data regarding the ownership and lease of Indian lands. The OTFM is responsible for the management of Trust Funds on behalf of the trust beneficiaries and is significantly dependent and reliant upon the receipt of timely and accurate information derived from records maintained by the BIA and other Departmental agencies.

The DOI maintains staff through a network of Regional, Agency and Field Offices located throughout the United States. The Regional Offices provide administrative and operational support for their respective Agency and Field Offices. Agency and Field Offices are strategically located near the tribes and individuals served. OST personnel are located at the various locations and offices and perform the redelegated functions particular to monetary Trust Funds activities.

## ORGANIZATION OF THE OTFM

The OTFM, established October 26, 1989, and located in Albuquerque, New Mexico, manages and is accountable for Tribal trust funds and IIM trust funds held in trust by the OST. The OTFM carries out its responsibilities through the following divisions.

The Division of Quality Assurance plans, develops, and controls the OTFM management systems review and evaluation program. The Division advises the Director of OTFM on the efficiency, economy, legality and effectiveness of operations at the program and field level. It ensures that all laws and regulations mandated are received, communicated, and complied with throughout OTFM. It conducts analyses, evaluations, and reviews of operations, including the timely and accurate reconciliation of all cash, assets, and systems. It serves as the liaison between the Office and external audit and evaluation organizations. The Division provides continuing oversight of trust fund systems at headquarters and field operations,

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identifies problems, and develops recommended action plans for the correction of identified weaknesses. The Division coordinates the development of trust funds policies issued in directives and, in coordination with the OST Directives Officer, assures that all policies and procedures are issued through the approved directives system prior to implementation.

The Division of Trust Funds Systems provides daily OST systems support for the trust funds systems currently in place. It ensures proper maintenance of the existing systems to support the financial management of trust funds. The Division is responsible for testing and implementing automated trust funds financial systems and provides technical support for trust fund aspects of automated data processing, including hardware and software recommendations, acquisitions, installation, and training; and ensures necessary interfaces with other systems. It identifies training needs and provides ongoing training in the operation of automated systems. It manages the OTFM local area network, identifies and installs trust fund related computer equipment and software, and ensures that applications are compatible with other mainframe systems.

The Division of Trust Funds Accounting operates and controls accounting activities which properly record and report all funds received, disbursed, invested, and held in trust for individual Indians and Indian tribes. It plans, develops, and recommends policies and procedures governing trust operations. It also coordinates with other Federal agencies as necessary in the maintenance of trust accounts.

The Division of Trust Funds Services plans, develops, operates, and controls the buying, selling, and trading of investment instruments in accordance with applicable laws, regulations, and policies. The Division plans, develops, and recommends policies and procedures governing the investment of controlled trust fund accounts, including: accounts belonging to minors; accounts belonging to adult Indians in situations where competent authority has determined that the account must be supervised; accounts of tribal funds made available through judgment awards; contributed funds; and funds deposited to other controlled accounts. The Division provides technical advice and assistance to Indian tribes in developing financial plans requiring access to tribal funds and provides assistance in developing investment strategies for tribal and individual Indian trust funds. It provides technical advice and assistance to BIA Regional offices, agencies, and Indian tribes in developing financial plans and investment strategies for tribal trust funds. The Division functions as the liaison between the OTFM and other public or private sector organizations involved with investments and provides technical information to BIA Regional and Agency operating officials and to tribes regarding the status of funds invested.

The Division of Reporting and Reconciliation reconciles subsidiary and control accounts and monitors trust fund activities at the OTFM and field level. The Division prepares internal and external financial accounting reports and is responsible for their accuracy and timely submission.

The Division of Field Operations located in Oklahoma City, OK, is responsible for coordinating 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 relating to receiving, recording, and disbursing general trust and judgment funds collected by the BIA, belonging to individual Indian adults, minors, legal incompetents, deceased beneficiaries, and tribes; examining, verifying, and maintaining accounts and accounting data for IIM accounts; and preparing, maintaining, and reconciling records. It also responds to

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IIM account holders' questions concerning the status of accounts, receipts, or other related matters. The field activities of the OTFM are divided among 12 geographical jurisdictions.

#### THE REFORM ACT

The Reform Act included the following as actions required of the Secretary necessary to properly discharge the trust responsibilities of the U.S. Federal Government:

- Providing adequate systems accounting for and reporting trust fund balances;
- Providing adequate controls over receipts and disbursements;
- Providing periodic, timely reconciliation to assure the accuracy of accounts;
- Determining accurate cash balances;
- Preparing and supplying account holders with periodic statements of their account performance and with balances of their account which shall be available on a daily basis;
- Establishing consistent, written policies and procedures for trust fund management and accounting;
- Providing adequate staffing, supervision, and training for trust fund management and accounting;
- Appropriately managing the natural resources located within boundaries of Indian reservations and trust lands;
- Properly accounting for and investing, as well as maximizing, in a manner consistent with the statutory restrictions imposed on the Secretary's investment options, the return on the investment of all trust fund monies;
- Preparing accurate and timely reports to account holders (and other, as required) on a periodic basis regarding all collections, disbursements, investments, and return on investments related to their trust accounts; and
- Maintaining complete, accurate, and timely data regarding the ownership and lease of Indian lands.

#### TRUST REFORM

- *High Level Implementation Plan* - The Reform Act directs the OST to consult with Indian tribes and Indian organizations to develop a comprehensive strategic plan to reform Trust Funds management. In 1997 the Special Trustee prepared and submitted to Congress and the Secretary a strategic plan. The Secretary and the Special Trustee agreed that selected improvements and clean-up efforts should proceed as soon as possible. In July 1998 the Secretary published the first High Level Implementation Plan (HLIP) for the Trust Management Improvement Project. The HLIP provided information on and described 13 subprojects, responsible Bureaus and Offices, supporting tasks, critical milestones, work plans, resource estimates, and accountable officials. In February 2000 the Secretary published a revised and updated HLIP that identified and outlined 11

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specific subprojects for the improvement and operation of Trust Funds management for American Indians. (Two of the original subprojects were merged with other subprojects.) In 2002 the Secretary's initiatives advanced trust reform and the accounting efforts beyond the point first envisioned by the original HLIP, resulting in the HLIP milestones becoming increasingly disconnected from the overall objectives of trust reform, and eventually rendering the HLIP obsolete.

- *The Office of Historical Trust Accounting* - Secretarial Order 3231 (July 10, 2001) established the Office of Historical Trust Accounting (OHTA) to plan, organize, direct, and execute the historical accounting of Individual Indian Money (IIM) accounts. In July 2002, OHTA released a report to Congress containing a plan for an accounting for all Individual Indian Money accounts, indicating that such an accounting would be very expensive and would take years to complete.

Recently, OHTA provided 560 IIM account holders in Arizona with detailed accounting statements that include starting balances, monthly interest and ending balances of accounts that were established through a judgment award. The mailing was the first phase of an effort to notify thousands of IIM account holders across Indian country that their trust fund balances have been investigated and reconciled.

- *The Office of Indian Trust Transition* - Secretary Order 3235 (November 20, 2001) established the Office of Indian Trust Transition (OITT) to be responsible for planning and implementing the transition of trust-related functions within the Department to a separate trust organization housed within the Department. In addition to its reorganization responsibilities, the OITT is charged with preparing the Department's required reporting to the U.S. District Court (for the District of Columbia) and coordinating the efforts toward the Indian Trust Business Plan.
- *Indian Trust Business Plan* - In November 2001, the Secretary initiated a re-organization for the management of all trust systems, operations and programs within the Department. This decision was based on various recommendations and the recognized need to consolidate the trust activities of the Department within a single organization. As part of the re-organization, an information gathering effort is underway to identify existing ("As Is") trust activities/processes. The information will be used to determine which business processes should remain or be reengineered and established as ("To Be") standard business processes.

#### FINANCIAL STATEMENTS AND ANNUAL AUDITS

Since 1995, OTFM has contracted for an independent audit of the financial statements of the trust funds it manages for the benefit of individual Indians, tribes, and others. The 1995 audit covered the statement of assets and trust fund balances, internal controls, and compliance with laws and regulations. Audits for fiscal years 1996 through 2002 also included the statement of changes in trust fund balances.

The Office of Inspector General oversees the audit and reviews the resulting reports prior to their release to the public. Certain information in the financial statements of the trust funds is incorporated into the Department's consolidated financial statements.

The annual audits of the Trust Funds financial statements meet the audit requirement of the Reform Act.

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

**Financial Statements**

**September 30, 2002 and 2001**

**(With Independent Auditors' Report Thereon)**

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6565 Americas Parkway, NE #700  
Post Office Box 3939  
Albuquerque, NM 87190

## Independent Auditors' Report

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

We have audited the accompanying statements of assets and trust fund balances of the Tribal and Other 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) and the related statements of changes in trust fund balances as of September 30, 2002 and 2001 and for the years then ended. 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 audits.

Except as discussed in the fourth paragraph of this report, we conducted our audits in accordance with auditing standards generally accepted in the United States of America; and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 audits provide a reasonable basis for our opinion.

As described in note 2, these financial statements were prepared on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

As discussed in note 3, cash balances reflected in the accompanying financial statements are materially greater than balances reported by the U.S. Department of the Treasury. In addition, it was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the fairness of trust fund balances in the accompanying financial statements as of September 30, 2002 and 2001 due to inadequacies in certain Department of the Interior trust related systems. Trust fund balances enter into the determination of financial position and changes in trust fund balances. Certain parties for whom the OTFM holds monetary assets in trust do not agree with balances recorded by the OTFM; and certain of these parties have filed, or are expected to file, claims against the U.S. Federal Government.

In our opinion, except for the effects on the financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to apply adequate procedures to support the difference in reported cash balances and determine the fairness of trust fund balances and related changes in trust fund balances, as discussed in the preceding paragraph, the financial statements referred to in the first paragraph above present fairly, in all material respects, the financial position of the Tribal and Other Trust Funds managed by the OTFM as of September 30, 2002 and 2001, and the changes in trust fund balances for the years then ended in conformity with the basis of accounting described in note 2.



In accordance with *Government Auditing Standards*, we have also issued a separate report dated December 13, 2002, on our consideration of internal control over financial reporting and compliance with certain provisions of laws and regulations of the Tribal and Other Trust Funds managed by the OTFM. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be read in conjunction with this report in considering the results of our audit.

KPMG LLP

December 13, 2002

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

Statements of Assets and Trust Fund Balances – Cash Basis

September 30, 2002 and 2001

(In thousands)

<b>Assets</b>	<u><b>2002</b></u>	<u><b>2001</b></u>
Cash and cash equivalents (note 3)	\$ 723,702	748,467
Investments (note 4)	<u>2,132,587</u>	<u>2,056,550</u>
Total assets	<u><u>\$ 2,856,289</u></u>	<u><u>2,805,017</u></u>
<b>Trust Fund Balances</b>		
Held for Indian tribes (notes 6 and 8)	\$ 2,633,118	2,610,916
Held by the Department of the Interior and considered to be U.S. Government funds (note 6)	<u>223,171</u>	<u>194,101</u>
Total trust fund balances	<u><u>\$ 2,856,289</u></u>	<u><u>2,805,017</u></u>

See accompanying notes to financial statements.

**U.S. DEPARTMENT OF THE INTERIOR  
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TRIBAL AND OTHER TRUST FUNDS  
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Statements of Changes in Trust Fund Balances – Cash Basis

Years ended September 30, 2002 and 2001

(In thousands)

	<b>2002</b>	<b>2001</b>
Increases:		
Receipts	\$ 293,785	360,435
Interest received on invested funds	139,249	169,074
Gain on disposition of investments, net	1,690	6,602
	434,724	536,111
Decreases:		
Disbursements to and on behalf of Indian tribes and other trust funds and withdrawal of trust funds by Indian tribes (note 8)	(383,452)	(467,280)
Increase in trust fund balances, net	51,272	68,831
Trust fund balances, beginning of year	2,805,017	2,736,186
Trust fund balances, end of year (notes 6 and 8)	\$ 2,856,289	2,805,017

See accompanying notes to financial statements.

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

Notes to Financial Statements

September 30, 2002 and 2001

**(1) Background and Description of the Trust Funds**

**(a) Overview of the Trust Funds**

**Establishment and management of the Trust Funds** – The legislation which authorizes the Secretary of the U.S. Department of the Interior (the Secretary) to manage the Tribal and Other Trust Funds (Trust Funds) recognizes the unique trust relationship that exists between the Indian tribes, individual Indians, and the U.S. Federal Government. Agreements between the U.S. Federal Government and the various Indian tribes, many of these in the form of treaties, recognize the sovereignty of tribes. During the course of the Nation's history and the U.S. Federal Government's evolving policies toward Indian tribes, the trust relationship has retained characteristics based upon tribal sovereignty. The Secretary has been designated by the U.S. Congress as the primary U.S. Federal Government trustee with fiduciary responsibility for the monetary and non-monetary resources held in trust on behalf of American Indian tribes, individual Indians, and other trust funds. In carrying out the management and oversight of the Indian trust assets, the Secretary has a fiduciary responsibility to ensure all monies are received for the use of Indian lands and the extraction of natural resources from Indian lands, disburse such monies collected to the appropriate beneficiaries, ensure that trust accounts are properly maintained and invested, and ensure that accurate and complete reports are provided to the trust beneficiaries in accordance with applicable law.

The balances that have accumulated in the Trust Funds have resulted generally from judgment awards, settlement of claims, land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources and investment income.

The accompanying financial statements include only the monetary balances held in trust by the Office of the Special Trustee for American Indians (OST) Office of Trust Funds Management (OTFM) for trust beneficiaries and do not include (i) the operating account balances of OST or OTFM (e.g., Fund Balance with Treasury, Property, Plant, and Equipment) or (ii) other Indian trust assets, including but not limited to, Indian lands, buildings, or other non-monetary assets managed by the U.S. Department of the Interior (Department).

**The Reform Act** – The American Indian Trust Fund Management Reform Act of 1994 (Pub. L. 103-412) (the Reform Act) authorized the establishment of the OST which is headed by the Special Trustee for American Indians (Special Trustee) who reports to the Secretary. Under this legislation, the Special Trustee is responsible for oversight, reform and coordination of the policies, procedures, systems and practices used by various agencies of the Department, including but not limited to, the OTFM, the Bureau of Indian Affairs (BIA), Minerals Management Service (MMS), and the Bureau of Land Management (BLM), in managing Indian trust assets.

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

Notes to Financial Statements

September 30, 2002 and 2001

Prior to February 1996, the Secretary 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 BIA. On February 9, 1996, in accordance with the authority provided by the Reform Act, Secretarial Order 3197 established the OST and delegated all program and administrative authority necessary to carry out the responsibilities of the OST to the Special Trustee. In addition, the OTFM was transferred intact from the BIA to the OST, and certain trust service employees in field offices located throughout the U.S. were also transferred from the BIA to the OST and the OTFM.

**Office of the Special Trustee for American Indians** – Indian trust assets, including the Trust Funds, are managed under the delegated authority of the OST and the BIA. Management of Indian trust assets on behalf of the trust beneficiaries is a process that is dependent upon the processing of trust related transactions within the accounting systems of the Department, including but not limited to, the OTFM, the BIA, MMS, and certain other Departmental agencies. The BIA, MMS, and other Departmental agencies are responsible for managing the natural resources located within the boundaries of Indian reservations and trust lands as well as the processing of data regarding the ownership and lease of Indian lands.

- **Office of Trust Funds Management** – The OTFM, established October 26, 1989, and located in Albuquerque, New Mexico, manages the Tribal and Other Trust Funds and the Individual Indian Monies (IIM) Trust Funds held in trust by the Department. The allocation and distribution of receipts and disbursements by the OTFM to trust beneficiaries is significantly dependent and reliant upon the receipt of timely and accurate information derived from records maintained by the BIA and other Departmental agencies (see note 7).
- **Regional Offices** – The OTFM and the BIA maintain regional offices located throughout the U.S. which provide administrative and operational support for their respective agency and field offices.
- **Agency and Field Offices** – The OTFM and the BIA maintain agency and field offices located throughout the U.S. which generally are physically located near the tribes and individual Indians served. OTFM and BIA personnel located at most of the agency offices perform various functions related to trust fund activities. Each of the agency and field offices are organized under one of the regional offices.

**(b) Description of the Trust Funds**

Certain of the Tribal and Other Trust Funds are subject to legal, regulatory, budgetary, court ordered or other restrictions (see note 6). A brief description of the Trust Funds follows:

- **Tribal Trust Funds** – Approximately 1,400 accounts comprise the Tribal Trust Funds which totaled approximately \$2,796,346,000 and \$2,746,488,000 as of September 30, 2002 and 2001, respectively.

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Tribes realize receipts from a variety of sources, including judgment awards, settlement of claims, land use agreements, royalties on natural resource depletion, other proceeds directly derived from trust resources and investment income.

- **Other Trust Funds** – Other Trust Funds represent other monetary assets currently managed by the OTFM. Authorization for management of these assets is based on U.S. Congressional Acts or the bequest establishing such funds. Other Trust Funds totaled approximately \$59,943,000 and \$58,529,000 as of September 30, 2002 and 2001, respectively.

Other trust funds realize receipts from a variety of sources, including contracts, leases, licenses, permits, rights of way, settlement of Indian claims, donations and bequests, and investment income.

**(c) *Investment of Trust Funds***

Authorizing legislation and a substantial body of case law specify how Indian trust funds should be managed and which financial instruments constitute appropriate investments for Indian Trust Funds. The Trust Funds are 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.

**(2) Summary of Significant Accounting Policies**

**(a) *Basis of Accounting***

The OTFM uses the cash basis of accounting for the Tribal and Other Trust Funds which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The cash basis of accounting differs from accounting principles generally accepted in the United States of America in that receivables and payables are not recorded and premiums and discounts are not amortized or accreted. Receipts are recorded when received and disbursements are recorded when paid. Investments are stated at historical cost. Interest received on invested funds reported in the statements of changes in trust fund balances reflects interest received during the fiscal year.

**(b) *Cash and Cash Equivalents***

Management considers all highly liquid financial instruments with maturities of three months or less when purchased to be cash equivalents.

**(c) *Investments***

Investment securities at September 30, 2002 and 2001 consist of U.S. Treasury and U.S. Federal Government Agency issues and other securities that are guaranteed by the U.S. Federal Government and mortgage-backed securities. Investment securities are recorded at historical cost. Interest and dividend income are recognized when received.

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

**(d) Receipts**

Receipts from various leasing activities, mineral royalties and sales of extracted minerals, timber and forest products, fees and fines and the granting of easements are generated from a variety of non-monetary assets that are held in trust by the U.S. Federal Government and managed by the BIA and other Departmental Agencies on behalf of tribes. Receipts on hand at the regional and agency offices at September 30, 2002 and 2001, if any, awaiting deposit to the U.S. Treasury are not included in the financial statements.

Receipts also include payments from the U.S. Federal Government for judgment awards and the settlement of claims.

**(e) Disbursements**

Payments disbursed from the Trust Funds consist of accumulations of funds from various income producing activities such as leasing, royalty receipts, minerals extraction, timber and forest product sales, judgment awards and settlement of claims, and investment income. Under certain conditions, tribes disburse per capita payments to their enrolled members.

Pub. L. 103-412 specifically allows for the voluntary withdrawal of judgment awards and settlement of claims funds from the Trust Funds program. Except where prohibited by statute, an Indian tribe may submit a plan to withdraw some or all funds held in trust for the tribe in accordance with 25 CFR 1200.

**(f) Use of Estimates**

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets at the date of the financial statements and the reported amounts of increases and decreases in trust fund balances during the reporting period. Actual results could differ from those estimates.

**(3) Cash and Cash Equivalents**

Cash equivalents of approximately \$723 million and \$747 million at September 30, 2002 and 2001, respectively, consist primarily of overnight investments with the U.S. Treasury.

Cash balances reported by the OTFM for the Tribal and Other Trust Funds and the Individual Indian Monies Trust Funds exceed the balances reported by the U.S. Treasury by approximately \$33 million as of September 30, 2002 and 2001.

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**(4) Investments**

The historical cost, gross unrealized holding gains, gross unrealized holding losses and fair value of investment securities by major security type and class of security at September 30, 2002 and 2001, were as follows:

<i>(In thousands)</i>	<u>Historical cost</u>	<u>Gross unrealized holding gains</u>	<u>Gross unrealized holding losses</u>	<u>Fair value</u>
<b>At September 30, 2002</b>				
U.S. Treasury and Agency securities	\$ 2,065,975	134,386	(439)	2,199,922
Mortgage-backed securities	<u>66,612</u>	<u>5,256</u>	<u>—</u>	<u>71,868</u>
	<u>\$ 2,132,587</u>	<u>139,642</u>	<u>(439)</u>	<u>2,271,790</u>
<b>At September 30, 2001</b>				
U.S. Treasury and Agency securities	\$ 1,979,928	111,754	(184)	2,091,498
Mortgage-backed securities	<u>76,622</u>	<u>3,574</u>	<u>—</u>	<u>80,196</u>
	<u>\$ 2,056,550</u>	<u>115,328</u>	<u>(184)</u>	<u>2,171,694</u>

Maturities of investment securities were as follows at September 30, 2002:

<i>(In thousands)</i>	<u>Historical cost</u>	<u>Fair value</u>
Due in one year or less	\$ 236,321	239,163
Due after one year through five years	782,867	825,785
Due after five years through ten years	375,776	398,094
Due after ten years	<u>737,623</u>	<u>808,748</u>
	<u>\$ 2,132,587</u>	<u>2,271,790</u>

**(5) Commitments and Contingencies**

Several Indian tribes have filed various claims against the U.S. Federal Government for failure to fulfill its fiduciary responsibilities and for other related charges. In addition, a class-action lawsuit brought by a group of individual Indians was filed against the U.S. Federal Government alleging breach of trust with respect to the U.S. Federal Government's handling of IIM trust fund accounts and various other claims. Neither the OST nor the Office of the Solicitor for the Department can presently determine the outcome of these actions nor the total amount, responsibility, and funding source of the potential liability.

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Accordingly, no amounts have been accrued in the accompanying Trust Funds financial statements for potential claims receivable from the U.S. Federal Government.

Any settlement resulting from an adverse outcome of the contingencies described above is generally not expected to be satisfied with trust fund balances.

**(6) 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, 2002 and 2001 for which the OTFM has a fiduciary responsibility.

The Trust Funds contain the following Trust Fund Balance categories for U.S. Federal Government budget purposes, which are reflected as separate components in the accompanying financial statements:

- *Held for Indian tribes* – These represent funds held on behalf of Indian tribes. These funds are considered non-Federal monies.
- *Held by the Department of the Interior and considered to be U.S. Government funds* – These represent funds, some of which will be transferred to the *Held for Indian tribes* category provided certain conditions are satisfied, and for others the corpus of the fund may be nonexpendable. These funds are considered Federal monies.

A portion of trust fund balances represents advance payments and advance deposits on production type leases for which certain tribes and individual Indians hold an interest (see note 7). When identified, any advance deposits in excess of production are returned to the depositor.

Included in the Trust Funds are certain balances which are presently not identified to specific Indian tribes because judgment awards were granted to several Indian tribes in a particular geographic area for settlement of claims related to certain lands.

**(7) Related Party Transactions with Other U.S. Federal Government Organizations**

**(a) U.S. Department of the Interior Bureau of Indian Affairs**

The BIA is responsible for the collection of monies resulting from the management and use of Indian trust lands and other trust resources. In processing collections for deposit, certified Collection Officers must obtain trust accounting information from BIA program staff. Upon deposit of the trust funds, deposit and related trust accounting information is forwarded either manually or via electronic transfer to the OTFM. Upon receipt, the OTFM records the deposit of trust funds to the proper trust accounts based on the information received from the BIA.

**(b) U.S. Department of the Interior Minerals Management Service**

For certain trust leases, MMS receives royalty payments on behalf of Indian tribes and individual Indians holding mineral rights. MMS deposits the royalty payments with the U.S. Treasury and electronically transfers to OTFM the related accounting information, generally the next business day.

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The accounting information received from MMS provides the OTFM an allocation of 100% tribally-owned lease royalties, enabling the OTFM to record trust deposits directly into tribal accounts. For tribally and individually co-owned leases, allocation and accounting data is forwarded to OTFM via electronic interface through the Royalty Distribution Reporting System that is maintained by the BIA. Pursuant to established procedure and appropriate authorization, the data is recorded by the OTFM. MMS and the BLM both perform verification and other monitoring procedures of mineral assets. Oil and gas companies sometimes forward payments to MMS based on estimated mineral production in order to comply with the Federal Oil and Gas Royalty Management Act of 1982 that requires timely distribution of royalties. These estimated payments may be disbursed by the OTFM to the beneficiaries. Typically, the oil and gas companies adjust future payments for excess or shortfall amounts, if any, based on actual production.

**(c) Other**

During the year ended September 30, 2002, certain trust deposits and distributions could not be processed by the MMS and BIA on behalf of account holders due to a temporary restraining order prohibiting internet access by certain Department offices. To alleviate the negative financial impact to account holders, the OTFM received authorization and made certain estimated payments totaling approximately \$3.6 million. As of September 30, 2002, the backlog of unprocessed distributions has been brought current and substantially all estimated payments have been recouped.

The U.S. Treasury holds cash and overnight investments and disburses for the OTFM. The Department's Office of the Solicitor serves as legal counsel for the OST and OTFM.

**(8) Transfers of Trust Funds**

The OTFM, pursuant to information provided by the BIA, utilizes special deposit accounts maintained within the IIM Trust Funds for both tribal and IIM beneficiaries as suspense accounts whereby funds are temporarily posted when the proper allocation information is not provided when the funds are received. Following the determination of the proper allocation by the BIA, the funds are transferred from the special deposit accounts to the appropriate tribal and/or IIM account(s). In addition, certain per capita disbursements authorized by tribes result in transfers from the Tribal and Other Trust Funds to the IIM Trust Funds while certain oil and gas distributions may result in transfers from the IIM Trust Funds to the Tribal and Other Trust Funds. Net transfers of trust funds from the Tribal and Other Trust Funds to the IIM Trust Funds totaled approximately \$17 million and \$42 million during the years ended September 30, 2002 and 2001, respectively. These transfers are reflected as disbursements in the accompanying statements of changes in trust fund balances.



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**Financial Statements**

**September 30, 2002 and 2001**

**(With Independent Auditors' Report Thereon)**

**COPY**



6565 Americas Parkway, NE #700  
Post Office Box 3939  
Albuquerque, NM 87190

## Independent Auditors' Report

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

We have audited the accompanying statements of assets and 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 (the OST) Office of Trust Funds Management (the OTFM) and the related statements of changes in trust fund balances as of September 30, 2002 and 2001 and for the years then ended. 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 audits.

Except as discussed in the fourth paragraph of this report, we conducted our audits in accordance with auditing standards generally accepted in the United States of America; and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 audits provide a reasonable basis for our opinion.

As described in note 2, these financial statements were prepared on the modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

As discussed in note 3, cash balances reflected in the accompanying financial statements are materially greater than balances reported by the U.S. Department of the Treasury. In addition, it was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the fairness of trust fund balances in the accompanying financial statements as of September 30, 2002 and 2001 due to inadequacies in certain Department of the Interior trust related systems. Trust fund balances enter into the determination of financial position and changes in trust fund balances. Certain parties for whom the OTFM holds monetary assets in trust do not agree with balances recorded by the OTFM; and certain of these parties have filed, or are expected to file, claims against the U.S. Federal Government.

In our opinion, except for the effects on the financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to apply adequate procedures to support the difference in reported cash balances and determine the fairness of trust fund balances and related changes in trust fund balances, as discussed in the preceding paragraph, the financial statements referred to in the first paragraph above present fairly, in all material respects, the financial position of the Individual Indian Monies Trust Funds managed by the OTFM as of September 30, 2002 and 2001, and the changes in trust fund balances for the years then ended in conformity with the basis of accounting described in note 2.



In accordance with *Government Auditing Standards*, we have also issued a separate report dated December 13, 2002, on our consideration of internal control over financial reporting and compliance with certain provisions of laws and regulations of the Individual Indian Monies Trust Funds managed by the OTFM. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be read in conjunction with this report in considering the results of our audit.

KPMG LLP

December 13, 2002

**U.S. DEPARTMENT OF THE INTERIOR  
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Statements of Assets and Trust Fund Balances – Modified Cash Basis

September 30, 2002 and 2001

(In thousands)

<b>Assets</b>	<u><b>2002</b></u>	<u><b>2001</b></u>
Cash and cash equivalents (note 3)	\$ 44,018	44,140
Investments (note 4)	362,796	354,580
Accrued interest receivable	<u>4,531</u>	<u>5,420</u>
Total assets	<u><u>\$ 411,345</u></u>	<u><u>404,140</u></u>
<b>Trust Fund Balances</b>		
Held for individual Indians (notes 6 and 8)	<u><u>\$ 411,345</u></u>	<u><u>404,140</u></u>

See accompanying notes to financial statements.

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Statements of Changes in Trust Fund Balances – Modified Cash Basis

Years ended September 30, 2002 and 2001

(In thousands)

	2002	2001
Increases:		
Receipts (note 8)	\$ 168,248	199,641
Interest and dividends earned on invested funds	23,022	26,262
Gain on disposition of investments, net	83	84
	191,353	225,987
Decreases:		
Disbursements to and on behalf of account holders	(184,148)	(221,716)
Increase in trust fund balances, net	7,205	4,271
Trust fund balances, beginning of year	404,140	399,869
Trust fund balances, end of year (notes 6 and 8)	\$ 411,345	404,140

See accompanying notes to financial statements.

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Notes to the Financial Statements

September 30, 2001 and 2000

**(1) Background and Description of the Trust Funds**

*(a) Overview of the Trust Funds*

**Establishment and management of the Trust Funds** – The legislation which authorizes the Secretary of the U.S. Department of the Interior (the Secretary) to manage the Individual Indian Monies Trust Funds (IIM Trust Funds) recognizes the unique trust relationship that exists between the Indian tribes, individual Indians, and the U.S. Federal Government. Agreements between the U.S. Federal Government and the various Indian tribes, many of these in the form of treaties, recognize the sovereignty of tribes. During the course of the Nation's history and the U.S. Federal Government's varying policies toward individual Indians and Indian tribes, the trust relationship has retained characteristics based upon tribal sovereignty. The Secretary has been designated by the U.S. Congress as the primary U.S. Federal Government trustee with fiduciary responsibility for the monetary and non-monetary resources held in trust on behalf of American Indian tribes, individual Indians, and other trust funds. In carrying out the management and oversight of the Indian trust assets, the Secretary has a fiduciary responsibility to ensure all monies are received for the use of Indian lands and the extraction of natural resources from Indian lands, disburse such monies collected to the appropriate beneficiaries, ensure that trust accounts are properly maintained and invested, and ensure that accurate and complete reports are provided to the trust beneficiaries in accordance with applicable law.

The balances that have accumulated in the IIM Trust Funds have resulted generally from settlement of claims, land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources, receipt of judgment and tribal per capita distributions and investment income.

The accompanying financial statements include only the monetary balances held in trust by the Office of the Special Trustee for American Indians (OST) Office of Trust Funds Management (OTFM) for trust beneficiaries and do not include (i) the operating account balances of OST or OTFM (e.g., Fund Balance with Treasury, Property, Plant, and Equipment) or (ii) other Indian trust assets, including but not limited to, Indian lands, buildings, or other non-monetary assets managed by the U.S. Department of the Interior (Department).

**The Reform Act** – The American Indian Trust Fund Management Reform Act of 1994 (Pub. L. 103-412) (the Reform Act) authorized the establishment of the OST which is headed by the Special Trustee for American Indians (Special Trustee) who reports to the Secretary. Under this legislation, the Special Trustee is responsible for oversight, reform, and coordination of the policies, procedures, systems, and practices used by various agencies of the Department, including but not limited to, the OTFM, the Bureau of Indian Affairs (BIA), Minerals Management Service (MMS), and the Bureau of Land Management (BLM), in managing Indian trust assets.

Prior to February 1996, the Secretary 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 BIA. On February 9, 1996, in accordance with the authority provided by the Reform Act, Secretarial Order 3197 established the OST and delegated all program and administrative authority necessary to carry out the responsibilities of the OST to the Special Trustee. In

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addition, the OTFM was transferred intact from the BIA to the OST, and certain trust service employees in field offices located throughout the U.S. were transferred from the BIA to the OST and the OTFM.

**Office of the Special Trustee for American Indians** – Indian trust assets, including the Trust Funds, are managed under the delegated authority of the OST and the BIA. Management of Indian trust assets on behalf of the trust beneficiaries is a process that is dependent upon the processing of trust related transactions within the accounting systems of the Department, including but not limited to, the OTFM, the BIA, MMS, and certain other Departmental agencies. The BIA, MMS, and other Departmental agencies are responsible for managing the natural resources located within the boundaries of Indian reservations and trust lands as well as the processing of data regarding the ownership and lease of Indian lands.

- **Office of Trust Funds Management** – The OTFM, established October 26, 1989, and located in Albuquerque, New Mexico, manages the Tribal and Other Trust Funds and the IIM Trust Funds held in trust by the Department. The allocation and distribution of receipts and disbursements by the OTFM to trust beneficiaries is significantly dependent and reliant upon the receipt of timely and accurate information derived from records maintained by the BIA and other Departmental agencies (see note 7).
- **Regional Offices** – The OTFM and the BIA maintain regional offices located throughout the U.S. which provide administrative and operational support for their respective agency and field offices.
- **Agency and Field Offices** – The OTFM and the BIA maintain agency and field offices located throughout the U.S. which generally are physically located near the tribes and individual Indians served. OTFM and BIA personnel located at most of the agency offices perform various functions related to trust fund activities. Each of the agency and field offices are organized under one of the regional offices.

**(b) Description of the Trust Funds**

Certain of the IIM Trust Funds described below are subject to legal, regulatory, budgetary, court ordered, or other restrictions. Approximately 252,000 and 247,000 open accounts, held for the benefit of individual Indian account holder beneficiaries and tribal entities, comprise the IIM Trust Funds as of September 30, 2002 and 2001, respectively. The IIM Trust Funds contain certain special deposit accounts for certain tribal entities.

The IIM Trust Funds are primarily funds on deposit for individual Indians with a beneficial interest in those funds. IIM account holders realize receipts primarily from settlement claims, land use agreements, royalties on natural resource depletion, other proceeds derived directly from trust resources, judgment and tribal per capita distributions and investment income.

**(c) Investment of Trust Funds**

Authorizing legislation and a substantial body of case law specify how Indian trust funds should be managed and which financial instruments constitute appropriate investments for Indian Trust Funds. The IIM Trust Funds are pooled and invested in U.S. Federal Government securities, including U.S.

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September 30, 2001 and 2000

Treasury and U.S. Federal Government Agency issues, as well as certain other securities that are guaranteed by the U.S. Federal Government.

**(2) Summary of Significant Accounting Policies**

**(a) Basis of Accounting**

The OTFM uses the cash basis of accounting with certain modifications for the IIM Trust Funds which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Receipts are recorded when received with the exception of interest earned on invested funds (including discount accretion and premium amortization), and disbursements are recorded when paid. Investments are stated at amortized cost. Accrual adjustments to reflect interest and dividends earned but not received, and to record any applicable accretion of discounts and amortization of premiums over the terms of the investments have been recorded in the accompanying financial statements. Interest income reported in the statements of changes in trust fund balances reflect interest earned, net of any premium amortization or discount accretion recognized during the fiscal year.

**(b) Cash and Cash Equivalents**

Management considers all highly liquid financial instruments with maturities of three months or less when purchased to be cash equivalents.

**(c) Investments**

Investment securities at September 30, 2002 and 2001 consist of U.S. Treasury and U.S. Federal Government Agency issues and other securities that are guaranteed by the U.S. Federal Government. IIM Trust Funds are pooled and invested. Investment securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts. Premiums and discounts are amortized or accreted over the life of the related investment security as an adjustment to yield using the effective interest method. Dividend and interest income are recognized when earned.

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

**(d) Receipts**

Receipts from various leasing activities, mineral royalties and sales of extracted minerals, timber and forest products, fees and fines, and the granting of easements are generated from a variety of non-monetary assets that are held in trust by the U.S. Federal Government and managed by the BIA and other Departmental Agencies on behalf of individual Indians. Receipts on hand at the regional and agency offices at September 30, 2002 and 2001, if any, awaiting deposit to the U.S. Treasury are not included in the financial statements.

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Receipts also include payments from the U.S. Federal Government for judgment awards and the settlement of claims.

**(e) Disbursements**

Payments disbursed from the IIM Trust Funds consist of accumulations of funds from various income producing activities such as leasing, royalty receipts, mineral extraction, timber and forest product sales, judgment and tribal per capita distributions and investment income.

**(f) Use of Estimates**

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets at the date of the financial statements and the reported amounts of increases and decreases in trust fund balances during the reporting period. Actual results could differ from those estimates.

**(3) Cash and Cash Equivalents**

Cash equivalents of approximately \$43 million and \$44 million at September 30, 2002 and 2001, respectively, consist primarily of overnight investments with the U.S. Treasury.

Cash balances reported by the OTFM for the Tribal and Other Trust Funds and the IIM Trust Funds exceed the balances reported by the U.S. Treasury by approximately \$33 million as of September 30, 2002 and 2001.

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**(4) Investments**

The amortized cost, gross unrealized holding gains, gross unrealized holding losses, and fair value of investment securities by major security type and class of security at September 30, 2002 and 2001, were as follows:

<i>(In thousands)</i>	<u>Amortized cost</u>	<u>Gross unrealized holding gains</u>	<u>Gross unrealized holding losses</u>	<u>Fair value</u>
<b>At September 30, 2002</b>				
U.S. Treasury and Agency securities	\$ <u>362,796</u>	<u>26,816</u>	<u>(4)</u>	<u>389,608</u>
<b>At September 30, 2001</b>				
U.S. Treasury and Agency securities	\$ <u>354,580</u>	<u>19,091</u>	<u>—</u>	<u>373,671</u>

Maturities of investment securities were as follows at September 30, 2002:

<i>(In thousands)</i>	<u>Amortized cost</u>	<u>Fair value</u>
Due in one year or less	\$ 20,000	20,063
Due after one year through five years	97,767	103,584
Due after five years through ten years	65,760	72,541
Due after ten years	<u>179,269</u>	<u>193,420</u>
	\$ <u>362,796</u>	<u>389,608</u>

**(5) Commitments and Contingencies**

A class-action lawsuit brought by a group of individual Indians was filed against the U.S. Federal Government alleging breach of trust with respect to the U.S. Federal Government's handling of IIM trust fund accounts and various other claims. Neither the OST nor the Office of the Solicitor for the Department can presently determine the outcome of these actions nor the total amount, responsibility and funding source of the potential liability. Accordingly, no amounts have been accrued in the accompanying IIM Trust Funds financial statements for potential claims receivable from the U.S. Federal Government.

Any settlement resulting from an adverse outcome of the contingencies described above is generally not expected to be satisfied with trust fund balances.

**COPY**

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

Notes to the Financial Statements

September 30, 2001 and 2000

**(6) 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, 2002 and 2001 for which the OTFM has a fiduciary responsibility.

The net total of the balances reflected in the IIM account holders' subsidiary detail of accounts is less than the trust fund balances reported in the financial statements as of September 30, 2002 and 2001 due to certain cumulative differences.

- The aggregate sum of positive account balances in the IIM subsidiary detail of account holders' balances exceeds the trust fund balances reported in the financial statements by approximately \$6.0 million and \$6.7 million, respectively, as of September 30, 2002 and 2001.
- There are certain accounts with negative balances in the IIM account holders' subsidiary detail aggregating approximately \$44 million as of September 30, 2002 and 2001.

The subsidiary detail of IIM account balances contains approximately 21,000 and 20,000 special deposit accounts with balances totaling approximately \$62 million and \$67 million as of September 30, 2002 and 2001, respectively. A portion of the special deposit account monies held in the IIM Trust Funds has not been distributed to the beneficiaries because the ultimate disposition of the funds has not been determined.

The subsidiary detail of IIM account balances contains certain oil and gas holding accounts with balances totaling approximately \$6.5 million and \$4.1 million as of September 30, 2002 and 2001, respectively, which have not been distributed to the beneficiaries. Upon receipt of the allocation and accounting data, provided by MMS, the monies will be distributed to the proper IIM account holders' accounts (see note 7).

A portion of trust fund balances represents advance payments and advance deposits on production type leases for which certain individual Indians and tribes hold an interest (see note 7). When identified, any advance deposits in excess of production are returned to the depositor.

**(7) Related Party Transactions With Other U.S. Federal Government Organizations**

**(a) U.S. Department of the Interior Bureau of Indian Affairs**

The BIA is responsible for the collection of monies resulting from the management and use of Indian trust lands and other trust resources. In processing collections for deposit, certified Collection Officers must obtain trust accounting information from BIA program staff. Upon deposit of the trust funds, deposit and related trust accounting information is forwarded either manually or via electronic transfer to the OTFM. Upon receipt, the OTFM records the deposit of trust funds to the proper trust accounts based on the information received from the BIA.

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Notes to the Financial Statements

September 30, 2001 and 2000

**(b) U.S. Department of the Interior Mineral Management Service**

For certain trust leases, MMS receives royalty payments on behalf of Indian tribes and individual Indians holding mineral rights. MMS deposits the royalty payments with the U.S. Treasury and electronically transfers to OTFM the related accounting information, generally the next business day. For tribally and individually co-owned leases, the allocation and accounting data provided by MMS to distribute the monies to the proper IIM account is forwarded to OTFM via electronic interface through the Royalty Distribution Reporting System that is maintained by the BIA. Pursuant to established procedure and appropriate authorization, the data is recorded by the OTFM. MMS and the BLM both perform verification and other monitoring procedures of mineral assets. Oil and gas companies sometimes forward payments to MMS based on estimated mineral production in order to comply with the Federal Oil and Gas Royalty Management Act of 1982 that requires timely distribution of royalties. These estimated payments may be disbursed by the OTFM to the beneficiaries. Typically, the oil and gas companies adjust future payments for excess or shortfall amounts, if any, based on actual production.

**(c) Other**

During the year ended September 30, 2002, certain trust deposits and distributions could not be processed by the MMS and BIA on behalf of account holders due to a temporary restraining order prohibiting internet access by certain Department offices. To alleviate the negative financial impact to account holders, the OTFM received authorization and made certain estimated payments totaling approximately \$3.6 million. As of September 30, 2002, the backlog of unprocessed distributions has been brought current and substantially all estimated payments have been recouped.

The U.S. Treasury holds cash and overnight investments and disburses for the OTFM. The Department's Office of the Solicitor serves as legal counsel for the OST and OTFM.

**(8) Transfers of Trust Funds**

The OTFM, pursuant to information provided by the BIA, utilizes special deposit accounts maintained within the IIM Trust Funds for both tribal and IIM beneficiaries as suspense accounts whereby funds are temporarily posted when the proper allocation information is not provided when the funds are received. Following the determination of the proper allocation by the BIA, the funds are transferred from the special deposit accounts to the appropriate tribal and/or IIM account(s). In addition, certain per capita disbursements authorized by tribes result in transfers from the Tribal and Other Trust Funds to the IIM Trust Funds while certain oil and gas distributions may result in transfers from the IIM Trust Funds to the Tribal and Other Trust Funds. Net transfers of trust funds to the IIM Trust Funds from the Tribal and Other Trust Funds totaled approximately \$17 million and \$42 million during the years ended September 30, 2002 and 2001, respectively. These transfers are reflected as receipts in the accompanying statements of changes in trust fund balances.



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

**Auditors' Report on Internal Controls over  
Financial Reporting and Compliance with  
Laws and Regulations**

**September 30, 2002**





6565 Americas Parkway, NE #700  
Post Office Box 3939  
Albuquerque, NM 87190

## Independent Auditors' Report

The Special Trustee  
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 of the Tribal and Other Trust Funds as of September 30, 2002 and 2001, and the related statements of changes in trust fund balances for the years then ended, and the statements of assets and trust fund balances of the Individual Indian Monies Trust Funds as of September 30, 2002 and 2001, and the related statements of changes in trust fund balances for the years then ended (collectively referred to as the Trust Fund financial statements) managed by the U.S. Department of the Interior Office of the Special Trustee for American Indians Office of Trust Funds Management (OTFM), and have issued our reports thereon dated December 13, 2002.

Our reports were qualified because cash balances reflected in the Trust Fund financial statements were materially greater than balances reported by the U.S. Department of the Treasury and it was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the fairness of trust fund balances in the Trust Fund financial statements as of September 30, 2002 and 2001. Trust fund balances enter into the determination of financial position and changes in trust fund balances and inadequacies in certain Department of the Interior trust related systems raise questions about the fairness of trust fund balances. Also, certain parties for whom the OTFM holds monetary assets in trust do not agree with the trust fund balances recorded by the OTFM; and certain of these parties have filed, or are expected to file, claims against the U.S. Federal Government.

Our reports also state that the Trust Fund financial statements are prepared in accordance with a basis of accounting which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America as described in note 2 to the financial statements. The objective of our audits was to express an opinion on the fair presentation of the Trust Fund financial statements. In connection with our audits, we also considered the OTFM's internal control over financial reporting and tested the OTFM's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on the Trust Fund financial statements.



## Summary

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

- A. Reliance on processing of trust transactions at the Bureau of Indian Affairs
- B. Financial reporting – unresolved matters from current and prior periods
- C. Improve controls over information technology systems

We consider reportable conditions A and B above to be material weaknesses.

The results of our tests of compliance with the laws and regulations described in the Responsibilities section of this report disclosed no instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards*.

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

### Internal Control over Financial Reporting

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the OTFM's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal control, misstatements, due to error or fraud may nevertheless occur and not be detected.

### Overview – Trust Fund Financial Statements

The accounting systems and internal control procedures used in the processing of Indian trust transactions have suffered historically from a variety of system and procedural internal control weaknesses. In addition, current management is burdened with the ongoing impact of decades of accumulated discrepancies in the accounting records.

The Secretary of the Department of the Interior (the Secretary) has been designated by the U.S. Congress as the primary U.S. Federal Government trustee with fiduciary responsibility for the monetary and non-monetary resources held in trust on behalf of American Indian tribes, individual Indians, and other trust funds. In carrying out the management and oversight of the Indian trust assets, the Secretary has a fiduciary responsibility to ensure all monies are received for the use of Indian lands and the extraction of natural resources from Indian lands, disburse such monies collected to the appropriate beneficiaries, ensure that trust accounts are properly maintained and invested, and ensure that accurate and complete reports are provided to the trust beneficiaries in accordance with applicable law.

Prior to February 1996, the Secretary delegated authority for management of 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).

On February 9, 1996, in accordance with the authority provided by The American Indian Trust Fund Management Reform Act of 1994 (Pub. L. 103-412) (the Reform Act), Secretarial Order 3197 established the Office of the Special Trustee for American Indians (OST) and delegated all program and administrative authority necessary to carry out the responsibilities of the OST to the Special Trustee for American Indians (Special Trustee) who reports to the Secretary. In addition, the OTFM was transferred intact from the BIA to the OST, and certain trust service employees in field offices located throughout the U.S. were transferred from the BIA to the OST and the OTFM.

Under this legislation, the Special Trustee is responsible for oversight, reform and coordination of the policies, procedures, systems and practices used by various agencies of the Department of the Interior (Department), including but not limited to, the OTFM, the BIA, Minerals Management Services (MMS), and the Bureau of Land Management (BLM), in managing Indian trust assets.

The Reform Act delineates the following actions required of the Secretary to properly discharge the trust responsibilities of the U.S. Federal Government:

- Providing adequate systems for accounting for and reporting trust fund balances;
- Providing adequate controls over receipts and disbursements;
- Providing periodic, timely reconciliation to assure the accuracy of accounts;
- Determining accurate cash balances;
- Preparing and supplying account holders with periodic statements of their account performance and with balances of their account which shall be available on a daily basis;
- Establishing consistent, written policies and procedures for trust fund management and accounting;
- Providing adequate staffing, supervision, and training for trust fund management and accounting;
- Appropriately managing the natural resources located within boundaries of Indian reservations and trust lands;
- Properly accounting for and investing, as well as maximizing, in a manner consistent with the statutory restrictions imposed on the Secretary's investment options, the return on the investment of all trust fund monies;
- Preparing accurate and timely reports to account holders (and others, as required) on a periodic basis regarding all collections, disbursements, investments, and return on investments related to their trust accounts; and
- Maintaining complete, accurate, and timely data regarding the ownership and lease of Indian lands.

Pursuant to the Reform Act, in April of 1997, the Special Trustee prepared and submitted a comprehensive strategic plan that identified all reforms to policies, procedures, practices, and systems of the Department, including the BIA, MMS, OFTM, and the BLM as well as a timetable for implementing the various reforms. The Secretary's decision on system improvements and data cleanup efforts were organized into 13 separate, but complementary subprojects, which comprised the Trust Management Improvement Project, and the original High Level Implementation Plan (HLIP) which was approved in July 1998. The HLIP provided information on responsible Bureaus and Offices, supporting tasks, critical milestones, work plans, resource estimates, and accountable officials. In February 2000, a revised and updated HLIP was issued by the Secretary. In 2002, the Secretary's initiatives advanced trust reform and the accounting efforts beyond the point they were first envisioned, and the HLIP was determined to be obsolete.

On November 20, 2001, Secretarial Order 3235 established the Office of Indian Trust Transition (OITT) as a temporary office within the Department. The OITT was charged the responsibility for planning and implementing the transition of the Department's Indian trust functions, located in various units of the Department, to a new trust organization housed within the Department. In addition, OITT was charged with assisting in the development of an operational plan to guide the design and implementation of developed trust business processes, and oversight of several trust improvement projects, including coordinating the preparation of the Department's quarterly status reports to the U.S. District Court of Columbia. In 2002, the OITT commenced the planning and development of the Indian Trust Business Plan (the Plan). The Plan, which replaces the HLIP, is intended to be the first comprehensive operational plan for DOI trust operations, and will define and describe the vision, goals, and objectives of trust reform, and the management of Indian trust. The mission statement, goals and objectives of the Plan were approved by managers of affected Departmental agencies, including the OST, BIA, MMS, and the BLM, as well as the Tribal Task Force Plan Subcommittee.

The Plan, which the Department expects to complete by the end of the second quarter of fiscal year 2003, begins with six major goals, as follows:

1. Beneficiary Services
2. Ownership Information
3. Land and Natural Resource Assets
4. Trust Fund Assets
5. Indian Self-Governance and Self-Determination
6. Administrative Services

The objectives of the Plan are to be accomplished through the development and implementation of standardized trust business processes. A three-stage approach to standardizing these processes will: (i) identify existing business process ("As-Is"), (ii) determine which of those processes should remain or be reengineered ("To-Be"), and (iii) develop the universal support functions cross-cutting the baseline business model. The "To-Be" business process model effort will begin upon completion of the "As-Is" business process modeling, which is scheduled for completion in the second quarter of fiscal year 2003.

We noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that the following reportable conditions are material weaknesses:

**A. Reliance on Processing of Trust Transactions at the Bureau of Indian Affairs**

*Condition*

Indian trust assets, including the Trust Funds, are managed under the delegated authority of the OST and the BIA. Management of Indian trust assets on behalf of the trust beneficiaries is a process that is dependent upon the processing of trust related transactions within the accounting systems of the Department, including but not limited to, the OTFM, the BIA, MMS, and certain other Departmental agencies. The BIA, MMS, and other Departmental agencies are responsible for managing the natural resources located within the boundaries of Indian reservations and trust lands as well as the processing of data regarding the ownership and lease of Indian lands. The OTFM is responsible for the management of Trust Funds received on behalf of trust beneficiaries. The allocation and distribution of receipts and disbursements by the OTFM to trust beneficiaries is significantly dependent and reliant upon the receipt of timely and accurate information derived from the records of the ownership and lease of Indian land maintained by the BIA and other Departmental agencies.

The independent auditors' report on internal control over financial reporting for the years ended September 30, 2002 and 2001 at the BIA contained two reportable conditions which were considered material weaknesses. Specifically, material weaknesses related to controls over information technology systems and controls over processing of Indian trust transactions were included in the BIA report. The presence of these reportable conditions directly impacts the OTFM's ability to process monetary trust transactions on behalf of trust beneficiaries and to provide accurate information to account holders due to the interrelationship between the BIA and the OTFM.

The first material weakness relates to controls over information technology systems at the BIA. Specifically, weaknesses in the BIA's computer systems raise concerns about the integrity of information being reported on in the financial statements of the Trust Funds. Although the BIA has developed a formal security program, the BIA has not implemented information systems security policies or procedures to effectively control and protect information systems, programs and data supporting the BIA's operations and assets, and has failed to meet minimum information technology (IT) security requirements. Weaknesses in the following IT control areas were noted: 1) Entity-wide security program, 2) Segregation of duties, 3) Access controls, 4) Application software development and change controls, 5) System software controls, and 6) Service continuity. The second material weakness relates to controls over the processing of Indian trust transactions. The BIA performs a critical role in the initial input and subsequent changes to Indian trust accounting data in its various regional and agency offices. In this fiduciary capacity, the BIA performs a variety of functions related to Indian trust transactions. Weaknesses in the following areas were noted: 1) Probate backlog, 2) Segregation of duties, and 3) Untimely deposits.

#### ***Recommendation***

We recognize that program and administrative authority necessary to carry out the responsibilities of the OST was delegated to the Special Trustee and that the OTFM was transferred intact from the BIA to the OST in February 1996 under Secretarial Order 3197, and that certain trust functions are performed by non-OTFM staff (i.e., BIA and tribal) over which the OTFM has no management control nor line authority. However, we recommend management continue to work collaboratively with the OST Office of Trust Risk Management to monitor progress towards completion of the various Indian trust reform subprojects being addressed by the BIA to help to ensure the OTFM fulfills its fiduciary responsibility to the trust fund beneficiaries.

#### ***Management's Response***

OTFM concurs, recognizes and acknowledges that, as reported, its ability to process (i.e., account for) trust funds receipts and disbursements for trust beneficiaries is significantly dependent and critically reliant upon the financial information derived from trust records that are maintained and provided by BIA and other Departmental offices. OTFM also shares in the concerns regarding the integrity of trust data it receives from BIA and understands the reportable conditions reported as material weaknesses in (BIA's) independent auditors' report on internal controls. OTFM remains committed to working collaboratively with all Departmental offices towards trust management reform.

### **B. Financial Reporting – Unresolved Matters from Current and Prior Periods**

#### ***Condition***

As of September 30, 2002, several significant financial reporting differences have not been resolved. The presence of these unresolved differences has a material effect on the financial statements of the Trust Funds as of September 30, 2002 and 2001 and for the years then ended. These matters include the following:

*Cash – Tribal and IIM*

Total cash balances converted from prior general ledgers to the current Trust Funds Accounting System (TFAS) were materially greater than the total balances as reported by the U.S. Treasury (Treasury). The composition of the difference is not known and no reliance has been obtained that either the OTFM balances or the balances as reported by the Treasury is correct. As a result, the unreconciled difference continues to be reflected as a reconciling item in periodic cash reconciliations of activity between TFAS and Treasury. The out of balance condition, which changes as reconciling items are identified and cleared, is approximately \$33 million as of September 30, 2002 and 2001.

*Investments – Lack of Reliable IIM Balance Available for Investing – IIM*

The TFAS control account for IIM account holders is purported to represent the aggregate net balance of trust funds held on behalf of IIM account holders as reflected in the detailed subsidiary accounts also in TFAS. The balance per the control account does not agree to the sum of the balances per the IIM subsidiary accounts and it cannot be determined which balance, if either, is correct. Consequently, the balance of funds invested for IIM account holders may not be correct. The amount invested for IIM is based on the IIM control account balance in TFAS. As of September 30, 2002 and 2001, the aggregate sum of all positive balances included in the detailed subsidiary ledger of IIM accounts exceeded the control account by approximately \$6,000,000 and \$6,700,000, respectively. Accordingly, IIM account holders with positive balances may be penalized by lower interest earnings. The net decrease in the excess balance was due to the identification and correction of certain transactions recorded in the IIM control account but not recorded in the IIM subsidiary accounts in prior periods in connection with the review of certain special deposit accounts performed by the OTFM, together with the BIA and a contractor during fiscal year 2002. In addition, the IIM detailed subsidiary ledger accounts contain negative account balances totaling approximately \$44,000,000 as of September 30, 2002 and 2001.

*Trust Fund Balances – Tribal and IIM*

A historical "Undistributed Interest Account" of approximately \$1,800,000 existed at September 30, 1995. The balance in this account as of September 30, 2002, is approximately \$1,715,000.

*Cash – Tribal*

As of September 30, 2002, there are twelve accounts in TFAS with negative balances totaling approximately \$724,000 carried forward from the previous trust funds accounting system prior to the conversion to TFAS.

*Cash – Failure to Analyze Suspense Accounts – Tribal and IIM*

An analysis of the many historical items that comprise several Treasury suspense and budget clearing accounts has not been completed. The OTFM's current procedures for researching and proposing adjustments to the cash out of balance condition may not consider whether an offset may already exist within one of these account balances. Funds to cover an adjustment 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, 2002 and 2001 were approximately (\$3,378,000), \$5,966,000 and (\$3,310,000).

### *Special Deposit Accounts – Inconsistent Practices – IIM*

As of September 30, 2002 and 2001, there were approximately 21,000 and 20,000 special deposit accounts, respectively, reflected in the detailed subsidiary ledger accounts in TFAS (IIM accounts) with a balance totaling approximately \$62 million and \$67 million, respectively. Per 25 CFR, special deposit accounts are to be used as suspense accounts for which funds are posted when the allocation of the funds is not immediately known upon receipt. The funds are to reside in the suspense accounts temporarily until the proper recipient is identified at which time the funds are to be transferred to the proper account. A significant number of special deposit accounts have remained inactive for the past several years and new accounts continued to be established during the years ended September 30, 2002 and 2001. During fiscal years 2002 and 2001, we understand management of the OTFM, together with the BIA and a contractor, initiated a pilot project to develop a formal plan to address special deposit accounts. The pilot project is scheduled for completion in late December 2002. At September 30, 2002, a significant number of special deposit accounts continue to require resolution.

### *Trust Fund Balances – IIM*

During fiscal 2002, approximately \$922,000 was transferred from certain special deposit accounts to an “undistributed interest” house account in connection with the review of certain special deposit accounts performed by the OTFM, together with the BIA and a contractor. The funds were invested, and interest earnings are allocated to current IIM account holders.

### *Automated Disbursements – IIM*

The OTFM was unable to provide documentation supporting the authorization of certain fiscal 2002 automated disbursements, which were based on account maintenances performed prior to the conversion to TFAS. A “100% disbursement” tickler type is established in TFAS based on documentation provided by account owners authorizing the automatic disbursement of their funds when an account balance reaches an established threshold. A significant number of fiscal 2002 disbursements resulted from this “100% disbursement” tickler type.

### *Recommendation*

We recommend that management of the OTFM continue to work to resolve these matters as soon as practical. In situations where actions or inputs from Department of the Interior officials are needed to resolve a matter, we recommend management of the OTFM continue to work with appropriate Department of Interior officials such that all matters are resolved as soon as practical.

### *Management’s Response*

OTFM concurs, recognizes and acknowledges the presence of the unresolved matters as reported. OTFM has addressed these matters by having i) prepared issue papers, ii) developed and proposed action plans, and iii) submitted the items to designated Departmental personnel.

We noted the following reportable condition that is not considered to be a material weakness:

## **C. Improve Controls over Information Technology Systems**

### *Condition*

Sufficient internal control over information technology (IT) systems and applications is necessary to ensure the OTFM fulfills its fiduciary responsibility to trust beneficiaries and that the OTFM accomplishes its mission. During our audits, we noted certain matters related to internal control over IT that could be improved as indicated below.

### *Security Programs*

Security programs, including security policies and a related implementation plan, for general support systems and major applications are the foundation of an entity's security control structure and a reflection of senior management's commitment to addressing security risks. As outlined in OMB Circular A-130, an effective security program includes a risk assessment process, a certification process, and an effective incident response and monitoring capability. The OTFM has not completed the development and implementation of a comprehensive security program which includes all critical components for its general support systems and all major financial applications (i.e. the DADS application).

### *Segregation of Duties – DADS Application*

Segregation of duties between the programming, maintenance, and production environments of applications is necessary to maintain proper controls over the potential for unauthorized changes to production code as well as the processing of unauthorized transactions. The OTFM has not developed or implemented policies to ensure that individuals who process transactions using the DADS application are appropriately restricted from making changes to the production code.

### *Accreditations*

The OTFM has no formal accreditation process to authorize the operation of applications and systems in a secure environment. Specifically, management has not accredited and certified its general support systems and all major applications used to process, store or transmit sensitive information as required by OMB Circular A-130. By not identifying the risks of these systems, testing these systems, and ultimately authorizing these systems and applications to process information, management has not appropriately mitigated the risks associated with system and application security.

### *Access Controls*

Access controls should provide reasonable assurance that computer resources (data files, application programs, and computer-related facilities and equipment) are protected against unauthorized modification, disclosure, loss, or impairment. During fiscal year 2002, there were procedural and technical control weaknesses related to logical access to the OTFM's network and certain financial applications.

### *Change Control Policies and Procedures*

Establishing controls over program and system development activities will help ensure that programs and systems meet established design specifications and may prevent the unauthorized modification of applications and operating systems. Also, adherence to change control policies and procedures may enable the more efficient performance of system maintenance activities. Although the OTFM has documented the system development life cycle, the methodology and related policies and procedures have not been fully implemented.

### *Recommendation*

We recommend that the OTFM develop and/or implement policies and/or procedures that address the following:

- A comprehensive security program which includes all critical components for its general support systems and all major financial applications (i.e. the DADS application).

- The current lack of segregation of duties between the programming, maintenance, and production environments of the DADS application.
- A formal accreditation process to authorize the operation of applications and systems in a secure environment.
- Current procedural and technical control weaknesses related to logical access to the OTFM's network and certain financial applications.
- The implementation of recently-created system development and change control methodology and related policies and procedures.

***Management's Response***

OTFM concurs and in fiscal year 2003, will develop and/or implement policies and/or procedures for 1) a comprehensive security program which includes all critical components for its general support systems and all major financial applications (i.e., the DADS applications); 2) the current lack of segregation of duties between the programming, maintenance, and production environments of the DADS application; 3) a formal accreditation process to authorize the operation of applications and systems in a secure environment; 4) current procedural and technical control weaknesses related to logical access to the OTFM's network and certain financial applications; and 5) the implementation of recently created system development and change control methodology and related policies and procedures.

A summary of the status of prior year reportable conditions is included as Exhibit I. We also noted other matters involving internal control over financial reporting and its operation that we have reported to OTFM management in a separate letter dated December 13, 2002.

**Compliance with Laws and Regulations**

The results of our tests of compliance with the laws and regulations described in the Responsibilities section of this report disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We also noted other matters involving compliance with laws and regulations that, under *Government Auditing Standards*, were not required to be included in this report, that we have reported to OTFM management in a separate letter dated December 13, 2002.

**Responsibilities**

***Management's Responsibility***

The American Indian Trust Fund Management Reform Act of 1994 requires that the Secretary shall cause to be conducted an annual audit on a fiscal year basis of all funds held in trust by the United States for the benefit of an Indian tribe or an individual Indian which are deposited or invested pursuant to the Act of June 24, 1938 (25 U.S.C. 162a). To meet the Reform Act reporting requirements, the OTFM prepares annual Trust Fund financial statements.

Management is responsible for:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
- Establishing and maintaining internal controls over financial reporting; and
- Complying with laws and regulations.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies.

### ***Auditors' Responsibility***

Our responsibility is to express an opinion on the financial statements of the Trust Funds managed by the OTFM based on our audits. Except as discussed in the fourth paragraph of our auditors' reports, we conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes:

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

We believe that our audits provide a reasonable basis for our opinion.

In planning and performing our audits, we considered the OTFM's internal control over financial reporting by obtaining an understanding of the OTFM's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982. The objective of our audits was not to provide assurance on internal controls over financial reporting. Consequently, we do not provide an opinion on internal control over financial reporting.

As part of obtaining reasonable assurance about whether the Trust Funds' financial statements are free of material misstatement, we performed tests of the OTFM's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to the OTFM. Providing an opinion on compliance with laws and regulations was not an objective of our audits, and, accordingly, we do not express such an opinion.

### **Distribution**

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

**KPMG LLP**

December 13, 2002

**U.S. Department of the Interior  
Office of the Special Trustee for American Indians  
Tribal and Other Trust Funds and Individual Indian Monies Trust Funds  
Managed by the Office of Trust Funds Management**

**Status of Reportable Conditions, Reported as of September 30, 2001**

September 30, 2002

Ref	Condition	Current Year Status
OTFM-2001-A	Reliance on Processing of Trust Transactions at the Bureau of Indian Affairs	Repeated, with certain modifications in current year report, – see reportable condition A, considered a material weakness.
OTFM-2001-B	Financial Reporting – Unresolved Matters from Prior Periods	Incorporated in current year report, – see reportable condition B, considered a material weakness.
OTFM-2001-C	Improve Controls over Information Technology Systems	Repeated, with certain modifications in current year report, – see reportable condition C.

**Status of Reportable Conditions, Reported as of September 30, 2000\***

September 30, 2002

Ref	Condition	Current Year Status
OTFM-1997-32	Missing and/or Incomplete Documents – Tribal and IIM	<i>This condition noted missing or incomplete critical documentation for receipts and disbursements in prior years. In current year, certain documentation relating to automated disbursements was missing, and this matter was incorporated in current year report – see reportable condition B, considered a material weakness. OTFM management considers the remainder of matters noted in OTFM-1997-32 resolved.</i>
OTFM-1997-33	Improper Transaction Coding – Tribal and IIM	OTFM management considers this condition resolved.

\*Reported at September 30, 2000 by other auditors