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

AUDIT REPORT

DETERMINATION OF THE REIMBURSABILITY OF ENVIRONMENTAL ACTIVITIES COSTS ASSOCIATED WITH GLEN CANYON DAM BY THE BUREAU OF RECLAMATION

REPORT NO. 98-I-258
FEBRUARY 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

FEB 23 1998

AUDIT REPORT

Memorandum

To: Assistant Secretary for Water and Science

From: Robert J. Williams
Acting Inspector General

Subject: Audit Report on Determination of the Reimbursability of Environmental Activities Costs Associated With Glen Canyon Dam by the Bureau of Reclamation (No. 98-I-258)

INTRODUCTION

This report presents the results of our review of the Bureau of Reclamation's determination of the reimbursability of the environmental activities costs associated with Glen Canyon Dam. The initial objective of our review was to evaluate the Bureau's reallocation of costs required by Section 1804 of the Reclamation Projects Authorization and Adjustment Act of 1992 (Public Law 102-575). At the time of our initial review in May 1996, the Bureau stated that it had not performed the reallocation because the General Accounting Office had not issued its required audit report on the Bureau's final environmental impact statement on the operations of the Dam.[1] As a result, we revised our objective to evaluate the Bureau's implementation of Section 1807 of the Act. Section 1807 required the Bureau to determine the reimbursability of the costs associated with the preparation of the Dam's environmental impact statement (including supporting studies) and with the long-term monitoring programs and activities for fiscal years 1993 through 1997 and to forward this determination to the Secretary of the Interior for reporting to the Congress.

BACKGROUND

Glen Canyon Dam, which is located on the Colorado River in northwestern Arizona, was authorized by the Colorado River Storage Project Act of 1956 (43 U.S.C. 620). The multipurpose dam, constructed by the Bureau and placed into operation in 1963, stores and

[1]The General Accounting Office issued the required report, "An Assessment of the Environmental Impact Statement on the Operations of the Glen Canyon Dam" (No. GAO/RCED-97-12), in October 1996.

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

FEB 23 1998

Memorandum

To: Assistant Secretary for Policy, Management and Budget
(Attention: Focus Leader for Management Control and Audit Followup)

From: Robert J. Williams
Acting Inspector General

Subject: Referral of Audit Report "Determination of the Reimbursability of Environmental Activities Costs Associated With Glen Canyon Dam by the Bureau of Reclamation" (No. 98-I-258), Dated February 1998

In accordance with the Departmental Manual (361 DM 1), the two recommendations in the subject audit report (Attachment) are being referred to you for tracking of implementation.

Based on the February 3, 1998, response (Appendix 1 to the Attachment) to the draft report from the Commissioner, Bureau of Reclamation, we considered Recommendations 1 and 2 resolved but not implemented.

According to the response, the target dates for implementation of Recommendations 1 and 2 are March 31, 1998, and May 1, 1998, respectively, and the official responsible for implementation is the Chief, Washington Liaison Office, Program Analysis Office.

The report did not identify any lost or potential additional revenues, funds to be put to better use, or questioned costs.

If you have any questions regarding this referral, please contact me at (202) 208-4252 or Mr. Roger La Rouche, Director of Performance Audits, at (202) 208-5520.

Attachment

cc: Assistant Secretary for Water and Science
Commissioner, Bureau of Reclamation
Audit Liaison Officer, Water and Science
Audit Liaison Officer, Bureau of Reclamation

releases water from Lake Powell, which has a storage capacity of over 24 million acre-feet of water.[2] Lake Powell and the nearly 1 million acres surrounding the Dam constitute Glen Canyon National Recreation Area. Below the Dam, the Colorado River flows through 15 miles of Glen Canyon and through 278 miles of Grand Canyon National Park before emptying into Lake Mead in southern Nevada. Since its completion, the power plant at the Dam has been used primarily for generating hydroelectric power during high demand periods (peaking power). The Western Area Power Administration, U.S. Department of Energy, markets and transmits reliable, low-cost electric power from the Dam. The daily fluctuations in water releases associated with the generation of peaking power and the resultant detrimental effects on downstream cultural resources, vegetation, wildlife, and other river resources, have been the causes of major concerns among Federal, state, and tribal resource management agencies; fishing and rafting interests; and environmental groups. Since the Dam was completed before the National Environmental Policy Act was enacted, no environmental impact statements were prepared regarding the effects of constructing or operating the Dam.

In 1982, the Bureau initiated a multiagency effort to study the environmental impacts of operating the Dam and to respond to concerns of the general public; environmental organizations; and Federal, state, and tribal agencies. Phase I of the Glen Canyon environmental studies was completed in January 1988 and consisted of 39 technical studies in areas such as biology, recreation, sedimentation, and hydrology. While these studies provided considerable information on the effects of floods, they provided only limited information on the effects of power plant operations. Therefore, in June 1988, the Department initiated Phase II, which consisted of gathering additional information on specific operations of the power plant. Phase II was initially scheduled to take 4 to 5 years to complete. However, after the Secretary, on July 27, 1989, stated that "[i]t is time to gather the facts about this issue, to give all interested parties a chance to explain their positions, and to do so in full view of the American people," he directed the Bureau to prepare an environmental impact statement on the Dam's operations, noting that this issue is "an opportunity to balance energy and environmental needs." Thus, the Bureau began to incorporate the results of its environmental studies into an environmental impact statement, which was completed in March 1995.

In 1992, the Congress passed the Reclamation Projects Authorization and Adjustment Act, which consists of 40 separate titles covering a wide variety of Bureau projects and activities. Title 18 of the Act, "The Grand Canyon Protection Act," requires the Secretary to (1) operate the Dam to "protect, mitigate adverse impacts to, and improve the values for which Grand Canyon National Park and Glen Canyon National Recreation Area were established," being consistent with existing compacts and laws; (2) complete a final environmental impact statement on the Dam's operations; (3) adopt new criteria and operating plans for the Dam based on the recommendations made in the environmental impact statement; and (4) reallocate (in consultation with the Secretary of Energy) the costs of construction, operation, maintenance, replacement, and emergency expenditures for the Dam among the various project purposes. In addition, Section 1807 of Title 18 states that for fiscal years 1993

[2]An acre-foot of water is the volume of water that will cover an acre of land to a depth of 1 foot (approximately 326,000 gallons).

through 1997, the costs of preparing the environmental impact statement on the Dam's operations and conducting other monitoring activities will be reimbursable if the Secretary determines that enactment of the Act causes a reduction in "net offsetting receipts"[3] generated by all provisions of the Act. Section 1807 also states that the Secretary is required to report to the Congress by January 31 of each fiscal year, beginning in 1994, a detailed accounting of expenditures under the Reclamation Projects Authorization and Adjustment Act, the offsetting receipts generated by the Act, and any increase or reduction in net offsetting receipts. In June 1997, the Bureau filed reports detailing the Bureau's analysis of expenditures and offsetting receipts for fiscal years 1993, 1994, and 1995 with the appropriate Congressional committees.

SCOPE OF AUDIT

Our fieldwork was conducted at the Bureau's Upper Colorado Region in Salt Lake City, Utah, which has jurisdiction over Glen Canyon Dam. To meet our revised objective, we reviewed the Grand Canyon Protection Act and related legal documents and interviewed (1) various program and budget officials from the Bureau's headquarters office in Washington, D.C., and the regional office in Salt Lake City and (2) attorneys from the Office of the Solicitor's headquarters office in Washington, D.C., and its field office in Phoenix, Arizona. In conjunction with our fieldwork, we obtained a legal interpretation from the Office of Inspector General's General Counsel regarding the requirements of Section 1807 of the Act in determining reimbursable costs. After we received the General Counsel's legal interpretation of the Act, which was agreed to by the Acting Field Solicitor and was provided to and discussed with Upper Colorado Regional officials, the Bureau revised and filed its reports for fiscal years 1993 through 1995.[4] At the time of our review, the Bureau had not prepared its final determination of the reimbursability of environmental activities costs for fiscal year 1996.

Our audit was made in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary to accomplish our objective. We also reviewed the Department of the Interior's Annual Statement and Report, which is required by the Federal Managers' Financial Integrity Act, for fiscal years 1993 through 1995 and determined that the Department did not report any material weaknesses related to the objective and scope of our audit. In addition, we evaluated the Bureau's system of internal controls related to implementing Title 18. While the Bureau had determined the reimbursability of the environmental activities costs associated with Glen Canyon Dam for fiscal years 1993 through 1995, it had not delivered the required annual reports to the appropriate Congressional committees on time. Further, we identified omissions regarding the amounts that the Bureau should have included in offsetting receipts and in environmental

---

[3]The term "net offsetting receipts" was not defined by the Act.

[4]Although the Act requires that a determination of reimbursability or nonreimbursability be made through fiscal year 1997, our report addresses only the determination through fiscal year 1995, which was the Bureau's latest report to the Congress.

activities costs. We also found that some of the amounts provided to the Bureau by the Western Area Power Administration were estimates instead of actual amounts. The impact of these omissions and estimates on the annual reports is discussed in the Results of Audit section of this report. The recommendations made, if implemented, should address our concerns in these areas.

PRIOR AUDIT COVERAGE

During the past 5 years, neither the Office of Inspector General nor the General Accounting Office has issued any reports on the Bureau's determination of the reimbursability of Glen Canyon Dam environmental activities costs.

RESULTS OF AUDIT

We found that, except for a net decrease of $306,526 in reimbursable costs, the Bureau of Reclamation, in general, determined the reimbursable environmental activities costs for Glen Canyon Dam for fiscal years 1993, 1994, and 1995 and reported these amounts to the Congress in June 1997. However, the Bureau did not report the amounts on time (January 31 of each fiscal year) and had not completed its report for fiscal year 1996. Specifically, we found that there were some omissions in the Bureau's determinations and that some of the costs associated with purchasing power for fiscal years 1994 and 1995, which were provided by the Western Area Power Administration, were only estimates instead of actual costs. These estimates, when finalized, could affect the amount of reimbursable costs in the fiscal years involved because of the high cost of purchasing "peak" power.

The Bureau's reports to the Congress for fiscal years 1993, 1994, and 1995, as required by Section 1807 of Title 18 of the Act, identified the offsetting receipts, the costs of the Dam's environmental activities, and the resultant amount of reimbursable and/or nonreimbursable environmental activities costs as follows:

			Environmental Activities Costs	
Fiscal Year	Offsetting Receipts	Environmental Activities Costs	Amount Reimbursable*	Amount Not Reimbursable
1993	$8,771,053	$16,088,154	$7,317,101	$8,771,053
1994	$36,573,358	$21,017,472	0	$21,017,472
1995	$3,826,193	$14,076,194	$10,250,001	$3,826,193

*Environmental activities costs are considered reimbursable to the extent that the costs exceed offsetting receipts on a fiscal year basis.

Our review confirmed that these amounts were identified and applied in accordance with the provisions of the Act and the legal advice provided by our Office of General Counsel except for adjustments to offsetting receipts and environmental activities costs, which we identified,

that were not properly included in the Bureau's determination and its reports to the Congress for fiscal years 1993, 1994, and 1995 as follows:

- **Fiscal Year 1993.** Title 9, Section 903 (a), of the Act provided that the Secretary "is authorized to enter into a contract with the State of Kansas, accepting a payment of $365,424 . . . as full satisfaction of reimbursable costs associated with irrigation of the Cedar Bluff Unit, including the Cedar Bluff Irrigation District's obligations." During fiscal year 1993, the Bureau received the $365,424 payment in accordance with this provision. Accordingly, this amount should have been included as an offsetting receipt in the Bureau's fiscal year 1993 determination. In addition, our review identified a prior year adjustment that reduced the Bureau's Glen Canyon Dam helicopter costs in the amount of $41,748 which was not included in the Bureau's determination. Accordingly, the environmental activities costs should have been reduced by $41,748 for fiscal year 1993. As a result of these omissions, the reimbursable amounts reported to the Congress for fiscal year 1993 should be reduced by $407,172 ($365,424 plus $41,748).

- **Fiscal Year 1994.** Title 23, Section 2302(a), of the Act provided that the Secretary "is authorized and directed to . . . [a]ccept a one-time payment of $450,000" from the Conejos Water Conservancy District in full satisfaction of its repayment obligation. During fiscal year 1994, the Bureau received the $450,000 payment in accordance with this provision. Accordingly, this amount less the $25,143 usually received annually under the repayment contract should have been included as an offsetting receipt in the Bureau's fiscal year 1994 determination. Furthermore, Title 29, Section 2901(a), provided that the Secretary "shall credit to the unpaid capital obligation of the San Juan Suburban Water District . . . an amount equal to the documented price paid by the District for pumps and motors provided by the District to the Bureau of Reclamation, in 1991 and 1992, for installation at Folsom Dam." The Bureau's $20,998 reduction to the District's water service charges in fiscal year 1994 as a partial reimbursement for the pumps and motors should have been included as a reduction to offsetting receipts in the Bureau's fiscal year 1994 determination. Therefore, an additional $403,859 ($450,000 less [$25,143 plus $20,998]) should have been included as offsetting receipts for fiscal year 1994. However, since other offsetting receipts already exceeded the environmental activities costs, these omissions did not change the reimbursable amounts for fiscal year 1994.

- **Fiscal Year 1995.** For fiscal year 1995, we identified additional reductions to offsetting receipts associated with implementing Titles 23 and 29 of the Act. Under Title 23, Section 2302(a), the one-time payment of $450,000 from the Conejos Water Conservancy District in fiscal year 1994 for full satisfaction of its repayment obligation had the effect of reducing offsetting receipts in subsequent years by $25,143, the annual amount that would have been received under the District's repayment contract. In addition, under Title 29, Section 2901(a), the San Juan Suburban Water District's unpaid capital obligation should be credited for the documented price paid by the District for pumps and motors provided to the Bureau. Accordingly, the Bureau's $44,655 reduction to the District's water service charges in fiscal year 1995 as partial reimbursement for the pumps and motors should have been included as a reduction to offsetting receipts in the Bureau's fiscal year 1995 determination. Further, our review identified a prior year adjustment that increased Glen Canyon Dam helicopter costs

in the amount of $30,848, which was not included in the Bureau's determination. Accordingly, the environmental activities costs should have been increased by $30,848 for fiscal year 1995. As a result of these omissions, the reimbursable amounts reported to the Congress for fiscal year 1995 should be increased by $100,646 ($25,143 plus $44,655 plus $30,848).

The Western Area Power Administration, on March 7, 1997, provided the Bureau with the Administration's environmental activities costs associated with Glen Canyon Dam for fiscal years 1983 through 1996. The costs included purchased power[5] costs of $5,211,587, $5,193,935, and $3,931,440 for fiscal years 1993, 1994, and 1995, respectively, and miscellaneous costs applicable to the preparation of the environmental impact statement on the Dam's operations. The Bureau incorporated this cost information into its reports to the Congress for fiscal years 1993, 1994, and 1995. Although actual purchased power costs were reported for fiscal year 1993, we found that the purchased power costs reported for fiscal years 1994 and 1995 were only estimates. Power Administration officials told us that they were in the process of determining the actual purchased power costs because of changes in the operation of the Dam for fiscal years 1994 through 1996. We believe that, when the actual purchased power costs for fiscal years 1994 and 1995 are determined, the Bureau should adjust the reports to the Congress for these years if the actual costs affect the reimbursability of environmental activities costs.

Recommendations

We recommend that the Commissioner, Bureau of Reclamation:

1. Amend the Bureau's determination of reimbursability or nonreimbursability of Glen Canyon Dam environmental activities costs in the reports to the Congress to reflect the additional amounts identified by our audit for fiscal years 1993 through 1995 and the actual Western Area Power Administration costs for fiscal years 1994 and 1995.

2. Prepare and report to the Congress the Bureau's determination of the reimbursability of Glen Canyon Dam environmental activities costs for fiscal years 1996 and 1997, which is required by Section 1807, Title 18, of the Reclamation Projects Authorization and Adjustment Act of 1992.

Bureau of Reclamation Response and Office of Inspector General Reply

In the February 3, 1998, response (Appendix 1) to the draft report from the Commissioner, Bureau of Reclamation, the Bureau concurred with the two recommendations and identified the actions that it is taking to implement each recommendation. Based on the response we consider both recommendations resolved but not implemented. Accordingly, the

---

[5]Changes in the operation of Glen Canyon Dam reduced the generation of power, thus requiring the Western Area Power Administration to purchase power from other sources to meet contractual demands. The costs of this purchased power were considered to be environmental activities costs.

recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation, and no further response to the Office of Inspector General is required (see Appendix 2).

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, the monetary impact of audit findings, actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the assistance of personnel from the Bureau of Reclamation during the conduct of our audit.

United States Department of the Interior

BUREAU OF RECLAMATION
WASHINGTON, D.C. 20240

IN REPLY REFER TO:
D-5010
ADM-8.00

FEB - 3 1998

MEMORANDUM

To: Office of Inspector General
Attention: Assistant Inspector General for Audits

From: Eluid L. Martinez
Commissioner

Subject: Draft Audit Report on Determination of the Reimbursability of Environmental Activities Costs Associated With Glen Canyon Dam by the Bureau of Reclamation (Assignment No. W-IN-BOR-008-96)

The Bureau of Reclamation (Reclamation) offers the following comments in response to the recommendations in the subject report:

Recommendation 1

Amend the Bureau's determination of reimbursability or non-reimbursability of Glen Canyon Dam environmental activities costs in the reports to the Congress to reflect the additional amounts identified by our audit for fiscal years 1993 through 1995 and the actual Western Area Power Administration costs for fiscal years 1994 and 1995.

Response

Concur. Reclamation is in the process of updating the reports for fiscal years 1993 through 1995. In addition, Reclamation has met with representatives of Western Area Power Administration's (Western) staff and they are working on finalizing their actual costs for fiscal years 1994 and 1995. Reclamation will forward the revised reports to the Congress within 30 days of receipt of the final actual cost figures from Western.

The responsible official is the Chief, Washington Liaison Group, Program Analysis Office. The estimated target date for submitting the reports to the Congress is March 31, 1998.

Recommendation 2

Prepare and report to the Congress the Bureau's determination of the reimbursability of Glen Canyon Dam environmental activities costs for fiscal years 1996 and 1997, which is required by Section 1807, Title 18, of the Reclamation Projects Authorization and Adjustment Act of 1992.

Response

Concur. Reclamation is in the process of finalizing the fiscal year 1996 report. This report will be submitted 30 days after receipt of Western's actual costs for fiscal year 1996. The net offsetting receipts portion of the report have been identified and are ready for submittal.

All appropriate entities within Reclamation have been notified to submit their final fiscal year 1997 data for inclusion in this report. The report will be submitted 30 days after receipt of Western's actual costs for fiscal year 1997.

The responsible official is the Chief, Washington Liaison Office, Program Analysis Office. The estimated target date for submitting the fiscal year 1996 report to the Congress is March 31, 1998. The estimated target date for submitting the fiscal year 1997 report is May 1, 1998.

If you have any questions or require additional information, please contact Luis Maez at (303) 236-3289, extension 245.

cc: Assistant Secretary - Water and Science, Attention: Laura Brown

STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/ Recommendation Reference	Status	Action Required
1 and 2	Resolved; not implemented	No further response to the Office of Inspector General is required. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

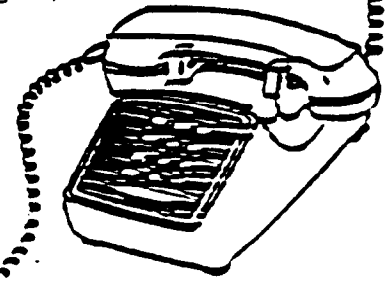
(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free Numbers:
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240



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

SURVEY REPORT

USE OF THE GOVERNMENTWIDE PURCHASE CARD, U.S. GEOLOGICAL SURVEY

REPORT NO. 98-I-316
MARCH 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAR 18 1998

MEMORANDUM

TO: The Secretary

FROM: Robert J. Williams
Acting Inspector General

SUBJECT SUMMARY: Final Survey Report for Your Information - "Use of the Governmentwide Purchase Card, U.S. Geological Survey" (No. 98 -I-316)

Attached for your information is a copy of the subject final survey report. The objective of the survey was to determine whether the U.S. Geological Survey managed the Governmentwide Purchase Card Program in accordance with applicable laws, regulations, and guidelines.

We found that the Geological Survey's approving officials either did not certify the cardholders' statements or certified the statements without obtaining vendor invoices or itemized receipts to verify that some items purchased were for valid Government purposes. We also found that cardholders either allowed noncardholders to use their card, did not maintain telephone logbooks, or split orders. In addition, cardholders did not always adequately safeguard their purchase cards. The deficiencies occurred because (1) approving officials did not perform all of the required review procedures; (2) the Office of Acquisition and Federal Assistance did not perform periodic reviews of the Purchase Card Program; and (3) the Geological Survey did not provide adequate training to cardholders and approving officials in the areas of acquiring, documenting, and reviewing purchases. As a result, the Geological Survey did not have reasonable assurance that improper uses of the purchase cards would be prevented or detected in a timely manner.

Based on the Geological Survey's response to the draft report, we considered four of the report's five recommendations resolved and implemented and requested the Geological Survey to reconsider its response to the remaining recommendation, which is unresolved.

If you have any questions concerning this matter, please contact me at (202) 208-5745.

Attachment

E-IN-GSV-017-96

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAR 18 1998

SURVEY REPORT

Memorandum

To: Director, U.S. Geological Survey

From: Robert J. Williams *Robert J. Williams*
Acting Inspector General

Subject: Survey Report on the Use of the Governmentwide Purchase Card, U.S. Geological Survey (No. 98-I-316)

INTRODUCTION

This report presents the results of our survey on the use of the Governmentwide purchase card at the U.S. Geological Survey in Reston, Virginia. The original objective of the review was to determine whether the Geological Survey managed the Governmentwide Purchase Card Program in an efficient and economical manner and in accordance with applicable laws, regulations, and guidelines. However, during our survey, the General Accounting Office issued the report entitled "Acquisition Reform: Purchase Card Use Cuts Procurement Costs, Improves Efficiency" (No. GAO/NSIAD-96-138) on August 6, 1996. The report stated: "Agencies have found they can support their missions at reduced costs by having program staff use the purchase card for simple purchases. Further, agency studies have shown that purchase card use reduces labor and payment processing costs." Based on these statements, we revised our objective to address the management of the Geological Survey's Program rather than the Program's efficiency and economy.

BACKGROUND

In 1989, the General Services Administration awarded a contract to Rocky Mountain BankCard System to provide credit card services within the Federal Government. The card was intended to streamline the small purchase and payment processes. The BankCard System issued instructions on the proper use and approval of items purchased with the credit cards as follows: (1) Cardholder Instructions for the Use of the Governmentwide Credit Card and (2) Approving Official Instructions for the Use of the Governmentwide Credit Card. In April 1990, the Geological Survey implemented the

Governmentwide Purchase Card Program. On June 28, 1990, the Department of the Interior issued the "Handbook for Utilization of the Governmentwide Commercial Credit Card," under Department of the Interior Acquisition Policy Release 90-35. In December 1994, the Geological Survey issued its guidance in the revised "Supplemental Bankcard Handbook," which augmented the cardholder instructions issued by the Bankcard System and by the Department of the Interior.

At the Geological Survey, the purchase cards are used primarily for the acquisition of supplies and services costing $2,500 or less. The Geological Survey's Office of Acquisition and Federal Assistance is responsible for administering and managing the Governmentwide Purchase Card Program.

On a monthly basis, the BankCard System submits invoices to the Geological Survey's Office of Financial Management, in Reston. The monthly invoices represent the aggregate credit card amounts for each Geological Survey division. In addition, the BankCard System submits to each cardholder a monthly statement that itemizes the cardholder's transactions. Upon receipt of the monthly cardholder statement, the cardholder is required to reconcile the statement with the transaction documentation and certify that all purchases listed on the statement are accurate and were made for official Government purposes. The cardholder is required to forward the certified statement and all supporting documentation to the cognizant approving official. The approving official is required to review the cardholder's statement and supporting documentation and to certify that the cardholder's purchases were made for valid Government purposes. The BankCard System also submits to each approving official a statement that lists monthly purchase amounts made by all cardholders assigned to the approving official.

The use of the purchase card within the Geological Survey has increased significantly since the first year the Program was started in 1990 and has continued to increase to approximately 3,000 purchase cards nationwide as of September 30, 1996, as shown in the following table:

	1990	1994	1995	1996
Purchase Cards	100	1,200	2,100	3,000
Purchase Transactions	900	29,000	57,000	84,000
Purchase Amount	$129,000	$3,660,000	$11,130,000	$21,200,000

SCOPE OF SURVEY

Our survey included purchases made with the Government purchase card by Geological Survey employees in Reston during the 5-month period of October 1, 1995, through February 28, 1996. We judgmentally selected 462 purchases, totaling $313,244, made by 32 cardholders and reviewed by 11 approving officials. These cardholders and approving officials were selected based on the highest dollar value transactions for the period reviewed.

Our survey was made in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances. In planning our survey, we reviewed the Secretary's Annual Statement and Report to the President and the Congress, which is required by the Federal Managers' Financial Integrity Act, for fiscal year 1995 and determined that there were no reported weaknesses related to the objective and scope of our survey.

We also evaluated the Geological Survey's system of internal controls related to purchase card activities and found weaknesses in the areas of approving officials' reviews, card security, card usage, purchase limits, and telephone order logbooks. We also determined that the Geological Survey did not provide adequate oversight of purchases made with the card. These weaknesses and the recommended corrective actions are discussed in the Results of Survey section of this report. The recommendations, if implemented, should improve the internal controls in these areas.

PRIOR AUDIT COVERAGE

Neither the Office of Inspector General nor the General Accounting Office has issued any reports during the past 5 years concerning the Geological Survey's management of the Governmentwide purchase card that specifically addressed our revised survey objective. However, as discussed previously, the General Accounting Office's August 6, 1996, report stated that agency studies revealed that use of the purchase card reduced labor and payment processing costs. Although the Department of the Interior was included in the study, no findings were directly related to the Department.

RESULTS OF SURVEY

We found that for 138 ($98,879) of the 462 ($313,244) transactions reviewed, the Geological Survey's approving officials either did not certify the cardholders' statements or certified the statements without obtaining vendor invoices or itemized receipts to verify that the items purchased were for valid Government purposes. We also found that for 193 transactions, totaling $193,036, cardholders either allowed noncardholders to use their card, did not maintain telephone logbooks, or split orders. In addition, we found that 7 of the 32 cardholders reviewed did not adequately safeguard their purchase cards. The instructions and procedures for the use of the Governmentwide purchase card are included in the Bankcard System's Cardholder Instructions and Approving Officials Instructions, the Department's "Handbook," and the Geological Survey's "Handbook." The deficiencies occurred because (1) approving officials did not perform all of the required review procedures; (2) the Office of Acquisition and Federal Assistance did not perform periodic reviews of the Purchase Card Program; and (3) the Geological Survey did not provide adequate training to

cardholders and approving officials in the areas of acquiring, documenting, and reviewing purchases. As a result, the Geological Survey did not have reasonable assurance that improper uses of the purchase cards would be prevented or detected in a timely manner.

Approving Officials' Review

Section IV of the Department's "Handbook" states that the approving officials are responsible for (1) maintaining a current listing of all cardholders under their purview, (2) reviewing cardholders' transactions and performing a monthly reconciliation and certification of each cardholder's statement against the monthly statement submitted to the approving officials by the Bankcard System, (3) verifying that all transactions were made for valid Government purchases, and (4) ensuring that all goods and/or services have been received. After certifying that the cardholders' statements are accurate, the approving official is to forward the original statements to the finance office. In order to adequately verify that the purchases made by the Geological Survey's cardholders are valid and for official Government purposes, approving officials need to (1) review the approving officials' statements to ensure that all cardholders submitted their statements; (2) review all of the documentation, such as invoices or itemized receipts, required by the Department's "Handbook" and by the Geological Survey's "Handbook"; and (3) ensure that a description of the items purchased is annotated on the statement by the cardholder and that the statement is in agreement with the description on the invoice or the itemized receipt.

We found that for 138 (30 percent) of the 462 transactions we reviewed, all of the 11 approving officials either did not certify the cardholders' statements or certified the cardholders' statements without documents such as vendor invoices or itemized receipts to verify that the purchases were valid and for official Government use. In addition, 6 of the 11 approving officials did not reconcile the cardholders' statements to the corresponding approving officials' statements to ensure that all cardholders who made purchases submitted their statements. Examples of the lack of certification and/or documentation and the lack of the approving officials' reconciliation efforts are as follows:

- A cardholder's statement containing 10 transactions, valued at $3,218, was paid, even though the approving official in the Geologic Division had not certified that the purchases were valid and necessary. According to the description provided by the cardholder on the statement, these purchases consisted of items such as computer memory, plotter supplies, and software. The approving official stated that she did not sign this particular statement because the cardholder never provided the statement to her for review and that without this statement, there was no way of knowing that the cardholder had used the purchase card. However, this discrepancy would have been identified if the approving official had reviewed and reconciled the cardholder's statement to the approving official's statement.

- An approving official in the Geologic Division approved 21 transactions, valued at $19,044, even though the cardholders did not provide vendor invoices or itemized receipts

in support of the purchases. In addition, the cardholders had not provided a detailed description for $17,018 of the $19,044 in transactions, as required by the Geological Survey's "Handbook." According to the descriptions provided by the cardholders for the remaining purchases of $2,026, items such as computer disks, laboratory supplies, and software were purchased. The approving official stated that he instructed his secretary to review the transactions and that, based on her review, he signed the cardholders' statements. The secretary, however, did not compare the cardholders' statements with the invoices and receipts supporting the statements. In addition, the approving official told us that he did not reconcile the approving official's statement with cardholders' statements because the approving official's statement was "redundant" and "did not really serve any purpose."

- A Geologic Division approving official who approved 13 transactions, valued at $8,665, that did not have supporting invoices and receipts had delegated the review of cardholder statements to her Administrative Operations Assistant. According to the description provided by the cardholder on the statements, the items purchased included laptop computers, a modem, and various software. The approving official signed the statements based on the Assistant's review. The approving official told us that she did not compare the approving official's statement with the cardholders' statements because by the time she received the approving official's statement, the cardholders' statements had already been reviewed and sent to the finance office.

- A Water Resources Division employee who was not an approving official certified a statement for purchases totaling $1,067. Although the Geological Survey "Handbook" allows a "responsible employee" to certify the cardholders' statements when the approving officials are not available, the Division employee stated that he had not received any purchase card training and was unaware of the certification requirements. The employee also acknowledged signing cardholders' statements on more than one occasion. In addition, the approving official informed us that he did not reconcile the approving official's statement with the cardholders' statements.

By not reviewing itemized receipts and invoices and by not reconciling the approving official's statement with the cardholders' statements, inappropriate purchases could be made and not be detected. For example, although the Geological Survey's Doraville, Georgia, office was not included in our review, an August 1996 investigation conducted by the Assistant Inspector General for Investigations found that a cardholder in the Doraville office used the Government purchase card for personal use and was subsequently criminally prosecuted and found guilty. The items purchased over a 9-month period totaled $25,633 and included food, clothing, gasoline, toys, cellular telephone service, videos, and computer games. Whenever the approving official asked the cardholder whether the purchase card was used, the cardholder stated that it had not been used. However, if the approving official's statement had been reviewed and reconciled as required, the approving official would have known in the first month of the card's use that the card had been used for personal items.

Other Deficiencies

Geological Survey cardholders did not follow purchase card procedures for 193 purchases, totaling $193,036. Specifically, we found that (1) individuals who were not authorized cardholders made five purchases, (2) the purchase card limit was exceeded on 39 purchases, and (3) cardholders did not always maintain a written logbook for 149 purchases made by telephone. As a result, the potential existed for items to be purchased that were not for valid Government purposes.

Unauthorized Use. The Department's "Handbook" (Section X) and the Geological Survey's "Handbook" (Section 4A(1)) require that the purchase card be used only by the cardholder. However, we found that for five purchases, totaling $9,560, the sales receipts were signed by three individuals who were not the authorized cardholders. The Chief, Branch of Facilities Management, said that in those instances, receipts were signed in the absence of the cardholder and with the knowledge that the cardholder had previously authorized and placed the call for the purchases. The Chief further stated that he would establish guidelines which stated that the only signature acceptable was that of the authorized cardholder. In our opinion, employees who are not cardholders but who receive delivery of purchases ordered by telephone should be instructed to print the words "phone order" on the sales draft and sign their name and "received by" next to their signature. The receipt should then be provided to the cardholder for use in reconciling the monthly statement.

Split Purchases. The Department's "Handbook" (Section VII) and the Geological Survey "Handbook" (Section 4(6)) state that purchases should not be split to avoid the single purchase limit. The single purchase limit established by the Geological Survey was $2,500. However, we found that the cardholders split 16 orders for similar items from the same vendors into 39 orders, totaling $65,268. The total amount paid to each of the vendors for the items exceeded the single purchase limit of $2,500. For example, an employee in the Information Systems Division requested that a cardholder purchase computer equipment. On September 22, 1995, the cardholder placed two separate orders with the same vendor for the equipment in the amounts of $2,424 and $290, respectively. For another purchase, a cardholder made separate purchases for two computers of $2,152 each from the same vendor. The requests for the purchase of these two computers were received on the same day; however, the cardholder placed the order with the vendor on two separate days.

Telephone Order Logbooks. The Department's "Handbook" (Attachment C) and the Geological Survey's "Handbook" (Section 4A(5)) require that purchase card users maintain a logbook of all transactions made by telephone. Each purchase card transaction is to be entered in the logbook at the time the order is placed. The logbook is maintained so that individual and cumulative costs of orders can be tracked to ensure that the delegated monthly limit is not exceeded. The monthly limit is the amount each cardholder may spend in a 30-day period and is established by the approving official based on anticipated usage and budgetary considerations. The monthly limit for the cardholders reviewed ranged from

$5,000 to $25,000. We found that cardholders did not maintain a logbook for 149 telephone purchases, valued at $121,126. We concluded that because cardholders did not follow purchase card procedures, there was an increased risk that the card could be used for personal use and that purchase limits could be exceeded.

Card Security

The Department's "Handbook" (Section X) states that purchase cards should be safeguarded in the same manner as cash. The Geological Survey's "Handbook" states that protecting the card from loss or theft is the responsibility of the cardholder. The Geological Survey's "Handbook" further states that the card should be kept in a safe place.

We found that 7 of 32 cardholders in our sample were not properly safeguarding their purchase cards in that they kept their cards in unlocked desk or file cabinet drawers. In addition, one cardholder posted the purchase card number on a bulletin board outside his work station. The lack of security over purchase cards increases the potential for cards to be lost, stolen, or used for inappropriate purposes.

Oversight Reviews

In accordance with the Geological Survey Manual, the Office of Acquisition and Federal Assistance and the Office's regional branches conduct reviews of purchase card transactions as part of the Office's small purchase reviews of regions and makes recommendations to the field offices regarding any deficiencies identified. The Eastern Region has 39 field offices. According to the Geological Survey Manual, reviews are to be conducted every 4 years. However, the Reston office has never been reviewed. Our examination of reviews that had been performed at eight field offices in the Eastern Region indicated that purchase card transactions were included in the reviews and that deficiencies such as the purchase of personal items, unauthorized purchases, split purchases, and the absence of a logbook were identified in the Purchase Card Program. Recommendations were made by the review team to address the deficiencies identified. Since the procedures used by the team for reviewing purchases were not documented, we could not determine whether the review team verified that approving officials were performing all of the required review procedures. Therefore, we were unable to determine whether the reviews were complete.

In conclusion, the Geological Survey was not adequately performing its oversight responsibilities of the Purchase Card Program. By not including the Reston office in its scheduled reviews and by not documenting the review procedures used, the Geological Survey was not ensuring that all cardholders and approving officials were complying with Departmental and Geological Survey requirements when using the purchase card. As a result, the Geological Survey could not ensure that all items purchased were for valid Government purposes.

Training

The Department's "Handbook" (Section VI) states: "All approving officials and cardholders must receive training on the use of the Governmentwide credit card program, its features, bureau procedures, and, as appropriate, small purchase procedures, upon or immediately following designation. In all cases, appropriate training must be received prior to cardholder receipt of the credit card."

The Geological Survey had not provided formal training to any of the cardholders or approving officials during the period of our review. However, Geological Survey personnel responsible for managing the Purchase Card Program stated that, in lieu of formal training courses, they relied on signed certifications from the cardholders stating that the cardholders had read the Geological Survey's "Handbook" and that they understood the requirements for the proper use of the purchase card. However, based on the deficiencies that we found, we believe that this method of training was not completely effective.

In February 1995, the Geological Survey developed a formal training course and presented it at two pilot sessions. In February 1996, the course, for which attendance was voluntary, was revised and presented at the Reston location, where it was attended by 2 of the 11 approving officials and 8 of the 32 cardholders included in our review. Since there were no outlines of the course contents or evaluations of the courses, we were unable to determine whether the training was adequate. Also, we believe that the training should be mandatory for all cardholders and approving officials.

Recommendations

We recommend that the Director, U.S. Geological Survey:

1. Ensure that approving officials follow the review procedures established by the Department and the Geological Survey when certifying cardholders' statements.

2. Ensure that cardholders comply with the purchase card policies and procedures concerning unauthorized purchases, split purchases, and telephone orders.

3. Ensure that purchase cards are adequately safeguarded.

4. Ensure that written procedures are developed for documenting the review of purchase card transactions and that the Geological Survey's Reston office is included in the schedule for these reviews.

5. Ensure that cardholders and approving officials receive adequate training in the proper use of the purchase card.

U.S. Geological Survey Response and Office of Inspector General Reply

In the January 8, 1998, response (Appendix 1) to our draft report from the Associate Director for Operations, the Geological Survey generally agreed with the finding and recommendations and provided suggested changes to the report, which we incorporated as appropriate. Based on the response, we consider Recommendations 1, 2, 4, and 5 resolved and implemented and request that the Geological Survey reconsider its response to Recommendation 3, which is unresolved (see Appendix 2).

Regarding Recommendation 3, the Geological Survey's "Handbook" instructs cardholders to keep their purchase cards in a safe place and not to allow others to use their cards. However, as stated in our report, we found that this requirement, which was in effect during our review, was not always complied with. Therefore, the Geological Survey should state what actions it is taking to ensure that cardholders are safeguarding their purchase cards and the purchase card account numbers. Specifically, we suggest that the Geological Survey issue a notice to all cardholders which states that purchase cards should not be kept in unlocked desks or file cabinets and that the purchase card account number should not be posted for public viewing. In addition, the safeguarding of purchase cards should be included in the Geological Survey's review of the purchase card program.

In accordance with the Departmental Manual (360 DM 5.3), we are requesting a written response to this report by April 15, 1998. The response should provide the information requested in Appendix 2.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, the monetary impact of audit findings, actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the assistance of Geological Survey personnel in the conduct of our survey.

United States Department of the Interior

U.S. GEOLOGICAL SURVEY
Office of the Director
Reston, Virginia 20192

In Reply Refer To:
Mail Stop 105
#10427

JAN 0 8 1998

MEMORANDUM

To: Assistant Inspector General for Audits

From: Barbara J. Ryan
Associate Director for Operations

Subject: Draft Survey Report on the Use of the Governmentwide Purchase Card, U.S. Geological Survey (Assignment No. E-IN-GSV-017-96)

This memorandum is in response to your November 25, 1997, draft audit report on the Use of the Governmentwide Purchase Card. Although we were provided the opportunity to comment on the Preliminary Draft, we have a few additional comments that were inadvertently missed.

> Page 10 (last paragraph): The investigation referred to was conducted in Doraville, Georgia, not Atlanta. We would also suggest that the Inspector General indicate that criminal prosecution of the employee ensued.
>
> Page 14 (section entitled "Oversight Reviews," paragraph one, sixth line): Change reference to field reviews occurring "every 2 to 3 years" to "every 4 years." Survey Manual Chapter 401.2.6.A.(1)(a) states, "Offices responsible for conducting Acquisition Management Review (AMR's) will ensure field offices under their cognizance are reviewed at least once every 4 years."

Any questions or comments concerning this issue may be addressed to Marty Eckes, Chief, Program Operations Office, on (703) 648-4430. Our responses to your recommendations are as follows:

Recommendation 1: Ensure that approving officials follow the review procedures established by the Department of the Interior (DOI), and the U.S. Geological Survey (USGS), when certifying cardholder's statements.

Response: Since the period covered by this review, the USGS Office of Acquisition and Federal Assistance (OAFA) has emphasized, through memoranda and in training sessions, the importance of the approving official's review and that this review is the primary safeguard against waste, fraud, and other misuse by cardholders. A memorandum dated March 27, 1997, was issued by OAFA reminding approving officials of their responsibility as a review official and of other rules governing card use. An e-mail message to all employees was sent on September 27, 1996, describing bankcard program problems and offered suggested methods of prevention, and again emphasized the importance of increased monitoring for management control. In addition to the above efforts to educate approving officials and emphasize their responsibilities, all records and transaction documentation are now subject to review via an AMR or a statistical sampling program.

Recommendation 2: Ensure that cardholders comply with the purchase card policies and procedures concerning unauthorized purchase, split purchases, and telephone orders.

Response: In addition to our AMR program for reviewing the practices at field offices, the USGS has implemented two additional bureauwide review and oversight processes. In September 1996, the USGS Office of Financial Management (OFM) began a statistical sampling program for all transactions in the Federal Financial System. Procedures for this review were set forth in an instructional memorandum. All cardholder statements, with supporting receipts and documentation, are subject to this review. This review includes an examination of <u>all</u> individual cardholder statements with monthly purchases of $10,000 or more, and the examination of randomly selected samples of cardholder statements below that threshold. This review follows a checklist to ensure that cardholders are not in violation of items including, but not limited to: use of the card for travel expenses, rental of land or buildings, telephone services, or cash advances; or that individual purchases were not split to avoid the $2,500 single purchase limit. Findings from the reviews are then communicated to division administrative officers for further action, as appropriate.

OAFA also conducts periodic reviews of transactions using the Cardholder Activity Report provided by the bank. This report is reviewed and transactions are manually selected based primarily on the dollar value, vendor used, and possible split requirements. To date, these reviews have revealed minimal problems with compliance, and where appropriate, further action was taken to remedy deficiencies.

Recommendation 3: Ensure that purchase cards are adequately safeguarded.

Response: The USGS Handbook instructs cardholders to protect the International Merchant Purchase Authorization Card (IMPAC) as they would their driver's license; to keep the card in a safe place, and not allow others to use their card. It also cautions users to keep the IMPAC card separate from their personal credit cards to avoid accidental misuse. To date, we have experienced very few instances of lost or stolen cards and believe these safeguards contribute to these results.

Recommendation 4: Ensure that written procedures are developed for documenting the review of purchase card transactions and that the USGS Reston office is included in the schedule for these reviews.

Response: The USGS has developed written instructions for the use, documentation, and oversight of the purchase card program. For example, Survey Manual chapter 403.7 entitled "Commercial Purchase Cards" contains bureauwide policy for management of the commercial purchase card program. The USGS Handbook outlines statement reconciliation responsibilities and documentation procedures. Cardholders are also warned that these records are subject to review at any time. Survey Manual Chapter 401.2 contains information on the Acquisition Management Review program, which includes the review of cardholder activity. Additional review programs implemented by the USGS are described in our response to Recommendation 2. The AMR program covers acquisition activities in field offices, which make purchases under a delegated procurement authority. The statistical sampling reviews and the cardholder activity report reviews cover all USGS cardholders, including those in Reston.

Recommendation 5: Ensure that cardholders and approving officials receive adequate training in the proper use of the purchase card.

Response: The USGS developed a formal training regimen as of February 1995. Since that time, OAFA has conducted numerous formal training sessions for cardholders and approving officials nationwide. There are additional classes scheduled for fiscal year 1998, at least one at each of the regional field offices. OAFA is also evaluating the development of an interactive training application that could be adapted throughout all USGS field locations in an effort to reach and train cardholders and approving officials in the more remote field offices.

In addition to the formal training program, training sessions are conducted by special request at field office sites. Also, during scheduled AMR field reviews, the reviewing official often arranges to conduct training for the cardholders at that location.

In an effort to enhance communication to cardholders and keep them appraised of program changes, OAFA has established an Intranet site for bankcard information. The Survey Manual chapter, the USGS Bankcard Handbook, frequently asked questions, reminders to cardholders, relevant memoranda or e-mail messages, and a variety of other useful information are maintained at this site. The Intranet site and the use of all employee e-mail messages are seen as an efficient method for making information available and notifying program participants of changes in the USGS Handbook instructions, restrictions, and other areas of concern.

STATUS OF SURVEY REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
1, 2, 4, and 5	Implemented.	No further action is required.
3	Unresolved.	Reconsider the response to indicate how assurance is provided that cardholders are safeguarding their purchase cards. Also, provide an action plan that includes target dates and titles of officials responsible for implementation.

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free Numbers:
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

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

AUDIT REPORT

PROGRAMS AND OPERATIONS, DEPARTMENT OF VOCATIONAL REHABILITATION, GOVERNMENT OF GUAM

REPORT NO. 98-I-335
MARCH 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAR 20 1998

MEMORANDUM

TO: The Secretary

FROM: Robert J. Williams
Acting Inspector General

SUBJECT SUMMARY: Final Audit Report for Your Information - "Programs and Operations, Department of Vocational Rehabilitation, Government of Guam" (No. 98-I-335)

Attached for your information is a copy of the subject final audit report. The objective of the review was to determine whether the Department of Vocational Rehabilitation carried out its responsibilities effectively in accordance with Title 17, Chapter 41, of the Guam Code Annotated and complied with applicable Federal laws and regulations for Federal programs.

We found that the Department did not manage its Federal programs in accordance with Federal regulations. Specifically, the Department provided services to ineligible clients and clients who were not periodically evaluated to support continuation, provided services not supported by medical recommendations, did not provide needed services in a timely manner, inappropriately used Federal funds instead of local funds, and did not charge personal services costs based on actual work load distribution. These conditions occurred because the Department did not have written procedures to ensure that clients were eligible to participate in the program and/or that their medical progress was evaluated, medical recommendations were complied with, and program costs were properly classified and charged to the benefiting program. As a result, the Department incurred questioned costs totaling $826,007 for program management and an additional $311,152 for personal services costs.

Based on the response from the Director of the Department of Integrated Services for Individuals with Disabilities (successor department to the Department of Vocational Rehabilitation), we requested additional information for the report's five recommendations.

If you have any questions concerning this matter, please contact me at (202) 208-5745.

Attachment

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAR 16 1998

The Honorable Carl T.C. Gutierrez
Governor of Guam
Office of the Governor
Agana, Guam 96910

Subject: Audit Report on Programs and Operations, Department of Vocational Rehabilitation, Government of Guam (No. 98-I-335)

Dear Governor Gutierrez:

This report presents the results of our review of programs and operations of the Department of Vocational Rehabilitation, Government of Guam. The objective of the review was to determine whether the Department: (1) carried out its responsibilities effectively, as specified by Title 17, Chapter 41, of the Guam Code Annotated, and (2) complied with applicable laws and regulations. Our review covered Federal and local program activities that occurred in fiscal years 1992, 1993, and 1994.

We found that the Department provided services to ineligible clients, provided services that were contrary to medical evaluations, did not provide timely services, and inappropriately used Federal grant funds instead of local funding. In addition, the Department incorrectly charged personal services costs to Federal grant programs. These conditions occurred because the Department did not have written procedures to ensure that: (1) clients were eligible to participate in the program and/or that their medical progress was evaluated; (2) medical recommendations were complied with; and (3) program costs were properly classified and charged to the benefiting program. As a result, we questioned costs of about $1 million charged to the Federal grants.

To correct the conditions noted, we recommended that you, as Governor of Guam, instruct the Departmental Director to: (1) develop and implement written procedures to ensure applicant eligibility and client progress evaluation; (2) comply with medical evaluations and recommendations for determining client services needed; (3) ensure that funding of local programs is not supplanted with Federal grant funding; and (4) charge program and personal services costs to the correct program.

On October 15, 1997, we transmitted a draft of this report to you, requesting your comments by November 21, 1997. On November 20, 1997, the Department of Integrated Services for Individuals with Disabilities (successor department to the Department of Vocational Rehabilitation) delivered its response (see Appendix 3) dated November 19, 1997, to our office. On December 10, 1997, we provided the Department with requested

information on the vocational rehabilitation cases and questioned costs discussed in the report. Based on the response, which generally concurred with the report's five recommendations, we requested additional information on all of the recommendations (see Appendix 4).

The Inspector General Act, Public Law 95-452, Section 5(a)(3), as amended, requires semiannual reporting to the U.S. Congress on all audit reports issued, the monetary impact of audit findings (Appendix 1), actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

In view of the above, please provide a response, as required by Public Law 97-357, to this report by April 3, 1998. The response should be addressed to our North Pacific Region, 238 Archbishop F.C. Flores Street, Suite 807; Pacific News Building; Agana, Guam 96910. The response should provide the information requested in Appendix 4.

We appreciate the assistance of the staff of the Department of Vocational Rehabilitation during the conduct of our audit.

Sincerely,

Robert J. Williams

Robert J. Williams
Acting Inspector General

cc: Director, Department of Integrated Services
for Individuals with Disabilities
Acting Director, Bureau of Budget and Management Research

CONTENTS

Page

INTRODUCTION 1

BACKGROUND 1
OBJECTIVE AND SCOPE 2
PRIOR AUDIT COVERAGE 2

FINDINGS AND RECOMMENDATIONS 4

A. PROGRAM MANAGEMENT 4
B. PERSONAL SERVICES COSTS 12

OTHER MATTERS 18

APPENDICES

1. CLASSIFICATION OF MONETARY AMOUNTS 20
2. PROGRAM COSTS AND QUESTIONED COSTS FOR FISCAL YEARS 1992, 1993, AND 1994 21
3. DEPARTMENT OF VOCATIONAL REHABILITATION RESPONSE TO THE DRAFT REPORT 25
4. STATUS OF AUDIT REPORT RECOMMENDATIONS 43

INTRODUCTION

BACKGROUND

The Rehabilitation Act of 1973 (U.S. Public Law 99-506, as amended) was enacted for the purpose of assisting persons with disabilities to maximize employment, economic self-sufficiency, independence, and integration into society through vocational rehabilitation programs, independent living centers and services, research, and training. In order to participate in the programs authorized by the Act, Guam was required to submit a state plan for vocational rehabilitation services that included the designation of a state agency as the entity to administer the plan. Guam submitted its state plan for fiscal years 1992 through 1994 on July 15, 1991.

The Department of Vocational Rehabilitation (the designated state agency) was established by Title 17, Chapter 41, of the Guam Code Annotated for the purpose of evaluating individuals' vocational rehabilitation potential, determining the nature and scope of services needed, and providing needed services to eligible applicants. Pursuant to Title 17, Sections 41103 and 41104, of the Code, the activities of the Department are under the overall supervision of a Director, who is advised by a Rehabilitation Advisory Council. The Council comprises seven individuals involved in vocational rehabilitation programs.

Under the Act, the Department administers four programs (Vocational Rehabilitation Services, Supported Employment Services, Independent Living Services for Older Blind Individuals, and Independent Living Rehabilitation Services) for which it receives Federal grant funds from the U.S. Department of Education. The Department also administers two locally funded programs: the Workshop Center and Independent Living Rehabilitation Services. For the six programs, the Department reported an average of 306 client cases annually and receipts and expenditures of about $2.8 million and $2.4 million, respectively, for fiscal year 1992; $3 million and $2.9 million, respectively, for fiscal year 1993; and $3.3 million and $1.9 million, respectively, for fiscal year 1994. (The receipts and expenditures are presented for each fiscal year in Appendix 2.)

In addition to the Guam Code Annotated, the Department is required, for Federal and related local programs, to comply with Title 34, Chapter III, Parts 361, 363, 365, and 367, of the Code of Federal Regulations and U.S. Office of Management and Budget Circular A-87, "Cost Principles for State and Local Governments." In June 1993, the grantor agency performed a review of the Department's operations and recommended that the Department's Regulations and Procedures Manual (dated October 1986) be completely revised because it was "outdated" and contained "vague and conflicting" material. However, the Manual had not been completely revised as of the time of our review.

OBJECTIVE AND SCOPE

The objective of our audit was to determine whether the Department (1) carried out its responsibilities in accordance with Title 17, Chapter 41, of the Guam Code Annotated and (2) complied with applicable Federal laws and regulations for Federal grant programs. The scope of the audit included a review of the Department's activities that occurred during fiscal years 1992 through 1994. Audit work was conducted at the Departments of Vocational Rehabilitation, Administration, and Law and at the offices of five rehabilitative services contractors. Our audit work included a review of accounting records, financial and program reports, participant files, and other supporting documentation.

The audit was conducted, as applicable, in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances.

As part of the audit, we evaluated the system of internal controls in the areas of program management, cost allocation, and procurement to the extent that we considered necessary to accomplish the audit objective. Significant internal control weaknesses were identified in the areas of program management and cost allocation. These weaknesses are discussed in the Findings and Recommendations section of this report. Our recommendations, if implemented, should improve the internal controls in these areas. Although no significant weaknesses were noted in the area of procurement, officials of the Department of Law and the Department of Administration's General Services Agency stated that the Client Authorization Form used by the Department of Vocational Rehabilitation was "not a valid procurement document" for obtaining supplies and services. After our review, the Director of Vocational Rehabilitation initiated action to conduct procurement activities by means of approved Government of Guam forms.

PRIOR AUDIT COVERAGE

During the past 5 years, neither the U.S. General Accounting Office nor the Office of Inspector General has issued any reports that evaluated the programs and operations of Guam's Department of Vocational Rehabilitation. However, an independent public accounting firm issued a single audit report on the Government of Guam for the fiscal year ended September 30, 1990. The report stated that (1) a written rehabilitation program was not prepared for one client; (2) financial assistance was not solicited from other sources; (3) eight clients did not acknowledge, by signature, the receipt of their individual written rehabilitation program; and (4) prior approval was not obtained from the grantor agency to purchase a capital asset. Based on our review, we determined that the Government's actions were sufficient to correct these deficiencies.

In addition, an independent public accounting firm issued single audit reports on the Department of Vocational Rehabilitation for the fiscal years ended September 30, 1991, and 1992. These reports stated that personal services costs were not charged to grants

appropriately. Further, the 1992 report stated that the financial status reports were not submitted timely and that the matching requirement for maintenance of effort was not maintained. Based on our review, we determined that the Department did not take sufficient action to correct these deficiencies. The single audit reports for fiscal years 1993, 1994, and 1995 did not have findings related to the areas included in the objective and scope of our current audit.

FINDINGS AND RECOMMENDATIONS

A. PROGRAM MANAGEMENT

The Department of Vocational Rehabilitation did not manage its Federal grant programs in accordance with the requirements of the Code of Federal Regulations. Specifically, the Department (1) provided services to clients who were ineligible and who had not been periodically evaluated to support continuation; (2) provided services that were not supported by medical recommendations; (3) did not provide needed services to clients in a timely manner; and (4) inappropriately used Federal funding instead of local funding. These conditions occurred because the Department had not developed and implemented procedures to address these issues. As a result, we questioned costs of $826,007 that the Department charged to the Federal program during the audit period.

Client Eligibility

Title 34, Chapter III, Section 363.3, of the Code of Federal Regulations states that an individual is eligible for the Supported Employment Program if "the individual has been determined to be an individual with the most severe disabilities." (Emphasis added.) In addition, Section 361.1 states that an individual has a severe handicap if the person is one "who has a severe physical or mental disability that seriously limits one or more functional capacities . . . in terms of employability." (Emphasis added.) Also, Section 361.40 states, "The State plan must assure that an individualized written rehabilitation program is initiated and periodically updated for each eligible individual." Finally, Section 363.11(g)(3)(ii) requires that the individualized written rehabilitation program provide for "periodic monitoring to ensure that each individual with severe disabilities is making satisfactory progress towards meeting the weekly work requirement established in the individualized written rehabilitation program."

Based on our review of 34 client case files, we determined that 7 clients were not eligible to participate in the Supported Employment Program and 2 additional clients were not eligible to continue to participate because the case files did not contain the required periodic evaluations supporting such continuation. As a result, for these nine clients, we questioned costs of $136,897 that were incurred during fiscal years 1992 through 1994. For example, one client's case file contained an evaluation by a vocational/psychological psychiatrist which concluded that the client was functioning at a "mildly retarded level" and was "happy" with his job at a fast food restaurant. Since the medical evaluation did not indicate that the client met program eligibility requirements for "severely handicapped" individuals, we determined that the client was not eligible to participate in the Supported Employment Program and questioned the related expenditures of $19,265 charged to the Program from May 1993 to September 1994.

In another example, the file for a client receiving job training from a rehabilitative service contractor contained contractor-prepared monthly progress reports. The report for February 1993 stated that the client was "ready to work at the private sector." Further, the file

contained the Vocational Rehabilitation Counselor's comment that the client did not need to continue job training and was "job ready." Although the documentation indicated that Program participation should have been discontinued, the Counselor extended the client's participation, and the client continued in the job training through September 1994. As a result, the Department incurred $21,729 in excess costs from March 1993 through September 1994.

Medical Evaluations/Vocational Rehabilitative Services

Title 34, Section 361.31(b), of the Code of Federal Regulations on eligibility requires "the presence of a physical or mental disability which for the individual constitutes or results in a substantial handicap to employment; and a reasonable expectation that vocational rehabilitation services may benefit the individual in terms of employability." Further, Title 17, Chapter 41, of the Guam Code Annotated states that the Department "shall, as a free public service, provide rehab [rehabilitation] services to qualifying handicapped individuals." Finally, Title 34, Section 361.33(a), of the Code of Federal Regulations states, "When an individual's eligibility for vocational rehabilitation has been determined, there is a thorough diagnostic study to determine the nature and scope of services needed by the individual."

Based on our review of the case files of 34 clients, we identified 8 clients who received services that were not supported by medical evaluations and/or received medical rather than vocational rehabilitation services and 14 clients for whom needed services were not provided timely. As a result, the Department incurred $67,479[1] of questioned costs and delayed providing needed vocational services to eligible persons. For example:

- A client had received hip replacement surgery based on an authorization by a Departmental Counselor, who was not a physician. However, the file contained a recommendation from the client's physician that an alternative medical procedure rather than a hip replacement should be performed. In addition, the file contained a report from the Department's Medical Consultant (a physician) which stated that "medical care was not part of vocational rehabilitation services" and recommended that the client be referred to the Medically Indigent Program or the Catastrophic Illness Assistance Program, both of which are administrated by the Department of Public Health and Social Services. The Counselor said that she authorized the surgery because the client was enrolled in the Independent Living Program and was therefore "entitled to receive services." The authorized costs for the hip replacement surgery were $24,000.

- A client was identified in June 1993 as having a behavioral problem. An assessment in the client's file stated, "If behavior is not modified, he [the client] would not succeed in his goal." However, the client was not approved for therapeutic sessions with a psychologist until June 1994, or 1-year later.

---

[1]We determined that the Department had incurred questioned costs of $85,278. However, to avoid duplicate reporting, this amount was reduced by $17,799, which had already been included as questioned costs in the section "Client Eligibility" in the finding.

Local Program Expenditures

Title 34, Section 361.86(b)(1), of the Code of Federal Regulations states:

> In fiscal year 1990 and each subsequent fiscal year, the Secretary reduces amounts otherwise payable to a State under this section for that fiscal year if the State's expenditures from non-Federal sources, . . . for the prior fiscal year, are less than . . . (2) the average of the State's total expenditures from non-Federal sources for the three fiscal years preceding that prior fiscal year. (Referred to as maintenance of effort.)[2]

The Department did not comply with the "maintenance of effort" requirement in that it used Federal grant funds rather than available local funds to support its Workshop Center Program. This occurred, according to the Acting Administrative Services Officer, because there was some "confusion" between the Officer's employees and the Vocational Rehabilitation Counselors on the proper use of Federal and local program funds. As a result, for fiscal years 1993 and 1994, the Department incurred a maintenance of effort deficiency of $621,631 for not maintaining local expenditures at the level required by the grantor. Specifically, the Department's budget submission to the Government of Guam for fiscal years 1993 and 1994 contained an impact statement for the Workshop Center Program to support its request for local funds, which it received. However, clients participating in the local program during this time period were paid with funds from the Federal Vocational Rehabilitation Services Program, with the locally appropriated funds reverting to the General Fund.

Title 34, Section 361.86(e)(1), of the Code of Federal Regulations states:

> The Secretary may waive or modify any requirement . . . if the Secretary determines that a waiver or modification of the State maintenance of effort requirement is necessary to permit the State to respond to uncontrollable circumstances, such as major natural disaster or a serious economic downturn.

On March 21, 1994, the U.S. Department of Education advised the Department of Vocational Rehabilitation that a maintenance of effort deficiency existed for fiscal year 1993 in the amount of $463,949. The Department requested that the U.S. Department of Education grant a waiver of the maintenance of effort requirement, as allowed by Section 361.86(e)(1). The U.S. Department of Education granted the waiver, because, according to the request, Guam had experienced "major natural disasters and serious economic downturn that have caused significant unanticipated expenditures and reduction in revenue." However, the Department did not disclose that local funding had been provided for the Workshop Center Program. If this information had been made available to U.S. Department of Education officials, we believe that the officials may not have approved the Department's request for a

---

[2]The Code of Federal Regulations (34 CFR 361.86) provides that Federal grant funds are subject to reduction if local governments do not maintain local program expenditures at the same level as in prior years, as determined by the U.S. Department of Education. This requirement is called "maintenance of effort."

waiver. Therefore, we questioned costs of $463,949 related to the maintenance of effort deficiency. Further, during fiscal year 1994, the Department charged an additional $157,682 to the same Federal program for clients certified for the same local program, which we also questioned.

We discussed these program management issues with a Rehabilitation Program Specialist at the U.S. Department of Education and with the Director of Vocational Rehabilitation. The Program Specialist said that Education's review of operations of the Department of Vocational Rehabilitation in 1992 found that the Department was not following medical recommendations and was providing medical services unrelated to vocational rehabilitation. The Director of Vocational Rehabilitation also agreed that Program funds were used for medical rather than vocational rehabilitation services and that clients were not provided services in a timely manner. This occurred, according to the Director, because the Department "did not have policies and procedures for the Vocational Rehabilitation Counselors and an effective monitoring system to ensure that vocational rehabilitation requirements were followed."

Recommendations

We recommend that the Governor of Guam instruct the Director of the Department of Integrated Services for Individuals with Disabilities[3] to:

1. Develop and implement written procedures which ensure compliance with the requirements of Title 34, Chapter III, of the Code of Federal Regulations and Title 4, Chapter 14, of the Guam Code Annotated related to the eligibility of clients, the eligibility of the types of services rendered to clients, and the maintenance of effort for programs that are locally funded.

2. Advise Region IX, U.S. Department of Education, of the questioned costs and either resolve the questioned costs or arrange for repayment.

Department of Vocational Rehabilitation Response and Office of Inspector General Reply

In the November 19, 1997, response (Appendix 3) to the draft report from the Director of the Department of Integrated Services for Individuals with Disabilities (formerly the Department of Vocational Rehabilitation), the Department generally concurred with the two recommendations and indicated that corrective action had been or would be taken. However, the Department provided additional comments that disagreed with certain aspects of our finding and reserved its position pending receipt of further data on

[3]The Department of Vocational Rehabilitation was reorganized as one of five divisions under the Department of Integrated Services for Individuals with Disabilities, which was created by Guam Public Law 24-16.

questioned costs. Based on the response, we are requesting additional information for the two recommendations (see Appendix 4).

Recommendation 1. Concurrence.

Department of Vocational Rehabilitation Response. The Department stated that it had developed a Policy and Procedures Manual for Vocational Rehabilitation Services which was implemented in January 1996 and that the "maintenance of effort for locally funded programs has been resolved" with the grantor agency.

Office of Inspector General Reply. We found that the Manual did not include procedures to ensure that the Department met maintenance of effort requirements for locally funded programs. Therefore, the Department needs to provide our office with a copy of policies and procedures developed to address the issue of maintenance of effort. Additionally, the Department did not provide documentation that the grantor agency was advised of and resolved the reported maintenance of effort deficiencies.

Recommendation 2. Concurrence.

Department of Vocational Rehabilitation Response. The Department stated that "upon final resolution to the draft audit report response," it would advise the grantor agency of any questioned costs and resolve them as appropriate.

Office of Inspector General Reply. On December 10, 1997, we provided the Department with information on the cases and questioned costs discussed in the finding, including client names, case numbers, time periods, and calculations of related questioned costs. The Department needs to provide our office with appropriate documentation showing that the grantor agency has been informed of the reported questioned costs for final disposition.

General Comments on Finding

In its response to the draft report, the Department provided comments that disagreed with certain aspects of the finding related to Recommendation 2. These comments and our replies are as follows:

Department of Vocational Rehabilitation Response. With regard to the section of the finding on "Client Eligibility," the Department stated that it "agree[d] that in order for an individual to be eligible to participate in the Supported Employment Program, such an individual must be determined to be an individual with the <u>most severe disability</u> and that his/her Individualized Written Rehabilitation Program (IWRP) provide for 'periodic' monitoring to ensure that the individual is making satisfactory progress towards meeting the weekly work requirement established in the IWRP." (Emphasis in original.) However, the Department further stated that it could not provide specific comments on the alleged

ineligible applicants and related questioned costs without information such as clients' names or case numbers to identify and verify the audit finding.

Office of Inspector General Reply. We provided the Department, on December 10, 1997, with information on the cases and questioned costs discussed in the finding, including client names, case numbers, time periods, and calculations of related questioned costs.

Department of Vocational Rehabilitation Response. Regarding the section in the finding entitled "Medical Evaluations/Vocational Rehabilitative Services," the Department stated that while it "agree[d] that medical evaluations play a major part in the assessment process for determining eligibility for VR [Vocational Rehabilitation] services," other evaluations must be taken into consideration and that "[t]his is the primary reason why VR Counselors, on certain circumstances, make decisions contrary to the Department's medical consultant's recommendations." Furthermore, under the informed choice provision of the Rehabilitation Act of 1973, as amended in 1992, the choice of services is made jointly by the client and the counselor. The Department also said it would "like to withhold" its position on the related questioned costs until it received information to identify and verify the specific cases cited in the finding.

Office of Inspector General Reply. We agree that Vocational Rehabilitation Counselors determine client eligibility for services, and, under the Rehabilitation Act of 1973, as amended, the choice of services is made jointly by the client and the Counselor. However, we believe that the Counselors should adequately support (document) their determinations and obtain approval for those determinations from their supervisors. During our audit, we found no documentation as to why the medical consultant's determinations, made on the basis of diagnostic studies performed in accordance with the requirements of Title 34, Section 361.33(a), of the Code of Federal Regulations, were not accepted.

Department of Vocational Rehabilitation Response. The Department said that a 1-year delay in approving vocational rehabilitation services "may have been too lengthy" but that "circumstances beyond the control of the counselor," such as the client being off-island or not being able to make the appointment, existed. The Department further stated that there were "no set timelines required by either federal or local laws" as to when vocational rehabilitation services should be provided to consumers. The Department also cited 34 CFR 361.41(b)(1), which provides a 60 calendar day time frame for making client eligibility determinations but allows longer time periods for "exceptional and unforeseen circumstances beyond the control of the agency" or when the agency "determines that an extended evaluation is necessary for an individual." The Department said it would state its position on client eligibility and medical evaluation/vocational rehabilitation services within 90 days upon the receipt of the information requested.

Office of Inspector General Reply. The citation from the Code of Federal Regulations pertains to client eligibility and is not applicable to the provision of services

to clients who have already been approved for participation in the Department's vocational rehabilitation programs. The 14 cases cited in the report were clients who had been determined to be eligible for Departmental services but who were delayed at least 1 year for approval of specific services. We believe that the clients should be reevaluated after a reasonable time period because the clients' situations may have changed in a manner that could have affected their eligibility or the type of vocational rehabilitation services needed.

Department of Vocational Rehabilitation Response. On the section of the finding entitled "Local Program Expenditures," the Department did not concur that it "utilized the maintenance of effort funds rather than available funds to support its Workshop Center Program," explaining that it met matching fund requirements through "local funds directly appropriated for the VR [Vocational Rehabilitation] program." The Department also stated that the Workshop Center (now called Goodwill) was a "locally funded program," with local funds appropriated "to train disabled individuals job skills so that they can go out to the work force." The Department further stated that although it "concurs that VR [Vocational Rehabilitation] federal funds were spent on consumers" who were at the Workshop Center, "these expenditures were for consumers who were sent to [the Workshop Center] for services such as vocational adjustment training, vocational evaluation and work evaluation."

Office of Inspector General Reply. In accordance with Federal guidelines, "matching fund requirements" and "maintenance of effort requirements" are common to Federally funded programs. A "matching fund requirement" (or "cost sharing") means that for each dollar provided to a program from Federal funds, the local government must provide a certain matching percentage (usually 10 to 25 percent) from local funds. A "maintenance of effort requirement" (or "level of effort") means that the local government must maintain the amount of local funding at no less than the same level as in prior years. If the local government reduces the level of local funding provided to support a program, a greater amount of Federal funds are required to maintain a program's operations at the same level as in prior years. The issue addressed in our finding is not whether Workshop Center clients were referred for vocational rehabilitation services but whether the Department maintained a constant "level of effort" in the Workshop Center. Our review disclosed that, for fiscal years 1993 and 1994, funds appropriated for the Workshop Center were not fully utilized and reverted to Guam's General Fund, thus reducing the "level of effort" funded by the local government.

Department of Vocational Rehabilitation Response. The Department stated that "confusion" concerning the maintenance of effort for the Workshop Center "was not regarding the proper use of funds," as stated in the report. Rather, according to the Department, "when the auditor learned of the numerous programs being charged for consumers at the Workshop Center," the question was posed "as to whether the appropriate account number was being indicated on the authorization form[s]" for services to clients. The Department further stated that it had changed its procedures "to ensure clarity in identifying the appropriate program to be charged."

Office of Inspector General Reply. When our auditor questioned the Department's employees concerning the source of funding for services provided to clients of the Workshop Center, there was some confusion on the part of the employees as to which accounts, Federal or local, should have been charged. Because the Department charged certain costs related to the locally funded Workshop Center to Federal grant accounts, the Department did not maintain the level of effort required by the Federal grant requirements.

Department of Vocational Rehabilitation Response. The Department did not concur with questioned costs of $463,949 and $157,682 related to maintenance of effort deficiencies in fiscal years 1993 and 1994, respectively. With regard to the questioned costs of $463,949 for fiscal year 1993, the Department stated: "The approval to the department's maintenance of effort waiver request was granted [by the grantor agency] for the justifications stated on the request. Whether or not the Federal officials were aware of the local appropriations for the Workshop Center is another matter." With regard to the questioned costs of $157,682 for fiscal year 1994, the Department stated that it used Federal Basic Support funds for consumers participating in the Workshop Center program for services such as vocational adjustment training, vocational evaluation, and work evaluation and that it "can only respond when provided specific caseload numbers or client's name."

Office of Inspector General Reply. We disagree with the Department's statement that "whether or not the Federal officials were aware of the local appropriations for the Workshop Center is another matter" because the grantor agency made its determination on the Department's waiver request without having all of the pertinent facts. Had the grantor agency known about the local funding that was provided for the Workshop Center but that later reverted to the General Fund, the grantor agency's decision may have been different. In our opinion, it is inappropriate to use Federal funds to supplant a locally funded program. Additionally, the Department's statement that the "1993 Basic Support grant was reduced by $199,321 . . . because [the Department] did not meet the criteria established for the granting of a waiver" supports our position that the maintenance of effort requirements were not met. Therefore, our audit findings should be considered by the grantor agency in its decision to approve or disapprove the Department's request for a maintenance of effort waiver. We provided the Department, on December 10, 1997, with information on the specific cases and our calculation of questioned costs discussed in the finding.

B. PERSONAL SERVICES COSTS

The Department of Vocational Rehabilitation did not charge personal services costs to Federal grants based on actual work load distribution. The requirements for determining the allowability of charges for personal services are contained in Office of Management and Budget Circular A-87. However, the Department did not have procedures which ensured that charges for personal services costs were made in accordance with the Federal requirements. As a result, we questioned personal services costs of $294,120 for fiscal years 1992 through 1994. We also questioned, for the same period, indirect costs of $17,032 that were applicable to the questioned direct costs, for total questioned costs of $311,152.

Employee Time Distribution

Circular A-87, Attachment B, Section B.10.b, states:

> Amounts charged to grant programs for personal services, regardless of whether treated as direct or indirect costs, will be based on payrolls documented and provided in accordance with generally accepted practice of the State, local, or Indian tribal government. Payrolls must be supported by time and attendance or equivalent records for individual employees. Salaries and wages of employees chargeable to more than one grant program or other cost objective will be supported by appropriate time distribution records. The method used should produce an equitable distribution of time and effort.

We reviewed all payroll records, together with supporting documentation, for fiscal years 1992, 1993, and 1994 and interviewed 20 of the Department's 34 employees to determine whether the Department had correctly charged personal services costs to Federal grant programs. We found that personal services costs had been incorrectly charged to the Federally funded Vocational Rehabilitation Services Program for all 3 fiscal years. Specifically:

- During fiscal year 1992, payroll documentation for 16 of the 20 employees reviewed showed that 100 percent of their time was charged to Rehabilitation Services. However, eight of the employees stated that they had worked on other programs. For example, one employee stated that she spent only 50 percent of her time working on Rehabilitation Services. Therefore, we questioned personal services costs of $11,463 (50 percent) that were charged to the grant for this employee. Based on our review, we determined that for fiscal year 1992, the Department improperly charged personal services

costs of $75,199[4] to Rehabilitation Services. We also questioned indirect costs of $7,377 ($75,199 multiplied by a 9.81 percent indirect cost rate) applicable to the questioned direct costs, for total questioned costs of $82,576 for fiscal year 1992.

- During fiscal year 1993, payroll documentation for 19 of the 20 employees showed that 100 percent of their time was charged to Rehabilitation Services. However, 13 of the employees stated that they had worked on other programs. For example, one employee stated that she spent 80 percent of her time working on Rehabilitation Services. Therefore, we questioned personal services costs of $6,630 (20 percent) charged to the grant for this employee. Based on our review, we determined that for fiscal year 1993, personal services costs of $93,715 were improperly charged to Rehabilitation Services. We also questioned indirect costs of $8,586 ($93,715 multiplied by a 9.14 percent indirect cost rate) applicable to the questioned direct costs, for total questioned costs of $102,281 for fiscal year 1993.

- During fiscal year 1994, payroll documentation for all 20 of the employees reviewed showed that 100 percent of their time was charged to Rehabilitation Services. However, 12 of the employees stated that they had worked on other programs. For example, one employee stated that she spent only 50 percent of her time working on Rehabilitation Services. Therefore, we questioned personal services costs of $13,482 (50 percent) charged to the grant for this employee. In addition, we found that an employee who was shown as spending 100 percent of her time working on Rehabilitation Services had not been at work because she had been in an accident. During her absence, the employee continued to be paid with grant funds. After the employee used all of her leave because of the accident, the Department continued to pay the employee and charge the costs to the grant. The employee subsequently retired. Therefore, we questioned personal services costs of $4,408 incurred while the employee was neither at work nor on approved leave. Also, the employee may not have been entitled to the payments while not on approved leave because Guam laws do not contain these entitlement provisions. Based on our review, we determined that for fiscal year 1994, the Department improperly charged personal services costs of $125,207 to Rehabilitation Services. We also questioned indirect costs of $1,089 ($125,207 multiplied by an 0.87 percent indirect cost rate) applicable to the questioned direct costs, for total questioned costs of $126,296 for fiscal year 1994.

In June 1993, officials from Region IX, U.S. Department of Education, conducted a program review and advised the Department of Vocational Rehabilitation to take appropriate action to ensure that all staff salaries, fringe benefits, and administrative costs were charged to the appropriate Federal or local programs. In response to that review, the Department, in July 1993, implemented a time distribution sheet for all employees to complete. However, the Department continued to improperly charge all personal services costs to the Vocational Rehabilitation Services Program. Departmental officials said that the Department's local

---

[4]To determine the amount of questioned personal services costs for each sampled employee, we determined the percentage of each employee's time that was related to Rehabilitation Services and applied that percentage to the total salary costs charged to the grant for each employee. We then combined the questioned costs for all of the sampled employees to arrive at the total questioned amount. The same procedure was used for fiscal years 1993 and 1994.

budget did not include personal services costs to administer local programs. Therefore, according to the officials, they did not charge personal services costs to local programs but rather to the Federal program.

Recommendations

We recommend that the Governor of Guam instruct the Director of the Department of Integrated Services for Individuals with Disabilities to:

1. Develop and implement written procedures which ensure that personal services costs are documented and charged to Federal grants in accordance with the requirements of U.S. Office of Management and Budget Circular A-87.

2. Advise Region IX, U.S. Department of Education, of the questioned costs and either resolve the questioned costs or arrange for repayment.

3. Request that the Guam Attorney General determine the propriety of the payments made to the employee who was neither at work nor on approved leave and, if the payments are determined to have been improper, determine whether the Department has a legal basis to seek recovery of the funds.

Department of Vocational Rehabilitation Response and Office of Inspector General Reply

In the November 19, 1997, response (Appendix 3) to the draft report from the Director, Department of Integrated Services for Individuals with Disabilities (formerly the Department of Vocational Rehabilitation), the Department generally concurred with all three recommendations and said that corrective action had been or would be taken. However, the Department provided additional comments that disagreed with certain aspects of our finding and reserved its position pending receipt of further data on questioned costs. Based on the response, we are requesting additional information for the three recommendations (see Appendix 4).

Recommendation 1. Concurrence.

Department of Vocational Rehabilitation Response. The Department stated that it had policies and procedures in place which became effective in fiscal year 1994. The Department further stated that because it was operating under a 3-year budget from fiscal years 1993-1995, no costs were allocated for salaries and benefits to be paid out of the local programs. However, the Department said that in its fiscal year 1996 budget submission, it requested that local funds be appropriated for salaries and benefits. The Department stated that its staff was currently using time records to report their time directly to the individual programs for which time is spent and that "only up to 10% of staff spend time on programs other than VR [vocational rehabilitation]."

Office of Inspector General Reply. During our audit, our review of employee time records for fiscal years 1992, 1993, and 1994 disclosed that personal services costs had been incorrectly charged to the Federally funded programs. In addition, the Department's response confirms our finding that charges were made to the grant programs for personal services costs that were outside the scope of the programs for fiscal years 1993 and 1994. The Department needs to provide our office with a copy of the policies and procedures for personal services costs that incorporate the use of time distribution records.

Recommendation 2. Concurrence.

Department of Vocational Rehabilitation Response. The Department said that it "will seek resolution to the questioned costs before forfeiting any federal dollars."

Office of Inspector General Reply. The Department needs to provide our office with appropriate documentation showing that the grantor agency has been informed of the reported questioned costs for final disposition.

Recommendation 3. Concurrence.

Department of Vocational Rehabilitation Response. The Department stated that it had conferred with the Attorney General's Office regarding the propriety of payments to the employee who was neither at work nor on leave and that it had "communicated" its response regarding the questioned personal services costs of $4,408 to the Attorney General's Office.

Office of Inspector General Reply. The Department needs to provide our office with a copy of the Attorney General's formal opinion on the propriety of the payments to the employee.

General Comments on Finding

In its November 19, 1997, response to the draft report, the Department provided comments that disagreed with certain aspects of the finding related to Recommendation 2. These comments and our replies are as follows:

Department of Vocational Rehabilitation Response. The Department said that it is "withholding" its position regarding specific questioned costs and requested names and "individual amounts for the 16 employees with alleged personal services costs improperly charged" to the Rehabilitation Services Program for fiscal years 1992, 1993, and 1994.

Office of Inspector General Reply. Based on the Department's response, we provided the Department, on December 10, 1997, with the requested employee names, time periods, and calculations of related questioned costs.

Department of Vocational Rehabilitation Response. The Department stated that, in fiscal year 1993, it had sought assistance from the Department of Administration to prepare a cost allocation plan for employees who worked for Federal grant programs other than the Vocational Rehabilitation Services Program. However, according to the response, the Department did not implement the cost allocation plan but instead charged all administrative expenses directly to the program for which services were rendered. The Department said that in fiscal year 1994, it developed a new time sheet and implemented policies for all employees to charge their time directly to the program for which time was spent. The Department stated that time sheets are currently "utilized on a daily basis for all employees to charge their time directly to the program of which their time is spent." The Department further stated that there was "not a problem as far as charging the other federal programs" but that "the problem was with the locally funded programs not having funds appropriated to capture administrative salaries and benefits." The Department said,"This was due to the department having to operate under a three-year budget."

Office of Inspector General Reply. We commend the Department for including salaries and wages in its local programs for fiscal year 1996 and subsequent years. However, we found that the Department did not take action to make adjustments to correct the salaries and wages that were not properly allocated between Federal and/or local programs during fiscal years 1992, 1993, and 1994. Therefore, the Department's records should be adjusted to reflect what should have been charged to each program prior to fiscal year 1996.

Department of Vocational Rehabilitation Response. The Department stated that it agreed that for fiscal years 1992 and 1994, one employee spent only 50 percent of her time working on the Vocational Rehabilitation Services Program, but it also stated that it had an agreement with the Social Security Administration for one employee to spend 50 percent of her time working on the Vocational Rehabilitation Services Program and the other 50 percent on Social Security's Disability Determination Services Program. Therefore, according to the Department, this employee's time was "captured accordingly." The Department also stated, regarding the eight employees who said they spent time on other programs during fiscal year 1992, that the grantor agency told the Department in fiscal year 1994 that "this was an audit exception." The Department said that it "immediately took action" to address this matter and that "this matter was corrected" with the approval of its budget in fiscal year 1996.

Office of Inspector General Reply: We took no exception to the personal services costs that were charged 50 percent to the Vocational Rehabilitation Services Program and 50 percent to Social Security's program for fiscal years 1993 and 1994. However, we found that the employee's time had not been allocated properly for fiscal year 1992; therefore, we took exception to those costs.

Department of Vocational Rehabilitation Response. Regarding the questioned indirect costs, the Department stated, "This allegation is ambiguous and would need further clarification to support the auditor's findings." The Department further stated that

the indirect cost "is captured against the program's expenditures" and that "[b]ased on the indirect cost rate for that year, the total is deducted and taken out at the end of the year. The Department further stated: "This is a function of the Department of Administration, Division of Accounts. The indirect cost that is captured is used to support only the external government agencies for their time spent on the program."

Office of Inspector General Reply. The Department's statement regarding the manner in which indirect costs are accounted for is correct. However, once direct salaries and wages are questioned, the corresponding indirect costs must also be questioned because indirect costs are based on a percentage of direct salaries and wages. Therefore, we applied the applicable indirect cost rate to questioned direct salaries and wages to derive the amount of indirect costs questioned.

Department of Vocational Rehabilitation Response. The Department stated that the employee who spent 100 percent of her time working on the Vocational Rehabilitation Services Program but who had not been to work because of an accident was given work assignments to be completed at home "for intermittent periods between June 1994 to August 1994, which terminated when the employee could no longer complete her tasks productively as a result of the injuries she received from the accident." The Department said that the employee was subsequently placed on leave status and "was loaned additional leave" from her coworkers and a relative once all her leave was used.

Office of Inspector General Reply. We questioned the employee's time that was charged to the program between the pay periods ending June 11 to August 6, 1994, because the employee was neither at work nor on approved leave during this period. Leave that was donated from her coworkers and a relative were for different time periods (from August 8 to November 25, 1994, and from February 20 to March 3, 1995). In addition, the Department provided no documentation to support that the employee performed work at home. Further, as a Developmental Disability aide, the employee's job duties included client interviews, job coaching and development, home visits, and client followup visits, none of which could have been performed by the employee from home. In addition, although not questioned, we believe that personal services costs charged to the Federal program while the employee was on donated leave may not have been proper because the donated leave was funded by local sources.

OTHER MATTERS

Title 34, Subpart D, Section 80.23(b), of the Code of Federal Regulations states, "A grantee must liquidate all obligations incurred under the award not later than 90 days after the end of the funding period." Of the 436 outstanding obligations, totaling $406,685, from the Department's encumbrance reports[5] for September 30, 1992, through September 30, 1994, we reviewed 11 obligations, valued at $111,864. We noted four instances, totaling $54,173 (all occurring in fiscal year 1992), in which the Department had incurred additional Vocational Rehabilitation Services Program costs for services that were not provided within the required 90-day liquidation period. For example, the Department entered into an interagency agreement with a local radio station to provide an outreach program for the Department. The funds for the agreement were obligated on September 30, 1992; however, services totaling $28,250 were not provided until 6 months later, or 3 months after the 90-day liquidation requirement.

A U.S. Department of Education official from Region IX told us that, although he had orally given the Department of Vocational Rehabilitation permission to carry unliquidated obligations beyond the 90-day requirement, he requested that this issue be mentioned in our audit report. We therefore suggest that the Department confer with Region IX officials regarding the carrying of unliquidated obligations beyond the 90-day requirement to determine whether subsequent payment of those obligations could be properly charged to the Federal funds.

Department of Vocational Rehabilitation Response and Office of Inspector General Reply

In the November 19, 1997, response (Appendix 3) to the draft report from the Director of the Department of Integrated Services for Individuals with Disabilities (formerly the Department of Vocational Rehabilitation), the Department included comments on this issue as follows:

Department of Vocational Rehabilitation Response. The Department stated that in fiscal year 1992, it had obtained approval from the U.S. Department of Education to carry unliquidated obligations beyond the 90-day requirement because of the nonreceipt of invoices from the various vendors who performed services but that in fiscal year 1993 and subsequent years, it had "carried over federal dollars into the subsequent year." As such, according to the Department, the funds were available for obligation for an additional year. The Department also stated that it had "gone without" any technical assistance regarding financial matters from Region IX, Rehabilitation Services Administration, for the past 5 years. Finally, the Department stated that in July 1997, its officials and those from Guam's Department of Administration met with U.S. Department

[5]The encumbrance reports listed amounts that were set aside to pay for unfilled purchase orders and contracts for goods and services.

of Education officials on revising Financial Status Reports dating as far back as fiscal year 1992. As a result of the meeting, the issue was corrected and the reports were restructured.

Office of Inspector General Reply. The Department did not provide documentation supporting the approval received from the U.S. Department of Education for the fiscal year 1992 carryover or provide documentation that this action was taken. The Department needs to provide the substantiating documents to our office.

CLASSIFICATION OF MONETARY AMOUNTS

Finding Areas	Questioned Costs		
	Federal Funds	Local Funds	Total
A. Program Management			
Client Eligibility	$121,813	$15,084	$136,897
Medical Evaluations	10,288	57,191	67,479
Local Program Expenditures	621,631		621,631
Subtotal	753,732	72,275	826,007
B. Personal Services Costs	233,364	77,788	311,152
Total	$987,096	$150,063	$1,137,159

PROGRAM COSTS AND QUESTIONED COSTS FOR FISCAL YEARS 1992, 1993, AND 1994

Programs	Receipts	Total Costs	Total Audited	Questioned Costs
Federal Funds:				
Vocational Rehabilitation Services	$5,248,109	$5,047,893	$1,975,368	$910,535
Supported Employment	130,310	83,786	76,565	76,561
Independent Living for the Older Blind	580,380	231,968	2,025	
Independent Living	59,057	43,944	230	
Subtotal - Federal Funds	$6,017,856	$5,407,591	$2,054,188	$987,096
Local Funds:				
Vocational Rehabilitation Services (Federal Program)	$1,820,910	$1,065,726	$204,736	$92,872
Workshop Center	586,418	541,289	229,711	30,375
Independent Living	556,925	84,296	30,002	26,816
Subtotal - Local Funds	$2,964,253	$1,691,311	$464,449	$150,063
Total	$8,982,109	$7,098,902	$2,518,637	$1,137,159

Program Costs and Questioned Costs for Fiscal Year 1992

Programs	Receipts	Total Costs	Total Audited	Questioned Costs
Federal Funds:				
Vocational Rehabilitation Services	$1,764,771	$1,687,508	$542,593	$86,248
Supported Employment	47,202	4,549		
Independent Living for the Older Blind	193,460	78,139		
Independent Living	17,750	8,000		
Subtotal - Federal Funds	$2,023,183	$1,778,196	$542,593	$86,248
Local Funds:				
Vocational Rehabilitation Services (Federal Program)	$449,647	$295,488	$106,970	$25,320
Workshop Center	289,418	289,418		
Independent Living				
Subtotal - Local Funds	$739,065	$584,906	$106,970	$25,320
Total	$2,762,248	$2,363,102	$649,563	$111,568

Program Costs and Questioned Costs for Fiscal Year 1993

Programs	Receipts	Total Costs	Total Audited	Questioned Costs
Federal Funds:				
Vocational Rehabilitation Services	$1,603,566	$2,026,754	$823,637	$559,133
Supported Employment	39,938	39,927	37,755	37,751
Independent Living for the Older Blind	193,460	67,997		
Independent Living	19,028	17,432	80	
Subtotal - Federal Funds	$1,855,992	$2,152,110	$861,472	$596,884
Local Funds:				
Vocational Rehabilitation Services (Federal Program)	$699,624	$589,902	$59,522	$31,728
Workshop Center	150,000	105,662	102,420	16,200
Independent Living	281,275	19,427	7,714	7,714
Subtotal - Local Funds	$1,130,899	$714,991	$169,656	$55,642
Total	$2,986,891	$2,867,101	$1,031,128	$652,526

Program Costs and Questioned Costs for Fiscal Year 1994

Programs	Receipts	Total Costs	Total Audited	Questioned Costs
Federal Funds:				
Vocational Rehabilitation Services	$1,879,772	$1,333,631	$609,138	$265,154
Supported Employment	43,170	39,310	38,810	38,810
Independent Living for the Older Blind	193,460	85,832	2,025	
Independent Living	22,279	18,512	150	
Subtotal - Federal Funds	$2,138,681	$1,477,285	$650,123	$303,964
Local Funds:				
Vocational Rehabilitation Services (Federal Program)	$671,639	$180,336	$38,244	$35,824
Workshop Center	147,000	146,209	127,291	14,175
Independent Living	275,650	64,869	22,288	19,102
Subtotal - Local Funds	$1,094,289	$391,414	$187,823	$69,101
Total	$3,232,970	$1,868,699	$837,946	$373,065

UFISINAN I MAGA'LAHI
TERITORION GUAM

NOV 20 1997

Mr. Peter Scharwark, Jr.
Senior Auditor
U.S. Department of Interior
North Pacific Region
238 Archbishop F.C. Flores Street, Suite 807
Pacific Daily News Building
Agana, Guam 96910

RECEIVED
NOV 20 1997
DS/016/NR

Re: Draft Audit Report on the Programs and Operations, Department of Vocational Rehabilitation (N-IN-GUA-005-94)

Pursuant to the subject matter, I am pleased to enclosed the Department of Integrated Services for Individuals with Disabilities (DISID) response to the findings and recommendations stated in the above referenced report.

Thank you for the opportunity to comment on the report.

Sincerely,

CARL T.C. GUTIERREZ

Enclosures

Post Office Box 2950, Agana, Guam 96910 • (671)472-8931 • Fax: (671)477-GUAM

November 19, 1997

MEMORANDUM:

TO: Director, Bureau of Budget and Management Research

ATTN: Chief Internal Auditor

FROM: Director, Department of Integrated Services for Individuals with Disabilities

SUBJECT: **RESPONSE TO THE INSPECTOR GENERAL'S DRAFT REPORT**

Hafa Adai!

This is a response to the October 1997 draft report of the Office of the Inspection General regarding the Department of Vocational Rehabilitation's, Government of Guam, federal and local activities that occurred in Fiscal Year 1992 through 1994.

Our response to the auditor's findings and the proposed recommendations in the draft report are as follows:

A. PROGRAM MANAGEMENT

1. Client Eligibility

Findings:

The Department provided services to seven (7) consumers who were ineligible to participate in the Supported Employment Program and two (2) additional consumers were not eligible to continue to participate because the case files did not contain the required periodic evaluations supporting such continuation. As a result, for these nine consumers, a questioned costs of **$136,897** were incurred during fiscal years 1992 through 1994.

Response:

Generally, we agree that in order for an individual to be eligible to participate in the Supported Employment Program, such an individual must be determined to be an individual with the most severe disability and that his/her Individualized Written Rehabilitation Program (IWRP) provide for "periodic" monitoring to ensure that the individual is making satisfactory progress towards meeting the weekly work requirement established in the IWRP.

However, we are not able to provide specific comment on the alleged ineligible applicants without specific information about their records such as caseload numbers or client's names so that we can accurately verify the audit findings. While the single audit conducted in FY 1992 has a list of caseload numbers, we found that they are not similar cases. Thus , we request that we be provided the caseload numbers or names of the nine consumers in order for us to review the case files of these consumers before we state our position regarding the questioned costs of **$136,897** incurred during FY 1992 through 1994. Additionally, we also need the caseload number or the name of the client whom the auditor determined was not eligible to participate in the Supported Employment Program and questioned the related expenditures of **$19,265** charged to the program from May 1993 to September 1994. As well, we also need the caseload number or the name of the client who was "Job Ready" but continued to received job training from February 1993 through September 1994. As a result, the Department incurred **$21,729** in excess costs.

Again, we would like to withhold our position regarding the above questioned costs of **$19,265** and **$21,729** until we obtain the information requested on two consumers.

2. **Medical Evaluation/Vocational Rehabilitation Services**

Findings:

The Department provided services that were not supported by medical

recommendations. As a result, the Department incurred **$64,479** of questioned costs and delayed providing needed vocational services to eligible persons. Also, a client received hip replacement contrary to the client's physician and department's medical consultant's recommendation. The hip replacement costs was **$24,000.** Another client who had a behavioral problem was not approved for therapeutic sessions with a psychologist until June 1994, or a one year delay.

Response:

We would like to withhold our positions, regarding the questioned costs of **$64,479** and **$24,000**, respectively, until we obtain additional information, such as the caseload numbers or names of the consumers identified in the findings to enable us to review and verify the alleged questioned costs.

While we do agree that medical evaluations play a major part in the assessment process for determining eligibility for VR services, there are other evaluations such as unique strengths, resources, priorities, interests and needs, including the need for Supported Employment that are also considered in making the determinations. This is the primary reason why VR Counselors, on certain circumstances, make decisions contrary to the Department's medical consultant's recommendations. Furthermore, under the informed choice provision of the Rehab Act of 1973, as amended in 1992, the choice of VR services is made jointly by the client and the VR Counselor.

Title 34, Section 361.42 of the Code of Federal Regulation (CFR) on eligibility specifies that this responsibility is vested in the State unit. Further, Chapter 4, page 154 of the updated VR Services Manual, assigns the VR Counselor the primary responsibility to make eligibility

determination.

On the issue of client receiving medical rather than vocational rehabilitation services, CFR, Title 34, Section 361.48, identifies "physical and mental restoration services as one of the VR services available to its clientele. Medical services are provided to reduce or

correct medical problems of consumers to enable to participate in VR programs without undue interruptions.

Findings:

The Department did not provide needed services to consumers in a timely manner. A client was identified in June 1993 as having a behavioral problem. However, the client was not approved for therapeutic sessions with a psychologist until June 1994, or a one year delay.

Response:

We agree that a one year delay in approving VR services in the IWRP may have been too lengthy. However, there are circumstances beyond the control of the counselor for such lengthy delays in the delivery of services. For example, the client may have been off-island or unavailable to make appointments, etc. It should be noted that with the exception of processing of applications, providing VR services to consumers has no set timelines required by either federal or local laws applicable to VR services.

Title 34, Section 361.41(b)(1) stated that "The State Plan must assure that once an individual has submitted an application for VR services, eligibility determination will be made within 60 calendar days unless --

(i) Exceptional and unforeseen circumstances beyond the control of the agency preclude a determination within 60 calendar days and the individual is so notified and agrees that an extension of time is warranted; or

(ii) The State unit determines that an extended evaluation is necessary for an individual.

We will state our positions on each of the above mentioned findings within 90 days upon the receipt of the information requested above.

3. Local Program Expenditures

Findings:

The department did not comply with the "maintenance of effort" requirement in that it used federal grant funds rather than available local funds to support its workshop center program.

Response:

The Department does not concur with the finding of which the department utilized the maintenance of effort funds rather than available funds to support its Workshop Center Program.

The Rehabilitation Act of 1973, as amended, requires that states provide matching funds for the VR program. State agencies may meet the required match using a combination of cash or in-kind contributions from state and local sources. Guam's matching funds for the Basic Support Program are local funds directly appropriated for the VR program.

A locally funded program titled Workshop Center funds was appropriated for "to train disabled individuals job skills so that

they can go out to the work force. There is no specific area of employment that this program is limited to. It is any type of job skill that a person with a disability can be trained to perform out in the employment market." These funds although titled "Workshop Center," was not the sole funding source for consumers who were undergoing services at the Workshop. Basic Support funds and the Independent Living local funds were also utilized concurrently for fiscal years 1992-1994 for consumers at Goodwill (Workshop Center). The counselors made the determination as to which program the consumers were eligible for in obtaining services. Each program had its own criteria for eligibility.

The department concurs that VR federal funds were spent on consumers who were at Goodwill (former Workshop Center). However, these expenditures were for consumers who were sent to Goodwill for services such as vocational adjustment training, vocational evaluation and work evaluation.

A total of $150,000 in fiscal year 1993 and $160,000 in fiscal year 1994 was appropriated for the Workshop Center Program. Both years funds were expended for the program with $30,658 and $871.00, consecutively, reverting back to the general fund at the close of the fiscal years. **(See Atch 1)**

The "confusion" was not regarding the proper use of funds, but at the time of inquiry, the confusion was when the auditor learned of the numerous programs being charged for consumers at the Workshop Center, also known as Goodwill. It was presumed that the sole source of funding was the account that held the title of Workshop Center. The secretaries for the counselors were then questioned as to why they were charging accounts other than the Workshop Center Program account. That posed the question as to whether the appropriate account number was being indicated on the authorization form. Their

response was that the account number was provided by the department's Fiscal Office. When questioned, the Acting ASO informed the auditor that the Counselor's secretaries did not decide which program to identify on the authorization form without the counselor informing them as to which program to charge.

This problem was corrected to ensure clarity in identifying the appropriate program to be charged. The current practice is for the counselor to identify the program by name, for which services are to be charged to. The program's title is then typed on the authorization form and forwarded to the Fiscal Office where the Accounting Technician types the coinciding account number onto the authorization form.

Furthermore, DVR was $199,321 short of matching the fiscal year 1992 maintenance of effort requirement. As a result, DVR's 1993 Basic Support grant was reduced by $199,321. DVR's request for a waiver was denied because it did not meet the criteria established for the granting of a waiver request. **(See Atch 2)**

Findings:

Questioned costs of $463,949 related to the maintenance of effort deficiency for fiscal year 1993.

Response:

The department does not concur with this finding. The approval to the department's maintenance of effort waiver request was granted for the justifications stated on the request. Whether or not the Federal officials were aware of the local appropriations for the Workshop Center is another matter. As mentioned earlier, the Basic Support federal dollars are matched

with direct cash appropriated from the general fund specifically for the program. The department fell short in meeting its MOE from local expenditures from the VR local matching funds and no other locally funded programs. **(See Atch 3)**

In response to the additional amount of $157,682 of questioned costs charged to the federal program for fiscal year 1994, for consumers certified for the same local program. The department utilized federal Basic Support funds for consumers participating in the Workshop Center Program for services such as vocational adjustment training, vocational evaluation and work evaluation. However, the department can only respond when provided specific caseload numbers or client's name, should there be a specific allegation as to the appropriateness of the service/s provided totaling this amount.

Recommendation:

1. Develop and implement written procedures which ensure compliance with the requirements of Title 34, Chapter III, of the Code of Federal Regulation and Title 4, Chapter 14, of the Guam Code Annotated related to the eligibility of consumers, the eligibility of types of services rendered to consumers, and the maintenance of effort for programs that are locally funded.

Response:

The Policy and Procedures Manual for VR services was developed and submitted through the local adjudication process and implemented in January 1996. **(See Atch 4)**

The maintenance of effort for locally funded programs has been resolved with RSA. This is discussed in detail under the "local program expenditure."

2. Advise Region IX, U.S. Department of Education, of the questioned costs and either resolve the questioned costs or arrange for payment.

Response:

Upon final resolution to the draft audit report response, we will advise RSA IX of any questioned costs, and resolve them, as appropriate.

B. Personal Service Costs

Findings:

The department withholds its position respectively, regarding the total questioned costs of $311,152 of direct and indirect costs for fiscal years 1992 through 1994.

The Department of Vocational Rehabilitation did not charge personal services costs to Federal grants based on actual work load distributions. As a result, a total of $311,152 of direct and indirect costs was questioned for fiscal years 1992 through 1994.

Response:

The department sought the assistance of the Department of Administration, Division of Accounts in fiscal year 1993, to prepare a cost allocation plan for the department's employee's who worked under a separate federal program, other than VR. At that time, a decision was made, that the department would not be implementing a cost allocation plan, but instead would charge all administrative expenses directly to the program from which services are rendered. In Fiscal year 1994, a new time sheet was developed and policies implemented for all employees to charge their time directly to the programs for which time is spent.

There was not a problem as far as charging the other federal programs. However, the problem was with the locally funded programs not having funds appropriated to capture administrative salaries and benefits. The department submitted requests to modify the existing local program accounts to accommodate these expenditures. There was no action taken, however, the department was advised by their Budget Analyst from the Bureau of Budget and Management Research, that the request for changes to the existing local appropriations would only be entertained during the submission of the department's next budget request to the Bureau and to the Legislature which was for fiscal year 1996. This was due to the department having to operate under a three-year budget, which was for fiscal years 1993 to 1995. As such, the department incorporated this request to appropriate funds in salaries and benefits in their fiscal year 1996 and all subsequent budget document submissions. Time sheets are utilized on a daily basis for all employees to charge their time directly to the program of which their time is spent. **(See Atch 5)**

Finding:

During fiscal year 1992, payroll documentation for 16 of the 20 employees reviewed showed that 100 percent of their time was charged to Rehabilitation Services. However, eight of the employees stated that they had worked on other programs. For example, one employee stated that she spent only 50 percent of her time working on Rehabilitation Services. Therefore, a questioned cost for personal services of $11,463 (50 percent) that was charged to the grant for this employee was identified. Based on the review, it was determined that the Department improperly charged personal services costs of $75,199 to Rehabilitation Services. In addition, the amount of $7,377 of indirect costs, applicable to the questioned direct costs, for a total of $82,576 for fiscal year 1992.

Response:

The department concurs with the finding that one employee spent only 50% of her time working on Rehabilitation Services. DVR has an agreement with the Social Security Administration for one employee to spend 50% of her time working on the VR services program and the other 50% of her time is spent on the Disability Determination Services Program, which is another 100% federally funded program under DVR's purview. This employee's time and salary are captured accordingly. VR funds are not used to pay for more than 50% of her salary. **(See Atch 6)**

As for the eight employees who stated that they spent their time on programs other than VR during fiscal year 1992. The department was advised in fiscal year 1994, by a representative of the RSA Region IX Grantor Agency Office, that this was an audit exception. The department immediately took action to address this concern. The delay for the corrective action was due to the department having to operate under a three-year budget from fiscal years 1993 to 1995. This matter was corrected in the approval of the department's budget request in fiscal year 1996. **(See attachment 5)**

We are withholding our position regarding the questioned costs of $75,199 charged to Rehabilitation Services. The department requests that specific names and the individual amounts for the 16 employees with alleged personal services costs improperly charged to the Rehabilitation Services program, be provided in order for the department to fairly respond to the individual allegations.

As for the questioned indirect costs of $7,377 for fiscal year 1992. This allegation is ambiguous and would need further clarification to support the auditor's findings. The department has no control of the amount of indirect costs taken out. The indirect cost is captured against the program's expenditures. Based on the indirect cost rate for that year, the total is deducted

and taken out at the end of the year. This is a function of the Department of Administration, Division of Accounts. The indirect cost that is captured is used to support **only** the external governmental agencies for their time spent on the program.

Finding:

During fiscal year 1993, payroll documentation for 19 of the 20 employees showed that 100 percent of their time was charged to Rehabilitation Services. However, 13 of the employees stated that they had worked on other programs. For example, one employee stated that she spent 80 percent of her time working on Rehabilitation Services. Therefore, there was a questioned personal services costs of $6,630 charged to the grant for this employee. For fiscal year 1993, it was determined that a total of $93,715 of personal services costs were improperly charged to Rehabilitation Services. The auditors also questioned indirect costs of $8,586 of indirect costs, for a total questioned costs of $102,281 for fiscal year 1993.

Response:

The department respectively withholds its position regarding the questioned personal services costs of $93,715. The department is requesting for the names of the 13 employees and the titles of the other programs worked. In addition, the department is requesting for the name of the employee alleged to have spent only 80 percent of her time working on Rehabilitation Services with a questioned personal services costs of $6,630 charged to the grant, in order to respond to these allegations.

As for the indirect costs of $8,586 in question, this questioned cost is ambiguous and the department requests further clarification to support the auditor's findings. The indirect cost is captured against the program's expenditures. The department has no control of the

amounts captured at the close of the fiscal year. This is a function of the Department of Administration, Division of Accounts. The indirect cost that is captured is used to support **only the external** governmental agencies for their time spent on the program.

Finding:

During fiscal year 1994, payroll documentation for all 20 employees showed that 100 percent of their time was charged to Rehabilitation Services. However, 12 of the employees stated that they had worked on other programs. For example, one employee stated that she spent only 50% of her time working on Rehabilitation Services, therefore a questionable cost of $13,482 was identified as been charged to the grant for this employee. Based on the review, a total of $125,207 was the alleged total of personal services costs improperly charged to the Rehabilitation Services program.

Response:

The department withholds its position regarding the 12 employees who stated that they had worked on other programs. The department is requesting for names and individual amounts which was used to determine the total questioned personal services costs in order to fairly support a qualified response to the individual allegations reasonably.

The department concurs with the finding that one employee spent only 50% of her time working on the Rehabilitation Services program. The department has an agreement with the Social Security Administration regarding this matter. This employee has a dual responsibility of 50% of her time spent and charged to the VR Basic Support Program and another 50% of her time is spent and charged to the Disability Determination Services Program which is 100% federally funded by the Department of Health and Human Services. **(See Atch 7)**

Finding:

Questioned personal services costs of $4,408 for the employee who was neither at work or on approved leave.

Response:

The employee mentioned as spending 100 percent of her time working on Rehabilitation Services yet had not been to work because of an accident, was given work assignments by her immediate supervisor, to be completed at home. This was only for intermittent periods between June 1994 to August 1994, which terminated when the employee could no longer complete her tasks productively as a result of the injuries she received from the accident. Subsequently, the employee was placed on leave status. When she exhausted all her annual and sick leave, she was loaned additional leave hours from other co-workers within the department who offered their leave via the Government of Guam leave sharing policies and procedures. Later, the employee's brother utilized his excess leave to carry her through till the effective date of her disability retirement. **(See Atch 8)**

Recommendation:

1. Develop and implement written procedures which ensure that personal services costs are documented and charged to Federal grants in accordance with the requirements of U.S. Office of Management and Budget circular A-87.

Response:

The department has policies and procedures in place which were made effective in fiscal year 1994. The problems encountered in the implementation process, was due to the three-year budget that the department was operating under, which did not

accommodate for salaries and benefits to be paid out of the local programs. As stated earlier, this was corrected in the submission of the fiscal year 1996 budget documents. The staff of the department are now utilizing time records to report their time directly to the individual programs for which time is spent. There are only up to 10% of staff who spend time on programs other than VR. **(See Atch 5)**

Recommendation:

2. Advise Region IX, U.S. Department of Education, of the questioned costs and either resolve the questioned costs or arrange for repayment.

Response:

The department will seek resolution to the questioned costs before forfeiting any federal dollars.

Recommendation:

3. Request that the Guam Attorney General determine the propriety of the payments made to the employee who was neither at work nor on approved leave and, if the payments are determined to have been improper, determine whether the Department has a legal basis to seek recovery of the funds.

Response:

The department has conferred with the Attorney General's Office concerning this matter. The department's response to the questioned personal services costs of $4,408 for this employee was also communicated to the AG's Office.

OTHER MATTERS (p. 11)

In regards to the obligations which incurred beyond the 90 days after the end of the funding period, the following explanation is provided:

In Fiscal Year 1992, the department did obtain approval from U.S. DOE to carry unliquidated obligations beyond the 90-day requirement due to non-receipt of invoices from the various vendors who performed services. However, in Fiscal Year 1993 and all subsequent years, the department had carried over federal dollars into the subsequent year. As such, the funds were available for obligation for an additional year. As far as the agreement between DVR and KGTF, the funds were obligated on September 30, 1992, however, payment was made in increments upon delivery of services. One of the delayed service was the production of the annual reports for the department. The department was not pleased with the draft reports and returned them to the vendor for additional information to be included. As such, payment was rendered when the final product was delivered to the department's satisfaction in accordance with the agreement.

The Department of Vocational Rehabilitation has gone without any technical assistance regarding financial matters from the USDOE/RSA Region IX Office for the past five years. The Financial Specialist position at Region IX was recently filled by Mr. Joe Pepin in February 1997.

Furthermore, in July 1997, Mr. Joseph Cameron, DVR Director, Rita Sotomayor, DVR Administrative Services Officer and Peter Aguon, Accountant, Department of Administration, Division of Accounts, met with Financial Specialists from the Central and Regional Offices of the U.S. DOE, Rehabilitation Services Administration, in Washington, D.C., to revise SF 269 Financial Status Reports dating as far back as fiscal year 1992. The department was advised that they were reporting the match incorrectly and instead had been overmatching the federal grant dollars in addition to being penalized for not meeting the maintenance of effort. These issues were corrected and the reports restructured. **(See Atch 9)**

In conclusion, we would like to express our appreciation for the opportunity to respond to the draft audit report.

Those issues needing further clarification will be responded to within 90 days from receipt of the information. Mr. Albert T. San Agustine, Acting VR Administrator, for the Division of Vocational Rehabilitation, will be responsible for ensuring that implementation and action is completed in a timely manner.

Please feel free to contact Mr. San Agustine at (671) 475-4636/7, if you have any questions or if you would like to discuss the response further.

Joseph Artero-Cameron

JOSEPH ARTERO-CAMERON
Director

9 Attachments
as stated

[ATTACHMENTS NOT INCLUDED BY OFFICE OF INSPECTOR GENERAL.]

STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
A.1	Management concurs; additional information needed.	Provide a copy of the policy and procedures relating to the maintenance of effort and of grantor agency resolution of the maintenance of effort deficiencies for locally funded programs.
A.2 and B.2	Management concurs; additional information needed.	Provide documentation that Region IX, U.S. Department of Education, has been advised of the questioned costs and the target date to either resolve the questioned costs or arrange for repayment.
B.1	Management concurs; additional information needed.	Provide a copy of policy and procedures relating to personal services costs.
B.3	Management concurs; additional information needed.	Provide a copy of the Guam Attorney General's opinion regarding payments made to the employee who was neither at work nor on approved leave.

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

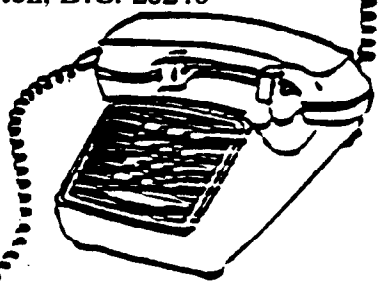
(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free Numbers:
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240



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

AUDIT REPORT

GENERAL CONTROLS OVER THE AUTOMATED INFORMATION SYSTEM, ROYALTY MANAGEMENT PROGRAM, MINERALS MANAGEMENT SERVICE

REPORT NO. 98-I-336
MARCH 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAR 24 1998

MEMORANDUM

TO: The Secretary

FROM: Robert J. Williams
Acting Inspector General

SUBJECT SUMMARY: Final Audit Report for Your Information - "General Controls Over the Automated Information System, Royalty Management Program, Minerals Management Service" (No. 98-I-336)

Attached for your information is a copy of the subject final audit report. The objective of our audit was to evaluate the adequacy of the general controls over the Minerals Management Service Royalty Management Program's automated information system in the areas of security program development, physical and logical access, software development and change management, separation of duties, system software, and service continuity.

We found that the Royalty Management Program had established general controls over its automated information system; however, except for the controls over physical access to the automated information system, we concluded that the general controls were not adequate in the six major areas reviewed. Specifically, the Program did not identify and address all risks affecting proprietary and financial data in the automated information system, have adequate security-related personnel policies and procedures, and have security awareness statements on file for all employees who used the automated information system; have adequate logical access controls in the areas of resource classification, default settings, commercial off-the-shelf software access controls, access levels granted to users, and numbers of allowed log-in attempts; have controls to ensure that client/server application software changes were authorized, approved, and tested before being moved into production; separate the duties of the client/server application programmers from the duties of the users and separate the duties of client/server security administrators from reviewers; use mainframe security software that was supported by the vendor and use available mainframe computer system audit tools to ensure integrity over system processing and data; and include local area networks and personal computers which maintain proprietary and financial data in the Program's disaster recovery plans. We made 24 recommendations to improve the general controls over the Program's automated information system.

Based on the response to the draft report from the Director, Minerals Management Service, we deleted one recommendation and revised one recommendation. Also, based on the

response, we considered 1 recommendation resolved and implemented and 12 recommendations unresolved, and we requested additional information for 10 recommendations.

If you have any questions concerning this matter, please contact me at (202) 208-5745.

Attachment

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAR 23 1998

AUDIT REPORT

Memorandum

To: Director, Minerals Management Service

From: Robert J. Williams
Acting Inspector General

Subject: Audit Report on General Controls Over the Automated Information System, Royalty Management Program, Minerals Management Service (No. 98-I-336)

INTRODUCTION

This report presents the results of our audit of the general controls over the automated information system at the Minerals Management Service's Royalty Management Program. We performed this audit to support our audit of the Service's financial statements, which is required by the Chief Financial Officers Act. The objective of this audit was to evaluate the adequacy of the general controls over the Program's automated information system in the areas of security program development, physical and logical access, software development and change management, separation of duties, system software, and service continuity.[1]

BACKGROUND

The Minerals Management Service's Royalty Management Program is responsible for collecting and disbursing revenues of about $4 billion annually that are generated from leasing Federal and Indian lands and for collecting royalties for minerals extracted from leased lands. To aid in accomplishing its mission objectives and meeting its financial reporting requirements, the Program uses an automated information system that includes a mainframe computer, a minicomputer, and personal computers and servers which support local area networks for each Program division, a wide area network, and an enterprisewide

[1]Logical access refers to controls that provide a technical means of controlling what information users can utilize, the programs they can run, and the modifications they can make. (An Introduction to Computer Security: The NIST Handbook, Special Publication 800-12, National Institute of Standards and Technology.)

network.[2] For collecting rents and royalties, the Program primarily uses the mainframe computer. For disbursing rents and royalties, verifying collections, and reporting financial information, the Program uses all of the components of its automated information system.

The Program's mainframe computer, minicomputer, and some of the personal computers and servers are located in three buildings at the Denver Federal Center, in Denver, Colorado. The Program also has personal computers and servers located in leased buildings in Golden, Colorado, and at Program division offices in Dallas and Houston, Texas.

Since 1992, Program management has been planning, developing, and moving to a "client/server" processing environment.[3] In a client/server environment, data are more difficult to protect. Specifically, the data are stored and processed in multiple locations, and the data must travel through telecommunication systems between the clients and the servers where the data are inherently susceptible to being released to unauthorized outside parties, lost, or damaged. Additionally, the Program's data are "proprietary"; therefore, if access to the data is denied or if the data are inappropriately released, lost, or damaged, the Program, suppliers of the data, or others having an interest in the data could be adversely impacted.

The Program's automated information system was operated and maintained by the contractor American Management Systems Operations Corporation. The contract with the Corporation requires the Corporation to: (1) maintain system software; (2) maintain and develop application software; and (3) maintain other software, such as teleprocessing and general utilities.

Overall system security policies for the Program are established by the Installation Automated Information System Security Officer, within the Program's Systems Management Division. System security administration for the mainframe computer, the minicomputer, the wide area network, and the enterprisewide network is the responsibility of the Corporation. Security administration for the Program's local area networks is the responsibility of each of the Program's seven divisions, which consist of the Accounting and Reports Division, the Royalty Valuation Division, the Systems Management Division, the State and Indian Compliance Division, and the Compliance Divisions at Dallas and Houston and Lakewood, Colorado.

---

[2]Servers are computers that provide services to client computers on a network. Local area networks are communication networks located in a small geographical area which connect many computerized input/output devices, generally server computers, client computers, and peripheral hardware such as printers, through low-cost communication mediums. These networks typically do not use common carrier circuits, such as U.S. West, and their circuits do not cross public thoroughfares or property owned by others. Wide area networks span large geographical areas and typically use circuits provided by common carriers. Enterprisewide networks are networks that result when all the networks in a single organization are connected together. (Jerry Fitzgerald and Alan Dennis, Business Data Communications and Networking, 5th edition, John Wiley & Sons, Inc., 1996, pps. 249, 522, 529, 542, and 549.)

[3]A "client/server" processing environment is a computerized architecture in which one or more "computers called servers manage shared resources and provide access to those shared resources as a service to their clients," which are personal computers. (David Vaskevitch, Client /Server Strategies, a Survival Guide for Corporate Reengineering, IDG Books Worldwide, Inc., San Mateo, California, 1993, page 96.)

SCOPE OF AUDIT

To accomplish our objective, we reviewed the general controls that were in place during January through June 1997. Specifically, we reviewed the controls in six major areas: security program development; logical and physical access; software development and change management; separation of duties; system software; and service continuity. We interviewed Program and contractor personnel, reviewed systems documentation, observed and became familiar with computer center operations and network components, analyzed system security, and evaluated service continuity procedures and testing. In addition, we reviewed procedures to maintain system and application software for the mainframe computer, the local area networks, the wide area network, and the enterprisewide network. Because our review was limited to evaluating the adequacy of general controls over the automated information system, we did not evaluate the effectiveness of manual control procedures that may have operated as compensating controls for the automated information system general controls. While our objective was to review the general controls of the automated information system, the primary emphasis was on the servers that supported data processed and maintained on the local area, wide area, and enterprisewide networks.

Our audit, which was conducted during December 1996 through August 1997 at the Program's facilities in Denver and Golden, was made in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances.

As part of our audit, we evaluated the internal controls that could adversely affect the Program's automated information system. The control weaknesses that we found are summarized in the Results of Audit section and discussed in detail in Appendix 1 to this report. If implemented, our recommendations should improve the internal controls in the areas reviewed. Because of inherent limitations in any system of internal controls, losses, noncompliance, or misstatements may occur and not be detected. We also caution that projecting our evaluations to future periods is subject to the risk that controls or the degree of compliance with the controls may diminish.

PRIOR AUDIT COVERAGE

During the past 5 years, the General Accounting Office has not issued any reports related to the objective and scope of this audit. However, in July 1997, the Office of Inspector General issued the report "Royalty Management Program's Automated Information Systems, Minerals Management Service" (No. 97-I-1042), which identified weaknesses in mainframe application software development and change management. During our current audit, we noted that Program management had agreed with the seven recommendations made in our prior audit report and that two of the seven recommendations had been implemented. One of the implemented recommendations and three of the recommendations that were resolved but not implemented affected the change request process (change management), which is discussed in the scope of this audit. We further noted that implementation of the three

recommendations was delayed because of the priority of implementing the changes mandated by the Federal Oil and Gas Royalty Simplification and Fairness Act of 1996.

RESULTS OF AUDIT

The Royalty Management Program had established general controls over its automated information system; however, except for the controls over physical access to the automated information system, we concluded that the general controls were not adequate in the six major areas reviewed. Office of Management and Budget Circular A-130, "Management of Federal Information Resources," and National Institute of Standards and Technology publications require Federal agencies to establish and implement computer security and management and internal controls to improve the protection of sensitive information in the computer systems of executive branch agencies.[4] Additionally, the Congress enacted laws, such as the Privacy Act of 1974 and the Computer Security Act of 1987, to improve the security and privacy of sensitive information in computer systems by requiring executive branch agencies to ensure that the level of computer security and controls over the sensitive information is adequate. Further, the Department of the Interior and the Program have issued policies and procedures to implement general controls to protect sensitive data in automated information systems. The controls were not adequate because Program management had not established necessary policies and procedures, had not assigned responsibilities for ensuring that policies and procedures were developed and followed, and had not held officials accountable for noncompliance with the established controls. The lack of adequate controls increased the risk of (1) unauthorized access and modifications to and disclosure of Program data, (2) theft or destruction of Program software and sensitive information, and (3) loss of critical Program systems and functions in the event of a disaster or system failure.

Overall, we identified 13 weaknesses and made 23 recommendations for improving the general controls over the Program's automated information system. A summary of the weaknesses noted in the six major areas is provided in the following paragraphs, and specific details of the weaknesses and our respective recommendations to correct these weaknesses are in Appendix 1.

Security Program Development

We found weaknesses in the automated information system security program. Specifically, Program management did not identify and address all risks affecting proprietary and financial data in the automated information system, did not have adequate security-related personnel policies and procedures, and did not have security awareness statements on file for all employees who used the automated information system. As a result, there was an increased risk that sensitive data may be impaired or compromised by individuals and that data may be inadvertently disclosed or destroyed or erroneously modified. We made seven recommendations to address these weaknesses.

[4]The Computer Security Act defines "sensitive" data as "any information the loss, misuse, or unauthorized access to or modification of which could adversely affect the national interest or the conduct of Federal programs, or the privacy to which individuals are entitled under the Privacy Act."

Access Controls

We found weaknesses in logical access controls over the Program's automated information system. These weaknesses were in the areas of resource classification, default settings, commercial off-the-shelf software access controls, access levels granted to users, and numbers of allowed log-in attempts. As a result, there was an increased risk that sensitive data maintained on the automated information system were vulnerable to unauthorized access, manipulation, and disclosure. We made eight recommendations to address these weaknesses.

Software Development and Change Management

We found that the controls over changes to client/server application software were not adequate. Specifically, Program management did not have controls to ensure that client/server application software changes were authorized, approved, and tested before being moved into production. As a result, there was an increased risk that the most critical client/server application software changes were not made and that client/server applications would not perform as intended. We made one recommendation to address this weakness.

Separation of Duties

We found that Program management did not separate the duties of the client/server application programmers from the duties of the users and did not separate the duties of client/server security administrators from reviewers. As a result, there was an increased risk that accidental or intentional actions by programmers could threaten the integrity of the Program's data and disrupt system processing and that inappropriate actions by security administrators would not be detected or detected timely. We made two recommendations to address these weaknesses.

System Software Controls

We found that the controls over system software were not adequate in detecting and determining inappropriate use. Specifically, the security software in use for the mainframe computer was no longer supported by the vendor, and available mainframe computer system audit tools to ensure integrity over system processing and data were not used. As a result, there was an increased risk that programs and data files would not be protected from unauthorized access and that inappropriate mainframe computer system initialization and processing would not be recorded and identified. Additionally, without periodic reviews of the system audit trails, there was an increased risk that processing problems or unauthorized activities may not be detected or detected timely and that the responsible individual or individuals may not be held accountable for the inappropriate action. We made four recommendations to address these weaknesses.

Service Continuity

We found that local area networks and personal computers used by the Program's divisions which maintain proprietary and financial data were not included in the Program's disaster recovery plans. As a result, there was an increased risk that critical systems may not be recovered in the event of a disaster or system failure. We made one recommendation to address this weakness.

Minerals Management Service Response and Office of Inspector General Reply

In the January 21, 1998, response (Appendix 2) from the Director, Minerals Management Service, to our draft report, the Service stated that of the report's 24 recommendations, it "agree[d]" with 11 recommendations, "partially agree[d]" with 2 recommendations, and "disagree[d]" with 11 recommendations. Based on the response, we deleted one recommendation (No. F.3) and revised one recommendation (No. I.1) in the draft report. Also based on the response, we consider 1 recommendation resolved and implemented and 12 recommendations unresolved, and we request additional information for 10 recommendations. The status of each recommendation is in Appendix 3, and the Service's responses to the recommendations and our comments are presented within each finding.

Additional Comments on Audit Report

The Service said that it "disagree[d]" with the overall "implicit conclusion" that the Royalty Management Program's automated information system was not in compliance with Office of Management and Budget Circular A-130 and that it believes that it is in "substantial compliance with the spirit and intent" of the Circular. Further, the Service stated that the audit report "does not actually deal with the overall or general controls" because we did not review redundant and compensating controls. In addition, the Service stated that "recurring management control reviews have addressed such manual controls and generally found they were working effectively or prompted corrective actions to resolve minor control deficiencies." Further, the Service stated that "audits performed under the Chief Financial Officers Act of 1990 have covered these controls, and each report concluded that our financial information was reliable."

The criteria we used included not only Office of Management and Budget Circular A-130 but also standards and guidelines referenced in the Circular from the Department of Commerce (National Institute of Standards and Technology), the General Services Administration, and the Office of Personnel Management and policies and procedures of the Department and the Program. Since the controls cited in and referenced by Appendix III of Circular A-130 are "a minimum set of controls" to be included in an agency's automated information security program, we believe that any deviation from these minimum controls would indicate that an agency's automated information system security program does not reduce risk to an acceptable level and ensure that an agency is in compliance with the Circular. However, since our review identified weaknesses in the general controls over the

automated information system in the areas of security program development, access controls, software development and change management, separation of duties, system software controls, and service continuity, we do not believe that the Service's "substantial compliance" with the minimum controls set forth in the Circular was adequate to address the potential risks identified by our review.

While we stated that we did not evaluate the effectiveness of manual control procedures which may have operated as compensating controls in the scope section of the report, the audit staff did evaluate the general controls that were defined in the Program's policies and procedures. Because redundant or compensating controls were not cited by the Program in its policies and procedures as the primary controls used to ensure the integrity, confidentiality, and availability of Program information, these controls were not evaluated.

During the audit, we reviewed an Automated Information Systems Review that the Service performed in fiscal year 1996 which concentrated on the Program's change management controls over applications in the mainframe environment. The Service's review identified weaknesses concerning application testing and documentation that we also cited in the Prior Audit section of this report. Further, we found similar weaknesses in software development and change management controls in the client/server environment (see Finding I in Appendix 1.)

While we are not questioning that the financial statements were presented fairly, we found, as a result of our evaluation, inadequacies in the Program's general controls over the automated information system in the areas of security program development, access controls, software development and change management, separation of duties, system software controls, and service continuity. These weaknesses, identified with the general controls, will result in our having to raise the overall level of risk of possible loss associated with the internal control structure of the Royalty Management Program in future financial statement audits.

Regarding system security, we agree that system security controls implemented should be measured against costs and risks. However, the Program did not provide evidence that such a measurement study was performed. Further, our findings identified breakdowns in existing controls cited in the Program's policies and procedures. While no system is completely free of errors, an adequate security program would provide a foundation for the Service to determine what controls were operating effectively and the level of risk that the Service is mitigating with these controls.

We disagree that the Program is being held to "unattainable standards" because the standards we used were those cited in Appendix III of Circular A-130 as "the minimum set of controls" to be included in an agency's automated information security program. In addition, in our evaluation of the Program's general controls as defined in its policies and procedures, we found that the controls were not operating effectively.

We disagree with the Service's statement that our findings did not demonstrate a "single negative impact" because the impact of these inadequacies taken as a whole indicates that there is no assurance that the overall risk to the Program was at an acceptable level.

In accordance with the Departmental Manual (360 DM 5.3), we are requesting a written response to this report by April 17, 1998. The response should provide the information requested in Appendix 3.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the assistance of Minerals Management Service personnel in the conduct of our audit.

DETAILS OF WEAKNESSES AND RECOMMENDATIONS

SECURITY PROGRAM

A. Risk Assessments

Condition: Risk assessments of the Royalty Management Program's automated information system did not identify and address all risks affecting proprietary and financial data in the automated information system or correctly assess some of the risk elements. For example, we found that Program management did not:

- Identify and address the impact that (1) converting to the year 2000 would have on application processing, (2) using system security software which is no longer supported by the vendor could have on operations, and (3) having royalty and financial information on local area network applications and personal computer databases could have on operations.

- Correctly assess the risk for the "Geopolitical" and "External Directives" elements, which were assessed as low risk. Significant geopolitical and external directives, such as the possible abolishment of the Program and the enactment of the Federal Oil and Gas Royalty Simplification and Fairness Act, have impacted the Program during the past 2 years. We believe that the level of risk associated with these elements was such that it increased the potential for lowering employee morale and thus increased the risk of sabotage or breach of other physical security measures, as well as the possibility of data errors and omissions that affect data and system integrity.

Criteria: Office of Management and Budget Circular A-130, Appendix III, "Security of Federal Automated Information Resources," states that adequate security "includes assuring that systems and applications used by the agency operate effectively and provide appropriate confidentiality, integrity, and availability, through the use of cost-effective management, personnel, operational, and technical controls." The Circular further states that, although formal risk analyses need not be performed, "the need to determine adequate security will require that a risk-based approach be used." According to the Circular, "This risk assessment approach should include a consideration of the major factors in risk management: the value of the system or application, threats, vulnerabilities, and the effectiveness of current or proposed safeguards." Also, the National Institute of Standards and Technology's "An Introduction to Computer Security: The NIST Handbook" provides guidance on computer security risk management. The NIST Handbook specifically addresses the

SECURITY PROGRAM

selection of safeguards to mitigate risk and the acceptance of residual risk. In addition, Program policy requires that local area network administrators participate in the risk assessment process.

Cause: Program management did not ensure that risk assessments were performed in accordance with risk management guidelines. Specifically, the assessments did not address (1) all risks associated with its automated information system, (2) the selection of safeguards to mitigate risks, and (3) the acceptance of residual risk. In addition, Program management did not effectively communicate the responsibility of local area network administrators to participate in risk assessments and had not adequately addressed that local area network applications and personal computer databases should be included in the Program's security program.

Effect: Without identifying all significant threats and vulnerabilities to the automated information system, Program management was unable to determine the most appropriate measures needed to protect against threats or reduce the vulnerabilities. Further, without including the Program's local area network applications and personal computer databases as part of the risk assessments, there was little assurance that all threats and vulnerabilities were identified and considered when Program security policies and plans were developed. Therefore, there was an increased risk that critical Program resources would not be adequately protected and that expensive controls would be implemented for resources that did not require significant protection.

Recommendations:

We recommend that the Director, Minerals Management Service:

1. Ensure that risk assessments are conducted in accordance with guidelines which recommend that risk assessments support the acceptance of risk and the selection of appropriate controls. Specifically, the assessments should address significant risks affecting systems, appropriately identify controls implemented to mitigate those risks, and formalize the acceptance of the residual risk.

2. Formally assign and communicate responsibility to local area network administrators to participate in risk assessments and ensure compliance with the Program's security policy.

3. Determine the risks associated with local area network applications and personal computer databases which contain proprietary and financial data and, based on the results of the risk assessments, establish appropriate security policies and procedures.

SECURITY PROGRAM

Minerals Management Service Response and Office of Inspector General Reply

Based on the Service's response, we request that the Service provide additional information for Recommendation 3 and that it reconsider its responses to Recommendations 1 and 2, which are unresolved (see Appendix 3).

Recommendation 1. Nonconcurrence.

Service Response. The Service stated that it "plans to enhance and better document" its risk assessment process. The Service further stated that it believed its "previous assessments were in accordance with guidelines" because of the "rapidly changing computing and communication environment."

Office of Inspector General Reply. We disagree that "previous assessments were in accordance with guidelines." Office of Management and Budget Circular A-130, Appendix III, and referenced standards and guidelines of the National Institute of Standards and Technology state that "risk management is the process of assessing risk, taking steps to reduce risk to an acceptable level, and maintaining that level of risk." Since the Service did not address a number of significant conditions/issues that affect risks to the Program's automated information system, identify the risks associated with these conditions, or identify the controls in place to reduce the risks to an acceptable level, we believe that the Program's risk assessment process was not in accordance with the guidelines. Additionally, Appendix III of Circular A-130 was revised so that Federal computer security programs could better respond to the rapidly changing technological environment. Although the Service disagreed with the recommendation, we believe that its action to enhance and document its risk assessment process is indicative of its intent to comply with the recommendation. However, we request that the Service clarify its intent (see Appendix 3).

Recommendation 2. Nonconcurrence.

Service Response. The Service stated that policies "define the LAN [local area network] administrators' role in contingency planning and security," and it provided additional information to support its position.

Office of Inspector General Reply. While the additional information did address the administrators' role in contingency planning and security, it did not address the recommendation. The "RMP Automated Information Systems Security Manual" states that administrators should participate in the risk assessment process. During our audit, we found

SECURITY PROGRAM

that the administrators were not always aware of their responsibilities to identify risks and implement controls that would mitigate risks and that the administrators' individual position descriptions did not always address these responsibilities.

Additional Comments on Finding

The Service stated that it believes that we did not apply risk assessment criteria appropriately because "Circular A-130 states '*the Appendix no longer requires the preparation of formal risk analyses*' and that risk assessments '*can be formal or informal, detailed or simplified, high or low level, quantitative (computationally based) or qualitative (based on descriptions or rankings), or a combination of these. No single method is best for all users and all environments.* '"

We agree that formal risk analyses are not required and that risk assessments can be formal or informal. However, we found that the Program's analyses were not based on risk-based management as described by Appendix III of Circular A-130 and referenced standards and guidelines of other Federal executive branch agencies and the Departmental Manual (375 DM 19). According to the NIST Handbook, risk-based management "is the process of assessing risk, taking steps to reduce risk to an acceptable level, and maintaining that level of risk." In its response, the Service provided additional information related to each of the examples in this finding. However, the additional information provided did not indicate that the Program used risk-based management in developing its controls.

SECURITY PROGRAM

B. Security-Related Personnel Policies and Procedures

Condition: The Program's security-related personnel policies and procedures were not adequate to ensure system integrity. Specifically, we found that:

- Contractor employees received the same type of background check and security clearance regardless of their duties and the risk associated with the computer-related work they performed. Thus, contractor employees, such as system programmers and computer operators, who could bypass technical and operational controls, received the same security clearance as administrative assistants.

- Computer-related work was not technically reviewed by contractor or Program personnel whose position sensitivity was greater than that of the position sensitivity of individuals performing the work.

- Contractor employees did not always submit requests for background checks for security clearances. Further, the requests that were submitted for background checks were not submitted within the time frames specified in the contract. An average of 175 calendar days elapsed, instead of the 2 weeks stipulated in the contract, between the dates the employees were hired and the dates the requests were received by the Minerals Management Service's Security Officer in Personnel for forwarding to the Office of Personnel Management. The Office of Personnel Management performed background checks for the same employees in an average of 84 days, and the Minerals Management Service approved the security clearances in an average of 22 days. Thus, most of the delay in the security clearance process was attributable to contractor and Program personnel.

- Systems Management Division employees did not have documentation to support that appropriate background checks for security clearances and required periodic followup background checks had been performed.

Criteria: The Departmental Manual (441 DM) specifies that position sensitivity should be based upon risk factors such as degree of public trust, fiduciary responsibilities, importance to program, program authority level, and supervision received. In addition, the Manual requires consideration of automated data processing (ADP) factors, such as the level of responsibility and technical review of work, for incumbents who are responsible for planning, directing, and implementing computer security; planning, directing, implementing, operating, and maintaining computer systems; and accessing or

SECURITY PROGRAM

processing automated information records systems that contain proprietary data. Further, work is to be technically reviewed by individuals filling ADP "critical-sensitive" positions when individuals filling ADP "noncritical-sensitive" positions perform computer work such as directing, planning, designing, operating, and maintaining a computer system to ensure system integrity. In addition, the terms of the contract require that the "assistant manager" positions' sensitivity level be ADP "critical-sensitive," that background check requests be submitted to the Service within 2 weeks after an employee's hire date, and that the employees be in probationary status until the background checks are completed and the security clearances are approved.

Cause: The Systems Management Division staff and the contractor staff who were responsible for technical reviews of the work were not in positions classified as ADP "critical-sensitive." Additionally, Program contracting personnel did not ensure that contractor personnel (1) submitted requests for background checks and (2) remained in probationary status and did not perform critical computer work until background checks were completed and security clearances were approved. Further, personnel or security files did not reflect that appropriate background checks or that required periodic followup background checks were performed.

Effect: As a result, there was an increased risk that employees would perform critical automated information system operations and maintenance work without appropriate oversight or adequate assurance that their backgrounds would warrant such trust.

Recommendations:

We recommend that the Director, Minerals Management Service:

1. Evaluate Systems Management Division and contractor ADP positions to determine position sensitivity in relation to risk and ADP factors. Also, assurance should be provided that automated information system work is technically reviewed by persons whose position sensitivity levels are greater than the position sensitivity levels of the employees who are performing the work.

2. Establish controls to ensure that the contractor is fulfilling its contractual obligation of submitting requests for background checks within the specified time frame and that contractor employees who are in probationary status and awaiting security clearances are not performing critical ADP work.

SECURITY PROGRAM

3. Establish controls to ensure that personnel or security files accurately reflect that background checks and periodic followup background checks are performed as required.

Minerals Management Service Response and Office of Inspector General Reply

Based on the Service's response, we request that the Service provide additional information for Recommendations 1 and 2 and that it reconsider its response to Recommendation 3, which is unresolved (see Appendix 3).

Recommendation 1. Partially concur.

Service Response. The Service stated it planned to "reevaluate the position sensitivity level for the senior personnel in charge of the contractor activity to determine if those position[s] should be classified at a higher level. In accordance with Departmental criteria, most ADP [automated data processing] staff are designated noncritical sensitive. We doubt it was the OIG's [Office of Inspector General] intention to imply that *all* work must be reviewed by persons at a higher sensitivity level; however, this would be impossible in a multiple level organization because there are only two sensitivity levels from which to choose, i.e., 'noncritical-sensitive' and critical-sensitive.'"

Office of Inspector General Reply. The Departmental Manual identifies four sensitivity levels. Further, although the Service indicated that some staff would have the next higher security level of "critical-sensitive" to perform technical reviews, we found that only one ADP staff position was classified as "critical-sensitive" and that the position was not responsible for performing technical reviews. Although the Service only partially concurred with the recommendation, we believe that the action to reevaluate position sensitivity levels is indicative of its intent to comply with the recommendation.

Recommendation 2. Partially concur.

Service Response. The Service said that it agreed that controls were needed to ensure that the contractor submitted requests for background checks in a timely manner. The Service further stated that the contractor had been "directed" and had "begun to track and is accountable for the status of its submission of these requests." The Service also said that it agreed that contractor employees awaiting clearances should be in "probationary status" but that having the employees not performing their assigned duties would be "unacceptably costly." According to the Service, it was "exploring alternatives" with the contractor such as having the contractor "perform a preliminary 'criminal and credit check' which is quick and inexpensive."

SECURITY PROGRAM

Office of Inspector General Reply. Preliminary investigations would be a suitable alternative to prohibiting contractor employees from performing their assigned duties before the background clearances have been accomplished. Although the Service only partially concurred with the recommendation, we believe that its action to evaluate alternatives such as preliminary investigations is indicative of its intent to comply with this recommendation.

Recommendation 3. Nonconcurrence.

Service Response. The Service stated that controls are "in place to ensure that personnel or security files accurately reflect background checks." The Service further stated that its Office of Administration and Budget "maintains documentation and a tracking system" on all security clearances and background checks of its employees and contractors. The Service stated that it disagreed with our statement that followup background checks are required, stating that it is in compliance with Department of the Interior guidance which states that followup checks "are authorized *only* for national security positions and not for public trust positions."

Office of Inspector General Reply. The Office of Administration and Budget's documentation and tracking system, while serving as part of the control, did not ensure that personnel or security files accurately reflected that background checks were requested and documented in the "official personnel files" of the employees. Additionally, the Departmental guidance included by the Service was dated 1993; however, the Code of Federal Regulations (5 CFR 1), dated 1997, states that followup background checks are required of employees in positions that are for national security and other positions considered to be "high risk." The Office's Security Officer verified that the Program has employees in "high risk" positions, such as the Chief, Systems Management Division; the Installation Security Officer; the Contractor's Project Manager; and supervisors within the Systems Management Division. As such, employees in these positions would be required to have followup background checks.

SECURITY PROGRAM

C. Security Awareness Statements

Condition: We found that automated information system users did not have security awareness statements on file acknowledging the employees' acceptance of their responsibilities to safeguard the Program's proprietary data and assets.

Criteria: The Department's "Automated Information Systems Security Handbook" requires employees who use sensitive automated information system resources to sign statements acknowledging their responsibilities for the security of the resources. Additionally, the "RMP [Royalty Management Program] Automated Information Systems Security Manual" requires that employees sign a Minerals Management Service Security Statement, which acknowledges their responsibilities to safeguard Program-sensitive data and assets, and requires the Installation Automated Information System Security Officer (Installation Security Officer) to verify that security awareness statements are signed by the employees before their system access requests are approved.

Cause: Program management did not ensure that its employees signed security awareness statements. In addition, the Installation Security Officer did not ensure that security statements were on file before the Installation Security Officer approved access to the automated information system.

Effect: As a result, employees may not be aware of their responsibilities to safeguard automated information system data and assets and thus inadvertently disclose sensitive information.

Recommendation:

We recommend that the Director, Minerals Management Service, establish controls to enforce Program policy which requires employees to sign security awareness statements before access to system resources is approved by the Installation Automated Information System Security Officer.

SECURITY PROGRAM

Minerals Management Service Response and Office of Inspector General Reply

Based on the Service's response, we request that the Service reconsider its response to the recommendation, which is unresolved (see Appendix 3).

The Service stated that while its own test sample confirmed that users have appropriate access to the Program's systems, it "concur[s] that [its] filing system for access approvals needed improvement." The Service further stated that all statements are "now consistently filed and reconciled by the ADP security officer."

The Service agreed with the recommendation and said that it was implemented. However, while the security awareness statements referred to in the finding provide evidence that users accepted their responsibility to safeguard the Program's proprietary data and assets, these statements do not support the appropriateness of access to Program systems. Without familiarity with the methodology employed in the Service's test, such as sample selection and test performance, we must rely on the tests performed using statistical sampling software and generally accepted Government auditing standards followed by the audit staff. Further, the Service stated, in its response to Recommendation D.2, that "all MMS [Minerals Management Service] employees are granted access to view royalty, production, and reference data." Accordingly, if the Service's tests did not include all Service employees, there is no assurance that all statements have been filed and reconciled. Therefore, we consider this recommendation unresolved and request that the Service reconsider its response to the recommendation (see Appendix 3).

ACCESS CONTROLS

D. Resource Classifications

Condition: The Program's computer resources (data files, application programs, and computer-related facilities and equipment) were not classified appropriately to determine the levels of access controls that should be implemented over the resources. For example, no "major application"[1] was identified in the Program's annual security plan, even though the applications and data files were "proprietary" and critical to the Program in accomplishing its mission and reporting financial information. Further, access controls over sensitive data on the servers used by the Program's divisions were not as stringent as the access controls over sensitive data on the mainframe.

Criteria: Office of Management and Budget Circular A-130, Appendix III, directs agencies to assume that all major systems contain some sensitive information that needs to be protected but to focus extra security controls on a limited number of particularly high-risk or major applications. According to the NIST Handbook, "Security levels, costs, measures, practices, and procedures should be appropriate and proportionate to the value of and degree of reliance on the information systems and to the severity, probability, and extent of potential harm." Further, the determinations should flow directly from the results of risk assessments that identify threats, vulnerabilities, and the potential negative effects that could result from disclosing confidential data or failing to protect the integrity of data supporting critical transactions or decisions. Accordingly, Program policy requires that users be given access only to the resources needed to perform their assigned duties.

Cause: Program management had not identified the resources that needed significant protection. Further, Program management did not require application owners who are responsible for approving user access levels to the applications to classify their resources based on the level of sensitivity of the information contained in their applications.

Effect: As a result, there was an increased risk that resources were not adequately protected from unauthorized access and disclosure and therefore were subject to either accidental or intentional changes to computer operations and data.

[1]Office of Management and Budget Circular A-130, Appendix III, identifies a "major application" as an "application that requires special attention to security due to the risk and magnitude of harm resulting from the loss, misuse, or unauthorized access to or modification of the information in the application." The Appendix further states that "certain applications, because of the information in them, however, require special management oversight and should be treated as major."

ACCESS CONTROLS

Conversely, the level of protection provided for low-risk resources may be in excess of that required. Furthermore, Program management did not have a reliable basis for making critical decisions regarding security safeguards for its sensitive applications.

Recommendations:

We recommend that the Director, Minerals Management Service:

1. Ensure that individual computer resources are classified based on the level of sensitivity associated with each resource.

2. Evaluate controls over resources to ensure that the access controls have been implemented commensurate with the level of risk and sensitivity associated with each resource.

Minerals Management Service Response and Office of Inspector General Reply

Based on the Service's response, we request that the Service reconsider its response to Recommendations 1 and 2, which are unresolved (see Appendix 3).

Recommendation 1. Nonconcurrence.

Service Response. The Service said that it believed that its "current classifications are appropriate." The Service further stated that its mainframe systems "receive heightened security because they are more mission critical, not because they are more sensitive" and that these systems "must be protected more strenuously to ensure the integrity of the official records." The Service also stated: "A more moderate level of protection is necessary for proprietary information than for mission critical information. The umbrella protection mechanism for all types of proprietary information is physical controls coupled with employee training."

Office of Inspector General Reply. We disagree that the Service's current classifications are appropriate. In its response to Recommendation M.1, the Service indicated that the Program had not identified all "mission critical" systems. Further, in our opinion, mission critical systems resided on personal computers and local area networks that supported the Program's mission to accurately and timely disburse rents, bonuses, and royalty revenues to the U.S. Treasury, the states, and the Indian tribes, as well as financial transactions and external reporting. Additionally, the Service stated that the umbrella protection over its proprietary data, which do not reside on the mainframe computer, is

ACCESS CONTROLS

limited to "physical controls" and "employee training." However, these controls do not meet the minimum controls required for Federal automated information resources. The purpose of resource classification is to provide a basis for determining the controls necessary to ensure appropriate implementation of risk-based management, as required by Office of Management and Budget Circular A-130, Appendix III.

Recommendation 2. Nonconcurrence.

Service Response. The Service said that it believes that its "existing access controls over resources already meet the intent of this recommendation." The Service further stated that all of its employees "are granted access to view royalty, production, and reference data. Since most of this data is proprietary, employees are trained in its proper use and must sign statements acknowledging their responsibility to protect it. State and Tribal employees have access to such data within their jurisdictions only. The ability to add or change data is limited to those employees who require that access to perform their jobs."

Office of Inspector General Reply. We disagree that the Service's existing access controls meet the intent of the recommendation. By its response, we inferred that the Service had not complied with the personnel control of "least privilege" required by Appendix III of Circular A-130 and the "RMP Automated Information Systems Security Manual." The Circular defines least privilege as "the practice of restricting a user's access (to data files, to processing capability, or to peripherals) or type of access (read [which means to view], write, execute, delete) to the minimum necessary to perform" an employee's job. Further, the Program's Manual states, "[P]rivileges granted to users are only those privileges that are absolutely necessary for job performance." In addition, Appendix III of Circular A-130 and the Departmental Manual (375 DM 19) state that the "greatest threat" to most computer systems comes from authorized users. However, as stated by the Service, "All [Service] employees are granted access to view royalty, production, and reference data." Therefore, we believe that allowing all Service employees to have access to view Program data indicates that access controls were not implemented commensurate with the level of risk and sensitivity of each resource. Further, as cited in Findings E, F, and G in this report, controls over access were inadequate; therefore, we believe that the Service's current access controls over resources do not meet the intent of the recommendation.

ACCESS CONTROLS

E. Default Settings Provided With Commercial Off-the-Shelf Software

Condition: Default settings provided with commercial off-the-shelf software were not removed after the software was installed and implemented. For example, we found that the default user identification (ID) and associated default password had not been removed when Program management upgraded to the latest version of the Integrated Data Management System (IDMS).[2] The default user ID provides users with administrative privileges to establish and remove users and to access all mainframe computer resources.

Criteria: The "RMP Automated Information Systems Security Manual" requires that default user IDs and passwords be removed once commercial off-the-shelf software is implemented.

Cause: Rather than deleting the default user ID and password, Program management relied on the mainframe security software to protect against unauthorized access.

Effect: As a result, there was an increased risk that the automated information system could be accessed by unauthorized users.

Recommendation:

We recommend that the Director, Minerals Management Service, implement controls to enforce Program policy that default user IDs and passwords are to be removed from the automated information system when commercial off-the-shelf software is implemented.

Minerals Management Service Response and Office of Inspector General Reply

In its response, the Service indicated agreement with the recommendation. However, the Service needs to provide additional information for the recommendation (see Appendix 3).

Additional Comments on Finding

Even though the Service agreed with this recommendation, it stated that our conclusion was incorrect that "the use of this default ID allows access to all mainframe computer resources" because "the security architecture prevented" the misuse of resources. The security

[2]Integrated Data Management System (IDMS) is a licensed product of Computer Associates International, Inc., which manages database applications that reside on mainframe computers.

ACCESS CONTROLS

architecture requires that a user who wants to access the mainframe have a "valid RACF logon password" and a "user ID defined to the data dictionary." We disagree that the security architecture prevented the misuse of resources. Vendor documentation states that the default ID can be used to establish a user in the dictionary and perform all activities cited in this finding. In addition, we found that at least two applications did not rely on the Program's "security architecture."

ACCESS CONTROLS

F. Commercial Off-the-Shelf Software Access Controls

Condition: Commercial off-the-shelf software access controls were not implemented to safeguard against unauthorized access to the mainframe computer, personal computers, and servers. Specifically, we found that:

- Resource Access Control Facility (RACF)[3] provides the capability to set rules for passwords in which the installation can require the use of specific characters (a mix of letters and numbers) within the passwords, but this feature was not used.

- A default security setting was found on a server file that allows passwords to be unencrypted.

- The "SECURE CONSOLE" command was not found on a server file which removes the Disk Operating System (DOS) from the server memory. The removal of DOS from the server memory prevents an individual from inserting a diskette into the server drive and loading unauthorized software that could perform such functions as change passwords, establish trustee rights, create users, and assign security levels. Also, the "SECURE CONSOLE" command disables the users' ability to change the server date and time, thus allowing users to bypass access restrictions.

Criteria: Office of Management and Budget Circular A-130, Appendix III, requires agencies to establish controls to ensure adequate security for all information processed, transmitted, or stored in Federal automated information systems. Also, the Department's "Automated Information Systems Security Handbook" states that proprietary, personnel, sensitive, and mission-critical information should be protected from unauthorized disclosure. In addition, the Program's Automated Information Systems Security Manual states that a mix of letters and numbers is recommended for passwords used to access the Program's automated information system.

Cause: The Program's policy recommended rather than required the use of a mix of both letters and numbers in passwords to access its automated information

[3]Resource Access Control Facility (RACF) is an IBM-licensed software security product that protects information by controlling access to the information. RACF provides security by identifying and verifying users to the system, authorizing users' access to protected resources, and recording and reporting access attempts. (Resource Access Control Facility General Users Guide, Version 1, Release 9.2, 9th edition, IBM Corp., 1993, page 1-1.)

ACCESS CONTROLS

system. In addition, there was no centralized security administration for the local area networks and personal computers that contain proprietary and financial data, and no Program procedures were in place to ensure that controls were adequate to safeguard these local area networks and personal computers.

Effect: As a result, there was an increased risk that unauthorized access could be gained to the automated information system, which could result in the loss of data and in unauthorized individuals gaining access to sensitive data files.

Recommendations:

We recommend that the Director, Minerals Management Service:

1. Evaluate the current Program policy which only recommends that passwords contain a mix of letters and numbers for all automated information system components. Implement, if the Program determines that a mix of letters and numbers should be required, the security software option within RACF that would enforce this requirement. If the Program determines that a mix of letters and numbers is not required, the risk should be addressed in the risk assessment.

2. Develop and implement centralized security administration for the local area networks used by the Program's divisions that contain proprietary and financial data.

Minerals Management Service Response and Office of Inspector General Reply

In its response, the Service indicated agreement with both recommendations. However, the Service needs to provide additional information for Recommendations 1 and 2 (see Appendix 3).

ACCESS CONTROLS

G. Access Levels Granted

Condition: We found that controls were not adequate to ensure that access levels granted to users of the Program's automated information system were appropriate. Specifically, access managers had not approved all automated information system access granted to users of the access managers' applications and had not performed periodic reviews to determine who the users were and whether the levels of access granted in the automated information system were the access levels approved.

Criteria: The "RMP Automated Information Systems Security Manual" states that supervisors and managers are responsible for ensuring that employees' ADP access certifications are appropriate for the job they will perform before users are set up to access the automated information system. Also, the "Generally Accepted Principles and Practices for Securing Information Technology Systems," issued by the National Institute of Standards and Technology, states: "It is necessary to periodically review user account management on a system. Reviews should examine the levels of access each individual has, conformity with the concept of least privilege, whether all accounts are still active, [and] whether management authorizations are up-to-date."

Cause: Program management had not ensured that its policies were implemented effectively because access managers were not included in the process of approving access to the automated information system. Additionally, the Program's policies and procedures did not require that access managers perform periodic reviews of users' levels of access to application files and system records. In addition, Program management could not efficiently, through automated means, perform reconciliations of authorization forms and access levels granted in the automated information system because the audit tools available for the automated information system had not been acquired. Although automated capabilities were not acquired, Program management could ensure that user access levels were appropriate to the work performed through a recertification process whereby users resubmit the ADP access certifications annually.

Effect: As a result, there was an increased risk that unauthorized access, data manipulation, or disclosure of proprietary information may occur. In addition, a periodic review of access files may limit the damage resulting from accidents, errors, or unauthorized use of automated information system resources and increase assurance that access levels were revised when users were reassigned or promoted or they terminated their employment. Additionally, since periodic

ACCESS CONTROLS

reviews were not performed, there was an increased risk that unauthorized access would not be detected or detected timely.

Recommendations:

We recommend that the Director, Minerals Management Service:

1. Implement controls to ensure that access managers approve all access to their applications in accordance with Program policy.

2. Document procedures which require that users' access levels be reviewed periodically or that employees be recertified to ensure that the levels of access granted are appropriate for the duties assigned to the users.

Minerals Management Service Response and Office of Inspector General Reply

Based on the Service's response, we request that the Service reconsider its responses to Recommendations 1 and 2, which are unresolved (see Appendix 3).

Recommendation 1. Nonconcurrence.

Service Response. The Service stated that it believes that "effective controls have been in place to assure that application managers approve all access to their applications." It further stated that it "acknowledge[d] that our filing system for such approvals needed improvement and are in the process of resolving this problem."

Office of Inspector General Reply. We disagree that effective controls were in place which ensured that application managers approved all access to their applications. We found that the Program did not enforce its policy which required application managers to approve all access granted to users of their applications. We performed a statistical test of users who had access to Program applications and production data and found that over 10 percent of those users tested did not have their access approved by the application manager or the Installation Security Officer. We discussed access approvals with application managers and found that these managers were unaware of how many of the users had access to the managers' applications. Therefore, the problem was not attributable to the "filing system" but to the lack of enforcement of Program policy.

ACCESS CONTROLS

Recommendation 2. Concurrence.

Service Response. The Service stated that it "concur[red] with the need to document these procedures" but "disagree[d] with the OIG's [Office of Inspector General] implication (in its statement of effect) of any significant risk of security breaches." The Service further stated: "Access to mission-critical systems has been carefully managed and controlled through documented security procedures and controls, including mainframe access matrices and annual reviews by the Security Manager. Our own tests confirmed that no unauthorized access exists or has existed."

Office of Inspector General Reply. The Service agreed that procedures should be documented but stated that it had procedures and controls in place for mission-critical systems. However, we disagree that adequate procedures and controls were in place because the Program's procedures did not address periodic reviews of users' access levels. The Service disagreed that any significant risk of security breaches would occur because mission critical systems are "carefully managed and controlled" through "documented security procedures and controls." Since the Service stated in its response to Recommendation M.1 that it had not identified all mission critical systems, it is unclear how the Service managed and controlled its mission critical systems. Regarding the annual review, under the current version of the security software, a review of user access levels within the system could not be performed. Therefore, the Program's procedures did not ensure that all users' access levels were reviewed periodically and that the levels of access granted were appropriate for the duties assigned to the users, thus ensuring implementation of "least privilege." Further, the use of the matrix identified users within a group and the group's levels of access, but it did not identify access levels for each user. In addition, without familiarity with the methodology employed in the Service's test, such as the sample selection and test performance, we must rely on the tests performed using statistical sampling software and generally accepted Government auditing standards followed by the audit staff.

ACCESS CONTROLS

H. Number of Log-in Attempts

Condition: The Program's number of unsuccessful log-in attempts to access its automated information system exceeded the standard established by the Department. Specifically, in 1992, Program management increased the number of unsuccessful log-in attempts from three to five before a user's ID and password were revoked.

Criteria: The Department's "Automated Information Systems Security Handbook" states that the number of unsuccessful log-in attempts should be three.

Cause: Program management did not follow the Departmental standard because, they stated, it was difficult for some state and tribal organizations, which are external customers, to access the mainframe computer through telephone lines.

Effect: As a result, the increased number of invalid attempts reduced the effectiveness of the password as an access control. Thus, there was an increased risk of unauthorized access to sensitive information.

Recommendation:

We recommend that the Director, Minerals Management Service, evaluate the need to deviate from the Departmental standard for the number of unsuccessful log-in attempts. If the Program determines that this number should remain at five, Program management should request, from the Department, a waiver from the standard of three attempts.

Minerals Management Service Response and Office of Inspector General Reply

Based on the Service's response, we consider this recommendation resolved and implemented (see Appendix 3).

SOFTWARE DEVELOPMENT AND CHANGE MANAGEMENT

I. Client/Server Application Software Changes

Condition: Change management controls over client/server application software were not adequate. Specifically, we found that there were no controls to ensure that: (1) Program management authorized and approved software changes and (2) the changes to the application software were adequately tested before the changed software was moved into production.

Criteria: National Institute of Standards and Technology Special Publication 500-161, "Software Configuration Management: An Overview," states that software configuration control management procedures should define the specific steps taken to analyze and evaluate the change request, clarify the meaning of the request, and resolve the problem described. In addition, the procedures should identify the appropriate individuals or organization responsible for evaluating the requests and discuss the submission of the evaluation results to the appropriate review board or individuals for approval or disapproval. Federal Information Processing Standards Publication 106, "Guideline on Software Maintenance," states that testing is a critical component of software maintenance and that, as such, test procedures must be consistent and based on sound principles. Further, the Publication states that tests should examine whether the application software is "doing what it is supposed to do."

Cause: Program management did not enforce procedures for authorizing, approving, and testing client/server application software.

Effect: As a result, there was an increased risk that the most critical client/server application software changes were not made and that applications would not perform as intended.

Recommendation:

We recommend that the Director, Minerals Management Service, enforce its procedures for authorizing, approving, and testing client server application software before the software is moved into production.

SOFTWARE DEVELOPMENT AND CHANGE MANAGEMENT

Minerals Management Service Response and Office of Inspector General Reply

In its response, the Service stated that the documented procedures "are already in place."

Although the Service provided additional information in its response showing that client/server software development and change management procedures had been in place since 1995, the information, which we requested, was not provided during our audit. Based on the subsequent information provided by the Service, we agree that the Service has documented procedures. However, we found that these procedures had not been enforced during fiscal year 1997. Specifically, in our review of four client/server applications, we found no evidence to support that software changes were authorized, approved, and tested. Therefore, we have revised this finding and recommendation and request that the Service respond to the revised recommendation (see Appendix 3).

SEPARATION OF DUTIES

J. Duties Related to Client/Server Applications

Condition: The duties related to client/server applications were not separated effectively. Specifically, we found that:

- Application programmers were authorized to access client/server production data to perform "ongoing maintenance" on applications.

- At least one application programmer acted as a backup to an end user, which required the programmer to change production data in the Minerals Management Service Appeals Tracking System.

- The individual responsible for setting up users of the Royalty Management Program Desktop applications was also the person designated to review server security logs, which record the activities of the users of the applications.

Criteria: Office of Management and Budget Circular A-130, Appendix III, requires that security controls for personnel include least privilege and separation of duties. The Circular states, "Least privilege is a practice of restricting a user's access (to data files, to processing capability, or to peripherals) or type of access (read, write, execute, delete) to the minimum necessary to perform his or her job." Separation of duties is the practice of dividing the steps in a critical function among different individuals. Also, the NIST Handbook states, "Separation of duties refers to dividing roles and responsibilities so that a single individual cannot subvert a critical process." The "RMP Automated Information Systems Security Manual" states, "Access to sensitive data is limited to those persons who use or process the data in performing their official duties."

Cause: Program management did not appropriately assign duties for application programmers to ensure that critical processes were not subverted. Specifically, programmers should not have access to production data because access to production data should be restricted to users. Also, Program management had not ensured that independent reviews of server security logs were performed periodically.

Effect: As a result, there was an increased risk that accidental or intentional unauthorized actions by programmers could threaten the integrity of the Program's data and disrupt system processing. Furthermore, there was an

SEPARATION OF DUTIES

increased risk that inappropriate actions by the individuals who established system users would not be detected or would not be detected timely.

Recommendations:

We recommend that the Director, Minerals Management Service:

1. Implement controls to ensure that application programmers do not have access to the production client/server application data or the capability to update/change these data.

2. Improve detection controls by ensuring that management or the Installation Security Officer reviews server security logs periodically.

Minerals Management Service Response and Office of Inspector General Reply

Based on the Service's response, we request that the Service provide additional information for Recommendation 2 and that it reconsider its response to Recommendation 1, which is unresolved (see Appendix 3).

Recommendation 1. Nonconcurrence.

Service Response. The Service stated: "While application programmers do not routinely require update access to any RMP [Royalty Management Program] production data, there are instances when temporary access is needed by specific programmers under controlled circumstances. To mitigate any future risks associated with this access, procedures have been reinforced which detail actions to be taken when requesting temporary access to mainframe and client/server production data." The Service also "refute[d]" our statement that application programmers serve as backups to end users.

Office of Inspector General Reply. The Service indicated that procedures were in place to control the risk when application programmers had update access to Program data. However, we did not find such procedures; therefore, we could not test the procedures to ensure that temporary access was provided to specific programmers under controlled circumstances. To resolve this recommendation, the Service is requested to provide documentation of the procedures the Program uses that mitigate risk when programmers are allowed update access to production data.

SEPARATION OF DUTIES

Regarding application programmers serving as backups to end users, we found during our audit that a programmer analyst had been given access to a client/server application to change the database, to make table updates, and to print reports. According to Program personnel who were responsible for the application, this access was authorized so that the programmer could provide backup duties to a Program employee.

Recommendation 2. Concurrence.

Service Response. The Service stated that the contractor was "being directed to address the review of server security logs within their overall internal control procedures."

Office of Inspector General Reply. We accept the Service's alternative of having the contractor review the logs rather than Program management or the Installation Security Officer. However, regardless of who does the review, the procedures must ensure adequate separation of duties between the key functions of the security log reviewer and the security administrator.

SYSTEM SOFTWARE CONTROLS

K. Security Software

Condition: The version of RACF, the commercial mainframe security software, that was used by the Program was no longer supported by the vendor. Although the upgraded version of RACF had been purchased, it had not been implemented.

Criteria: Federal Information Processing Standards Publication 106, "Guideline on Software Maintenance," states that "the goal of software maintenance management is to keep systems functioning."

Cause: Program management had not implemented the upgraded version of RACF because management was in the process of requesting a waiver from the Department from consolidating its mainframe operations with another mainframe operation, which has the upgraded RACF, as required by Office of Management and Budget Bulletin 96-02, "Consolidation of Agency Data Centers." If the waiver is granted to the Program, the upgraded version of RACF will need to be implemented immediately.

Effect: Using security software that was not supported by the vendor increased the risk that security software would not be maintained and that programs and data files would not be protected from unauthorized access.

Recommendation:

We recommend that the Director, Minerals Management Service, ensure that the upgraded version of RACF is implemented immediately if the Program is granted a waiver from consolidating its mainframe operations with another mainframe operation.

Minerals Management Service Response and Office of Inspector General Reply

In its response, the Service stated that it believes that we "misunderstood the effects of delaying this software upgrade. Although this is a moot point now that MMS [Minerals Management Service] has replaced its processor, the decision not to upgrade the RACF software was well founded."

Although the Service indicated that it had replaced its processor, we were not provided information to determine whether the Service has ensured that the upgraded version of RACF or equivalent security software was implemented on the new processor. Therefore, we

SYSTEM SOFTWARE CONTROLS

consider this recommendation unresolved and request that the Service reconsider its response to the recommendation (see Appendix 3).

Additional Comments on Finding

The Service stated that the Program "initially delayed the upgrade because it was considering a processor replacement that would require an entire new suite of mainframe software products." The Service further stated, "Upgrading RACF at that time would have been an inherently risky and potentially expensive decision." Regarding these statements, we were not provided any documentation to support these statements that the decision to not implement the upgraded version of RACF was based on the Service's plan to implement a new processor or that the upgrade of RACF would be "risky and potentially expensive."

SYSTEM SOFTWARE CONTROLS

L. Mainframe Computer System Audit Tools

Condition: Program management did not use available system audit tools to ensure integrity over system processing and data and to detect inappropriate actions by authorized users. Specifically, we found that:

- System integrity verification and audit software was not used. This software could assist data center and installation security management in identifying and controlling the mainframe computer operating system's security exposures such as setting system options inappropriately, installing "back doors" to the operating system, and introducing viruses and Trojan horses, that can destroy production dependability and circumvent existing security measures.

- Computer operators and system programmers had the capability to change the system initialization process and thus affect system processing. Additionally, system options that produce a system audit trail were not implemented. Therefore, an audit trail that logs the results of actions taken by computer operators and system programmers in the SYSLOG during system initialization could not be produced for periodic review.

- Periodic reviews of System Management Facility (SMF) logs to identify critical events affecting system processing were not performed.[4] For example, reviews were not performed of record type 7, which records when the system audit trail is lost, and record type 90, which records events such as "SET TIME," "SET DATE," and "SET SMF," all of which affect system processing and production of audit trails.

- Periodic reviews of SMF logs to identify unauthorized changes to data by authorized users were not performed. Even though one of the SMF record types, record type 60, which logs all activity affecting Virtual Storage Access Method data sets that contain lease and site security data, was activated during our audit, the logs were not reviewed to detect inappropriate actions or unusual activity by authorized users.

Criteria: Office of Management and Budget Circular A-130, Appendix III, requires agencies to establish controls to ensure adequate security for all information processed, transmitted, or stored in Federal automated information systems. In

[4]The System Management Facility (SMF) logs record all system activity and serve as an audit trail of system activity, including identification of users who performed the activity.

SYSTEM SOFTWARE CONTROLS

addition, the Circular states that individual accountability is one of the personnel controls required in a general support system. The Circular further states that an example of one of the controls to ensure individual accountability is reviewing or looking at patterns of users' behavior, which requires reviews of the audit trails. The NIST Handbook states that audit trails are a technical mechanism to achieve individual accountability.

Cause: Program management did not acquire system integrity and verification software, did not implement system options to record actions taken affecting system initialization, did not encourage the use of available system audit trails to detect and identify inappropriate actions affecting the system processing and data integrity, and did not establish procedures requiring periodic reviews of resultant logs because the logs were extensive and difficult to read. Further, Program management had not considered converting the logs to a more useful format to extract critical information. Instead, Program management relied on its staff to make appropriate changes to the system initialization process and on authorized users to make only appropriate changes.

Effect: As a result, inappropriate mainframe computer system initialization and processing were not recorded and identified. Additionally, without periodic reviews of the system audit trails, there was an increased risk that processing problems or unauthorized activities would not be detected or would not be detected timely and that the individual responsible would not be held accountable for the inappropriate actions.

Recommendations:

We recommend that the Director, Minerals Management Service:

1. Evaluate acquiring system verification and auditing software.

2. Implement the system options to record activities in the SYSLOG during the system initialization process and develop and implement procedures to ensure that periodic reviews of the SYSLOG for unauthorized or inappropriate activities are performed and that unauthorized or inappropriate activities are reported to Program management.

3. Evaluate the available SMF record types and implement procedures to ensure that critical SMF logs are reviewed periodically and that Program management addresses the problems identified.

SYSTEM SOFTWARE CONTROLS

Minerals Management Service Response and Office of Inspector General Reply

In its response, the Service indicated agreement with Recommendations 2 and 3. However, the Service needs to provide additional information for Recommendations 2 and 3 and needs to reconsider its response to Recommendation 1, which is unresolved (see Appendix 3).

Recommendation 1. Nonconcurrence.

Service Response. The Service stated that the Program "routinely uses a number of system-assurance mechanisms such as control reports, system-assurance programs and user-reconciliation reports" but that it "remains alert to any technologic developments that would improve system integrity and operations." The Service further stated, "As these packages become available, they will be examined for applicability to the RMP [Royalty Management Program] computing environment."

Office of Inspector General Reply. The mechanisms cited by the Service provide information related mainly to application processing system assurance. Although the Service said that it will evaluate the use of software packages to assist in providing assurance over system integrity and operations, the Service should state concurrence or nonconcurrence with the recommendation to evaluate the acquisition of operating system-verification and auditing software that would identify mainframe operating system security exposures.

SERVICE CONTINUITY

M. Disaster Recovery Plans

Condition: Local area networks and personal computers used by the Program's divisions that maintain proprietary and financial data were not included in the Program's disaster recovery plans.

Criteria: Office of Management and Budget Circular A-130, Appendix III, states that agencies should establish a contingency plan and periodically test the plan to ensure that operations will continue in the event that automated systems fail.

Cause: Program management did not ensure that all systems which maintain proprietary and financial data were included in its disaster recovery plans.

Effect: If the disaster recovery plans are incomplete because all sensitive systems are not included, personnel required to perform the disaster recovery procedures may not be able to recover critical systems in the event of a disaster or a system failure.

Recommendation:

We recommend that the Director, Minerals Management Service, update the disaster recovery plans to include all mission-critical systems.

Minerals Management Service Response and Office of Inspector General Reply

Based on the Service's response, we request that the Service provide additional information for the recommendation (see Appendix 3).

Additional Comments on Finding

The Service stated, "We believe the disaster recovery plans we have in place for our mainframe and client servers provide coverage for virtually all of our mission-critical applications." In our opinion, this statement implies that disaster recovery plans are not required for other components of the Program's automated information system, such as local area networks and personal computers used by the Program's divisions. The local area networks and personal computers used by the Program's divisions were the components of the automated information system used to develop the Program's financial statements and

SERVICE CONTINUITY

to report financial information to the U.S. Treasury and the Office of Management and Budget. Further, these components also support the Program's mission to accurately and timely disburse rents, bonuses, and royalty revenues to the U.S. Treasury, the states, and the Indian tribes. Therefore, we believe that these components not only are "mission critical" to the Program but also are part of the Program's general support system. Office of Management and Budget Circular A-130, Appendix III, defines general support systems as "an interconnected set of information resources under the same direct management control which shares common functionality." Further, the Circular addresses the need for continuity of support for general support systems as well as major applications.

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

JAN 16 1998

Memorandum

To: Assistant Inspector General for Audits

Through: Bob Armstrong JAN 21 1998
Assistant Secretary for Land and Minerals Management

From: Cynthia Quarterman
Acting Director, Minerals Management Service

Subject: Office of Inspector General Draft Audit Report A-IN-MMS-001-97, "General Controls Over the Automated Information System, Royalty Management Program, Minerals Management Service"

Thank you for the opportunity to respond to this draft report on the general controls over our royalty automated information system. Of the 24 Recommendations, we agree with 11, partially agree with 2, and disagree with 11. We're sending you our general comments on the audit findings and specific ones on the recommendations. We've also included nine Enclosures to our response as additional background material for your review.

Please contact Bettine Montgomery at (202) 208-3976 if you have any further questions.

Attachments

[ENCLOSURES REFERRED TO IN THE MINERALS MANAGEMENT SERVICES' RESPONSE NOT INCLUDED BY THE OFFICE OF INSPECTOR GENERAL.]

MINERALS MANAGEMENT SERVICE RESPONSE TO DRAFT AUDIT REPORT "GENERAL CONTROLS OVER THE AUTOMATED INFORMATION SYSTEM, ROYALTY MANAGEMENT PROGRAM, MINERALS MANAGEMENT SERVICE"

Audit Agency: Office of Inspector General (OIG)

Audit Number: A-IN-MMS-001-97

We appreciate the opportunity to comment on this draft report. MMS shares OIG's concern for security and controls and concurs with some of the findings and recommendations presented in the report. In fact, the Royalty Management Program (RMP) is actively implementing solutions to rectify some of the weaknesses pointed out by the OIG and to enhance system security. We concur with OIG's use of OMB Circular A-130 as the principal criteria for evaluation; however, we cannot agree with OIG's implicit conclusion that RMP systems do not comply with the Circular. It is important to recognize these criteria are general, leaving considerable room for judgement and interpretation based on the individual facts and circumstances.

We indeed believe RMP systems are in substantial compliance with the spirit and intent of the OMB Circular and strenuously disagree with the overall conclusion of the report -- that general controls were inadequate. The OIG review identified some spot failures and procedural weaknesses, many of which we have agreed to change. However, in terms of materiality, the sum total of these weaknesses, in our opinion, is not significant enough to constitute an overall finding of inadequate. Furthermore, the report does not actually deal with the overall or general controls. To do so would require an evaluation of redundant and compensating controls. Yet, the OIG report stated "we did not evaluate the effectiveness of manual control procedures that may have operated as compensating controls for the automated information system general controls."

MMS would also point out that our recurring management control reviews have addressed such manual controls and generally found they were working effectively or prompted corrective actions to resolve minor control deficiencies. While these reports, as well as the supporting workpapers, were reviewed during this and prior OIG audits of our automated system, no adverse findings in this regard were reported. Moreover, past OIG audits performed under the Chief Financial Officers Act of 1990 have covered these controls, and each report concluded that our financial information was reliable.

We must dispute many of the OIG's facts, conclusions, and interpretations. System security is a complex network of redundant measures and policies which must strike an appropriate balance between risk and cost. Taken together, this network provides overall security for the key operating systems. No system is perfect, especially given the rapidly changing technological environment and the competing needs for funds. However, we believe OIG is holding RMP to

an unattainable standard in concluding general controls were "not adequate." MMS has established and continues to improve on a system of security controls that we believe should instead be viewed as a positive example, or even a model within the government.

Finally, the OIG report does not demonstrate a single negative impact of its findings. The OIG reported no incidents -- no loss or corruption of data and no theft or unauthorized access. We believe the absence of such incidents reflects favorably on our existing automated and manual compensating controls. Our primary comments on the facts and conclusions are shown below by topic. Additional comments on the facts and conclusions are included in our comments on the recommendations.

RISK ASSESSMENTS

MMS believes the risk assessment criteria were not appropriately applied. Circular A-130 states *"The Appendix no longer requires the preparation of formal risk analyses"* and that risk assessments *"can be formal or informal, detailed or simplified, high or low level, quantitative (computationally based) or qualitative (based on descriptions or rankings), or a combination of these. No single method is best for all users and all environments."* Given the breadth of judgement allowed on this matter, RMP's previous risk assessment documents and processes were clearly in accordance with the guidelines. We must also disagree with OIG's findings that MMS did not properly assess the risks regarding year 2000 program conversion, "unsupported" system security software, and "geopolitical" and "external directives" risks.

In 1996, RMP management anticipated the potential risks associated with the Year 2000 conversion and tasked its operations and maintenance contractor to conduct a detailed analysis of major systems and develop a plan for modifying and testing the programs. The resultant $1.6 million project was begun by the contractor in March 1997 and is on track for completion in 1998. (Enclosures 1, 2, 3 and 4). In May 1997, RMP management also initiated a parallel internal project to assess non-mainframe, stand-alone systems. Given the fact that OMB Circular A-130 does not even require formal risk analyses; it would seem that such an explicit recognition of this risk and timely action toward its elimination is as an accomplishment rather than a failure.

We also believe the OIG misunderstood the circumstances involving the "Resource Access Control Facility" (RACF) mainframe security software. The system-security software was never "unsupported" in the sense implied by OIG; this was a contractual matter that would have required a paid service call rather than a supported call if a problem arose. Because RMP was planning to upgrade to a different operating system, we chose not to incur the expense of a software upgrade at that time. RMP was never at any risk regarding this software.

We also take issue with OIG's opinion regarding our assessment of "geopolitical" and "external directives" risks. In our view, OIG's opinion that RMP was at risk of employee sabotage because of low morale associated with potential program abolishment or downsizing is overstated. Since the program's inception in 1982, RMP employees have become accustomed to such proposals. While they may indeed weaken morale, we have learned external threats are more likely to rally our employees than to foster mischief. While we consider the employee morale issue to be important matter, RMP correctly assessed this risk as "low."

SOFTWARE DEVELOPMENT AND CHANGE MANAGEMENT

RMP disagrees with OIG's statement that "Program management did not have procedures to ensure that client/server application software changes were authorized, approved, and tested before being moved into production." Such procedures have been in place since 1995 and are published in an on-line help text format (Enclosure 5). The Client/Server Guidelines clearly define the steps/processes for testing to be included in the Implementation Plan (part of the Visualization Step) and the Unit, System, and User Testing required as part of the Operational Prototype (Development Step). These Guidelines include a separate Procedural Overview of Testing including an example test plan. While testing processes for client-server applications are different from those for mainframe systems because of the emphasis on interactive prototyping and Graphical User Interface design, they are no less adequate.

DEFAULT SETTINGS

The OIG found one instance where a default ID provided with off-the-shelf software was not removed as required. However, it is factually incorrect to say that use of this default ID allows access to all mainframe computer resources. The security architecture prevented any unauthorized or inappropriate user from using this ID because users must first be able to access the system through a valid RACF logon password and have a user ID defined to the data dictionary. At no time were RMP resources at risk

SECURITY SOFTWARE

The OIG seems to have misunderstood the reasons for and the effects of RMP's decision not to upgrade RACF, the commercial mainframe security software. As noted above, RMP initially delayed the upgrade because it was considering a processor replacement that would require an entire new suite of mainframe software products. Upgrading RACF at that time.would have been an inherently risky and potentially expensive decision. Moreover, the current version of RACF had been very stable. The only risk of running "unsupported" software is contractual; that is, in the unlikely event of a RACF failure, IBM would have to be called in for service on demand rather than as a fully supported maintenance call.

DISASTER RECOVERY PLANS

The OIG seems to have generalized two distinct concepts and used them interchangeably. Sensitive or proprietary information is not synonymous with mission critical-systems and information. Although most MMS mission-critical information is sensitive, the reverse is not the case. Most sensitive data is not mission critical.

The central repository for mission-critical information resides on the mainframe computer. This is where MMS's key systems reside--the heart of the MMS' operations--requiring a comprehensive disaster recovery plan. Users know they can always go to this central repository for the official and current data. This database is updated continuously, centrally managed, and routinely backed up. Because most of this data is also business-sensitive, security controls are also in place to prevent unauthorized disclosure.

In addition, large amounts of redundant data reside in paper and electronic format in and on desks, file cabinets, and personal computers. This includes sensitive and financial data. However, because most of this data is redundant, it is not "mission critical." Therefore, while it is important to prevent unauthorized disclosure of this information, disaster recovery plans are, in most cases, not cost effective, feasible, or necessary.

Therefore, OIG's conclusion that disaster recovery plans are needed for *all local area networks and personal computers that contain proprietary and financial data* is erroneous. We believe the disaster recovery plans we have in place for our mainframe and client servers provide coverage for virtually all of our mission-critical applications. We are currently reviewing "stand alone" PC systems to determine if any are truly mission critical. If so, they will need to be brought onto the network and managed accordingly.

COMMENTS ON RECOMMENDATIONS

A1. Ensure that risk assessments are conducted in accordance with guidelines, which recommend that risk assessments support the acceptance of risk and the selection of appropriate controls. Specifically, the assessments should address significant risks affecting systems, appropriately identify controls implemented to mitigate those risks, and formalize the acceptance of the residual risk.

DISAGREE - While MMS plans to enhance and better document our risk assessment process due to the rapidly changing computing and communication environment, we believe our previous assessments were in accordance with guidelines.

A2. Formally assign and communicate responsibility to local area network administrators to participate in risk assessments and ensure compliance with the Program's security policy.

DISAGREE - RMP policies define the LAN administrators' role in contingency planning and security. (Enclosure 6).

A3. Determine the risks associated with local area network applications and personal computer databases that contain proprietary and financial data and, based on the results of the risk assessments, establish appropriate security policies and procedures.

AGREE - RMP will conduct a risk analysis on user written applications as well as data residing on networks and personal computers to determine appropriate security and disaster recovery procedures. An inventory of these applications and the business functions they support is already being performed as part of RMP's Year 2000 project.

B1. Evaluate Systems Management Division and contractor ADP positions to determine position sensitivity in relation to risk and ADP factors. Also, assurance should be provided that automated information system work is technically reviewed by persons whose position sensitivity level is greater than the position sensitivity levels of the employees who are performing the work.

PARTIALLY AGREE - We plan to reevaluate the position sensitivity level for the senior personnel in charge of the contractor activity to determine if those position should be classified at a higher level. In accordance with Departmental criteria, most ADP staff are designated noncritical sensitive. We doubt it was the OIG's intention to imply that *all* work must be reviewed by persons at a higher sensitivity level; however, this would be impossible in a multiple level organization because there are only two sensitivity levels from which to choose, i.e., "noncritical-sensitive" and "critical-sensitive."

B2. Establish controls to ensure that the contractor is fulfilling its contractual obligation of submitting requests for background checks within the specified time frame and that contractor employees who are in probationary status and awaiting security clearances are not performing critical ADP work.

PARTIALLY AGREE - We agree controls are needed to assure the contractor timely submits requests for background checks. The contractor has been directed and has begun to track and is accountable for the status of its submission of these requests. We also agree that employees awaiting clearances should be in probationary status; however, it would be unacceptably costly to prohibit employees from performing critical ADP work. Except for positions which require access to information dealing with national security, all Federal employees are hired and perform

the full scope of their jobs while the appropriate investigation is conducted and a suitability determination is made. We believe a similar criterion is appropriate for our contractors. Most all software development and system operation work could be considered critical. As a practical matter, we could not delay replacing contractor employees in such work pending the completion of background checks. However, we are exploring alternatives with the contractor such as having them perform a preliminary "criminal and credit check" which is quick and inexpensive .

B3. Establish controls to ensure that personnel or security files accurately reflect that background checks and periodic follow-up background checks are performed as required.

DISAGREE - Controls are already in place to ensure that personnel or security files accurately reflect background checks. MMS's Office of Administration and Budget maintains documentation and a tracking system on all MMS employee and contractor security clearances and background checks. We also disagree with the OIG's statement that followup background checks are required. MMS is in compliance with Departmental guidance (Enclosure 7) that followup checks are authorized *only* for national security positions and not for public trust positions.

C1. Establish controls to enforce Program policy that requires employees to sign security awareness statements before their access to system resources is approved by the Installation Automated Information System Security Officer.

AGREE - While our own test sample has confirmed that our users have appropriate access to RMP systems, we concur that our filing system for access approvals needed improvement. All statements are now consistently filed and reconciled by the ADP security officer.

D1. Ensure that individual computer resources are classified based on the level of sensitivity associated with each resource.

DISAGREE - We believe our current classifications are appropriate. Most RMP data is sensitive or "proprietary" and must be protected from unauthorized disclosure. Our mainframe systems receive heightened security because they are more mission critical, not because they are more sensitive. As explained in previous segments, these systems must be protected more strenuously to ensure the integrity of the official records.

A more moderate level of protection is necessary for proprietary information than for mission critical information. The umbrella protection mechanism for all types of proprietary information is physical controls coupled with employee training. RMP works in a secure environment and trains employees to protect all forms of proprietary information such as paper copies, information on their PC's, and floppy disks, in addition to information which resides on networks and

servers. While it would be possible to install network security measures equivalent to the mainframe measures, we believe the significant additional cost would not be justified. We believe the protection level over all proprietary information is appropriate.

The OIG is technically correct in its statement that MMS had not officially designated any of its systems as "major". However, RMP has treated its mission-critical mainframe applications as major (as allowed by OMB Circular A-130) by providing extra security controls and disaster recovery capabilities. Based on our interpretation of A-130, the fact that these systems were not officially designated as major systems in our annual security plan is incidental and not substantive.

D2. Evaluate controls over resources to ensure that the access controls have been implemented commensurate with the level of risk and sensitivity associated with each resource.

DISAGREE - We believe our existing access controls over resources already meet the intent of this recommendation. All MMS employees are granted access to view royalty, production, and reference data. Since most of this data is proprietary, employees are trained in its proper use and must sign statements acknowledging their responsibility to protect it. State and Tribal employees have access to such data within their jurisdictions only. The ability to add or change data is limited to those employees who require that access to perform their jobs.

E1. Implement controls to enforce Program policy that default user ID's and passwords are to be removed from the automated information system when commercial off-the-shelf software is implemented.

AGREE - The contractor has implemented a verification procedure to ensure this situation does not recur.

F1. Evaluate the current Program policy which only recommends that passwords contain a mix of letters and numbers for all automated information system components. Implement, if the Program determines that a mix of letters and numbers should be required, the security software option within RACF that would enforce this requirement. If the Program determines that a mix of letters and numbers is not required, the risk should be addressed in the risk assessment.

AGREE - RMP will assess this issue and document the decision.

F2. Develop and implement centralized security administration for the local area networks used by the Program's divisions that contain proprietary and financial data.

AGREE - We are in process of implementing centralized security administration for efficiency purposes. However, we cannot support OIG's basis for this recommendation, i.e., that ". . . no Program procedures were in place to ensure that controls were adequate to safeguard these local area networks and personal computers" as evidenced by two allegedly inappropriate software settings. As discussed below, we disagree the settings are inappropriate. RMP has had security and recovery procedures in place for its LAN's since 1993, and the fileservers are secure.

F3. Change the "SET UNENCRYPTED PASSWORD" to "OFF" and include the "SECURE CONSOLE" command in the AUTOEXEC.NCF file on all file servers to prevent users from gaining unauthorized access to sensitive files.

DISAGREE - RMP was aware of the software settings issues suggested by the OIG and had consciously decided to leave the settings as they are. In both cases, the judgements were based on operational issues, taking risk into consideration. The limited security exposure was mitigated by the physical controls. The servers in question are in a locked LAN room within a controlled access building. Both of these decisions fall under the security judgement mandated by the A-130 and the National Institute of Standards and Technology (NIST) handbook which states that "The costs and benefits of security should be carefully examined in both monetary and non-monetary terms to ensure that the cost of controls does not exceed expected benefits". It was RMP's judgement that the real costs of setting these parameters in the way suggested by OIG clearly exceeded their limited security benefits.

G1. Implement controls to ensure that access managers approve all access to their applications in accordance with Program policy.

DISAGREE - We believe effective controls have been in place to assure that application managers approve all access to their applications (see Enclosure 7). We acknowledge that our filing system for such approvals needed improvement and are in the process of resolving this problem.

G2. Document procedures which require that users' access levels be reviewed periodically or that employees be re-certified to ensure that the levels of access granted are appropriate for the duties assigned to the users.

AGREE - We concur with the need to document these procedures. However, we disagree with the OIG's implication (in its statement of effect) of any significant risk of security breaches. Access to mission-critical systems has been carefully managed and controlled through documented security procedures and controls, including mainframe access matrices and annual reviews by the Security Manager. Our own tests confirmed that no unauthorized access exists or has existed.

H1. Evaluate the need to deviate from the Departmental standard for the number of unsuccessful log-in attempts. If the Program determines that this number should remain at five, Program management should request, from the Department, a waiver from the standard of three attempts.

AGREE - A DOI waiver for RMP to extend the password attempts from three to five for the RMP was granted on November 14, 1997. (Enclosure 9)

I1. Document procedures for authorizing, approving, and testing client/server application software before the software is moved into production.

DISAGREE - These documented procedures are already in place. (Enclosure 5)

J1. Implement controls to ensure that application programmers do not have access to the production client/server application data or the capability to update/change these data.

DISAGREE - While application programmers do not routinely require update access to any RMP production data, there are instances when temporary access is needed by specific programmers under controlled circumstances. To mitigate any future risks associated with this access, procedures have been reinforced which detail actions to be taken when requesting temporary access to mainframe and client/server production data. We also refute OIG's statement that application programmers serve as "backup" to end-users. This does not occur.

J2. Improve detection controls by ensuring that management or the Installation Security Officer reviews server security logs periodically.

AGREE - The contractor is being directed to address the review of server security logs within their overall internal control procedures. (We do not believe MMS management or the Installation Security Officer should carry out this procedure.)

K1. Ensure that the upgraded version of RACF is implemented immediately if the Program is granted waiver from consolidating its mainframe operations with another mainframe operation.

DISAGREE - As discussed under Risk Assessments (Page 2), we believe OIG misunderstood the effects of delaying this software upgrade. Although this is a moot point now that MMS has replaced its processor, the decision not to upgrade the RACF software was well founded.

L1. Evaluate acquiring system-verification and auditing software.

DISAGREE - RMP routinely uses a number of system-assurance mechanisms such as control reports, system-assurance programs and user-reconciliation reports. Nonetheless, RMP remains

alert to any technologic developments that would improve system integrity and operations. As these packages become available, they will be examined for applicability to the RMP computing environment.

L2. Implement the system options to record activities in the SYSLOG during the system initialization process and develop and implement procedures to ensure that periodic reviews of the SYSLOG for unauthorized or inappropriate activities are performed and that unauthorized or inappropriate activities are reported to Program management.

AGREE - System initialization activities as well as operator commands are already recorded in the SYSLOG. Because we are uncertain of the payoff and cost effectiveness of the periodic reviews, we will conduct a pilot test. The SYSLOG will be reviewed following system initialization for inappropriate and unauthorized activities that may have occurred during the test. Based on the results, we will assess the feasibility of fully implementing this routine.

L3. Evaluate the available System Management Facility (SMF) record types and implement procedures to ensure that critical SMF logs are reviewed periodically and that Program management addresses the problems identified.

AGREE - We have evaluated record types and concluded that certain log record types may be worthwhile for periodic review. We will pilot test a monthly review of these record types. Depending on the volume of records and the payoff, RMP will continue, expand, or reconsider this detection method. Program management will be notified when problems are identified.

M1. Update the disaster recovery plans to include all mission-critical systems.

AGREE - We plan to update the disaster recovery plans to include all mission-critical systems. However, we do not agree with the OIG's presumption that all systems containing proprietary or financial data are "mission critical." Many PC-based systems contain *copies* of such data for analysis, but these systems are not considered mission critical. MMS' ongoing Year 2000 project is identifying and classifying any stand-alone systems that managers judge to be "mission critical." If so, these systems will be reclassified as such and will be required to reside on LAN's or servers that can be centrally backed up for recovery purposes.

STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
A.1	Unresolved.	Reconsider the recommendation to clarify that the enhanced risk assessment process will include the identification of significant risks affecting systems, will appropriately identify controls implemented to mitigate those risks, and will formalize the acceptance of residual risk. Also, an action plan that includes target dates and titles of officials responsible for implementation should be provided.
A.2	Unresolved.	Reconsider the response to ensure that local area network administrators participate in the risk assessment process, and provide an action plan that includes target dates and titles of officials responsible for implementation.
A.3, F.1, F.2, L.2, L.3, and M.1	Management concurs; additional information needed.	Provide an action plan that includes titles of officials responsible for implementation.
B.1, B.2, E.1, and J.2	Management concurs; additional information needed.	Provide an action plan that includes target dates and titles of officials responsible for implementation.

Finding/Recommendation Reference	Status	Action Required
B.3, D.1, D.2, and L.1	Unresolved.	Reconsider the recommendations, and provide action plans that include target dates and titles of officials responsible for implementation.
C.1	Unresolved.	Provide information relating to how the reconciliation of the statements was performed and the dates the actions were completed.
G.1	Unresolved.	Reconsider the recommendation, and provide information regarding controls which ensure that all access managers approve all access to their applications. Also, an action plan that includes target dates and titles of officials responsible for implementation should be provided.
G.2	Unresolved.	Reconsider the recommendation, and provide information regarding documentation of procedures requiring users' access level reviews or recertification of users' access be performed periodically. Also, an action plan that includes target dates and titles of officials responsible for implementation should be provided.
H.1	Implemented.	No further action is required.

Finding/Recommendation Reference	Status	Action Required
I.1	Unresolved.	Respond to the revised recommendation, and provide an action plan that includes target dates and titles of officials responsible for implementation.
J.1	Unresolved.	Reconsider the recommendation, and provide the procedures that mitigate risks when application programmers are allowed update access to production data.
K.1	Unresolved.	Reconsider the recommendation, and provide information on whether the upgraded version of the security software has been implemented on the new processor.

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free Numbers:
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

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

AUDIT REPORT

FOLLOWUP OF MAINTENANCE ACTIVITIES, NATIONAL PARK SERVICE

REPORT NO. 98-I-344
MARCH 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAR 27 1998

MEMORANDUM

TO: The Secretary

FROM: Robert J. Williams
Acting Inspector General

SUBJECT SUMMARY: Final Audit Report for Your Information - "Followup of Maintenance Activities, National Park Service" (No. 98-I-344)

Attached for your information is a copy of the subject audit report. The objective of the audit was to determine whether the National Park Service had satisfactorily implemented the recommendations made in the audit reports "Maintenance Work Performed for Non-Governmental Recipients, National Park Service" (No. 91-I-1321), issued in September 1991, and "Maintenance of the National Park System, National Park Service" (No. 92-I-455), issued in February 1992, and whether any new recommendations were warranted.

We found that the Park Service had fully implemented five of the prior reports' eight recommendations and partially implemented three recommendations. Specifically, we found that the Park Service had not taken sufficient action to recover the Park Service's costs for maintaining facilities used by concessioners and other non-Governmental entities and had largely discontinued use of its standardized maintenance management system, which was developed to provide the parks with a mechanism to plan and manage their maintenance activities and to supply data needed to support Park Service budget requests for maintenance funding. The report recommended that the Park Service (1) pursue opportunities to modify concession maintenance agreements so that concessioners are required to perform or pay for the maintenance of their facilities, (2) require lessees at one park area to perform or pay for their maintenance work, (3) operate a maintenance management system in accordance with the requirement of Public Law 98-540, and (4) redesignate the lack of a standardized maintenance management system as a material management control weakness.

The Park Service did not provide a formal response to the draft report. Therefore, we considered the report's four recommendations to be unresolved.

If you have any questions concerning this matter, please contact me at (202) 208-5745.

Attachment

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

AUDIT REPORT

MAR 27 1998

Memorandum

To: Assistant Secretary for Fish and Wildlife and Parks

From: Ronald K. Stith
Acting Assistant Inspector General for Audits

Subject: Audit Report on Followup of Maintenance Activities, National Park Service (No. 98-I-344)

INTRODUCTION

This report presents the results of our followup review of recommendations contained in two prior reports on maintenance of the national park system: "Maintenance Work Performed for Non-Governmental Recipients, National Park Service" (No. 91-I-1321), issued in September 1991 (see Appendix 2), and "Maintenance of the National Park System, National Park Service" (No. 92-I-455), issued in February 1992 (see Appendix 3). The objective of our review was to determine whether the National Park Service had satisfactorily implemented the recommendations made in these two reports and whether any new recommendations were warranted.

BACKGROUND

The National Park Service is responsible for protecting, safeguarding, and maintaining the assets of the national park system, which include about 15,000 buildings, 8,000 miles of roads, 1,400 bridges, 5,200 housing units, 1,500 water and sewer systems, and an extensive network of trails. These assets, valued at over $50 billion, are located in approximately 370 park units, encompassing over 80 million acres. The Park Service is also responsible in some cases for maintaining and repairing concessioner and/or Government-owned buildings, structures, and lands used by concessioners. According to the Concessions Program Manager at the Park Service's Headquarters, as of June 1, 1997, there were 212 contracts that authorized concessioners to operate in 88 park units. The specific maintenance responsibilities of the concessioner and the Park Service were generally identified in the concession contracts and in maintenance agreements between concessioners and park units.[1]

---

[1]Sections B.2b and C.1, Chapter 26, of the National Park Service Guidelines for Concession Management (NPS-48) provide guidance for maintenance agreements and require the agreements "to be in conformity with the existing contract or permit." In 1990, the Park Service issued guidance (Chapter 37 of NPS 48) that was to help personnel in developing maintenance agreements which are in accordance with the terms of the contracts and that required annual reviews of the maintenance agreements.

In fiscal year 1996, the Park Service received funds of about $349 million under its Operation of the National Park System appropriation for maintenance of the national park system.[2] Of this amount, approximately $275 million was budgeted for operational maintenance activities for meeting daily park needs such as providing janitorial services; removing snow; and performing routine maintenance and repair of buildings, grounds, roads, and park-operated utility systems. About $59 million was budgeted for regional maintenance activities, which included a cyclical maintenance program and a repair and rehabilitation maintenance program. Cyclical maintenance is performed on a periodic basis of more than 1 year and includes such activities as resealing roads, repainting and reroofing buildings, and taking other preventive measures necessary to prolong the life of an asset. The repair and rehabilitation maintenance program addresses larger-scale projects that occur on a less frequent basis such as rehabilitating campgrounds and trails and replacing water and sewer lines. The remaining $15 million was budgeted for Servicewide maintenance programs that address national-level concerns such as employee housing, dam safety, and hazardous waste cleanup. The Park Service also received reimbursements for performing maintenance work for concessioners. These funds were retained by the respective park units for use in their maintenance programs. However, we could not readily determine the total reimbursements received in fiscal year 1996 because some park units did not record these reimbursements in the designated account.

According to various reports, the Park Service's maintenance backlog, which included repair/rehabilitation and reconstruction/replacement projects, has increased significantly over the years. In 1988, after the Park Service completed a $1 billion program to restore and rehabilitate park facilities, the General Accounting Office reported that the backlog was about $1.9 billion, which consisted of routine maintenance items such as repairing buildings, as well as major capital improvements such as replacing water and sewer systems and reconstructing roads.[3] In 1996, the Park Service reported to the House of Representatives Committee on Appropriations that the backlog had reached an estimated $4.5 billion. The Park Service's most recent estimate is contained in the January 1997 document "National Park Service Maintenance Backlog Data."[4] This document identified a backlog of "unfunded capital construction needs" (for projects over $500,000) of $5.6 billion, which consisted of $4.4 billion for resource preservation, repair, and rehabilitation of existing facilities and $1.2 billion for the construction of new facilities (see Appendix 6). (According to the Park Service's definition of maintenance, however, the construction of new facilities is not

---

[2]According to documentation provided by the Park Service's Park Facility Management Division, "Park maintenance is an inclusive term for the operation, routine maintenance, day to day maintenance, cyclic maintenance, repair/rehabilitation, and reconstruction/replacement work that is funded and accomplished at the park level." Repair/rehabilitation and reconstruction/replacement projects (not including roads) that cost more than $500,000 each are typically funded through the line item activity of the Park Service's Construction appropriation. Major rehabilitation/construction on roads is funded through the Department of Transportation's Federal Lands Highway Program.

[3]*Park Service Managers Report Shortfalls in Maintenance Funding* (No. GAO/RCED-88-91BR), March 21, 1988.

[4]We did not verify the accuracy of the estimates contained in the document.

considered a maintenance project.) The document also reported a maintenance project backlog of between $435 million and $575 million. Although the Park Service listed specific projects in its $5.6 billion backlog, it did not identify the specific projects that the maintenance project backlog comprised. The document stated, "As part of its budget formulation process, the NPS [National Park Service] Washington Office surveys the field for desired annual funding levels, but actual backlog project lists are not collected centrally, since they quickly become outdated because of new priority requirements."

SCOPE OF AUDIT

The scope of our audit was limited to reviewing implementation actions taken by the Park Service on the eight recommendations contained in our 1991 and 1992 reports. As of October 30, 1995, the Department of the Interior's Division of Management Control and Audit Followup considered the eight recommendations implemented. These recommendations and the implementing actions are detailed in Appendices 2 and 3. This followup review was made in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances.

To accomplish our audit objective, we reviewed fiscal year 1995 and 1996 maintenance activities related to the implementation of the recommendations at Golden Gate and Lake Mead National Recreation Areas and Sequoia/Kings Canyon and Everglades National Parks. Based on the results of our review at these four park units, we expanded our testing procedures by judgmentally selecting 18 additional concession contracts and related maintenance agreements from 12 other park units to determine the extent to which these agreements required park unit personnel to perform maintenance work without reimbursement that benefited concessioner operations. In addition, we obtained information on whether each of the 16 park units included in our review (4 visited and 12 contacted) was using the Park Service's standardized system to help manage and plan its maintenance operations in an effective manner. The locations visited and contacted during the audit and the concession contracts and related maintenance agreements included in this review are listed in Appendices 4 and 5, respectively.

Because of the limited scope of our review, we evaluated the Park Service's system of internal controls related to its management of maintenance operations only to the extent that the internal controls affected the corrective actions taken in regard to the eight recommendations included in the two prior reports. We identified a control weakness related to the implementation of the Park Service's standardized maintenance management system. This weakness is discussed in the Results of Audit section of this report. Our recommendations, if implemented, should improve the internal controls in this area. We also reviewed the Department of the Interior's Annual Statement and Report to the President and the Congress, which is required by the Federal Managers' Financial Integrity Act, for fiscal year 1995 and the Department's Accountability Report for fiscal year 1996, which includes information required by the Act, and determined that no material weaknesses were reported that directly related to the objective and scope of this audit.

PRIOR AUDIT COVERAGE

Neither the General Accounting Office nor the Office of Inspector General has audited the Park Service's maintenance activities during the past 5 years.

RESULTS OF AUDIT

Of the eight recommendations made in our two prior audit reports, we found that five recommendations had been fully implemented and that three recommendations had been partially implemented. We considered the three recommendations partially implemented because the park units we reviewed (1) had not taken sufficient action to modify concessioner maintenance agreements to provide for the recovery of the Park Service's costs for maintaining concessioner-operated facilities (Recommendation 2 in our 1991 report) and (2) had discontinued using the standardized maintenance management system developed to provide the park units with a mechanism for effectively planning and managing maintenance activities and for supporting budget requests for those activities (Recommendations 1 and 3 in our 1992 report[5]).

Reimbursement of Maintenance Costs

Our 1991 report (No. 91-I-1321) identified park units that had, in effect, subsidized some concessioners by performing maintenance work which should have been paid for or performed by the concessioners. This occurred mainly because the maintenance responsibilities were not clearly delineated in the concession contracts or the related maintenance agreements. We also found instances in which (1) maintenance agreements did not require the concessioner to perform maintenance work that was specifically required in the concession contract or (2) concession contracts and related maintenance agreements specifically assigned the park unit responsibility for maintenance that benefited the concessioner. Our prior report also stated that park units generally were not recording reimbursable-type maintenance costs in the Park Service's accounting system to ensure the recovery of those costs.

At the time of the prior audit, the responsible concession management specialists told us that the responsibilities for such maintenance would be transferred to the concessioners when the contracts and related maintenance agreements expired and were renegotiated. They further stated that the park units would require reimbursement for performing maintenance required to be accomplished by the concessioner. In that regard, Recommendation 2 of the report required park units to (1) identify all maintenance activities that directly benefit concessioners and other non-Governmental recipients, (2) specifically define the maintenance responsibilities of both the concessioners and the park units in future concession contracts or maintenance agreements, (3) use the Park Service's accounting system or park

[5]The Park Service's response to the 1992 report identified a single corrective action to resolve both recommendations.

unit maintenance management systems to track concessioner maintenance costs, and (4) bill the concessioners or other non-Governmental recipients for their share of the maintenance costs that benefit their operations.

We determined that of the four park units visited during our followup review, only Sequoia/Kings Canyon National Park had taken adequate action to fully implement Recommendation 2. Specifically, a major concession contract and a maintenance agreement were finalized, which shifted the responsibility for certain maintenance work to the concessioner. We also found that when the Park performed maintenance work, such as snow plowing, which directly benefited the concessioner's operations, the applicable costs were properly identified, tracked, and billed to the new concessioner. Under the terms of the previous concession contract, which had been in effect for 25 years, the Park Service was required to perform maintenance work for the concessioner without any reimbursement.

Based on our limited review of maintenance agreements judgmentally selected and obtained from the 12 park units we contacted, we found that the agreements for 4 of these units (Bryce Canyon, Mesa Verde, Rocky Mountain, and Zion National Parks) more clearly defined concessioner maintenance responsibilities. (We did not determine whether these 4 park units had fully implemented Recommendation 2 because we did not test the maintenance expenditures at the 12 park units contacted to substantiate that the terms of the maintenance agreements were met.) However, the other three park units we visited (Lake Mead and Golden Gate National Recreation Areas and Everglades National Park) and the other eight park units we contacted (Big Bend, Death Valley, Grand Canyon, Grand Teton, Olympic, Petrified Forest, and Yellowstone National Parks and Lake Meredith National Recreation Area) had not taken sufficient actions to fully implement the recommendation. Specifically, these park units had not clearly defined the concessioners' maintenance responsibilities when concession contracts expired or were extended by amendment or formal extension. Supervisory maintenance personnel at 4 of the 16 park units included in our review (Everglades, Grand Canyon, and Yellowstone National Parks and Lake Mead National Recreation Area) estimated that the Park Service spent about $597,000 annually at their park units for maintenance work that directly benefited the concessioners' operations (see Appendix 1). Examples of work performed at these locations that we believe should have been performed or paid for by the concessioners are as follows:

- Everglades National Park personnel routinely performed maintenance for the concessioner under a maintenance agreement that was inconsistent with terms included in the 1979 concession contract. Under the contract, the concessioner was responsible for all maintenance of Government- and concessioner-owned buildings and grounds used in its operations. However, despite the contract terms, the Park assumed responsibility for much of this work when it negotiated a maintenance agreement with the concessioner in 1981. The Park's chief of maintenance stated that these maintenance activities, which included mowing grass and trimming trees on concession grounds, cost an estimated $167,000 annually. Park Service personnel could not explain why the Park assumed these maintenance responsibilities in the 1981 agreement.

- Lake Mead National Recreation Area personnel, in compliance with the terms of the maintenance agreements, performed work related to concessioner facilities and operations, such as cleaning and maintaining concessioner parking lots, air landing strips, and fish-cleaning and comfort stations. The chief of maintenance estimated that about $173,000 was spent annually by the Park Service to perform this work.

- Under three maintenance agreements, Grand Canyon National Park personnel were responsible for providing maintenance services that benefited concessioner facilities and operations. These services included removing snow and repairing roads, trails, parking areas, paths, and curbs. The chief of maintenance estimated that the Park spent almost $219,000 annually to perform this work.

In addition, Lake Mead National Recreation Area maintenance personnel performed road maintenance for cabin lessees within the park unit. While not a concession issue, these expenditures, estimated at $13,000 annually, provided a special benefit to the cabin lessees. As required by Office of Management and Budget Circular A-25, "User Charges," which established guidelines for Government agencies to assess fees for Government services, the cabin lessees should have been responsible for these costs.

Overall, we concluded that park unit management generally had not taken advantage of opportunities to negotiate maintenance agreements to assign concessioners responsibility for maintaining the facilities used in their operations. These managers told us that, in most instances, they did not seek to recover the costs of maintenance work because the terms of the concession contracts or related maintenance agreements specifically required that the work be performed by the Park Service and did not provide for reimbursement from the concessioners. However, we found that many of the maintenance agreements reviewed were associated with long-term contracts which had expired, some as many as 10 years ago. Overall, 21 of the 36 concession contracts and related maintenance agreements that we reviewed had expired. The Concessions Program Manager at the Park Service's San Francisco Office said that when a concession contract expires, the Park Service can formally amend the contract for a multiple-year period, usually for 3 years, or it can issue a formal extension which will extend the terms of the original contract for an additional year. The Concessions Program Manager at Park Service Headquarters said that the park unit concessions managers have an opportunity to modify their maintenance agreements and transfer maintenance responsibilities to the concessioner when contracts are formally amended or formally extended. They further stated that concessions managers can modify the agreements when concession operations are sold because the Park Service is required by NPS-48 to formally ratify any sale before the new concessioner can begin operations. In that regard, we noted that the Park Service had an opportunity to modify the maintenance agreements for 30 of the 36 contracts we reviewed: 21 expired contracts and 9 of the 15 unexpired concession contracts that had been purchased by new entities.

We found, however, that most of the park units in our review did not modify the terms of the maintenance agreements when they had the opportunity to do so. The responsible concessions managers told us that they generally wanted to wait until new contracts were formally negotiated before they revised the maintenance agreements. Based on our review

of the 36 maintenance agreements, we found only two instances where park units had modified the terms of the maintenance agreements: Rocky Mountain National Park, when a contract had expired, and Bryce Canyon National Park, when a concession operation was purchased by another entity. In the latter instance, the chief of maintenance stated that the Park modified the maintenance agreement in 1994, 10 years after the start of the contract. By modifying the agreement, certain maintenance responsibilities previously performed by Park Service personnel were transferred to the new concessioner. The chief of maintenance estimated that the Park would "save" from $25,000 to $100,000 annually over the remaining 10 years of the contract as a result of the modification and stated that these savings were used to address the Park's deferred maintenance backlog.

Based on our tour of facilities at the four park units visited and on our discussions with the chiefs of maintenance, we determined that maintenance of Park Service facilities had been deferred, in part, because funds were used to maintain facilities used in the concessioners' operations. For example, the chief of maintenance at Everglades National Park said that he did not have $40,000 available to replace a deteriorated visitor facility, which provided access to a popular wilderness wetlands area, but that the Park spent an estimated $167,000 annually to perform maintenance work associated with the concessioner's operations. Based on our review of available documentation and on discussions with the Park's current and former concessions management officials, we determined that little effort had been made to negotiate the transfer of these maintenance responsibilities to the concessioner. In that regard, the Park did not take advantage of an opportunity to revise the maintenance agreement in 1985, when the concession operation was sold to another party, or in 1994, when the 25-year contract period expired.

We believe that the Park Service could reduce maintenance costs for concession facilities by modifying the terms of applicable maintenance agreements at the earliest opportunity. During our discussions with the Concessions Program Manager at the Park Service's Headquarters, we were told that as many as 70 of the Park Service's 212 concession contracts will expire by January 1998. Considering the large number of expiring contracts, we believe that the Park Service should take prompt action to review all maintenance agreements and aggressively pursue modification of the agreements to assign concessioners full responsibility for the maintenance of concession facilities. Based on the conditions noted, we concluded that the Park Service had not taken sufficient action to implement the recommendation.

Maintenance Management System

Our 1992 report (No. 92-I-455) discussed the large backlog of repair and rehabilitation maintenance projects and stated that "funding shortages and other external and internal factors such as the addition of new park areas, increased park visitation, and compliance with environmental laws . . . have contributed to certain maintenance program deficiencies." In its response to Recommendations 1 and 3 in our 1992 report, the Park Service stated that it would "make every effort to ensure, through effective management and planning, that all maintenance needs . . . [were] fully documented and that budget requests reflect those needs."

At the time of our prior review, the Park Service was taking actions to improve its ability to budget for, plan, and manage its maintenance activities, including the development and implementation of a comprehensive, standardized maintenance management system. The system was mandated by the Congress in 1985 as part of Public Law 98-540 (an act to amend the Volunteers in the Parks Act of 1969), which directed the Park Service to develop and implement such a system. Section 4(a) of Public Law 98-540 specifically required the maintenance system to include the following seven elements:

(1) a work load inventory of assets including detailed information that quantifies for all assets (including but not limited to buildings, roads, utility systems, and grounds that must be maintained) the characteristics affecting the type of maintenance performed;

(2) a set of maintenance tasks that describe the maintenance work in each unit of the National Park System;

(3) a description of work standards including frequency of maintenance, measurable quality standards to which assets should be maintained, methods for accomplishing work, required labor, equipment and material resources, and expected worker production for each maintenance task;

(4) a work program and performance budget which develops an annual work plan identifying maintenance needs and financial resources to be devoted to each maintenance task;

(5) a work schedule which identifies and prioritizes tasks to be done in a specific time period and specifies required labor resources;

(6) work orders specifying job authorizations and a record of work accomplished which can be used to record actual labor and material costs; and

(7) reports and special analyses which compare planned versus actual accomplishments and costs and can be used to evaluate maintenance operations.

The Congressional mandate came about 5 months after the 1984 General Accounting Office report "National Park Service Needs a Maintenance Management System" (No. GAO/RCED-84-107), which concluded that the Park Service did not have the ability to document and monitor its maintenance activities. Thus, according to the report, the Park Service could not "assure that its assets [received] needed upkeep and that park maintenance activities [were] efficient."

Through 1992, the Secretary of the Interior's Annual Statement and Report to the President and the Congress had identified the lack of a "formal, systematized methodology for managing maintenance operations" as a Servicewide material weakness. In 1993, the Park Service informed the Department that implementation of its standardized maintenance management system (which cost an estimated $11 million for development and

implementation) had eliminated this weakness. In its fiscal year 1997 budget justifications, the Park Service stated that its maintenance management system/program provides "a formalized, systematic process for managing maintenance operations" in the most economic and efficient manner and "standard procedures for the performance of work and for reporting on the completion of projects."

However, we found that the system was no longer used on a Servicewide basis to document maintenance needs and to assist the park units in managing, planning, and developing budget data for their maintenance programs. The park units reviewed had essentially discontinued the use of the standardized system. Specifically, we found that only 7 of the 16 park units we reviewed were using the system: 5 that used the standardized system and 2 that used the standardized system in conjunction with another commercial computer software program. Of the nine remaining park units, eight used the commercial software program exclusively, and the remaining park unit (Everglades National Park) had no computer-based maintenance management system in use.

Park unit managers and maintenance personnel said that they discontinued use of the Servicewide system for various reasons, including the lack of technical support, system failures, inaccurate system-generated reports, and prohibitive costs. For example:

- A maintenance supervisor at Everglades National Park said that the Park had discontinued using the system in 1995 because of a system failure which was reportedly caused by an attempt to upgrade the system.

- Maintenance personnel at Sequoia/Kings Canyon National Park said that they changed to a commercial computer software program in 1996, with the Region's concurrence, after the standardized system provided "erroneous results" for fiscal year 1995.

- Maintenance personnel at Lake Mead National Recreation Area stated that they also received Regional permission in 1996 to use the same commercial software program that Sequoia was using.

The Regional facilities manager said that the Region had approved requests from Sequoia/Kings Canyon National Park and Lake Mead National Recreation Area to discontinue using the standardized maintenance management system primarily because of the numerous complaints it had received from the park units and because the standardized system did not have a preventive maintenance module.

We also found that Park Service personnel at 11 of the 16 park units reviewed had not fully implemented two of the seven elements mandated by Public Law 98-540. Specifically, the requirements of Section 4(a) of Public Law 98-540 pertaining to "measurable quality standards" described in element 3 and the "work program and performance budget" described in element 4 were not in place. These two requirements enable park unit managers to determine their actual maintenance needs and to effectively prioritize the maintenance work. In our opinion, implementation of a system having all seven of the elements will help to

provide managers with the information they need to plan, organize, direct, and review their maintenance activities.

Based on the conditions noted, we concluded that the Park Service had not taken sufficient actions to implement the two related recommendations (Nos. 1 and 3) in our 1992 report. Specifically, the Park Service had not successfully implemented and maintained a Servicewide maintenance management system that provides complete data and/or information for prioritizing maintenance projects, monitoring and measuring maintenance activities, or fully supporting budgetary requests for maintenance backlog funding.

Recommendations

We recommend that the Director, National Park Service:

1. Direct park unit management to actively pursue all opportunities to modify concession maintenance agreements to ensure that maintenance responsibilities of each party are clearly defined and that concessioners are required to perform or pay for all maintenance related to the facilities used in their operations. If a concessioner has not assumed full maintenance responsibility, its maintenance agreement should be modified when the concession contract is amended, when a formal extension is issued, or when the Park Service is ratifying the sale of the concession operation to another entity.

2. Direct Lake Mead National Recreation Area management to discontinue performing maintenance work which provides special benefits to cabin lessees unless the cost of the work is reimbursed by the benefiting lessees.

3. Ensure that the Park Service fully complies with the requirement of Public Law 98-540 to maintain a standardized maintenance management system which contains all seven of the legislatively mandated elements.

4. Report the lack of a standardized maintenance management system as a material management control weakness in accordance with the requirements of the Federal Managers' Financial Integrity Act.

National Park Service Response and Office of Inspector General Comments

We requested that the Director, National Park Service, provide written comments to the draft report by February 9, 1998. Based on a Park Service request, we extended the date for comment to March 2, 1998. However, because a response to the draft report was not received, we consider all of the recommendations unresolved. Therefore, in accordance with the Departmental Manual (360 DM 5.3), we are requesting a written response to this report by April 27, 1998. The response should provide the information requested in Appendix 7.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, the monetary impact of audit findings

(Appendix 1), actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the assistance of National Park Service personnel in the conduct of our audit.

CLASSIFICATION OF MONETARY AMOUNTS

Finding	Funds To Be Put To Better Use[1]
Reimbursement of Maintenance Costs	
Everglades National Park	$167,000
Grand Canyon National Park	219,000
Lake Mead National Recreation Area	186,000
Yellowstone National Park	25,000
Total	$597,000

[1]These amounts, which were provided by the park units' chiefs of maintenance, represent the estimated annual costs (unreimbursed) for performing work associated with the maintenance of concessioner facilities and operations.

STATUS OF RECOMMENDATIONS AND CORRECTIVE ACTIONS FOR AUDIT REPORT "MAINTENANCE WORK PERFORMED FOR NON-GOVERNMENTAL RECIPIENTS" (No. 91-I-1321)

Recommendations	Status of Recommendations and Corrective Actions
1. Require the headquarters to establish written guidelines and policies on maintenance cost recovery from identifiable beneficiaries. These guidelines and policies should be similar to the ones contained in the Service's Special Directive 83-2, "Rates for NPS-Produced Utilities."	1. Implemented. The Associate Director for Budget and Administration issued written guidance on September 3, 1992, to the field directorate to improve the system for controlling and recording revenues from concessioners, expenditures, and other financial activities. The guidance became effective for fiscal year 1993 and specified the types of costs incurred in providing services to the concessioners that were required to be reimbursed. A separate accounting code was established to accumulate these costs for reimbursement purposes.
2. Require the parks to (a) identify all maintenance activities that directly benefit park concessioners and other non-Governmental recipients, (b) specifically define the maintenance responsibilities of both the concessioners and the parks in future concessions contracts or concessioner maintenance agreements, (c) use the Service's accounting system or park maintenance management systems to track concessioner maintenance costs, and (d) bill the concessioners or other non-Governmental recipients for their share of the maintenance costs that benefit their operations.	2. Partially implemented. We concluded that parts a and c of this recommendation were implemented through the actions taken for Recommendation 1.. However, we considered parts b and d as only partially implemented because park managers had not modified the maintenance agreement terms when the related contracts expired or when the concessioners' operations were purchased by other entities.
3. Pursue legislation which will allow the individual parks to retain and utilize for park maintenance-related activities all maintenance costs reimbursed by concessioners and other non-Governmental recipients.	3. Implemented. The Park Service proposed commentary for new legislation (S.208) that addressed the recommendation, but the commentary was subsequently deleted by the Office of Management and Budget. However, during our followup review, we found that the Park Service had an ongoing policy of retaining these funds in the parks under the authority of the United States Code (16 U.S.C. 1b).
4. Obtain a Solicitor's opinion to determine who is responsible for maintaining the Beartooth Highway and, if applicable, the propriety of Yellowstone National Park's billing of the States of Wyoming and Montana for past maintenance costs.	4. Implemented. The Park Service provided documentation whereby the Regional Solicitor, Rocky Mountain Region, provided the opinion that the Park Service was responsible for maintaining Beartooth Highway.

STATUS OF RECOMMENDATIONS AND CORRECTIVE ACTIONS FOR AUDIT REPORT "MAINTENANCE OF THE NATIONAL PARK SYSTEM" (No. 92-I-455)

Recommendations	Status of Recommendations and Corrective Actions
1. Ensure, through effective management and planning, that sufficient funds are available to administer an effective preventative maintenance program at the time that maintenance actions are required. To the extent possible, park operational and regional cyclic and repair and rehabilitation programs should be made available at a level necessary to reduce the increases in the existing backlog.	1. Partially implemented. Since 1992, the Park Service has sought additional Congressional funding for maintenance operations to address the backlog of repair and rehabilitation needs. In addition, the Park Service implemented a standardized maintenance management system in 1993 that was designed to help ensure the effective management and planning of its maintenance operations. However, during our followup review, we found that the system did not contain all of the features required by the Congress and that the use of the system was subsequently discontinued at some locations.
2. Instruct the regions and parks to discontinue the practice of using limited park operational and regional program maintenance funds for construction of new facilities, major equipment purchases, or any other non-maintenance-related activity.	2. Implemented. The Associate Director, Operations, issued a memorandum to all Regional Directors clarifying the use of funds from the National Park Service Maintenance appropriation for the construction of new facilities. In addition, the regions were instructed to place greater emphasis on budget integrity and to obtain prior approval before they spent any funds for purposes other than those allotted. Also, the replacement of major equipment is now funded through the Park Service's construction appropriation instead of Operation of the National Park Service appropriation. Our tests of maintenance expenditures at the park units we visited indicated that park unit personnel had complied with these instructions.
3. Place increased emphasis on maintenance in the budget planning process and specifically address both the external and internal factors that impact park maintenance needs.	3. Partially implemented. The Park Service reorganized into seven regions, which helped to reduce central overhead and levels of review and oversight and also helped to improve the delivery of support services to the parks. However, we also found that some park units had discontinued using the standardized maintenance management system which was developed, in part, to improve the effectiveness of the budget planning process (see Recommendation 1).

Recommendations	Status of Recommendations and Corrective Actions
4. Either (a) budget and account for fee program revenues as supplemental funds separately from the operations appropriations in accordance with Public Law 100-203 or (b) request a waiver from the Appropriations Committees concerning the requirement to spend fee program revenues on specific projects which meet the prescribed uses identified in the legislation.	4. Implemented. The Park Service developed revised primary work elements for its operating accounts. The revised elements more clearly allow for delineation of the expenditure of funds derived from the special fees.

REGIONAL OFFICE AND PARK UNITS VISITED AND/OR CONTACTED

Regional Offices and Park Units	Location
Intermountain Region*	Colorado
Big Bend National Park*	Texas
Bryce Canyon National Park*	Utah
Grand Canyon National Park*	Arizona
Grand Teton National Park*	Wyoming
Lake Meredith National Recreation Area*	Texas
Mesa Verde National Park*	Colorado
Petrified Forest National Park*	Arizona
Rocky Mountain National Park*	Colorado
Yellowstone National Park*	Wyoming
Zion National Park*	Utah
Pacific West Region**	California
Death Valley National Park*	California
Golden Gate National Recreational Area**	California
Lake Mead National Recreational Area**	Nevada
Olympic National Park*	Washington
Sequoia/Kings Canyon National Park**	California
Southeast Region*	Georgia
Everglades National Park**	Florida

*Sites contacted.
**Sites visited.

SELECTED INFORMATION RELATED TO CONCESSION CONTRACTS AT PARK UNITS VISITED OR CONTACTED

Park Unit	Concession Contract No.	Existing Contract Term	Maintenance Agreement Date	Original Concessioner
		Park Units Visited		
Everglades National Park	EVER 001	6/79 - 5/94	September 1981	No
	EVER 002	1/82 - 12/91	February 1982	Yes
Golden Gate National Recreation Area	GOGA 001	1/84 - 12/98	May 1985	No
	GOGA 008	1/88 - 12/92	August 1987	Yes
	GOGA 010	1/88 - 12/91	March 1988	Yes
	MUWO 001	1/85 - 12/94	February 1996	No
Lake Mead National Recreation Area	LAME 001	1/73 - 12/91	March 1983	No
	LAME 002	1/80 - 12/89	February 1992	Yes
	LAME 003	1/73 - 12/97	March 1983	No
	LAME 004	7/88 - 9/03	***No agreement***	Yes
	LAME 005	1/67 - 12/86	April 1994	Yes
	LAME 006	11/72 - 10/87	April 1984	Yes
	LAME 007	1/84 - 12/01	March 1983	No
	LAME 008	1/87 - 12/96	December 1986	Yes
	LAME 009	1/88 - 12/02	November 1987	Yes
	LAME 010	7/71 - 12/89	March 1992	No
	LAME 014	1/62 - 12/88	***No agreement***	No
Sequoia/Kings Canyon National Park	SEKI 006	11/96 - 10/11	August 1996	Yes
		Park Units Contacted		
Big Bend National Park	BIBE002	9/21/82 - 9/20/02	February 1990	Yes
Bryce Canyon National Park	BRCA003	1/1/84 - 12/31/03	April 1994	No
Death Valley National Park	DEVA001	1/1/83 - 12/31/92	Not signed	No
	DEVA002	1/1/81 - 12/31/85	April 1983	Yes
Grand Canyon National Park	GRCA001	1/1/69 - 12/31/98	June 1975	No
	GRCA002	1/1/84 - 12/31/03	November 1984	No
	GRCA003	1/1/68 - 12/31/87	May 1983	Yes
Grand Teton National Park	GRTE001	1/1/73 -12/31/02	November 1984	No
	GRTE002	1/1/90 - 12/31/94	August 1991	No
	GRTE003	12/5/66 - 12/31/89	August 1991	No
Lake Meredith National Recreation Area	LAMR002	1/1/87 - 12/31/96	***No agreement***	No
Mesa Verde National Park	MEVE001	10/1/81 - 9/30/01	January 1992	Yes
Olympic National Park	OLYM001	12/28/78 -12/31/93	November 1989	No
Petrified Forest National Park	PEFO001	1/1/85 - 12/31/94	January 1985	Yes
Rocky Mountain National Park	ROMO001	10/1/71- 5/31/91	March 1996	Yes
Yellowstone National Park	YELL002	10/1/69 - 9/30/99	***No agreement***	Yes
	YELL077	11/1/91 - 10/31/01	May 1995	No
Zion National Park	ZION003	1/1/84 - 12/31/03	February 1997	No

NATIONAL PARK SERVICE BACKLOG DATA

Project Type	Existing Facilities	New or Additional Facilities[1]	Total
Buildings; Visitor Use, Park Support	$893,737,600	$673,476,200	$1,567,213,800
Housing; Permanent and Seasonal Employees	360,708,400	81,218,400	441,926,800
Landscape Work, Erosion Protection, Site Restoration	889,378,200	193,617,200	1,082,995,400
Utilities; Electric, Gas, Water/Sewage Treatment	300,144,410	4,046,000	304,190,410
Subtotal	$2,443,968,610	$952,357,800	$3,396,326,410
Roads, Bridges, Tunnels, Transportation Systems[2]	1,912,374,400	279,075,600	2,191,450,000
Total	$4,356,343,010	$1,231,433,400	$5,587,776,410[3]

[1]These estimates represent the amount needed to construct new facilities in new/developing park units and additional facilities in older/established park units.

[2]The reconstruction/ replacement of existing roads and the construction of new roads are funded by the Federal Lands Highway Program, which is authorized by the Intermodal Surface Transportation Efficiency Act.

[3]These backlog data provided to us by the Park Service consist of estimates of $4.36 billion for repair/rehabilitation and reconstruction/replacement projects involving existing facilities and estimates of $1.23 billion for new construction projects. The estimates represent only individual projects that generally exceed $500,000 (not including roads), which are typically funded by the line item activity of the Park Service's Construction appropriation. The Park Service estimated that it would need another $435 million to $575 million to fund maintenance projects costing less than $500,000, each of which is funded by the Park Service's Operation of the National Park System appropriation. All data are unaudited.

STATUS OF AUDIT REPORT RECOMMENDATIONS

Findings/Recommendations Reference	Status	Action Required
1-4	Unresolved.	Provide a response to each recommendation. If concurrence is indicated, provide a plan identifying actions to be taken, including target dates and titles of officials responsible for implementation. If nonconcurrence is indicated, provide specific reasons for the nonconcurrence.

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free Numbers:
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

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

SURVEY REPORT

USE OF THE GOVERNMENTWIDE PURCHASE CARD, BUREAU OF LAND MANAGEMENT

REPORT NO. 98-I-352
MARCH 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MEMORANDUM

TO: The Secretary

FROM: Robert J. Williams
Acting Inspector General

SUBJECT SUMMARY: Final Survey Report for Your Information - "Use of the Governmentwide Purchase Card, Bureau of Land Management" (No. 98-I-352)

Attached for your information is a copy of the subject final survey report. The objective of the survey was to determine whether the Bureau of Land Management managed the Governmentwide Purchase Card Program in accordance with applicable laws, regulations, and guidelines.

We concluded that, overall, the Bureau managed the Program in accordance with applicable laws, regulations, and guidelines. Therefore, we terminated the audit at the end of the survey. However, we did note instances in which cardholders' statements had not been processed promptly, receipts were not maintained for some transactions, and some purchases were made by unauthorized personnel. These conditions occurred because cardholders and procurement officials did not comply with established regulations and procedures in the Bureau's Training Manual. We made two recommendations to improve management and internal controls over the Program.

The Bureau's response to the draft report did not indicate concurrence or nonconcurrence with either recommendation. Therefore, based on the response, we considered both recommendations unresolved and have requested the Bureau to reconsider these recommendations.

If you have any questions concerning this matter, please contact me at (202) 208-5745.

Attachment

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAR 31 1998

SURVEY REPORT

Memorandum

To: Director, Bureau of Land Management

From: Robert J. Williams
Acting Inspector General

Subject: Survey Report on Use of the Governmentwide Purchase Card, Bureau of Land Management (No. 98-I-352)

INTRODUCTION

This report presents the results of our survey on the use of the Governmentwide purchase card at the Bureau of Land Management. The original objective of the survey was to determine whether the Bureau managed the Governmentwide Purchase Card Program in an efficient and economical manner and in accordance with applicable laws, regulations, and guidelines. However, during our survey, the General Accounting Office issued the report entitled "Acquisition Reform, Purchase Card Use Cuts Procurement Costs, Improves Efficiency" (No. GAO/NSIAD-96-138). The report stated: "Agencies have found they can support their missions at reduced costs by having Program staff use the purchase card for simple purchases. Further, agency studies have shown that purchase card use reduces labor and payment processing costs." Therefore, based on these statements, we revised our objective to determine whether the Program was managed in accordance with applicable laws, regulations, and guidelines rather than efficiently and economically.

BACKGROUND

In 1989, the General Services Administration awarded a contract to Rocky Mountain BankCard System (Rocky Mountain Bank) to provide credit card services within the Federal Government. The card was intended (1) to streamline the small purchase and payment processes and (2) to be used only for official purposes. On June 28, 1990, the Department of the Interior issued the "Handbook for Utilization of the Governmentwide Commercial Credit Card," under Department of the Interior Acquisition Policy Release (DIAPR) 90-35. According to the Release, the Department's intent in issuing the Handbook was to present the general policy within which each bureau could develop its own credit card policy.

The Bureau, through participation in a Department of Commerce pilot study, has used the card since 1987. On January 30, 1990, the Bureau issued general policies and procedures on the use of the purchase card in its "Purchasing - BLM [Bureau of Land Management]

Handbook H-1510-1." In July 1993, the Bureau issued specific policies and procedures on the use of the purchase card in its National Training Center Training Manual "Using Government Purchase Cards." The Training Manual is also used as a quick reference guide for card users. In July 1995, the Bureau updated the guidance in its Training Manual to incorporate new Departmental and Bureau regulations and requirements that resulted from a new contract awarded in 1994 by the General Services Administration. According to the updated Training Manual, the purchase card may be used to acquire items that fall into four basic categories: small supply purchases, short-term rental of nonvehicular equipment, miscellaneous services and repairs, and property. The purchase card is to be used only by the individual to whom the card was issued and cannot be used for cash advances, travel-related costs, the rental of vehicles or buildings, repairs for vehicles in the General Services Administration fleet, gas or oil for vehicles, telephone services, personal items, or printing. An exception is made for crew chiefs of the fire, cadastral survey, or wild horse and burro operations, who are allowed to use the card for travel-related costs in emergency situations.

The Rocky Mountain Bank electronically transmits a monthly invoice and a data file containing each individual transaction for the month to the Bureau's National Business Center, in Denver, Colorado. The Bureau totals the data by what it calls its "Level 4 offices,"[1] prepares a payment document, and processes the payment to the Bank. In addition, the Bank submits to each cardholder a monthly statement that itemizes the cardholder's transactions. Within 5 days of receiving the statement, the cardholder is required, by the Training Manual, to review and reconcile the transactions and certify that the transactions were recorded accurately. The cardholder is then required to forward the certified statement and all applicable supporting documentation to the cognizant approving official. The approving official is required, by the Training Manual, to certify the cardholder's statement within 10 days of receiving the documentation and to determine whether the purchases were appropriate and were recorded accurately. The Training Manual further states that if the cardholder will not be available to sign the statement, the cardholder is required to arrange for someone else to review, reconcile, and certify that the transactions were recorded accurately. If the approving official is unavailable to approve the statement within the required time period, the approving official is responsible for designating an "acting" official, who must write on the statement that he/she is acting.

The use of the card within the Bureau has been increasing annually. Specifically, our January 1993 audit report (see Prior Audit Coverage) indicated that fiscal year 1990 card purchases were approximately $3 million; fiscal year 1991 card purchases were approximately $4.3 million; and fiscal year 1992 card purchases (as of August 31, 1992) were $5.1 million, at which time 1,200 cards had been issued. Since that time, the number of cardholders and the card's use have continued to increase to approximately 3,891 cards

[1]The Level 4 offices are the state offices of Alaska, Arizona, California, Colorado, Eastern States, Idaho, Montana, New Mexico, Nevada, Oregon, Utah, Wyoming; the National Business Center; the National Interagency Fire Center; the Washington, D.C. headquarters office; and the Helium Operations office.

and $22.6 million in purchases Bureauwide as of June 1, 1997, as shown in the following table:

	September 30, 1995	September 30, 1996	June 1, 1997
Purchase Cards	2,936	3,409	3,891
Purchase Transactions	76,453	101,279	77,876
Net Purchases	$17,773,491	$26,625,467	$22,599,928

SCOPE OF SURVEY

Our survey was conducted from March through July 1996 and May through June 1997[2] and included purchases made by Bureau employees for the 18 monthly billing periods from September 14, 1994, through March 13, 1996, and the period of April 14, 1997, to May 13, 1997. We judgmentally selected 130 statements for 83 cardholders from the approximately 630 cardholders working at 3 of the Bureau's 16 Level 4 offices. The 130 statements involved 846 individual transactions, totaling $380,700. Survey fieldwork was conducted at the Utah State Office and the Salt Lake City District Office, in Salt Lake City, Utah; the Vernal District Office, in Vernal, Utah; the Nevada State Office, in Reno, Nevada; the Carson City District Office, in Carson City, Nevada; the headquarters office, in Washington, D.C.; and the Bureau's National Business Center, in Denver, Colorado. In addition, with the assistance of the Bureau Purchase Card Coordinator, we contacted all 16 of the Bureau's Level 4 offices and obtained information on the annual review of credit card transactions required by the Bureau's purchasing handbook.

Our survey was made in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary to accomplish our objective. As part of our survey, we reviewed the Department's Accountability Report for fiscal year 1996, which includes information required by the Federal Managers' Financial Integrity Act, to determine whether any reported weaknesses were within the objective and scope of our audit. There were no reported weaknesses that were within the objective and scope of our audit. We also evaluated the Bureau's system of internal controls related to card activities and found that, overall, the Bureau provided adequate management control of purchases made with the card. However, we did find some areas where improvements are needed. The improvements and recommended corrective actions are discussed in the Results of Survey section of this report. The recommendations, if implemented, should improve the internal controls in these areas.

---

[2] We suspended work on this audit from July 1996 to May 1997 in order to conduct our audit of the Bureau's financial statements for fiscal year 1996.

PRIOR AUDIT COVERAGE

During the past 5 years, the Office of Inspector General and the General Accounting Office have each issued an audit report that addressed issues related to the management of Government purchase cards as follows:

- The Office of Inspector General report "Use of the Government Credit Card, Bureau of Land Management" (No. 93-I-370), issued in January 1993, reported that the Bureau of Land Management had little or no control over card purchases made by personnel at the field offices reviewed. Specifically, purchases made by individual cardholders were required to be made in accordance with the General Services Administration's "Cardholder Instructions" and with the Federal Acquisition Regulation. However, the Bureau paid for card purchases, even though the acquired goods and services (1) were specifically excluded from acquisition under the Program and (2) were not properly signed for and approved. Additionally, the report stated that the Bureau may have issued more Government credit cards than were necessary for the efficient and effective use of the cards. As a result, the Bureau had no assurance that all fiscal year 1991 card purchases, amounting to $4.3 million, were (1) necessary for Program operations, (2) obtained at the least cost, or (3) actually received by the Bureau. The report recommended that the Bureau (1) review the credit card program and implement sufficient internal controls to ensure compliance with the Federal Acquisition Regulation and Departmental acquisition regulations and (2) ensure that the number of cards issued at each field location was limited to the number actually needed for efficient and effective operations. In response to our recommendations, the Bureau issued Instruction Memorandum No. 93-166, dated March 8, 1993, which discussed our audit report and emphasized the need for controls to the field offices, and Information Bulletin No. 93-577, dated September 3, 1993, which requested a review of and report on the need for all cards. During our current review, we found that, overall, the Bureau had made improvements in its management of the purchase cards. However, we noted that some improvements are still needed.

- The General Accounting Office report "Acquisition Reform, Purchase Card Use Cuts Procurement Costs, Improves Efficiency" (No. GAO/NSIAD-96-138), issued in August 1996, stated that "agencies have found [that] they can support their missions at reduced costs by having program staff use the purchase card for simple purchases." The review included 12 civilian and military agencies, including the Department of the Interior. There were no recommendations in the report addressed to the Department. Instead, the report recommended that the Administrator for Federal Procurement Policy provide Federal Acquisition Regulation coverage and establish electronic media such as the Acquisition Reform Net to facilitate agencies' efforts to exchange information about problems or progress with the purchase card.

RESULTS OF SURVEY

We concluded, overall, that the Bureau of Land Management Governmentwide Purchase Card Program was being managed in accordance with applicable laws, regulations, and guidelines. Therefore, we terminated the audit at the end of the survey. However, we did note several conditions, which are discussed in the following paragraphs, that need to be addressed by Bureau management.

Based on our judgmental sample of 846 transactions out of the 255,608 transactions made during the audit period, we found that some cardholders' statements had not been processed promptly, receipts were not maintained for some transactions, and some purchases were made by unauthorized personnel. These conditions occurred because cardholders and procurement officials did not comply with established regulations and procedures in the Bureau's Training Manual. We believe that oversight of the Purchase Card Program by Bureau management should be improved to ensure that the Bureau complies with the Program's policies and procedures.

Untimely Processing of Statements

The Bureau's Training Manual states that the cardholder has 5 days from receipt of the statement to reconcile, sign, and forward the statement to the approving official. The approving official has 10 days to review and approve the statement. However, of the 130 statements reviewed, totaling $380,700, we found 11 statements, totaling $50,448, for 10 cardholders that were processed from 2 to 16 days late. The cardholders stated that they were out of town and/or that other work load requirements precluded the prompt processing of the statements. However, as stated in the Training Manual, other arrangements are to be made if the cardholders will be unavailable to review, reconcile, and certify the statements within the 5-day time limit. These requirements are important controls that will assist Bureau management in identifying and correcting problems in purchase card usage in a timely manner.

Missing Receipts

The Bureau's Training Manual requires that individual purchases be supported by receipts which list the items or services purchased and indicate that these items or services were received. In our review of the 846 purchases, totaling $380,700, we found 39 purchases, totaling $19,925, for 14 cardholders that did not have the required receipts. For 36 of the 39 purchases, both the cardholders and the approving officials had signed the statements indicating that a receipt for each transaction was attached. One procurement office cardholder who made 16 purchases, totaling $10,473, of the 39 purchases said that vendors did not send receipts on telephone orders. Instead, according to the cardholder, the receiving copies of the requisition form were generally signed and dated when the purchase was

received. However, in those instances reviewed, the cardholder said that she was detailed to another office just before the statement we reviewed was received and that the individual who processed the statement may not have noticed that the receiving reports were not signed and dated. For the remaining 23 purchases, the cardholders stated that they had lost the receipts.

Unauthorized Use

The Bureau's Training Manual requires the purchase card to be used only by the cardholder. However, of the 846 purchases reviewed, totaling $380,700, we found 6 purchases, totaling $3,500, for one cardholder that were made by individuals other than the cardholder. According to the cardholder, the card was routinely used by other individuals in the office who had reached their purchase limits on their own cards and by one employee who had his card taken away because the employee had not processed his statements in a timely manner. In one instance, a $500 phone order purchase was made on the card by the cardholder's approving official.

Annual Reviews

The Bureau's "Purchasing - BLM [Bureau of Land Management] Handbook H-1510-1" requires that a warranted contracting officer review the record of card transactions at least once annually to ensure proper use of the card. However, during our review of the 16 Level 4 offices, we found that 2 offices were not performing the required annual reviews. Although the required annual reviews were performed in the remaining 14 offices (3 of which we visited), improvements are needed to ensure that the cardholders and management comply with the established regulations and procedures, as discussed in the previous paragraphs.

Recommendations

We recommend that the Director, Bureau of Land Management:

1. Ensure that cardholders comply with established Purchase Card Program policies and procedures and that the purchases are reviewed by a warranted contracting officer at least annually. In addition, any weaknesses identified, including the untimely processing of statements, missing receipts, and unauthorized use, should be corrected.

2. Ensure that the purchase limit is adequate for the needs of each cardholder's official duties.

Bureau of Land Management Response and Office of Inspector General Reply

In the January 22, 1998, response (Appendix 1) to the draft report from the Director, Bureau of Land Management, the Bureau did not indicate concurrence or nonconcurrence with either recommendation. Based on the response, the Bureau is requested to reconsider its response to both recommendations, which are unresolved (see Appendix 2).

Recommendation 1. Concurrence/nonconcurrence not indicated.

Bureau of Land Management Response. In its response, the Bureau stated that a handbook for program coordinators and procurement users was being developed and that this handbook, which will be issued by June 1998, will "set forth policy and procedures for warranted cardholders and local Purchase Card Program managers." The Bureau further stated that the cardholders are no longer required to process the statements within 5 days because of implementation of the Bank Card interface; that requisitions are used as receipts by warranted cardholders; that invoices are not always available, particularly for telephone orders; and that all offices are now performing required annual reviews. In addition, the Bureau stated that although telephone orders were placed by the cardholder, the items purchased were picked up by other individuals and that therefore there was no unauthorized use of the card.

Office of Inspector General Reply. Although the recommendation was for the Bureau to ensure compliance with established polices and procedures and the Bureau response indicated that the revised handbook would set forth policy and procedures, the Bureau did not address how it would ensure compliance with the policy and procedures set forth in the new handbook. The Bureau should also emphasize, in its handbook or training courses, that, for warranted cardholders, requisitions need to be signed and that, for nonwarranted cardholders, documentation such as packing receipts is necessary to demonstrate that goods or services have been received. In addition, we suggest that the Bureau emphasize that the card is to be used only by the cardholder and only for items needed in the official duties of the cardholder. In the instances we identified, the cardholder stated that she did not make the calls and did not have a need for the items in performing her duties but that the calls were made by other individuals and that the purchases were for items necessary for them to perform their duties. Further, the Bureau did not provide any information on the offices that have completed their annual reviews.

Recommendation 2. Concurrence/nonconcurrence not indicated.

Bureau of Land Management Response. In its response, the Bureau stated that cardholders may request an increase in their monthly purchase limit but that the

monthly purchase limit is "a tool for controlling budget within an office and is at the discretion of the cardholder's supervisor."

Office of Inspector General Reply. Although cardholders may request an increase in their monthly purchase limit, they apparently were not seeking such an increase. We found that cardholders were borrowing cards from other cardholders to make purchases when they reached the limits on their own cards. We suggest that the Bureau review card limits and/or notify the cardholders of the option to increase their limit to ensure that the limits meet the needs of individual offices and the Bureau.

In accordance with the Departmental Manual (360 DM 5.3), we are requesting a written response to this report by May 11, 1998. The response should provide the information requested in Appendix 2.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the assistance of Bureau of Land Management personnel in the conduct of our audit.

United States Department of the Interior

BUREAU OF LAND MANAGEMENT
Washington, D.C. 20240

In Reply Refer To:
1510 (850)

JAN 22 1998

MEMORANDUM

To: Assistant Inspector General for Audits

Through: Bob Armstrong JAN 28 1998
Assistant Secretary, Land and Minerals Management

From: Director, Bureau of Land Management

Subject: Response to Draft Survey Report: Use of Governmentwide Purchase Card, Bureau of Land Management, November 1997; C-IN-BLM-003-96

Thank you for the opportunity to respond to the subject draft survey report. We have reviewed the draft survey report and offer the following response to both recommendations. Our detailed comments are attached.

Recommendation 1: "Ensure that cardholders comply with established Purchase Card Program policies and procedures and that the purchases are reviewed by a warranted contracting officer at least annually. In addition, any weaknesses identified, including the untimely processing of statements, missing receipts, and unauthorized use, should be corrected."

Response: A handbook for Program Coordinators and procurement users is being developed. This handbook will set forth policy and procedures for warranted cardholders and local Purchase Card Program managers. It is expected to be completed by June 1998.

Recommendation 2: "Ensure that the purchase limit is adequate for the needs of each cardholder's official duties."

Response: Cardholders may request an increase in their monthly purchase limit. However, the monthly purchase limit is a tool for controlling budget within an office and is at the discretion of the cardholder's supervisor.

The Assistant Director, Business and Fiscal Resources, is the official responsible for implementation.

If you have any questions, please contact Cynthia Martin, BLM Purchase Card Program Coordinator, at 202-452-5174 or Gwen Midgette, BLM Audit Liaison Officer, at 202-452-7739.

Attachment

USE OF THE GOVERNMENTWIDE PURCHASE CARD
BUREAU OF LAND MANAGEMENT
November 1997
Assignment No. C-IN-BLM-003-96

Page 5, Untimely Processing of Statements. Nonconcurrence.

Office of Inspector General (OIG) Conclusion: The Bureau's Training Manual states that the cardholder has 5 days from receipt of the statement to reconcile, sign, and forward the statement to the approving official.

Bureau of Land Management (BLM) Response: As a result of the implementation of the Bank Card Interface, it is no longer necessary for another employee to reconcile, sign, and forward an absent employee's statement of account when the cardholder will be absent for a short period of time.

Under the new Remote Data Entry procedures, the BLM is no longer at risk of incurring interest under the Prompt Payment Act because of delayed processing of statements. The training manual has been updated to reflect the change in procedures.

Page 5, Missing Receipts. Partial Concurrence.

OIG Conclusion: The Bureau's Training Manual requires that individual purchases be supported by receipts which list the items or services purchased and indicate that these items or services were received.

BLM Response: As stated in the training manual, page iv, "this self-study training package was developed for nonprocurement users of the program . . . . " The requirement for receipts to be attached to the statement of accounts applies to nonprocurement cardholders only. Purchases made by procurement cardholders are supported by requisitions. This is the same as though the transaction were a purchase order instead of a credit card.

OIG Conclusion: For 36 of the 39 purchases, both the cardholders and the approving officials had signed the statements indicating that a receipt for each transaction was attached.

BLM Response: Receipts should be attached, when available, for purchases made by nonprocurement type cardholders. Receipts are not always available, particularly for telephone orders.

Cardholder and approving official signatures certify that the purchases were made for official Government business, that the items have been received, and that "all statements are true, correct, complete and made in good faith . . . "; therefore, payment is authorized.

Greater emphasis is being placed on approving officials' responsibilities to ensure that all purchases are for official Government business, funds are available, and required documentation is in place. Management's efforts include Instruction Memorandum No. 97-159 (Attachment 1), which has been incorporated into the training manual. With the assistance of the OIG's Eastern Division Investigations Office, a presentation on prevention of fraud and abuse for the Purchase Card Program was made at the BLM's annual training workshop conference in Denver in March 1997. All regional Purchase Card Program managers were present.

Page 6, Unauthorized Use. Nonconcurrence.

OIG Conclusion: According to the cardholder, the card was routinely used by other individuals in the office who had reached their purchase limits on their own cards and by one employee who had his card taken away because the employee had not processed his statements in a timely manner.

BLM Response: These orders were placed by the cardholder over the telephone. Other employees then went to pick up the items. Employees were required by merchants to sign as picking up the item, thus, giving the appearance of use by someone other than the cardholder.

The monthly purchase limit is a control point and budget tool, and may be raised at the discretion of the supervisor.

Page 6, Annual Reviews: Concurrence.

OIG Conclusion: Improvements are needed to ensure that the cardholders and management comply with the established regulations and procedures.

BLM Response: All offices are now performing required annual reviews. Efficient and effective management of the Purchase Card Program is a priority with BLM management as is evidenced by the periodic issuance of policy statements. An example is Instruction Memorandum 97-47 (Attachment 2), which reiterates the BLM's policy for training, use of good business judgment, and emphasis on approving officials' responsibilities.

UNITED STATES DEPARTMENT OF THE INTERIOR
BUREAU OF LAND MANAGEMENT
WASHINGTON, D.C. 20240

August 8, 1997

In Reply Refer To
1510, 1510 13 (850) P
Ref: IM 97-47

EMS TRANSMISSION 8/12/97
Instruction Memorandum No. 97-159
Expires: 9/30/98

To: All WO and Field Officials

From: Director

Subject: Responsibilities of the Purchase Card Program Approving Official

One of the many Bureau of Land Management (BLM) initiatives to streamline business practices is the use of the purchase card by employees to meet their own acquisition needs. Instruction Memorandum (IM) No. 97-47 set forth a goal to make 90 percent of all acquisition transactions less than $2,500 by using the IMPAC purchase card (VISA).

While there are significant benefits for both the Government and industry by using the purchase card, there is also increased potential for fraud and abuse. The Purchase Card Program has controls built in the system; when these controls are followed, the opportunity for fraud or abuse is significantly reduced.

The most important control is the review performed by the approving official. The approving official, who is usually the cardholder's supervisor or program leader who manages program funds, is the principal management and quality control point. It is the approving official who reviews and approves the cardholder's monthly statement of account. By signing the statement of account, both the approving official and cardholder are certifying that purchases are for official Government business and are appropriate acquisitions.

The purpose of this Instruction Memorandum is to emphasize the importance of the approving official's role and to provide information on how to protect the Purchase Card Program from fraud and abuse. Each approving official is encouraged to be proactive in managing the program. The approving official must assure that purchase cards are used responsibly, i.e., only reasonably priced items needed for job performance are purchased. He or she ensures that funds are available for all purchases and takes appropriate action when misuse occurs. Attachment 1 provides tips on preventing fraud and abuse. A detailed description of the approving official's duties is contained in BLM National Training Center Course Number SS 1500-11, which should be used as a desk guide. For assistance in identifying acquisitions which require special processing, Attachment 2 is provided. It also lists items that are prohibited purchases.

2

If you have any questions regarding the Purchase Card Program or how you can be proactive in preventing fraud and abuse, as well as actions to take when you suspect there may be a problem, please contact your local procurement analyst or Cynthia Martin, BLM Purchase Card Coordinator, on 202 452-5174.

Peter W. Niebauer
Acting Assistant Director for Business
and Fiscal Resources

2 Attachments
1 - How to Protect the Purchase Card Program From Fraud and Abuse (1 p)
2 - Items Which May Require Special Processing or May Be Prohibited (4 pp)

HOW TO PROTECT THE PURCHASE CARD PROGRAM FROM FRAUD AND ABUSE

Tips to protect the Purchase Card Program from fraud.

- Review, update, and follow internal control procedures;
- Make sure that employees are correctly trained on the proper use of the purchase card;
- Review summary reports and question any undocumented or suspicious purchases;
- Match monthly approving official reports with cardholder monthly statements;
- Never accept "I don't know" as an answer;
- Watch spending patterns (A sudden unexplained increase in purchases may be an indication of a problem);
- Take action when fraudulent activity is discovered;
- Report fraudulent activity to manager; and
- Treat your card as if it were your personal card. (Protect the number, do not leave it lying around).

OPPORTUNITIES FOR FRAUD AND ABUSE

Following are some opportunities for fraud and may require special attention.

- Remote locations;
- Little or no onsite supervision or review;
- Downsizing or restructuring of divisions or offices;
- During large or repetitive purchases;
- During holidays or special projects; and
- During travel.

FRAUD INDICATORS AND ABUSE

The following are fraud indicators to be aware of.

- Purchases from inappropriate or prohibited vendors. (See Attachment 2 for a list of items which may be prohibited or require special handling);
- Poor or nonexisting documentation of purchases;
- Unusual or unexplained entries or purchases;
- Photocopied records in place of originals;
- An individual that appears to be living above their means;
- An individual with financial difficulties;
- A drastic change in behavior as it relates to the use of the card; and
- Numerous billing mistakes.

Attachment 1

ITEMS WHICH MAY REQUIRE SPECIAL PROCESSING OR MAY BE PROHIBITED

"Appropriations shall be applied only to the objects for which the appropriations were made except as otherwise provided by law."

Principles of Federal Appropriations Law
Office of the General Counsel
U.S. General Accounting Office (GAO)

For supplies or services listed below, special rules or regulations apply. Purchase cardholders and approving officials must review this list and become familiar with these items. See your Acquisition Office if you have any questions or would like more information.

ADP EQUIPMENT AND SERVICES

ADVERTISING IN NEWSPAPERS OR PERIODICALS

AIRCRAFT, HIRE OF
Use of your purchase card is prohibited for the hire of aircraft. Contact your local Office of Aircraft Services for assistance.

AIRLINE, BUS, TRAIN, OR OTHER TRAVEL-RELATED TICKETS

ALCOHOL
No alcohol products are authorized to be purchased.

ANNUITANTS

APPRAISAL SERVICES

ARCHITECT-ENGINEER (A-E) SERVICES

ARMS AND AMMUNITION

AUDIOVISUAL SERVICES

AWARDS, NONMONETARY
See IB No. 96-84 or the Human Resources Management office for more information.

BUSINESS CARDS
Using appropriated funds for business cards is prohibited. Also, see Greeting Cards.

CALENDARS

CARPETING

Attachment 2-1

CASH ADVANCES
Cash advances are prohibited. For travel-related cash advances, use the travel card.

CHEMICALS

CLOTHING

CONSTRUCTION

CONTESTS, ENTRY FEES

DECALS, BLM

DECORATIONS, SEASONAL

DIESEL

DRAPERIES

DUPLICATING AND PRINTING SERVICES

EMPLOYEES, PURCHASES FROM

ENTERTAINMENT FOR GOVERNMENT EMPLOYEES
Paying for entertainment is generally not allowed.

ENVELOPES

EQUIPMENT RENTAL WITH OPERATOR

EXPERT AND CONSULTANT SERVICES

FINES AND PENALTIES
As a general rule, no authority exists for the Federal Government to use appropriated funds to pay fines or penalties incurred as a result of its activities or those of its employees.

FILM PROCESSING MAILERS
You may not purchase processing mailers that include the cost of film processing. This would amount to paying for a service in advance which is prohibited by law.

FURNISHINGS, OFFICE (Decorative Items)

GASOLINE

GIFTS
Gifts cannot be purchased with appropriated funds.

GREETING CARDS
Business, greeting, or holiday cards are considered personal use items. You cannot use Government funds to obtain them.

INFORMATION TECHNOLOGY/ADP EQUIPMENT AND SERVICES

INSURANCE
The Government is essentially self-insured, primarily in regard to loss or damage to Government property and the liability of Government employees insofar as the Government is legally responsible or would ultimately bear the loss.

MEALS, DRINKS, LODGING
Meals, drinks and lodging are prohibited except for authorized crew chiefs.

MEMBERSHIP FEES

MOTION PICTURE PRODUCTION AND REPRODUCTION

NEWSPAPERS, MAGAZINES, PERIODICALS, AND OTHER PUBLICATIONS

PAID ADVERTISING IN SUPPORT OF THE WILD HORSE AND BURRO PROGRAM

PERSONAL CONVENIENCE ITEMS
Government funds may not be used to buy items intended for any employee's personal convenience or to satisfy personal desires (i.e., a desk heater, humidifier, special desk accessories.)

PERSONAL EXPENSES AND FURNISHINGS
Personal furnishings are not authorized to be purchased under appropriations in the absence of specific provision, if such furnishings are for the personal convenience, comfort, or protection of an individual employee, or are such as to be reasonably required for accomplishing his or her job.

PERSONAL INTEREST IN PURCHASES
No employee may approve, disapprove, recommend, reject, or otherwise participate in a purchase or contract in which the employee or family or business associates have any interest, except as authorized by the Department's Personnel Manual. Participation with such an interest is a criminal violation, subject to fines and imprisonment.

PERSONAL OR NONPERSONAL SERVICES

PROTECTIVE CLOTHING AND EQUIPMENT

RENTAL OR LEASE OF VEHICLES
When in travel status, use the travel card for the rental or lease of vehicles.

RENTAL OR LEASE OF BUILDINGS
The rental or lease of buildings is prohibited.

SAFETY ARTICLES

SENSITIVE PROPERTY
Regardless of unit acquisition, the cost must be entered into the property system. Examples of sensitive property are firearms, laptop computers, and global positioning stations.

SERVICE, CONTRACTING

SERVICES, PERSONAL

SIGNS

SLIDE SHOWS

SPECIAL EQUIPMENT AND FURNISHINGS FOR EMPLOYEES TO PERFORM OFFICIAL DUTIES
The need for special equipment and furnishings for individual employees must be justified, proving the item is essential for the transaction of official business from the Government's standpoint. An item which is essential or desirable for a particular individual employee or group of employees, but is not essential to the transaction of official business from the Government's standpoint, shall not be purchased with BLM funds.

STATIONARY

SUBSCRIPTIONS

TELEPHONE SERVICES
Any services that are covered by FTS 2000, i.e., a PBX or telephone lines are prohibited.

TEMPORARY HELP

TOBACCO PRODUCTS
The BLM does not furnish tobacco products to employees, even if subsistence is furnished.

TRANSPORTATION OF ITEMS

VEHICLE MAINTENANCE

Attachment 2-4

United States Department of the Interior
Bureau of Land Management
1849 C Street, N.W.
Washington, D.C. 20240

December 27, 1996

In Reply Refer To:
1510.13 (850)P

EMS TRANSMISSION 1/2/97
Instruction Memorandum No. 97-47
Expires: 9/30/98

To: All Field and WO Officials

From: Director

Subject: Establishment of Purchase Card (VISA) Use Goal

The purpose of the governmentwide commercial VISA card is to:

- improve the efficiency and economy of buying goods or services, particularly at or below the $2,500 micropurchase level;
- reduce administrative costs, and
- avoid unnecessary administrative and logistical burdens.

To promote optimal use of the VISA card, a Bureauwide goal has been established for its use. This Instruction Memorandum sets forth that policy and goal.

The goal for transactions under $2,500 is to have 90 percent handled via VISA.

The policy for those employees needing to purchase supplies or services under $2,500 is that supervisors shall empower them with a VISA card. Procurement personnel will focus their resources on more complex transactions. In the event a vendor does not accept the VISA card, any requisitions submitted to the procurement office for under $2,500 must state "vendor does not accept VISA card" or provide other justification.

For the convenience of nonprocurement VISA card users, an easy to complete self-study training package has been created to provide Bureau of Land Management potential VISA cardholders and approving officials with a basic knowledge of Federal acquisition regulations and policies, as well as procedures for processing Government VISA card transactions.

After completing this training, VISA cardholders will be able to make proper purchases, using good business judgment, and increase overall efficiency in meeting program needs. Approving officials will be aware of their responsibility to review and approve VISA card statements.

VISA cardholder and transaction data, by State, will be provided periodically to enable you to track your progress toward the goal and compare progress in relation to other States.

For more information on obtaining the training package or how to obtain a VISA card, contact your local procurement analyst.

Robert Henry
Acting, Assistant Director for Business and
Fiscal Resources

STATUS OF SURVEY REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
1 and 2	Unresolved	Reconsider the recommendations, and provide action plans that include target dates and titles of officials responsible for implementation.

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

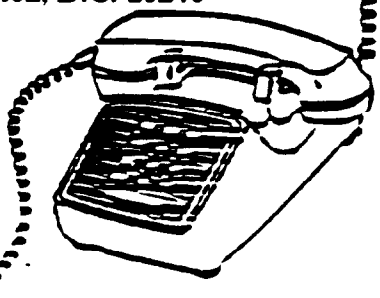
(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free Numbers:
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240



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

ADVISORY REPORT

THE DEL WEBB LAND EXCHANGE IN NEVADA, BUREAU OF LAND MANAGEMENT

REPORT NO. 98-I-363
MARCH 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAR 23 1998

MEMORANDUM

TO: The Secretary

FROM: Robert J. Williams,
Acting Inspector General

SUBJECT SUMMARY: Final Advisory Report for Your Information - "The Del Webb Land Exchange in Nevada, Bureau of Land Management" (No. 98-I-363)

Attached for your information is a copy of the subject final advisory report, which is being issued as part of our followup review of our July 1996 audit report "Nevada Land Exchange Activities, Bureau of Land Management" (No. 96-I-1025). We will also issue a report focusing on the Bureau of Land Management's actions to implement the recommendations included in our July 1996 report. This advisory report is being issued because of our concerns regarding the Bureau's conformance with applicable standards, procedures, and controls relating to the appraisal and valuation of land for the Del Webb exchange (No. N-60167).

During its processing of the exchange, the Bureau of Land Management's Washington Office did not fully conform to established standards, procedures, and controls for appraisals and land valuations and did not justify or document the propriety of its actions. Specifically, the Bureau's Washington Office (1) allowed Del Webb to use an appraiser who was not preapproved by the Nevada State Office, which was not in accordance with established statewide procedures and practice; (2) allowed the Del Webb appraiser to perform a development-based appraisal of the selected Federal land, which was not in accordance with the Federal standards which state that comparable sales should be relied on when adequate sales data are available; and (3) relieved the Nevada State Chief Appraiser of his appraisal review responsibilities for this exchange, which was contrary to the statewide procedures and guidance in the Bureau Manual. In addition, the Bureau issued a contract for an appraisal review to a firm nominated by Del Webb. As a result, if external pressure had not caused the Bureau to obtain a second appraisal, the Government would have lost $9.1 million on the Federal land selected for exchange because the development approach was used in the initial appraisal.

Although the report contained no recommendations, we stated that the Bureau should establish a moratorium on land exchanges in Nevada until new control processes are instituted, including having an external Departmental team review and provide advice on

exchanges. We will formally recommend that such processes and an external team be established in our followup report.

In response to the draft report, the Director, Bureau of Land Management, stated that he did not believe a moratorium was necessary because of its significant impact on relationships which the Bureau has with various local, county, and state governments. In addition, the Director stated that he had established procedures for a second-level review of land exchanges involving land valued in excess of $500,000. Further, the Director stated that he was considering a Bureauwide land exchange team to assist in high priority exchanges.

If you have any questions concerning this matter, please contact me at (202) 208-5745 or Mr. Ronald K. Stith, Acting Assistant Inspector General for Audits, at (202) 208-4252.

Attachment

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAR 23 1998

ADVISORY REPORT

Memorandum

To: Director, Bureau of Land Management

From: Robert J. Williams
Acting Inspector General

Subject: Advisory Report on the Del Webb Land Exchange in Nevada, Bureau of Land Management (No. 98-I-363)

INTRODUCTION

This report provides, for your information, the results of our review of the Del Webb Corporation land exchange administered by the Bureau of Land Management. We are issuing this report as part of our followup review of our July 1996 audit report "Nevada Land Exchange Activities, Bureau of Land Management" (No. 96-I-1025). We will also issue a report focusing on the Bureau's actions to implement the recommendations included in our July 1996 report. We are issuing this advisory report because of our concerns regarding the Bureau's conformance with applicable standards, procedures, and controls relating to the appraisal and valuation of lands for the Del Webb exchange (No. N-60167).

BACKGROUND

The Bureau of Land Management is responsible for managing and protecting over 260 million acres of Federal land, of which about 48 million acres are in the State of Nevada. The Congress has emphasized the use of land exchanges and fee purchases to acquire lands containing resource values of public significance and to improve the manageability of Federal land by consolidating its land ownership. The Bureau prefers to acquire land through exchanges, which may be initiated by the Bureau or other interested parties called proponents.[1] In recent years, the Bureau has identified about 70,000 acres of Federal land for disposal in the Las Vegas Valley of Nevada, which continues to be one of the fastest growing metropolitan areas in the United States. The potential for real estate development in the private market associated with this growth in the Valley has created significant interest in acquiring available Federal land.

[1]The Bureau prefers to acquire lands through exchanges because of the relatively low impact that exchanges have on local government tax revenues.

The Bureau conducts land exchanges under the authority of Section 206 of the Federal Land Policy and Management Act of 1976 (Public Law 94-579), which authorizes the Secretary of the Interior to dispose of Federal land by exchange when the public interest will be well served. Under Section 206, the values of the lands exchanged must be equal or, if not equal, must be equalized by a cash payment by either party except in circumstances where the value of the Federal land transferred by the Government is not more than $150,000 (the value of the Federal land transferred in the Del Webb exchange exceeded $150,000). Section 206 specifically directs the Secretary to make the amount of such payments as small as possible but states that in no event may the value difference between the properties exceed 25 percent of the value of the Federal land exchanged. On August 20, 1988, the Congress enacted the Federal Land Exchange Facilitation Act of 1988 (Public Law 100-409), which granted the Secretary limited authority to approve adjustments in the values of lands exchanged as a means of compensating a party for incurring costs such as those for land surveys, mineral examinations, and title searches, which would ordinarily be borne by the other party. In December 1993, the Bureau finalized comprehensive regulations for land exchanges (43 CFR 2200) to implement the provisions of both Acts.

The values of the public and private lands exchanged are established by appraisals conducted in accordance with principles defined in the "Uniform Appraisal Standards for Federal Land Acquisitions," issued by the Interagency Land Acquisition Conference in 1992. The "Standards" stipulates that each appraisal be carefully reviewed by a qualified review appraiser and that the review be documented by a written report indicating the scope of the review and the actions recommended by the reviewer. The "Standards" also states that appraisals should rely on the comparable sales method to value Federal property when adequate sales information is available. Section 9310 of the Bureau Manual provides specific policies and procedures for management and administration of the Bureau's appraisal function, including the preparation of appraisal reports and the requirement that the State Chief Appraiser should review appraisal reports and approve the fair market value estimated in those reports in accordance with professional standards.

PRIOR REVIEW

Our 1996 audit report "Nevada Land Exchange Activities, Bureau of Land Management" (No. 96-I-1025) concluded that while the Nevada State Office had acquired some high quality properties by exchanging lands with private entities, it did not consistently follow prescribed land exchange regulations or procedures or ensure that fair and equal value was received in completing three of the four exchanges we reviewed. As a result, we estimated that the Government may have lost revenues totaling about $4.4 million in completing the three exchanges. In addition, we concluded that the State Office acquired about 2,500 acres of land, with an exchange value of $2.7 million, that had no discernable mission-related purpose.

In our 1996 report, in regard to exchange processing, we recommended that the Director of the Nevada State Office (1) institute competitive procedures (sale or exchange) into the land disposal process to the maximum extent possible, (2) direct that all easements on Federal land proposed for disposal be reviewed to verify grantee needs and that actions be taken to remove any easements which are not needed before the Federal lands are exchanged or sold, and (3)

establish controls necessary to ensure that land exchanges are processed in full accordance with applicable laws and regulations and Bureau procedures. At a minimum, these controls should ensure that the land to be acquired is obtained in conformance with approved land-use plans or properly executed amendments; that land acquired and disposed of is properly valued; and that all significant decisions involving the exchange transactions, particularly those affecting land valuation, are fully justified and documented in the exchange files. Our report contained two other recommendations. However, these recommendations were related to Santini-Burton Act lands and were not specifically relevant to issues discussed in this report.

DISCUSSION

During its processing of the Del Webb land exchange, the Bureau of Land Management's Washington Office did not fully conform to established standards, procedures, and controls for appraisals and land valuations and did not justify or document the propriety of its actions. Specifically, we concluded that the Bureau's Washington Office (1) allowed Del Webb to use an appraiser who was not preapproved by the State Office, which was not in accordance with established statewide procedures and practice; (2) allowed the Del Webb appraiser to perform a development-based appraisal of the selected Federal land, which was not in accordance with the Federal standards which state that comparable sales should be relied on when adequate sales data are available; and (3) relieved the Nevada State Chief Appraiser of his appraisal review responsibilities for this exchange, which was contrary to the statewide procedures and guidance in the Bureau Manual. In addition, the Bureau issued a contract for an appraisal review to a firm nominated by Del Webb. As a result, if the Bureau had not obtained a second appraisal, the Government would have lost $9.1 million on the Federal land selected for exchange because the development approach was used in the initial appraisal.

The Del Webb Corporation is a publicly traded national real estate company and developer of planned communities, including its Sun Cities retirement developments in Phoenix, Arizona; Las Vegas, Nevada; Palm Desert and Roseville, California; Hilton Head, South Carolina; and Georgetown, Texas. On September 29, 1994, Del Webb submitted a proposal to acquire, through an exchange with the Bureau, about 4,975 acres of Federal land located southwest of the City of Henderson, Nevada.[2] According to the exchange proposal, Del Webb intended to develop the acquired Federal land as "a Master Planned Community incorporating a mixture of commercial, residential and recreational uses, with the residential uses to be primarily for an age-restricted community for residents [aged] 55 and over."

On September 29, 1995, the Bureau's Nevada State Office determined that the proposed exchange could be executed in multiple phases over a period of 3 to 7 years, with each phase including about 1,000 acres of Federal land. The initial exchange transaction, Phase IA,

---

[2]This was the proponent's initial estimate of the total acreage desired at the time it proposed the exchange. The final acreage, for which the appraisal was approved (4,756 acres), was smaller because some of the original Federal lands selected were eliminated from the exchange because they were part of a Wilderness Study Area.

was finalized on July 29, 1997, when the Bureau acquired four properties[3] totaling 5,328 acres, valued at $10,990,000, in exchange for 922 acres of Federal land in the Las Vegas Valley, valued at $11,452,639.

Acceptance of Del Webb Appraiser

The Bureau's Washington Office overrode the Nevada State Office's usual practice for appraising Federal land by allowing the Del Webb Corporation to use its own appraiser to value the Federal land selected for exchange. In order to ensure that the Bureau received fair market value for the Federal land exchanged, appraisal requests were to be processed through the State Office, and the appraisals were generally conducted by contract appraisers preapproved by the Bureau. Section 9310 ("Real Property Appraisals") of the Bureau Manual requires state directors to impartially administer an appraisal program in accordance with applicable laws and Departmental policies. Section 9310.04 of the Bureau Manual requires that state chief appraisers be responsible for "planning, organizing, and providing program leadership for the appraisal function . . . including procuring . . . qualified real estate appraisal expertise [and] . . . approve an amount which represents the Bureau's estimate of fair market values." In carrying out these delegated responsibilities, the Nevada State Chief Appraiser established procedures that included using appraisal firms under contract with the Bureau to perform the appraisals of the Federal land selected by proponents in land exchanges.

In a November 27, 1995, letter to a Del Webb representative, the Nevada State Director[4] stated, "We [the Bureau] will appraise both the offered [private] lands and selected [Federal] lands as we enter into each phase of the exchange." Additionally, the draft agreement to initiate the exchange stated:

> The BLM [Bureau of Land Management] or other benefiting Federal agency will arrange with a contractor to prepare an appraisal of the selected lands for each phase within ninety days of the initiation of that phase of the exchange. The appraisal will be done in accordance with federal appraisal standards and will be subject to federal review and approval.

However, according to the exchange file chronology, the Del Webb Corporation disagreed with this appraisal arrangement and informed the Bureau, at a November 30, 1995, meeting between representatives of the Nevada State Office and the Del Webb Corporation, that it was having its own appraisal performed of the selected Federal land. Del Webb took issue with the Nevada State Director's position on the appraisal in its January 16, 1996, letter which stated:

---

[3]The properties acquired by the Bureau in Phase IA consisted of the Knox, Kent, and Weishaupt Ranches in Churchill County, Nevada, and the Kings Canyon property in Carson City, Nevada.

[4]Four officials, the Deputy Director, the Nevada State Director, the Nevada State Chief Appraiser, and the Associate District Manager, who were involved in this exchange either have been reassigned to positions within the Bureau or have left the Bureau for positions within the Department.

> The proposed [appraisal] language in your draft is far more restrictive than the plain language of the Federal Regulations [43 CFR 2201.3 and 3-1] and we believe that the process will be aided immeasurably by adhering to federal regulations rather than by restricting those regulations with a localized policy not specifically designed to produce the best available appraiser.[5]

The letter from Del Webb did not, however, provide information on how Del Webb was providing the "best available appraiser." We noted that, in 1994, the Nevada State Office had implemented the Statewide practice of using Bureau contract appraisers to ensure that the Government received fair value for the lands it was exchanging. According to documents in the exchange file, the Del Webb Corporation contacted the Deputy Director regarding the initial appraisal and the use of its own appraiser. On February 2, 1996, the Nevada State Director signed an agreement that initiated the exchange and enabled Del Webb to provide an appraisal of the selected Federal land. This appraisal provision was contrary to the provision in the draft agreement submitted to Del Webb by the State Director to initiate the exchange and was contrary to the State Office's practice of using its preapproved contract appraisers.

We did not find any documentation that justified a change from the State Office's initial position as reflected in the November 27, 1995, letter to a Del Webb representative and the draft agreement to initiate the exchange. Our reviews of four land exchanges processed in the Las Vegas Field Office from June 1, 1995, through August 1, 1997, found that, with the exception of the Del Webb exchange, Bureau contract appraisers valued the Federal land selected. In our discussions with Bureau officials from the Nevada State Office, including the State Director and the Associate State Director, these officials stated that the Deputy Director had made the decision to allow Del Webb to hire its own appraiser and had directed the State Director to sign the agreement. The Bureau's Deputy Director stated that he had consulted with officials in the Nevada State Office but that the State Office had made the decision to allow Del Webb to use its own appraiser. However, a July 1, 1996, letter from the Chairman of the Board and Chief Executive Officer of Del Webb makes reference to the Deputy Director's "intervention on numerous occasions in order to get Nevada BLM [Bureau of Land Management] to comply with FLEFA [Federal Land Exchange Facilitation Act of 1988] and the Justice Department's Uniform Appraisal Guidelines." We noted that the Federal Land Exchange Facilitation Act allows either party to the exchange to obtain the appraisal of the selected Federal land by stating, "[T]he Secretary concerned and the other party or parties involved in the exchange shall arrange for appraisal of the lands or interests therein involved in the exchange." In addition, the Code of Federal Regulations (43 CFR 2201.3-1) states that the appraiser may be an employee or contractor to the Federal or non-Federal exchange parties. As such, the Nevada State Office's practice of using a Bureau contract appraiser to conduct the appraisal of the selected Federal land was also in compliance with the Act and implementing regulations.

---

[5]The Code of Federal Regulations (43 CFR 2201.3-1) states: "A qualified appraiser(s) shall provide to the authorized officer appraisals estimating the market value of the Federal and non-Federal properties involved in an exchange. A qualified appraiser may be an employee or a contractor to the Federal or non-Federal exchange parties."

Use of Development Approach

The initial appraisal, which was prepared by Del Webb's appraiser, valued the 4,776 acres of Federal land at $43 million using the development approach. This approach reflects the highest price a proponent of a land exchange could afford to pay for the lands and still earn its desired profit. The "Uniform Appraisal Standards for Federal Land Acquisitions" states, "[W]hen comparable sales are available to determine the property's fair market value, the developer's residual approach [development approach] should not be employed, as the approach is highly speculative, prone to error, and reflects not so much value [of the lands being appraised] as the highest price a developer can afford to pay for the lands and still earn the desired profit." The Nevada State Chief Appraiser had informed Del Webb's appraiser of his concern regarding the use of this method on March 5, 1996. Subsequently, the Bureau ordered a second appraisal of the selected Federal land. The second appraisal relied on comparable sales and estimated the value of the selected Federal land at $52.1 million (an increase of $9.1 million over the initial appraisal). The appraisal report validated the Nevada State Chief Appraiser's position that the comparable sales approach should be relied on for estimating the value of the selected Federal land (see the section "Contract for Second Appraisal" in this report).

State Chief Appraiser Relieved of Responsibilities

The Bureau's Deputy Director relieved the Nevada State Chief Appraiser of his responsibilities for reviewing the appraisal of the Federal land selected by Del Webb, and the Washington Office decided to contract with a non-Federal source for the appraisal review. Section 1203 of the Bureau Manual, which was in effect at the time, limited the responsibility for reviewing and approving exchange values to "the State Office Chief Appraiser only." According to a chronology of events on the Del Webb exchange prepared by the State Chief Appraiser, the State Chief Appraiser was relieved of his responsibilities because a Del Webb representative had stated to the Washington Office that the State Chief Appraiser had expressed a "preconceived opinion of value" during a meeting with Del Webb's appraiser and other Bureau and Del Webb officials on March 5, 1996. However, based on our review of the exchange files and interviews with Nevada State Office officials, we did not find any evidence of a "preconceived opinion of value" by the State Chief Appraiser. We confirmed with the Associate District Manager for the Las Vegas District, who was present at the meeting with Del Webb, that the State Chief Appraiser did not express a "preconceived opinion of value." In addition, our review of the files in the Nevada State Office found no information documenting or justifying the decision to relieve the State Chief Appraiser of his responsibilities or information supporting Del Webb's view that he had a "preconceived opinion of value" regarding the selected Federal land. Instead, according to the State Director and the Associate District Manager and the chronology prepared by the State Chief Appraiser, the State Chief Appraiser wanted to comply with the "Standards" regarding the valuation of property (comparable sales versus development approach).

During the March 5, 1996, meeting, Del Webb's appraiser informed the State Chief Appraiser that he was relying on the development approach as the method to estimate the value of the selected Federal land. The State Chief Appraiser stated that he informed the Del Webb representatives that the appraisal would not be in conformance with the "Uniform Standards for Federal Land Acquisitions" unless it relied substantially on comparable sales. The State Chief Appraiser stated that he was subsequently notified by his supervisor that he was relieved of his responsibilities regarding the Del Webb exchange.

Appraisal Review Contract

After the State Chief Appraiser was relieved of his review responsibilities on this exchange, a Bureau contracting officer (from the Bureau's National Business Center in Denver, Colorado), relying on the recommendation of the Washington Office Chief Appraiser, awarded a contract on May 10, 1996, with limited competition for an appraisal review to a firm nominated by the Del Webb Corporation.[6] Before this contract was awarded, the Nevada State Director stated that the Nevada State Office had recommended that another state chief appraiser assume the responsibility for reviewing the appraisal. However, this recommendation was not accepted by the Deputy Director.

According to the Washington Office Chief Appraiser, competition for the contract award was limited "to avoid greater expense to the United States and weaken the integrity of the appraisal report." However, we did not find documentation such as estimated costs or other rationale concerning the extent and nature of the adverse impact on the Government or the appraisal if a fully competitive contract were to be awarded. In addition, the justification for the award noted that the contractor was selected because the firm was experienced "in appraising master planned communities" and is "familiar with the Las Vegas real estate market," but it did not document why the other appraisal firms solicited were not selected.

The appraisal review contractor approved an appraisal that was not performed in accordance with the "Uniform Appraisal Standards for Federal Land Acquisitions" (development approach versus comparable sales). The Del Webb appraiser had valued the 4,776 acres of Federal land at $43 million by relying on the development approach. The December 5, 1996, appraisal review report, obtained by the Bureau under the contract, accepted the appraiser's value of the land without any adjustments. On December 9, 1996, the Bureau's Washington Office Chief Appraiser accepted the appraisal review report and the $43 million valuation and recommended that this value be approved by the Bureau's Las Vegas District Manager.

---

[6]The competition was limited because of an "unusual and compelling urgency." The contract was executed using the simplified acquisition procedures in the Federal Acquisition Regulation. The Washington Office Chief Appraiser interviewed five appraisal firms, including the firm nominated by Del Webb, to determine their qualifications for conducting the appraisal. The Washington Office Chief Appraiser ordinarily works on developing Bureau policy and guidance on appraisals.

Contract for Second Appraisal

On December 12, 1996, we notified the Bureau of our intent to perform a followup audit of its Nevada land exchange activities. In a December 23, 1996, letter responding to a request from Senator Harry Reid from Nevada about the status of the Del Webb exchange, the Deputy Director stated:

> Another factor which may potentially affect the timing of the Del Webb exchange is the investigation of land exchange activities in Nevada by the Office of Inspector General (IG). . . . We will meet with the IG's office during the week of January 6, 1997, to discuss this new audit.

On January 7, 1997, we held an entrance conference on our followup audit with Bureau officials and informed them that the Del Webb exchange would be included as part of the scope of our audit. On January 27, 1997, the Bureau contracted for a second appraisal on the Federal land selected by the Del Webb Corporation. This contract, which also did not use an appraisal firm preapproved by the Nevada State Office and which was reviewed by the Washington Office Chief Appraiser instead of the Nevada State Chief Appraiser, used the comparable sales method to value the selected Federal land.

According to the Bureau, a "large number of [Department] officials, including BLM [Bureau of Land Management] Washington and Field Officials, Solicitor's Office representatives, and a representative of the Assistant Secretary's Office . . . made a consensus decision to seek a second appraisal." The Bureau stated that it made this decision for the following reasons:

> The concerns that led to this conclusion included: 1) the values recommended by the contract review may be too low; 2) the public had not had an opportunity to comment on the appraisal during the public comment period on the initial Notice of Decision; 3) the appraisal review contractors had identified 10 comparable sales, some of which had not been identified by Del Webb's appraiser; 4) BLM continued to have questions regarding the appraisal methodology (feasibility of the preferred approach based on comparables); 5) several protests questioned the initial appraisal; and 6) there was an unresolved issue concerning a power line right-of-way that potentially affected appraised value.

The Bureau received the second appraisal, dated March 21, 1997, which valued 4,756 acres of selected Federal land at $52.1 million. In addition, the appraisal report validated the Nevada State Chief Appraiser's position by stating, "[O]nly the Sales Comparison Approach to value was directly applicable in this analysis." The appraisal increased the value of the Federal land selected by Del Webb from $43 million for 4,776 acres (an average of about $9,000 per acre) to $52.1 million for 4,756 acres (an average of about $11,000 per acre), or an increase of $9.1 million for 20 fewer acres. The initial exchange transaction (Phase IA), which was subsequently finalized on July 29, 1997, provided 922 acres of selected Federal land valued at $11,452,639 (an average of $12,423 per acre for this land) to Del Webb using the higher appraisal value.

Conclusion

As presented in our audit reports issued in 1991 and 1992 and, more recently, in July 1996,[7] the Bureau of Land Management had not administered land exchanges in accordance with established standards and procedural controls.

On June 20, 1996, three members of the U.S. House of Representatives (including the Chairman of the House of Representatives Resources Committee and the Chairman of the House of Representatives Subcommittee on National Parks, Forests and Lands) sent a letter to the Secretary requesting that a moratorium be placed on all land exchanges in Nevada. In his July 19, 1996, response to the request, the Bureau's Deputy Director stated that the Bureau had:

> . . . instituted several procedural and policy changes to set priorities on exchange proposals, to streamline the paperwork process, to improve coordination with local governments, to improve management of the land exchange process and to assure that the public receives a fair value for land exchanges.

The Deputy Director informed the Congress that a partial moratorium had been imposed but that the Bureau was concentrating on six high priority exchange proposals (which included the Del Webb exchange).

On July 30, 1996, the Subcommittee on National Parks, Forests and Lands, Committee on Resources, House of Representatives, conducted hearings with the Inspector General regarding the Office of Inspector General's July 1996 audit report on Bureau land exchange activities in Nevada. At this hearing, in response to a question from a member of the Subcommittee as to whether a moratorium was necessary on all land exchanges in Nevada, the Inspector General stated:

> I do not believe that the results indicated in our [July 1996] audit report require a moratorium on land exchanges. We did not come to that conclusion. We believe that there are problems with the process that need to be addressed and that should be addressed as promptly as possible, but I would not go so far as to say we have concluded that there is a need for a moratorium on land exchanges.

During the hearing, another member of the Committee asked the Inspector General if it was the Inspector General's "expectation that no future land exchanges would occur without the

---

[7]These reports consist of the June 1991 audit report "Land Exchange Activities, Bureau of Land Management" (No. 91-I-968); the May 1992 audit report "Land Acquisitions Conducted With the Assistance of Nonprofit Organizations, Department of the Interior (No. 92 -I-833); and the July 1996 audit report "Nevada Land Exchange Activities, Bureau of Land Management" (No. 96-I-1025).

implementation of those three recommendations . . . [in the July 1996 audit report]." In response, the Inspector General stated:

> Obviously it would be our hope that any future exchanges incorporate the recommendations that we have made. . . . There are certain things like ensuring that appraisal values are approved by a chief appraiser. That is something that doesn't require any period of time to implement. . . . I think based on the Bureau's response [to the July 1996 audit report], they [the Bureau] are talking about reviewing all of their processes to ensure that, in fact, they are in compliance with the applicable rules and regulations [for land exchanges]. But it is certainly my hope that the particular items that we have pointed out in the audit report, to the extent that they arise again in another exchange, that they would be able to do it the right way. . .

In reviewing the Del Webb exchange, we found that the Bureau's Washington Office did not fully conform to established standards, procedures, or controls. The Bureau had assured the Congress, in response to several inquiries from its members about land exchanges, and our office, in response to our prior audit report on Nevada land exchanges, that it would comply with established land exchange procedures and controls. However, on December 9, 1996 (about 6 months after its response to the June 1996 House of Representatives letter and about 5 months after the Congressional hearing), the Washington Office Chief Appraiser accepted and recommended approval of the initial appraisal and appraisal review when the appraisal did not conform to the "Standards" preferred method of appraising Federal land and was not reviewed and approved by the Nevada State Chief Appraiser. As stated previously, a second appraisal was obtained that increased the value of the selected Federal land. The processing of the Del Webb exchange without the second appraisal would have resulted in a $9.1 million loss to the Government.

Because the Bureau has not conformed to established procedures and controls, notwithstanding its assurances of such to the Congress and the Office of Inspector General, we believe that the Bureau should establish a moratorium on land exchanges in Nevada until new control processes are instituted, including having an external team review and provide advice on land exchanges. We will formally recommend that such processes and an external team be established in our followup report.

Bureau of Land Management Response and Office of Inspector General Reply

In the February 25, 1998, response (Appendix 1), the Director, Bureau of Land Management, included, as Attachment 1, a chronology of Del Webb land exchange events. The excerpted narrative from this chronology and our comments and clarifications of the events are presented in Appendix 2. The Bureau's comments on the report and exchange actions are discussed in the following paragraphs.

In his response, the Director discussed the benefits of the land exchange program for acquiring land containing resource values of public significance and improving the

manageability of Federal land ownership. The Director stated that the Del Webb exchange was "one of the largest and most challenging exchanges ever undertaken" by the Bureau and that this exchange was given "unprecedented attention" in both the Nevada State Office and the Bureau's Washington Headquarters Office because of the "very speculative and volatile nature of the land values in the Las Vegas area, and the size of this exchange." The Director further stated that our draft advisory report "expresses concern about different/several decisions made early" in the exchange. Specifically, according to the Director, our report "does not question the consistency of these decisions with controlling law or regulations" but the "departure, . . . from established standards or procedures." The Director also stated that our report "only suggests that, had BLM [Bureau of Land Management] not undertaken a second appraisal, there could have been a $9.1 million loss to the Federal government." The Director further stated that "[m]ore relevant to the ultimate question of whether the public interest was served in this matter, I believe there is no doubt that BLM [Bureau of Land Management] acted with appropriate caution before making any final decisions on this exchange" and that the decision to obtain the second appraisal "effectively eliminated concerns about the appropriateness of the final decision." The Director further stated that the Bureau "takes particular issue with" the draft report's "implied criticism that there is something inappropriate about elevating decisions on high priority, high visibility and/or sensitive issues from a field organization to Headquarters."

The Director agreed that the "exchange program [should] be maintained on a solid footing" and that procedures for a secondary review and concurrence by either the State Director or the Washington Headquarters Office of exchanges exceeding $500,000 in value had been established. The Director also stated that he was "considering establishing a Bureauwide land exchange team to assist in the review of high priority exchanges, provide additional technical support to BLM [Bureau of Land Management] field offices, and address policy and procedural issues." Finally, the Director disagreed with the draft report's suggestion that the Bureau should establish a moratorium on land exchanges until new controls are instituted, stating that the moratorium would have an "adverse impact" on the Bureau's relationship with various local governments.

Office of Inspector General Reply In our July 1996 audit report of land exchanges (discussed in the Prior Review section of this report), we noted that the Bureau had "acquired some high quality properties by exchanging lands with private entities." However, we also identified deficiencies in the Bureau's administration of land exchanges, most notably in the valuation of lands through appraisals, which limited the program's benefits and resulted in the Bureau not obtaining fair value in its Nevada land exchanges. This advisory report discusses our newest concerns regarding the Del Webb land exchange.

Our criticism was not with the elevation of decisions to the Headquarters level but with the Washington Office's nonconformance with established standards and controls. Our particular concerns with this exchange were that (1) the Bureau did not comply with appraisal standards and established policies and procedures; (2) the proponent was significantly involved in the decision-making process; (3) the Nevada State Chief Appraiser was removed from his appraisal review responsibilities; and (4) the Washington Office Chief Appraiser decided to accept the first appraisal and appraisal review, concluded that the $43 million value was

reasonable and adequately supported, and recommended (December 9, 1996) to the Las Vegas District Manager that the appraisal be approved. We are encouraged by the Director's reference to the additional procedures that were implemented or are under consideration to provide better control over the land exchange process. However, except for the decision of the Bureau's Washington Office to obtain a second independent appraisal, we do not agree that the Bureau's decisions on the Del Webb exchange were reasonable or appropriate or ensured that the public interest was served.

We do not believe that the Bureau's Washington Office was justified in its acceptance of the purported urgency of the appraisal or in its actions to facilitate completion and review of an appraisal of the entire Federal parcel. We found that Del Webb did not have sufficient offered property available to exchange for all the selected public land. For example, even after the Bureau approved an appraised value for the selected public land on April 8, 1997, almost 15 months after the date of Del Webb's letter to the Nevada State Director, the Bureau was able to accept only four properties valued at about $11 million in the initial exchange transaction.

Additional Comments on Advisory Report

In its response, the Bureau provided additional comments on our report. The comments and our replies to the comments are as follows:

Bureau Response. The Bureau stated: "The decision to allow Del Webb to furnish the initial appraisal for the proposed exchange was in compliance with the Federal Land Exchange Facilitation Act of 1988 (P.L. 100-409) and implementing regulations (43 CFR 2200). Section 2201.3-2 states 'A qualified appraiser may be an employee or a contractor to the Federal or non-Federal exchange parties.' To the extent that a decision to allow Del Webb to furnish the initial appraisal conflicted with a field policy or practice, the decision was fully within the discretion of BLM [Bureau of Land Management] Headquarters' Officials."

Office of Inspector General Reply. Our preliminary draft report did not state that the Bureau had not complied with authorizing land exchange legislation or its implementing regulations. However, we reported that the Bureau did not comply with established policies, standards, and controls for appraisals and land valuations. Our report also noted that the decisions of Headquarters officials to override the Nevada State Office's standard policy and practice of obtaining the appraisal of selected public land was not justified or documented to show the propriety of this action. Furthermore, the Bureau's response conflicts with the information provided to us during interviews with Headquarters officials concerning the Washington Office's involvement in the decision-making process for the Del Webb exchange. Specifically, the Deputy Director and the Washington Office Chief Appraiser both told us that they offered only advice to Nevada State officials who made the decision to allow Del Webb to furnish the appraisal and that the Washington Office did not make this decision.

Bureau Response. The Bureau stated: "The use of the 'cost development approach' is acceptable under the Department of Justice's 'Uniform Appraisal Standards for Federal Land Acquisitions', when the Appraiser, in his or her professional judgment, concludes there

are inadequate or no comparable sales. It is appropriate for reviewing appraisers to withhold judgment on an appraiser's reasoning and appropriate use of appraisal methods until the appraisal is reviewed. The Contracting Appraiser . . . appraisal supplied by Del Webb met Federal Standards although it was not accepted by BLM [Bureau of Land Management]. It should be noted that there was some market analysis included in the first appraisal. Lack of confidence in this market, however, was one of the primary reasons for deciding to do a second appraisal."

Office of Inspector General Reply. The "Uniform Appraisal Standards for Federal Land Acquisitions" states that the cost development approach is "highly speculative, prone to error, and reflects not so much value as the highest price a developer can afford to pay for the land and still earn the desired profit." The "Standards" also states that the use of this approach should be reserved for providing a check on the accuracy of value determined by the more reliable comparable sales method or in situations where "no comparable sales" are available.

We believe that the Nevada State Chief Appraiser correctly advised (March 5, 1996) Del Webb's appraiser of the "Standards" preference for the comparable sales approach and that adequate information was available to use this approach. Further, we noted that the Solicitor's Office suggested that the comparable sales approach be used by the appraisers who were preparing the second appraisal for the Bureau.

Bureau Response. The Bureau stated: "The decision to remove the BLM [Bureau of Land Management] Nevada Chief Appraiser . . . from the reviewing appraiser function was based on the perception that [the Nevada State Chief Appraiser] had a dispute with [Del Webb's appraiser] before the initial appraisal was performed in which he [the Nevada State Chief Appraiser] strongly expressed inappropriate preconceived notions of value or methodology. This disagreement between [the Nevada State Chief Appraiser and Del Webb's appraiser] could have potentially jeopardized the processing of the exchange. . . . Obtaining BLM in-house appraisal review expertise would have added additional delay in the land exchange processing."

Office of Inspector General Reply We noted that the second appraisal supported the Nevada State Chief Appraiser's position that only the comparable sales approach was appropriate for valuing the public land sought by Del Webb. In addition, the Solicitor's Office advised the Washington Office Chief Appraiser to advise the second appraisers of the requirement in the "Standards" that the comparable sales approach was the preferred method to be used when appraising Federal lands. As stated in the report (pages 6 and 7), we found no evidence to support the position that the State Chief Appraiser expressed a preconcieved notion of value. To the contrary, we noted that the State Chief Appraiser was attempting to comply with the "Standards" preferred method of valuation.

The Bureau stated that obtaining an in-house appraisal review would have additionally delayed the exchange processing. However, we noted that there were extensive delays in processing this exchange that were caused in part by the concerns raised by Nevada State Office officials about the Del Webb appraisal and its contract review.

Bureau Response. The Bureau stated: "As the chronology shows, discussions within BLM [Bureau of Land Management] about securing a second appraisal began before the IG [Inspector General] announced a follow-up audit and well before the IG informed BLM that the following audit would include the Del Webb exchange. Ultimately, a large number of DOI [Department of the Interior] officials, including BLM Washington and Field Officials, Solicitor's Office representatives, and a representative of the Assistant Secretary's Office were involved in these discussions and made a consensus decision to seek a second appraisal. The concerns that led to this conclusion included: 1) the values recommended by the contract review may be too low; 2) the public had not had an opportunity to comment on the appraisal during the public comment period on the initial Notice of Decision; 3) the appraisal review contractors had identified 10 comparable sales, some of which had not been identified by Del Webb's appraiser; 4) BLM continued to have questions regarding the appraisal methodology (feasibility of the preferred approach based on comparables); 5) several protests questioned the initial appraisal; and 6) there was an unresolved issue concerning a power line right-of-way that potentially affected appraised value. (See December 9, 1996 and September 10, 1996 chronology.)"

Office of Inspector General Reply. We have incorporated the Bureau's reasons for acquiring the second appraisal into the report. However, notes prepared by the Washington Office Chief Appraiser of a December 18, 1996, meeting attended by the Deputy Director, the Washington Office Chief Appraiser, the Nevada State Director, the Las Vegas District Manager, and a representative of the Assistant Secretary for Land and Minerals Management stated that decisions on whether to use the first appraisal and on how to proceed would not be made until the Bureau could determine whether our audit would include the Del Webb exchange (see December 18, 1996, in Appendix 2 chronology).

Bureau Response. The Bureau stated: "The decision to seek a second appraisal and the subsequent decision to accept that appraisal led to BLM [the Bureau of Land Management] receiving greater value for its lands. These decisions support a conclusion that the safeguards to protect and serve the public interest in the exchange process worked in the case of the Del Webb exchange; they do not support the inferences in the IG [Inspector General] report that improper processes and procedures were followed."

Office of Inspector General Reply. We disagree that proper processes and procedures were followed and that safeguards to protect the public interest worked in the Del Webb exchange. The procedural safeguards established by the Nevada State Office, which were designed to ensure that a fair value was established and that the appraisal was conducted in accordance with Federal appraisal standards, were overridden by the Washington Office in February and March 1996. We firmly believe that the exchange would have been consummated using the initial appraisal had the Bureau not been subjected to external factors that exerted pressure on it to obtain a second appraisal.

Since this report does not contain any recommendations, a response is not required.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the assistance of Bureau personnel in the conduct of our review.

United States Department of the Interior

BUREAU OF LAND MANAGEMENT
Washington, D.C. 20240

In Reply Refer To:
1245/2200 (350)

FEB 24 1998

Memorandum

To: Office of Inspector General

Through: Assistant Secretary, Land and Minerals Management FEB 25 1998

From: Director, Bureau of Land Management

Subject: Review of Preliminary Draft Advisory Report - Del Webb Land Exchange Assignment No. (W-IN-BLM-001-97A) (The Draft Advisory Report)

I appreciate the opportunity to review and comment on the Office of the Inspector General's Preliminary Draft Advisory Report on the Del Webb land exchange, which was delivered to our office on February 5, 1998.

As is stated in the draft report, Congress has emphasized the use of land exchanges and fee purchases to acquire land containing resource values of public significance and to improve the manageability of federal land by consolidating its land ownership. I support this program as an effective tool for managing the lands BLM administers. By working with the BLM State Directors, we have made significant progress in land adjustments between private and state ownerships where all entities benefit through more effective land management. We have gained thousands of acres of quality habitat areas for multiple use management, especially for the enhancement of plant and animal diversity.

The Del Webb land exchange covered by the Preliminary Draft Advisory Report is one of the largest and most challenging exchanges ever undertaken by the BLM. Because of the very speculative and volatile nature of the land values in the Las Vegas area, and the size of this exchange, BLM gave this exchange unprecedented attention in both the Nevada State Office and the Washington Headquarters Office.

The Preliminary Draft Advisory Report expresses concern about different/several decisions made early in the Del Webb exchange process. The Draft Advisory Report does not question the consistency of these decisions with controlling law or regulations, but rather questions the departure, in some instances without full explanation in the record, from established standards or procedures. In addition, the Draft Advisory Report does not question BLM's ultimate decision to proceed with the exchange, but only suggests that, had BLM not undertaken a second appraisal, there could have been a $9.1 million loss to the Federal government.

I have attached a chronology of significant events on the Del Webb exchange. A second attachment is an explanation of the reasons for particular Del Webb decisions that represents the consensus of the major BLM participants in those decisions.

I would appreciate your examining this information thoroughly as you prepare the final report, so as to ensure a full and accurate description of events. Hindsight is always 20/20, but my review of the record here convinces me that what the Preliminary Draft Advisory Report reflects is basically a good faith disagreement by reasonable people over the wisdom of some decisions made in the early stage of this exchange proposal; not, however, the result.

More relevant to the ultimate question of whether the public interest was served in this matter, I believe there is no doubt that BLM acted with appropriate caution before making any final decisions on this exchange. Specifically, the decision to obtain a second appraisal and to provide additional procedural steps before completing its decisionmaking effectively eliminated concerns about the appropriateness of the final decision.

The BLM takes particular issue with the PreliminaryDraft Advisory Report in its implied criticism that there is something inappropriate about elevating decisions on high priority, high visibility and/or sensitive issues from a field organization to Headquarters. Such actions are not unusual and of themselves cannot imply any impropriety.

As the new BLM Director, I share your concern that our exchange program be maintained on a solid footing. I have undertaken measures to continue our quest for excellence in this program. On December 29, 1997, I established procedures for a second level review by either the State Director or the Washington Headquarters Office, and concurrence in decisions involving exchanges in excess of $500,000 in value. In addition, I am considering establishing a Bureau-wide land exchange team to assist in the review of high priority exchanges, provide additional technical support to BLM field offices, and address policy and procedural issues.

Although the Preliminary Draft Advisory Report ends with the observation that it does not contain any recommendation, the preceding paragraph recommends that the Bureau establish a moratorium on land exchanges until new control processes are instituted. I do not believe such a moratorium is wise because of its significant adverse impact on the ongoing relationships with the various local, county and state governments with which BLM works to effectuate appropriate land management and land exchange decisions. I am moving with dispatch to provide additional oversight on our exchange program.

I appreciate the opportunity to comment.

Attachments

CHRONOLOGY
Del Webb Land Exchange

September 29, 1994	Initial exchange proposal made by Del Webb.
November 27, 1995	The Nevada BLM State Director (Ann Morgan) forwards by letter a draft "Agreement to Initiate Exchange" to Del Webb, that provides that the Bureau will appraise the private and Federal lands involved in the proposed exchange.
January 16, 1996	Del Webb responded by letter to the Nevada State Director (Ann Morgan) regarding the provisions of the draft exchange agreement between BLM and Del Webb. The letter stated: "the proposed appraisal language in your draft is far more restrictive than the plain language of the Federal Regulations [43 CFR, Part 2201.3 and 3-1] and we believe the process will be aided immeasurably by adhering to federal regulations rather than by restricting those regulations with a localized policy not specifically designed to produce the best available appraiser." The letter was expressing concern that the BLM would not promptly start the appraisal process and that Gregg Harris was better qualified than any appraiser on BLM Nevada's list of qualified appraisers. Del Webb anticipated having an appraisal completed by early March 1996; BLM's timing would have been later.
February 2, 1996	Upon the advice of the Washington Office, Nevada State Director (Ann Morgan) signs revised "Agreement to Initiate Land Exchange" for Del Webb land exchange. Agreement provides for Del Webb to assist in the exchange by preparing several of the required documents and studies, including appraisal reports. Basically, BLM agreed with Del Webb that the regulations provide for the exchange proponent to appraise the lands, subject to BLM review. BLM felt that the contracting appraiser selected by Del Webb could do as good a job as a BLM appraiser.
March 5, 1996	Associate District Manager and Project Lead (Gary Ryan), and BLM Nevada Chief Appraiser (Jerry Stoebig) and Shawn Redfield, BLM Arizona Chief Appraiser, meet in Phoenix, Arizona with the Contract Appraiser (Gregg Harris) and Don Moon and Virginia Turner representing Del Webb. The purpose of the meeting is to discuss instructions for completion of the appraisal report. Jerry Stoebig expresses concern with Gregg Harris and the Del Webb representatives over use of the "Cost Development Approach", a valuation method proposed to be used by Gregg Harris.

Attachment 1

March 14, 1996	Contract Appraiser (Gregg Harris) completes appraisal, based upon a "Cost Development Approach", for Del Webb for 5,312.5 acres of selected lands in the proposed exchange.
March 25, 1996	(Approximate date) A conference call was held involving Deputy Director (Mat Millenbach), Washington Office Chief Appraiser (David Cavanaugh), Deputy State Director-Resources (Saundra Allen) and Associate State Director (Jean Rivers-Council). The purpose of the call was to discuss options for reviewing the appraisal. During the course of the conversation, Jean Rivers-Council informed Mat Millenbach and David Cavanaugh that Nevada had decided to remove (BLM Nevada State Chief Appraiser) Jerry Stoebig from the appraisal review responsibilities because of his possible lack of objectivity to the appraisal process and perceived poor working relationships with Del Webb. Mat Millenbach and David Cavanaugh concurred with this decision. (Note: Mr. Stoebig was not removed from his job--just the Del Webb exchange process.) It was concluded that it would be very difficult to find another BLM appraiser with the expertise and time to conduct this review. BLM had recently lost appraisal staff in several states, existing workload in other states was perceived as heavy, and BLM did not have the level of expertise for the appraisal of these types of property. Additionally, appraisers from other state offices are generally uncomfortable in assisting another state to provide an impartial review of appraisals for another Chief Appraiser. Obtaining BLM in-house appraisal review expertise would have added additional delay in the land exchange processing. As a solution to this problem, David Cavanaugh pointed our that the regulations authorized the use of a contract review appraiser. Mat Millenbach approved the use of this approach since the Washington Office was unable to provide another appraiser from within the Bureau.
March 27, 1996	Washington Office Chief Appraiser (David Cavanaugh) conducted telephone interviews with six prospective review appraisers. The IG's preliminary draft says five prospective contractors were contacted (footnote, page 14).
April 25, 1996	On April 25, 1996, the former Associate District Manager for the Las Vegas District (Gary Ryan) and the Washington Office Chief Appraiser

	(David Cavanaugh) met with the prospective contract reviewers (Cushman & Wakefield) in Phoenix, Arizona. Based on the interview and discussion of the statement of work, a contract was awarded to Cushman & Wakefield following appropriate procurement procedures through the BLM National Business Center (Denver) on May 10, 1996.
May 10, 1996	Award contract to Cushman & Wakefield (Steve Leach and Mike Miller) to review the Contract Appraiser's (Gregg Harris) appraisal report. The Contracting Officer complied with all requirements for simplified acquisitions in Federal Acquisition Regulations (FAR) Part 13.106-2(d)(3), which only required a notation to explain the absence of competition. The award in the amount of $12,500 was for less than the simplified acquisition threshold regarding competition. The Preliminary Draft IG Report (p.14) says FAR was not complied with. BLM also prepared a Justification for Other than Full and Open Competition (JOFOC), in accordance with portions of the Part 6.303-2 regulations. The JOFOC authorized the Contracting Officer to proceed with a "Sole Source" acquisition.
July 16, 1996	Memorandum from Washington Office Chief Appraiser (David Cavanaugh) to Las Vegas District Manager (Mike Dwyer), providing a copy of the initial appraisal review report prepared by Cushman & Wakefield. David Cavanaugh advises Mike Dwyer that some additional sales transactions are being reviewed which may provide some comparable sales information, and that the appraisal review report may need to be updated and may have an impact upon the appraised value.
September 10, 1996	Letter from Acting Deputy Director (Gwen Mason) to Del Webb, advising Del Webb that appraisals may need to be revised if additional comparable sales information becomes available prior to final actions on the land exchange, to ensure that appraisals reflect current market value.
October 14, 1996	Contract Appraiser (Gregg Harris) completes update of earlier appraisal, including some comparison with comparable sales. Property appraised includes 4,776 acres and a separate value for Phase 1 only. Appraiser concludes $43,000,000 for entire property, and $20,285,000 for Phase 1 only.
November 4, 1996	Decision Record and Notice of Decision issued on the proposed land exchange, which provides for a 45 day public comment and protest period.

November 21, 1996	E-Mail message from Washington Office Chief Appraiser (David Cavanaugh) to Washington Office Manager (Ray Brady) summarizing telephone conversations with Las Vegas District Manager (Mike Dwyer) and later with Don Moon and Virginia Turner. The District Manager expressed concern the values were too low and the report fails to use adequate comparable sales information. Cavanaugh expressed concern with earlier drafts prepared by the reviewers.
November 27, 1996	Protest letter from Sierra Club raises concern regarding the appraisal of lands and indicates the lands may be under valued. Requests an opportunity to review the appraisals.
December 5, 1996	Steve Leach and Mike Miller (Cushman & Wakefield) submit appraisal review report. Their review includes reference to 10 potential comparable sales. The reviewers concluded, however, that the additional market analysis supported the Contracting Appraiser's (Gregg Harris's) opinion of value.
December 9, 1996	Washington Office Chief Appraiser (David Cavanaugh), contracting officer representative (COR), accepts the appraisal review report for purposes of authorizing payment under the contract only. The appraisal review prepared by Steve Leach and Mike Miller (Cushman & Wakefield) was forwarded to the authorized officer (Mike Dwyer) for approval. It was never approved by either the authorized officer or the State Director (Ann Morgan). Washington Office Chief Appraiser (David Cavanaugh), in his evaluation of the appraisal review report forwarded to Las Vegas District Manager (Mike Dwyer), raised four issues: 1) A perception that the appraised values are too low; 2) agreement by the reviewers that the value per acre for Phase 1 is lower than for the entire tract; 3) the review report assumes the sale of the entire property and does not consider any lapse in time between the first and final transactions; 4) the review report assumes the land is free and clear of all encumbrances including mining claims and that any costs to clear assumed by a prospective buyer would be a reduction in value. Also included in David Cavanaugh's evaluation is a discussion of an option to prepare an additional appraisal or appraisal reviews.
December 10, 1996	Protest letter from Charles Hancock (private citizen) requesting an opportunity to review the appraisal reports and asserts that a competitive sale of the lands would increase values.
December 12, 1996	OIG notifies the Bureau of intent to perform a follow up audit of its Nevada land exchanges. This notification gave no indication that the

ongoing Del Webb land exchange would be included in the follow up audit. The notification indicated only that "recently completed exchanges" would be reviewed. The Del Webb exchange was not completed at this time.

December 16, 1996 — Letter from Senator McCain (AZ) to Assistant Secretary, Land and Minerals Management requesting information on the status of the Del Webb land exchange.

December 17, 1996 — Cushman and Wakefield provide a presentation in the BLM Washington Office on the appraisal review. Attendees were Department, BLM Headquarters, and field managers and staff, including Las Vegas District Manager (Mike Dwyer) and Nevada State Director (Ann Morgan).

December 18, 1996 — Following the December 17 meeting, Las Vegas District Manager (Mike Dwyer) prepares handwritten comments critiquing the Harris appraisal report and review prepared by Cushman and Wakefield. Copies of these comments were given to Dave Cavanaugh and the contract review appraisers. The major issues raised by Mike Dwyer regarded the cost approach for the appraisal, unsupported adjustments to price, and poor justification for the discount rate applied to the appraisal.

December 18, 1996 — Letter from Senator Reid (NV) to Assistant Secretary, Land and Minerals Management requesting information on the status of the Del Webb land exchange.

December 19, 1996 — Protest letter from Howard Hughes Corporation expressed concern that the appraisal documents were unavailable for review, and that values of the exchange lands are unknown.

December 19, 1996 — Public comment period on the Notice of Decision ends. Seven protests are received on the land exchange. Three of these protests raise issues related to the appraisal of the lands involved in the exchange. (See the November 27, 1996, December 10, 1996, and December 19, 1996 entries above.)

December 23, 1996 — Washington Office Chief Appraiser (David Cavanaugh) sends an electronic message to Nevada State Director (Ann Morgan), Las Vegas District Manager (Mike Dwyer) and others as a follow up to Mike Dwyer's comments on the appraisal review. Mike Dwyer's comments were also forwarded to Cushman & Wakefield with a request for the contract review appraisers to respond to the comments. David Cavanaugh concludes in the electronic message that: "Therefore, I still think we need an appraisal that relies primarily on a market analysis, which to the extent may be appropriate, includes a reference to the appraisal and appraisal review."

December 23, 1996	In response to the December 16, 1996, letter from Senator McCain (AZ) and December 18, 1996, letter from Senator Reid (NV), Deputy Director (Mat Millenbach) writes to Senator McCain and Senator Reid regarding BLM's progress in processing the Del Webb land exchange. The letter states that "we intend to follow all applicable statutes, regulations, and procedures in processing this exchange and to continue to involve the public, as appropriate, to ensure that any final exchange transaction serves the public interest." He also states: "Another factor which may potentially affect the timing of the Del Webb exchange is the investigation of land exchange activities in Nevada by the Office of Inspector General (IG)." The thought here is that if the IG discovered a serious deficiency, BLM would have taken the time to address and correct the problem.
January 2, 1997	Phil Dion (Chairman of the Board and CEO, Del Webb Corporation) writes Senator McCain criticizing BLM's handling of the land exchange. The letter references an upcoming meeting on January 7.
January 6, 1997	Cushman & Wakefield respond to Las Vegas District Manager's (Mike Dwyer) comments regarding the appraisal review report, including the concerns regarding the development cost approach for the appraisal. The review appraisers state: "This approach has current market acceptance, is very reliable given the depth of data available and provides subject specific value indicators which cannot be derived from the sales data."
Jan. 7 and 8, 1997	Las Vegas District Manager (Mike Dwyer) and Nevada State Director (Ann Morgan) provide a briefing paper for discussions in meetings with BLM Washington Office, Solicitor's Office and the Assistant Secretary's Office of several issues concerning the appraisal report, the procedural error of not providing the public an opportunity to comment on the appraisal during the public comment period of the Notice of Decision, ledger imbalance, OIG audit, resolution of protests, and Nevada Power appeal. In a description of options, Mike Dwyer indicates BLM Chief Appraiser (David Cavanaugh) recommends ordering new appraisal. Justification is the appraiser would be independent from first effort, fresh set of eyes, and an opportunity to clarify instructions.
January 7, 1997	OIG holds entrance conference on the followup audit with BLM officials and informs BLM that the Del Webb land exchange will be included within the scope of audit.

January 14, 1997	Letter from Deputy Director (Mat Millenbach) to Phil Dion summarizing decisions made at a January 7-8 meeting of BLM and DOI officials. Officials discussed protests in response to the Notice of Decision (NOD) published on November 4, 1996. It was agreed a second appraisal would be ordered, a supplemental environmental assessment would be prepared, a new NOD would be issued, and property would be exchanged subject to Nevada Power right-of-way.
January 21-22, 1997	Meetings with Del Webb in Washington, DC to address implementation of the January 14 letter.
January 27, 1997	BLM contracts for a second appraisal. The existing BLM Nevada contract list had only one appraiser from the Las Vegas area and we were concerned regarding the quality of his previous work and reports. Because the BLM Nevada Chief Appraiser had previously been removed from the appraisal work for this exchange (March 25, 1996 decision), there was no consideration to bring him into the process again. The BLM decided to procure appraisal services from a reputable local firm not on the current contracting list. It was also decided by the State Director and Deputy Director that the Washington Office Chief Appraiser (David Cavanaugh) would review the appraisal report. The BLM contracted with a top Las Vegas accounting firm (Piercy, Bowler, Taylor & Kern) that had an excellent appraisal staff.
January 30, 1997	Deputy Director (Mat Millenbach) sends a follow-up letter to Phil Dion summarizing meetings with his staff on January 21-22, 1997. The meetings put in place procedural steps implementing decisions made at the January 7-8, 1997 meeting. A timetable prepared by Las Vegas District Manager (Mike Dwyer) is attached to the letter.
February 25, 1997	Meeting with Del Webb in Washington, DC to discuss progress with the exchange.
March 21, 1997	BLM receives the second appraisal. The appraiser's conclusions were based on a comparable sale analysis and also evaluated and considered the Cost Development Approach from the earlier appraisal.
March 31, 1997	Washington Office Chief Appraiser (David Cavanaugh) accepts the appraisal report prepared by the contract appraiser.
April 8, 1997	Approval of appraised value by Authorized Officer (Mike Dwyer) and Nevada State Director (Ann Morgan). BLM letter to Del Webb providing copy of approved appraisal and offer of $31.5 million for Phase I of the Del Webb exchange.

May 6, 1997	Del Webb acceptance of offer.
May 21, 1997	New Notice of Decision issued for Phase I of the Del Webb exchange. Notice of Decision provides for public review of the approved appraisal.
July 29, 1997	Title transfers and patents issued on the initial land transfers of Phase I-A of the Del Webb land exchange.

BLM Comments on Del Webb Exchange Actions

1. The decision to allow Del Webb to furnish the initial appraisal for the proposed exchange was in compliance with the Federal Land Exchange Facilitation Act of 1988 (P.L. 100-409) and implementing regulations (43 CFR 2200). Section 2201.3-2 states "A qualified appraiser may be an employee or a contractor to the Federal or non-Federal exchange parties." To the extent that a decision to allow Del Webb to furnish the initial appraisal conflicted with a field policy or practice, the decision was fully within the discretion of BLM Headquarters' Officials.

2. The use of the "cost development approach" is acceptable under the Department of Justice's "Uniform Appraisal Standards for Federal Land Acquisitions", when the Appraiser, in his or her professional judgment, concludes there are inadequate or no comparable sales. It is appropriate for reviewing appraisers to withhold judgment on an appraiser's reasoning and appropriate use of appraisal methods until the appraisal is reviewed. The Contracting Appraiser (Gregg Harris) appraisal supplied by Del Webb met Federal Standards although it was not accepted by BLM. It should be noted that there was some market analysis included in the first appraisal. Lack of confidence in this market, however, was one of the primary reasons for deciding to do a second appraisal.

3. The decision to remove the BLM Nevada Chief Appraiser (Mr. Stoebig) from the reviewing appraiser function was based on the perception that Mr. Stoebig had a dispute with Mr. Harris before the initial appraisal was performed in which he (Mr. Stoebig) strongly expressed inappropriate preconceived notions of value or methodology. This disagreement between Mr. Stoebig and Mr. Harris could have potentially jeopardized the processing of the exchange. (Mr. Dwyer was not involved with this decision.) Obtaining BLM in-house appraisal review expertise would have added additional delay in the land exchange processing.

4. As the chronology shows, discussions within BLM about securing a second appraisal began before the IG announced a follow-up audit and well before the IG informed BLM that the following audit would include the Del Webb exchange. Ultimately, a large number of DOI officials, including BLM Washington and Field Officials, Solicitor's Office representatives, and a representative of the Assistant Secretary's Office were involved in these discussions and made a consensus decision to seek a second appraisal. The concerns that led to this conclusion included: 1) the values recommended by the contract review may be too low; 2) the public had not had an opportunity to comment on the appraisal during the public comment period on the initial Notice of Decision;

Attachment 2

3) the appraisal review contractors had identified 10 comparable sales, some of which had not been identified by Del Webb's appraiser; 4) BLM continued to have questions regarding the appraisal methodology (feasibility of the preferred approach based on comparables); 5) several protests questioned the initial appraisal; and 6) there was an unresolved issue concerning a power line right-of-way that potentially affected appraised value. (See December 9, 1996 and September 10, 1996 chronology .)

5. The decision to seek a second appraisal and the subsequent decision to accept that appraisal led to BLM receiving greater value for its lands. These decisions support a conclusion that the safeguards to protect and serve the public interest in the exchange process worked in the case of the Del Webb exchange; they do not support the inferences in the IG report that improper processes and procedures were followed.

BUREAU OF LAND MANAGEMENT CHRONOLOGY OF DEL WEBB LAND EXCHANGE EVENTS AND OFFICE OF INSPECTOR GENERAL COMMENTS

In order to present the Office of Inspector General's comments to the Bureau of Land Management's "Chronology - Del Webb Land Exchange" (Attachment 1 to Appendix 1), we have replicated the Bureau's comments except that names of individuals have been replaced with their official titles or other designations. This appendix provides discussions of our disagreement or additional clarification of the facts in the Bureau's Attachment 1. If the information in Attachment 1 did not affect the facts and conclusions presented in our report, we did not comment accordingly.

Bureau Chronology	Office of Inspector General Comments and Supplemental Information
September 29, 1994 Initial exchange proposal made by Del Webb.	**September 29, 1994** Del Webb's exchange proposal identified a solid block of Federal land in the Las Vegas Valley that Del Webb sought to acquire (approximately 5,000 acres), but the proposal did not identify any specific private lands offered in exchange.
	September 29, 1995 The Associate District Manager approved a feasibility report for the exchange which stated that Del Webb had selected 4,975 acres of public land and that the exchange would be completed in phases, of which each phase would consist of about 1,000-acre parcels and would be exchanged over a period of 3 to 7 years.
November 27, 1995 The Nevada BLM State Director forwards by letter a draft "Agreement to Initiate Exchange" to Del Webb, that provides that the Bureau will appraise the private and Federal lands involved in the proposed exchange.	**November 27, 1995** The draft agreement also stated that the Bureau "or other benefitting Federal agency will arrange with a contractor to prepare an appraisal of the selected lands for each phase within 90 days of the initiation of that phase of the exchange."
	November 30, 1995 Del Webb's representative advised the Las Vegas District Manager and the Associate District Manager that Del Webb was having an appraisal performed on the selected public land.

Bureau Chronology	Office of Inspector General Comments and Supplemental Information
January 16, 1996 Del Webb responded by letter to the Nevada State Director regarding the provisions of the draft exchange agreement between BLM and Del Webb. The letter stated: "the proposed appraisal language in your draft is far more restrictive than the plain language of the Federal Regulations [43 CFR, Part 2201.3 and 3-1] and we believe the process will be aided immeasurably by adhering to federal regulations rather than by restricting those regulations with a localized policy not specifically designed to produce the best available appraiser." The letter was expressing concern that the BLM would not promptly start the appraisal process and that Del Webb's appraiser was better qualified than any appraiser on BLM Nevada's list of qualified appraisers. Del Webb anticipated having an appraisal completed by early March 1996; BLM's timing would have been later.	**January 16, 1996** The Bureau's statement confirms that Del Webb had already selected an appraiser to estimate the value of the selected public land before the "Agreement to Initiate Land Exchange" was approved by the Bureau. Further, the Bureau did not provide information on when Del Webb retained the services of the appraiser, identify the Bureau official who approved the selection of this appraiser, or specify the date when the approval was given. We believe that Del Webb's desire to expedite the appraisal in order to establish the price for all of the approximately 5,000 acres of public land it sought to acquire was understandable given the rapid increases in land prices in the Las Vegas area. However, we found that Del Webb did not have sufficient offered property available to exchange for all of the selected public land. For example, even after the Bureau approved an appraised value for the selected public land on April 8, 1997, almost 15 months after the date of Del Webb's letter to the Nevada State Director, the Bureau was able to accept only four properties valued at about $11 million in the initial exchange transaction. Accordingly, we do not believe that the Bureau's Washington Office was justified in its acceptance of the purported urgency of the appraisal or in its actions to facilitate completion and review of an appraisal of the entire Federal parcel.
February 2, 1996 Upon the advice of the Washington Office, Nevada State Director signs revised "Agreement to Initiate Land Exchange" for Del Webb land exchange. Agreement provides for Del Webb to assist in the exchange by preparing several of the required documents and studies, including appraisal reports. Basically, BLM agreed with Del Webb that the regulations provide for the exchange proponent to appraise the lands, subject to BLM review. BLM felt that the contracting appraiser selected by Del Webb could do as good a job as a BLM appraiser.	**February 2, 1996** We agree that Bureau regulations authorize Bureau officials to allow exchange proponents to appraise exchange lands. The authorized officials for this exchange, the State Director and the State Chief Appraiser, acting in accordance with the authority delegated to them in Sections 1203 and 9310 of the Bureau Manual, had previously established and complied with a policy that the State Office would obtain its own appraisals of the public land. Their policy was also in compliance with the law. Given the significant interest in Nevada exchanges and the "very speculative and volatile nature of land values in the Las Vegas area" cited by the Director in his response to the draft report, we believe that the Nevada State Office's policy was a valid and reasonable method for providing the Bureau's authorized officers with an acceptable level of confidence in the appraised value of lands to be exchanged. However, we believe that the Washington Office's advice that Del Webb should be allowed to use the appraiser raised concerns that Del Webb was exerting undue influence over the exchange.

Bureau Chronology	Office of Inspector General Comments and Supplemental Information
March 5, 1996 Associate District Manager and Project Lead, and BLM Nevada Chief Appraiser and BLM Arizona Chief Appraiser, meet in Phoenix, Arizona with the Del Webb Appraiser and Del Webb representatives. The purpose of the meeting is to discuss instructions for completion of the appraisal report. The Nevada State Chief Appraiser expresses concern with Del Webb's appraiser and the Del Webb representatives over use of the "Cost Development Approach," a valuation method proposed to be used by the Del Webb appraiser.	**March 5, 1996** When using a new appraiser on an appraisal assignment, the Bureau State Chief Appraiser meets with the appraiser before work begins to ensure that the appraiser has a thorough understanding of the scope of the work and of the "Uniform Appraisal Standards for Federal Land Acquisitions," which is required to be complied with in Federal land acquisitions and exchanges (private sector appraisers are not subject to these requirements). The Nevada State Chief Appraiser, the Arizona State Chief Appraiser, and the Associate District Manager stated that their impression after the meeting was that Del Webb's appraiser had completed most of his work and was not interested in expending additional effort to develop a substantive comparable sales analysis.
March 14, 1996 Del Webb's Appraiser completes appraisal, based upon a "Cost Development Approach," for Del Webb for 5,312.5 acres of selected lands in the proposed exchange.	**March 14, 1996** Del Webb's appraiser completed his appraisal using the more complex development approach in only 9 days after the appraisal meeting with the Nevada Chief Appraiser and other Bureau representatives. Although there are no established time frames for conducting appraisals, the second appraisal of the Bureau land required about 8 weeks to complete. Consequently, we believe that Del Webb's appraiser had substantially completed this assignment before the March 5, 1996, meeting with Bureau officials.
March 25, 1996 (Approximate date) A conference call was held involving Deputy Director, Washington Office Chief Appraiser, Deputy State Director-Resources and Associate State Director. The purpose of the call was to discuss options for reviewing the appraisal. During the course of the conversation, the Associate State Director informed the Deputy Director and the Washington Office Chief Appraiser that Nevada had decided to remove the BLM Nevada State Chief Appraiser from the appraisal review responsibilities because of his possible lack of objectivity to the appraisal process and perceived poor working relationships with Del Webb. The Deputy Director and the Washington Office Chief Appraiser concurred with this decision. (Note: The BLM Nevada State Chief Appraiser was not removed from his job--just the Del Webb exchange process.) It was concluded that it would be very difficult to find another BLM appraiser with the expertise and time to conduct this review. BLM had recently lost appraisal staff in several states, existing workload in other states was perceived as heavy, and BLM did not have the level of expertise for the appraisal of of these types of property. Additionally appraiser from other state offices are	**March 25, 1996** The information presented in the Bureau's chronology for March 25, 1996, conflicts with information we obtained during the audit and omits other relevant information about the meeting. The Nevada State Director, the Associate State Director, and the Deputy State Director-Resources told us that Nevada officials initiated this conference call just before a scheduled meeting between the Deputy Director and Del Webb's representative because Del Webb wanted to select and hire an appraiser to review the appraisal report prepared by Del Webb's appraiser. Further, the Deputy State Director - Resources said that she told the Deputy Director that there was no evidence to support Del Webb's assertions against the State Chief Appraiser but that if the Washington Office decided to remove the State Chief Appraiser from the Del Webb appraisal, there were other qualified Bureau State Chief Appraisers who should perform the review. The Deputy State Director - Resources also said that the Deputy Director stated that he would not make an immediate decision on the appraisal review. The Bureau's chronology does not note that Del Webb's representative directly participated in the conference call. However, the Deputy State Director - Resources informed us that after the initial discussion between the Bureau's Nevada State Office and the Washington Office, Del Webb's representative, who was waiting to meet the Deputy Director, was brought into the meeting. Del Webb's representative stated that Del Webb did not

Bureau Chronology	Office of Inspector General Comments and Supplemental Information
March 25, 1996 (continued) generally uncomfortable in assisting another state to provide an impartial review of appraisals for another Chief Appraiser. Obtaining BLM in-house appraisal review expertise would have added additional delay in the land exchange processing. As a solution to this problem, the Washington Office Chief Appraiser pointed out that the regulations authorized the use of a contract review appraiser. The Deputy Director approved the use of this approach since the Washington Office was unable to provide another appraiser from within the Bureau.	**March 25, 1996 (continued)** want the Nevada Chief Appraiser to perform the review because he was "biased" and did not want any other Bureau State Chief Appraisers to perform the review because Del Webb did not believe that they were qualified to evaluate a complex development approach appraisal. The Deputy Director said at the meeting that the Bureau would contract for an appraisal review. The Nevada State Director told us that she remained adamant that a Bureau State Chief Appraiser was needed to review and approve the value of the selected Federal land. We believe that the concerns expressed by the Nevada State Director were valid because the use of a Bureau State Chief Appraiser to perform the appraisal review would have enabled the Bureau to maintain proper oversight of the exchange. The Bureau's chronology states that the Nevada State Chief Appraiser was removed "because of his possible lack of objectivity to the appraisal process and perceived poor working relationships with Del Webb." However, as previously stated in our audit report, we found no evidence to support the allegations in the exchange file records; in the State Chief Appraiser's performance evaluations; or in our interviews with the Associate District Manager and Arizona Chief Appraiser, both of whom also attended the March 5, 1996, meeting with Del Webb's appraiser and representatives.
	March 26, 1996 Del Webb's representative sent a memorandum to the Washington Office Chief Appraiser requesting specific language to be included in the scope of work for the Bureau's appraisal review contract which stated that any written or verbal communication between the Bureau's contract review appraiser and Bureau employees was precluded unless Del Webb's representatives also participated. In addition, according to Del Webb's language for the proposed scope of work, the Washington Office Chief Appraiser would have been the only Bureau official allowed to communicate with the contractor. The requested language was included in the draft scope of work prepared by the Washington Office Chief Appraiser.

Bureau Chronology	Office of Inspector General Comments and Supplemental Information
March 27, 1996 Washington Office Chief Appraiser conducted telephone interviews with six prospective review appraisers. The IG's preliminary draft says five prospective contractors were contacted (footnote, page 14).	**March 27, 1996** Records from the Washington Office Chief Appraiser indicated that the Chief Appraiser made telephone calls to seven different appraisal contractors but conducted telephone interviews with only five of these contractors. Therefore, we do not believe that our report needs to be corrected. In addition, the Bureau's chronology did not identify all the parties involved in the telephone interviews. The Washington Office Chief Appraiser told us that Del Webb's representatives were allowed to "listen in" as the Chief Appraiser conducted these interviews.
	March 28, 1996 The Washington Office Chief Appraiser tentatively selected the appraisal firm nominated by Del Webb to perform the appraisal review.
	March 29, 1996 In a conference call with the Deputy Director, the Field Special Assistant to the Director, and the Group Manager, Lands and Realty Group, the Nevada State Director argued unsuccessfully "that a Bureau of Land Management person should review the report."
	April 3, 1996 Records of the conference call held to discuss the statement of work for the appraisal review contract indicated that the State Director was concerned about the statement of work. The areas of concern were (1) the number of acres that could be legally conveyed at that time and (2) the involvement of Del Webb's representatives. The Washington Office Chief Appraiser stated that he " underestimated" the State Director's concern that Del Webb was trying to "unduly influence the valuation and exchange process."
	April 5, 1996 The Washington Office Chief Appraiser changed the proposed statement of work to eliminate Del Webb's language regarding restrictions on communications (see March 26, 1996, entry).
	April 8, 1996 The Washington Office Chief Appraiser discussed the changes in the statement of work with Del Webb's representatives. The records of the Washington Office Chief Appraiser stated that Del Webb's representative felt that the Bureau reneged on its earlier agreement with Del Webb regarding the statement of work.

Bureau Chronology	Office of Inspector General Comments and Supplemental Information
	April 11, 1996 Records of the Washington Office Chief Appraiser stated that Del Webb's representatives "requested a conference call to arbitrate their being taken out of the statement of work." The conference call included the Deputy Director, the Field Special Assistant to the Director, the Washington Office Chief Appraiser, the Deputy State Director-Resources, the Las Vegas District Manager, and Del Webb's representatives. The Washington Office Chief Appraiser's records stated that Del Webb's representative "was complaining" that because of earlier statements by the Nevada State Chief Appraiser and members of the State Office, it was essential that Del Webb's representatives be involved in observing discussions with the review appraiser to protect their client.
April 25, 1996 On April 25, 1996, the Associate District Manager for the Las Vegas District and the Washington Office Chief Appraiser met with the prospective contract reviewers in Phoenix, Arizona. Based on the interview and discussion of the statement of work, a contract was awarded to the contract review appraisers following appropriate procurement procedures through the BLM National Business Center (Denver) on May 10, 1996.	**April 25, 1996** No comment.
May 10, 1996 Award contract to contact review appraisers to review the Del Webb Appraiser's report. The Contracting Officer complied with all requirements for simplified acquisitions in Federal Acquisition Regulations (FAR) Part 13.106-2(d)(3), which only required a notation to explain the absence of competition. The award in the amount of $12,500 was for less than the simplified acquisition threshold regarding competition. The Preliminary Draft IG Report (p. 14) says FAR was not complied with. BLM also prepared a Justification for Other than Full and Open Competition (JOFOC), in accordance with portions of the Part 6.303-2 regulations. The JOFOC authorized the Contracting Officer to proceed with a "Sole Source" acquisition.	**May 10, 1996** We have modified our report to recognize that this action was executed using the simplified acquisition procedures in the Federal Acquisition Regulation. However, our concern is that the Bureau awarded this contract to a Del Webb-nominated appraiser on the basis of unusual and compelling urgency and cited as its justification the need "to avoid greater expense to the United States and weaken the integrity of the appraisal report." The Bureau did not substantiate the urgency of this contract during the audit or in its response and chronology.
July 16, 1996 Memorandum from Washington Office Chief Appraiser to Las Vegas District Manager, providing a copy of the initial appraisal review report prepared by the contract review appraisers. Washington Office Chief Appraiser advises the Las Vegas District Manager that some additional sales transactions are being reviewed which may provide some comparable sales information, and that the appraisal review report may need to be updated and may have an impact upon the appraised value.	**July 16, 1996** The Washington Office Chief Appraiser resolved any outstanding value issues by accepting the appraisal review, agreeing that the appraisal report and analysis reasonably supported the appraiser's $43 million value, and forwarding the appraisal and appraisal review to the District Manager for approval (see December 9, 1996, entry).

Bureau Chronology	Office of Inspector General Comments and Supplemental Information
September 10, 1996 Letter from Acting Deputy Director to Del Webb, advising Del Webb that appraisals may need to be revised if additional comparable sales information becomes available prior to final actions on the land exchange, to ensure that appraisals reflect current market value.	**September 10, 1996** No comment.
October 14, 1996 Del Webb's appraiser completes update of earlier appraisal, including some comparison with comparable sales. Property appraised includes 4,776 acres and a separate value for Phase I only. Appraiser concludes $43,000,000 for entire property, and $20,285,000 for Phase I only.	**October 14, 1996** As discussed in the report, this appraisal relied mainly on the development approach, which the "Uniform Appraisal Standards for Federal Land Acquisitions" states should be used only as a last resort or as a check on values derived by the more reliable comparable sales approach.
	October 31, 1996 An attachment to a December 17, 1996, letter to Senator McCain from the Chairman of the Board and Chief Executive Officer of Del Webb states: "At an October 31 meeting, one of Del Webb's representatives asked directly whether 'we had agreement on the Phase I and Phase II land values' as agreed to by the four appraisers. Both the Authorized Officer and the [Washington Office] Chief Appraiser answered 'yes.' Webb was told [by these officials] that the contract reviewers would be providing further information on the comparable sales discussed in the appraisal, but that the numbers [$43 million] were firm."
November 4, 1996 Decision Record and Notice of Decision issued on the proposed land exchange, which provides for a 45 day public comment and protest period.	**November 4, 1996** The Bureau stated in its decision that the exchange was in the public interest and should proceed immediately. This followed the above-noted October 31, 1996, meeting between the Bureau's authorized officer, Del Webb's representatives, and the appraisers. We believe this indicates that the Bureau was willing to use the $43 million appraised value as the basis for proceeding with the exchange.
November 21, 1996 E-Mail message from Washington Office Chief Appraiser to Washington Office Manager summarizing telephone conversations with Las Vegas District Manager and later with Del Webb's representatives. The District Manager expressed concern the values were too low and the report fails to use adequate comparable sales information. The Washington Office Chief Appraiser expressed concern with earlier drafts prepared by the reviewers.	**November 21, 1996** We believe that the Bureau's comments regarding the Washington Office Chief Appraiser's "expressed concern with earlier drafts" were not consistent with his actions, since he accepted the appraisal review, agreed with the reviewers that the appraisal report and analysis reasonably supported the $43 million value, and forwarded the appraisal and appraisal review to the Las Vegas District Manager for approval (see December 9, 1996, entry).
November 27, 1996 Protest letter from Sierra Club raises concern regarding the appraisal of lands and indicates the lands may be under valued. Requests an opportunity to review the appraisals.	**November 27, 1996** No comment.

Bureau Chronology	Office of Inspector General Comments and Supplemental Information
December 5, 1996 Contract review appraisers submit appraisal review report. Their review includes reference to 10 potential comparable sales. The reviewers concluded, however, that the additional market analysis supported the Del Webb appraiser's opinion of value.	**December 5, 1996** No comment.
December 9, 1996 The Washington Office Chief Appraiser, who was the contracting officer representative (COR), accepts the appraisal review report for purposes of authorizing payment under the contract only. The appraisal review prepared by the contract review appraisers was forwarded to the Las Vegas District Manager for approval. It was never approved by either the Las Vegas District Manager or the State Director. Washington Office Chief Appraiser, in his evaluation of the appraisal review report forwarded to Las Vegas District Manager, raised four issues: 1) A perception that the appraised values are too low; 2) agreement by the reviewers that the value per acre for Phase 1 is lower than for the entire tract; 3) the review report assumes the sale of the entire property and does not consider any lapse in time between the first and final transactions; 4) the review report assumes the land is free and clear of all encumbrances including mining claims and that any costs to clear assumed by a prospective buyer would be a reduction in value. Also included in the Washington Office Chief Appraiser's evaluation is a discussion of an option to prepare an additional appraisal or appraisal reviews.	**December 9, 1996** In its chronology, the Bureau stated that the Washington Office Chief Appraiser "accepts the appraisal review report for purposes of authorizing payment under the contract only." When authorizing payment to contractors, contracting officer's representatives are required to ensure that the services and products provided to the government meet the requirements established in the purchase order. We believe that if the Washington Office Chief Appraiser accepted work that was not in full conformance with the "Standards," he did not fulfill his duties as the contracting officer's representative. In the evaluation report (page 4), the Washington Office Chief Appraiser states, "I agree with the reviewers that the appraisal report and the analysis reasonably supports the appraisers conclusion of value." In addition, we believe that the Chief Appraiser's statement that "the appraisal review is acceptable and is being forwarded to the authorized officer for their approval" indicates a recommendation to the authorized officer that the $43 million value should be used for the exchange. The four issues discussed by the Washington Office Chief Appraiser in his evaluation report involve significant deficiencies in the appraisal and appraisal review. As such, we believe the Washington Office Chief Appraiser should not have accepted the appraisal review and forwarded it to the authorized officer for his approval.
December 10, 1996 Protest letter from private citizen requesting an opportunity to review the appraisal reports and asserts that a competitive sale of the lands would increase values.	**December 10, 1996** No comment.

Bureau Chronology	Office of Inspector General Comments and Supplemental Information
December 12, 1996 OIG notifies the Bureau of intent to perform a follow up audit of its Nevada land exchanges. This notification gave no indication that the ongoing Del Webb land exchange would be included in the follow up audit. The notification indicated only that "recently completed exchanges" would be reviewed. The Del Webb exchange was not completed at this time.	**December 12, 1996** The announcement memorandum for our audit stated that the objective of the audit would be "to determine whether the Nevada State Office, Bureau of Land Management, has complied with applicable laws and regulations during all phases of the land exchange process and whether the Bureau has received fair market value for the lands included in recently completed exchanges." (Emphasis added.)
	December 13, 1996 The Deputy Director asked the Office of Inspector General whether our audit would include ongoing exchanges and, in particular, if we would include the Del Webb exchange. During a telephone conversation, the auditor-in-charge of the followup audit informed the Bureau's Audit Liaison Officer that we intended to review all exchanges completed since our last audit and all exchanges currently in process, including the Del Webb exchange.
December 16, 1996 Letter from Senator McCain to Assistant Secretary, Land and Minerals Management requesting information on the status of the Del Webb land exchange.	**December 16, 1996** No comment.
December 17, 1996 Contract review appraisers provide a presentation in the BLM Washington Office on the appraisal review. Attendees were Department, BLM Headquarters, and field managers and staff, including Las Vegas District Manager and Nevada State Director .	**December 17, 1996** No comment.

Bureau Chronology	Office of Inspector General Comments and Supplemental Information
December 18, 1996 Following the December 17 meeting, Las Vegas District Manager prepares handwritten comments critiquing Del Webb appraiser's appraisal report and review prepared by contract review appraisers. Copies of these comments were given to Washington Office Chief Appraiser and the contract review appraisers. The major issues raised by the Las Vegas District Manager regarded the cost approach for the appraisal, unsupported adjustments to price, and poor justification for the discount rate applied to the appraisal.	**December 18, 1996** A meeting was held on this date in the Bureau's Washington Office to discuss the status of the Del Webb exchange. Attendees consisted of the Deputy Director, the Nevada State Director, the Las Vegas District Manager, a representative of the Assistant Secretary for Lands and Minerals Management, and the Washington Office Chief Appraiser. According to the Chief Appraiser's notes of the meeting, discussions related to our followup audit included the following: - "IG [Inspector General] Audit -- We have indications from the IG that this audit may focus on appraisals and perhaps specifically the appraisal associated with the Del Webb exchange. The Bureau of Land Management will work with the Inspector General to schedule a meeting for the week of January 6, 1997 to discuss the subject of the audit in order to determine how to proceed with the Del Webb exchange." - "Appraisal -- The appraisal and the Review of the Appraisal were delivered to the State Director on December 10, 1996. These documents are under review and a decision by the authorized officer will be made following the meeting with the IG." - "The analysis of the appraisal, analysis and resolution of the protests, and all other work associated with the Del Webb exchange will proceed. No decisions will be made until after the meeting with the IG."
December 18, 1996 Letter from Senator Reid to Assistant Secretary, Land and Minerals Management requesting information on the status of the Del Webb land exchange.	**December 18, 1996** No comment.
December 19, 1996 Protest letter from Howard Hughes Corporation expressed concern that the appraisal documents were unavailable for review, and that values of the exchange lands are unknown.	**December 19, 1996** No comment.
December 19, 1996 Public comment period on the Notice of Decision ends. Seven protests are received on the land exchange. Three of these protests raise issues related to the appraisal of the lands involved in the exchange. (See the November 27, 1996, December 10, 1996, and December 19, 1996 entries above.)	**December 19, 1996** No comment.

Bureau Chronology	Office of Inspector General Comments and Supplemental Information
December 23, 1996 Washington Office Chief Appraiser sends an electronic message to Nevada State Director, Las Vegas District Manager and others as a follow up to the Las Vegas District Manager's comments on the appraisal review. The Las Vegas District Manager's comments were also forwarded to contract review appraisers with a request for the contract review appraisers to respond to the comments. Washington Office Chief Appraiser concludes in the electronic message that: "Therefore, I still think we need an appraisal that relies primarily on a market analysis, which to the extent may be appropriate, includes a reference to the appraisal and appraisal review."	**December 23, 1996** The Washington Office Chief Appraiser stated in his December 9, 1996, evaluation report that he identified significant problems with the appraisal and review that could warrant obtaining a new appraisal. However, he concurred with the reviewer's acceptance of the value and forwarded the appraisal and review to the authorized officer for approval. Then, in the December 23, 1996, electronic mail message cited by the Bureau, the Washington Office Chief Appraiser stated that the Bureau should obtain a new appraisal which relies primarily on a market analysis. However, in a subsequent message to the review appraisers, the Washington Office Chief Appraiser stated that he wanted to "resurrect the appraisal and appraisal review" and that he did "not want management to be displeased with our efforts and flirt with trashing the whole thing."
December 23, 1996 In response to the December 16, 1996, letter from Senator McCain and December 18, 1996, letter from Senator Reid, the Deputy Director writes to [the Senators] regarding BLM's progress in processing the Del Webb land exchange. The letter states that "we intend to follow all applicable statutes, regulations, and procedures in processing this exchange and to continue to involve the public, as appropriate, to ensure that any final exchange transaction serves the public interest." He also states: "Another factor which may potentially affect the timing of the Del Webb exchange is the investigation of land exchange activities in Nevada by the Office of Inspector General (IG)." The thought here is that if the IG discovered a serious deficiency, BLM would have taken the time to address and correct the problem.	**December 23, 1996** No comment.
	December 31, 1996 The Washington Office Chief Appraiser provided the contract review appraisers with his suggested responses to a portion of the District Manager's December 18, 1996, comments on the appraisal and appraisal review.
January 2, 1997 The Chief Executive Officer, Del Webb Corporation writes Senator McCain criticizing BLM's handling of the land exchange. The letter references an upcoming meeting on January 7.	**January 2, 1997** No comment.

Bureau Chronology	Office of Inspector General Comments and Supplemental Information
January 6, 1997 The contract review appraiser respond to the Las Vegas District Manager's comments regarding the appraisal review report, including the concerns regarding the development cost approach for the appraisal. The review appraisers state: "This approach has current market acceptance, is very reliable given the depth of data available and provides subject specific value indicators which cannot be derived from the sales data."	**January 6, 1997** No comment.
January 7 and 8, 1997 The Las Vegas District Manager and Nevada State Director provide a briefing paper for discussions in meetings with BLM Washington Office, Solicitor's Office and the Assistant Secretary's Office of several issues concerning the appraisal report, the procedural error of not providing the public an opportunity to comment on the appraisal during the public comment period of the Notice of Decision, ledger imbalance, OIG audit, resolution of protests, and Nevada Power appeal. In a description of options, the Las Vegas District Manager indicates Washington Office Chief Appraiser recommends ordering new appraisal. Justification is the appraiser would be independent from first effort, fresh set of eyes, and an opportunity to clarify instructions.	**January 7 and 8, 1997** No comment.
January 7, 1997 OIG holds entrance conference on the followup audit with BLM officials and informs BLM that the Del Webb land exchange will be included within the scope of audit.	**January 7, 1997** No comment.
January 14, 1997 Letter from Deputy Director to Del Webb's Chief Executive Officer summarizing decisions made at a January 7-8 meeting of BLM and DOI officials. Officials discussed protests in response to the Notice of Decision (NOD) published on November 4, 1996. It was agreed a second appraisal would be ordered, a supplemental environmental assessment would be prepared, a new NOD would be issued, and property would be exchanged subject to Nevada Power right-of-way.	**January 14, 1997** No comment.
January 21 and 22, 1997 Meetings with Del Webb in Washington, DC to address implementation of the January 14 letter.	**January 21 and 22, 1997** No comment.

Bureau Chronology

January 27, 1997
BLM contracts for a second appraisal. The existing BLM Nevada contract list had only one appraiser from the Las Vegas area and we were concerned regarding the quality of his previous work and reports. Because the BLM Nevada Chief Appraiser had previously been removed from the appraisal work for this exchange (March 25, 1996 decision), there was no consideration to bring him into the process again. The BLM decided to procure appraisal services from a reputable local firm not on the current contracting list. It was also decided by the State Director and Deputy Director that the Washington Office Chief Appraiser would review the appraisal report. The BLM contracted with a top Las Vegas accounting firm (second appraisers) that had an excellent appraisal staff.

Office of Inspector General Comments and Supplemental Information

January 27, 1997
The Bureau's contract for a second appraisal required the appraisers to consider the results of the previous appraisal and appraisal review. Specifically, we noted that the contract statement of work prepared by the Washington Office Chief Appraiser included a requirement that the new appraisal "shall consider information, assumptions, and conclusions reached by [Del Webb's appraiser] in an appraisal report dated October 14, 1996." The statement of work also required that the appraiser "consider information, assumptions, and conclusions reached by [contract review appraisers] in their December 5, 1996 review of the [Del Webb's appraiser's] appraisal report."

January 27, 1997
Solicitor's Office correspondence on this date stated that "specific concerns" remained relative to the purpose and scope of the second appraisal and appraisal review.

During meetings with Del Webb's representatives, the Washington Office Chief Appraiser had stated that "the second appraisers would not start with a clean slate, but would be instructed to 'consider' the first appraisal." In the January 27, 1997, correspondence, a Solicitor's Office attorney disagreed with this approach, stating that "the purpose of the second appraisal is to truly provide a 'second opinion' on the public land value, and to give decision makers information they are comfortable with. This should be clearly communicated to the second appraisers."

The Solicitor's Office attorney was also concerned about the possibility of receiving another development cost approach appraisal. In the correspondence, the attorney stated: "Many in the Department are uncomfortable with the development cost approach, and the regulations show a clear preference for the market approach or comparable sales. This regulatory preference ought to be communicated to the appraiser, who should be instructed that if another method is used, the appraiser should give a clear and thorough rationale for not using market information."

Finally, the Solicitor's Office attorney was concerned with how the second appraisal would be reviewed. According to the correspondence, the Washington Office Chief Appraiser had "expressed his belief that the same (outside) review appraisers should be used in the second as were used in the first." The Solicitor's Office attorney disagreed with this approach, stating that "an in-house review is called for to meet the goals outlined in paragraph one [to provide a second opinion of value and to give decision makers information they would be comfortable with]."

Bureau Chronology	Office of Inspector General Comments and Supplemental Information
January 30, 1997 Deputy Director sends a follow-up letter to the Del Webb Chief Executive Officer summarizing meetings with his staff on January 21-22, 1997. The meetings put in place procedural steps implementing decisions made at the January 7-8, 1997 meeting. A timetable prepared by Las Vegas District Manager is attached to the letter.	**January 30, 1997** No comment.
February 25, 1997 Meeting with Del Webb in Washington, DC to discuss progress with the exchange.	**February 25, 1997** No comment.
	March 4, 1997 Based on a February 20, 1997, request by the Washington Office Chief Appraiser, the contracting officer issued a technical instruction which amended the contract by eliminating the requirement that the new appraisers should meet with the previous appraisers regarding their analyses and conclusions and instructing the new appraisers to state in their appraisal report that their conclusions reflected their own "independent judgement."
March 21, 1997 BLM receives the second appraisal. The appraiser's conclusions were based on a comparable sale analysis and also evaluated and considered the Cost Development Approach from the earlier appraisal.	**March 21, 1997** We agree that the appraisers based their conclusion of value on the sales comparison approach ($52.1 million for the entire 4,756-acre parcel assuming the exchange was consummated in two installments before the end of 1998 and $31.5 million for the 2,535.5-acre Phase I land only). However, we noted that the appraisers evaluated and considered the cost development approach from the earlier appraisal "at the request of the client" (see discussion of January 27, 1997, regarding contract language) and that they concluded that "only the Sales Comparison Approach to value was directly applicable in this analysis."
March 31, 1997 Washington Office Chief Appraiser accepts the appraisal report prepared by the contract appraiser.	**March 31, 1997** No comment.
April 8, 1997 Approval of appraised value by the Las Vegas District Manager and Nevada State Director. BLM letter to Del Webb providing copy of approved appraisal and offer of $31.5 million for Phase I of the Del Webb exchange.	**April 8, 1997** No comment.
May 6, 1997 Del Webb acceptance of offer.	**May 6, 1997** No comment.

Bureau Chronology	Office of Inspector General Comments and Supplemental Information
May 21, 1997 New Notice of Decision issued for Phase I of the Del Webb exchange. Notice of Decision provides for public review of the approved appraisal.	**May 21, 1997** No comment.
July 29, 1997 Title transfers and patents issued on the initial land transfers of Phase I-A of the Del Webb land exchange.	**July 29, 1997** No comment.

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

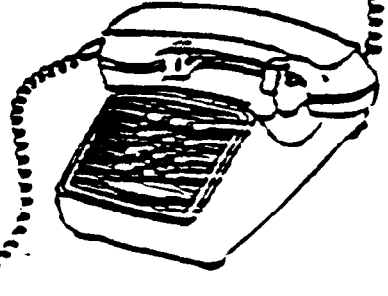
(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free **Numbers:**
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240



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

AUDIT REPORT

CENTRAL VALLEY PROJECT RESTORATION FUND, BUREAU OF RECLAMATION

REPORT NO. 98-I-383
MARCH 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAR 31 1998

AUDIT REPORT

Memorandum

To: Commissioner, Bureau of Reclamation

From: Robert J. Williams
Acting Inspector General

Subject: Final Audit Report on the Central Valley Project Restoration Fund, Bureau of Reclamation (No. 98-I-383)

INTRODUCTION

This report presents the results of our review of the Bureau of Reclamation's Central Valley Project Restoration Fund. The Fund was established by the Central Valley Project Improvement Act, Title 34 of the Reclamation Projects Authorization and Adjustment Act (Public Law 102-575), enacted on October 30, 1992. The objective of the audit was to determine whether the Bureau complied with requirements of the Central Valley Project Improvement Act as they related to Restoration Fund assessments, collections, and expenditures.

BACKGROUND

The Central Valley Project, authorized in 1935 and located in the Central Valley of California, is an integrated network that includes 16 storage dams and reservoirs, 3 diversion dams, over 600 miles of canals and aqueducts, 2 pump-generating plants, 7 hydroelectric power plants, and 3 fish hatcheries. It is the Bureau's largest multipurpose water project and has been operated primarily to provide flood control, water for irrigation and municipal and industrial use, and power generation. The Project provides water, through over 250 water service contracts with water districts and authorities, for irrigation of about 3 million acres of farmland and for more than 2 million urban residents and Federal, state, and private wildlife refuges.

The Central Valley Project Improvement Act significantly expanded the Secretary of the Interior's authority to restore fish and wildlife and their habitats in the rivers and streams impacted by the Project. Specifically, the Act required the Secretary to develop and implement activities to protect, restore, and enhance fish and wildlife and their associated

habitats in the Central Valley and in the Trinity River Basin.[1] The Act identified over 40 specific restoration activities, which included (1) nonstructural actions such as acquiring water and land and improving habitat conditions in streams and tributaries and (2) structural actions such as constructing a temperature control device at Shasta Dam and fish passage facilities at Red Bluff Diversion Dam. Specific cost-sharing requirements by the State of California were included in 15 of the more than 40 specific restoration activities.

As specified in the Act, these restoration activities are funded by direct Federal appropriations, cost sharing from California, and the Restoration Fund. The Restoration Fund obtains revenues from annual charges of up to $50 million (October 1992 price levels) from Project water and power users. However, as required by Section 3404 of the Act, full annual charges cannot be collected from the water users until an environmental impact statement is completed on the Project.[2] Until that time, water user charges are primarily limited to restoration payments and to surcharges on water delivered through the Project's Friant Division, as stipulated in Sections 3406(c)(1), 3407(c), and 3407(d) of the Act. Restoration payments and surcharges are assessed based on the acre-feet of water delivered.

The Bureau's Mid-Pacific Region, in Sacramento, California, is responsible for accounting for Restoration Fund revenues and expenditures. To account for these revenues and expenditures, the Region used the Governmentwide Federal Financial System, which accounts for financial statement and budget-related data Bureauwide; the Region's Water Payment, Delivery and Revenue Accounting System (referred to as the 705 Works System), which serves essentially as the customer billing and accounts receivable system for the Central Valley Project; and spreadsheet systems maintained by the Regional Office and area offices.

Since inception of the Restoration Fund on October 30, 1992, to June 30, 1997, the Bureau collected about $129 million from water and power users. Restoration Fund collections totaled about $33.6 million for fiscal year 1995, $46.8 million for fiscal year 1996, and $18.7 million for fiscal year 1997 (through June 30, 1997). Since passage of the Act on October 30, 1992, through June 30, 1997, expenditures for restoration activities totaled about $175 million, of which $87 million was provided by the Restoration Fund and $88 million by direct Federal appropriations. Restoration Fund expenditures totaled $24.5 million for fiscal year 1995, $30 million for fiscal year 1996, and $23 million for fiscal year 1997 (through June 30, 1997).

---

[1]The Trinity River Basin was included because part of the Central Valley Project's water is released to the Trinity River for purposes of fishery restoration, propagation, and maintenance.

[2]Section 3409 of the Act requires that the Secretary, not later than 3 years after enactment or by October 30, 1995, "prepare and complete a programmatic environmental impact statement pursuant to the National Environmental Policy Act," which analyzes the direct and indirect impacts and benefits of implementing the Act, including the potential renewal of all existing Project water contracts. Because of the magnitude and complexity of the work, the programmatic statement has not been completed. The draft programmatic statement was released in November 1997 for public review and comment. The estimated completion date of the final programmatic statement is April 1998. Full annual charges under the Act are derived from collections of water contracts' prerenewal charges (Section 3404(c)(3)), tiered water rates (Section 3405(d)), transferred water rates (Section 3405(a)(1)(B)), Friant Division surcharges (Section 3406(c)(1)), municipal and industrial surcharges (Section 3407(d)(2)(A)), and restoration payments by water and power beneficiaries (Sections 3407(c) and (d)).

In accordance with Section 3406(h) of the Act, the Bureau of Reclamation and the U.S. Fish and Wildlife Service, in June 1994, entered into a cost-sharing agreement with the State of California in which California is required to pay up to $50 million toward restoration activities contingent on available State funding and legislative authority. The agreement requires that individual task orders be executed for each restoration activity. Since June 1994, the State of California has signed one cost-sharing task order agreement to contribute $1.5 million for the restoration-related Georgiana Slough Control Barrier activity.

On November 5, 1996, California voters passed Proposition 204, also known as the Safe, Clean, Reliable Water Supply Act, which funds numerous environmental activities within the State, including restoration of the Bay-Delta (San Francisco Bay/Sacramento - San Joaquin Delta in California), levee rehabilitation, and assistance to California in meeting most of its cost-sharing commitment under the Act. The proposition provides for issuing bonds totaling $995 million. Under this proposition, $93 million of the $995 million of bond sales was to be used to meet California's cost-sharing requirements under Section 3406 of the Central Valley Project Improvement Act. Since passage of the proposition, California has sold bonds totaling about $64.4 million to assist California in meeting a portion of its cost-sharing requirements under the Act. Regional officials told us that since June 1997, the Bureau's Mid-Pacific Region and the Service have been negotiating with California to finalize four task orders totaling about $30 million to fund restoration activities under the Act. Regional officials also stated that for fiscal year 1998, the Mid-Pacific Region and the Service also plan to negotiate additional task orders with California totaling about $30.4 million to fund additional restoration activities under the Act.

SCOPE OF AUDIT

We conducted our audit at the Bureau's Mid-Pacific Regional Office and at selected area offices within the Region (see Appendix 1). To accomplish our objective, we reviewed and analyzed documents, financial records, and activities of the Restoration Fund that occurred from October 30, 1992, through June 30, 1996. We also performed tests of Restoration Fund assessments, collections, and expenditures for fiscal years 1995 and 1996 (through June 30, 1996). These tests included verifying the accuracy of assessments and collections based on the delivery of Project water for fiscal year 1995; confirming the validity of accounts receivable balances of non-Federal contractors as of March 31, 1996; and reviewing the propriety of selected expenditures. We also interviewed Bureau and Service program and administrative personnel and an assistant regional solicitor from the Office of the Solicitor's Pacific Southwest Regional Office, in Sacramento, concerning programmatic and legislative requirements of the Act. In addition, in July 1997, we discussed our preliminary findings with officials and updated the Fund's revenue and expenditures to reflect balances as of June 30, 1997.

Our audit was made in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances. As part of our audit, we reviewed the Department of the Interior's Annual Statement and Report for fiscal year 1995, which is required by the Federal Managers' Financial Integrity Act, and the Departmental Report on Accountability for fiscal year 1996, which contains information

required by the Act, and determined that none of the Department's reported weaknesses were related to the objective of this audit. We also evaluated the Mid-Pacific Region's system of internal controls related to Restoration Fund assessments, collections, and expenditures to the extent we considered necessary. The internal control weaknesses identified are discussed in the Results of Audit section of this report. Our recommendations, if implemented, should improve the internal controls.

PRIOR AUDIT COVERAGE

Neither the Office of Inspector General nor the General Accounting Office has issued any reports on the Restoration Fund. However, in July 1995, the Office of Inspector General issued the advisory letter "Anadromous Fish Restoration Activities, Central Valley Project" (No. 95-AL-5), which related to restoration activities. The letter concluded that restoration funds were spent for approved purposes but noted that (1) the Mid-Pacific Region had not developed formalized cost allocation and repayment procedures for reimbursable restoration costs, (2) the State of California had not developed a revenue-collection mechanism to meet its cost-sharing commitment under the Central Valley Project Improvement Act, and (3) the Mid-Pacific Region had not developed procedures for applying reimbursement "credits." During our current audit, we found that the Mid-Pacific Region was taking actions to address the concerns noted.

RESULTS OF AUDIT

Overall, we found that the Bureau of Reclamation was in compliance with the requirements of the Central Valley Project Improvement Act as they pertained to Restoration Fund assessments, collections, and expenditures. In that regard, the Bureau had issued interim guidelines for assessing, collecting, and crediting payments from Central Valley Project water and power contractors and had involved stakeholder work groups in establishing priorities for uses of the Restoration Fund. In addition, in August 1996, Regional Office officials established a Restoration Fund Team to centralize financial activities associated with the Central Valley Project Improvement Act and to function as a focal point for the Region's internal and external customers by providing assessment, collection, and expenditure data as the data pertained to the financial management of the Act and the Restoration Fund. However, we concluded that the Regional Office could improve its accounting for Restoration Fund activities by integrating the automated systems used to account for assessments and payments for water deliveries. The Regional Office also had not annually accounted for the costs incurred under the agreement with the State of California to identify the State's share of costs of restoration activities or negotiated additional task orders for repayment of California's share of ongoing restoration activities (which we estimated to be over $31.6 million). In addition, we found that the Bureau had not submitted to the Congress the following: (1) the program report for fiscal year 1995 and the program and financial reports for fiscal year 1996, as required by the Act, and (2) the special reports for fiscal year 1996.

Accounting Systems

The Mid-Pacific Regional Office used three independent systems to account for water deliveries, assessments, and payments. The General Accounting Office Policy and Procedures Manual for Guidance of Federal Agencies (Title 2) and the Treasury Accounting Manual require that accounting data be timely to be meaningful in managing Federal programs. Office of Management and Budget Circular A-127, "Financial Management Systems," also requires that financial management systems process and record financial transactions effectively and efficiently, including providing complete, timely, and reliable information to Federal decision makers and the public. In addition, Executive Order No. 13011, dated July 17, 1996, which addresses Federal information technology, provides Federal agencies with the "clear authority and responsibility to make measurable improvements in mission performance and service delivery to the public" through implementation of integrated information systems. Instead of an integrated system, the Region tracked water deliveries through the Works System; recorded payment information in the Federal Financial System; and recorded combined information on water deliveries, assessments, and payments in a spreadsheet-based system maintained by the Regional Office. The maintenance of three separate systems resulted in the inefficient use of Regional Office resources (personnel and funds) and delayed the posting of payments in the system. In turn, the delayed posting of payments caused the receivables account identified in the Federal Financial System to be overstated.

The Federal Financial System was designed to account for revenues and expenditures on a Bureauwide basis to produce annual consolidated financial statements that are required by the Chief Financial Officers Act of 1990. Although the system records revenues, it does not have an automated assessment and collection component to establish accounts receivable for the Restoration Fund. As a result, receivables are established in the Federal Financial System based on calculations made by regional finance personnel through their spreadsheet system.

The Works System was designed to record, accumulate, and report on Project water deliveries, associated water charges, and the advance payment balances for the Project's water service contractors. The Works System was intended to provide historical water delivery and financial data such as monthly water contractor statements (Water Delivery Charges reports[3]) and the monthly revenue-earned statements (Water Delivery Revenue reports[4]). However, the Works System had not been modified to account for additional legislative requirements, such as the restoration water charges imposed by the Central Valley Project Improvement Act, since the system was developed in the 1970s and 1980s. A June 1995 report prepared by an independent accountant on the Project's financial systems

---

[3]Water Delivery Charges reports were designed to reflect the current status of deliveries by type of water (for example, irrigation or municipal and industrial), the costs charged to the contractor for the water, the balance of the contractor's allotment of water, and the status of the cash advance account against which the charges were made.

[4]Water Delivery Revenue reports provide revenue information for contract water deliveries and water transfers based on water-delivery requirements of the Reclamation Reform Act of 1982 and historical water delivery and revenue data that can be used in the Central Valley Project's rate-setting and operation and maintenance deficit-determination processes.

and rate-setting practices substantiated these and other deficiencies in the Works System. The report was requested by the Central Valley Project Water Association, an organization of Project water contractors. The report stated that the Works System "has not kept pace with the changing accounting environment and has not been properly maintained." The report also stated that "neither the Bureau nor the contractors placed a very high degree of reliance upon payment and advance account information obtained from the system" because information was not timely and reliable.

The Mid-Pacific Region maintained a comprehensive spreadsheet system to assess and collect Restoration Fund revenues because neither the Federal Financial System nor the Works System adequately accounted for and reported water contractor payments. To assess charges for restoration activities, Regional personnel manually entered the contractor water deliveries recorded in the Works System into the Region's spreadsheet system, which automatically calculated the payments due. On a monthly basis, Regional personnel manually reconciled the payments due with the revenues from restoration payments from the water contractors recorded in the Federal Financial System. If payment was not received from a water contractor within the 30-day payment period, personnel sent a bill to the water contractor and identified the outstanding amount and manually established the accounts receivable in the Federal Financial System. We reviewed the $784,000 non-Federal accounts receivable balance as of March 31, 1996, in the Federal Financial System and found that the amount was overstated by 25 percent. Of the 72 outstanding receivables that constituted the $784,000, we found that 37 receivables, totaling about $200,000, were not valid because they either were paid or were not required to be paid. Delays in recording and reconciling water contractor payments in the Federal Financial System, the Works System, and the Regional spreadsheet system caused receivables to be overstated because invalid receivables were kept in the account.

We also found that the process used by the Regional Office to record water contractor payments was not timely. According to a Regional official, water contractors send their payments to a bank lockbox in San Francisco, California, for deposit. Each day, the Regional Office receives a report from the bank identifying the checks received. The bank mails copies of the checks and supporting payment documents to the Regional Office. Water contractors can also take or send their payments to the Regional Office or to the nearest Regional field office in California. The field offices send the payments to the lockbox for deposit and the payment information to the Regional Office's accounts receivable personnel for recording into the Federal Financial System. Because there is no automated process to update the Restoration Fund account in the Federal Financial System, it is necessary to use the separate Regional system to calculate Restoration Fund revenues in order to record Fund revenues in the Federal Financial System.

We also found that the Northern California Area Office and the Willows Construction Office had each developed systems which produced monthly water contractor statements that showed water deliveries, assessments, payments, and account balances. At both offices, personnel manually entered contractor water delivery and payment information into spreadsheet systems to account for the assessment and collection of Restoration Fund revenues. Both offices also requested that water contractors send or bring payments to the offices rather than send the payments to the bank so that they would have more timely and

complete payment information. The area offices forwarded the payments either to the bank or to the Regional Office for recording in the accounting systems. Officials at these offices told us that they had developed the separate systems because of the unreliable data in the Works System and because of the 1-month delay that it took for the Regional Office to completely record water contractor payments and to notify area and field offices that payment had been made.

A Regional Office official acknowledged the lack of an integrated accounting system, stating that with the present system, Regional Office employees who should be performing analytical and review functions were used primarily as data entry clerks. We believe that an integrated accounting system which produces reliable monthly statements would improve the assessment and collection processes, provide better service to meet the water contractors' needs, and result in the more efficient use of Regional Office employees. According to Regional Office officials, the Region was implementing an integrated accounting system, which is referred to as the Reclamation Accounting Information Network (RAIN System). This system will (1) replace the Works System, including the function of accounting for additional legislative requirements that are not part of the Works System, such as the restoration water charges imposed by the Central Valley Project Improvement Act, and (2) will be linked with the Federal Financial System. If implemented, the RAIN System should eliminate the need for multiple data entries and additional subsystems and better service the water contractors' needs by providing timely monthly statements. A Regional Office official said that the Region planned to have the Reclamation Accounting Information Network fully implemented by October 1, 1998.

Cost Sharing

As of June 1997, the State of California had not contributed $31.6 million of its $33.1 million share of restoration activity costs. The Central Valley Project Improvement Act identifies 15 restoration activities that stipulate cost sharing by California. For example, Section 3406(b)(6) states that the Secretary of the Interior is directed and authorized to:

> . . . install and operate a structural temperature control device at Shasta Dam and develop and implement modifications in CVP [Central Valley Project] operations as needed to assist in the Secretary's efforts to control water temperatures in the upper Sacramento River in order to protect anadromous fish in the upper Sacramento River. Costs associated with planning and construction of the structural temperature control device shall be reimbursed in accordance with the following formula: 37.5 percent shall be reimbursed as main project features, 37.5 percent shall be considered a nonreimbursable Federal expenditure, and 25 percent shall be paid by the State of California.

California's 25 percent share of the $77 million expended on the Shasta Dam Temperature Control Device, which was completed in May 1997, is approximately $19.2 million.

Expenditures on all restoration activities totaled about $175.8 million, which consisted of payments from the Restoration Fund of approximately $87.3 million and Federal appropriations of about $88.5 million. Of the $175.8 million, expenditures totaling

$124 million were for 13 of the 15 sections of the Act, which required cost sharing from California (there were no reported expenditures on the other 2 restoration activities). Based on the cost-sharing percentages identified in the Act, California's share of the $124 million is approximately $33.1 million (see Appendix 2).

The Bureau and the U.S. Fish and Wildlife Service successfully negotiated a cost-sharing agreement with California on June 27, 1994, under which California is required to pay up to $50 million toward restoration activities. However, the agreement is contingent on available State funding and legislative authority and included additional provisions as follows:

> One party may fund all, none, or any percentage of the cost of an individual restoration action, as long as the total amount expended by each party equals that party's overall cost allocation under Section 3406 of the Act.
>
> Individual task orders will subsequently be executed pursuant to this Agreement for each restoration action or element thereof and shall be made a part of this Agreement.
>
> The parties shall make an annual accounting, on a fiscal year basis, for their costs incurred under this agreement. The accounting shall include the dollar value of any in-lieu services as well as direct expenditure of funds. Each party shall submit its accounting to the other party by February 1 of each year.
>
> The parties shall jointly develop a work plan which includes a budget and schedule for carrying out the restoration actions. . . . The work plan will be used as the basis for negotiating task orders for the restoration actions, or elements thereof, and shall be updated at least annually.

As of June 1997, the Mid-Pacific Region and the Service and California had signed only one task order for $1.5 million for the Georgianna Slough Control Acoustic Fish Repulsion Barrier Evaluation. The Regional Office also had not provided California with a formal accounting of expenditures for restoration activities requiring State cost sharing. Regional Office officials said that they had not performed an annual accounting of expenditures for restoration activities requiring California cost sharing because California had not identified sources of funds but that they were not concerned as long as California eventually met its cost-sharing obligations. However, by not executing task orders and obtaining California's share of the costs in conjunction with restoration activity construction, the Federal Government funds a disproportionate share of activity financing costs. Therefore, we believe that the Bureau should prepare and submit to California the annual cost summaries that identify the cumulative cost-sharing obligation and expenditures for restoration activities and negotiate task orders for ongoing and completed restoration activities. Subsequent to our review (since June 1997), the Mid-Pacific Region and the Service have been negotiating with California to finalize four task orders totaling about $30 million to fund restoration activities under the Act. For fiscal year 1998, the Mid-Pacific Region and the Service also plan to negotiate additional task orders totaling about $30.4 million to fund restoration activities under the Act.

Reporting

The Bureau had not submitted all of the annual program and financial reports required by the Central Valley Project Improvement Act and the special reports requested by the Committees on Appropriations, U.S. Senate and U.S. House of Representatives.

Annual Reports. Section 3407(f) of the Act required the Secretary of the Interior to submit an annual financial report[5] that described "all receipts to and uses made of monies within the Restoration Fund" for the prior fiscal year, including projections of receipts and uses of the Restoration Fund for the next fiscal year. Section 3408(f) of the Act required the Secretary to submit a program report[6] that described significant actions taken to achieve "the intent, purposes and provisions of this title [Title 34]," including "recommendations for authorizing legislation or other measures" needed to implement the Act. These reports were to be submitted not later than September 30 of each year.

We found that the Bureau had submitted only the financial report for September 30, 1995. The 1996 financial report had been drafted and the 1995 program report had been updated to include 1996 program information.[7] Although both reports were forwarded by the Commissioner's Office to the Assistant Secretary for Water and Science and the Assistant Secretary for Fish and Wildlife and Parks for review, they had not been approved for issuance and submittal to the Congress as of December 1997. A Regional Office official said that "numerous and diverse reviews throughout the entire report writing process" delayed the timely preparation and submission of the reports. The official further stated that planned changes in the review process should decrease the preparation and review time for the annual reports in the future. However, we did not obtain any details on the planned changes.

Special Reports. In hearings held for fiscal year 1996 by the House and Senate Committees on Appropriations, the Committees directed that the Bureau provide, by November 15, 1995, a report on the extent to which the State of California had met its cost-sharing obligations under the Act and that the Secretary provide, by February 1996, a report "display[ing] priorities and activities for a 5-year period beginning with fiscal year 1997, associated with the restoration requirements and goals of the CVPIA [Central Valley Project Improvement Act]." We found that as of December 1997, the Bureau had not submitted these reports. The Bureau Special Projects Officer attributed the delay of the cost-sharing and 5-year priority reports to the same lengthy review process required for the

---

[5]The financial report is to be provided to the Senate Committee on Energy and Natural Resources and the Committee on Appropriations and the House of Representatives Committee on Interior and Insular Affairs, the Committee on Merchant Marine and Fisheries, and the Committee on Appropriations.

[6]The program report is to be provided to the Senate Committee on Energy and Natural Resources and the House of Representatives Committee on Interior and Insular Affairs and the Committee on Merchant Marine and Fisheries.

[7]The Bureau included the 1995 and 1996 program information with the special cost-sharing reports required by the House and Senate Committees on Appropriations.

annual reports. As of December 1997, the Secretary's report[8] had been drafted and included public comments, but it was at the U.S. Fish and Wildlife Service for completion.

Recommendations

We recommend that the Commissioner, Bureau of Reclamation, direct the Regional Director, Mid-Pacific Region, to:

1. Integrate the Regional Office's and area offices' accounting systems with the Federal Financial System to provide timely and reliable water delivery and payment information to the Regional Office and water contractors.

2. Provide, to the State of California, a formal annual cost summary of restoration activities requiring cost sharing by the State, as required by the cost-sharing agreement. The cost summary should include cumulative expenditures for restoration activities that have occurred since enactment of the Central Valley Project Improvement Act and be used as the basis for negotiating additional task orders as appropriate.

We recommend that the Commissioner, Bureau of Reclamation:

3. Ensure that the required program report for fiscal year 1995 and the required program, financial, and special reports for fiscal year 1996 and future reports are submitted in a timely manner.

Bureau of Reclamation Response and Office of Inspector General Reply

The March 31, 1998, response (Appendix 3) from the Commissioner, Bureau of Reclamation, agreed with the three recommendations. Based on the response, we consider Recommendation 2 resolved and implemented and Recommendations 1 and 3 resolved but not implemented. Accordingly, Recommendations 1 and 3 will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

Since the report's recommendations are considered resolved, no further response to the Office of Inspector General is required (see Appendix 4).

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the cooperation of Bureau personnel in the conduct of our audit.

---

[8]The Secretary's report includes the U.S. Fish and Wildlife Service's current funding priorities for Restoration Funds and the anticipated biological benefit of each recommended funding action, as requested in the House's Energy and Water Development Report No. 103-533.

OFFICES VISITED

OFFICE	LOCATION
Mid-Pacific Region	Sacramento, California
Northern California Area Office	Redding, California
South Central Area Office	Fresno, California
Willows Construction Office	Willows, California
Office of the Solicitor's Pacific Southwest Regional Office	Sacramento, California

RESTORATION ACTIVITY EXPENDITURES AND STATE OF CALIFORNIA COST-SHARING REQUIREMENTS FROM OCTOBER 30, 1992, TO JUNE 30, 1997

P.L. 102-575 Section	Restoration Activity	Expenditures by Funding Sources: Restoration Fund	Expenditures by Funding Sources: Federal Appropriation	Expenditure Total[1]	State Cost-Sharing Requirement by Activity: Percent	State Cost-Sharing Requirement by Activity: Amount[2]
3406 (b) (1)	Anadromous Fish Program and other Central Valley Project Impacts	$7,013,089		$7,013,089		
3406 (b) (2)	Dedicated Project Yield	2,680,670		2,680,670		
3406 (b) (3)	Water Acquisition	11,905,482	$1,516,835	13,422,317		
3406 (b) (4)[3]	Tracy Fish Facility Improv./ Evaluation	0	0	0	25	0
3406 (b) (5)[3]	Contra Costa Canal Pumping		310,005	310,005[4]	25	$77,501
3406 (b) (6)[3]	Shasta Temperature Control Device	34,293,988	42,442,806	76,736,794[4]	25	19,184,199
3406 (b) (9)	Flow Fluctuation Study	170,632	48,313	218,945		
3406 (b) (10)[3]	Fish Passage Program	679,184	1,616,050	2,295,234[4]	25	573,809
	Demonstration Pumping Plant Evaluation	1,104,066	2,879,599	3,983,665[4]	25	995,916
	Demonstration Pumping Plant		20,472,555	20,472,555[4]	25	5,118,139
3406 (b) (11)	Coleman National Fish Hatchery	4,650,575		4,650,575		
	Keswick Fish Trap Modification	16,359	1,262,346	1,278,705		
3406 (b) (12)[3]	Clear Creek Restoration	273,876	7,008	280,884[4]	50	140,442
3406 (b) (13)[3]	Restore Spawning Gravel	75,822		75,822[4]	25	18,956
3406 (b) (14)[3]	Delta Cross Channel Structure	0	0	0	25	0
	Georgiana Slough Control Structure		950,000	950,000[4]	25	237,500
3406 (b) (15)[3]	Old River Barrier	0	0	0	25	0
	South Delta Barrier		230,766	230,766[4]	25	57,692
3406 (b) (16)[3]	CVP Assessment/Monitoring Program	1,497,980		1,497,980[4]	25	374,495

[1]Expenditure totals for restoration activities were provided by the Mid-Pacific Region.

[2]California's cost-sharing amount is computed by multiplying the restoration activity expenditures to date by California's cost-sharing percentage provided for in the Act.

[3]Fifteen sections of Public Law 102-575 identified restoration activities that required cost sharing by the State of California.

[4]Expenditures of approximately $124 million were made under 13 of the 15 sections of Public Law 102-575 that required cost sharing by the State of California.

P.L. 102-575 Section	Restoration Activity	Expenditures by Funding Sources: Restoration Fund	Expenditures by Funding Sources: Federal Appropriation	Expenditure Total[1]	State Cost-Sharing Requirement by Activity: Percent	State Cost-Sharing Requirement by Activity: Amount[2]
3406 (b) (17)[3]	Anderson-Cottonwood Irrigation District	77,446		77,446[4]	50	38,723
3406 (b) (18)[3]	Ecosystem and Water Modeling	0	0	0	50	0
3406 (b) (20)[3]	Hamilton City Pumping Plant-Glenn Colusa Irrigation District		4,584,126	4,584,126[4]	25	1,146,032
3406 (b) (21)[3]	Anadromous Fish Screen Program	689,586	7,304,710	7,994,296[4]	50	3,997,148
3406 (b) (22)	Agriculture Waterfowl Incentive Program	76,370		76,370		
3406 (c) (1)	San Joaquin River Basin Resource Management Initiative	1,571,830	895,536	2,467,366		
3406 (c) (2)	American River/Folsom South Conjunction Use Optimal Study		651,686	651,686		
3406 (d) (1), (2), & (5)	San Joaquin Basin Action Plan	3,081,479	311,302	3,392,781		
3406 (d) (1-4)[3]	Refuge Water Supply	2,542,216	52,988	2,595,204[4]	25	648,801
3406 (d) (5)	Refuge Wheeling Costs	5,551,171		5,551,171		
3406 (d) (6)	Private Wetlands/Joint Venture	1,366,850		1,366,850		
3406 (e)	CVPIA Supporting Investigations	653,655		653,655		
3406 (f)	Project Fisheries Impact	1,416,341		1,416,341		
3406 (g)[3]	Ecosystem/Water Operations Models	995,332	1,031,415	2,026,747[4]	25	506,687
3408 (h)	Land Retirement	3,107,068	1,404,756	4,511,824		
3408 (i)	Water Conservation	50,834	465,119	515,953		
3408 (j)	Water Augmentation	1,788,305		1,788,305		
	Totals	$87,330,206	$88,437,921	$175,768,127		$33,116,040
3406 (b) (14)	Georgiana Slough Control Structures Task Order Agreement					(1,513,426)[5]
	Total State's Cost-Sharing Obligation					$31,602,614

[5]California has not paid any of its cost-sharing obligation under the restoration activities requiring cost sharing under the Act; however, it did sign the first cost-sharing task order agreement to contribute $1,513,426 of in-lieu services for the Georgiana Slough Control Acoustic Fish Repulsion Barrier Evaluation.

United States Department of the Interior

BUREAU OF RECLAMATION
WASHINGTON, D.C. 20240

IN REPLY REFER TO:

D-5010
ADM-8.00

MAR 31 1998

MEMORANDUM

To: Office of Inspector General
Attention: Assistant Inspector General for Audits

From: Eluid L. Martinez
Commissioner

Subject: Draft Audit Report on the Central Valley Restoration Fund, Bureau of Reclamation (Assignment No. W-IN-BOR-009-96)

The Bureau of Reclamation (Reclamation) offers the following comments in response to the recommendations in the subject report:

We recommend that the Commissioner, Bureau of Reclamation, direct the Regional Director, Mid-Pacific Region to:

Recommendation 1

Integrate the Regional Office's and area offices' accounting systems with the Federal Financial System to provide timely and reliable delivery and payment information to the Regional Office and water contractors.

Response

Concur. As cited by the report, the Mid-Pacific Region is in the process of implementing an integrated water and revenue accounting system, the Reclamation Accounting Information Network (RAIN System). When fully implemented, the RAIN System will eliminate the need for multiple data entries and additional subsystems and better service the water contractors' needs by providing timely monthly statements.

The RAIN System will be pilot tested concurrently with the region's 705 Works System to ensure the reliability of the RAIN data. This involves on-line use by 20 region users, including area office staff and various water authorities. Implementation of the RAIN System will replace the region's 705 System and local record keeping.

The responsible official is the Chief, Ratesetting and Economics Services, Business Resources Center, Mid-Pacific Regional Office. The estimated target date for integrating the accounting systems with the Federal Financial System is October 1, 1998.

Recommendation 2

Provide, to the State of California, a formal annual cost summary of restoration activities requiring cost-sharing by the State, as required by the cost-sharing agreement. The cost summary should include cumulative expenditures for restoration activities that have occurred since enactment of the Central Valley Project Improvement Act and be used as the basis for negotiating additional task orders as appropriate.

Response

Complied. The State of California was provided with a formal annual cost summary of restoration activities in September 1997. Reclamation will continue to provide cost summary reports to the State on an annual basis and periodically throughout the year as conditions warrant.

We recommend that the Commissioner, Bureau of Reclamation:

Recommendation 3

Ensure that the required program report for fiscal year 1995 and the required program financial, and special reports for fiscal year 1996 and future reports are submitted in a timely manner.

Response

Concur. Reclamation acknowledges that the reports need to be submitted in a more timely manner. The annual reports require coordination between Reclamation and the Fish and Wildlife Service from the regional levels up through the Department. Since this is a relatively new requirement, the review process has experienced extensive delays; however, as stated in the report, Reclamation is working with the Fish and Wildlife Service to improve the review process.

The fiscal year 1995 program report was updated to include 1996 information and was re-submitted to the Department in October 1996. The special reports on priorities and activities for a 5-year period have been redrafted at the regional level to include the integration and coordination of the Bay-Delta process and to acknowledge the State of California contribution in support of the Central Valley Project Improvement Act.

The estimated target date for submission of the special reports is June 30, 1998. The responsible official is the Mid-Pacific Region Special Projects Officer.

If you have any questions or require additional information, please contact Luis Maez at (303) 445-2793.

cc: Assistant Secretary - Water and Science, Attention: Laura Brown

STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/ Recommendation Reference	Status	Action Required
1 and 3	Resolved; not implemented.	No further response to the Office of Inspector General is required. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.
2	Implemented.	No further action is required.

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

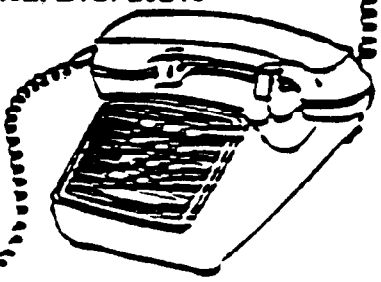
(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free Numbers:
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240



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

AUDIT REPORT

HURRICANE-RELATED CONTRACTING, DEPARTMENT OF EDUCATION, GOVERNMENT OF THE VIRGIN ISLANDS

REPORT NO. 98-I-384
MARCH 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MEMORANDUM APR 13 1998

TO: The Secretary

FROM: Robert J. Williams
Acting Inspector General

SUBJECT SUMMARY: Final Audit Report for Your Information - "Hurricane-Related Contracting, Department of Education, Government of the Virgin Islands" (No. 98-I-384)

Attached for your information is a copy of the subject final audit report. The objective of the audit was to determine whether (1) construction contracts were awarded in accordance with applicable laws and regulations, (2) controls existed to ensure that construction work was performed in accordance with building codes and other requirements, and (3) payments to contractors were reasonable, allowable, and allocable in accordance with contract provisions.

We found that the procurement and project management procedures used by the Department of Education and the Government's project management consultants excluded authorized Government agencies from key aspects of the post-hurricane construction contracting. Specifically, we found that (1) the Department of Public Works, on behalf of the Department of Education, allowed construction contractors to perform work on public schools without any formal contracts; (2) the Hurricane Recovery Managers used contracting procedures that excluded the Department of Property and Procurement and did not provide the level of competition required by the Virgin Islands Code; and (3) the Government and the Hurricane Recovery Managers did not maintain an adequate level of construction management oversight. As a result, there was little assurance that (1) the Government received the most favorable prices, terms, and conditions with regard to construction and other contractual services acquired at a total cost of more than $21.5 million; (2) contractors who received payments totaling more than $21 million performed construction work in accordance with the terms and conditions of their contracts; and (3) the safety of the occupants of public schools was adequately protected because the construction work did not always meet building code requirements. We made seven recommendations to improve the Government's procurement and project management practices and procedures.

Based on the response from the Governor of the Virgin Islands, we considered three recommendations resolved but not implemented; requested additional information for three recommendations; and requested a response for one recommendation, which was revised based on the Governor's response.

If you have any questions concerning this matter, please contact me at (202) 208-5745.

Attachment

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAR 31 1998

Honorable Roy L. Schneider
Governor of the Virgin Islands
No. 21 Kongens Gade
Charlotte Amalie, Virgin Islands 00802

Subject: Audit Report on Hurricane-Related Contracting, Department of Education, Government of the Virgin Islands (98-I-384)

Dear Governor Schneider:

This report presents the results of our review of contracts awarded by or for the Virgin Islands Department of Education after Hurricane Marilyn in September 1995. The objective of the audit was to determine whether (1) construction contracts were awarded in accordance with applicable laws and regulations; (2) controls existed to ensure that construction work was performed in accordance with building codes and other requirements; and (3) payments to contractors were reasonable, allowable, and allocable in accordance with contract provisions. The scope of the audit included construction and professional services contracts that were awarded during fiscal years 1996 and 1997.

Our review disclosed that the procurement and project management procedures used by the Department of Education and the Government's project management consultants excluded authorized Governmental agencies from key aspects of the post-hurricane construction contracting. Specifically, we found that:

- Immediately after the hurricane, the Department of Public Works, on behalf of the Department of Education, allowed construction contractors to perform work on public schools without any formal contracts and issued "after-the-fact" purchase orders for additional services acquired on behalf of the Department of Education. Additionally, the Hurricane Recovery Managers used contracting procedures that excluded the Department of Property and Procurement, which has overall responsibility for Government contracting, and did not provide the level of competition required by the Virgin Islands Code, even though emergency conditions existed after the hurricane. As a result, there was little assurance that the Government received the most favorable prices, terms, and conditions with regard to construction and other contractual services acquired at a total cost of more than $21.5 million and for "after-the-fact" purchase orders totaling $164,000.

- The Government and the Hurricane Recovery Managers did not maintain an adequate level of construction management oversight. For example, construction contractors' periodic requests for payment were not always approved by authorized personnel; inspection

and progress reports were not always sufficiently detailed to support contractors' payment requests; and the Government did not adequately monitor the activities of its project management consultants, including the Hurricane Recovery Managers. In addition, building permits were not obtained for work to be performed on the public schools, and such work was not always performed in accordance with building code requirements. As a result, there was little assurance that contractors who received payments totaling more than $21 million performed construction work in accordance with the terms and conditions of their contracts and that the safety of the occupants of public schools was adequately protected because the construction work did not always meet building code requirements. In addition, a contractor was overpaid at least $5,418.

On December 16, 1997, we transmitted a draft of this report to you, requesting your comments by January 30, 1998. On February 18, 1998, we received your response (Appendix 2) dated January 29, 1998, which generally concurred with six of the report's seven recommendations. Based on the response, we consider Recommendations A.1, A.2, and A.3 resolved but not implemented. Accordingly, these recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation. Also, additional information is requested for Recommendations B.1, B.2, and B.3, and a response is requested for Recommendation B.4, which was revised based on additional information in the response. (The status of all the recommendations is in Appendix 3.)

The Inspector General Act, Public Law 95-452, Section 5(a)(3), as amended, requires semiannual reporting to the U.S. Congress on all audit reports issued, the monetary impact of audit findings (Appendix 1), actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

In view of the above, please provide a response, as required by Public Law 97-357, to this report by May 15, 1998. The response should be addressed to our Caribbean Regional Office, Federal Building - Room 207, St. Thomas, Virgin Islands 00802. The response should provide the information requested in Appendix 3.

We appreciate the assistance of the Commissioners and staffs of the Department of Education and the Department of Property and Procurement during the conduct of our audit.

Sincerely,

Robert J. Williams

Robert J. Williams
Acting Inspector General

CONTENTS

Page

INTRODUCTION 1

BACKGROUND 1
OBJECTIVE AND SCOPE 2
PRIOR AUDIT COVERAGE 2

FINDINGS AND RECOMMENDATIONS 4

A. CONTRACT AWARD 4
B. CONTRACT OVERSIGHT 13

APPENDICES

1. CLASSIFICATION OF MONETARY AMOUNTS 22
2. GOVERNOR OF THE VIRGIN ISLANDS RESPONSE 23
3. STATUS OF AUDIT REPORT RECOMMENDATIONS 51

INTRODUCTION

BACKGROUND

On September 15, 1995, Hurricane Marilyn struck the United States Virgin Islands, causing extensive damage to public and private facilities. As a result, the President of the United States issued a major disaster declaration, which allowed the Federal Emergency Management Agency (FEMA) to provide disaster assistance funds in accordance with the Stafford Disaster Relief and Emergency Assistance Act, as amended (Public Law 100-707). FEMA provided the Government of the Virgin Islands with $22.7 million in disaster assistance funds for school repairs, consisting of $15 million for the acquisition of modular classrooms to be used at certain public schools while permanent repairs were being made, $2 million for repairs to public schools, and $5.7 million for an overall project management contract with the Hurricane Recovery Managers. In addition, the Department of Education received a total of $27.7 million from insurance proceeds and $6 million from local bond proceeds for the repair and reconstruction of public schools. During fiscal years 1996 and 1997, the Government awarded 41 construction contracts and 44 professional services contracts, totaling about $51.4 million, that related to the repair and reconstruction of the schools.

In September 1995, immediately after Hurricane Marilyn struck, the Government conducted a survey of the public school facilities to determine the extent of the damage. An official from the Department of Public Works was assigned as a Special Project Coordinator, with the responsibility to hire contractors to perform emergency debris removal and repair work at the schools.

In December 1995, the Government hired a joint venture of two off-island architectural/ engineering firms (commonly referred to as the Hurricane Recovery Managers) to act as its overall project manager for all hurricane-related construction, including repairs to public schools. According to their contract, the Hurricane Recovery Managers were responsible for preparing solicitation packages for architectural/engineering and construction services, soliciting and evaluating proposals from contractors, supervising construction work, maintaining financial oversight control of FEMA and other funds available for construction work, preparing construction progress reports, and coordinating with vendors for the purchase and delivery of materials. The contract was in the amount of $5.7 million plus a maximum of $748,000 in additional fees. However, in June 1996,[1] the Government and the Hurricane Recovery Managers mutually agreed to terminate the contract, primarily because of disagreements concerning the quality and timeliness of the work performed by contractors at some public schools.

In August 1996, the Government awarded a $1.9 million contract, effective retroactively to late June 1996, to a local architectural/engineering firm to act as the Government's project manager for Department of Education construction projects. According to the contract, the project manager's responsibilities included providing detailed architectural drawings for repair

[1]The formal termination agreement was not executed until June 1997.

work, preparing construction cost estimates, monitoring construction work through frequent on-site visits, ensuring that construction work was in accordance with the building codes, preparing and submitting to the Government any necessary construction contract change orders, and reviewing and recommending approval of contractor requests for progress payments. The contract remained in effect, with three extensions, through July 31, 1997.

OBJECTIVE AND SCOPE

The objective of the audit was to determine whether (1) construction contracts were awarded in accordance with applicable laws and regulations; (2) controls existed to ensure that construction work was performed in accordance with building codes and other requirements; and (3) payments to contractors were reasonable, allowable, and allocable in accordance with contract provisions. The scope of the audit included contracts and/or purchase orders for hurricane-related construction and professional services awarded by or for the Department of Education during fiscal years 1996 and 1997. We selected for review a judgmental sample of 18 (out of 44) professional services contracts and 30 (out of 41) construction contracts, totaling over $49.8 million, that were awarded on behalf of the Department of Education. The audit was performed at the Departments of Property and Procurement, Education, and Public Works. We also made site visits to 30 public schools to observe the construction work.

Our review was made, as applicable, in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances.

As part of our review, we evaluated the Government's system of internal controls related to the award and oversight of construction contracts and the accountability of funds for the hurricane-related contracts. The internal control weaknesses we identified in these areas are addressed in the Findings and Recommendations section of this report. Our recommendations, if implemented, should improve the internal controls in these areas.

PRIOR AUDIT COVERAGE

The Office of Inspector General has issued two reports during the past 5 years regarding hurricane-related construction for public schools in the Virgin Islands. The survey report "Procurement Practices for Hurricane-Related Repairs to Public Schools, Government of the Virgin Islands" (No. 96-E-1113), dated August 1996, concluded that the operating officials at the Departments of Education and Public Works did not always comply with the procurement requirements and that there was no assurance that the Government received the most favorable prices, terms, and conditions with regard to emergency debris removal and repair services acquired at a total cost of more than $1.5 million for public schools. We recommended that the Governor of the Virgin Islands direct all Executive Branch agencies to (1) submit hurricane-related work requirements to the Department of Property and Procurement and (2) ensure that the procurement process includes the use of competitive proposals to the maximum extent practicable, the issuance of formal contracts before work

was started, and the maintenance of complete files documenting the procurement actions taken with regard to each contract.

The audit report "Construction Contracts, Capital Improvement Program, Government of the Virgin Islands" (No. 94-I-1194), dated September 1994, included a review of contracts awarded to repair damage to schools caused by Hurricane Hugo in September 1989. With regard to procurement practices, the report concluded that (1) the Department of Property and Procurement did not adequately document actions taken to procure construction services and did not ensure that competitive procedures were used to the maximum extent practicable and (2) the Government and the Program Management Consultant did not provide adequate oversight of construction projects. As a result, 7 contracts, totaling $4.5 million, were not awarded on the basis of competitive procedures; 4 contracts, totaling $25 million, were not awarded to the lowest proposers; and 14 contracts, totaling $18 million, did not have sufficient information in the contract files to determine whether competitive procurement procedures had been used. Additionally, the report questioned construction costs of about $8 million charged against a grant from the U.S. Department of Education and $2.7 million paid to the Project Management Consultant. With regard to contracts for repairs to public schools, we recommended that the Governor of the Virgin Islands ensure that (1) the Department of Property and Procurement complies with the competitive procurement requirements of the Virgin Islands Code and of Virgin Islands Rules and Regulations, establishes formal policies and procedures regarding the contents of construction contract files, and enforces existing policies and procedures with regard to the issuance of change orders and supplemental contracts; (2) inspectors from the Department of Public Works or other inspectors authorized by the Department conduct regular inspections at each construction site and file appropriate inspection reports; and (3) the Department of Education provides the U.S. Department of Education with supporting documentation for the $8 million in questioned construction costs and the $2.7 million in questioned payments to the Project Management Consultant so that the funding agency can determine the allowability of those costs.

Our current review disclosed procurement and contract oversight deficiencies similar to those identified in the two prior reports.

FINDINGS AND RECOMMENDATIONS

A. CONTRACT AWARD

The Government did not maintain sufficient oversight of the procurement process to ensure that contracts related to repairs to public schools damaged by Hurricane Marilyn were awarded in an effective manner. Specifically, the Department of Public Works, on behalf of the Department of Education, allowed construction contractors on St. Thomas to perform work without competition or formal contracts and issued "after-the-fact" purchase orders for services for the Department of Education, and the Hurricane Recovery Managers used procurement procedures that did not provide the required level of competition. In addition, procurement files did not adequately document whether competitive procedures were used. The Virgin Islands Code and the Virgin Islands Rules and Regulations contain the requirements for competitive procurement. However, the Government did not provide adequate oversight of the procurement process in that the Department of Property and Procurement, which has overall responsibility for Government procurement, was generally excluded from the process and the procurement procedures did not allow for the active involvement of third parties, such as the Departments of Education and Public Works and the Hurricane Recovery Managers. As a result, the Government had little assurance that it received the most favorable prices, terms, and conditions with regard to construction and other contractual services acquired at a total cost of more than $21.5 million and for "after-the-fact" purchase orders totaling $164,000.

Procurement Requirements

Title 31, Section 239, of the Virgin Islands Code states that purchases may be made without the use of formal advertisement and competitive bidding when, among other exceptions, the "Governor declares in the public interest that a State of Emergency exists and specifies in such Proclamation those purchases and/or services which may be obtained without competitive bidding." The emergency proclamation that the Governor issued after Hurricane Marilyn allowed Governmental agencies to procure goods and services without formal advertising. However, the proclamation required that responsible agencies "negotiate on a competitive basis" and "make every reasonable effort to obtain the most favorable prices, terms, and conditions for the Government."

Title 31, Section 234, of the Virgin Islands Code, which was not waived by the Governor's emergency proclamation, states that "no purchase shall be made by any department or agency of the government or by any employee of the government for any agency of the government except by written order approved by the Commissioner of Property and Procurement." The penalties for violation of this requirement include personal liability for the purchase price, a fine of not more than $200, and/or dismissal from employment.

Procurement Methods Used

Although Title 31, Section 234, of the Virgin Islands Code designated the Commissioner of Property and Procurement as the procuring official for the Government of the Virgin Islands, the Department of Education and the Hurricane Recovery Managers executed their own procurement for emergency debris removal and repair work at the public school facilities. Of the 30 construction contracts we selected for review, we found that 20 contracts, totaling $18.7 million, were awarded noncompetitively and without the involvement of the Department of Property and Procurement.

Special Project Coordinator. After Hurricane Marilyn struck the Virgin Islands on September 15, 1995, the Department of Education used a Special Project Coordinator from the Department of Public Works to supervise and coordinate the repairs to the public schools on St. Thomas and St. John. This occurred without coordination with the Department of Property and Procurement, and, as a result, the Department of Education allowed the Special Project Coordinator to hire construction contractors noncompetitively. The Department of Education also did not execute formal contracts with the contractors before work commenced, as required by the Virgin Islands Code, to specify the detailed scope of work, method of payment, procedures for inspection of work, resolution of disputes, and other standard contract provisions to protect the interests of both the Government and the contractors.

After the hurricane, the Coordinator, through a public radio announcement, requested that contractors which had performed work on the schools during the summer restoration program provide emergency debris removal and repair services at the public schools damaged by Hurricane Marilyn. The Coordinator requested that the contractors submit a statement of general scope of work before they were assigned to perform work on the same structures they had worked on during the summer. However, we found 3 contracts, out of 30 awarded with the assistance of the Coordinator, that were prepared and executed after the contractors had started the repairs. For example:

- On December 7, 1995, a construction contract for $1.2 million was awarded to a contractor for repairs to a St. Thomas elementary school. A contractor invoice for $347,670 showed that construction work had begun on October 1, 1995. The Department of Property and Procurement was not involved in awarding this contract, which was executed after work had started.

- On December 7, 1995, a construction contract for $850,000 was awarded for repairs to another St. Thomas elementary school. A contractor invoice for $140,546 showed that construction work had begun before October 15, 1995. Additionally, there was no abstract of bids or a bid evaluation report in the contract files to indicate whether more than one contractor was given the opportunity to submit a proposal for this contract. An October 27, 1995, transmittal memorandum from the Department of Education's Director of Business Affairs to the then-Commissioner of Education stated that a contract was not in place at the time that work began, inspection reports had not been prepared to verify that the job was satisfactorily completed, and approvals for payment had not been obtained from all

of the appropriate Government officials. Nevertheless, a miscellaneous disbursement voucher for $87,869 was processed, and the contractor was paid.

In an October 23, 1995, letter to the Governor, the Commissioner of Property and Procurement stated:

> Contrary to the provisions of Title 31 V.I.C. [Virgin Islands Code] Section 239, the procurement regulations for open market purchases, the Department of Property and Procurement was kept completely out of the process [by the Department of Education]. As a result, we cannot protect the government's interest relative to costs, terms, completion dates, and assessments on those contracts.

In an internal memorandum dated October 30, 1996, an employee of the Department of Property and Procurement reported to the Commissioner that there were significant variances in the estimated costs for emergency construction work performed by contractors on 10 Department of Education projects. While the contractors submitted invoices totaling $6.8 million for emergency repairs performed at Department of Education facilities, architects/engineers representing the Government estimated that the work performed by the contractors was valued at $2.3 million, for an overall variance of $4.5 million. As of October 1997, these variances had not been resolved.

We also found that, although Title 31, Section 234, of the Virgin Islands Code requires that purchases be made by written orders, the Department of Public Works procured services for the Department of Education without purchase orders. Specifically, we found that nine purchase orders, totaling $164,000, were prepared after the work was completed. The Department of Public Works sent contractors' invoices to the Department of Education, which prepared and submitted purchase orders to the Department of Property and Procurement for approval. We believe that the submission of the purchase orders to the Department of Property and Procurement was an "after-the-fact" process which was contrary to the requirements of Title 31, Section 234, of the Virgin Islands Code.

Hurricane Recovery Managers. In December 1995, the Government of the Virgin Islands hired the Hurricane Recovery Managers, at a cost of $6.5 million, to serve as overall project managers for all hurricane-related construction projects. As a result, the Department of Property and Procurement was excluded, except for approving contractors recommended by the firm, because the firm acted independently in soliciting, evaluating, selecting, and negotiating with contractors for architectural, engineering, and construction services for structural repairs to be performed at public schools damaged by Hurricane Marilyn.

Under procedures established by the Hurricane Recovery Managers, contractors were solicited through the local media, direct mailings, and personal contacts after a Department of Education official prioritized the schools requiring repair work. The responding contractors filled out qualification statements, which were submitted to the Hurricane Recovery Managers, who screened the contractors based on data in these statements and prepared a list of qualified contractors. A selection board comprising representatives of the

Hurricane Recovery Managers interviewed the contractors, asking questions regarding their ability to perform the work required. Based on the information in the qualification statements and the responses to the selection board's questions, the Hurricane Recovery Managers recommended contractors to the Commissioner of Property and Procurement for final approval before the Hurricane Recovery Managers negotiated contracts with the selected contractors. The Hurricane Recovery Managers used construction master agreements as the basic contracts and assigned and controlled specific projects through task orders to the contractors. The task orders contained a description of the services required, drawings and specifications as applicable, the time frame for performance, the agreed-upon price, and the terms of payment.

However, the proposal, selection, and awarding procedures established by the Hurricane Recovery Managers differed from the Government's standard procurement process in that they did not (1) include the Department of Property and Procurement as an integral part of the process, (2) require the solicitation of competitive proposals for each contract to be awarded, or (3) include Governmental representatives on the contractor selection committees. Additionally, the Government did not have a system to monitor the Hurricane Recovery Managers' activities and to maintain adequate control over the construction contracts awarded by the Hurricane Recovery Managers. As a result, there was no opportunity for competition among the eligible contractors to ensure that the Government received the most favorable prices for repair work at the public schools, and there was little assurance that the Hurricane Recovery Managers and construction contractors performed work in accordance with their contracts.

Project Manager. On August 29, 1996, the Government, after mutually agreeing with the Hurricane Recovery Managers to terminate their contract, awarded a $1.9 million professional services contract noncompetitively to a former employee of the Department of Education to oversee completion of repair and reconstruction work at the public schools. The contract was effective retroactively to June 24, 1996. The contractor told us that the then-Commissioner of Education offered him the contract. As such, this contract was awarded without compliance with the competitive procurement requirements of Title 31, Chapter 23, of the Virgin Islands Code.

We believe that there was little assurance that the Government of the Virgin Islands received the most favorable prices, terms, and conditions for construction and other contractual services acquired at a cost of more than $21.5 million and for "after-the-fact" purchase orders totaling $164,000 because the Special Project Coordinator completely bypassed the Department of Property and Procurement in the process, did not solicit competitive proposals, and did not issue written contracts or purchase orders; the Hurricane Recovery Managers used procurement procedures that differed from the Government's standard procurement process; and the project manager was not selected competitively.

Contract Files

The official contract files maintained by the Department of Property and Procurement were not complete and did not contain sufficient documentation of procurement actions taken for the construction and professional services contracts reviewed. Based on our review of the 48 contract files selected, we determined that all of the files were missing at least one key document. For example, 23 files did not contain invitations for bids or requests for proposals, 29 files did not contain copies of the original plans and specifications, 30 files did not contain bonding information, 21 files did not contain copies of the contractors' business licenses, 37 files did not contain abstracts of bids, 32 files did not contain evaluation committee reports, 17 files did not contain notices to proceed, and 29 files did not contain building permits. Additionally, the files for 18 contracts, totaling $12.6 million, of the 30 construction contracts we reviewed did not contain sufficient documentation for us to determine whether competitive procurement procedures had been used. Because the Department of Education and the Hurricane Recovery Managers procured services in accordance with their own procedures, there was little assurance that documents were forwarded to the Department of Property and Procurement for the official contract files. Without complete contract files, the Government may not be able to refute claims of contractors who believe that they should have been awarded the contracts or resolve disputes by contractors over the terms, conditions, or prices of the contracts.

At the November 25, 1997, exit meeting on the preliminary draft of this report, the Commissioner of Education stated that immediately after the hurricane, there was "confusion" among Government agencies as to the accepted procurement practices to be followed under the Governor's emergency proclamation but that later procurement actions were made using procedures which were more in compliance with the legal requirements. The Commissioner also stated that his department had developed contingency plans for procuring emergency debris removal and school repair services in the event that another hurricane strikes the Virgin Islands.

Recommendations

We recommend that the Governor of the Virgin Islands:

1. Ensure that the Department of Property and Procurement carries out its procurement responsibilities in accordance with Title 31, Chapter 23, of the Virgin Islands Code and the Virgin Islands Rules and Regulations, including the use of competitive procedures to the maximum extent practicable and the issuance of formal contracts before work begins.

2. Enforce Title 31, Section 234, of the Virgin Islands Code, which requires that purchases be made by written orders approved by the Department of Property and Procurement.

3. Ensure that the Department of Property and Procurement maintains contract files which adequately document the procurement process. Specifically, the contract files should

contain, as appropriate, the invitation for bids or request for proposals; all bids or proposals received, including contractor qualification statements, evidence of bonding or other surety, copies of business licenses, and other documents that are required as part of a complete bid package; bid abstract sheets summarizing all bids or proposals received, including bid amounts; bid evaluation sheets of individual committee members and the final bid evaluation committee report; executed contracts and any subsequent amendments, supplements, or change orders; notices of award and notices to proceed; correspondence related to the contracts; progress payment requests and other documents related to payments to contractors; and documents related to actions taken with regard to any deficiencies noted, including the assessment of liquidated damages.

Governor of the Virgin Islands Response and Office of Inspector General Reply

The January 29, 1998, response (Appendix 2) to the draft report from the Governor of the Virgin Islands, which we received on February 18, 1998, concurred with the three recommendations and stated that the Commissioner of Property and Procurement had been "directed . . . to meet all the requirements" of the recommendations and report to the Governor on the status of corrective actions within 30 days. Based on the response, we consider the recommendations resolved but not implemented (see Appendix 3).

General Comments on Finding

The Governor's response also included comments on the finding. The Government's comments and our replies are as follows:

Governor of the Virgin Islands Response. The response stated that the Department of Education did not agree with the statement that there were significant variances, totaling $4.5 million, between amounts billed by construction contractors and estimates of the value of the work prepared by architects/engineers representing the Government. The response stated that "in some instances the architect/engineer's unit prices were below normal Virgin Islands prices, for construction, during normal circumstances" and that this caused some of the unit prices to be "even more unreal" because the work was done "during a time of great emergency when material [was] being sold at a premium due to its scarcity and labor costs were high due to the scarcity of manpower."

Office of Inspector General Reply. The intent of the report was to identify the existence of variances without making a judgment as to whether the contractors' invoices or the architects'/engineers' estimates were more accurate. However, the variances had not been resolved at the time of completion of our audit in October 1997. Further, we believe that the response statement that "in other cases such as Joseph Gomez and Evelyn Marcelli Elementary Schools, there was justification for questioning some of the prices submitted by contractors and the quantities of work which they claimed to have completed" would indicate that there were concerns about the prices and quantities of work billed.

Governor of the Virgin Islands Response. The response stated that the Department of Education did not agree that the Department of Property and Procurement was excluded from most aspects of the procurement process because the Hurricane Recovery Managers acted independently. The response stated that the Hurricane Recovery Managers "worked in concert" with the Governor's Authorized Representative and the Department of Property and Procurement.

Office of Inspector General Reply. Our statement was based on detailed descriptions of the procurement procedures used by the Hurricane Recovery Managers as provided to us by officials of the Departments of Property and Procurement and Education. Although the Hurricane Recovery Managers did interact with the Governor's Authorized Representative and the Department of Property and Procurement, that interaction did not afford that department the opportunity to participate in the day-to-day procurement process to the extent that its legal authority and responsibility as the Government's official procurement agency would require. To a large extent, procurement-related decisions were made by the Hurricane Recovery Managers that were later presented to the Department of Property and Procurement for approval.

Governor of the Virgin Islands Response. The response stated that the Department of Education did not agree that the Government did not have a system to monitor the Hurricane Recovery Managers' activities and to maintain control over the construction contracts awarded by the Hurricane Recovery Managers. The response stated that the Department "worked closely with the Hurricane Recovery Managers; attended weekly staff meetings; received reports; manpower and construction schedules; and maintained oversight of their activities."

Office of Inspector General Reply. We believe that our statement is accurate because the construction contract files that were made available to us during the audit did not contain evidence of close interaction and oversight activity by the Department of Education. Despite our inquiries, Department officials did not provide such documentation. In addition, the response acknowledges that the files were only being assembled in January 1998.

Governor of the Virgin Islands Response. The response stated that the Department of Education did not agree that there was no opportunity for competition among the list of contractors established by the Hurricane Recovery Managers to ensure that the Government received the most favorable prices for repair work and there was little assurance that the Hurricane Recovery Managers and construction contractors performed in accordance with their contracts. The response also stated that "the unit prices which the Hurricane Recovery Managers mandated for repair work at the public schools were acceptable and in the best interest of the Government" and that "construction contractors performed in accordance with their contracts."

Office of Inspector General Reply. Without the existence of price proposals from various contractors, it is impossible to definitively state whether or not a particular contract price was "the most favorable" or "in the best interest of the Government." As to whether contractors performed in accordance with their contracts, we believe that the examples in our

report of less-than-satisfactory contractor performance demonstrate that work was not in accordance with contracts. For example, Finding B cites construction deficiencies that we found at four schools (Ivanna Eudora Kean High School, Joseph Sibilly Elementary School, Arthur Richards Junior High School, and Alexander Henderson Elementary School) during on-site visits in May and June 1997. The response acknowledges that those deficiencies existed and states that corrective actions had been taken subsequent to completion of our audit. In the case of the Joseph Sibilly Elementary School, the response states that "the original contractor . . . was dismissed and a new contractor is presently completing the necessary repairs." Further, the response (pages 22 through 25) states that work performed under the Phase I repairs, which was not in conformance with building code requirements, was corrected by subsequent work under Phase II. We believe that these situations support our statements on the contractors not performing in accordance with their contracts.

Governor of the Virgin Islands Response. The response stated that the Department of Education disagreed with our conclusions regarding the procurement methods it used. Specifically, the response stated that the Government "received the most favorable prices, terms, and conditions for construction and other contractual services acquired at a cost of more than $21.5 million and for 'after-the-fact' purchase orders totaling $164,000"; that although the Special Project Coordinator "completely bypassed" the Department of Property and Procurement, did not solicit competitive proposals, and did not issue written contracts or purchase orders, the Special Project Coordinator acted in good faith on behalf of the Government"; that although the Hurricane Recovery Managers used procurement procedures that differed from the Government standard procurement process, the Hurricane Recovery Managers "operated in concert with the [Government Authorized Representative] and the Department of Property and Procurement"; and that although "the Commissioner of Education agrees that the Project Manager was not selected competitively . . . time was of the essence . . . and it was in the best interest of the Government to utilize this Project Manager" because "he possessed a thorough understanding of all the facets of contracting; payment requests; inspections and in general project oversight."

Office of Inspector General Reply. Although the response states that the Government's actions were taken because of the emergency conditions that occurred after Hurricane Marilyn, we have found and reported on similar procurement-related deficiencies in other prior audit reports, including the September 1994 report (see Prior Audit Coverage), which reported similar problems after Hurricane Hugo in 1989 and made recommendations for improving the Government's emergency-related procurement procedures. If, in response to the 1994 report, the Government had established contingency plans and procedures for procuring emergency repair services in the event of a future hurricane or other disaster, we believe that many of the problems disclosed in our current report could have been avoided. With regard to the statement in the response that "the Special Project Coordinator acted in good faith on behalf of the Government," we do not believe that "good faith" is an acceptable replacement for the objective price comparison that is achieved through the use of competitive procurement practices.

General Comments on Audit Report

The response stated that the Department of Education did not concur with our statement (Objective and Scope section) regarding the award of construction contracts. The response stated that "all contracts were awarded by the Department of Property and Procurement and the Hurricane Recover Managers."

Office of Inspector General Reply. We believe that our statement is correct because the Department of Education, immediately after Hurricane Marilyn, issued eight purchase orders, totaling about $500,000, for hurricane-related repairs and debris removal at public schools. Although purchase orders are not formal construction contracts, they bind the Government to a contractual obligation with an outside firm for repair work to schools. The eight purchase orders were issued without the involvement or the approval of the Department of Property and Procurement. Thus, we have revised the wording of the Objective and Scope section to state that "contracts <u>and/or purchase orders</u> for hurricane-related construction and professional services were awarded by or for the Department of Education." (Emphasis added.)

B. CONTRACT OVERSIGHT

The Government did not maintain sufficient oversight of construction projects to ensure that repairs to public schools damaged by Hurricane Marilyn were performed in accordance with existing requirements. Specifically, contractors' requests for periodic payments were not always approved, inspection and progress reports were not always sufficiently detailed to support contractors' payment requests, and building permits were not always obtained. The Virgin Islands Code requires the Department of Public Works to supervise the construction and repair of Government buildings and specifies the conditions for obtaining building permits. However, the Government did not provide the required oversight of construction projects in that it allowed project management contractors rather than the Department of Public Works to supervise the construction and repair of public schools and did not have procedures for monitoring the activities of the project management contractors. As a result, there was little assurance that construction and professional services contractors who received over $21 million for work on public schools performed the work in accordance with their contracts or that the work performed on the schools was in compliance with building code requirements, thus creating the potential for safety deficiencies in the public schools. We also found that a contractor was overpaid by at least $5,418.

Documentation of Oversight Activities

Title 3, Section 138, of the Virgin Islands Code requires the Department of Public Works to supervise the construction and repair of all government buildings. However, during the period of October to December 1995, which was the period of time prior to the contract with the Hurricane Recovery Managers, the Government did not maintain documentation showing whether the construction projects were inspected by the Department of Public Works. Additionally, during the period of December 1995 to June 1996, the Government had the Hurricane Recovery Managers carry out the Government's contract oversight responsibilities. Specifically, the Hurricane Recovery Managers were required to (1) review architectural designs and plans prepared by contracted architects/engineers, (2) monitor design and construction activities, and (3) provide the Government with construction progress reports. However, we found no progress reports in the contract files to support progress payment requests submitted by the contractors for 27 of the 30 construction contracts reviewed.

Additionally, in a February 20, 1996, memorandum to the Commissioner of Property and Procurement, the Hurricane Recovery Managers indicated that their contractor selection process was focused on identifying qualified architectural/engineering firms for four schools. However, during our review of the Hurricane Recovery Managers' files located at the Department of Education, we found no architectural sketches or plans for the work performed at the schools. Further, because there was no documentation in the files showing how the Hurricane Recovery Managers monitored and reviewed the work of contractors, there was little assurance that the construction firms fulfilled their contractual obligations. There was also no documentation in the files to show that the Government monitored the activities of the Hurricane Recovery Managers to ensure that they carried out their contractual obligations as the Government's overall project management consultant.

The project manager hired in June 1996 to replace the Hurricane Recovery Managers conducted joint inspections with an inspector from the Department of Public Works of construction work performed at the public schools. But the project manager's invoices did not provide sufficient details to support the quantity or quality of work he performed. For example, the project manager's first invoice, dated August 19, 1996, billed the Government $222,528 for services rendered during the period of June 23 to August 17, 1996. However, the supporting documentation attached to the invoice indicated that only $214,179 was owed for 3,355 hours of staff time and $2,931 was owed for mileage on the firm's vehicles. Therefore, the project manager was overpaid $5,418. Additionally, the invoice did not indicate which schools were visited or the type of services provided at each school.

During May and June 1997, we made on-site visits to 30 public schools (12 on St. Thomas and 18 on St. Croix) that had been repaired or renovated after Hurricane Marilyn and found that construction contractors did not satisfactorily complete all of the work required by their contracts as follows:

- The roof of the gymnasium at the Ivanna Eudora Kean High School on St. Thomas leaked, and, as a result, the floors of the gymnasium's main entrance, teachers' offices, and boys' restroom flooded after heavy rains. The contract required the contractor to remove and replace 8,000 square feet of seam roofing and temporary roofing, for which the contractor was paid $263,000. The contract for all work to be performed at the High School was for an amount not to exceed $1,488,941.

- At the Joseph Sibilly Elementary School on St. Thomas, the contractor was required to perform repair and reconstruction work that included renovating the art building. However, no work had been done on the art building since Hurricane Marilyn, and the contractor was paid $481,000. The contract for all work to be performed at the School was for the amount of $850,000.

- At the Arthur Richards Junior High School on St. Croix, repairs had not been made to the roof guttering; windows in classrooms; and ceiling tiles in the girls' restroom, auditorium, and kitchen. The contractor was required to perform the cited repairs on the entire school and had been paid a total of $551,000. The contract for all work to be performed at the Junior High School was for the amount of $618,427.

- At the Alexander Henderson Elementary School on St. Croix, the classroom roof leaked and ceiling tiles in the men's restroom still needed to be replaced. The contractor was paid $116,300 to make these repairs. The contract for all work to be performed at the School was for the amount of $129,257.

At the November 25, 1997, exit meeting on the preliminary draft report, the Commissioner of Education stated that corrective actions had been taken on some of the construction deficiencies noted. Specifically, he stated that (1) repairs to the roof of the gymnasium at the Ivanna Eudora Kean High School were completed, (2) the original contractor for the Joseph Sibilly Elementary School was dismissed and a new contractor was completing the necessary repairs, and (3) repairs at the Arthur Richards Junior High School and the Alexander

Henderson Elementary School on St. Croix were in process. The Commissioner also stated that the ongoing repair work was periodically inspected by representatives of the Department of Education and the Department of Planning and Natural Resources (the agency responsible for building code enforcement).

Payment Process. During the period of October to December 1995, contractors were paid $918,490, although inspections were not performed and invoices and periodic estimates were not approved by the Governmental officials responsible for certifying that the work was accomplished satisfactorily. For example, in October 1995, a payment of $87,869 was made to a contractor by means of a miscellaneous disbursement voucher. A memorandum from the Department of Education's Director of Business Affairs to the then-Commissioner of Education that was attached to the voucher stated that there were no (1) contracts in place for the construction work, (2) inspection reports to verify that work was completed satisfactorily, or (3) approvals by the authorized Government representatives to certify the work for payment. However, the voucher was certified for payment by the then-Commissioner of Education, and a check was issued to the contractor on October 27, 1995.

The Hurricane Recovery Managers and the subsequent project manager submitted contractors' invoices and periodic payment requests, along with their recommendations for approval of payment, to the Department of Education. The Department then prepared the payment vouchers and submitted the invoices, periodic payment requests, and vouchers to the Department of Property and Procurement for processing. The invoices and periodic payment requests were to be signed by authorized representatives of the Departments of Property and Procurement, Public Works, and Education certifying that the work was satisfactorily completed. However, in the 48 construction and professional services contract files that we reviewed, we found 65 payments (out of 154), totaling over $21 million, that were made without all of the required approvals by Governmental representatives.

In addition, the invoices of the Hurricane Recovery Managers were not properly reviewed and approved. For example, during the period of December 20, 1995, to February 21, 1997, the Hurricane Recovery Managers submitted 10 invoices, totaling $5.7 million, to the Governor's Authorized Representative (GAR).[2] A letter dated April 19, 1996, from the GAR to the Hurricane Recovery Managers which was attached to the miscellaneous disbursement vouchers stated that the GAR was giving "conditional approval" of the payments but that he had not performed a detailed review and verification of the Hurricane Recovery Managers' work. The letter further stated that the GAR "disavowed," at that time, the representations in the Certification of Authorized Government Representative but that the Government reserved the right, upon detailed review and verification, to make appropriate adjustments against future invoices. However, there was no documentation in the files indicating whether detailed reviews or payment adjustments were subsequently made. We believe that the GAR's disclaimers indicate that the correct review process was not followed with regard to the Hurricane Recovery Managers' invoices and that there was little assurance that amounts paid were reasonable and allowable.

---

[2]The "Governor's Authorized Representative" was the Virgin Islands Director of Management and Budget, who, in accordance with FEMA regulations, acted on the Governor's behalf in administering disaster assistance funds.

Building Code and Permits

The 1994 Uniform Building Code (which is incorporated by reference into Title 29, Chapter 5, of the Virgin Islands Code) requires that developers request a building permit before they begin construction by submitting a set of architectural plans to the Division of Permits of the Department of Planning and Natural Resources. Section 106.1 of the Building Code further requires that the building official issue a separate building permit for each structure erected, constructed, enlarged, altered, repaired, moved, converted, or demolished. Despite these requirements, which apply to Governmental facilities, the Government did not ensure that architectural plans were submitted for approval or that building permits were obtained for all repair work to the public schools. We found that plans and building permits were not available for 29 of 41 school construction projects. Additionally, correspondence in the contract files indicated that some of the construction work was not in compliance with the building code requirements. For example:

- A status report prepared by the Hurricane Recovery Managers in May 1996 stated that repair work at the Joseph Sibilly, Charlotte Amalie, and Kirwan Terrace schools was not in compliance with the building codes and recommended that the Government issue stop work orders to the respective construction contractors. On May 21, 1996, the Department of Property and Procurement issued a stop work order to the contractor working at the Charlotte Amalie High School. However, in a June 11, 1996, memorandum, the then-Commissioner of Education authorized the contractor to continue all repair work at the High School "that does not relate to meeting provisions of the Uniform Building Code or other code requirements." We found no documentation in the files to indicate whether followup actions were taken to have the contractor correct the building code violations that resulted in the stop work order or whether the Department of Education, the Hurricane Recovery Managers, or other representatives of the Government ensured that the contractor's subsequent work was in accordance with the Commissioner's instructions. We also did not find documentation in the files to indicate whether stop work orders were issued to the contractors at the Joseph Sibilly and Kirwan Terrace schools or whether the building code violations reported by the Hurricane Recovery Managers were corrected.

- In another instance, a new roof that was constructed at the Uller Muller School after Hurricane Marilyn was blown off the school by Hurricane Bertha in July 1996. The local media reported that an architect/engineer said that the new roof had not been constructed in accordance with building code requirements.

We believe that substandard construction work and the resultant potential for unsafe public schools existed because the Government and its representatives did not ensure that architectural plans were prepared and approved, building permits were issued, and building code requirements were met.

At the November 25, 1997, exit meeting on the preliminary draft report, the Commissioner of Education stated that repair work at almost all schools had subsequently been inspected by representatives of the Department of Education and the Department of Planning and Natural Resources and that, where necessary, additional work was performed to mitigate the

effects of repair work that originally was not in compliance with building code requirements. Specifically, he stated that corrective actions had been taken with regard to building code deficiencies at the Joseph Sibilly, Kirwan Terrace, and Uller Muller schools but that some problems still existed relating to the quality and timeliness of the repair work at the Charlotte Amalie High School. The Commissioner also stated that he had taken a "hard line" with contractors by refusing to approve payments in cases where the repair work was not performed in accordance with contract and building code requirements. Further, the Commissioner stated that the Department had obtained and compiled the contract files originally held by the Hurricane Recovery Managers and the subsequent project manager.

Recommendations

We recommend that the Governor of the Virgin Islands:

1. Direct the Department of Property and Procurement, in coordination with the Department of Public Works, to establish procedures for the contract oversight function which include assigning a Department of Public Works inspector to conduct regular inspections at each construction site and file appropriate inspection reports with the Department of Property and Procurement and to ensure that all appropriate Government representatives review and approve construction progress reports before periodic payments are made to contractors.

2. Direct the Department of Property and Procurement, in coordination with the Department of Planning and Natural Resources, to establish procedures which ensure that architectural plans are submitted and approved and building permits are issued for all Government construction projects.

3. Direct the Department of Public Works, in coordination with the Department of Planning and Natural Resources, to inspect all public schools which required construction work after Hurricane Marilyn to ensure that the work was performed in accordance with building code requirements. Any violations should be reported to the Department of Property and Procurement for subsequent correction by the contractors.

4. Direct the Department of Education to obtain a refund from (or make offsets against amounts that may be owed to) the contractor who was overpaid by $5,418.

Governor of the Virgin Islands Response and Office of Inspector General Reply

The January 29, 1998, response (Appendix 2) to the draft report from the Governor of the Virgin Islands, which we received on February 18, 1998, expressed concurrence with Recommendations 1, 2, and 3. The response also expressed nonconcurrence with Recommendation 4, which was revised based on additional information that one contractor was not overpaid because the contract amount was increased by an amendment. Based on the response, we request additional information for Recommendations 1, 2, and 3 and request

that the Governor respond to the revised Recommendation 4, which is unresolved (see Appendix 3).

General Comments on Finding

The Governor's response also included comments on the finding. The Governor's comments and our replies are as follows:

Governor of the Virgin Islands Response. The response stated that the Department of Education did not agree with our statement that "the Government did not maintain sufficient oversight of construction projects to ensure that repairs to public schools . . . were performed in accordance with existing requirements."

Office of Inspector General Reply. The examples in the report and our comments on the response, as discussed in the following paragraphs, provides the basis for our conclusion. For example, the response expressed concurrence with our statement that "inspection and progress reports were not always sufficiently detailed to support contractors' payment requests." As such, we believe that this concurrence further supports our overall conclusion because it acknowledges that contractors did not provide Government officials with sufficiently detailed information on which to make decisions concerning the quality and quantity of work performed by contractors.

Governor of the Virgin Islands Response. The response stated that the Department did not agree that contractors' requests for periodic payment "were not always approved." The response stated that the respective Governmental agencies approved "all requests for period payments" but that "the final approval signatures were that of the Department of Property and Procurement." The response acknowledged that the files at the Departments of Education and Public Works did not contain documentation to show that all necessary approvals had been obtained. The response further stated that the Department of Property and Procurement did not provide the Departments of Education and Public Works with copies of the payment requests that included all approval signatures.

Office of Inspector General Reply. In addition to the acknowledgment in the response that files at the Departments of Education and Public Works did not contain documentation to show that the necessary approvals had been obtained, our review also found that such documentation was not always present in the official contract files located at the Department of Property and Procurement. Therefore, we believe that the statement on the lack of appropriate documentation in the contract files was correct.

Governor of the Virgin Islands Response. The response stated that the Department did not agree that "building permits were not always obtained." The response further stated that although "immediate reconstruction/repairs . . . identified as Phase I Reconstruction/Repairs . . . were performed without building permits," Phase II permanent reconstruction/repairs were performed "in full compliance with the 1994 Uniform Building Code," including the requirement to obtain building permits. The response also stated that the auditors found that certain documents were absent from the files at the Department of

Education and the Department of Property and Procurement "because the Project Manager had not turned these files over to the Department of Education" but that the pertinent files were to be submitted to Property and Procurement by February 27, 1998.

Office of Inspector General Reply. We believe that these statements support our conclusion that the Government's official contract files were incomplete. Additionally, the response addresses only these missing documents that related to construction supervised by the Project Manager. Finding A of the report disclosed that at least one key document was missing from the files for all 48 construction projects we reviewed, including projects supervised by the Special Project Coordinator and the Hurricane Recovery Managers.

Governor of the Virgin Islands Response. The response stated that the Department did not agree that the Government "did not provide the required oversight of construction projects in that it allowed project management contractors rather than the Department of Public Works to supervise the construction and repairs." The response stated that Virgin Islands Code requirement with regard to supervision of construction contracts "was adhered to by the Department of Public Works who supervised the construction and repair of Government buildings under the Phase II reconstruction/repairs." The response further stated that "the Project Manager representing the Department of Education was authorized to provide project oversight in conjunction with the Department of Public Works."

Office of Inspector General Reply. The response provided information to show that construction work under Phase II was supervised by the Department of Public Works and that the Department of Education was represented by the Project Manager. The response did not address the lack of construction oversight during Phase I work or the lack oversight of the activities of the Special Project Coordinator and the Hurricane Recovery Managers. We believe that this is significant because most of the deficiencies discussed in the report relate to the activities of the Special Project Coordinator and the Hurricane Recovery Managers, primarily during Phase I. We acknowledged in the finding that the Project Manager "conducted joint inspections with an inspector from the Department of Public Works." Additionally, the only two reported deficiencies relating to the performance of the Project Manager did not address the Project Manager's oversight responsibilities but the fact that the firm was awarded its contract on a noncompetitive basis and that one of the firm's invoices contained an error that resulted in an overpayment of $5,418.

Governor of the Virgin Islands Response. The response stated that the Department did not agree that "there was little assurance" that contractors who received more than $21 million [incorrectly quoted in the Governor's response as "421 million"] for work on public schools performed in accordance with their contracts or that the work performed on the schools was in compliance with building code requirements. The response stated that the Department of Education "closely monitored" the activities of its project management contractors and that, as a result, "there was assurance that contractors performed in accordance with their contracts and that building code requirements were met."

Office of Inspector General Reply. The response acknowledged that repairs during Phase I were performed without building permits, that inspection and progress reports were

not always sufficiently detailed to support contractors' payment requests, and that only project management activities of the Project Manager were closely supervised by the Department of Education. We believe that these acknowledgments support our overall conclusion that the Government "did not maintain sufficient oversight of construction projects."

Governor of the Virgin Islands Response. The response stated that the Department did not agree that "two contractors were overpaid a total of $12,363." The response stated that the Department of Public Works was requested to review the possible overpayment of $5,418 to the Project Manager but that the construction contractor at Alexander Henderson Elementary School was not overpaid $6,945 because the original contract (in the amount of $109,356) was amended by a change order dated November 19, 1996, which increased the contract amount by $19,901.

Office of Inspector General Reply. A copy of the contract change order referred to in the response was not in the official contract files during our audit. However, based on this additional information, we have revised the report to delete all references to the potential $6,945 overpayment, but the Department needs to take action on the remaining $5,418.

Governor of the Virgin Islands Response. The response stated that the Department of Education did not concur that the Governor had the Hurricane Recovery Managers perform the Government's contract oversight responsibilities because the Hurricane Recovery Managers "worked in concert with the Department of Education" in carrying out contract oversight activities. Also, the response stated that the Department's Division of Engineering "will be directed" to research its files "to discover copies of all 'progress reports' which will support progress payment requests submitted by the contractors for 27 of 30 construction contracts" and that the Hurricane Recovery Managers' files located at the Department of Education "will be researched to discover architectural sketches and/or plans for the work performed" at the schools discussed in the finding. The response stated that such documents would be made available by February 3, 1998.

Office of Inspector General Reply. The response acknowledged that the files at the Department of Education would have to be researched to locate certain documents, including progress reports and architectural sketches and/or plans for projects supervised by the Hurricane Recovery Managers, so that the documents can be made available. We believe that this statement supports that such documents were not available at the time of the audit (March through August 1997). During the review, our auditors attempted to locate pertinent contract management documents in the files located at the Departments of Property and Procurement, Education, and Public Works, including files of the Hurricane Recovery Managers that were in the custody of the Department of Education. However, as of March 12, 1998, we had not received any of the subject documents from the Department of Education.

Governor of the Virgin Islands Response. The response stated that the Department of Education did not agree that contractors were paid $918,490 during the period of October to December 1995, "although inspections were not performed and invoices and periodic

estimates were not approved by the Government officials responsible for certifying that the work was accomplished." The response stated that inspections of the work performed were "executed" and that invoices and periodic estimates were approved by the Government officials "responsible for certifying that the work was accomplished satisfactorily" but that the Department of Property and Procurement did not submit copies of the approved documents for the files at the Departments of Education and Public Works.

Office of Inspector General Reply. We previously noted that inspection reports and approved invoices and periodic estimates for progress payments were not found in the contract files at the Departments of Education and Public Works or in the official files at the Department of Property and Procurement. As of March 12, 1998, we had not received any of the subject documents from the Department of Education.

Governor of the Virgin Islands Response. The response stated that the Department of Education did not agree with the "Building Code and Permits" section in Finding B because, although "work performed under Phase I reconstruction/repairs [was] performed without building permits," all work under Phase II "was done in full compliance with the 1994 Uniform Building Code; the required drawings and specifications were prepared . . . and the necessary Building Permits received." The response also stated that the auditors did not find these documents in the files at the Departments of Education and Property and Procurement because "the Project Manager had not turned these files over to the Department of Education." The response further stated that "all work performed under the Phase I reconstruction/repairs, which was not in compliance with the 1994 Uniform Building Code, was corrected by subsequent work performed in full compliance with the . . . Code."

Office of Inspector General Reply. Key documents relating to compliance with the building permit and building code requirements were not made available during the audit. We reviewed the official contract files at the Department of Property and Procurement, additional contract files at the Departments of Education and Public Works, and files of the Hurricane Recovery Managers that were in the custody of the Department of Education. With respect to all of the files reviewed, there were instances in which we could not locate documents to show that building permit and building code requirements were met. As of March 1998, we had not received any of the subject documents from the Department of Education. In addition, the response acknowledges that "work performed under Phase I reconstruction/ repairs [was] performed without building permits." Further, during a separate audit of building permit fees of the Department of Planning and Natural Resources (Report No. 98-I-191, dated December 1997), we also reviewed building permit files pertaining to hurricane-related repairs to Government buildings (including public schools). As stated in the report, the Permits Manager of the Department of Planning and Natural Resources "told us that 'most' of the 67 building permits issued to Government of the Virgin Islands agencies for reconstruction and repair work after Hurricane Marilyn were based on 'as built' plans, meaning that the architectural plans were prepared and approved after-the-fact."

CLASSIFICATION OF MONETARY AMOUNTS

Finding	Questioned Costs
B. Contract Oversight	
Documentation of Oversight Activities	$5,418*

* Amount represents local funds

THE UNITED STATES VIRGIN ISLANDS
OFFICE OF THE GOVERNOR
GOVERNMENT HOUSE
Charlotte Amalie, V.I. 00802
809-774-0001

January 29, 1998

Honorable Wilma A. Lewis
Inspector General
U.S. Department of the Interior
Office of the Inspector General
Washington, D.C. 20240

Subject: **Draft Audit Report on Hurricane Related Contracting, Department of Education, Government of the Virgin Islands, V-IN-VIS-002-97**

Dear Inspector General Lewis:

This is to acknowledge receipt of your Draft Audit Report on Hurricane Related Contracting, Department of Education, Government of the Virgin Islands, V-IN-VIS-002-97.

The Following is our official response to the above-referenced Draft Audit Report which was prepared by our Audit Response Task Force in the Department of Education.

BACKGROUND

On September 15, 1995, Hurricane Marilyn struck the United States Virgin Islands, causing extensive damage to public and private facilities. As a result, the President of the Unites States issued a major disaster declaration, which allowed the Federal Emergency Management Agency, (FEMA) to provide disaster assistance funds in accordance with the Stafford Disaster relief and Emergency Assistance act, as amended (Public Law 100-707). FEMA provided the Government of the Virgin Islands with $22.7

million in disaster assistance funds for school repairs, consisting of $15 million for the acquisition of modular classrooms to be used at certain public school, and $5.7 million for an overall project management contract with the Hurricane Recovery managers. In addition, the Department of Education received a total of $27.7 million from insurance proceeds and $6 million from local bond proceeds for the repair and reconstruction of public schools. During the fiscal years 1996 and 1997, the Government awarded 41 construction contracts and 44 professional services contracts, totaling about $51.4 million, that related to the repair and reconstruction of the schools.

"The Department of Education concurs with this finding."

In September 1995, immediately after Hurricane Marilyn struck, the Government conducted a survey of the public school facilities to determine the extent of the damage. An official from the Department of Public Works was assigned as a Special Projects Coordinator, with the responsibility to hire contractors to perform emergency debris removal and repair work at the schools.

"The Department of Education concurs with this finding."

In December 1995, the Government hired a joint venture of two off-island architectural/engineering firms (commonly referred to as the Hurricane Recovery Managers) to act as its overall project manager for all hurricane-related construction, including repairs to public schools. According to their contract, the Hurricane Recovery Managers were responsible for preparing solicitation packages for architectural/engineering and construction services, soliciting and evaluating proposals from contractors, supervising construction work, maintaining financial oversight control of FEMA and other funds available for construction work, preparing construction progress reports, and coordinating with vendors for the purchase and delivery of materials. The contract was in the amount of $5.7 million plus a maximum of $748,000 in additional fees. However, in June 1996, the Government and the Hurricane Recovery Managers mutually agreed to terminate the contract, primarily because of disagreements concerning the quality and speed of work performed by contractors at some public schools.

"The Department of Education concurs with this finding."

In August 1996, the Government awarded a $1.9 million contract, effective retroactively to late June 1996, to a local architectural/engineering firm to act as the Government's project manager for Department of Education construction projects. According to the contract, the project manager's responsibilities included providing detailed architectural drawings for repair work, preparing cost estimates monitoring construction work through frequent on-site visits, ensuring that construction work was in accordance with the building codes, preparing and submitting to the Government any necessary construction contract change orders, and reviewing and recommending approval of contractor requests for progress payments. The contract remained in effect, with three extensions through July 31, 1997.

"The Department of Education concurs with this finding."

OBJECTIVE AND SCOPE

The objective of the audit was to determine whether: (1) construction contracts were awarded in accordance with applicable laws and regulations; (2) controls existed to ensure that construction work was performed in accordance with building codes and other requirements; and (3) payment to contractors were reasonable, allowable, and allocable in accordance with contract provisions. The scope of the audit included contracts for hurricane-related construction and professional services awarded by or for the Department of Education during fiscal years 1996 and 1997. We selected for review a judgement sample of 18 (out of 44) professional services contracts and 30 (out of 41) construction contracts, totaling over $49.8 million, that were awarded by the Department of Education, **"The Department of Education states a non-concurrence with this finding." The preceding statement indicates the Department of Education awarded construction contracts, all contracts were awarded by the Department of Property and Procurement and the Hurricane Recovery Managers"** *the Department of Property and Procurement, or the Hurricane Recovery Managers. The audit was performed at the Departments of Property and Procurement, Education and Public Works. We also made site visits to 30 public schools to observe the construction work.*

"The Department of Education concurs with the contents of the latter part of the preceding paragraph."

Our review was made, as applicable, in accordance with the "Government Auditing Standards," Issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances.

As part of our review, we evaluated the Government's system of internal controls related to the award and oversight of construction contracts and the accountability of funds for the hurricane-related contracts. The internal control weaknesses we identified in these areas are addressed in the Findings and recommendations section of this report. Our recommendations, if implemented, should improve the internal controls in these areas.

PRIOR AUDIT COVERAGE

The Office of Inspector General has issued two reports during the past 5 years regarding

hurricane-related construction for public schools in the Virgin Islands. The survey report "Procurement Practices for Hurricane-Related Repairs to Public Schools, Government of the Virgin Islands: (No. 96-E-1113), dated August 1996, concluded that the operating officials at the Departments of Education and Public Works did not always comply with the procurement requirements and there was no assurance that the Government received the most favorable prices, terms and conditions with regard to emergency debris removal and repair services acquired at a total cost of more than $1.5 million for public schools. We recommended that the Governor of the Virgin Islands direct all Executive Branch agencies to: (1) submit hurricane-related work requirements to the Department of Property and Procurement and **"Hurricane-related work requirements will retroactively be submitted to the Department of Property and Procurement by March 15, 1998;** *(2) ensure that the procurement process includes the use of competitive proposals to the maximum extent practicable, the issuance of formal contracts before work was started, and the maintenance of complete files documenting the procurement actions taken with regard to each contract.*

"The Department of Education concurs with the contents of the latter part of the preceding paragraph."

The audit report "Construction Contracts, Capital Improvement Program, Government of the Virgin Islands" (No. 94-I-1194), dated September 1994, included a review of contracts awarded to repair damage to schools caused by Hurricane Hugo in September 1989. With regard to procurement practices, the report concluded that: (1) the Department of Property and Procurement did not adequately document actions taken to procure construction services and did not ensure the competitive procedures were used to the maximum extent practicable and (2) the Government and the Program Management Consultant did not provide adequate oversight of construction projects. As a result, 7 contracts, totaling $4.5 million, were not awarded to the lowest proposers; and 14 contracts, totaling $18 million, did not have sufficient information in the contract files to determine whether competitive procurement procedures had been used. Additionally, "the report questioned construction costs of about $8 million charged against a grant from the U.S. Department of Education" and "$2.7 million paid to the Project Management Consultant." With regard to contracts for repairs to public schools, we recommended that the Governor of the Virgin Islands ensure that: (1) the Department of Property and Procurement adheres to the competitive procurement requirements of the Virgin Islands Code and Virgin Islands Rules and Regulations, establishes formal policies and procedures regarding the contents of construction contract files, and enforces existing policies and procedures with regard to the issuance of change orders and supplemental contracts: (2) inspectors from the Department of Public Works or other inspectors authorized by the Department conduct regular inspections at each construction site and file appropriate inspection reports **"The Department of Education**

concurs with the contents of the preceding paragraph."; *and (3) the Department of Education provides the U.S. Department of Education with supporting documentation for the $8 million in questioned construction costs and the $2.7 million in questioned payments to the Project Management Consultant so that the funding agency could make a determination as to the allowability of those costs.* **"The Department of Education concurs with item (3) and will provide the requested supporting documentation by April 15, 1998; the official responsible for the implementation of this task is the Honorable Liston A. Davis Commissioner, Department of Education."**

Our current review disclosed procurement and contract oversight deficiencies similar to those identified in the two prior reports.

FINDINGS AND RECOMMENDATIONS

A. CONTRACT AWARD

The Government did not maintain sufficient oversight of the procurement process to ensure that contracts related to repairs to public schools damaged by Hurricane Marilyn were awarded in an effective manner. Specifically, the Department of Public Works on behalf of the Department of Education, allowed construction contractors on St. Thomas to perform work without competition or formal contracts and issued "after-the-fact" purchase orders for services for the Department of Education, **"The Department of Education concurs with this finding." However be reminded accordingly, (1) following the devastating effects of Hurricane Marilyn it was necessary to effect repairs/construction work on an immediate basis to facilitate the expeditious reopening of the schools. The Department of Public Works in conjunction with the Department of Education had their focus set on early commencement and completion of reconstruction/repairs of the schools and in consequence bypassed the Department of Property and Procurement. Although the Department of Property and Procurement is charged with the procurement of services, their time consuming methods would have placed the school reopening program in jeopardy; and (2) the encumbering of contractual funds and preparation of contractual documents is another necessary but time consuming exercise which would have further delayed the repairs/reconstruction process ."** *and the Hurricane Recovery Managers*

used procurement procedures that did not provide the required level of competition. In addition, procurement files did not adequately document whether competitive procedures were used. The Virgin Islands Code and the Virgin Islands Rules and Regulations contain the requirements for competitive procurement. However, the Government did not provide adequate oversight of the procurement process in that the Department of Property and Procurement, which has overall responsibility for Government procurement, was excluded for the most part from the process and the procurement procedures did not allow for the active involvement of third parties, such as the Department of Education and Public Works and the Hurricane recovery Managers. As a result, the Government had little assurance that it receive the most favorable prices, terms, and conditions with regards to construction and other contractual services acquired at a total cost of more than $21.5 million and for "after-the-fact" purchase orders totaling $164,000.00 **"The Department of Education concurs with this findings of the preceding paragraph."**

Procurement Requirements

Title 31, Section 239, of the Virgin islands Code provides that purchases may be made without the use of formal advertisement and competitive bidding when, among other exceptions, the "Governor declares in the public interest that a State of Emergency exists and specifies in such Proclamation this purchases and/or services which may be obtained without competitive bidding," The emergency proclamation that the Governor issued after Hurricane Marilyn allowed Government agencies to procure goods and services without formal advertising. **"The Department of Education concurs with this finding."** *However, the proclamation required that responsible agencies "negotiate on a competitive basis" and "make every reasonable effort to obtain the most favorable prices, terms, and conditions for the Government.* **"The Department of Education states a concurrence with this finding."**

Title 31, Section 234, of the Virgin Islands Code, which was not waived by the Governor's emergency proclamation, states that "no purchase shall be made by any department or agency of the government or by any employee of the government for any agency of the government except by written order approved by the Commissioner of Property and Procurement." The penalties for violation of the requirements include personal liability for the purchase price, a fine of not more than $200, and/or dismissal from employment. **"The Department of Education concurs with this finding."**

Procurement Methods Used

Although Title 31, Section 234, of the Virgin Islands Code designated the Commissioner of Property and Procurement as the procuring official for the Government of the Virgin Islands, the Department of Education and the Hurricane Recover Managers executed their own procurement for emergency debris removal and repair work at the public school facilities; Of the 30 construction contracts we selected for review, we found that 20 contracts, totaling $18.7 million, were awarded noncompetitively and without the involvement of the Department of Property and Procurement. **"The Department of Education concurs with this finding."**

Special Project Coordinator: *After Hurricane Marilyn struck the Virgin islands on September 15, 1995, the Department of Education used a Special Project Coordinator from the Department of Public Works to supervise and coordinate the repairs to the public schools on St. Thomas and St. John. This occurred without coordination with the Department of Property and Procurement, and, as a result, the Department of Education allowed the Special Project Coordinator to hire construction contractors noncompetitively. The Department of Education also did not execute formal contracts with the contractors before work commenced, as required by the Virgin Islands Code, to specify the detailed scope of work, method of payment, procedures for inspection of work, resolution of disputes, and other standard contract provisions to protect the interests of both the Government and the contractors.* **"The Department of Education concurs with this finding."**

After the hurricane, the Coordinator, through a public radio announcement, requested that contractors which had performed work on the schools during the summer restoration program provide emergency debris removal and repair services at the public schools damaged by Hurricane Marilyn. The Coordinator requested that the contractors submit a statement of general scope of work before they were assigned to perform work on the same structures they had worked during the summer. However, we found 3 contracts, out of 30 awarded with the assistance of the Coordinator, that were prepared and executed after the contractors had started repairs. For example:

- *On December 7, 1995, a construction contract for $1.2 million was awarded to a contractor for repairs to a St. Thomas elementary school* **Namely Edith Williams Elementary School."**. *A contractor invoice for $347,670 showed that construction work had begun on October 1, 1995. The Department of Property and Procurement was not involved in awarding this contract, which was executed after work had started.* **"The Department of Education concurs with this finding."**

On December 7, 1995, a construction contract for $850,000 was awarded for repairs to another St. Thomas ,elementary school. A contractor invoice for $140,546 showed that construction work had begun before October 15, 1995 **"Namely Joseph Sibilly Elementary School."**. *Additionally , there was no abstract of bids or a bid evaluation report in the contract files to indicate whether more than one contractor was given the opportunity to submit a proposal for this contract. An October 27, 1995, transmittal memorandum from the Department of Education's Director of Business Affairs to the then-Commissioner of Education stated that a contract was not in place at the time that work began, inspection reports had not been prepared to verify that the job was satisfactorily completed, and approvals for payment had not been obtained from all of the appropriate Government official. Nevertheless, a miscellaneous disbursement voucher for $87,869 was processed, and the contractor paid.*

In an October 23, 1995, letter to the Governor, the Commissioner of Property and Procurement stated:

> *Contrary to the provisions of title 31 V.I.C. [Virgin Islands Code] Section 239, the procurement regulations for open market purchases, the Department of Property and Procurement was kept completely out of the process [by the Department of Education]. As a result we cannot protect the governor's interest relative to costs, terms, completion dates, and assessments on those contracts;* **"The Department of Education concurs with this finding."**

In an internal memorandum dated October 30, 1996, an employee of the Department of Property and Procurement reported to the Commissioner that there were significant variances in the estimated costs for emergency construction work performed by the contractors on 10 Department of education projects. While the contractors submitted invoices totaling $6.8 million for emergency repairs performed at Department of Education facilities, architect/engineers representing the government estimated that the work performed by the contractors was valued at $2.3 million, for an overall variance of $4.5 million. As of October 1997, these variances had not been resolved. **"The Department of Education does not concur with this finding." A review of some of the documents of contention, namely Addelita Cancryn Junior High School and the Ralph O. Wheatley Skill Center, it was very obvious that in some instances the architect/engineer's unit prices were below normal Virgin islands prices, for construction, during normal circumstances. This even made some of the unit prices even more unreal since the work was done**

during a time of great emergency when material were being sold at a premium due to its scarcity and labor costs were high due to the scarcity of manpower. However in other cases such as Joseph Gomez and Evelyn Marcelli Elementary Schools, there was justification for questioning some of the prices submitted by contractors and the quantities of work which they claimed to have completed.

We also found that, although Title 31, Section 234, of the Virgin Islands Code requires that purchases be made by written orders, the Department of Public Works procured services for the Department of Education without purchase orders. Specifically, we found that nine purchase orders, totaling $164,000, were prepared after the work was completed. The Department of Public Works sent contractors' invoices to the Department of Education, which prepared and submitted purchase orders to the Department of Property and Procurement for approval. We believe that the submission of the purchase orders to the Department of Property and procurement was an "after-the -fact" process that was contrary to the requirements of title 33, section 234, of the Virgin Islands Code. **" The Department of Education concurs with your findings, however in the interest of expeditious reconstruction/repairs, the Department of Public Works was of great assistance since they were able to acquire the services of contractors, who also supplied materials during a period when labor and materials were a scarcity.**

Hurricane Recovery Managers: *In December 1995, the Government of the Virgin Islands hired the Hurricane Recovery Managers, at a cost of $6.5 million, to serve as overall project managers for all hurricane-related construction projects. As a result the Department of Property and Procurement was excluded, except for approving contractors recommended by the firm, because the firm acted independently in soliciting, evaluating and negotiating with contractors for architectural, engineering and construction services for structural repairs to be performed at public schools damaged by Hurricane Marilyn.* **"The Department of Education does not concur with this finding." The Hurricane Recovery Managers did not operate independently of the Government; they worked in concert with the (GAR) and the Department of Property and Procurement.**

Under procedures established by the Hurricane Recovery Manages, contractors were solicited through the local media, direct mailings and personal contacts after a Department of Education official prioritized the schools requiring repair work. The responding contractors filled out qualification statements which were submitted to the Hurricane Recovery Managers, who screened the contractors based on data in these statements and prepared a list of qualified contractors. A selection board composed of representatives of the Hurricane Recovery Managers interviewed the contractors, asking questions regarding their ability to perform the work required. Based on the information in the qualification statements and the responses to the selection boards's questions, the Hurricane Recovery Managers recommended contractors to the Commissioner of Property and Procurement for final approval before the Hurricane Recovery Managers negotiated contracts with the selected contractors. The Hurricane Recovery Managers used construction master agreements as the basic contracts and assigned and controlled specific projects through task orders to the contractors. The task orders contained a description of the services required, drawings and specifications as applicable, the time frame for performance, the agreed-upon price, and the terms of payment. **"The Department of Education concur with this finding."**

However, the proposal, selection, and awarding procedures established by the Hurricane Recovery Managers differed from the Government's standard procurement process because they did not: (1) include the Department of Property and Procurement as an integral part of the process; **"The Department of Education does not concur with this finding."** *(2) require the solicitation of competitive proposals for each contract to be awarded;* **"The Department of Education concurs with this finding."** *(3) include Governmental representatives on the contractor selection committee* **"The Department of Education concurs with this finding.".** *Additionally, the Government did not have a system to monitor the Hurricane Recovery Managers' activities and to maintain adequate control over the construction contracts awarded by the Hurricane Recover Managers;* **"The Department of Education does not concur with this finding." The Department of Education worked closely with the Hurricane Recovery Managers; attended weekly staff meetings; received reports; manpower and construction schedules; and maintained oversight of their activities."** *As a result, there was no opportunity for competition among the contractors in the pool to ensure that the Government received the most favorable prices for repair work at the public schools, and there was little assurance that the Hurricane Recovery Managers and construction contractors performed in accordance with their contracts.* **"The Department of Education does not concur with this finding." The unit prices which the Hurricane**

Recovery Managers mandated for repair work at the public schools were acceptable and in the best interest of the Government; and construction contractors performed in accordance with their contracts."

Project Manager: *On August 29, 1996, the Government, after mutually agreeing with the HurricaneRrecovery Managers to terminate their contract, awarded a $1.9 million professional services contract noncompetitively to a former employee of the Department of Education to oversee completion of repair and reconstruction work at the public schools;* **"The Department of Education concurs with this finding."** *The contract was effective retroactively to June 24, 1996. The contractor told us that the then-Commissioner of Education offered him the contract. As such, this contract was awarded without adherence to the competitive procurement requirements of Title 31; Chapter 23, of the Virgin Islands Code.* **The Department of Education concurs with this finding."**

We believe there was little assurance that the Government of the Virgin Islands received the most favorable prices, terms, and conditions for construction and other contractual services acquired at a cost of more than $21.5 million and for "after-the-fact" purchase orders totaling $164,000 because the Special Project Coordinator completely bypassed the Department of Property and Procurement, did not solicit competitive proposals, and did not issue written contracts or purchase orders; the Hurricane recovery managers used procurement procedures that differed from the Government standard procurement process, and the project manager was not selected competitively. **"The Department of Education does not concur with the findings of the preceding paragraph." The Government of the Virgin Islands received the most favorable prices, terms, and conditions for construction and other contractual services acquired at a cost of more than $21.5 million and for "after-the-fact" purchase orders totaling $164,000; it is true that the Special Project Coordinator completely bypassed the Department of Property and Procurement, did not solicit competitive proposals, and did not issue written contracts or purchase orders; nonetheless predicated upon the emergency condition which prevailed, the Special Projects Coordinator acted in good faith on behalf of the Government. It is true that the Hurricane recovery Managers used procurement procedures that differed from the Government standard procurement process, however the Hurricane Recovery Managers**

operated in concert with the GAR and the Department of Property and Procurement. The Commissioner of Education agrees that the Project Manager was not selected competitively; but time was of the essence and predicated upon the knowledge and experience of the Project Manager (an architect and ex-employee of the Department of Education) it was in the best interest of the Government to utilize this Project Manager as he possessed a thorough understanding of all the facets of contracting; payment requests; inspections and in general project oversight.

Contract Files

The official contract files maintained by the Department of Property and Procurement were not complete and did not contain sufficient documentation of procurement actions taken for the construction and professional services contracts reviewed; **"The Department of Education concurs with the finding. of the preceding paragraph"** *Based on our review of the 48 contract files selected, we determined that all of the files were missing at least one key document. For example, 23 files did not contain invitations for bids or requests for proposals, 29 files did not contain copies of the original plans and specifications, 30 files did not contain bonding information, 21 files did not contain copies of the contractor's business licenses, 37 files did not contain abstract of bids, 32 files did not contain evaluation committee reports, 17 files did not contain notices to proceed, and 29 files did not contain building permits. Additionally, the files for 18 contracts, totaling $12.6 million, of the 30 construction contracts we reviewed did not contain sufficient documentation for us to determine whether competitive procurement procedures had been used;* **"The Department of Education concurs with the findings of the preceding paragraph."** *Because the Department of Education;* **"the GAR"** *and the Hurricane Recovery Managers procured services in accordance with their own procedures, there was little assurance that documents were forwarded to the Department of Property and Procurement for the official contract files. Without complete contract files, the government may not be able to defend its position in the event of (1) claims by unsuccessful contractors that they should have been awarded the contracts (2) disputes between the Government and successful contractors over the terms, conditions, or price of the contracts.* **"The Department of Education concurs with this finding."**

At the November 25, 1997 exit meeting on the preliminary draft report, the Commissioner of Education stated that in the immediate aftermath of the hurricane, there was "confusion" among

Government agencies as to the accepted procurement practices to be followed under the Governor's emergency proclamation but that later procurement actions were made using procedures which were more in compliance with the legal requirements. The Commissioner also stated that his department had developed contingency plans for procuring emergency debris removal and school repair services should another hurricane strike the Virgin Islands. **The Department of Education concurs with the contents of the preceding paragraph"**

Recommendations

We recommend that the Governor of the Virgin islands:

1. Ensure that the Department of Property and Procurement carries out its procurement responsibilities in accordance with Title 31, Chapter 23 of the Virgin Islands Code and the Virgin islands Rules and regulations, including the use of competitive procedures to the maximum extent practicable and the issuance of formal contracts before work begins.

2. Enforce Title 31, Section 234 of the Virgin islands Code, which requires that purchases be by written orders approved by the Department of Property and Procurement.

3. Ensure that the Department of Property and Procurement maintain contract files which adequately documents the procurement process. Specifically, the contract files should contain, as appropriate, the invitation for bids or request for proposals; all bids or proposals received, including contractor qualification statements, evidence of bonding or surety, copies of business licenses, and other documents that are required as part of a complete bid package; bid abstract sheets of individual committee members and the final bid evaluation committee report; executed contracts and any subsequent amendments, supplements, or change orders; notices of award and notices to proceed; correspondence related to the contracts; progress payment requests and other documents related to payments to contractors; and documents related to actions taken with regards to any deficiencies noted, including the assessment of liquidated damages.

I have directed the Commissioner of Property and Procurement to meet all of the requirements of the three above recommendations and to report to me the status of his actions within thirty days.

2 CONTRACTOVERSIGHT

The Government did not maintain sufficient oversight of construction projects to ensure that repairs to public schools damaged by Hurricane Marilyn were performed in accordance with existing requirements. Specifically, Contractors' requests for periodic payment were not always approved **"The Department of Education does not concur with this finding." All requests for periodic payments were always approved by the respective Governmental Agencies; however, the final approval signatures were that of the Department of Property and Procurement. It is their responsibility to ensure that the other Governmental Approval Agencies received duly approved copies of all requests for payments for their files; this was not done and in consequence the files at the Department of Education and the Department of Public Works did not reflect all approval signatures. I will mandate that the Department of Property and Procurement ensure that all approval agencies be provided with copies of all payment requests documentation in the future.",** *inspection and progress reports were not always sufficiently detailed to support contractors' payment requests;* **"The Department of Education concurs with this finding."** *and building permits wee not always obtained;* **"The Department of Education does not concur with this finding." Following the aftermath of Hurricane Marilyn, immediate reconstruction/repairs was performed and identified as <u>Phase I Reconstruction/Repairs; building;</u> work performed under the Phase I banner were performed without building permits. Under the Phase II banner permanent reconstruction/repairs were performed ; all such work was done in full compliance with the 1994 Uniform Building Code; the required drawings and specifications were prepared, submitted to the Department of Planning and Natural Resources and the necessary Building Permits received. When the auditors reviewed the files at the Department of Education and the Department of Property and Procurement their findings indicated the absence of these documents; this was because the Project Manager had not turned these files over to the Department of Education. At present however, said documentation is at the Department of Education who will be transmitting copies of said**

documentation to the Department of Property and Procurement for their files by February 27, 1998." *The Virgin Islands Code requires the Department of Public Works to supervise the construction and repair of Government buildings and specifies the conditions for obtaining building permits. However, the Government did not provide the required oversight of construction projects in that it allowed project management contractors rather than the Department of Public Works to supervise the construction and repair of public schools and did not have procedures for monitoring the activities of the project management contractors. As a result, there was little assurance that construction and professional services contractors who received over 421 million for work on public schools performed the work in accordance with their contracts or that the work performed on the schools was in compliance with building code requirements, thus creating the potential for safety deficiencies in the public schools. We also found that two contractors were overpaid a total of $12,363.* **"The Department of Education does not concur with this finding." The requirements set forth in The Virgin Islands Code wa s adhered to by the Department of Public Works who supervised the construction and repair of Government buildings under the Phase II reconstruction/repairs, for which all building permits were obtained. The Government did provide the required oversight of construction projects; the project Manager representing the Department of Education was authorized to provide project oversight in conjunction with the Department of Public Works on the construction and repair of public schools. The Department of Education closely monitored the activities of its project management contractors. As a result, there was assurance that construction and professional services contractors who received over 421 million for work on public schools performed the work in accordance with their contracts and that all work performed on the schools under the Phase II reconstruction/repairs was in compliance with building code requirements, thus eliminating the potential for safety deficiencies in the public schools."** *We also found that two contractors were overpaid a total of $12,363;* **"The Department of Education does not concur with this finding." The findings states that two (2) contractors were overpaid a total of $12,363.90, which consisted of payments to the project manager, Caribbean Professional Consultants, and Custom**

Builders. With reference to Caribbean Professional Consultants, this finding has been forwarded to the Department of Public Works for a response. Attached, please find copy of memorandum dated January 23, 1998 to the Commissioner of Public Works from the Commissioner of Education transmitting a copy of the draft report to be reviewed, investigated and responded to by that agency by February 4, 1998.

Custom Builders was awarded contract No. CC-35-DE-T-96 dated July 27, 1996 in the amount of $109,355.83 to repair Alexander Henderson Elementary School on St. Croix. Subsequently, Change Order No. 1 dated November 19, 1996 and approved by the Commissioner of Education on 2/10/97 increasing this contract by the amount of $19,900.74, thus, changing the total amount of this contract to $129,256.57, charged to account code: 3132-25620-000-PPE-TO3106.

Documentation of Oversight Activities

Title 3, Section 138, of the Virgin Islands Code requires the Department of Public Works to supervise the construction and repair of all government buildings. However, during the period of October to December 1995, which was the period of time prior to the contract with the Hurricane Recovery Managers, the Government did not maintain documentation showing whether the construction projects were inspected by the Department of Public Works; **"The Department of Education does not concur with this finding."** *Additionally, during the period of December 1995 to June 1996, the Government had the Hurricane Recovery Managers carry out the Government's contract oversight responsibilities;* **"The Department of Education does not concur with this finding." The Hurricane Recovery Managers worked in concert with the Department of Education"** *Specifically, the Hurricane Recovery Managers were required to: (1) review architectural designs and plans prepared by contracted architects/engineers; (2) monitor design and construction activities; and (3) provide the Government with construction progress reports. However, we found no "progress reports" in the contract files to support progress payment requests submitted by the contractors for 27 of the 30 construction contracts reviewed;* **"The Department of Education does not concur with this finding." The Department of Education, Division of Engineering, will be**

directed to research their files to discover copies of all "progress reports" which will support progress payment requests submitted by the contractors for 27 of the 30 construction contracts reviewed, February 27, 1998.

Additionally, in a February 20, 1996, memorandum to the Commissioner of Property and Procurement, the Hurricane Recovery Managers indicated that their contractor selection process was focused on identifying qualified architectural/engineering firms for four schools. However, during our review of the Hurricane Recovery Managers' files located at the Department of Education, we found no architectural sketches or plans for the work performed at the schools; **"The Department of Education does not concur with this finding." The four schools in question were (1) Bertha C. Boschulte Junior High School; (2) Lockhart Elementary School; (3) Peace Corps Elementary School and (4) Joseph Sibilly Elementary School; However, the Hurricane Recovery Managers' files located at the Department of Education, will be researched to discover architectural sketches and/or plans for the work performed at the schools in question. Documentation was submitted to the Department of Education showing how the Hurricane Recovery Managers monitored and reviewed the work of contractors, there was assurance that the construction firms fulfilled their contractual obligations. There is also documentation in the files to show that the Government monitored the activities of the Hurricane Recovery Managers to ensure that they carried out their contractual obligations as the Government's overall project management consultant, said files will be made available by February 13, 1998."**

The project manager hired in June 1996 to replace the Hurricane Recovery Managers conducted joint inspections with an inspector from the Department of Public Works of construction work performed at the public schools; **"The Department of Education does not concur with this finding."** *But the project manager's invoices did not provide sufficient details to support the quantity or quality of work he performed;* **The Department of Education concurs with this finding."** *For example, the project manager's first invoice, dated August 19, 1996, billed the Government $222,528 for services rendered during the period of June 23 to August 17, 1996. However, the supporting documentation attached to the invoice indicated that only $214,179 was owed for 3,355 hours of staff time and $2,931 was owed for mileage on the firm's*

vehicles. Therefore, the project manager was overpaid $5,418; **The Department of Education concurs with this finding;" and will correct this overpayment.** *Additionally, the invoice did not indicate which schools were visited or the type of services provided at each school.* **The Department of Education conccurs with this finding."" and will provide modified invoices which will indicate schools and the type of services provided respectively."**

During May and June 1997, we made on-site visits to 30 public schools (12 on St. Thomas and 18 on St. Croix) that had been repaired or renovated after Hurricane Marilyn and found that construction contractors did not satisfactorily complete all of the work required by their contracts as follows:

The roof of ,the gymnasium at the Ivanna Eudora Kean High School on St. Thomas leaked, and, as a result, the floors of the gymnasium's main entrance, teachers' offices, and boys' restroom flooded after heavy rains. The contract required the contractor to remove and replace 8,000 square feet of seam roofing and temporary roofing, for which the contractor was paid $263,000. The contract for all work to be performed at the High School was for an amount not to exceed $1,488,941.; **"The Department of Education concurs with this finding." with your findings, however corrective actions has been taken and repairs to the roof of the gymnasium at the Ivanna Eudora Kean High School is now complete.**

At the Joseph Sibilly Elementary School on St. Thomas, the contractor was required to perform repair and reconstruction work that included renovating the art building. However, no work had been done on the art building since Hurricane Marilyn, and the contractor was paid $481,000. The contract for all work to be performed at the School was in the amount of $850,000. **"The Department of Education concurs with this finding." Corrective actions has been taken. The original contractor for the Joseph Sibilly Elementary School was dismissed and a new contractor is presently completing the necessary repairs.**

At the Arthur Richards Junior High School on St. Croix, repairs had not been made to the roof guttering; windows in classrooms; and ceiling tiles in the girls' restroom, auditorium, and kitchen. The contractor was required to perform the cited repairs on the entire school and had been paid a total of $551,000. The contract for all work to be performed at the Junior High School was in the

amount of $618,427. **"The Department of Education concurs with this finding." However, corrective actions has been taken. Repairs to the Arthur Richards Junior High School is presently in progress."**

At the Alexander Henderson Elementary School on St. Croix, the classroom roof leaked and ceiling tiles in the mens' restroom still needed to be replaced. The contractor was paid $116,300 to make these repairs. The contract for all work to be performed at the School was in the amount was in the amount of $109,355, indicating that the contractor was overpaid by $6,945. **"The Department of Education concurs with this finding." However, corrective actions has been taken and repairs to the the Alexander Henderson Elementary School on St. Croix is presently in progress. Be advised however, that the repairs presently in progress are as specified in the contractors scope of work. Additional repairs will be required to the school in question, and as such a new scope of work will be formulated and a contract put in place for the execution of such work.**

At the November 25, 1997, exit meeting on the preliminary draft report, the Commissioner of Education stated that corrective actions had been taken on some of the construction deficiencies noted. Specifically, he stated that: (1) repairs to the roof of the gymnasium at the Ivanna Eudora Kean High School was completed; (2) the original contractor for the Joseph Sibilly Elementary School was dismissed and a new contractor was completing the necessary repairs; and (3) repairs at the Arthur Richards Junior High School and the Alexander Henderson Elementary School on St. Croix were in process. The Commissioner also stated that the ongoing repair work was periodically inspected by representatives of the Department of Education and the Department of Planning and Natural Resources (the agency responsible for building code enforcement).

Payment Process. *During the period of October to December 1995, contractors were paid $918,490, although inspections were not performed and invoices and periodical estimates were not approved by the Governmental officials responsible for certifying that the work was accomplished satisfactorily;* **The Department of Education does not concur with this finding;"During the period of October to December 1995, contractors were paid $918,490, inspections of the work performed was executed and invoices and periodical estimates approved by the Governmental officials responsible for certifying that the work was accomplished satisfactorily"**; *For Example, in October 1995, a payment of $87,868 was made to a contractor* **(Namely, Morgan**

Construction) *by means of a miscellaneous disbursement voucher. A memorandum from the Department of Education's Director of Business Affairs to the then-Commissioner of Education that was attached to the voucher stated that there were no: (1) contracts in place for the construction work; (2) inspection reports to verifying that work was completed satisfactorily; or (3) approvals by the authorized Government representatives to certify the work for payment. However, the voucher was certified for payment by the then-Commissioner of Education, and a check was issued to the contractor on October 27, 1995;* **"The Department of Education concurs with this finding."**

The Hurricane Recovery Managers and the subsequent project manager submitted contractors' invoices and periodic payment requests, along with their recommendations for approval of payment, to the Department of Education. The Department then prepared the payment vouchers and submitted the invoices, periodic payment requests, and vouchers to the Department of Property and Procurement for processing. The invoices and periodic payment requests were to be signed by authorized representatives of the Departments of Property and Procurement, Public Works, and Education certifying that the work was satisfactorily completed. However, in the 48 construction and professional services contract files that we reviewed, we found 65 payment (out of 154) totaling over $21 million, that were made without all of the required approvals by the Governmental representatives. **"The Department of Education does not concur with this finding." All requests for periodic payments were always approved by the respective Governmental Agencies; however, the final approval signatures were that of the Department of Property and Procurement. It is their responsibility to ensure that the other Governmental Approval Agencies received duly approved copies of all requests for payments for their files; this was not done and in consequence the files at the Department of Education and the Department of Public Works did not reflect all approval signatures. I will mandate that the Department of Property and Procurement ensure that all approval agencies be provided with copies of all payment requests documentation in the future."**, *inspection and progress reports were not always sufficiently detailed to support contractors' payment requests;* **"The Department of Education does not concur with this finding." Following the aftermath of Hurricane Marilyn, immediate reconstruction/repairs was performed and identified as <u>Phase I Reconstruction/Repairs; building;</u> work performed under the Phase I banner were performed without building permits. Under the Phase II banner**

permanent reconstruction/repairs were performed ; all such work was done in full compliance with the 1994 Uniform Building Code; the required drawings and specifications were prepared, submitted to the Department of Planning and Natural Resources and the necessary Building Permits received. When the auditors reviewed the files at the Department of Education and the Department of Property and Procurement their findings indicated the absence of these documents; this was because the Project Manager had not turned these files over to the Department of Education. At present however, said documentation is at the Department of Education who will be transmitting copies of said documentation to the Department of Property and Procurement for their files by February 13, 1998."

In addition, the invoices of the Hurricane Recovery Managers were not properly reviewed and approved. For example, during the period of December 20, 1995, to February 21, 1997, the Hurricane Recovery Managers submitted 10 invoices, totaling $5.7 million, to the Governor's Authorized Representative (GAR). A letter dated April 19, 1996, from the GAR to the Hurricane Recovery Managers which was attached to the miscellaneous disbursement vouchers stated that the GAR was giving "conditional approval" of the payments but that he had not performed a detailed review and verification of the Hurricane Recovery Managers' work. The letter further stated that the GAR "disavowed," at that time, the representations in the Certification of Authorized Government Representative but that the Government reserved the right, upon detailed review and verification, to make appropriate adjustments against future invoices. However, there was no documentation in the files indicating whether detailed reviews or payment adjustments were subsequently made. We believe that the GAR's disclaimers indicate that the correct review process was not followed with regard tot he Hurricane Recovery Managers' invoices and that there was little assurance that amounts paid were reasonable and allowable. **"The Department of Education concurs with this finding." "The Audit Response Task Force" will investigate this outstanding matter in conjunction with the "GAR," to verify the 10 invoices totaling $5.7 million, which the Hurricane Recovery Managers submitted to the "GAR" for approval during the period of December 20, 1995, to February 21, 1997. The extenuating circumstances surrounding the conditional approval of the invoices by the "GAR" will be researched and subject to detailed review and verification. The "GAR's" files will be researched to ascertain whether**

or not detailed reviews or payment adjustments were ever made; and if they were reasonable and allowable. The target completion date for this task will March 6, 1998.

Building Code and Permits

The 1994 Uniform Building Code (which is incorporated by the reference into Title 29, Chapter 5, of the Virgin Islands Code) requires that developers request a building permit before they begin construction by submitting a set of architectural plans to the Division of Permits of the Department of Planning and Natural Resources. Section 106.1 of the Building Code further requires that the building official issue a separate building permit for each structure erected, constructed, enlarged, altered, repaired, moved, converted, or demolished. Despite these requirements, which apply to Governmental facilities, the Government did not ensure that architectural plans were submitted for approval or that building permits were obtained for all repair work to the public schools. We found that plans and building permits were not available for 29 of 41 school construction projects. **"The Department of Education does not concur with this finding." Following the aftermath of Hurricane Marilyn, immediate reconstruction/repairs was performed and identified as <u>Phase I Reconstruction/Repairs; building;</u> work performed under the Phase I reconstruction/repairs were performed without building permits. Under the Phase II reconstruction/repairs permanent reconstruction/repairs were performed ; all such work was done in full compliance with the 1994 Uniform Building Code; the required drawings and specifications were prepared, submitted to the Department of Planning and Natural Resources and the necessary Building Permits received. When the auditors reviewed the files at the Department of Education and the Department of Property and Procurement their findings indicated the absence of these documents; this was because the Project Manager had not turned these files over to the Department of Education. At present however, said documentation is at the Department of Education which will be transmitting copies of said documentation to the Department of Property and Procurement for their files by February 13, 1998."** *Additionally, correspondence in the contract files indicated that some of the construction work was not in compliance with the building code requirements.* **"The**

Department of Education does not concur with this finding." All work performed under the Phase I reconstruction/repairs. which was not in compliance with the 1994 Uniform Building Code, was corrected by subsequent work performed in full compliance with the 1994 Uniform Building Code, under the Phase II Phase I reconstruction/repairs. *For example:*

A status report prepared by the Hurricane Recovery Managers in May 1996 stated that repair work at the Joseph Sibilly, Charlotte Amalie, and Kirwan Terrace schools was not in compliance with the building codes and recommended that the Government issue stop work orders to the respective construction contractors. **"The Department of Education does not concur with this finding." All work performed under the Phase I reconstruction/repairs. which was not in compliance with the 1994 Uniform Building Code, was corrected by subsequent work performed in full compliance with the 1994 Uniform Building Code, under the Phase II reconstruction/repairs.** *On May 21, 1996, the Department of Property and Procurement issued a stop work order to the contractor working at the Charlotte Amalie High School. However, in a June 11, 1996, memorandum, the then-Commissioner of Education authorized the contractor to continue all repair work at the High School "that does not relate to meeting provisions of the Uniform Building Code or other code requirements;.* **"The Department of Education does not concur with this finding". All work performed under the Phase I reconstruction/repairs. which was not in compliance with the 1994 Uniform Building Code, was corrected by subsequent work performed in full compliance with the 1994 Uniform Building Code, under the Phase II reconstruction/repairs.**

We found no documentation in the files to indicate whether follow up actions were taken to have the contractor correct the building code violations that resulted in the stop work order or whether the Department of Education, the Hurricane Recovery Managers, or other representatives of the Government ensured that the contractor's subsequent work was in accordance with the Commissioner's instructions. We also did not find documentation in the files to indicate whether stop work orders were issued to the contractors at the Joseph Sibilly and Kirwan Terrace schools or whether the building code violations reported by the Hurricane Recovery Managers were corrected. **"The Department of Education does not concur with this finding." All work performed under the Phase I reconstruction/repairs. which was not in**

compliance with the 1994 Uniform Building Code, was corrected by subsequent work performed in full compliance with the 1994 Uniform Building Code, under the Phase II reconstruction/repairs.

In another instance, a new roof that was constructed at the Ulla Muller Elementary School after Hurricane Marilyn was blown off the school by Hurricane Bertha in July 1996. An architect/engineer alleged to the press that the new roof had not been constructed in accordance with the building code requirements. **"The Department of Education does not concur with this finding." All work performed under the Phase I reconstruction/repairs. which was not in compliance with the 1994 Uniform Building Code, was corrected by subsequent work performed in full compliance with the 1994 Uniform Building Code, under the Phase II reconstruction/repairs.**

We believe that substandard construction work and the resultant potential for unsafe public schools existed because the Government and its representatives did not ensure that architectural plans were prepared and approved, building permits were issued, and building code requirements were met. **"The Department of Education does not concur with this finding." All work performed under the Phase I reconstruction/repairs. which was not in compliance with the 1994 Uniform Building Code, was corrected by subsequent work performed in full compliance with the 1994 Uniform Building Code, under the Phase II reconstruction/repairs.**

At the November 25, 1997, exit meeting on the preliminary draft report, the Commissioner of Education stated that repair work at almost all schools had subsequently been inspected by representatives of the Department of Education and the Department of Planning and Natural Resources and that, where necessary, additionally work was performed to mitigate the effects of repair work that originally was not in compliance with building code requirements. Specifically, he stated that corrective actions had been taken with regard to building code deficiencies at the Joseph Sibilly, Kirwan Terrace, and Ulla Muller schools but that some problems still existed relating to the quality and timeliness of the repair work at the Charlotte Amalie High School. The Commissioner also stated that he had taken a "hard line" with contractors by refusing to approve payments in cases where the repair work was not performed in accordance with contract and building code requirements. Further, the Commissioner stated that the Department had obtained and compiled that contract files originally held by the Hurricane Recovery Managers and the subsequent project manager.

Recommendations

We recommend that the Governor of the Virgin Islands:

1. Direct the Department of Property and Procurement, in coordination with the Department of Public Works, to establish procedures for the contract oversight function which include assigning a Department of Public Works inspector to conduct regular inspections at each construction site and file appropriate inspection reports with the Department of Property and Procurement and to ensure that all appropriate Government representatives review and approve construction progress reports before periodic payments are made to contractors;

We concur with this recommendation. I have directed my Commissioners of the Departments of Property and Procurement and Public Works to coordinate an effort to establish appropriate procedures for contract oversight. I have been informed that many of these procedures have already been put in place.

2. Direct the Department of Property and Procurement, in coordination with the Department of Planning and Natural Resources, to establish procedures which ensure that architectural plans are submitted and approved and building permits are issued for all government construction projects;

The Commissioner of the Department of Planning and Natural Resources is working with the Commissioner of the Department of Property and Procurement to ensure that architectural plans for all government construction projects are submitted and approved by that Department. Newly established procedures require that the appropriate building permits be issued before construction of these projects begin.

3. Direct the Department of Public works, in conjunction with the Department of Planning and Natural Resources, to inspect all public schools which required construction work after Hurricane Marilyn to ensure that the work was performed in accordance with building code requirements. Any violations should be reported to the Department of Property and Procurement for subsequent correction by the contractors.

The Commissioner of Public Works and Planning and Natural Resources have been directed to conduct inspections of all public school construction work performed after hurricanes Marilyn to ensure that this work was performed in accordance with new building code requirements. Any discovered violations will be reported to the Department of Property and Procurement for subsequent correction by the contractors. This matter will be given top priority by my administration.

4. Direct the Department of Education to obtain refunds from (or make offsets against amounts that may be owed to) the two contractors who were overpaid a total of $12,363.00. **"The Department of Education does not concur with this finding." (See Documentation of Oversight Activities $12,363)**

CLASSIFICATION OF MONETARY AMOUNTS

Finding	Questioned Costs
B. Contract Oversight	
Documentation of Oversight Activities	$12,363

"The Department of Education does not concur with this finding." The findings states that two (2) contractors were overpaid a total of $12,363.90, which consisted of payments to the project manager, Caribbean Professional Consultants, and Custom Builders. With reference to Caribbean Professional Consultants, this finding has been forwarded to the Department of Public Works for a response. Attached, please find copy of memorandum dated 1/23/98 to the Commissioner of Public Works from the Commissioner of Education transmitting a copy of the draft report to be reviewed, investigated and responded to by that agency.

Custom Builders was awarded contract No. CC-35-DE-T-96 dated July 27, 1996 in the amount of $109,355.83 to repair Alexander Henderson Elementary School on St. Croix. Subsequently, Change Order No. 1 dated November 19, 1996 and approved by the Commissioner of Education on 2/10/97 increasing this contract by the amount of $19,900.74, thus, changing the total amount of this contract to $129,256.57, charged to account code: 3132-25620-000-PPE-TO3106.

At the time of this audit review the following payments were being

processed:

PERIODICAL ESTIMATE NO. 1

Periodical Estimate in the amount of $98,420.25 was paid from two (2) different funding sources under:

ACCOUNT CODE: 3132-25620-000-PPE-TO3106.

Periodical Estimate No. 1	**$ 98,420.25**
Payment	**$ 78,068.50**

PERIODICAL ESTIMATE NO. 2.

Payment	**$ 17,910.66**
Sub Total	**$ 95,979.16**

PAYMENT WAS PAID AGAINST

ACCOUNT CODE: 9340-95250-000-02M-FD9340

Balance of Per. Estimate No. 1	**$ 20,351.75**
Grant Total to Contractor	**$ 116,330.91**

We have outlined in detail a response to your Draft Audit Report. Should you have any further questions relating to our responses, please feel free to contact my office.

Sincerely,

Roy L. Schneider, M.D.
Governor

Enclosure

cc: Mr. Arnold E. vanBeverhoudt, Jr., Director of Insular Area Audits
Honorable Liston A..Davis, Commissioner of Education
Mr. Elmo D. Roebuck, Special Asst. for Audit & Policy Evaluation

STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
A.1-A.3	Resolved; not implemented.	No further response to the Office of Inspector General is required. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.
B.1-B.3	Management concurs; additional information needed.	Provide target dates for completion of corrective actions. Upon completion, appropriate supporting documentation should be provided to our Caribbean Regional Office.
B.4	Unresolved.	Respond to the revised recommendation, and provide a response indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that includes target dates and titles of the officials responsible for implementation. If nonconcurrence is indicated, provide specific reasons for the nonconcurrence.

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free Numbers:
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

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

EVALUATION REPORT

FOLLOWUP OF OFFSHORE MINERALS LEASING ACTIVITIES, MINERALS MANAGEMENT SERVICE

REPORT NO. 98-I-385
MARCH 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

EVALUATION REPORT

MAR 27 1998

Memorandum

To: Director, Minerals Management Service

From: Ronald K. Stith
Acting Assistant Inspector General for Audits

Subject: Evaluation Report on Followup of Offshore Minerals Leasing Activities, Minerals Management Service (No. 98-I-385)

INTRODUCTION

This report presents the results of the followup evaluation of our December 1993 audit report "Offshore Minerals Leasing Activities, Minerals Management Service" (No. 94-I-179). The objective of our evaluation was to determine whether the Minerals Management Service had satisfactorily implemented the recommendation in our 1993 report and whether any new recommendations were warranted. During our review, we noted a condition relating to lease rental terms that warranted immediate consideration by Service management. Accordingly, we are also issuing a quick-reaction evaluation report concerning this issue.

BACKGROUND

The Minerals Management Service's mission includes managing the Offshore Minerals Leasing Program under the provisions of the Outer Continental Shelf Lands Act, as amended. To accomplish this part of its mission, the Service prepares oil and gas leasing schedules, holds lease sales on offshore tracts (up to 5,760 acres), and awards leases on offshore Federal lands to the highest qualified bidder. For each lease awarded, the Service receives revenues in the form of bonus bids, rental fees, and royalties if a lessor begins production of oil and gas on the leased tracts. Bonus bids are a one-time cash amount paid per acre to the Service by the highest qualified bidders to obtain leases. Rental fees are annual payments based on a fixed dollar amount per acre, which is established at the time the lease is issued and paid by a lessor to preserve its rights to the lease. Lessors make royalty payments equal to a stated share or percentage of the value of the oil or gas produced on a tract. During calendar years 1996 and 1997, revenues from the sale of Federal offshore oil and gas leases totaled about $8.9 billion, which comprised royalties of about $6.5 billion, bonus bids of $2.1 billion, and rents of $321 million.

SCOPE OF EVALUATION

The scope of our followup evaluation included a review of actions taken by the Service to implement the recommendation made in our December 1993 audit report. As part of the evaluation, we reviewed documents and records pertaining to the Service's offshore oil and gas leasing program for calendar years 1994 through 1997. We also interviewed Service personnel responsible for administering the program. Furthermore, we reviewed the Secretary's Annual Statement and Report to the President and the Congress for fiscal year 1995, which was required by the Federal Managers' Financial Integrity Act, and the Departmental Report on Accountability for fiscal year 1996, which includes information required by the Act, and determined that no material weaknesses were included in the reports which directly related to the objective and scope of our evaluation. Our evaluation was conducted from December 1997 to February 1998 at the Service's Economics Division in Herndon, Virginia.

Our evaluation was made in accordance with the "Quality Standards for Inspections," issued by the President's Council on Integrity and Efficiency. Accordingly, we included such tests of records and other evaluation procedures that were considered necessary under the circumstances to accomplish our stated objective. Because of the limited scope and objective of our review, internal controls were reviewed only to the extent that they related to corrective actions taken on the recommendation in our prior report.

PRIOR AUDIT COVERAGE

In our December 1993 audit report "Offshore Minerals Leasing Activities, Minerals Management Service" (No. 94-I-179), we reported that the Service had established a $25 minimum bonus bid per acre and a $3 rental fee per acre, which were less than the $32.50 bonus bid per acre and the $5.00 rental fee per acre recommended in internal studies performed by the Service.

Specifically, our prior audit found that a March 1992 study conducted by the Service (the most current study available at the time of the prior review) concluded that raising the minimum bonus bid would be in accordance with current market conditions and would increase Federal revenues. In order to indicate the potential for increased bonus bid revenues, we included an estimate in the prior report that the Government would have received up to $25.5 million in additional revenues from 1988 to 1992 had the minimum bonus bid rate been set at $32.50 per acre (the rate recommended in the March 1992 study) at the beginning of 1988.

In addition, our prior audit found that the annual rental fee should be increased because the $3 per acre fee, which was established before 1954, represented only a small percentage of the total costs involved in oil and gas exploration and that therefore an increase in the fee would not impact the Service's ability to lease tracts. In order to indicate the potential for increased rental fee revenues, we included estimates in the prior report that a $5 per acre rental fee (the $3 fee established in 1954 and a $2 increase, the optimal amount recommended by the Service's March 1992 study) for the period of 1988 to 1992 would have

increased rental fee revenues by $120.6 million and that the additional revenues from 1993 to 1996 for leases issued during 1988 to 1992 would have added about $35 million to revenues. In addition, we concluded that higher minimum bonus bids and higher rental fees may encourage companies to begin production or relinquish tracts in a more timely manner, with a potential increase in bonus bid revenues from the resale of relinquished tracts.

RESULTS OF EVALUATION

Our December 1993 audit report (No. 94-I-179) contained the following recommendation:

We recommend that the Director, Minerals Management Service, establish a procedure that requires that the adequacy of the minimum bonus bid and annual rental fee charges be evaluated before each sale and that appropriate adjustments be made if necessary to ensure that the Government receives optimum value for offshore oil and gas leases.

The Acting Director concurred with the recommendation, stating that he believed that "periodic evaluation of the effects of minimum bids and rental rates on Government receipts as well as other leasing objectives is clearly in the public interest." Based on our followup evaluation, we found that the Minerals Management Service had taken quick action to fully implement this recommendation and had increased rental fee rates per acre, which generated an estimated $141 million (Appendix 1) in increased lease revenues between September 1993 and August 1997. Specifically, we found that 11 lease sales were conducted from September 1993 to August 1997, which resulted in the leasing of 4,861 tracts totaling about 26 million acres, and that the Service had evaluated the total effect on revenues of raising the minimum bonus bids and rental fees per acre for each of these sales. Before each lease sale, the Service prepared a Decision Memorandum for the Assistant Secretary for Land and Minerals Management that set forth the terms and conditions for the Final Notice of Sale to be published in the "Federal Register." For example, for Lease Sale No. 168, the Decision Memorandum stated that the Service had considered increases in the minimum bid up to a level of $50 per acre and rental fees up to $10 and concluded that maintaining the minimum bonus bid level at $25 but increasing rental fees would increase Federal revenues and encourage oil and gas exploration and development of the leased tracts.

Based on its analyses, the Service raised the per acre rental fee for leased tracts in water depths of less than 200 meters from $3 to $5, beginning with Sale No. 143 in September 1993, and increased per acre rental fees for tracts of property in water depths of greater than 200 meters from $3 to $7.50, beginning with Sale No. 157 in April 1996. The Service stated that one factor considered in deciding to increase fees for tracts in water depths of 200 meters or more was a November 1995 amendment to the Outer Continental Shelf Lands Act (Title III of Public Law 104-58) which suspends royalties on a specified amount of oil or gas where production is in water exceeding 200 meters. The Service stated that the increased fees for these tracts "would be expected to speed the rates of exploration and development of productive tracts and relinquishment of leased marginal tracts."

The Service said that it expects that leasing activities for tracts in water depths of more than 200 meters will continue to increase for at least the next several years. Because of the

corresponding increase in rental rates for those tracts, the increase in future revenues as a result of the implementation of the prior report's recommendation is expected to continue. We estimated that the leases issued between September 1993 and August 1997 (Lease Sales Nos. 143 through 168) will generate an estimated $194 million in increased lease revenues between 1998 and 2001, as shown in Appendix 2.

Since this report does not contain any recommendations, a response is not required.

We appreciate the assistance of Minerals Management Service personnel during the conduct of our evaluation. We also commend the Director, Minerals Management Service, for the quick implementation of our prior report's recommendation, which has resulted in significant increased revenues and future revenues cited in this report.

cc: Assistant Secretary for Land and Minerals Management

ADDITIONAL RENTAL REVENUES FOR CALENDAR YEARS 1993 TO 1997 FROM TRACTS LEASED FROM 1993 TO 1997

Sale Number	Acres*	Rate Increased by	1993	1994	1995	1996	1997	Total 1993 through 1997
143	807,882	$2.00	$1,615,764	$1,454,188	$1,308,769	$1,177,892	$1,060,103	$6,616,716
147	1,749,520	2.00		3,499,040	3,149,136	2,834,222	2,550,800	12,033,198
150	1,025,550	2.00		2,051,100	1,845,990	1,661,391	1,495,252	7,053,733
152	2,896,478	2.00			5,792,956	5,213,660	4,692,294	15,698,910
155	1,445,251	2.00			2,890,502	2,601,452	2,341,307	7,833,261
157	2,050,808	2.00				4,101,616	3,691,454	7,793,070
157	2,590,544	4.50				11,657,448	10,491,703	22,149,151
144	105,274	2.00				210,548	189,493	400,041
161	944,299	2.00				1,888,598	1,699,738	3,588,336
161	2,463,117	4.50				11,084,026	9,975,624	21,059,650
166	1,835,567	2.00					3,671,134	3,671,134
166	3,399,393	4.50					15,297,268	15,297,268
149	10,263.5	2.00					20,527	20,527
168	655,720	2.00					1,311,440	1,311,440
168	3,736,808	4.50					16,815,636	16,815,636
Totals	25,716,475							$141,342,071

*Explanatory note: Similar to the Mineral Management Service's in-house studies, we assumed a 10 percent annual lease relinquishment rate. In addition, we assumed that none of the relinquished tracts would be acquired by another company in a subsequent lease sale and that the amount of increased revenues would therefore be greater than the amount estimated. Also, for purposes of calculating total rent, the Service treats each fraction of an acre as a full acre.

POTENTIAL ADDITIONAL RENTAL REVENUES FOR CALENDAR YEARS 1998 TO 2001 FROM TRACTS LEASED FROM 1993 TO 1997

Sale Number	Acres*	Rate Increased by	1998	1999	2000	2001	Total 1998 through 2001
147	1,147,860	2.00	$2,295,720				$2,295,720
150	672,863	2.00	1,345,726				1,345,726
152	2,111,532	2.00	4,223,064	$3,800,757			8,023,821
155	1,053,587.5	2.00	2,107,175	1,896,457			4,003,632
157	1,661,154	2.00	3,322,308	2,990,077	$2,691,069		9,003,454
157	2,098,341	4.50	9,442,532	8,498,278	7,648,450		25,589,260
144	85271.5	2.00	170,543	153,488	138,139		462,170
161	764,882	2.00	1,529,764	1,376,787	1,239,108		4,145,659
161	1,995,124.65	4.50	8,978,061	8,080,254	7,272,228		24,330,543
166	1,652,010	2.00	3,304,020	2,973,618	2,676,256	$2,408,630	11,362,524
166	3,059,453.6	4.50	13,767,541	12,390,786	11,151,707	10,036,536	47,346,570
149	9,237	2.00	18,474	16,627	14,964	13,468	63,533
168	590,148	2.00	1,180,296	1,062,266	956,040	860,436	4,059,038
168	3,363,127	4.50	15,134,072	13,620,664	12,258,597	11,032,737	52,046,070
Totals	20,264,590.7						$194,077,720

*Explanatory note: Similar to the Mineral Management Service's in-house studies, we assumed a 10 percent annual lease relinquishment rate. In addition, we assumed that none of the relinquished tracts would be acquired by another company in a subsequent lease sale and that the amount of increased revenues would therefore be greater than the amount estimated. Also, for purposes of calculating total rent, the Service treats each fraction of an acre as a full acre.

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

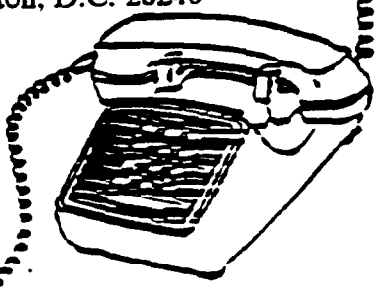
(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free Numbers:
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240



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

AUDIT REPORT

CONCESSIONER IMPROVEMENT ACCOUNTS, NATIONAL PARK SERVICE

REPORT NO. 98-I-389
MARCH 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

MAR 31 1998

Memorandum

To: Assistant Secretary for Fish and Wildlife and Parks

From: Robert J. Williams
Acting Inspector General

Subject: Audit Report on Concessioner Improvement Accounts, National Park Service (No. 98-I-389)

This report presents the results of our audit of concessioner improvement accounts maintained by National Park Service concessioners. The objective of the audit was to determine whether the amounts deposited into concessioner improvement accounts and the expenditures from those accounts were appropriate. At the request of the Park Service, we also reviewed the adequacy of its procedures for concessioner improvement accounts.

We concluded that projects financed with concessioner improvement account funds enhanced visitor facilities in the park units. However, the Park Service had not provided sufficient and timely guidance to ensure that concessioner improvement account funds were used appropriately and allowed concessioners to use these funds before procedures were issued. Although the Park Service did issue procedures in August 1995 relating to the use of these funds, the procedures did not provide sufficient guidance for determining the types of projects that could be funded or for establishing cost-sharing agreements for projects that benefited both the Park Service and the concessioner. We also found that the Park Service (1) did not amend existing concession contracts so that they would be in compliance with the new procedures, (2) approved projects which were not in conformance with the procedures, and (3) did not enforce concessioner compliance with contract provisions. As a result, concessioner improvement account funds were used for (1) projects initiated before the procedures were issued, that did not directly support concession operations, or that benefited both the concessioner and the Park Service and would have been appropriate for cost sharing ($17.5 million); (2) expenditures related to concession operations that would not be considered proper uses of the funds under the new procedures ($1.2 million); and (3) capital improvement projects for which the concessioner was improperly granted a possessory interest ($823,000). Furthermore, in the absence of sufficient guidance on the use of improvement account funds, there is no assurance that the funds will be used properly or consistently throughout the Park Service. In addition, we identified one concessioner that did not meet its capital improvement program expenditure requirement by about $100,000.

Regarding deposits to concessioner improvement accounts, we found that two concessioners made improper deductions from recorded gross receipts in determining the amounts required to be deposited into concessioner improvement accounts. As a result, these concessioners should have deposited additional funds of about $124,800, excluding interest, into these accounts.

In the January 21, 1998, response (Appendix 3) from the Director, National Park Service, the Park Service partially concurred with Recommendation A.1, did not address all parts of Recommendation A.2, and concurred with Recommendation B.1. Based on the response, we consider Recommendation B.1 resolved and implemented and request that the Park Service reconsider its responses to Recommendations A.1 and A.2, which are unresolved (see Appendix 4). The Park Service also provided comments on the text of the report, which we have considered in preparing the final report. One of these comments related to the Other Matters section of the draft report, which discussed a special set-aside arrangement at Yellowstone National Park. Based on the Park Service's comments, we agree that this arrangement was not a concessioner improvement account, and accordingly, we excluded the Others Matters section from the final report.

In accordance with the Departmental Manual (360 DM 5.3), we are requesting a written response to this report by May 22, 1998. The response should provide the information requested in Appendix 4.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, the monetary impact of audit findings (Appendix 1), actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the assistance of National Park Service personnel in the conduct of our audit.

CONTENTS

Page

INTRODUCTION 1

BACKGROUND 1
OBJECTIVE AND SCOPE 2
PRIOR AUDIT COVERAGE 2

FINDINGS AND RECOMMENDATIONS 4

A. IMPROVEMENT ACCOUNT PROJECTS 4
B. DEPOSITS TO CONCESSIONER IMPROVEMENT ACCOUNTS 15

APPENDICES

1. CLASSIFICATION OF MONETARY AMOUNTS 17
2. SITES VISITED, TYPES OF ACCOUNTS REVIEWED, AND CONCESSIONER DEPOSITS AND EXPENDITURES 18
3. NATIONAL PARK SERVICE RESPONSE 19
4. STATUS OF AUDIT REPORT RECOMMENDATIONS 23

INTRODUCTION

BACKGROUND

Since 1981, the National Park Service has included provisions in some of its concession contracts that require concessioners to deposit a percentage of gross receipts into interest-bearing bank accounts. (For the purpose of this report, these accounts will be referred to as concessioner improvement accounts[1]). Funds from these accounts are to be spent by the concessioners on projects approved by the Park Service for improving park or concessioner property related to concession operations. Generally, deposits are made to these accounts in lieu of the concessioners' paying franchise fees to the Park Service that must be deposited into the general fund of the U.S. Treasury and are not available to the Park Service. Before concessioner improvement accounts were established, improvements to Park Service-owned facilities assigned to concessioners were funded by the concessioners through a building improvement program and by the Park Service with appropriated funds. The funds deposited into and expended from concessioner improvement accounts are outside the appropriations process and supplement the appropriations made to the Park Service for improving visitor facilities. In fiscal year 1995, there were approximately 40 concessioner improvement accounts at 19 locations, which had annual deposits of about $19 million and expenditures of about $11 million. The Park Service has informed the Congress through the budget process of its use of concessioner improvement accounts.

In a February 7, 1995, opinion, the Office of the Solicitor concluded that the inclusion of improvement account provisions in concession contracts was authorized by law and stated that the concessioner improvement accounts ensured that concessioners have the financial ability to provide required visitor facilities. The Solicitor also concluded that the accounts should be used for activities that "directly support concession operations" and recommended that the Park Service issue procedures for these accounts. The Solicitor subsequently determined, in a March 1996 memorandum, that a construction set-aside account at Glen Canyon National Recreation Area funded by a visitor surcharge (4 1/2 percent of gross receipts) and concessioners' contributions (1/2 percent of gross receipts) was also a form of a concessioner improvement account.

The Park Service issued procedures for administering concessioner improvement accounts on August 11, 1995. These procedures identify two types of accounts: capital accounts and government improvement accounts. Capital accounts are to be used for significant capital improvements of a nonrecurring nature to government-owned or concessioner property or for the construction of new facilities that "directly support concession operations." Government improvement accounts are to be used for major repairs and improvements to government-owned structures assigned to concessioners for concession purposes. Park

[1]The various concession contracts use different terms for individual concessioner improvement accounts, including capital, capital improvement, construction and improvement, construction set-aside, and government improvement accounts.

Service procedures also state that capital and government improvement accounts are not to be used for routine maintenance and repairs and require that all projects undertaken with concessioner improvement account funds be approved in advance by the applicable Park Service regional director.

OBJECTIVE AND SCOPE

The objective of the audit was to determine whether the amounts deposited into concessioner improvement accounts and the expenditures from those accounts were appropriate. At the request of the Park Service, we also reviewed the adequacy of the Park Service's August 11, 1995, procedures for concessioner improvement accounts. In total, we reviewed eight accounts at five locations, which had fiscal year 1994 and 1995 deposits totaling about $25.6 million and expenditures totaling about $16.9 million (see Appendix 2). Although we focused our audit on improvement account projects that were active during 1994 and 1995, our scope included transactions that had taken place since project initiation. For example, at Glen Canyon we reviewed transactions that occurred since project initiation in 1987.

Our review was made in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances.

As part of our review, we evaluated the system of internal controls related to concessioner improvement accounts to the extent that we considered necessary. The internal control weaknesses identified are discussed in the Findings and Recommendations section of this report. The recommendations, if implemented, should improve internal controls over improvement account deposits and expenditures. We also reviewed the Department of the Interior's Annual Statement and Report, which is required by the Federal Managers' Financial Integrity Act of 1982, for fiscal year 1995 and found that no material weaknesses were reported which related to the objective and scope of our audit.

PRIOR AUDIT COVERAGE

During the past 6 years, the Office of Inspector General has issued three audit reports and the General Accounting Office has issued two reports on selected aspects of concessioner improvement accounts as follows:

- The Office of Inspector General report "Concessions Management, National Park Service" (No. 94-I-1211), issued in September 1994, recommended that the Park Service obtain a legal opinion on the establishment and use of concessioner improvement accounts and implement internal controls over the deposit and expenditure of account funds. Based on a February 1995 Solicitor's opinion, the Park Service issued concessioner improvement account procedures in August 1995.

- The Office of Inspector General report "Operations of National Park Concessions, Inc., Under Contract No. CC-0680-2-0001 With the National Park Service" (No. 96-E-541),

issued in March 1996, contained recommendations that the Park Service, in regard to concessioner improvement accounts, should (1) require the concessioner to reimburse ineligible expenditures, (2) establish new project initiation priorities, (3) amend the contract as it related to concessioner bank accounts and interest earned, and (4) ensure that administrative costs charged were supported. Because of the recency of this report, we did not follow up on the recommendations. However, the conditions noted were considered during our review at other parks.

- The Office of Inspector General report "National Park Service Financial Statements for Fiscal Years 1995 and 1996" (No. 97-I-936), issued in June 1997, concluded that the Park Service had not established a process for collecting reliable and timely information on the number of special concession accounts (including concessioner improvement accounts) and their deposits and disbursements to ensure that the information it reports in its notes to the financial statements is complete and accurate. However, the Park Service disagreed with the recommendation to establish such a process, stating that it did not plan to report this information in the notes to the financial statements in future years. Accordingly, we referred the recommendation to the Assistant Secretary for Policy, Management and Budget for resolution.

- The General Accounting Office report "Policies and Practices for Determining Concessioners' Building Use Fees, National Park Service" (No. GAO/T-RCED-92-66), issued in May 1992, covered testimony before the Environment, Energy, and Natural Resources Subcommittee, Committee on Government Operations, House of Representatives. In its report, the General Accounting Office recommended that the Park Service develop specific policies, methodologies, and guidelines on establishing, administering, and tracking set-aside (concessioner improvement) accounts and other contractual agreements for repairs, maintenance, and improvements to Federally owned facilities used by concessioners. Our current review found that the Park Service had complied with this recommendation with the issuance of its procedures in August 1995.

- The General Accounting Office report "Information on Special Account Funds at Selected Park Units, National Park Service" (No. GAO/RCED-96-90), issued in May 1996, contained background and financial information for each of eight different types of funds, including those from concessioner improvement accounts, received by park units that were not subject to the annual appropriations process. The report did not contain any recommendations.

FINDINGS AND RECOMMENDATIONS

A. IMPROVEMENT ACCOUNT PROJECTS

Overall, we concluded that the projects funded by concessioner improvement accounts enhanced visitor facilities in the parks. Without concessioner improvement account funds, many of the new park facilities may not have been built and many of the historical structures in the parks may have deteriorated further. However, we found that the Park Service had not provided clear, sufficient, and timely guidance to ensure that account funds were used appropriately and had allowed concessioners to use these funds before the procedures were issued. Although the major concession contracts at four of the five parks we reviewed and the Park Service concession improvement account procedures issued in August 1995 state that account funds were to be used for improvements that "directly support concession operations," neither the contracts nor the procedures adequately define the term "directly support concession operations" or provide sufficient guidance on the appropriate uses of account funds.[2] We also found that the procedures did not provide sufficient guidance on cost-sharing arrangements for projects which benefited both the concessioner and the Park Service. Further, the Park Service did not amend existing concession contracts that contained provisions which were in conflict with the new procedures and did not enforce concessioner compliance with contract provisions. As a result, concessioner improvement account funds were used or planned for (1) projects that did not directly support concession operations or that benefited both the Park Service and concessioners and would have been appropriate for cost sharing ($17.5 million), (2) expenditures that related to concession operations but that would not be considered proper uses of the funds under the new procedures ($1.2 million), and (3) capital improvement projects for which the concessioner was improperly granted a possessory interest ($823,000).[3] Furthermore, in the absence of sufficient guidance, there is little assurance that improvement account funds will be used appropriately and consistently throughout the Park Service. In addition, we identified one concessioner that did not meet its capital improvement program expenditure requirement by about $100,000.

Concessioner Improvement Account Procedures

The Park Service allowed the parks to establish concessioner improvement accounts and to initiate projects before it established procedures for the use of these accounts. At least 35 of the 40 concessioner improvement accounts were established before the August 1995 procedures were issued. Although the major concession contracts at four of the five parks we reviewed state that capital account funds can be used only for projects that "directly

---

[2]The concession contracts we reviewed at Yellowstone National Park, which was the first Park Service unit to establish an improvement account, did not contain this statement.

[3]These amounts included expenditures from project initiation through fiscal year 1995, or just after issuance of the Park Service's procedures.

support concession operations," we concluded that the contracts did not clearly define "directly support" or provide sufficient guidance on the appropriate uses of account funds to address the various circumstances surrounding account expenditures or contain provisions for cost-sharing arrangements. As a result, concessioner improvement account funds of $17.4 million[4] and $120,000 were used for some projects at Glen Canyon National Recreation Area and Mount Rushmore National Memorial, respectively, that, in our opinion, did not "directly support concession operations," benefited both concessioner and park operations and may have been appropriate for cost sharing, and/or may not have been considered proper uses of account funds under the new procedures. For example, at Glen Canyon, improvement account funds were used for projects such as comfort stations; a visitor center; shelters; landscaping; aerial mapping; water quality studies; road chip sealing; directional signs; the elimination of drainage problems; a school building for children of concessioner and Park Service employees; and several projects which benefited both concessioner and Park Service operations such as sewer system upgrades, water storage and distribution systems, electrical system improvements, boat ramps and related infrastructure, pedestrian trails, breakwaters, and road and parking lot expansion and paving.[5] We also noted that Glen Canyon had planned to conduct similar projects after fiscal year 1995. At Mount Rushmore, improvement account funds were used for projects such as removing asbestos from an old concessioner building that was converted to park administrative offices, parking lot stairways, and a nature trail.

In response to a February 1995 opinion and recommendation from the Office of the Solicitor, the Park Service issued procedures in August 1995 for administering concession improvement accounts. The procedures describe the types of projects and expenditures that are considered proper or improper uses of concessioner improvement accounts. Specifically, proper uses of capital accounts include projects that involve the "rehabilitation or construction of new facilities used directly to house or otherwise provide services to park visitors (such as hotels, restaurants, gift shops, and service stations) as well as concessioner support facilities necessary for the functioning of the primary visitor facilities." The procedures also authorize the use of these accounts on a shared-cost basis to provide infrastructure facilities that serve both Park Service and concessioner visitor facilities. Improper uses of capital accounts, according to the procedures, include projects that do not "directly support concession operations" and that are for general park purposes such as resource protection and ancillary Park Service management. These projects would include

---

[4]This amount includes $2.8 million for the construction of a school. Prior to construction, a regional solicitor stated, "The construction of a school directly supports concession activities by providing necessary educational opportunities for dependents of employees of the Concessioner and the NPS [National Park Service]." However, the new procedures, which were based on the Solicitor's February 1995 opinion, state that improvement account funds cannot be used to construct school facilities.

[5]Park Service employees at Glen Canyon provided information showing that appropriated funds were spent on construction and cyclic maintenance of similar projects that benefited the Park Service, as well as the concessioner, and stated that these expenditures constituted cost sharing. However, in the absence of cost-sharing guidelines, there is no basis for determining whether these expenditures met the Park Service's intent for cost-sharing arrangements.

constructing or repairing Government visitor facilities, such as visitor centers, interpretative facilities, entrance stations, restrooms, roads, and parking lots, as well as Government support facilities, such as employee housing, maintenance buildings, administrative buildings, and school buildings.

We concluded, however, that the August 1995 procedures did not provide clear and sufficient guidance on the use of improvement account funds. For example, although the procedures state that the construction or repair of facilities such as parking lots, roads, or school buildings is not a proper use of improvement account funds, there may be instances where such facilities "directly support concession operations" or support both the concessioner and the Park Service and may be appropriate for cost sharing. Further, although the procedures cite instances where cost-sharing arrangements may be appropriate, the procedures did not provide sufficient guidance on establishing such arrangements, including methodologies for allocating costs.

At the time of our review, the respective park managers indicated that they believed that concessioner improvement accounts could be used for construction or rehabilitation projects which directly affected park visitors, whether or not the projects enhanced the concession facilities. They also indicated that several of the projects funded prior to the procedures represented an appropriate use of the accounts under the new procedures. As such, we believe that the Park Service needs to provide additional guidance in its procedures regarding the proper uses of improvement account funds.

Concession Contract Provisions

Prior to the issuance of the August 1995 procedures, concessioner improvement account funds of about $1.2 million were used or planned for purposes that would not be considered proper uses of the funds under the new procedures. In addition, the Park Service did not attempt to amend the contracts to conform to the procedures in those instances in which the concession contracts included provisions that conflicted with the new procedures. Examples of conflicting contract provisions and improper uses of funds are as follows:

- The Park Service's procedures state that concessioner improvement accounts "are not to be used to pay or otherwise reimburse" Government appropriations accounts. Because the Park Service did not issue guidelines in a timely manner, we found that concessioner improvement account funds were used before issuance of the 1995 procedures to reimburse Government appropriations for services costing about $127,000 that were provided by the Park Service to concessioners as follows:

-- Both the Wahweap and the Uplake concession contracts at Glen Canyon permitted the improvement account to be used to reimburse the Park Service for "unprogrammed expenses of the permitted activity incurred as a result of the account, not to exceed 5 percent of total account expenditures." For 1995, more than $19,000 was reimbursed from the improvement account to the Park Service for unprogrammed expenses related to improvement account projects at Glen Canyon. Glen Canyon officials stated that the

unprogrammed expenses represented additional personnel services, travel, equipment, and other costs that would not have been incurred by the Park Service had there not been an improvement account.

-- Concessioner improvement account funds were used at Mount Rushmore and Yellowstone to reimburse the Park Service for expenses incurred, although the concession contracts did not provide for reimbursement of these expenses. At Mount Rushmore, about $67,000 was reimbursed from the improvement account in 1994 to the Park Service for the salary of an on-site construction inspector (a Park Service employee) hired under a term appointment to inspect the construction of the new concessioner restaurant and gift shop buildings. At Yellowstone, improvement account funds were used to reimburse the Park Service approximately $41,000 in 1994 and 1995 for costs related to concessions management support activities, such as engineering and project coordination.

- The Park Service's procedures state that trust accounts are not permissible for the deposit and expenditure of improvement account funds and that improvement account funds cannot be used by concessioners to pay income taxes on interest earned from deposits made to the accounts. Exhibit G to the Yosemite concession contract provided for the creation of a trust arrangement for the deposit and expenditure of capital improvement account funds and government improvement account funds. The trust agreements, which were established to assist the concessioner in administering the improvement accounts, were executed on November 15, 1993. Amendment 1 to the trust agreements, effective on October 1, 1994, authorized the trustee to use funds from the capital improvement and government improvement accounts to pay tax liabilities on the earnings of the accounts. The concessioner used the trust agreements for the deposit and expenditure of capital improvement funds and government improvement account funds and paid almost $31,000 in trust account administration fees for 1994 and 1995, including about $12,400 that was paid after the issuance of the Park Service's August 1995 procedures. The concessioner also used about $27,500 during 1994 and 1995 from the capital improvement account to pay taxes on the interest earnings of the accounts, including about $240 that was paid after the issuance of the new procedures.

- The Park Service's procedures state that concessioner improvement account funds may not be used to acquire personal property. We found that concessioner improvement account funds were used at Yellowstone before the August 1995 procedures were issued to purchase a tour boat during 1994, at a cost of $283,000, as permitted by Exhibit D of the concession contract. However, we also noted that similar purchases with concessioner improvement account funds, such as a new boat for the Bridge Bay Marina ($125,000), other specialized vehicles ($40,000), and computer hardware and software development ($35,000), were included in Yellowstone's list of approved projects that was revised after the procedures were issued.

- The Park Service's procedures state that concessioner improvement account funds are not to be used for redecorating and periodic recarpeting of facilities or for furniture. We

found that prior to the issuance of the August 1995 procedures, concessioner improvement account funds of about $485,000 were used or planned for these purposes as follows:

-- At Yellowstone, about $302,000 was expended from the improvement account, primarily during 1994, for the purchase of mattresses ($196,000), furniture ($99,000), and furniture refinishing ($7,000). Similar projects, such as additional mattress purchases, recarpeting, and floor refinishing, had been approved for 1996, after the Park Service's procedures were issued, at an estimated cost of $135,000.

-- At Glacier National Park, several recarpeting projects that were approved before the procedures had been issued were under way or had been completed at various concession facilities throughout Glacier at an estimated total cost of $48,000. However, during our audit, staff at Glacier stated that they would no longer approve the funding of recarpeting projects from the improvement account.

In addition, we noted that the major concession contract at Yosemite, which became effective on October 1, 1993, contains a provision (Section 10(b)(1)) which states that "ten (10%) percent of the funds deposited in the [capital improvement] fund shall be expended by the Concessioner as directed by the Secretary for construction of facilities necessary for visitor enjoyment of the area [park] even though such facilities do not directly support concession operations required or authorized under this contract." We found that no improvement account funds had been expended as of June 1996 at Yosemite for such projects, although about $407,000 (10 percent of 1995 deposits) was available for that purpose based on the provisions of the concession contract.

To ensure that concessioner improvement account funds are used for appropriate purposes, we believe that the Park Service should review each concession contract to identify any provisions that are inconsistent with the August 1995 procedures and initiate action to modify those contracts accordingly when the opportunity occurs. In the interim, the Park Service should not approve concessioner requests to use concessioner improvement account funds for purposes that are prohibited by the procedures or concession contracts.

Possessory Interest

The Park Service's procedures state that concessioners will not accrue any possessory interest in improvements made with concessioner improvement account funds.[6] The concession contract for Mount Rushmore required the concessioner to complete a construction and improvement program at a cost not to exceed $10 million, including the construction of a concession facility, a dormitory for concessioner employees, and support facilities. A December 1993 amendment to the contract specified that in lieu of paying franchise fees, the concessioner would deposit 5 percent of gross receipts into a concessioner

---

[6]The Park Service's procedures regarding possessory interest are supported by a December 26, 1996, opinion from the Office of the Solicitor, which states, "Completed improvements made with funds from the special accounts, we consider, properly may be considered as NPS [National Park Service] assets."

improvement account for use on other capital improvement projects. This amendment also specified that the concessioner was to have no ownership or possessory interest in improvements made with improvement account funds. In anticipation of an estimated $2 million cost overrun on the construction and improvement program, the Park Service orally instructed the concessioner in September 1994 to stop making deposits to the concessioner improvement account and to use the balance in the account to help fund the cost overrun. However, an amendment to the concession contract to document the oral instructions was not executed until December 1995, after the Park Service's procedures were issued. The amendment was retroactive to the period prior to August 31, 1995, and, contrary to the concession contract and Park Service procedures, granted the concessioner a possessory interest in the improvements constructed with monies accumulated in the improvement account up to that time. We determined that the value of this possessory interest was at least $823,000. This amount consisted of the $500,000 improvement account balance at September 16, 1994, and an additional $323,000 that would have been deposited into the improvement account had the concessioner continued to make deposits through August 31, 1995, as required by the concession contract.

Other Contract Provisions

The concession contract at Glacier requires the concessioner to undertake capital improvements by expending annually "not less than one (1%) percent of gross receipts . . . from the previous year on alterations, additions, improvements, and new facilities of the character normally considered to be capital improvements under generally accepted accounting principles." These projects were to be in addition to those funded under Glacier's concessioner improvement account.

We determined that the concessioner did not meet its capital improvement program expenditure requirement by about $100,000 for 1994 and 1995. After our fieldwork was completed, the Superintendent sent a July 17, 1996, letter informing the concessioner of this spending shortfall and requested that the concessioner make up the $100,000 deficiency in 1996 and 1997. The concessioner did not agree that a spending shortfall existed and said that the issue would be researched and appropriate action would be taken. Park Service officials said that in subsequent negotiations, the concessioner agreed, effective in fiscal year 1997, to submit a list of capital improvement projects for Park Service approval before funds are expended to ensure that all projects are legitimate capital improvements. Park Service officials also said that the concessioner did not agree to spend an additional $100,000 on capital improvements as compensation for the 1994 and 1995 spending shortfall because the Park Service had not acted in a timely manner to notify the concessioner of the capital expenditure deficiency. We disagree with the concessioner's position and believe that the Park Service should require that the concessioner spend an additional $100,000 on approved capital improvements, thereby fulfilling its contractual requirement for 1994 and 1995 capital improvement expenditures.

Recommendations

We recommend that the Director, National Park Service:

1. Revise the concessioner improvement account procedures to include clear and sufficient guidance on the use of funds in these accounts, including a clear definition of the term "directly support concession operations," and on cost-sharing arrangements for projects that benefit both the concessioner and the Park Service. These guidelines should include more specific examples of the types of projects that are appropriate uses of these funds and the types of projects that are appropriate for cost sharing.

2. Review each existing concession contract to identify any provisions which are inconsistent with concession improvement account procedures and initiate action to amend those contracts accordingly. In the interim, the Park Service should not approve concessioner requests to use improvement account funds for purposes that are prohibited by the procedures. Regarding the concession contracts we reviewed, the Park Service should:

- Amend the Mount Rushmore contract to specify that the concessioner will not have possessory interest in facilities constructed with improvement account funds.

- Amend the Glen Canyon contract to prohibit the use of improvement account funds for reimbursements to Government appropriations accounts.

- Amend the Yellowstone contract to eliminate equipment purchases as a proper use of improvement account funds and ensure that improvement account funds are no longer used to reimburse Government appropriations.

- Amend the Yosemite contract to eliminate the provision that 10 percent of capital improvement account fund deposits can be used for projects which do not directly support concession operations, require the concessioner to terminate the trust agreements for the deposit and expenditure of improvement account funds, and ensure that improvement account funds are no longer used to pay the concessioner's income taxes.

- Ensure that the concessioner at Glacier complies with the contract requirements and require the concessioner to spend an additional $100,000 on approved capital improvements.

National Park Service Response and Office of Inspector General Reply

In the January 21, 1998, response (Appendix 3) to the draft report from the Director, National Park Service, the Park Service partially concurred with Recommendation 1 and did not fully address Recommendation 2. Based on the response, we request that the Park Service reconsider its responses to both recommendations, which are unresolved (see Appendix 4).

Recommendation 1. Nonconcurrence.

National Park Service Response. The Park Service disagreed with our finding concerning the use of improvement account funds, stating that each contract which was examined during the audit was executed prior to the current procedures and that therefore "any comparison would be ineffectual." The Park Service also stated that in each instance, expenditures made with improvement account funds were consistent with the contract and therefore appropriate. Specifically, the Park Service stated that the landscaping, aerial mapping, road chip sealing, and elimination of drainage at Glen Canyon National Park "were all done in conjunction with concession operations" and that the construction of the stairway and nature trail at Mount Rushmore "was in direct support of the concession operation" and was necessary "to provide access to the existing concessioner facility during the construction of the new concession facility initiated in August 1994."

Despite its disagreement with the finding, the Park Service agreed to revise its procedures "to more clearly define the term 'directly support concession operations,'" stating, "Though our requirement that improvement accounts can only be used on facilities that directly support concession operations has not caused a problem thus far, we can see where this could be open to a variety of interpretations."

The Park Service, however, did not agree to revise its procedures to include clear and sufficient guidance for cost-sharing arrangements. The Park Service stated that in drafting its guidelines, it "did not plan to share construction costs with concession improvement account projects because of the unpredictability of Federal funds and the difficulty of melding a private project with a procurement project." The Park Service further stated that "if the time comes that cost sharing becomes a necessity, we will develop guidelines to address this issue."

Office of Inspector General Reply. Although the Park Service agreed to revise its procedures to more clearly define the term "directly support concession operations," its comments on the audit finding raise concerns regarding what it considers to be appropriate uses of concessioner improvement account funds. As discussed in the report, the concession contracts at four of the five parks we reviewed required that concessioner improvement account funds be used for projects which "directly support concession operations," which is also required under the new procedures. We disagree with the statement that all of the projects we reviewed were consistent with that requirement. For example, several of the projects we reviewed clearly did not directly benefit concession operations, such as the construction of a building at Glen Canyon to house fire and ambulance equipment, detention halls, associated offices (which support Park Service functions and not those of the concessioner), and the removal of asbestos from an old building at Mt. Rushmore that was converted to park administrative offices. Other projects appeared to benefit primarily Park Service operations, with some benefits to the concession operations, such as the temporary stairway at Mt. Rushmore, which was necessary to reach the monument viewing area from the parking area and the concessions facility in the area.

Regarding the statement that "any comparison [to the new procedures] would be ineffectual" because the projects we reviewed were executed before the current procedures were issued, the primary purposes of our review were (1) to determine whether concessioner improvement accounts were used in accordance with the provisions of the concession contracts (both the contracts and the new procedures required that funds be used for projects that "directly support concession operations"); (2) to determine the effect of the Park Service's delay in issuing those procedures; and (3) to determine whether the new procedures were adequate to address the various circumstances surrounding the expenditures of concession improvement account funds, as requested by the Park Service. For example, based on our review of these projects, we believe that the Park Service needs to clarify its guidance concerning the use of improvement account funds for projects that support primarily Government operations rather than concessioner operations. Specifically, the procedures need to address the issue of whether it is appropriate to use these funds for projects such as utility systems, parking lots, or boat ramps when only a small percentage of the use relates to the concession operations. In addition, some park managers indicated that concessioner improvement accounts could be used for construction or rehabilitation projects which directly affected park visitors, whether or not the projects enhanced concessioner facilities. This issue needs to be clearly addressed in the procedures.

Regarding cost sharing, the basis for the Park Service's comment that in drafting its guidelines "it did not plan to share construction costs with concession improvement account projects" appears to indicate that projects that also benefit the Park Service will be fully funded by the improvement accounts. The Park Service's procedures clearly recognize the potential for cost sharing "of a joint NPS [National Park Service]/concessioner infrastructure facility, such as where the concessioner joins NPS in the construction of a sewer plant which serves both NPS installations and concessioner visitor facilities." Furthermore, the Park Service did not include a detailed explanation in its response to support its decision not to consider cost sharing "because of the unpredictability of Federal funds and the difficulty of melding a private project with a procurement project." Because a large number of projects we reviewed benefited both concessioner and Park Service operations, we believe that this issue needs to be fully addressed in the guidelines. Accordingly, we consider the recommendation unresolved.

Recommendation 2. Nonconcurrence.

National Park Service Response. The Park Service stated that it "cannot unilaterally amend concession contracts" to conform to its current procedures but that it would attempt to amend the contracts during the contract reconsideration process. The Park Service further stated that three of the contracts will have expired by September 2001 and that as these contracts expire, it will "issue new contracts which will conform to our improvement account procedures."

In regard to amending the Mt. Rushmore contract, the Park Service stated that additional requirements for capital improvements were placed on the concessioner which were not anticipated when the concessioner's original obligations were established. The Park Service

further stated that because of these additional obligations, it allowed the concessioner to have a possessory interest in a portion of this contribution to provide the concessioner, in accordance with the Concessions Policy Act of 1965, "a reasonable opportunity for a profit commensurate with the capital invested and the obligations assumed."

In regard to requiring the concessioner at Yellowstone to deposit $65,000 into its concessioner improvement account fund because funds were used for maintenance activities, the Park Service stated that the expenditures were for resource management and environmental projects but not maintenance and that it added these responsibilities to the concessioner's maintenance plan "only to make it clear that these would not be NPS [National Park Service] responsibilities."

In regard to ensuring that the concessioner at Glacier spends an additional $100,000 on approved capital improvements, the Park Service stated that while the concessioner "had clearly expended in excess of this amount [1 percent of gross receipts] every year on capitalized items, the dispute centered on whether or not these items could be considered improvements." The Park Service further stated that it had reached a settlement with the concessioner that expenditures should be approved by the Park Service in advance and that the concessioner had met the minimum expenditure requirement for fiscal year 1997.

Office of Inspector General Reply. Although the Park Service agreed to attempt to amend the contracts when the opportunity occurs and to ensure that the new contracts conform to its improvement account procedures, it did not address the recommendation as it related to disapproving concessioner requests to use improvement account funds for purposes that are prohibited by the procedures.

In regard to the possessory interest issue at Mt. Rushmore, the Park Service did not include sufficient information in its response to support its position that it was necessary not only to allow the concessioner to use these funds to meet its financial obligations under the contract but also to grant the concessioner possessory interest in these facilities in order for the concessioner to make a reasonable profit. In addition, the Park Service did not specifically address amending the concession contract to specify that the concessioner will not have possessory interest in future facilities constructed with improvement account funds.

In regard to requiring the concessioner at Yellowstone to deposit $65,000 into the concessioner improvement account fund, the projects in question were included in the concessioner's maintenance plan and therefore were the concessioner's responsibility. However, since the Park Service authorized the concessioner to use improvement account funds for these projects, it would not be appropriate to require the concessioner to reimburse the improvement account at this time. As such, we have not included the finding and recommendation in the final report.

In regard to requiring the concessioner at Glacier to spend an additional $100,000 on approved capital improvements, the actions identified in the response are adequate to ensure that future expenditures of capital improvement account funds are proper. However, the Park

Service did not specifically identify the basis for its decision not to require the concessioner to spend an additional $100,000 on approved capital improvement projects to meet its contractual requirement. We do not believe that the Park Service's lack of timeliness in notifying the concessioner of the deficit is an appropriate basis for waiving the requirement.

Based on the Park Service's response, we consider the recommendation unresolved.

B. DEPOSITS TO CONCESSIONER IMPROVEMENT ACCOUNTS

Two of the five concessioners we reviewed made improper deductions from their recorded gross receipts in determining the amounts to be deposited into their concessioner improvement accounts. Section 9 of the concession contracts defines gross receipts as the total amount received or realized by the concessioner from all sales of services, accommodations, materials, and other merchandise less specified exclusions. Typical contract exclusions from gross receipts include receipts from the sale of genuine United States Indian and native handicrafts; intracompany earnings on charges to other departments; charges for employees' meals, lodging, and transportation; cash discounts on sales and purchases; and sales, excise, and gasoline taxes. However, Park Service personnel did not adequately analyze the exclusions made by the concessioners. As a result, we estimated that for 1994 and 1995, two concessioners should have deposited additional funds totaling about $124,800, excluding interest, into their concessioner improvement accounts (see Appendix 1).

We found that the concessioner at Glen Canyon deducted credit card fees and freight charges from gross receipts in determining the amounts to be deposited into the construction set-aside account. Also, a concessioner at Glacier National Park excluded sales to employees from gross receipts in determining the amounts to be deposited into the capital improvement account. Section 9 of the concession contracts (franchise fees) does not permit these exclusions and deductions from gross receipts; however, Park Service personnel did not adequately analyze revenue exclusions to ensure that concessioners deposited funds in accordance with the terms of the concession contracts, as required by Park Service Directive 90-7, as amended. As a result, for 1994 and 1995, concessioners did not deposit about $124,800, excluding interest, into a set-aside account at Glen Canyon ($119,500) and into an improvement account at Glacier ($5,300).

Park officials took prompt action to address these issues after we brought them to their attention. Specifically, the Superintendent at Glen Canyon, in a July 17, 1996, letter, informed the concessioner of the improper exclusions and instructed the concessioner to (1) stop the exclusions that were not identified as allowable in the concessioner contracts, beginning with the next monthly deposit; (2) submit records showing the itemized exclusions taken in calculating deposits from the inception of the program in 1987 through the current year; and (3) submit a proposal on how to resolve the issue for all previous years in which deposits were incorrect. Also, the Concessions Manager at Glacier, in a July 15, 1996, letter, informed the concessioner that the exclusion of sales to employees from the gross receipts was not appropriate and requested the concessioner to deposit about $5,300 plus interest into the capital improvement account. On August 5, 1996, the concessioner deposited $5,401 into the account to correct the error.

Recommendation

We recommend that the Director, National Park Service, ensure that park personnel sufficiently analyze all exclusions from gross receipts and confirm that deposits to

concessioner improvement accounts are made in accordance with the provisions of the concession contracts.

National Park Service Response and Office of Inspector General Reply

In the January 21, 1998, response (Appendix 3) to the draft report from the Director, National Park Service, the Park Service agreed with the recommendation. Based on the response and additional information provided by the Park Service, we consider the recommendation resolved and implemented (see Appendix 4).

CLASSIFICATION OF MONETARY AMOUNTS

Finding Area	Potential Additional Revenues
Other Contract Provisions	$100,000
Deposits to Concession Improvement Accounts	124,800
Total	$224,800[1]

[1]This amount represents additional funds that the concessioners should deposit into their concessioner improvement accounts.

SITES VISITED, TYPES OF ACCOUNTS REVIEWED, AND CONCESSIONER DEPOSITS AND EXPENDITURES

Site	Concession Contract Number	Type of Account	1994 Deposits	1994 Expenditures	1995 Deposits	1995 Expenditures
Mount Rushmore National Memorial	CC-MORU-001-93	Capital	$289,290	$194,470	*	0
Glacier National Park	CC-GLAC-002-81	Capital Improvement	1,067,452	348,892	$466,572	$117,592
Glen Canyon National Recreation Area	CC-GLCA-003-69	Construction Set Aside	2,679,281	1,841,513	2,877,034	4,825,362
	CC-GLCA-002-88	Capital Improvement	202,103	0	1,255,713	20,760
	CC-GLCA-002-88	Campground Improvement	38,310	1,500	41,367	1,500
Yellowstone National Park	CC-YELL-077-91	Construction and Improvement	3,973,933	3,635,879	4,148,186	4,318,362
Yosemite National Park	CC-YOSE-004-93	Capital Improvement	4,029,832	0	4,071,390	1,491,364
	CC-YOSE-004-93	Government Improvement	222,756	35,945	222,756	82,772
			$12,502,957	$6,058,199	$13,083,018	$10,857,712

*The account was terminated effective August 31, 1995. No funds were deposited into the account by the concessioner in 1995, and the funds remaining in the account were to be used by the concessioner to pay for a portion of the construction cost overrun discussed in the "Possessory Interest" section of this report.

United States Department of the Interior

NATIONAL PARK SERVICE
1849 C Street, N.W.
Washington, D.C. 20240

IN REPLY REFER TO:

JAN 21 1998

Memorandum

To: Robert J. Williams
Assistant Inspector General for Audits

From: Robert Stanton, Director, National Park Service

Subject: Draft Audit Report on Concessioner Improvement Accounts, National Park Service (Assignment No. C-SP-NPS-033-96)

We have reviewed the draft report and our comments are as follows.

A. Improvement Account Projects

Each contract that was examined was executed *prior* to the establishment of our current procedures and therefore any comparison would be ineffectual. In each instance, expenditures made from improvement accounts were consistent with the contract and therefore appropriate Additionally each contract that was examined by the Inspector General underwent legal review by the Office of the Solicitor as well as a 60-day congressional review.

While we do concur with the finding listed under "Concessioner Compliance" this issue is not related to "Improvement Account Projects" and therefore should be listed in the "Other Matters" section of the report.

"Directly Support Concession Operations"

Every use of improvement account funds at Glen Canyon was consistent with the provisions of the contract. Furthermore, the landscaping, aerial mapping, road chip sealing, and elimination of drainage problems were all done in conjunction with concession operations.

With regards to Mount Rushmore, construction of the stairway and nature trail using improvement account funds was in direct support of the concession operation. These projects were necessary to provide access to the existing concession facility during the construction of the new concession facility initiated in August of 1994. It was anticipated that access through a construction zone would eliminate access to the existing concession area during the winters of 1994-1995 and 1995-1996, unless a safe alternative route was

established. Therefore access directly from the parking area by means of a stairway to the orientation center and then to the concession facility by way of the nature trail were constructed during the summer of 1994. The stairway was a temporary structure and removed with the construction of the new parking facility and the nature trail remains as a permanent trail providing alternative access to all visitor facilities including the concession facility.

Cost-Sharing Projects

All funds spent from Glen Canyon's set-aside account were done so in accordance with the provisions of the concession contract. The NPS, in drafting its guidelines, did not plan to share construction costs with concessioner improvement account projects because of the unpredictability of Federal funds and the difficulty of melding a private project with a procurement project. However, if the time comes that cost sharing becomes a necessity, we will develop guidelines to address this issue.

Concession Contract Provisions

The NPS cannot unilaterally amend concession contracts. As each contract expires, new contracts will be executed which will conform with the new improvement account procedures.

Possessory Interest

In June of 1995 the NPS recognized that insufficient funds existed to construct the utilities, roads, landscaping and trails surrounding the new concession sales facility in Mt. Rushmore. The contract amendment signed in December of 1993 would not provide adequate funds to complete the planned improvements. Therefore a contract negotiation commenced in the summer of 1995 and concluded in August of 1995. This negotiation required the concessioner to contribute an additional $2 million to the capital improvement requirement of their contract. This contribution included the funds remaining in the improvement account plus approximately $1.2 million in additional concessioner funds. A specific part of that negotiation was the treatment of the approximate $800,000 in the improvement account.

The Concessions Policy Act of 1965 states that the NPS will provide concessioners with a reasonable opportunity for a profit commensurate with the capital invested and the obligations assumed. Since this additional requirement on the concessioner was unanticipated when their original obligation was set, we allowed the concessioner to have a possessory interest in a portion of their contribution.

Maintenance

These projects were resource management and environmental projects but not maintenance. The NPS added similar responsibilities to their maintenance plan only to make it clear that these would not be NPS responsibilities.

Concessioner Compliance

We agree with the majority of this finding regarding Glacier Park, Inc.'s failure to meet its contractual obligation to expend not less than one percent of their gross receipts on capital improvements for 1994 and 1995. While the concessioner had clearly expended in excess of this amount every year on capitalized items, the dispute centered on whether or not these items could be considered improvements.

The Superintendent reached a settlement with the concessioner that from 1996 onward, expenditures would be submitted for approval in advance for credit toward this contract requirement. This agreement has been in place and in 1997 the concessioner exceeded their minimum requirement. As we mentioned previously, this issue has no relation to improvement accounts and therefore we ask that it be addressed under the "Other Matters" section of your report.

Recommendations

1. Though our requirement that improvement accounts can only be used on facilities that directly support concession operations has not caused a problem thus far, we can see where this could be open to a variety of interpretations. Therefore, we agree to revise our improvement account procedures to more clearly define the term "directly support concession operations." The target date for the revision of these procedures will be June 30, 1998, and the responsible official will be the Concessions Program Manager.

2. As indicated previously, the National Park Service cannot unilaterally amend concession contracts. Where we have the opportunity during reconsiderations we will attempt to amend the contracts to conform to our current procedures. Additionally, three of these contracts will have expired by September 2001 and as these contracts expire we will issue new contracts which will conform to our improvement account procedures.

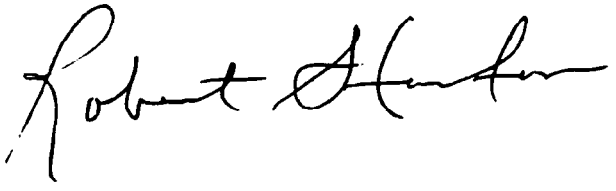
B. Deposits to Concessioner Improvement Accounts

The Park Service concurs with this finding and the recommendation. We will issue a memorandum reminding our parks to review the contract provision relating to improvement account deposits to make sure that their concessioners are in compliance with this requirement. The target date for the issuance of this memorandum will be February 15, 1998, and the responsible official will be the Concessions Program Manager.

Other Matters

The amendment requires the concessioner to spend a minimum amount of their receipts on maintenance and is therefore not considered to be an improvement account

We have no further comments on the report. Please contact Robert Yearout, Concessions Program Manager, at 202-565-1212 if you have any questions.



STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
A.1	Unresolved.	Reconsider the recommendation. If concurrence is indicated, provide an action plan that includes target dates and titles of the officials responsible for implementation. If nonconcurrence is indicated, provide the reasons for nonconcurrence, including the basis for the Park Service's position that cost-sharing arrangements are not appropriate and/or feasible.
A.2	Unresolved.	Reconsider the recommendation with respect to the following: not approving concessioner requests to use account funds for purposes that are prohibited by the procedures, requiring the concessioner at Glacier to spend an additional $100,000 on approved projects, and amending the Glacier contract to specify that the concessioner will not have possessory interest in future projects funded by the improvement account. If concurrence is indicated, provide an action plan that includes target dates and titles of the officials responsible for implementation. If nonconcurrence is indicated, provide reasons for the nonconcurrence.
B.1	Implemented.	No further action is required.

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

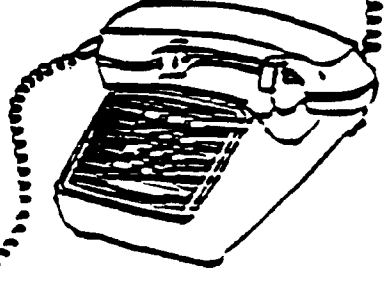
(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free Numbers:
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240



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

SPECIAL REPORT

EXTERNAL QUALITY CONTROL REVIEW OF THE AUDIT DIVISIONS, MINERALS MANAGEMENT SERVICE

REPORT NO. 98-I-398
APRIL 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

SPECIAL REPORT

Memorandum APR - 2 1998

To: Associate Director for Royalty Management,
Minerals Management Service

From: Robert J. Williams
Acting Inspector General

Subject: Special Report on the External Quality Control Review of the Audit Divisions, Minerals Management Service (No. 98-I-398)

INTRODUCTION

This report presents the results of our external quality control review of the Audit Divisions of the Minerals Management Service. The Service requested this review to be in compliance with the "Government Auditing Standards," issued by the Comptroller General of the United States, which requires organizations conducting audits in accordance with these standards to undergo an external quality control review every 3 years.

This is the second report we are issuing on the Service's Audit Divisions. The first report contained the results of our audit of the Minerals Management Service's work regarding alleged underpricing of California crude oil. Because the Service's work on the underpricing of California crude oil was conducted under different controls, including methodology and performance procedures, the conclusions in that report do not relate to the Service's audit work covered by our external quality control review.

BACKGROUND

The Minerals Management Service is responsible for managing royalties relating to minerals produced from most Federal and Indian lands. Specifically, the Service collects about $4.4 billion annually in rents, royalties, and other payments; maintains necessary accounting records; prepares royalty liability determinations; and conducts audits of royalty payments to ensure that royalties received represent fair and equitable value. To help accomplish its responsibilities, the Service has established financial and production accounting verification systems, compliance and enforcement programs, and an overall audit strategy.

The Audit Divisions are responsible for conducting audits of royalty payors to ensure that the correct amount of royalties is reported and received. The Divisions are guided by a 5-year audit strategy and an audit plan that is updated annually. The strategy provides for a wide range of audits that cover specific companies and special issues or projects such as processing allowances pertaining to gas plants, production allocations specified by unit agreements, contract settlements, and royalty payments made from individual Indian leases. These audits are performed by residency teams permanently stationed at the 11 largest royalty payor companies (see Appendix 1) and by mobile teams that visit smaller companies selected for review.

The Audit Divisions consist of a headquarters office in Washington, D.C., and compliance divisions located in Lakewood, Colorado, and Dallas and Houston, Texas. The Dallas Compliance Division also has compliance offices located in Oklahoma City and Tulsa, Oklahoma. The Audit Divisions have a total of approximately 190 auditors.

OBJECTIVE AND SCOPE

The objective of our review was to provide reasonable assurance that audit work of the Audit Divisions was performed in accordance with the "Government Auditing Standards" and with policies and procedures contained in the Service's Audit Procedures Manual.[1] To accomplish the objective, we judgmentally selected for review 19 audits, consisting of 6 audits each from the Lakewood and the Houston Compliance Divisions and 7 audits from the Dallas Compliance Division. The sample for the Dallas Compliance Division included two audits from the Oklahoma City Compliance Office and one audit from the Tulsa Compliance Office. Our sample was taken from summary lists prepared by the Service and reportedly represented all audits performed by the Service for the October 1, 1995, through May 1, 1997 period (see Appendix 2). Our review did not include any other work performed by the Audit Divisions during this time period and did not evaluate the economy or efficiency of the Audit Divisions operations. In addition, we did not evaluate the adequacy of the Audit Divisions overall audit strategy. The audits reviewed represented a cross section of audit activities, audit teams, and supervisory officials. We examined audit reports and other audit report products such as issue letters (formal notifications of royalty underpayments), orders to perform (demands for companies to recompute additional royalties owed), orders to pay additional royalties, and audit closure letters; the supporting working paper files; and employee training records.

The review was performed at the Service's Royalty Management Program offices in Lakewood and at Compliance Division offices in Lakewood, Dallas, and Houston. We also visited the Service's audit residency offices located at Chevron Oil Company in Concord, California, and Texaco, Incorporated, in Houston. Our review was made in accordance with

---

[1]The Audit Procedures Manual, dated December 1, 1989, was applicable to the audits that we examined for this external quality control review.

the discussion draft titled "Guide for Conducting External Quality Control Reviews of the Audit Operations of Offices of Inspector General,"[2] dated December 1996, and issued by the President's Council on Integrity and Efficiency.[3] This draft discussion guide provides the standards and detailed guidance for conducting external quality control reviews required by the quality control standard in the "Government Auditing Standards."

PRIOR REVIEW

The last external quality control review of the Audit Divisions was conducted by the Office of Inspector General in February and March 1991. The resultant May 1991 report concluded that, with only minor weaknesses in the areas of individual job planning, legal and regulatory requirements, internal controls, audit evidence, supervision, and reporting, the Royalty Compliance Division (which became the Audit Divisions in a 1992 reorganization) was in compliance with the "Government Auditing Standards." The report contained no recommendations.

During our current review, we noted that the Service was not timely with its request for an external quality control review, as the prior review was completed about 5 years before the Service requested the current review. Accordingly, we believe that the Service should ensure that it complies with the requirement (Paragraph 3.33) of the "Government Auditing Standards" by undergoing an external quality control review at least once every 3 years.

DISCUSSION

Based on our review of the 19 audits, we concluded that the audit work performed by the Audit Divisions was generally in compliance with the "Government Auditing Standards" and the Service's Audit Procedures Manual. Specifically, the audits were conducted in a professional manner; audit conclusions were adequately supported by the working papers; and, with few exceptions, auditors were current in their continuing education requirements. Although we found minor weaknesses in the areas of compliance with laws and regulations, internal quality controls, audit supervision, timeliness of report products, and working paper quality, we also found that the validity of each audit finding and conclusion was not adversely affected, as described in the following paragraphs.

---

[2]During the entrance conference for the external quality control review, officials representing the Minerals Management Service and the Office of Inspector General agreed that the review would be conducted using the draft discussion guide.

[3]The President's Council on Integrity and Efficiency was established by Executive Order in March 1981 to provide leadership in Governmentwide efforts to reduce fraud, waste, and mismanagement in Federal programs.

Compliance With Laws and Regulations

The working paper files for the 19 audits that we reviewed did not indicate that the Service had conducted a risk assessment to aid in detecting significant illegal acts. The "Government Auditing Standards" (Paragraph 6.28) states that a risk assessment should be performed so that specific audit procedures can be designed to provide reasonable assurance of detecting significant illegal acts. Because the royalty payment process for Federal and Indian mineral leases is complex and frequently involves large monetary amounts, we believe that auditors should be more cognizant of their responsibility to detect fraud and other illegal acts.

Internal Quality Controls

The Service established an internal quality control system, as required by the "Government Auditing Standards" (Paragraph 3.31), which we believe provided reasonable assurance that the Service's Audit Procedures Manual was complied with and that audits were generally conducted in accordance with the "Government Auditing Standards." However, we also concluded that the system could be strengthened as follows:

- **Internal Quality Control Review Program.** We found that the internal quality control review program which the Service initiated in 1996 generally operated efficiently and effectively. The program ensured that individual audit offices were evaluated on a regular and uniform basis, the internal reviews were completed timely, weaknesses identified in the internal review reports were balanced with noteworthy accomplishments of the offices, and appropriate officials were briefed on the results of the internal reviews. However, as currently designed, the internal quality control review program does not include tests for:

-- Compliance with the general standards covering staff qualifications, independence, and due professional care. The "Government Auditing Standards" (Paragraph 3.32) requires that an internal quality control review program be designed to evaluate compliance with all applicable standards. Accordingly, the scope of the program should be expanded to include testing of the general standards.

-- Determining whether a risk assessment for compliance with laws and regulations was performed, as required by the fieldwork standards of the "Government Auditing Standards" (Paragraph 6.28). Accordingly, the program should include this step to verify that the auditors assessed the risks that significant illegal acts could occur and, as necessary, that the auditors designed and performed procedures to provide reasonable assurance of detecting significant illegal acts, as discussed in the prior section ("Compliance With Laws and Regulations").

- **Other Quality Control Matters.** During our review, two issues that related to ensuring the accuracy of report products were disclosed as follows:

-- Five of the 19 audits reviewed did not have an independent verification of computations. Although neither the "Government Auditing Standards" nor the Audit Procedures Manual specifically requires an independent verification, this procedure helps to satisfy the "Government Auditing Standards" requirement (Paragraph 7.50) that findings should be presented accurately in reports.

-- The Audit Divisions were considering a significant policy change concerning the referencing process for final audit report products. Specifically, report referencing may become an optional rather than a mandatory procedure. In our opinion, the referencing process is an important tool that helps ensure the accuracy and overall quality of the report product. Accordingly, we strongly encourage the Audit Divisions to reconsider this policy change and to continue the existing requirements for report referencing.

Audit Supervision

We found that all audits were supervised but that the supervision was not always accomplished in a timely manner. The "Government Auditing Standards" (Paragraph 6.64) states that working papers should contain evidence of supervisory review of the work performed. Further, the Audit Procedures Manual (Section 7.6) requires supervisors to review the working papers "after segments[4] of the work are completed." However, for 12 of the 19 audits, the supervisory review of many working papers ranged from 3 to more than 12 months after the documents had been prepared. Additionally, for 5 of the 12 audits, the report product was issued, even though working papers had no indication that a supervisory review had been performed. The "Government Auditing Standards" (Paragraphs 6.22 and 6.23) requires staff to be properly supervised. Timely supervision of the working papers will reduce the risk that undetected errors or unsound conclusions could be included in the Service's report products.

Timeliness of Report Products

We found that report products for 2 of the 19 audits could have been issued more timely. Specifically, two orders to pay additional royalties relating to an audit of an oil company were issued at least 6 months after the draft orders had been prepared, and an order to pay additional royalties relating to the audit of a second oil company was issued about 2 years after the underpayments were identified. The "Government Auditing Standards" (Paragraph 7.6) states that reports should be issued "to make the information available for timely use."

Working Paper Quality

The supporting audit working papers were generally prepared in accordance with the Audit Procedures Manual (Section 7). However, some of the working papers and files for 13 of the 19 audits did not have one or more of the following items: the required source, purpose, and conclusion; a table of contents; indexing (specifically, page numbers); adequate cross-indexing

---

[4]A segment is a series of audit steps focusing on a specific area of the audit.

to the supporting working papers; the preparer's name; and a heading describing the working paper contents. Also, some records were not permanently attached to the files. In our opinion, these deficiencies did not adversely impact the overall quality of the audit working papers. However, we believe that the quality of working papers could be improved with more timely supervisory reviews.

A response to this report is not required. However, if you have any questions regarding this report, please call Mr. Alan Klein, Director of Performance Audits, at (303) 236-9243.

We appreciate the assistance of Minerals Management Service officials in the conduct of our review.

AUDIT RESIDENCY OFFICES
MINERALS MANAGEMENT SERVICE

Office Location	Company Name
Dallas Compliance Division	
Dallas, Texas	Mobil
Dallas, Texas	ARCO
Ponca City, Oklahoma	Conoco
Tulsa, Oklahoma	Amoco
Bartlesville, Oklahoma	Phillips
Houston Compliance Division	
Houston, Texas	Exxon
Houston, Texas	Shell
Houston, Texas	Texaco
Houston, Texas	Unocal
Lakewood Compliance Division	
Concord, California	Chevron
Findlay, Ohio	Marathon

AUDIT SAMPLE SELECTION

Office Location	Company Name	Case Number	Type of Audit
Dallas Compliance Division			
Dallas	ARCO	9340001	Residency*
Dallas	Thriftway	5-40222	Company**
Dallas	Sunwest Petroleum	9540229	Special issue***
Dallas	Meridian	9240205	Special issue
Oklahoma City	Jenex Petroleum	9665511	Special issue
Oklahoma City	Merrico (TriPower Resources)	6-65507.000 through .006	Company
Tulsa	Yates	5-40215.005, .011, and .014	Special issues
Houston Compliance Division			
Houston	Badger Oil	9520008	Company and special issue
Houston	CNG Producing	9320081	Special issue
Houston	Enron Oil & Gas	8820055	Special issue
Houston	UMC Petroleum	9420030	Special issue
Houston	Shell	2-22708.017 and .022	Residency
Houston	Texaco	3-20069	Residency

*Residency audits are comprehensive royalty reviews of the 11 largest royalty payor companies that are conducted by audit staff stationed at the companies (see Appendix 1).

**Company audits are comprehensive royalty reviews of the next largest 115 royalty payors, as well as randomly selected smaller companies, that are conducted by mobile audit teams.

***Special issues cover a variety of royalty verification activities, including audits of gas processing plants, the companies' royalty accounting systems, lease inspections performed by the Bureau of Land Management, individual leases, contract settlements, and royalty settlements. These audits are conducted by mobile audit teams.

Office Location	Company Name	Case Number	Type of Audit
Lakewood Compliance Division			
Lakewood	Chevron	3-30001.033	Residency
		6-30503.000	
		6-30501.022	
		5-30238.000	
Lakewood	Axem Resources	3-30094	Special issue
Lakewood	Energy Minerals	4-30057	Special issue
Lakewood	Questar	3-30004	Company
Lakewood	Mayo Foundation	5-30212	Company
Lakewood	Pan Canadian Petroleum	5-30206	Special issue

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

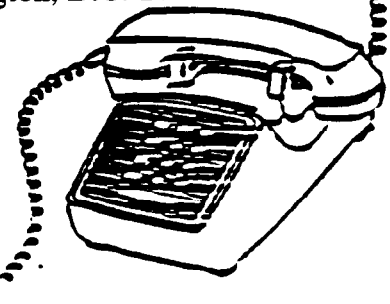
(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free Numbers:
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240



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

AUDIT REPORT

SALVAGE TIMBER PROGRAM, BUREAU OF LAND MANAGEMENT

REPORT NO. 98-I-399
APRIL 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

AUDIT REPORT

Memorandum APR 2 1998

To: Director, Bureau of Land Management

From: Robert J. Williams
Acting Inspector General

Subject: Audit Report on the Salvage Timber Program, Bureau of Land Management (No. 98-I-399)

INTRODUCTION

This report presents the results of our audit of the Bureau of Land Management's Salvage Timber Program. The objective of the audit was to determine whether the Bureau (1) conducted sales of blown-down, diseased, or fire-damaged timber in an expedient manner; (2) adequately pursued instances of timber theft; and (3) used the Forest Ecosystem Health and Recovery Fund as the Congress intended.

BACKGROUND

The Bureau of Land Management is responsible for managing, protecting, and improving 270 million acres of public land, including about 45 million acres of forest land in 11 western states and Alaska. The Bureau administers an additional 2.4 million acres of forest land in western Oregon, which include public domain lands, the revested Oregon and California Railroad grant lands, and the reconveyed Coos Bay Wagon Road grant lands.

The term "salvage timber sale" is defined by the Bureau as a timber sale designed to remove diseased or insect-infested trees; dead, damaged, or downed trees; or trees affected by fire or imminently susceptible to disease or insect attack. Such sales may also include removal of associated trees for purposes of ecosystem rehabilitation. According to Bureau officials, it is important that salvage timber is offered for sale as soon as practicable to prevent additional damage to adjacent green timber and also to prevent further deterioration of the damaged timber. Additionally, drought conditions in the western states over the past several years have significantly increased the occurrences and effects of forest wildfires and the subsequent death of trees. The drought conditions have also contributed to the increased occurrences and

severity of insect outbreaks and resultant bug-killed timber, creating the need for more salvage timber sales. As a result, damaged timber was placed as the highest priority in the Bureau's annual timber sales plans. However, the Bureau said that resources were not adequate to expeditiously market these sales and that therefore a large backlog of salvage timber projects was created.

In order to minimize the loss of merchantable volume[1] and to improve forest conditions, the Congress established the Forest Ecosystem Health and Recovery Fund on October 5, 1992. The Fiscal Year 1993 Department of the Interior and Related Agency Appropriation Act (Public Law 102-381) created this special fund in the U.S. Treasury, which was "to be derived hereafter from the Federal share of moneys received from the disposal of salvage timber prepared for sale from the lands under the jurisdiction of the Bureau of Land Management, Department of the Interior." This Act places requirements on the way the Bureau may spend these funds and also states that the formulas for the distribution of timber sales receipts specified by law are not changed. Specifically, Public Law 102-381 states in part:

> The money in this fund shall be immediately available to the Bureau of Land Management without further appropriation, for the purposes of planning and preparing salvage timber for disposal, the administration of salvage timber sales, and subsequent site preparation and reforestation. Nothing in this provision shall alter the formulas currently in existence by law for the distribution of receipts for the applicable lands and timber resources.

In regard to existing laws, the formulas for distribution of timber sales receipts (including salvage timber) from Oregon and California Railroad grant lands were established by Title II of the Oregon and California Grant Lands Act of 1937. Under the Act, timber sales proceeds were to be divided as follows: 50 percent to the Federal Government and 50 percent to the 18 western Oregon counties that contain Oregon and California Railroad grant lands.[2] The proceeds from timber sales on Coos Bay Wagon Road lands were to be divided as follows: 25 percent to the Federal Government and 75 percent to Coos and Douglas Counties. The Federal share of timber receipts from public domain lands is 96 percent, with the remaining 4 percent going to the state where the salvage sale occurred.

In response to environmental concerns, including old growth forest issues and the presence of the Northern Spotted Owl, restrictions on harvesting timber significantly decreased sales on Government lands in western Oregon. As a result, the 18 counties' shares of proceeds from timber sales on the Oregon and California Railroad grant lands and on the Coos Bay Wagon Road lands were substantially decreased. In order to stabilize the counties' revenues, appropriation language for fiscal years 1991, 1992, and 1993 included a provision for

---

[1]Salvage timber of commercially acceptable quality.

[2]The following Oregon counties (there are no California counties in the Oregon and California grant lands) receive 50 percent of the timber receipts, minimum payments, or special payments: Benton, Clackamas, Columbia, Coos, Curry, Douglas, Jackson, Josephine, Klamath, Lane, Lincoln, Linn, Marion, Multnomah, Polk, Tillamook, Washington, and Yamhill.

minimum payments to the Oregon and California counties, which would ensure that a county's payments would be equal to the annual average of the 5-year period between 1986 and 1990 (the payment could not exceed total receipts collected). In fiscal year 1993, the Congress passed the Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66), which established special county payments for fiscal years 1994 through 2003 based on an annually decreasing percentage of the 5-year average of 1986 through 1990. For example, special payments to the Oregon and California counties started at $78.6 million in fiscal year 1994 and are gradually reduced to $53.6 million in fiscal year 2003. These "special payments" temporarily replaced the counties' share of actual timber receipts for the Oregon and California Railroad grant lands and the Coos Bay Wagon Road lands. For fiscal years 1999 through 2003, the amount to be paid to the counties is the greater of the special payment amount established in Public Law 103-66 or the counties' 50 percent share of timber sales proceeds.

SCOPE OF AUDIT

To accomplish our objective, our audit of the Salvage Timber Program included a review of data relative to the initiation and final disposition of timber theft cases and a review of salvage timber projects, including allocation of sales receipts and project expenditures to the Forest Ecosystem Health and Recovery Fund.

Our audit was conducted in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances. We requested information from 24 Bureau offices (Appendix 1) and discussed Forest Ecosystem Health and Recovery Fund projects, expenditures, receipts, and/or policy and procedures with personnel from these offices. Each field office contacted had used the Fund to conduct salvage timber projects and had eliminated its respective backlog of salvage projects. We also reviewed law enforcement records and obtained other information from the Bureau's Law Enforcement Office in Boise, Idaho, and from Special Agents in the California and Utah State Offices.

As a part of our audit, we evaluated the system of internal controls related to salvage timber sales and the Forest Ecosystem Health and Recovery Fund to the extent we considered necessary.

We also reviewed the Department's Accountability Report for fiscal year 1996, which includes information required by the Federal Managers' Financial Integrity Act of 1982, and the Bureau's annual assurance statement to determine whether any reported weaknesses were within the objective and scope of our review. Neither the Accountability Report nor the Bureau's assurance statement addressed the Bureau's Salvage Timber Program.

PRIOR AUDIT COVERAGE

Neither the Office of Inspector General nor the General Accounting Office has issued any audit reports during the past 5 years on the Bureau's Salvage Timber Program or on the Forest Ecosystem Health and Recovery Fund.

RESULTS OF AUDIT

We found that the Bureau of Land Management conducted salvage timber sales in a timely manner and used the Forest Ecosystem Health and Recovery Fund to eliminate the backlog of salvage timber projects. Furthermore, our review disclosed that timber thefts did not appear to be a significant problem on lands administered by the Bureau. However, the Bureau may have been inappropriately depositing both the counties' and Federal shares of salvage timber sales proceeds into the Fund rather than just the Federal share specified by the Congress in Public Law 102-381. The counties' share of proceeds for Oregon and California Grants Lands was established at 50 percent of the sales receipts by the Oregon and California Grant Lands Act of 1937. Bureau financial officials said that they believed that Public Law 103-66, which provides for temporary special payments to the Oregon and California Railroad grant lands counties except if the counties' 50 percent share is greater than the special payment, eliminated the counties' shares of receipts and thereby authorized the Bureau to keep 100 percent of the proceeds from salvage timber sales. Since the U.S. Treasury has been making special payments to the counties in lieu of the counties' 50 percent share of actual receipts, we believe that the counties' shares should be deposited into the U.S. Treasury General Fund account to partially offset those special payments. As of August 31, 1997, the Bureau had deposited $5.2 million of the counties' shares of salvage timber sales receipts from fiscal years 1994 through 1997 into the Forest Ecosystem Health and Recovery Fund. Based on our review, the Bureau requested a Solicitor's opinion on this matter on May 28, 1997, in which it stated that its interpretation "of legislation [Public Law 103-66] is that the . . . salvage timber receipts are entirely the Federal Government's share during the special payment years."

The Forest Ecosystem Health and Recovery Fund has provided Bureau field offices with the additional funding necessary to expedite salvage timber sales and reduce the backlogged volume of salvage timber. Sales of salvage timber have increased from 10.4 million board feet in 1993 to nearly 39 million board feet in 1997. During the 5 years since the implementation of the Fund, the Bureau has sold over 141 million board feet of salvage timber and collected receipts of about $23.5 million. We contacted 17 Bureau field offices, and none of those field offices reported a backlog of salvage timber.

Our audit also disclosed that the number of timber thefts that occurred during fiscal years 1994 through 1996 was minimal. Data provided by the National Law Enforcement Office showed that an average of 12 timber theft cases were opened per state per year. The average loss per timber theft case was less than $1,400, based on the law enforcement officers' estimates of the value of the timber or other forest products removed. During this period, timber sales fluctuated between about $75 million and $100 million per year, and the loss

from timber theft was estimated at about $100,000 per year.[3] Furthermore, according to the Bureau's Uniform Crime Reporting System, about 50 percent of the timber theft cases reported were cleared by arrest or other means. While law enforcement officials did not provide statistics on the dollar value of cases cleared, they stated that they had had greater success working and obtaining prosecutions on the larger dollar cases. They also stated that many of the smaller cases involved theft of firewood or unauthorized tree cutting while roads were being constructed and that it was often difficult to obtain prosecution on these cases. Consequently, after reviewing all of the information provided by the Bureau, we concluded that timber thefts did not appear to be a significant problem on Bureau-managed lands.

The Bureau's accounting records showed that during fiscal years 1994 and 1995 (through June 1995), the Oregon and California counties' shares of salvage timber receipts were deposited into the U.S. Treasury General Fund. However, on June 16, 1995, Bureau officials decided that the counties' share could be deposited into the Bureau's Forest Ecosystem Health and Recovery Fund rather than the U.S. Treasury General Fund.

We reviewed correspondence which indicated that during 1995 and 1996, Bureau officials discussed this matter with the Department's Budget Office, which requested a Solicitor's opinion as to whether the Bureau could transfer 100 percent of salvage timber receipts into the Fund. The Solicitor did not provide a written opinion. However, correspondence dated April 20, 1995, between the Department's Budget Office and the Bureau stated:

> The Solicitor's office thought that such an interpretation was reasonable, but suggested that BLM/DOI [Bureau of Land Management/Department of the Interior] consult with OMB [Office of Management and Budget] and the relevant Congressional committees before beginning to handle the receipts in that way.

Correspondence from the Department's Budget Office also stated that the Bureau had not consulted with either the Office of Management and Budget or the relevant Congressional committees. Nevertheless, on June 16, 1995, the Bureau's Chief, Division of Finance, authorized the transfer of 100 percent of salvage timber receipts to the Fund for fiscal years 1994 through 2003. The memorandum authorizing the transfers indicated that the Solicitor had provided verbal assurance that the Bureau's interpretation of the law was reasonable.

The Congress initially appropriated $1 million for the Forest Ecosystem Health and Recovery Fund. For fiscal years 1993 to 1997 (through July 31, 1997), salvage timber sales receipts of $23.5 million had been deposited into the Fund. The Oregon and California and Coos Bay Wagon Road counties' shares of receipts deposited into the Fund totaled about $5.2 million for fiscal years 1993 to 1997 (through August 31, 1997). Because the Bureau deposited all salvage timber sales receipts into the Fund, the U.S. Treasury did not receive any revenue from the sale of salvage timber, but it pays the counties a share of those receipts (Public Law

---

[3]Total estimated timber thefts for calendar years 1994, 1995, and 1996 minus the cases cleared by arrest or other means.

103-66) through an appropriation based on the average sales receipts from fiscal years 1986 through 1990.

Public Law 102-381 authorized the Bureau to transfer only the Federal share of salvage timber receipts to the Forest Ecosystem Health and Recovery Fund (which was 50 percent of the sales receipts from Oregon and California lands and 25 percent from Coos Bay Wagon Road lands). Without specific authorization to deposit 100 percent of the salvage timber receipts into the Fund, we believe that the $5.2 million counties' share, which is 50 percent of the salvage timber sales proceeds from Oregon and California Railroad grant lands (about $5,150,000) and 75 percent of the salvage timber sales proceeds from Coos Bay Wagon Road lands (about $50,000), should be deposited into the General Fund of the U.S. Treasury.

During our exit conference, we recommended that the Bureau of Land Management obtain a formal written opinion from the Solicitor's Office as to whether the Bureau can retain 100 percent of the salvage timber sales receipts. The Bureau agreed, and on May 28, 1997, the Director of the Bureau requested a Solicitor's opinion on the issue of whether and/or how much of the counties' share of salvage timber receipts should be deposited into the Forest Ecosystem Health and Recovery Fund.

Conclusion

On January 29, 1998, the Deputy Associate Solicitor, Division of Law, Office of the Solicitor, responded to the Bureau's request for an opinion (see Appendix 2) on the Bureau's retention of 100 percent of the salvage timber receipts. The Solicitor's opinion stated:

> Although there is clearly ambiguity about how "Federal share" should be interpreted, we believe the structure for payment of the "special payment amount" in OBRA 93 [the 1993 Omnibus Budget Reconciliation Act] creates a sound basis for concluding that the BLM's [Bureau of Land Management's] practice is correct.
>
> We conclude that through FY [fiscal year] 2003, in any year when the payments to the counties are made from a General Fund appropriation under OBRA 93 [1993 Omnibus Budget Reconciliation Act), all salvage timber fee receipts will be retained by the Federal government and deposited to the FEHRF [Forest Ecosystem Health and Recovery Fund]. Between FY 1999 and 2003, if the payments are made from timber fee receipts under the pre-OBRA 93 formula, only the portion of such receipts retained by the Federal government should be deposited to the FEHRF.

Based on this opinion, we are not making any recommendations on this matter.

Other Matters

During our survey, we noted inconsistencies in the way the Bureau's forestry program managers interpreted guidance relative to Forest Ecosystem Health and Recovery Fund expenditures and deposits. Although these instances were not systemic, we believe that they should be corrected.

Forest Ecosystem Health and Recovery Fund Expenditures. Regarding expenditures of the Forest Ecosystem Health and Recovery Fund (Subactivity 5900), the Bureau's fiscal year 1996 Fund Coding Handbook states:

> [The Forest Ecosystem Health and Recovery Fund] includes all costs associated with the salvage of dead and dying timber on forest and woodland ecosystems on Public Domain Lands and on Oregon and California Railroad grant lands and Coos Bay Wagon Road lands in western Oregon. [It] includes maintenance and enhancement of the forest and woodlands ecosystems effected by fire, disease, insects etc. It includes only activities related to the sale of salvage timber and the subsequent site preparation, reforestation and maintenance of these sites. No program oversight or administrative costs should be coded to this account. [Emphasis added.]

We believe that some expenditures which were charged to the Fund should have been charged to the Bureau's appropriated funds budgeted for the forestry program as follows:

- In 1996, the Oregon, Idaho, and California State Offices charged $191,405, $78,645, and $78, respectively, to the Fund for allocation of state office overhead, while the Alaska, Arizona, Montana, New Mexico, and Wyoming State Offices did not charge the Fund for overhead. In our opinion, charging overhead costs to the Fund directly conflicts with the Handbook instructions that state, "No program oversight or administrative costs should be coded to this account."

- The Arizona Strip District Office is spending an estimated $3.5 million of Fund money on a research project to restore a ponderosa pine ecosystem to pre-European settlement conditions. The project is being designed by a university and basically involves the following: removing young trees, leaving the old growth trees, burning the underbrush, and seeding grasses. In our opinion, the use of the Fund for this project is not consistent with provisions of the Fund Coding Handbook because the area has not been affected by fire, disease, or insects. In addition, this project does not appear to meet the definition of salvage timber provided in Bureau Instruction Memorandum No. 95-132. Specifically, the memorandum states:

> The term "salvage timber sale" is defined as a timber sale designed to remove diseased or insect-infested trees; dead, damaged or downed trees; or trees affected by fire or imminently susceptible to disease or insect attack. Such sales may also include removal of associated trees for purposes of ecosystem rehabilitation.

Since this project does not appear to meet Bureau requirements, we believe that it should be subject to the Bureau's budget process and funded with appropriated forestry funds.

Forest Ecosystem Health and Recovery Fund Deposits. Our review of deposits made to the Fund (Subactivity 5900) during fiscal years 1995, 1996, and 1997 disclosed that the Craig, Colorado, and the Worland and Rawlins, Wyoming, field offices posted firewood and fencepost sales receipts to the Fund. During the Bureau's 1996 Alternative Management Control Review of the Fund, officials of the Prineville District Office stated that they would like the authority to deposit firewood permit receipts into the Fund. We believe that the Bureau should establish a policy as to whether the estimated $200,000 per year in firewood and fencepost receipts from the public domain lands should be retained by the Bureau in the Forest Ecosystem Health and Recovery Fund or deposited into the U.S. Treasury General Fund.

During the summer of 1996, an interagency review team concluded that considerable variation existed in the types of timber sales identified by field offices as meeting the definition of salvage timber sales, ranging from sales of mostly dead trees to sales of mostly live trees. The team, in its final report, stated that the broad definition of salvage timber was a significant factor contributing to this situation. On October 8, 1996, the interagency team issued a report which recommended that the Bureau and the U.S. Forest Service develop a common definition of salvage timber which is within the limits of their underlying legislative authorities. A March 4,1997, followup action plan developed by the interagency team recommended a legislative proposal to address this issue. This proposal had not been submitted to the Congress as of September 1, 1997. We believe that the Bureau of Land Management should review these matters to ensure that the Forest Ecosystem Health and Recovery Fund is administered effectively and efficiently.

Although the report did not contain any recommendations, the Director, Bureau of Land Management, in a March 31, 1998, response to the preliminary final report (Appendix 3), stated that because of our report, "Several items were brought to BLM's [Bureau of Land Management's] attention which will strengthen the integrity of the program."

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the assistance of Bureau personnel in the conduct of our audit.

OFFICES CONTACTED OR VISITED

OFFICES CONTACTED OR VISITED	LOCATION
National Offices	
Bureau of Land Management Budget Office	Washington D.C.
Bureau of Land Management Finance Office	Washington D.C.
Forest Ecosystem Health and Recovery Fund Program Coordinator	Boise, Idaho
Forestry Program Office	Washington, D.C.
National Business Center*	Lakewood, Colorado
National Law Enforcement Office	Boise, Idaho
Office of the Solicitor	Washington, D.C.
Arizona	
Arizona State Office	Phoenix, Arizona
Arizona Strip District*	St. George, Utah
California	
Eagle Lake Resource Area Office	Susanville, California
Folsom Resource Area	Folsom, California
Colorado	
Kremmling Resource Area	Kremmling, Colorado
Royal Gorge Resource Area Office	Canon City, Colorado
Idaho	
Idaho State Office	Boise, Idaho
Upper Columbia/Salmon Clearwater Districts	Coeur d'Alene, Idaho
Montana	
Butte District Office	Butte, Montana
Oregon	
Oregon State Office	Portland, Oregon
Coos Bay District Office	North Bend, Oregon
Eugene District Office	Eugene, Oregon
Klamath Falls Resource Area	Klamath Falls, Oregon
Medford District Office	Medford, Oregon
Roseburg District Office	Roseburg, Oregon
Wyoming	
Worland District Office	Worland, Wyoming
Rawlins District office	Rawlins, Wyoming

* Offices visited.

United States Department of the Interior

OFFICE OF THE SOLICITOR
Washington, D.C. 20240

JAN 28 1998

Memorandum

To: Director, Bureau of Land Management

From: Deputy Associate Solicitor - Division of General Law

Subject: Federal Share of Salvage Timber Receipts

In a memorandum of May 28, 1997 regarding the handling of salvage timber receipts from timber sales in Western Oregon from Oregon and California (O&C) and Coos Bay Wagon Road (CBWR) grant lands, the Bureau of Land Management (BLM) requested an opinion on whether BLM has been correct in depositing all salvage timber receipts from O&C and CBWR lands to the Forest Ecosystem Health and Recovery Fund (FEHRF). BLM has interpreted the statutory language establishing the FEHRF and the Omnibus Budget Reconciliation Act of 1993 as permitting this treatment of salvage timber receipts. The Office of Inspector General, in its auditing of BLM's salvage timber program, has questioned this interpretation. We find that BLM's interpretation of these laws is reasonable and therefore conclude BLM's treatment of these funds has been correct.

Background

Prior to fiscal year 1994, in accordance with statutes enacted in 1937 and 1939,[1] (1937 and 1939 statutes), 18 counties in Western Oregon (collectively, the counties) received as the result of timber sales on O&C and CBWR grant lands in the counties a share of timber harvest stumpage fee receipts through a permanent indefinite appropriation of these fee receipts. These fee receipts included stumpage fees from both so-called "green" or

[1] Title II of the Act of August 28, 1937, 50 Stat. 875, chapter 876; 43 U.S.C. 1181f, and the Act of May 24, 1939, 53 Stat. 753, chapter 144; 43 U.S.C. 1181f-1 et seq.

healthy timber, and "salvage" timber; i.e., timber that has been damaged by fire, insects, or disease.

Under the 1937 and 1939 statutes, 50 percent of timber receipts from O&C grant lands were paid to O&C counties, and 75 percent of timber receipts from CBWR grant lands were paid to CBWR counties. The remaining receipts were deposited in the General Fund of the United States Treasury (Treasury). In both fiscal years 1992 and 1993, Congress appropriated additional funds in the annual Department of the Interior (DOI) appropriation acts to supplement the counties' share of timber receipts because receipts from timber harvest stumpage fees in those years were lower than historical levels. The lower level of receipts had reduced the payments to the counties to a level below that which Congress thought was adequate.

Establishment of Forest Ecosystem Health and Recovery Fund

In the fiscal year 1993 DOI appropriation act[2], Congress established the FEHRF as a new permanent indefinite appropriation to BLM, using receipts from salvage timber sales. The appropriations language is as follows:

> "[There is] . . . established in the Treasury of the United States a special fund to be derived hereafter from the Federal share of moneys received from the disposal of salvage timber prepared for sale from the lands under the jurisdiction of the Bureau of Land Management, Department of the Interior. The money in this fund shall be immediately available to the Bureau of Land Management without further appropriation, for the purposes of planning and preparing salvage timber for disposal, the administration of salvage timber sales, and subsequent site preparation and reforestation."

This permanent indefinite appropriation supplements BLM's annual appropriations by several million dollars. At the time of the passage of the 1993 DOI appropriation act and its establishment of FEHRF, the split of timber receipts between the counties and

---

[2] FY 1993 Interior Appropriation Act, Public Law 102-381, 106 Stat. 1374, 1376 (October 5, 1992).

Federal government was governed by the 1937 and 1939 statutes, which, as indicated above, provided for a 50/50 or 75/25 split of all receipts between the counties and the Federal government.

1993 Omnibus Budget Reconciliation Act

Almost a year after the creation of the FEHRF, Congress, in the 1993 Omnibus Budget Reconciliation Act[3] (OBRA 93), changed for fiscal years 1994 through 2003 the arrangement for making the payments to the counties. This new law changed both the method of determining the payment amounts and the source of funds for making the payments.

Under OBRA 93, the payment to the counties is called the "special payment amount", and the formula for determining the amount is as follows: the "special payment amount" equals the average level of receipts from fiscal years 1986 through 1990 multiplied by a declining percentage, beginning with 85 percent for fiscal year 1994, and declining by 3 percent per year through fiscal year 2003. From fiscal year 1999 through fiscal year 2003, the payments will be in accordance with the law in effect before OBRA 93, or the "special payment amount" whichever is greater. Therefore, the payments to the counties, through fiscal year 1998, and potentially in fiscal years 1999-2003, are no longer related to current levels of timber receipts, and the payments are made through an appropriation from the General Fund of the Treasury, not from timber receipts.[4]

---

[3] Omnibus Budget Reconciliation Act of 1993, Public Law 103-66, 107 Stat. 682 (August 10, 1993).

[4] The original OBRA 93 language was deficient in that it did not identify a source of funds, one of the requirements of an appropriation. In an opinion dated October 5, 1994, Solicitor Leshy stated that OBRA 93 had not repealed the authority to make payments to the counties from timber receipts, but had attempted to provide an alternative source from which the payments could be made. Therefore, because of the deficiency in OBRA 93, the payment for fiscal year 1994 was made from timber receipts based on the old formula. Later, Congress amended OBRA 93 to remedy

(continued...)

Beginning in fiscal year 1995, payments to the counties have been made with appropriations from the General Fund, and BLM has deposited all "green", that is, non-salvage, timber fee receipts to the General Fund. All salvage timber fee receipts, except for a small amount from public domain lands, which were not affected by OBRA 93, have been deposited to the FEHRF[5].

Analysis

Whether BLM's practice has been correct depends upon whether the "Federal share" is now 100 percent of salvage timber fee receipts. Therefore, you asked if the definition of "Federal share" of salvage timber fee receipts refers to the percentage split that existed at the time the FEHRF was established, or whether the enactment of OBRA 93 changed the meaning of the term. Put another way, the question is whether the Congress, in creating the FEHRF (using the term "Federal share") and in enacting OBRA 93, intended to appropriate to the BLM 50 or 25 percent of salvage timber receipts, or whether Congress intended to appropriate whatever amount of receipts was not paid by the Federal government to the counties[6].

---

[4](...continued)
the deficiency in the appropriations language by specifically providing that the special payment would come from the General Fund of the Treasury. Public Law 103-443, 108 Stat. 4631.

[5] BLM has been depositing 100 percent of salvage timber receipts to the FEHRF based on informal advice from the Solicitor's Office. Memorandum dated June 16, 1995, to Team Leader, Budget and Finance Team, WO-880, signed by Michael Kirby.

[6] The legislative history of the FY 1993 appropriations act is not very illuminating on the question. The Senate report states, "The receipts from timber salvage receipts are to be deposited in the 'Forest ecosystems health and recovery account' . . .", S. Rep. No. 102-345 at 12 (1993)(emphasis added), indicating that all salvage timber receipts retained by the Federal government should be deposited to the FEHRF. At the time the report was written, however, there was no choice in the
(continued...)

Although there is clearly ambiguity about how "Federal share" should be interpreted, we believe the structure for payment of the "special payment amount" in OBRA 93 creates a sound basis for concluding that BLM's practice is correct. When Congress established in OBRA 93 that the counties would receive their "special payment amount" from the General Fund of the Treasury rather than the timber receipts themselves, Congress intended that for the years covered by OBRA 93, the salvage timber receipts were not to be deposited for the benefit of the counties. Thus, under our interpretation, the counties have no "share" of the salvage timber receipts for the years covered by OBRA 93, with the result that all the receipts are the "Federal share". To conclude that the "Federal share" is not comprised of all the salvage timber receipts would place the receipts that had formerly been paid to the counties in a "limbo" status, and would negate the philosophy underlying the enactment of OBRA 93.

We do not believe that references in 43 U.S.C. § 1181f(c) and 1181f-4 (portions of the statutes creating the mechanism for paying the counties percentages of timber fee receipts) to maximum percentages of receipts available for appropriation for the administration of the O&C and CBWR programs are in any way dispositive of the question at issue. When Congress used the term "Federal share" in the FY 1993 DOI appropriations act rather than referring to 43 U.S.C. §§ 1181f and 1181f-1 or particular percentages of salvage timber fee receipts it was appropriating, it eliminated the upper limit of what the "Federal share" could be. Thus, when it enacted OBRA 93, Congress established the special payment amount for a fixed period of years and, as discussed above, increased the amounts of the "Federal share" to 100 percent.

---

[6](...continued)
handling of those receipts. The pre-OBRA 93 statutory distribution was required then, and depositing all salvage timber receipts to the FEHRF was clearly not authorized. A fair reading of this language is that it was addressing the Federal share of timber receipts, which was at that time only a partial share of the receipts.

We believe this interpretation of "Federal share" to be reasonable under all the circumstances presented here. See Chevron v. Natural Resources Defense Council, 467 U.S. 837 (1984); Udall v. Tallman, 380 U.S. 1,16 (1965).

Conclusion

Based on the above analysis, we conclude that through FY 2003, in any year when the payments to the counties are made from a General Fund appropriation under OBRA 93, all salvage timber fee receipts will be retained by the Federal government and deposited to the FEHRF. Between FY 1999 and FY 2003, if the payments are made from timber fee receipts under the pre-OBRA 93 formula, only the portion of such receipts retained by the Federal government should be deposited to the FEHRF.[7]

Questions on this opinion should be directed to Robert H. Moll on 208-5216.

Timothy S. Elliott

Timothy S. Elliott

[7] OBRA 93 is silent about the period after FY 2003, with the result that the law applicable prior to OBRA 93 will be in effect. Nevertheless, the manner of handling the salvage timber receipts would remain the same, that is, the portion of salvage receipts retained by the Federal government would be deposited to the FEHRF.

United States Department of the Interior

BUREAU OF LAND MANAGEMENT
Washington, D.C. 20240

In Reply Refer To:
5000 (230)

March 30, 1998

Memorandum

To: Acting Assistant Inspector General for Audits

Through: Acting Assistant Secretary, Land and Minerals Management Piet deWitt MAR 31 1998

From: Director, Bureau of Land Management

Subject: Response to Preliminary Final Advisory Report, Salvage Timber Program, Bureau of Land Management, March 1998 (C-IN-BLM-001-97)

Following an in-depth review of the Bureau of Land Management's (BLM) salvage timber program, the report found no recommendations were necessary. The report found the Bureau (1) conducted sales of salvage timber in an expedient manner; (2) adequately controlled the theft of timber from lands administered by this agency; and (3) used the Forest Ecosystem Health and Recovery Fund as Congress intended. This satisfied the objectives of the review. The report concurred with the findings of our Solicitor's opinion regarding the deposit of receipts from the sale of salvage timber from the Oregon and California counties in western Oregon.

I appreciate the cooperative and informative nature of this review. Several items were brought to the BLM's attention which will strengthen the integrity of the program. The BLM personnel were encouraged to cooperate in every way and the report acknowledged their assistance. Although a response is not required, I take this opportunity to thank you and your employees for bringing this to a successful conclusion.

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free Numbers:
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

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

AUDIT REPORT

FOLLOWUP OF RECOMMENDATIONS CONCERNING UTILITY RATES IMPOSED BY THE NATIONAL PARK SERVICE

REPORT NO. 98-I-406
APRIL 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

APR 15 1998

AUDIT REPORT

Memorandum

To: Assistant Secretary for Fish and Wildlife and Parks

From: Robert J. Williams
Acting Inspector General

Subject: Audit Report on Followup of Recommendations Concerning Utility Rates Imposed by the National Park Service (No. 98-I-406)

INTRODUCTION

This report presents the results of our followup review of recommendations contained in our January 1991 audit report "Utility Rates Imposed by the National Park Service" (No. 91-I-333). The objective of the followup review was to determine whether the National Park Service had satisfactorily implemented the recommendations in the prior report and whether any new recommendations were warranted.

BACKGROUND

The Park Service often provides utility services, including water, electricity, and waste removal, to non-Governmental users, such as concessioners, inholders, and state agencies. In some park units, the Park Service constructs and operates its own utility systems, while in other park units, the Park Service purchases utility services from public utility companies. Federal law and regulations require the Park Service to obtain reimbursement for the cost of providing these services. Specifically, Title V of the Independent Offices Appropriations Act of 1952 (the User Fee Statute) authorizes Federal agencies to charge fees for services or benefits provided to beneficiaries. Office of Management and Budget Circular A-25,"User Charges," provides guidance to Federal agencies on implementing the User Fee Statute and requires agencies to establish internal controls over cash collections in accordance with Office of Management and Budget Circular A-123,"Internal Control Systems." Furthermore, the Department of the Interior Manual, Part 346, "Cost Recovery," requires (unless directed otherwise by statute or other authority) that a fee be established to recover an agency's costs for services such as utilities which provide special benefits or privileges to an identifiable non-Governmental recipient.

Park Service guidance and policies on utility cost recovery from non-Governmental users are contained in its June 20, 1985, Special Directive 83-2, "Rates for NPS-Produced Utilities." The Directive provides for the Park Service to recover from non-Governmental users its capital investment costs for constructing or expanding utility systems and for performing major rehabilitation or replacement of existing systems through cost sharing or other means. The Directive also provides for the recovery of utility system operational costs through the implementation of utility rates that are based on the higher of actual operational costs or comparable rates (rates for similar services in the same geographic location).

SCOPE OF AUDIT

To accomplish our audit objective, we reviewed construction data on capital investment costs at the Park Service's Denver Service Center, operational cost work sheets at specific parks, and reports from the Park Service's maintenance and financial management systems. We did not review source documents, such as individual time sheets and invoices, to verify the accuracy or completeness of the reported costs. We also reviewed the operating cost records and cash management procedures at the 4 parks we visited and sent questionnaires to 15 parks (including the 4 parks visited) at which, according to Service Center records, utility system construction had taken place since our prior audit. (Sites visited or contacted are in Appendix 2.) The responses to the questionnaires indicated that 11 of the 15 parks had each spent at least $1 million of appropriated funds on utility systems which would serve non-Governmental users and which were completed or almost completed at the time of our current review. In addition, we contacted officials at public utility companies to determine comparable rates and the companies' methodologies for recovering capital investment costs.

Our audit was made, as applicable, in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances. We also reviewed the Department's Fiscal Year 1996 Annual Report on Accountability, which includes information required by the Federal Managers' Financial Integrity Act of 1982, and the Park Service's annual assurance statement to determine whether any reported weaknesses were within the objective and scope of our review. Neither the Accountability Report nor the Park Service's assurance statement reported control weaknesses in the Park Service's recovery of utility system costs. Because of the limited scope of our review, we did not evaluate the Park Service's system of management controls related to cost recovery for utility services.

PRIOR AUDIT COVERAGE

The General Accounting Office has not issued any audit reports during the past 7 years that addressed the Park Service's recovery of utility system costs. However, the Office of Inspector General issued the report "Utility Rates Imposed by the National Park Service" in January 1991, which is the subject of this followup report. The January 1991 report stated that the Park Service was not recovering the cost of capital investments for utility systems that benefited non-Governmental users and was not fully recovering operational costs. We also found that procedures for the separation of duties for the billing and collection functions

and for the timely deposit of receipts were not enforced in accordance with the Park Service Operations and Evaluation Manual. The report recommended that the Park Service (1) revise Special Directive 83-2 to include specific guidelines for recovering capital investments in utility systems from non-Governmental users, (2) ensure compliance with the guidelines, (3) ensure that the park units were fully recovering operational costs, (4) provide training to park personnel who are responsible for establishing utility rates, and (5) ensure that internal controls over the collection and deposit of receipts for utility services were in compliance with prescribed procedures. The Park Service, in its December 5, 1990, response to the draft report, concurred with all of the report's recommendations. However, in an October 6, 1995, memorandum to the Director, Office of Financial Management, regarding implementation of those recommendations, the Park Service stated that recommendations regarding the recovery of capital investments were "rendered obsolete" because the Park Service had eliminated possessory interest from concession contracts. Based on that memorandum, the Office of Financial Management considered all of the recommendations implemented. We disagree that the recommendations are obsolete based on the action taken, as discussed in the Results of Audit section of this report.

RESULTS OF AUDIT

We found that none of the five recommendations made in our January 1991 report were fully implemented. Specifically, the National Park Service (1) did not establish procedures or issue specific guidance which ensured that the parks fully recovered their operating and investment costs in utility systems from concessioners and other non-Governmental users, (2) did not provide adequate oversight of the parks' cost recovery efforts, (3) did not ensure that park personnel were provided training in developing utility rates, and (4) did not ensure that all the parks were complying with prescribed standards pertaining to the separation of duties for the billing and collection functions and to the timeliness of deposits. As a result, from January 1991 through August 1997, the Park Service did not seek recovery of costs totaling about $6.3 million from non-Governmental users and may not recover additional capital investment costs of as much as $31.3 million unless it revises its procedures.

Prior Audit Report Recommendations

Recommendation A.1. Revise Special Directive 83-2 to include specific guidelines for recovering capital investments in utility systems that are identifiable to non-Government users. Any exceptions to full recovery of such capital investments should be properly authorized and documented.

Our prior audit report stated that, although Special Directive 83-2 authorized the parks to pursue cost sharing or other means of capital cost recovery, the Directive did not provide specific guidance on how cost recovery should be implemented. The report also stated that even when guidance was requested by park officials, it was not provided by Park Service headquarters officials. For example, according to the report, in December 1989, the Regional Director, Western Region, requested that Park Service headquarters provide specific guidance on whether cost recovery was mandatory, what approach should be used to recover

costs, and what types of costs were considered capital costs. However, the Region did not receive a response to its request. The report further stated that officials at the Denver Service Center, which is responsible for planning and financing new or expanded utility systems, were not aware of the requirement to pursue recovery of capital investment costs. In its response to the report, the Park Service agreed that non-Governmental users should pay a share of capital investment costs "to the extent that it is economically feasible" and said that it would document and justify the basis for any instances of less than full cost recovery.

In an October 6, 1995, memorandum to the Director, Office of Financial Management, regarding the status of implementation of the recommendations, the Park Service's Chief of the Accountability and Audit Team stated that the Park Service had taken all necessary actions to implement the outstanding recommendations. The memorandum further stated that Recommendations A.1 and A.2 had been "rendered obsolete" because the Park Service "had eliminated possessory interest from concession contracts so that capital investment is restricted to Government assets."

We do not consider the elimination of possessory interest from concession contracts to be relevant to the Park Service's recovery of its utility system investment costs from benefiting non-Governmental users. Accordingly, during our followup review, we asked the Park Service to explain how the elimination of possessory interest affected the Park Service's ability to recover utility system investment costs from benefiting non-Governmental users. Park Service officials did not provide a response to our inquiry. In our opinion, the elimination of concessioners' possessory interest has no bearing on the Park Service's recovery of utility system investment costs that were financed by the Government. In addition, at the parks visited, we did not identify any provisions in the two concessions contracts reviewed that would restrict the recovery of utility system capital investment costs. Consequently, we do not agree that Recommendations A.1 and A.2 are obsolete.

Despite the October 1995 memorandum, Park Service officials, during our followup review, stated that Park Service policy is to recover investments in utility systems when feasible. However, we found that the Park Service had not pursued the recovery of these costs, and no documentation was provided to show that the Park Service had analyzed the non-Governmental users' ability to pay these costs and/or had authorized an exemption to full cost recovery. Specifically, since January 1991, the Park Service has spent appropriated funds totaling $20,051,248 to construct utility systems at three of the four parks visited, of which $12,321,425 was subject to recovery from non-Governmental users. At the fourth park, a $1,526,462 construction project, which was not completed at the time of our review, had reimbursable costs of $870,083. However, the Park Service has not pursued recovery of these costs, which totaled $13,191,508 ($12,321,425 and $870,083) at the four parks visited, including $2,490,414 that was subject to recovery in fiscal years 1991 through 1997. The $10,701,094 balance could be recovered in future periods based on a 30-year project life calculated from the date of completion. Specifically:

- Grand Canyon National Park had not pursued the recovery of costs for constructing a water treatment facility and an electrical distribution system. The total cost of the systems was $10,746,849. Based on our review of consumption data, we determined that 86 percent

($9,242,290) was attributable to use by 26 non-Governmental users. We also determined that investment costs of $2,053,823 were subject to recovery but were not billed and collected from concessioners for fiscal years 1991 through 1997.

- Mesa Verde National Park had not pursued the recovery of costs for constructing a water treatment plant and pipelines. The total cost of the systems was $6,901,574. Based on our review of consumption data, we determined that the concessioner's use was 38 percent ($2,622,598). We also determined that investment costs of $360,502 were subject to recovery but were not billed and collected from the concessioner for fiscal years 1991 through 1997.

- Lake Mead National Recreation Area had not pursued the recovery of costs for constructing a sewage lagoon. The cost of the lagoon was $2,402,825, of which the concessioner's use was 19 percent ($456,537) based on consumption data. We determined that investment costs of $76,089 were subject to recovery but were not billed and collected from the concessioner for fiscal years 1993 through 1997. In addition, we found that the Recreation Area plans to spend $11.5 million for water treatment and wastewater facilities in fiscal years 1998 and 1999 and that it has not formalized any commitment for repayment of these costs from the concessioner.

- Glacier National Park had obligated $1,526,462 for rehabilitation of the Sperry Chalet utility system. We estimated that the concessioner's use would be 57 percent ($870,083). The Park Service plans to complete this project in 1998.

In addition to the results of our reviews at the four parks visited (having recoverable capital investment costs of about $13.2 million, of which $2.5 million was subject to recovery in fiscal years 1991 through 1997), we identified additional capital investment costs of $22,879,158 at 7 of the 11 parks contacted. Based on responses to our questionnaire, we determined that $2,294,710 was subject to recovery in fiscal years 1991 through 1997. However, none of these seven parks had pursued recovery of these costs. In total, we estimated that capital investment costs of $36 million were recoverable, of which $4.8 million was subject to recovery in fiscal years 1991 through 1997.

Based on discussions with Park officials, we concluded that costs were not recovered because Park personnel did not understand how to implement the provisions of Special Directive 83-2 regarding recovery through "cost sharing or other means." Consequently, we consider Recommendation A.1 not implemented.

Recommendation A.2. Provide sufficient oversight of all Park Service areas to ensure that capital investments in utility systems that are identifiable to non-Government users are fully recovered or that any exceptions to full recovery are properly authorized and documented.

Our prior audit found that the Park Service did not ensure that the parks pursued cost sharing or other means of recovering capital investment costs. As a result, we estimated that unless the Park Service revised its guidelines and provided sufficient oversight of individual parks,

the Park Service would not recover utility system investment costs of $32.5 million for fiscal year 1990 and beyond.

Our followup review found that the Park Service did not provide sufficient oversight of the parks' cost recovery efforts. For example, the Park Service, in its response to the prior audit report, stated that it will "delegate an individual in the Washington Office the responsibility for the Utility Fee Program." However, the various individuals whom the Park Service identified as having responsibility for oversight told us that they were not aware that they had been delegated such responsibility and that they had not performed any oversight reviews. As such, we consider Recommendation A.2 not implemented.

Recommendation B.1. Ensure that all Park Service areas comply with Special Directive 83-2. At a minimum, this action should include assigning specific individuals within the regional offices the responsibility of ensuring that the areas comply with the Directive.

Our prior audit found that the Park Service did not ensure that its field sites were complying with Special Directive 83-2 in formulating utility rates. As a result, we estimated that the Park Service did not recover operational costs of at least $2.6 million for utility services provided to non-Governmental users during fiscal years 1986 through 1989.

Our followup review found that the Park Service issued a November 27, 1995, memorandum designating 10 regional officials as Cost Recovery Liaison Officers. However, we found that 4 of the 10 officials were unaware of their designations or responsibilities, 4 had retired before the memorandum was issued (2 of these individuals had retired 31 and 16 months, respectively, before the memorandum was issued), and 2 officials had retired after the memorandum was issued. The regions did not reassign the responsibilities to other employees. As such, we concluded that the Park Service did not ensure that the field offices were ensuring compliance with Special Directive 83-2, which resulted in estimated unrecovered operational costs of $1,537,018 in fiscal years 1995 through 1997 at the four parks visited. For example:

- Grand Canyon National Park had not recovered operational costs of $551,927 for fiscal year 1995 because the Park official responsible for establishing the utility rates at the time mistakenly believed that rate increases were limited to 15 percent annually. The fiscal year 1995 water rate was established at $6.85 per thousand gallons despite information which indicated that the rate should have been $8.46 per thousand gallons. This official no longer works at the Park, and the rates for fiscal years 1996 and 1997 have been reestablished without this limitation. However, the 1996 rate ($9.09 per thousand gallons) did not include salary costs of $80,000 for maintenance support personnel, such as the Chief of Maintenance, the Maintenance Management Assistant, the Auto Shop supervisor, and maintenance clerks, that should have been reimbursed annually for fiscal years 1995 through 1997.

- Lake Mead National Recreation Area had not recovered operational costs of $384,000 for fiscal year 1997 because Recreation Area personnel excluded cyclic maintenance costs from the rate calculations. Since Special Directive 83-2 does not specify the costs that should be included as operational costs, Recreation Area personnel indicated

that there was "some confusion" as to what costs they should include in the rate computation. In addition, we identified maintenance supervisory personnel costs of $55,000 that were not included in the rates for fiscal years 1995 and 1997. The Recreation Area was not able to provide support for fiscal year 1996 costs because no rate work sheets were prepared. As such, we were unable to determine whether these personnel costs were excluded for that fiscal year.

- Mesa Verde National Park had not recovered operational costs totaling $60,981 for fiscal years 1995 through 1997 because the Park used the 1995 rate (based on 1994 actual costs) for 1996 and 1997. Therefore, the Park was not recovering cost increases attributable to inflation, such as cost of living increases for personnel, that had occurred since May 1994. In addition, the Park was recovering only 1 percent of its maintenance supervisory costs, even though Park officials said that a larger percentage should be recovered. Mesa Verde was the only park visited that included any maintenance supervisory costs in its rate calculation.

- Glacier National Park had not recovered estimated operational costs of $190,110 for fiscal year 1997 because utility charges were based on comparable rates that did not fully compensate the Park for actual maintenance costs incurred. Park maintenance personnel stated that they were unable to fully identify actual utility system costs in the accounting records or to estimate actual costs accurately. As a result, according to Park personnel, the Park established comparable rates based on local public utility company rates. We estimated the Park's reimbursable maintenance costs by determining the amount of maintenance costs attributable to utility systems, using data from the Park Service's Federal Financial System, and multiplying this amount by the percentage of non-Governmental use. The resultant amount was $190,110 higher than the amounts recovered, which were based on the comparable rates.

Based on these examples, we concluded that the Park Service had not properly delegated oversight responsibilities to specific individuals or provided sufficient oversight to ensure compliance with the Special Directive, which resulted in the parks not fully recovering their operational costs. Accordingly, we consider Recommendation B.1 not implemented.

Recommendation B.2. Ensure that all pertinent personnel at Park Service areas which provide utility services to non-Governmental users are trained and/or provided adequate guidance to formulate utility rates in accordance with the Park Service Special Directive 83-2.

Our prior audit report stated that the Park Service had not adequately trained and/or provided sufficient guidance to individuals who were responsible for formulating the utility rates. In its response to the prior report, the Park Service stated that training needs would be reviewed and a specific plan would be developed. The Park Service further stated that it would suggest joint training among regions to establish uniform application of Park Service policies and procedures and to promote the cost effectiveness of training.

Our followup review found that the actions outlined in the response had not been taken to provide training or guidance in the development of utility rates. Specifically, the employees responsible for developing utility rates at the 11 parks that had new utility systems which served non-Governmental users stated that they had not been provided training in the development of the rates or on the Special Directive and that, as discussed under Recommendations A.1 and B.1, sufficient guidance had not been provided by Park Service headquarters. Therefore, we consider Recommendation B.2 not implemented.

Recommendation C.1. Ensure that all Park Service areas providing utility services to non-Governmental users review their internal controls applicable to receipts and deposits and ensure that such controls are in compliance with prescribed standards. The areas should be required to provide written verification of compliance with prescribed standards to an organizational appointee designated by the Director.

Our prior audit found that the Park Service was not ensuring that all park units were complying with prescribed standards pertaining to the separation of duties for the billing and collection functions and to the timeliness of deposits, as required by Office of Management and Budget Circular A-123, "Internal Controls." Specifically, although the Park Service's Operations Evaluation Manual provided adequate guidelines for the separation of duties for the billing and collection functions, park personnel were not complying with the guidelines. As a result, the Park Service could not provide reasonable assurance that Government resources were protected from fraud, mismanagement, or misappropriation. In its response to the prior report, the Park Service stated that it would require park managers to evaluate the adequacy of their collection processes and that Servicewide compliance would be determined by the individual delegated responsibility for the utility program (see Recommendation B.1).

Our followup review found that there was not sufficient separation of duties at two of the four parks visited and that deposits were not made timely at three of the four parks visited as follows:

- At Mesa Verde National Park, we reviewed seven utility payments that exceeded $5,000 during fiscal years 1994 through 1996 to determine whether the Park was complying with Section IIB of guidance entitled "National Park Service Collection Procedures," which requires that deposits be made when the accumulated amount reaches $5,000. We found that six of the seven receipts were deposited from 1 to 17 days late. For example, one receipt for $20,760 on August 13, 1996, was not deposited until August 30, 1996, or 17 days after it was received. In addition, we found that the same individual who prepared the bills for collection also received payments and made deposits.

- At Glacier National Park, the same individual who prepared the bills also received the payments and deposited the receipts.

- At Grand Canyon National Park, there were undeposited receipts totaling $130,470 at the time of our visit on May 29, 1997. The receipts totaled more than $5,000 as of May 8, 1997; therefore, the deposit was overdue by 21 days.

- At Lake Mead National Recreation Area, we reviewed three deposits made on July 14, 1997, and found that one deposit for $28,449 contained a $22,849 receipt from July 2, 1997, which was deposited 12 days late.

Based on the cited examples, we consider Recommendation C.1 not implemented.

Other Issues

During our review, we obtained additional information that we believe the Park Service should consider in revising its cost recovery procedures. Specifically, we contacted five public utility companies and found that they recovered their capital investments through the rate process, which Special Directive 83-2 does not allow. In our opinion, the recovery of capital investment costs through the rate process rather than through the cost-sharing process, for which no guidance has been issued, would be easier for the parks to implement and would be consistent with utility company practices. Accordingly, we believe that the Park Service should revise the Special Directive to allow the parks to recover capital investment costs through the monthly billing process.

We also found that the Park Service had not provided sufficient guidance regarding the retention and use of utility cost reimbursements. As a result, officials at the four parks we visited stated that they were unsure of how the funds could be used and that they were returning all unspent funds in their utility reimbursement account to the U.S. Treasury at the end of each fiscal year. Park Service budget officials, who cited no regulations to support their position, said that the parks may retain and use such funds, provided that an adequate justification is prepared to support the need to carry over the funds to a subsequent year. To resolve any ambiguity regarding the proper retention and use of utility reimbursements, we believe that the Park Service should issue guidance, in coordination with the Solicitor's Office, to the parks regarding the retention of accumulated reimbursements of both operational and capital investment costs and ensure that such guidance is in accordance with applicable laws and regulations.

Recommendations

We recommend that the Director, National Park Service:

1. Revise Special Directive 83-2 to include specific guidelines for recovering capital investments in utility systems that are identifiable to non-Governmental users and to allow for the recovery of these investments through the utility rate process. Any exceptions to full recovery of such capital investments should be properly authorized and documented.

2. Establish an oversight process to ensure that capital investments in utility systems and operational costs which are identifiable to non-Governmental users are fully recovered and that any exceptions to full recovery are properly authorized and documented.

3. Issue guidance for the recovery of operational costs of utility systems. The guidance should include but not be limited to the various types of direct and indirect park maintenance costs that are to be included in rate computations and procedures for developing the rates.

4. Ensure that adequate training and/or guidance is provided to personnel who are responsible for formulating utility rates.

5. Ensure that park units which provide utility services to non-Governmental users have adequate internal controls relating to the separation of duties for the billing and collection functions and for the timely deposit of receipts.

6. Issue guidance to all park units on the procedures for retaining and spending utility system cost reimbursements and ensure that such guidance is in accordance with applicable laws and regulations.

National Park Service Response and Office of Inspector General Reply

In the March 26, 1998, response (Appendix 3) to our draft report from the Director, National Park Service, the Park Service generally concurred with the report's conclusions. Based on the response, we consider Recommendations 1 through 5 resolved but not implemented and Recommendation 6 unresolved. Accordingly, the unimplemented recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation, and the Park Service is requested to reconsider its response to Recommendation 6 (see Appendix 4).

The Park Service said that it did not concur with Recommendation 6 because the recommendation "implie[d] that the National Park Service has the authority to retain the capital costs recovered." The Park Service said that it would obtain a Solicitor's opinion regarding the retention and use of utility system capital cost reimbursements to settle the "question of authority." Although not incorporated into the recommendation, the discussion of this issue (page 9) states that Park Service budget officials did not provide any regulations to support their position that these funds could be retained. The report further notes that "to resolve any ambiguity regarding the proper retention and use of utility reimbursements, we believe that the Park Service should issue guidance, <u>in coordination with the Solicitor's Office</u>, to the parks regarding the retention of accumulated reimbursements of both operational and capital investment costs and ensure that such guidance is in accordance with applicable laws and regulations." (Emphasis added.) We believe that the Park Service's proposed action, when completed, should partially satisfy the intent of the recommendation. To fully implement the recommendation, the Service should request that the Solicitor's opinion also address the retention and use of utility system operational cost reimbursements. In addition, the Service needs to issue guidance on the appropriate accounting treatment for these reimbursements, particularly operational cost recoveries that are carried over from one fiscal year to the next. Furthermore, if the Solicitor finds that the Park Service can retain and use capital cost reimbursements, the Park Service will need to develop guidance on the

recording and use of these cost recoveries. Accordingly, the Park Service is requested to reconsider its response to this recommendation.

In accordance with the Departmental Manual (360 DM 5.3), please provide us with your written comments to this report by May 15, 1998. The response should provide the information requested in Appendix 4.

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, the monetary impact of audit findings (Appendix 1), actions taken to implement recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the assistance of National Park Service personnel in the conduct of our audit.

APPENDIX 1

CLASSIFICATION OF MONETARY AMOUNTS

Finding Area	Lost Revenues	Potential Additional Revenues
Recovery of Capital Investment	$4,785,124	$31,285,542
Recovery of Operational Costs	1,537,018	
Total	$6,322,142	$31,285,542

RECOVERY OF CAPITAL INVESTMENT

PARK OR RECREATION AREA	CAPITAL INVESTMENT	RECOVERABLE AMOUNT		
		LOST	POTENTIAL ADDITIONAL REVENUES	TOTAL
Visited				
Grand Canyon National Park	$10,746,849	$2,053,823	$7,188,467	$9,242,290
Mesa Verde National Park	6,901,574	360,502	2,262,096	2,622,598
Lake Mead National Recreation Area	2,402,825	76,089	380,448	456,537
Glacier National Park	1,526,462	0	870,083	870,083
Total	$21,577,710	$2,490,414	$10,701,094	$13,191,508
Contacted				
Bryce Canyon National Park	$1,777,000	0	0	0
Cuyahoga Valley National Recreation Area	3,499,900	0	0	0
Gateway National Recreation Area	2,892,000	$4,820	$428,980	$433,800
Golden Gate National Recreation Area	6,513,973	202,563	2,169,346	2,371,909
Hawaii Volcanoes National Park	1,991,162	65,708	591,375	657,083
Independence National Park	17,089,100	0	0	0
Kalaupapa National Historic Park	2,786,097	0	0	0
Petrified Forest National Park	1,337,294	43,834	223,625	267,459
Sequoia & Kings Canyon National Park	16,248,543	495,299	5,029,206	5,524,505
Yellowstone National Park	5,633,228	0	2,985,611	2,985,611
Yosemite National Park	14,779,792	1,482,486	9,156,305	10,638,791
Total	$74,548,089	$2,294,710	$20,584,448	$22,879,158
TOTAL ALL AREAS	$96,125,799	$4,785,124	$31,285,542	$36,070,666

United States Department of the Interior

NATIONAL PARK SERVICE
1849 C Street, N.W.
Washington, D.C. 20240

IN REPLY REFER TO:
F4217(2612)

MAR 2 6 1998

Memorandum

To: Acting Inspector General

From: Director

Subject: Draft Audit Report on Follow-up of Recommendations Concerning Utility Rates Imposed by the National Park Service (Assignment No. C-IN-NPS-001-97)

This responds to the draft audit report on utility rates that was issued by your office on February 12, 1998 and containing six recommendations for our consideration. We generally agree with the conclusions stated in the report. Our specific comments follow.

Recommendation 1: "Revise Special Directive 83-2 to include specific guidelines for recovering capital investments in utility systems that are identifiable to non-Governmental users and to allow for the recovery of these investments through the utility rate process. Any exceptions to full recovery of such capital investments should be properly authorized and documented."

Response: We concur in the recommendation. The Associate Director, Park Operations and Education (Concession Program), will revise Special Directive 83-2 to include specific guidelines for recovering capital investments in utility systems that are identifiable to non-Governmental users and to allow for the recovery of these investments through the utility rate process. The target date for implementation is October 1999.

Recommendation 2: "Establish an oversight process to ensure that capital investments in utility systems and operational costs, which are identifiable to non-Governmental users, are fully recovered and that any exceptions to full recovery are properly authorized and documented."

Response: We concur in the recommendation. The Associate Director, Park Operations and Education (Concession Program), will establish an oversight process to ensure that capital investments in utility systems and operational costs which are identifiable to non-Governmental users are fully recovered and that any exception to full recovery are properly authorized and documented. The target date for implementation is October 1999.

Recommendation 3: "Issue guidance for the recovery of operational costs of utility systems. The guidance should include but not be limited to the various types of direct and indirect park maintenance costs that are to be included in rate computations and procedures for developing the rates."

Response: We concur in the recommendation. The Associate Director, Park Operations and Education, through the professional utility engineering staff at the Field Operations Technical Support Center (FOTSC) in Denver, will provide input to go into the Service's overall revision of the Special Directive 83-2. The directive will address procedures for developing rates as well as various direct and indirect park maintenance costs that should be included in rate computations relating to recovering operational costs of park-owned utility systems. The target date for implementation is October 1999.

Recommendation 4: "Ensure that adequate training and/or guidance is provided to personnel who are responsible for formulating utility rates."

Response: We concur in the recommendation. As part of the revision of the Special Directive 83-2, the Service will issue guidance to assist park and regional personnel who are responsible for formulating utility rates. The Associate Director, Park Operations and Education, through the professional utility engineering staff at the Field Operations Technical Support Center (FOTSC) in Denver, will provide input on appropriate guidance for park and regional personnel to formulate rates for the Service's overall revision of the Special Directive 83-2. The target date for implementation is October 1999.

Recommendation 5: "Ensure that park units which provide utility services to non-Governmental users have adequate internal controls relating to the separation of duties for the billing and collection functions and for the timely deposit of receipts."

Response: We concur in the recommendation. The Associate Director, Administration (Accounting Operations Center), will provide guidance to all parks regarding the proper procedures for the handling of deposits and the methodologies to be used to ensure that all deposits are made in a timely manner. The National Park Service will, through the appropriate managers, ensure that separation of duties relative to the billing and collection of funds is accomplished where possible, accounting for the individual situations in a park and the available staffing levels. The target date for implementation is October 1999.

Recommendation 6: "Issue guidance to all park units on the procedures for retaining and spending utility system cost reimbursements and ensure that such guidance is in accordance with applicable laws and regulations."

Response: We do not concur in the recommendation as it is stated. At the exit interview on February 5, 1998, this recommendation was discussed at length. The recommendation implies that the National Park Service has the authority to retain the capital costs recovered. The draft audit report cites neither law nor regulation that would support this position. Thus, the question of authority is not settled. We will ask for an opinion on this matter from the Solicitor and respond accordingly. The responsible official for this action is the Associate Director, Administration (Accounting Operations Center).

Thank you for providing us with the opportunity to respond to the draft audit report.

cc: Assistant Secretary for Fish and Wildlife and Parks
Director, Office of Financial Management

STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
1, 2, 3, 4, and 5	Resolved; not implemented	No further response to the Office of Inspector General is required. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation. However, in accordance with the Departmental Manual (361 DM 1.4), a detailed action plan, which includes quarterly milestones for completing implementation of all of these recommendations, should be provided to Policy, Management and Budget.
6	Unresolved.	Reconsider the recommendation, and provide a plan identifying actions to be taken, including target dates and titles of officials responsible for implementation.

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free Numbers:
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

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

AUDIT REPORT

THE ADOPT-A-HORSE PROGRAM, BUREAU OF LAND MANAGEMENT

REPORT NO. 98-I-419
APRIL 1998

United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

APR 30 1998

Memorandum

To: Director, Bureau of Land Management

From: Robert J. Williams
Acting Inspector General

Subject: Audit Report on the Adopt-A-Horse Program, Bureau of Land Management (No. 98-I-419)

This report presents the results of our audit of the Bureau of Land Management's Adopt-A-Horse Program, which is a part of the Wild Horse and Burro Program. This is the last of three reports we are issuing on the Wild Horse and Burro Program. The first report, "Expenditures Charged to the Wild Horse and Burro Program, Bureau of Land Management" (No. 97-I-375), dated February 1997, determined whether expenditures charged to the Program were used for Program purposes. The second report, "Management of Herd Levels, Wild Horse and Burro Program, Bureau of Land Management" (No. 97-I-1104), dated August 1997, determined whether the Bureau was effectively managing the herd levels and monitoring the health of wild horse and burro populations on public lands. (These two reports are synopsized in the Prior Audit Coverage section of this report.)

The overall objective of this audit was to determine whether the Bureau of Land Management was operating the Wild Horse and Burro Program in accordance with applicable laws and regulations, including provisions that ensure that the animals receive adequate health care and humane treatment. Specifically, at the request of the Acting Director of the Bureau of Land Management, this audit focused on whether the Bureau complied with its policies and procedures to ensure that excess wild horses and burros received humane care when they were placed in the Adopt-A-Horse Program.

We determined that the three Bureau Program offices we reviewed were not adequately screening prospective adopters, performing inspections of adopters' facilities and adopted animals, and issuing titles for eligible adopted animals. The Bureau of Land Management Handbook H-4750-2, "Adoption of Wild Horses and Burros," requires the Bureau to determine whether prospective adopters are eligible to adopt animals and to perform inspections of adopters' facilities and adopted animals. In addition, the Public Rangelands Improvement Act of 1978 authorizes the Bureau to convey title of the animals to adopters who have provided humane treatment to their adopted animals for 1 year. However, Bureau management did not perform oversight reviews to ensure that the procedures in the Handbook were complied with or that other effective procedures were established by all

Program offices; Bureau management at the Jackson Office and, to a lesser degree, at the other two offices we visited focused its efforts on placing excess animals into private care instead of fully complying with existing procedures; and the Wild Horse and Burro Information System did not contain adequate information on the eligibility of adopters and was difficult to use. As a result, the Bureau had little assurance that the adopted animals received humane care; some of the animals were mistreated; and titles for adopted animals were not always issued, which adversely affected the Bureau's accountability for these animals and unnecessarily extended the Bureau's legal responsibility for the animals.

We made five recommendations to the Bureau, which related to (1) conducting reviews of Program offices to ensure that screening, inspection, and titling procedures were followed and determining whether the procedures were ensuring that adopted animals received humane care; (2) improving and modifying the Wild Horse and Burro Information System; (3) increasing the number of compliance inspections performed and improving documentation of the inspections; (4) establishing procedures to require that records of complaints received and actions taken on animal abuse or exploitation be maintained; and (5) ensuring that titles to animals are conveyed to adopters in a timely manner.

In the April 7, 1998, response (Appendix 5) from the Director, Bureau of Land Management, the Bureau concurred with Recommendations 1, 2, 4, and 5 and concurred "in part" with Recommendation 3. Based on the response, we consider Recommendation 5 resolved and implemented and Recommendations 1, 2, 3, and 4 resolved but not implemented. Accordingly, the unimplemented recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

Since the report's recommendations are considered resolved, no further response to the Office of Inspector General is required (see Appendix 6).

The legislation, as amended, creating the Office of Inspector General requires semiannual reporting to the Congress on all audit reports issued, actions taken to implement audit recommendations, and identification of each significant recommendation on which corrective action has not been taken.

We appreciate the assistance of Bureau of Land Management personnel in the conduct of our audit.

CONTENTS

Page

INTRODUCTION 1

BACKGROUND 1
OBJECTIVE AND SCOPE 2
PRIOR AUDIT COVERAGE 3
OTHER REVIEW 4

FINDING AND RECOMMENDATIONS 6

ADOPT-A-HORSE PROGRAM 6

APPENDICES

1. TOTAL BUREAU OF LAND MANAGEMENT WILD HORSES AND BURROS ADOPTED, TITLED, AND UNTITLED BY BUREAU STATE OFFICE OR FACILITY AS OF APRIL 1997 17
2. PROCEDURES FOR THE ADOPT-A-HORSE PROGRAM 18
3. RESULTS OF ADOPTION FILES REVIEWED - CLASSIFIED BY BUREAU OFFICE AND TYPE OF PROBLEM 20
4. ADOPTED WILD HORSES AND BURROS ELIGIBLE FOR BUT UNTITLED BY STATE OFFICE 21
5. BUREAU OF LAND MANAGEMENT RESPONSE 22
6. STATUS OF AUDIT RECOMMENDATIONS 27

INTRODUCTION

BACKGROUND

The Wild Free-Roaming Horses and Burros Act of 1971, as amended, authorized and directed the Secretary of the Interior to manage the wild free-roaming horses and burros in a manner designed to achieve and maintain a thriving natural ecological balance and protect wild free-roaming horses and burros as components of the public lands. The Act gives the Secretary authority to humanely capture and remove from the public lands excess wild free-roaming horses and burros for private care and maintenance for which the Secretary has determined an adoption demand exists. The Act defines "excess animals" as "wild free-roaming horses or burros (1) which have been removed from an area by the Secretary pursuant to applicable law or, (2) which must be removed from an area in order to preserve and maintain a thriving natural ecological balance and multiple-use relationship in that area."

The Wild Horse and Burro Program was established in 1971 to administer provisions of the Act. The Bureau manages wild horse and burro populations that exist in 10 western states: Arizona, California, Colorado, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, and Wyoming. As of September 1996, the Bureau estimated that these lands had a total population of 42,138 animals. The responsibility for the management direction and policy making of the Wild Horse and Burro Program was reassigned in January 1997 from the National Program Office in Reno, Nevada, to the Bureau of Land Management Headquarters in Washington, D.C., but the operational aspects of the Program remained at the National Program Office. Adoption program offices are located in Bureau state, district, and resource area offices in Arizona, California, Colorado, Idaho, Montana, Nevada, Oklahoma, Oregon, Utah, Mississippi, Wisconsin, and Wyoming to supervise adoptions throughout the continental United States. The Bureau also conducts adoptions at prison training programs in California, Colorado, Oklahoma, and Wyoming.

A primary focus of the Bureau's activities under the Wild Horse and Burro Program has been the placement of excess wild horses and burros from public lands to private individuals and organizations through the Bureau's Adopt-A-Horse Program. After 1 year of demonstrating humane care to the animal and upon application by the adopter, the Bureau is authorized to issue title to the adopter for up to four animals each year.[1] Once title has passed to the adopter, the Bureau is no longer legally responsible for the animal. As of April 1997, 151,814 animals had been placed in private care through the Adopt-A-Horse Program since its inception in May 1976. Of the 151,814 animals adopted, the Bureau had passed title to the adopters for 103,138 of these animals (see Appendix 1).

---

[1]When the Bureau's Adopt-A-Horse Program was first established in 1976 (actually, the first adoption took place in 1973 in Montana), there were no provisions to pass title for the animals to the adopters. The provisions to issue titles to adopters were included in the Public Rangelands Improvement Act of 1978.

The Bureau of Land Management Manual Handbook H-4750-2, "Adoption of Wild Horses and Burros," provides detailed information on the policies, standards, and procedures to be used in the Adopt-A-Horse Program. The Handbook provides the detailed procedures the Bureau established to implement Subpart 4750, "Private Maintenance," of the Code of Federal Regulations. Specifically, the Handbook describes adopter qualifications and application procedures and provides guidance for Bureau compliance inspections and enforcement activities. Further, the Handbook requires an applicant who has selected an animal for adoption to sign a private maintenance and care agreement that identifies prohibited acts and stipulates requirements for the adopter's facilities and for care of the animals (a narrative description of the procedures for animal adoption is in Appendix 2).

OBJECTIVE AND SCOPE

The audit objective was to determine whether the Bureau of Land Management was operating the Wild Horse and Burro Program in accordance with applicable laws and regulations, including provisions that ensure that the animals receive adequate health care and humane treatment. Specifically, this audit focused on whether the Bureau complied with its policies and procedures to ensure that excess wild horses and burros received humane care when they were placed in the Adopt-A-Horse Program.

To accomplish our objective, we made site visits to three Bureau offices: (1) the Canon City District Office in Canon City, Colorado, which administers the Program for the Colorado State Office; (2) the Jackson District Office in Jackson, Mississippi, one of two district offices that administer the Program for the Eastern States Office; and (3) the Oklahoma Resource Area Office in Moore, Oklahoma, which administers the Program for the New Mexico State Office.[2] As of April 1997, these three offices were responsible for 48,140 (32 percent) of the 151,814 animals adopted in the Program since its inception. In addition, these offices were responsible for 13,911 (42 percent) of the 32,794 untitled animals eligible for title as of April 1997 (see Appendix 1).

The three offices reviewed provided us with 130 of the 167 adopter files we judgmentally sampled. According to Bureau officials, the remaining 37 files were either lost or sent to archives. At the three offices visited, we reviewed the 130 adoption files representing animals titled during fiscal years 1995, 1996, and 1997 through April 18, 1997 (58 files); animals eligible for title as of April 18, 1997 (39 files); adopters or facilities that had five or more wild horses and burros from 1973 through April 18, 1997 (15 files); adopters whose names were in the complaint logs at the time of our visits (9 files); and adopters who used power of attorney to adopt wild horses and burros during 1995 through April 18, 1997 (9

[2]The Canon City District Office is responsible for the State of Colorado; the Jackson District Office is responsible for Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, and Virginia; and the Oklahoma Resource Office is responsible for Kansas, New Mexico, Oklahoma, and Texas.

files).[3] Our sample selection of adoption files was based on data maintained in the Wild Horse and Burro Information System, which identified the Bureauwide universe as 103,138 titled animals and 32,794 eligible but untitled animals as of April 18, 1997.

At each of these offices, we reviewed the Bureau's compliance with policies and procedures in its Handbook that related to screening adopters, performing compliance inspections, investigating complaints of abuse and exploitation, and titling animals and interviewed Bureau officials responsible for operating and managing the Program. In addition, we observed wild horse and burro adoptions at the Colorado State Penitentiary in Canon City, Colorado; the Cross Plains Adoption Center in Cross Plains, Tennessee; and a temporary adoption center in Herndon, Virginia.

This audit was made, as applicable, in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances.

As part of our audit, we evaluated the system of internal controls to the extent that we considered necessary. The internal control weaknesses we identified are discussed in the Finding and Recommendations section of this report. The recommendations, if implemented, should improve the internal controls in these areas.

We also reviewed the Departmental Report on Accountability for fiscal year 1996, which includes information required by the Federal Managers' Financial Integrity Act, and the Bureau's annual assurance statement and determined that no material weaknesses were reported that directly related to the objective and scope of our audit.

PRIOR AUDIT COVERAGE

During the past 5 years, the General Accounting Office has not audited the Bureau of Land Management's Wild Horse and Burro Program. However, the Office of Inspector General has issued four audit reports on the Program as follows:

- The report "Memorandum of Understanding Relating to the South Dakota Wild Horse Sanctuary, Bureau of Land Management" (No. 92-I-543), issued in March 1992, concluded that the Bureau made payments of $95,000 for services that were not the Bureau's responsibility, approved a basic rate increase for horse care that was not justified, and lost the opportunity to save $800,000 by not evaluating alternative offers for horse care. The report additionally stated that the sanctuary had not achieved financial self-sufficiency. The report's four recommendations were considered resolved and implemented.

---

[3]A power of attorney is a legal instrument authorizing one to act as the attorney or agent of the grantor.

- The report "Selected Aspects of the Wild Horse and Burro Program, Bureau of Land Management" (94-I-585), issued in May 1994, stated that it was not cost effective to maintain the Oklahoma wild horse sanctuary. The report recommended that the Bureau evaluate other options for the sanctuary horses, including returning the horses to the public lands and closing the sanctuary, since most of the sanctuary horses were old and unadoptable. The Bureau concurred with the recommendation but offered an alternative solution. Specifically, the Bureau decided to develop and implement an adoption initiative for the animals in the sanctuary, which had been successful in the Bureau's Montana State Office in 1992 in that over 500 sanctuary animals from South Dakota had been adopted. Subsequently, the Bureau reduced the number of horses at the Oklahoma sanctuary from 1,569 in October 1993 to 1,143 in February 1996. The sanctuary contractor reported that the reduction of 433 horses was due to 236 adoptions and 197 deaths.

- The report "Expenditures Charged to the Wild Horse and Burro Program, Bureau of Land Management" (No. 97-I-375), issued in February 1997, concluded that the Bureau had recorded and generally spent funds for Program purposes in accordance with its accounting procedures. However, the Bureau inaccurately classified certain indirect salaries and other expenditures as direct costs in its financial records. As a result, reported salary and other expenditures indicated that more direct work was accomplished for the Program than may have actually occurred. The Bureau concurred with the report's two recommendations, which we considered resolved but not implemented.

- The report "Management of Herd Levels, Wild Horse and Burro Program, Bureau of Land Management" (No. 97-I-1104), issued in August 1997, concluded that the Program had not been effective in achieving the goal of managing the sizes of the herds to maintain a thriving natural ecological balance, as required by the Wild Free-Roaming Horses and Burros Act of 1971, as amended. In addition, the Bureau was not systematically monitoring the health of the herds. Specifically, the Bureau had not placed sufficient numbers of animals through its Adopt-A-Horse Program; was prevented from disposing of excess healthy animals by legislative restrictions included in its appropriations acts; and had not aggressively pursued other options for controlling herd sizes, such as birthrate controls. Consequently, approximately 15,226 more wild horses and burros were on the range than the Bureau determined the range could sustain at the end of fiscal year 1996. Additionally, the Bureau did not have information regarding the health of the herds that managers needed to make decisions regarding the operations of the Program. The Bureau concurred with the report's two recommendations, but additional information was needed to consider the recommendations fully resolved.

OTHER REVIEW

In January 1997, the Director, Bureau of Land Management, established a temporary Policy Analysis Team to "review all aspects of the Bureau of Land Management's (BLM) Wild Horse and Burro (WH&B) Adoption Program." The Team's mission was to "analyze the

current program and make recommendations for changes in policy and procedures to better ensure that adopted animals receive short- and long-term humane care."

On April 18, 1997, the Team issued its report, which contained 33 recommendations in six categories: (1) compliance activities, including titling; (2) employee adoptions; (3) the Wild Horse and Burro Information System; (4) training; (5) public outreach; and (6) management and accountability. The Team's recommendations addressed a wide range of issues, including day-to-day management of the Adopt-A-Horse Program, such as contacting 100 percent of all new adopters; performing compliance inspections; and resolving long-standing problems associated with accounting for untitled horses. Although the recommendations proposed by the Team addressed a wide range of improvements needed in the Adopt-A-Horse Program, we found that the proposed recommendations did not fully address the weaknesses we identified, which are discussed in the Finding and Recommendations section of this report.

FINDING AND RECOMMENDATIONS

ADOPT-A-HORSE PROGRAM

The three Bureau of Land Management Wild Horse and Burro Program offices we reviewed were not adequately screening prospective adopters, performing compliance inspections of adopters' facilities before adoptions[4] and of animals subsequent to adoption, and issuing titles for all eligible adopted animals. The Bureau of Land Management Handbook H-4750-2, "Adoption of Wild Horses and Burros," requires the Bureau to (1) determine whether prospective adopters are eligible to adopt animals and (2) perform inspections of adopters' facilities and adopted animals. In addition, the Public Rangelands Improvement Act of 1978 requires the Bureau to convey title of the animals upon application by adopters who have provided humane treatment to their adopted animals for 1 year. However, Bureau management did not perform oversight reviews to ensure that procedures in the Handbook were complied with or that other effective procedures were established by all offices. In addition, Bureau management at the Jackson District Office and, to a lesser degree, at the other two offices we visited focused its efforts on placing the animals in private care instead of ensuring compliance with existing procedures, and the Wild Horse and Burro Information System did not contain adequate information on the eligibility of adopters and was difficult to use. As a result, the Bureau had little assurance that the adopted animals received humane care, and some of the animals were mistreated. In addition, titles for adopted animals were not always issued, which adversely affected the Bureau's accountability for these animals and continued the Bureau's legal responsibility for the animals.

Screening Prospective Adopters

The Bureau did not adequately screen prospective adopters to determine their eligibility to adopt and care for the animals. Specifically, the Bureau did not adequately review adoption applications and Bureau adoption records, interview applicants, or perform inspections of the facilities of applicants who applied to adopt five or more animals. These actions are the initial safeguards to ensure that adopters have the capability to provide humane care for the adopted animals.

Applications and Interviews. The Bureau Handbook (Chapter I, Section B) identifies three sources of information that Program personnel should use to screen applicants: a

[4]The Bureau's Handbook for adoption of wild horses and burros states that the Bureau must have a signed inspection report from a Bureau official or other qualified individual such as a veterinarian or humane official that certifies that the facilities for maintaining five or more animals satisfy Bureau requirements.

completed application; an interview with the applicant; and Bureau adoption records, including records in the Information System.[5]

In addition to the 37 files that were not provided, our review of the 130 adoption files provided by the Bureau disclosed that 13 applications were incomplete or were missing from the files (4 of the 13 applications had incomplete facility information) and that 72 files contained no evidence that an interview was conducted (see Appendix 3). This occurred because Bureau officials did not perform regularly scheduled oversight reviews of field offices for compliance with Program procedures. We noted that only three reviews were performed in 1994 and one review in 1995 and that these reviews covered various aspects of the Program in California, Montana, New Mexico, and Utah. However, these reviews did not determine whether the field offices complied with established procedures to screen adopters or to monitor adopters' compliance with private maintenance and care agreements. In our opinion, the Bureau should have included a requirement in its Handbook that regularly scheduled reviews of compliance with Program procedures or other internal controls should be performed to provide Bureau managers with sufficient information to make sound management decisions regarding Program operations.

In addition, we found that the Wild Horse and Burro Information System could not be used to determine the eligibility of adopters, even though the Information System was identified in the Handbook as a source to review. Program personnel stated that the Information System computer program was not "user friendly" and that the compliance inspection module, which was designed to contain information on inspections performed and the continued eligibility of adopters, was so difficult to use that no one attempted to enter data about problem adopters. Without this vital information, adopters who had improperly cared for animals could be allowed to adopt other animals. For example, in 1990, a Colorado wild horse specialist attempted to examine adopted animals that were eligible for title. The specialist was informed by the adopter that the animals had been sold to a "local horse trader." Bureau law enforcement officials investigated the incident and determined that the adopter had sold his four animals to another individual, who sold the animals to a "sale barn."[6] Since the sale barn had closed, Bureau personnel concluded that the horses were not traceable. The case was closed, and the adopter and the first purchaser were issued verbal warnings. The official adoption file maintained at the field office was marked "ineligible." However, as of July 1997, the Information System listed the two animals as alive and untitled but eligible for title, and the adopter was not identified as a "violator" or as ineligible to adopt other animals. In addition, none of the three offices we reviewed maintained any other listing or document that identified problem adopters which could be used as a screening source before

---

[5]The Handbook states that when an adopter violates the terms of the private maintenance and care agreement, the type of violation and the appropriate complaint and inspection results are required to be entered into the Information System. This action will create a hold on future titling or adoption by that individual.

[6]A "sale barn" is any location where livestock is sold, including horses. According to a Bureau official, it is commonly known that buyers go to sale barns to acquire animals that will be processed into commercial products.

applications were approved. As a result, the Bureau could not be fully assured that animals were placed with previous adopters who had demonstrated that they could care for their animals.

Preadoption Facility Inspections. Facility inspections are performed to help ensure that prospective adopters of five or more animals in 1 year can adequately provide humane care for those animals at their facility. The inspections are required by the Code of Federal Regulations (43 CFR 4750.3-3), which states:

> An individual applying to adopt more than 4 wild horses or burros within a 12-month period, or an individual or group of individuals requesting to maintain more than 4 wild horses or burros at a single location shall provide a written report prepared by the authorized officer [a Bureau employee assigned to the Wild Horse and Burro Program], or by a local humane official, veterinarian, cooperative extension agent, or similarly qualified person approved by the authorized officer, verifying that the applicant's facilities have been inspected, appear adequate to care for the number of animals requested, and satisfy the requirements . . . [for private maintenance and care of the animals].
>
> The report shall include a description of the facilities, including corral sizes, pasture size, and shelter, barn or stall dimensions, and shall note any discrepancies between the facilities inspected and representations made in the application form. When an applicant requests 25 or more animals or when 25 or more animals will be maintained at any single location, regardless of the number of applicants, the facilities . . . shall be inspected by the authorized officer prior to approving the application.

The codified requirements for adoptions of five or more animals in a year are more stringent than the requirements for adoptions of four or fewer animals per year because of the increased risk of animals being exploited or abused. Of the 37 files that Bureau officials could not locate at the three offices visited, 16 of these files were for adoptions of five or more animals. These 16 files represented adoptions of 868 wild horses and burros during 1976 through 1997 (March 1997).

We reviewed files for 15 adoptions of 5 or more wild horses and burros, which involved 355 animals, and found no evidence in these files that facility inspections had been performed by Bureau officials or their authorized representatives in 2 of 3 cases in Canon City, 5 of 8 cases in Jackson, and 2 of 4 cases in Oklahoma. The nine cases where facility inspections were not performed accounted for 248 of the 355 animals. Examples of the problems noted with the adoptions of five or more animals for which facility inspections were not performed are as follows:

- A state prison in Louisiana adopted 30 horses in October 1995. However, no inspection was conducted by Bureau personnel from the Jackson District Office, as required by the Code of Federal Regulations and further detailed in the Bureau Handbook. According to officials in the Jackson Office, the inspection was not performed because the responsible personnel were not notified by personnel from the Rock Springs District Office in Wyoming who conducted the adoption. When the facility was inspected by Jackson Office personnel approximately 15 months after the adoption occurred, the personnel could not confirm that the adopted animals were still at the prison because the freeze brands either were illegible or were not present on the animals at the facility. Consequently, the Bureau could not issue titles for the adopted animals. On June 10, 1997, Bureau personnel inspected the facility, re-branded 28 of the horses, and signed private maintenance and care agreements for the 28 horses. The other 2 horses died, one on July 15, 1996, from unknown causes and the other on November 22, 1996, from injuries incurred at a cattle guard. Under Bureau procedures, the private maintenance and care agreements should have been signed before the horses were adopted, and the deaths of the two horses should have been reported within 7 days of their deaths.

- During 1982 through 1985, a wild horse advocacy group in Colorado adopted 156 horses for the purpose of reassigning these animals to other adopters. When the animals were assigned to other adopters, the group's name was replaced with the new adopters' names in the Information System. Our review of the Information System showed that the group had adopted only 10 horses rather than the 156 horses identified in the field office's adoption file for the group. In addition, there was no evidence in the file that the Bureau conducted inspections of the group's facilities prior to the adoptions.

According to Jackson District Office Program personnel, facility inspections were not consistently performed because the Jackson field office placed a higher emphasis on removal of the animals from public lands and placement with private individuals and organizations. Specifically, several employees in the Jackson Office stated that the Program's priority had always been the removal and placement of the animals over the monitoring of compliance with Bureau procedures. In support of this position, we noted that the Wild Horse and Burro Adoption Program Policy Analysis Team Report, dated April 18, 1997, stated:

> The Policy Analysis Team believes that establishment and achievement of Appropriate Management Levels (AMLs) in Herd Management Areas (HMAs) is the highest overall Wild Horse and Burro priority. Efforts toward this objective should not be reduced to provide funding or staff time for implementation of our recommendations [regarding compliance and titling issues].

Further, during the June 24, 1997, exit conference on our prior report "Management of Herd Levels, Wild Horse and Burro Program, Bureau of Land Management" (No. 97-I-1104), the Bureau's Assistant Director for Renewable Resources and Planning stated that to reach the appropriate management levels by the year 2001 as the Bureau plans, it will need to remove

10,000 animals from public land per year. However, he also stated that without enlisting more volunteers to assist in monitoring and conducting compliance inspections, the Bureau will have difficulty in meeting this goal.

Postadoption Compliance Inspections

The Bureau did not adequately or consistently perform compliance inspections to ensure that adopted animals were receiving proper care because the Bureau offices we reviewed emphasized the placement of the animals in private care over the performance of inspections of the adopters. In addition, Bureau offices had not established procedures to ensure that complaints of animal mistreatment were fully investigated.

The Code of Federal Regulations (43 CFR 4760.1) states that a Bureau employee or an authorized representative may verify compliance with the private maintenance and care agreement by "visits to an adopter, physical inspections of the animals, and inspections of the facilities and conditions in which the animals are being maintained." In addition, the Bureau Manual (Section 4760.1) requires monthly compliance inspections of all adopters and animals when five or more animals are maintained in one location. The Manual also requires the Bureau to conduct compliance inspections whenever a complaint is received of inhumane treatment to an animal. The Bureau's "Strategic Plan for Management of Wild Horses and Burros on Public Lands," dated June 1992, states that the Bureau's goal is to inspect a minimum of 5 percent of all untitled animals each year.

Inspection Goal of 5 Percent. We reviewed 97 files of adopters who took four or fewer animals and determined that the Bureau conducted 39 compliance inspections of the adopters and their animals. This inspection level of 40 percent exceeded the Bureau's goal of inspecting 5 percent of all untitled animals each year. However, while our nonstatistical sample results indicated that the Bureau had exceeded its goal, we believe that the prescribed and actual levels of inspections are too low to ensure that adopted animals are treated humanely. Our opinion is consistent with the Bureau's "Policy Analysis Team Report" on the Program, dated April 18, 1997 (see "Other Review"section). Regarding the compliance inspection level, the report recommended that the Bureau:

> Increase on-site compliance inspections to assure statistically that 95 percent of untitled animals adopted within the last five years are being properly cared for in compliance with the PMACA [private maintenance and care agreements] by adopters. . . . The 95-percent compliance clearly requires an increase in the current level of on-site compliance effort. . . . The Team recommends doubling on-site compliance checks from approximately 2,200 per year to 4,400 per year.

The report further stated that the Bureau should use memoranda of understanding with various state and nonprofit organizations to conduct these inspections. We agree with this

strategy and believe that the Bureau can achieve the higher inspection level with the support of voluntary organizations, such as the Humane Society of the United States.

Monthly Inspections of Adopters of Five or More Animals. Our review of the 15 adoptions of 5 or more animals found that the Bureau did not conduct the required monthly inspections for 14 adoptions involving 248 animals. For example:

- In the Jackson District Office, none of the approximately 100 horses adopted in numbers of five or more were inspected monthly by Bureau officials or their authorized representatives. For example, in 1995 a university, through the Jackson Office, adopted five burros and four horses to provide an outreach educational program. The Jackson Office did not conduct the required monthly compliance inspections of the animals and the university's facilities. However, the Bureau did conduct an inspection on May 2, 1996, because Bureau personnel were in the area to conduct an adoption. The Bureau horse and burro specialist noted in her inspection report that one burro was missing and that the remaining animals were "malnourished." Subsequently, the specialist determined that one of the burros had died on January 24, 1996, of "unknown causes" and that this death was not reported to the Bureau as required. Also, the inspection report stated:

> The horses and burros . . . were in thin condition and their hoofs were extremely long. . . . had only been wormed once . . . and had received little to no handling . . . . The ribs . . . were easily seen, the tail head was prominent, the hip bone was easily discernible and the withers, shoulders and neck were accentuated. Their coats were dull, long, and in an unhealthy condition. . . . The hay on site was of very poor quality . . . . When the hay was given to the horses, they would not eat it.

The report further stated, "The poor condition of the animals attested to the inadequate amount and quality of grain and hay being fed to the animals. . . ." During a second inspection on May 5, 1996, the Bureau specialist stated, "Again, there was no evidence of feeding and the pens were without water." As a result of these inspections, the university received Bureau assistance in caring for the animals, and the condition of the animals improved.

- In the Canon City District Office, an adopter acquired 10 horses during fiscal years 1994 and 1995. The Bureau did not conduct monthly compliance inspections of the adopter and the animals. Subsequently, we found that one horse had died (the cause of death was not reported within the required 7 days), one was returned to the Bureau, and eight were titled to the adopter.

Inspections of Complaints of Animal Mistreatment. We could not determine, from our review of the adoption files and other records at the field offices we visited, whether the Bureau conducted inspections of adopters for which the Bureau had received complaints and

allegations relating to the mistreatment of adopted animals. Additionally, allegations of abuse were not always referred to law enforcement officials for appropriate action. For example:

- In the Jackson Office, we requested six files relating to animals for which complaints of abuse were received and recorded in the complaint logs. However, the Bureau could not locate 4 of the files (included in the 37 files we previously noted as not provided). Regarding the first of the remaining two files, the initial complaint of possible abuse was recorded on March 5, 1996. As of May 13, 1997, the Bureau had not performed a compliance inspection. Regarding the second of the two remaining files, the initial complaint, which was the reported death of an animal, was received in August 1996. As of November 10, 1997, no further action had been taken, even though the letter certifying the cause of death that had been requested in August 1996 had not been received.

Also in the Jackson Office, we reviewed an adoption file (see Appendix 3, "Evidence of Possible Animal Abuse") which stated that the adopter shot and killed his burro because it was unmanageable and continued to escape from its pen. Since this action was a prohibited act under the adopter's private maintenance and care agreement, the case should have been referred to law enforcement officials for appropriate action. However, no further action was taken by the Bureau on this burro's death, and the Bureau subsequently issued titles to this adopter for the three burros remaining in his custody.

In the early 1990s, according to several Bureau employees, a former District Manager of the Jackson Office stated that, pursuant to management directions, the Jackson Office would no longer refer adopters for prosecution of wrongdoing. In addition, an October 9, 1990, memorandum from the Deputy State Director in the New Mexico State Office stated that as a result of budget reductions for fiscal year 1991, a wild horse and burro adoption center would be closed and staff may not be able to respond to all compliance complaints. The memorandum further stated that complaints should be coordinated with investigations conducted by local humane officials.

We were not able to determine whether the Bureau had taken all necessary actions regarding complaints of animal mistreatment because it did not establish adequate procedures to ensure that its adoption files and complaint logs clearly documented the dispositions of complaints. Additionally, the Bureau did not ensure that a complete and accurate database of violators of the private maintenance and care agreements was maintained in the Bureau's Wild Horse and Burro Information System so that these individuals could be prevented from acquiring animals through future adoptions.

Untitled Wild Horses and Burros

The Bureau had not ensured that adopted wild horses and burros were titled to adopters after providing 1 year of humane care. The granting of title to the animal is the final step in the adoption process. The Act states that the Bureau is authorized, upon application, to grant

title to adopters who have provided humane treatment and care for their animals (up to four animals in any 1 year) for a period of 1 year. By issuing title, full responsibility for the animal is placed on the adopter, and the Bureau's responsibility for that animal is legally terminated. The Bureau's Information System showed that 32,794 animals eligible for title were untitled as of April 18, 1997. The large number of untitled animals was caused by (1) the Bureau's practice of waiting for the adopters to submit title applications to its field offices and (2) the lack of effective followup procedures at some field offices.

The titling process begins when the Bureau's Information System generates a title eligibility letter and application form that is mailed by personnel in the National Business Center to adopters within 2 months of the 1-year anniversary of the adoption. However, we found that the Bureau office administering the adoption did not normally take further action until it received the completed title application. Upon receipt of the application, Program personnel reviewed the application to ensure that the animal was certified as healthy by a "qualified individual other than the adopter."[7] If the Bureau determined that the animal was healthy, title was issued, and the animal became the private property of the adopter.

During October 1, 1992, to April 18, 1997, the number of animals eligible for title but untitled increased by 5,419 animals, or approximately 16.5 percent of the total 32,794 untitled animals (see Appendix 4). The Jackson Office, which administers the Program in 11 states (compared with 1 state and 4 states, respectively, administered by the two other offices we visited), has been responsible since fiscal year 1992 for 1,799 (33.2 percent) of the 5,419 untitled animals and 6,212 (18.9 percent) of the total of 32,794 untitled animals since Program inception. Although the number of untitled animals was significant, we found that procedures were not established at the Jackson Office to follow up on why title applications were not received from eligible adopters. At the Canon City Office, we found that procedures had been implemented to ensure that field inspections were scheduled for those adopters who had not submitted title applications in a timely manner (see section "Program Improvements"). As a result, since fiscal year 1992, the Canon City Office has added only 47 animals to its inventory of eligible but untitled animals, which totaled 596 animals for years prior to fiscal year 1992.

We also noted that the Information System reported that 773 of 6,215 animals being held in Bureau facilities as of April 18, 1997, were supposedly at facilities which were no longer in operation. Further we noted that a separate "history file," created by the Bureau in 1989 to track animals that could not be located, reported an additional 2,557 animals (not included in any other Bureau statistical totals) which the Bureau had not located as of April 18, 1997.

---

[7]As described on the title eligibility letter, a "qualified individual" is a "veterinarian, extension agent, local humane official, or other individual with knowledge about animal husbandry."

Program Improvements

During our review, we noted several proactive actions that Bureau offices had taken, or proposed to take, to ensure that animals received humane care and were not exploited for commercial purposes, as described in the following paragraphs.

Effective Inspection and Titling Practices. Both the Canon City District Office and the Oklahoma Resource Area Office developed local procedures which helped ensure that inspections were conducted and titles were issued. While the Canon City Office ensured that the Information System data was kept current and utilized the titling dates provided by the System, the Oklahoma Office manually reviewed adopter files to obtain current titling dates.

At the Canon City District Office, procedures included a wild horse and burro staff assistant's printing, from the Information System, a list of adopters who were eligible for title. From the list, a wild horse and burro specialist identified those adopters who were due or overdue for titling and matched their locations with the locations of volunteers available throughout the State of Colorado. The specialist then contacted those volunteers and arranged for them to perform compliance inspections of the animals. When a volunteer determined that an animal had been properly cared for, the volunteer and the adopter prepared the application for title and forwarded it to the Bureau. If any problems were noted during the inspection, a Bureau employee would follow up with appropriate action. The Canon City Office maintained these lists to also document the number of compliance inspections it conducted during each fiscal year.

The Oklahoma Resource Area Office developed a system that requires an administrative assistant to manually review adopter files to determine when title eligibility dates have passed. The files are marked with the title eligibility date on the file jacket. The administrative assistant reviews the files every 2 to 3 months and pulls the files of adopters whose title eligibility dates are more than 3 months past due. By that date, the adopter should have received three letters from the National Business Center regarding title eligibility. The assistant sends a certified letter to the adopter and continues to follow up until the adopter responds with a certified title application or other satisfactory response (such as a death certificate).

Slaughterhouse Agreements. The New Mexico State Office entered into a memorandum of understanding with a slaughterhouse whereby the facility's officials would voluntarily report to the Bureau freeze-branded animals (possibly wild horses) received at their facility. Under the agreement, the Bureau would determine whether the freeze-branded animals were wild horses and whether they were titled or untitled and, at Bureau expense, pick up the untitled animals. If the Bureau could not remove the animals immediately, the facility would care for the animals and charge the Bureau a nominal maintenance fee. Jackson District Office Program personnel provided us with information that this facility, during February 5, 1997, through March 13, 1997, notified the Bureau that it had received 25 freeze-

branded animals. The Bureau subsequently determined that four of the animals were untitled and picked up the animals. Of the four animals, two were readopted, and two were still at Bureau holding facilities as of June 24, 1997. The Bureau received restitution from one of the adopters involved and is seeking restitution from another. We believe that the Bureau should take all necessary actions to obtain these kinds of agreements with other slaughterhouses.

Volunteers and Partnerships. In written comments dated January 6, 1998, the Director noted that the Jackson District Office will be holding another wild horse and burro preadoption compliance training course for volunteers. The Director stated, "[I]t is anticipated that 10 to 15 people will take the course, providing the Jackson Office with significant increased pre-adoption compliance capability." Additionally the Director noted, "[A] significant partnership is being built with the Girl Scouts of central Florida where another Mustang Troop is being formed."

Recommendations

We recommend that the Director, Bureau of Land Management, ensure that:

1. Procedures are established to conduct regular oversight reviews of field offices to determine whether screening, preadoption and postadoption inspections, and titling procedures are complied with. The reviews should also determine whether the Bureau's screening and inspection procedures provide reasonable assurance that wild horses and burros in the Adopt-A-Horse Program receive humane care.

2. The Wild Horse and Burro Information System contains information on violators of wild horse and burro laws and regulations and other problem adopters to be used as a screening tool when offices evaluate prospective adopters. Additionally, the Information System should be evaluated and redesigned as appropriate to be more "user friendly" to Program personnel.

3. Revise the Bureau's strategic plan for the management of wild horses and burros to require a higher percentage of inspections to be performed, as recommended by the Bureau's "Policy Analysis Team Report." Also, the number of inspections performed should be accurately recorded in the Information System and reported to Bureau management.

4. Procedures are established which require records to be maintained on the complaints received of animal abuse or exploitation, the actions taken, and the final results of those actions.

5. Procedures are established to require all offices to contact adopters who have not submitted title applications in a timely manner and to take appropriate followup actions to issue titles. Further, consideration should be given to implementing, on a Bureauwide basis,

other effective procedures and memoranda of understanding with slaughterhouses that have been established at some offices.

Bureau of Land Management Response and Office of Inspector General Reply

In the April 7, 1998, response (Appendix 5) to the draft report from the Director, Bureau of Land Management, the Bureau concurred with Recommendations 1, 2, 4, and 5 and concurred "in part" with Recommendation 3. Based on the response, we consider Recommendation 5 resolved and implemented and Recommendations 1 through 4 resolved but not implemented.

Regarding Recommendation 3, the Bureau stated that it had "adopted the recommendations of the 'Policy Analysis Team Report'" to use "a statistical sampling approach as the best means to ensure the health and humane treatment of 95 percent of animals adopted within the past 5 years." The Bureau stated it will "perform more than 3,629 compliance inspections in FY [fiscal year] 1998, as identified in the BLM's [Bureau's] Annual Work Plan." Further, the Bureau stated that it will check (by telephone or physically) "100 percent of all new adoptions within 6 months after adoption" and that it will contact by mail "all adopters for the last 5 years who have animals eligible for title, but who have not yet titled those animals" in an effort to "ensure the health and humane treatment of the adopted, but not yet titled, animals." Additionally, the Bureau stated that it will "[c]ontinue the policy of 100 percent inspections on all complaints received."

We believe that the Bureau's proposed actions will satisfy the intent of this recommendation. The number of compliance inspections that the Bureau intends to perform, including inspections of all complaints of abuse, and the proposed additional contacts with adopters, whether by telephone or mail or by physical checks, should help to ensure that adopted animals are receiving proper care.

Subsequent to the Bureau's response, Bureau officials told us, regarding Recommendation 3, that the sample of 3,629 compliance inspections was drawn in December 1997 and that the telephonic or physical checks of 100 percent of all new adoptions within 6 months after the adoption occurs began in October 1997. Regarding Recommendation 4, the officials said that the Compliance Handbook for Wild Horse and Burros will be finalized by July 31, 1998. According to those officials, the Assistant Director for Renewable Resources and Planning is the official responsible for implementation of all the recommendations.

TOTAL BUREAU OF LAND MANAGEMENT WILD HORSES AND BURROS ADOPTED, TITLED, AND UNTITLED BY BUREAU STATE OFFICE OR FACILITY AS OF APRIL 1997

BUREAU STATE OFFICE	Total Number of Animals Adopted Since Program Inception	Total Number of Adopted Animals for Which Title Issued	Total Number of Adopted Animals Eligible for Title but Untitled	Total Number of Adopted Animals Not Yet Eligible for Title
ALASKA	0	13	53	2
ARIZONA	3,504	2,233	310	151
CALIFORNIA	15,905	9,016	5,082	557
COLORADO	4,598	3,497	643	528
EASTERN STATES	48,743	37,282	10,950	3,885
IDAHO	2,642	3,368	1,274	345
MONTANA	9,558	14,386	1,019	540
NEW MEXICO	15,590	16,003	7,057	1,114
NEVADA	12,175	2,790	812	189
OREGON	11,272	5,430	3,383	470
UTAH	3,732	2,991	944	571
WYOMING	13,819	6,401	1,266	1,018
Washington, D.C., National Program Office[1]	10,158	0	0	0
Animals not assigned to specific location[2]	105	9	0	0
Animals not assigned to general location[3]	13	0	0	0
Adjustment[4]	0	(281)	1	0
TOTAL	**151,814[5]**	**103,138**	**32,794**	**9,370**

[1]Prior to August 1992, the National Office was administratively responsible for certain adoptions of animals. Currently, only the state offices are listed as administrative offices for adoptions.

[2]For the total number of animals adopted, we identified 105 animals on the Wild Horse and Burro Information System that had no location code. For the total number of adopted animals for which title was issued, we identified nine from the Information System that had no location code.

[3]In addition to the 105 animals that did not have a location code, 13 animals were identified only by a freeze brand.

[4]A downward adjustment of 281 animals was required because of a discrepancy between the Information System summary total and the detailed total derived from available files. An upward adjustment of 1 was required for the adopted, eligible, and untitled animals.

[5]The total does not compute across because this amount includes 6,499 animals that died after adoption and the 13 animals referred to in footnote 3.

PROCEDURES FOR THE ADOPT-A-HORSE PROGRAM

The following narrative details the procedures for the Adopt-A-Horse Program as stated in Bureau of Land Management Handbook H-4750-2, "Adoption of Wild Horses and Burros."

Screening of Applicants. The Handbook requires that the prospective adopter fill out an application for adoption which may be accepted through the mail, on-site at holding facilities or temporary adoption facilities, or at any Bureau office that has an authorized Bureau officer. The application requires the applicant to sign a statement acknowledging that it is a crime to make a fraudulent statement to the Government. The application also requires the prospective adopter to describe the facilities that will be provided for the animals and to state whether the adopter will have more than four untitled animals at the same location, whether someone else will be selecting or caring for the animal under the adopter's authorization, whether the adopter has made any previous adoptions under the Program, and whether the prospective adopter has ever been convicted of abuse or inhumane treatment of animals. The Bureau then determines eligibility based on three sources: the completed application; Bureau adoption records, including the Wild Horse and Burro Information System; and an interview with the applicant.

When five or more animals are being adopted by one individual or maintained at one location, special adoption screening requirements apply. These requirements include a facility inspection and a signed statement of employment stating that the applicant is either not employed by or engaged in a livestock auction, rodeo, or slaughterhouse or is employed or engaged in the preceding, in which case the applicant is required to state in writing the reasons for adopting the animals. The Bureau must approve or disapprove the application within 10 days of receipt. If disapproval is based on an inadequate application, the applicant may reapply. Also, the applicant may appeal his disapproved application to the Department's Board of Land Appeals.

Once the approved applicant has selected an animal at an adoption event, a private maintenance and care agreement must be signed by the adopter and the $125 per wild horse or wild burro adoption fee paid. At that time, Bureau personnel reiterate the terms of the adoption and the prohibited acts to the adopter. After the adoption, the Bureau retains the responsibility for ensuring that adopters comply with the private maintenance and care agreements. The responsible Bureau office is required to update the Information System within 2 weeks of the adoption, and an official adopter file must be set up to include the following: an approved application; a copy of the care agreement; and other relevant documents, such as copies of compliance inspections and correspondence relating to the adoption. In cases in which a power of attorney is used to select and pick up the animals, the authorized official must contact the adopter within 2 weeks after the adoption to ensure that

the animals were received, to verify the location of the animals, and to review responsibilities and obligations with the adopter. A written record is required to be maintained for all contacts. Any adoption modification, such as adopter change of address or relocation of the animals to other facilities, must be sent to the authorized officer within 30 days. The death of any adopted animal must be reported to the responsible Bureau office within 7 days of the death. If the adopter provides a veterinarian's statement that the animal died or was destroyed within 6 months of the adoption date because of a condition existing at the time of adoption, the adopter is entitled to a replacement animal.

Compliance and Enforcement. Bureau policy does not require routine inspections of wild horses or burros adopted or maintained in groups of four or fewer animals. However, the Bureau's Wild Horse and Burro Strategic Plan establishes a goal to inspect a minimum of 5 percent of all untitled animals. Both random and scheduled compliance checks are encouraged. The Bureau Handbook does require that any adopter or facility/location which has five or more untitled animals be inspected at least monthly or when there is a complaint. Also, inspections are to be made during periods when weather conditions may adversely affect animals' feed, water, or shelter or if there is an outbreak of disease. Inspections may be coordinated with adopters, law enforcement officials, and humane organizations as appropriate. Results of inspections are to be discussed with the adopters and, as necessary, documented through written communications. The adopters' files are to contain records of inspections, and the Wild Horse and Burro Information System is to be updated with the dates and results of compliance inspections.

When a complaint of abuse or inhumane treatment is received, the Bureau is required to investigate the complaint regardless of the number of animals involved. The Bureau will recommend corrective action if appropriate. However, if the problems cannot or will not be resolved by the adopter, the Bureau may repossess the animals. At that point, the adopter's private maintenance and care agreement may be terminated either voluntarily or involuntarily, and the animal may be reassigned. In those cases of involuntary termination and repossession, the Bureau's law enforcement officials will be called in to assist.

Titling of Animals. One year after the adoption date, the animal is eligible for titling to the private adopter. Approximately 2 months prior to the end of the 1-year period, a notification for title letter is sent to the adopter. The Bureau sends out, from the National Business Center, three notification letters just prior to and shortly after this 1-year period. The letters require that a qualified individual, someone other than the adopter, certify that the freeze-branded animal listed on the form has received proper care and is in good health. If five or more animals are involved, an authorized Bureau official or designee must certify the condition of the animals. However, by law, the Bureau may title only up to four animals per year to an individual. Once title is issued, the Wild Horse and Burro Information System is updated with a record of the titling date, and a copy of the title is placed in the adopter file.

RESULTS OF ADOPTION FILES REVIEWED - CLASSIFIED BY BUREAU OFFICE AND TYPE OF PROBLEM

NUMBER OF CASES REQUESTED AND REVIEWED	JACKSON DISTRICT	CANON CITY DISTRICT	OKLAHOMA RESOURCE AREA	TOTAL
Number of files selected for review.	60	57	50	167
Number of files not provided by Bureau.	(5)	(17)	(15)	(37)
Number of files reviewed.	55	40	35	130

TYPE OF PROBLEM				
Application incomplete or not in file.	1	5	3	9
Facility information provided on application incomplete.	0	0	4	4
No evidence that interview of applicant was conducted.	18	23	31	72
Private maintenance and care agreement incomplete or not in file.	1	2	3	6
No evidence of adoption fee payment or fee not paid in full with no justification on file.	1	9	3	13
Evidence of possible animal abuse.	2	0	0	2
Five or more untitled animals adopted or at one location--problems include the absence of a facility inspection, lack of monthly compliance inspections until animals are titled, and no statement of employment from adopter.	8	3	4	15
Power of attorney - no followup to contact adopter.	1	1	0	2
Animals replaced without required veterinarian certification (after dying within 1 year following adoption).	2	0	0	2
TOTAL	34	43	48	125

ADOPTED WILD HORSES AND BURROS ELIGIBLE FOR BUT UNTITLED BY STATE OFFICE

BUREAU STATE OFFICE	THROUGH SEPTEMBER 1991	OCTOBER 1992 TO APRIL 1997	TOTAL AS OF APRIL 18, 1997
ALASKA	46	7	53
ARIZONA	208	102	310
CALIFORNIA	4,471	611	5,082
COLORADO	596	47	643
EASTERN STATES	8,126	2,825	10,951
IDAHO	1,128	146	1,274
MONTANA	795	224	1,019
NEW MEXICO	6,487	570	7,057
NEVADA	662	150	812
OREGON	3,164	219	3,383
UTAH	624	320	944
WYOMING	1,068	198	1,266
TOTAL	**27,375**	**5,419**	**32,794**

United States Department of the Interior

BUREAU OF LAND MANAGEMENT
Washington, D.C. 20240

In Reply Refer To:
1245 (220)

April 7, 1998

MEMORANDUM

To: Assistant Inspector General of Audits

Through: Bob Armstrong
Assistant Secretary, Land and Minerals Management

From: Director, Bureau of Land Management Pat Shea
Pat Shea

Subject: Response to Draft Audit Report: The Adopt-A-Horse Program, Bureau of Land Management, February 1998 (C-IN-BLM-004-96(C))

Thank you for the opportunity to respond to the draft audit report on the Adopt-A-Horse Program. Our specific responses to your recommendations are attached.

As discussed in our December 17, 1997, meeting, the Bureau of Land Management (BLM) welcomes this report as an important step in revitalizing the agency's Wild Horse and Burro Program. The BLM generally concurs with the report's recommendations and has already taken steps to implement them.

I would like to emphasize that the BLM's Wild Horse and Burro Program is in a period of transition. In the 1980s, the agency pursued mass adoptions as a means to move large numbers of animals off the range. In June of 1992, the BLM adopted a Strategic Plan for the Management of Wild Horses and Burros, which signaled a shift in the Bureau's emphasis to a more careful placement policy, stressing humane treatment of animals, adopter compliance, and protection of wild herds. The BLM today is concerned with both the health and welfare of animals in the adoption program and preserving healthy wild herds and their habitat. Our current policy embodies a dramatic change from earlier policies to one that focuses on the welfare of individually adopted animals and the free-roaming herds.

Last year, as part of this transition, the BLM conducted two intensive, internal reviews of the program, led by BLM State Directors Al Pierson and Pete Culp. As a followup to the Wild Horse and Burro Evaluation Report (Pierson Report) and the Wild Horse and Burro Adoption Program Policy Analysis Team Report (Culp Report), I appointed 3 independent fact-finders to answer more than 35 questions about the Wild Horse and Burro Program. The questions were formulated by concerned parties involved with or knowledgeable about the Wild Horse and Burro Program.

A new Wild Horse and Burro Advisory Board has been chartered and met for the first time in Reno, Nevada, on February 9-10, 1998. The nine member committee is composed of individuals from different constituency groups: three with strong science backgrounds, three from different advocacy groups, and three representing the public at large. The feedback from the meeting has been positive and has laid the groundwork for providing meaningful recommendations to the BLM on important program issues. At the Advisory Board meeting, the fact-finders presented their recommendations to improve the management of the Wild Horse and Burro Program.

With guidance from the three independent fact-finders, the reestablished Wild Horse and Burro Advisory Board, the Inspector General's recommendations, and the two internal BLM reports, we will be able to resolve recurring problems and give the Wild Horse and Burro Program new direction.

Questions to our responses may be addressed to Bud C. Cribley, BLM Wild Horse and Burro Specialist, at 202-452-5073 or Gwen Midgett, BLM Audit Liaison Officer, at 202-452-7739.

Attachment

RESPONSE TO DRAFT AUDIT REPORT
THE ADOPT-A-HORSE PROGRAM
BUREAU OF LAND MANAGEMENT
FEBRUARY 1998
(Report No. C-IN-BLM-004-96(C))

Recommendation 1: Procedures are established to conduct regular oversight reviews of field offices to determine whether screening, pre-adoption and post adoption inspections, and titling procedures are complied with. The reviews should determine whether the Bureau's screening and inspection procedures provide reasonable assurance that wild horses and burros in the Adopt-A-Horse Program receive humane care.

Concur: Through the Culp Report, the Bureau of Land Management (BLM) identified a need to conduct assistance visits to every BLM state involved in the Wild Horse and Burro Program (WH&B) on a 4- to 5- year cycle to provide improved consistency in national program implementation. Subsequent to that report and considering the recommendation from this draft report, the BLM has decided to conduct formal program reviews of all BLM state WH&B Programs to determine compliance with screening requirements, pre-adoption and post-adoption inspections, and titling procedures.

A memorandum will be issued from the BLM Washington Office defining the schedule for the Wild Horse and Burro Program review. We have committed to conducting program reviews in all BLM states by the year 2000. In Fiscal Year 1998, BLM will review programs in California, Idaho, and New Mexico.

Recommendation 2: The Wild Horse and Burro Information System (WHBIS) contains information on violators of wild horse and burro laws and regulations and other problem adopters to be used as a screening tool when offices evaluate prospective adopters. Additionally, the Information System should be evaluated and redesigned, as appropriate, to be more "user friendly" to Program personnel.

Concur: Over the past 18 months, the BLM has evaluated the WHBIS and redesigned it to be more "user friendly" to Wild Horse and Burro Program personnel. This will make the data base a more complete and effective tool for screening adopters and securing compliance and humane care. On January 5, 1998, the WHBIS data base was moved to a new computer platform, increasing reliability and making the system more accessible to field users. A new compliance module of the WHBIS data base is scheduled to be functional by June 1998; at that time, program specialists will be able to use the data base as a screening tool for compliance violations. The second phase modification, which will enable us to pull preprogrammed reports from the data base, will be in place by August 1998.

Recommendation 3: Revise the Bureau's strategic plan for the Management of Wild Horses and Burros to require a higher percentage of inspections to be performed, as recommended by the Bureau's "Policy Analysis Team Report." Also, the number of inspections performed should be accurately recorded in the Information System and reported to Bureau of Land Management.

Concur In Part: The BLM has adopted the recommendations of the "Policy Analysis Team Report" regarding the level of compliance checks to be performed on an annual basis. As a result of the internal reviews, the BLM identified the need to improve compliance and recommended a statistical sampling approach as the best means to ensure the health and humane treatment of 95 percent of animals adopted within the past 5 years. This statistical approach will require the BLM to conduct a sufficient number of compliance checks to provide a 95 percent confidence level in the conclusions. The BLM will perform more than 3,629 compliance inspections in FY 1998, as identified in the BLM's Annual Work Plan.

To further ensure the health and humane treatment of the adopted, but not yet titled, animals, the BLM will also:

- Telephone or physically check 100 percent of all new adoptions within 6 months after adoption. This will require 8,000 to 10,000 adopter contacts per year.

- Contact, by certified mailing, all adopters for the last 5 years who have animals eligible for title, but who have not yet titled those animals. Letters were mailed to 3,028 adopters at the end of January 1998. The BLM is in the process of following up on the responses.

- Continue the policy of 100 percent inspections on all complaints received.

The information collected in these efforts is required to be accurately entered into the WHBIS data base. The BLM will run reports of the records in the data base to verify that inspections are being completed and recorded as required.

Recommendation 4: Procedures are established which require records to be maintained on the complaints received of animal abuse or exploitation, the actions taken and the final results of those actions.

Concur: With the completion of the compliance module of the WHBIS data base (June 1998), the BLM will require that records of complaints of animal abuse or exploitation be entered into the national WHBIS data base and maintained along with records of actions taken and the effect of the actions on eligibility for future adoptions. Records of abuse or other violation will be immediately available to all field offices for their use in checking applications to adopt wild horses or burros. The procedures for requiring and accomplishing this task are included in the handbook on Compliance Handbook for Wild Horses and Burros which is currently being updated for review by the BLM's Headquarters staff and the Solicitor's Office.

Recommendation 5: Procedures are established to require all offices to contact adopters who have not submitted title applications in a timely manner and to take appropriate follow up actions to issue titles. Further, consideration should be given to implementing, on a Bureau wide basis, other effective procedures and memorandums of understanding with slaughterhouses that have been established in some offices.

Concur: It is the policy of the BLM that, as soon as the animal is eligible for titling and its health and proper care have been certified, title will be issued. The BLM sends a certified letter to adopters who have not applied for title to their animal by 15 months after the adoption date. If the adopter does not respond, BLM will follow up with a site visit to determine the reason, verify the health of the animal, and issue the title if appropriate.

The Culp Report also recommended that the BLM attempt to contact by mail the adopters of all animals that have not been titled over the 20-year life of the adoption program, in an effort to convey title to all eligible adopters. We believe that this would be a costly endeavor without corresponding benefit. Instead, we are contacting the people who have adopted, but not taken title to, horses or burros since October 1, 1992, to determine the status of those animals and convey titles where appropriate. We then plan to turn our attention to newly adopted animals, having established a new line of demarcation for the BLM's compliance efforts.

On February 4, 1998, the BLM issued Instruction Memorandum No. 98-59 to all affected field offices instructing them to contact all slaughterhouses that process horses for human consumption with the intent of entering into memoranda of understanding (MOU). These MOUs will establish monitoring procedures to ensure that untitled animals are not slaughtered. The field offices have contacted eight known processing plants. We have signed MOUs with three plants; we are working on MOUs with three plants; and, we have determined that two plants no longer process horses.

The BLM is also negotiating a cooperative agreement with the Department of Agriculture's Food Safety and Inspection Service (FSIS) to use FSIS inspectors to help determine the presence of untitled wild horses at slaughterhouses that process horses for human consumption.

STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
1, 2, 3, and 4	Resolved; not implemented.	No further response to the Office of Inspector General is required. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.
5	Implemented.	No further response to the Office of Inspector General is required.

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

Sending written documents to:

Calling:

Within the Continental United States

U.S. Department of the Interior
Office of Inspector General
1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240

Our 24-hour
Telephone HOTLINE
1-800-424-5081 or
(202) 208-5300

TDD for hearing impaired
(202) 208-2420 or
1-800-354-0996

Outside the Continental United States

Caribbean Region

U.S. Department of the Interior
Office of Inspector General
Eastern Division - Investigations
1550 Wilson Boulevard
Suite 410
Arlington, Virginia 22209

(703) 235-9221

North Pacific Region

U.S. Department of the Interior
Office of Inspector General
North Pacific Region
238 Archbishop F.C. Flores Street
Suite 807, PDN Building
Agana, Guam 96910

(700) 550-7428 or
COMM 9-011-671-472-7279

Toll Free Numbers:
1-800-424-5081
TDD 1-800-354-0996

FTS/Commercial Numbers:
(202) 208-5300
TDD (202) 208-2420

HOTLINE

1849 C Street, N.W.
Mail Stop 5341
Washington, D.C. 20240