

Part C

FINANCIAL SECTION

Message from the Chief Financial Officer

As the Chief Financial Officer of U.S. Department of Agriculture (USDA) Forest Service, I present the consolidated financial statements of the USDA Forest Service for fiscal year (FY) 2006. For five consecutive years beginning in FY 2002, our independent auditor has rendered an unqualified, "clean", opinion on our financial statements. The unqualified opinion for FY 2006 attests to the fact that the Forest Service financial statements are fairly presented and demonstrate discipline and accountability in the execution of our responsibilities as stewards of the American taxpayers' dollars.

The Forest Service continued agencywide improvement efforts to effectively and efficiently manage public funds and property through "Sustainable Financial Management activities." Strategic goals for financial management continue to be focused on creating an effective, efficient, and economic financial management organization; establishing financial management performance accountability; sustaining financial management improvements; resolving open audit recommendations and material weaknesses; and integrating financial processes and systems.

During FY 2006, the Forest Service obtained closure on one material weakness and had two other material weaknesses downgraded to reportable conditions from the FY 2005 financial statement audit. The Forest Service has developed corrective action plans and established target dates for all open recommendations, and we anticipate a further reduction in outstanding open audit recommendations by the end of FY 2007. In FY 2006 and continuing into FY 2007 the Forest Service is continuing to implement corrective actions associated with material weaknesses regarding the Financial Management and Reporting process and the Information Technology General Controls Environment.

The Forest Service took the steps necessary in FY 2006 to ensure that evaluations of the system of internal controls for the agency have been conducted in accordance with OMB guidelines and comply with the standards prescribed by the Comptroller General. The Forest Service evaluations included assessments regarding whether the financial management systems and internal accounting and administrative controls were in compliance with the standards prescribed by the Comptroller General. The results of the assessment, conducted at all levels throughout the agency, indicate that the system of internal accounting and administrative control in effect during FY 2006 complies with the requirement to provide reasonable assurance that the objectives have been met.

For FY 2007, the Forest Service commitment to effective and efficient management of its resources continues. Our goals will center on maintaining an unqualified audit opinion, eliminating material weaknesses, ensuring our financial systems and reporting meet Federal requirements, and implementing new initiatives. We continue to focus efforts on improving our ability to provide timely, accurate, and useful financial information with the effort and teamwork of program, business, financial management, and audit staff. I want to extend my appreciation to all individuals and organizations whose dedication and resolve made the FY 2006 unqualified opinion and reduction of material weaknesses possible. I anticipate another productive year in FY 2007 and continuous improvement in the level of financial services evidenced in our past successes.


JESSE L. KING
Chief Financial Officer



UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL



Washington D.C. 20250

NOV 13 2006

REPLY TO

ATTN OF: 08401-7-FM

TO: Dale Bosworth
Chief
Forest Service

ATTN: Sandy Coleman
Agency Liaison Officer
Forest Service

FROM: Robert W. Young
Assistant Inspector General
for Audit

SUBJECT: Forest Service's Financial Statements for Fiscal Years 2006 and 2005

This report presents the auditors' opinion on the Forest Service's (FS) principal financial statements for the fiscal years ending September 30, 2006 and 2005. The report also includes an assessment of FS' internal control structure and compliance with laws and regulations.

KPMG LLP, an independent certified public accounting firm, conducted the audits. We monitored the progress of the audit at all key points, reviewed KPMG's report, reviewed selected audit documentation, and performed other procedures, as we deemed necessary. We determined the audits were conducted in accordance with generally accepted auditing standards, *Government Auditing Standards* (issued by the Comptroller General of the United States), and the Office of Management and Budget Bulletin No. 06-03, "Audit Requirements for Federal Financial Statements."

It is the opinion of KPMG, that the financial statements present fairly, in all material aspects, the FS' financial position as of September 30, 2006, and 2005; and its net costs, changes in net position, budgetary resources, and reconciliation of net cost to budgetary obligations for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

KPMG's report on FS' internal control structure over financial reporting identified two material internal control weaknesses. Specifically, KPMG identified material weaknesses in FS':

- Financial management and reporting process (repeat material weakness); and
- general controls environment (repeat material weakness).

KPMG's report on FS' laws and regulations disclosed noncompliance with appropriation law and instances of noncompliance with the Federal Financial Management Improvement Act of 1996.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned, including the timeframes to address the report recommendations. Please note the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from report issuance.

Independent Auditors' Report



KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

Chief, USDA Forest Service and
Inspector General, United States Department of Agriculture:

We have audited the accompanying consolidated balance sheets of the United States Department of Agriculture (USDA) Forest Service as of September 30, 2006 and 2005 and the related consolidated statements of net cost, changes in net position, and financing, and the combined statements of budgetary resources for the years then ended (hereinafter referred to as the "financial statements"). The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our 2006 audit, we also considered the USDA Forest Service's internal controls over financial reporting, Required Supplementary Information, Required Supplementary Stewardship Information, and performance measures, and tested the USDA Forest Service's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these financial statements.

SUMMARY

As stated in our opinion on the financial statements, we concluded that the financial statements as of and for the years ended September 30, 2006 and 2005, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 5 to the financial statements, the USDA Forest Service changed its method of reporting for heritage assets and stewardship land in fiscal year 2006 to adopt the applicable provisions of the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards (SFFAS) No. 29, *Heritage Assets and Stewardship Land*. Also, as discussed in Note 1.P. to the financial statements, the USDA Forest Service changed its method of accounting for and reporting earmarked funds in fiscal year 2006 to adopt the provisions of the SFFAS No. 27, *Identifying and Reporting Earmarked Funds*.

Our consideration of internal controls over financial reporting, Required Supplementary Information, Required Supplementary Stewardship Information, and performance measures resulted in the following conditions being identified as reportable conditions. The first two are considered material weaknesses.

- The USDA Forest Service Needs to Continue to Improve its Financial Management and Reporting Process
- The USDA Forest Service Needs to Improve Its General Controls Environment
- The USDA Forest Service Needs to Refine and Monitor its Expense Accrual
- Accountability for Unliquidated Orders (ULOs) Needs Continued Improvement



- The Review of Purchase Card Transactions and Monitoring of the Program Needs Continued Improvement
- Controls Related to Physical Inventories of Capital Assets Need Continued Improvement
- The Design and/or Implementation of Controls Related to the Accurate Recording of Revenue-Related Transactions Needs Improvement
- The USDA Forest Service Needs to Continue to Improve its Internal Controls over its Reconciliation and Management of Fund Balances with Treasury
- The Design and/or Implementation of Controls Related to the Accurate Recording of Personal Property Transactions Needs Improvement
- The Compilation of Performance Measures Needs Improvement
- The Compilation of the USDA Forest Service's Required Supplementary Information Needs Improvement
- The Posting of Certain Transactions Needs to Contain the Proper Reference Data to Link Related Transactions
- A Segregation of Duties Policy related to Electronic Data Processing Must be Fully Implemented

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed the following instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*.

- The USDA Forest Service Does Not Obligate all Transactions Required by Appropriations Law
- The USDA Forest Service's Systems Do Not Comply with the *Federal Financial Management Improvement Act of 1996* (FFMIA)

The following sections discuss our opinion on the USDA Forest Service's financial statements, our consideration of the USDA Forest Service's internal controls over financial reporting, Required Supplementary Information, Required Supplementary Stewardship Information, and performance measures; our tests of the USDA Forest Service's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements, and management's and our responsibilities.

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying consolidated balance sheets of the USDA Forest Service as of September 30, 2006 and 2005 and the related consolidated statements of net costs, changes in net position, and financing, and combined statements of budgetary resources for the years then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the USDA Forest Service as of September 30, 2006 and 2005, and its net costs, changes in net



position, budgetary resources, and reconciliation of net costs to budgetary obligations for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 5 to the financial statements, the USDA Forest Service changed its method of reporting for heritage assets and stewardship land in fiscal year 2006 to adopt the applicable provisions of the SFFAS No. 29, *Heritage Assets and Stewardship Land*. Also, as discussed in Note 1.P. to the financial statements, the USDA Forest Service changed its method of accounting for and reporting earmarked funds in fiscal year 2006 to adopt the provisions of the SFFAS No. 27, *Identifying and Reporting Earmarked Funds*.

The information in the Management Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information sections is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles and OMB Circular No. A-136, *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and accordingly, we express no opinion on it. As a result of such limited procedures, we believe that the Required Supplementary Information related to deferred maintenance, heritage assets, and stewardship land may not be consistently prepared across all USDA Forest Service locations and controls have not been effectively designed to ensure the accuracy, completeness, and timeliness of the reported information.

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

In our fiscal year 2006 audit, we noted certain matters, described in Exhibits I and II, involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that the two reportable conditions presented in Exhibit I are material weaknesses. Exhibit II presents the other reportable conditions.

A summary of the status of prior year reportable conditions, including those open conditions on which we are making no further recommendations in this report, is included as Exhibit III.

We noted certain additional matters that we have reported to management of the USDA Forest Service in a separate letter.



INTERNAL CONTROLS OVER REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION AND PERFORMANCE MEASURES

Under OMB Bulletin No. 06-03, the definition of material weaknesses is extended to other controls as follows. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud, in amounts that would be material in relation to the Required Supplementary Stewardship Information or material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal control, misstatements due to error or fraud may nevertheless occur and not be detected.

Our consideration of the internal control over the Required Supplementary Stewardship Information and the design and operation of internal control over the existence and completeness assertions related to key performance measures would not necessarily disclose all matters involving the internal control and its operation related to Required Supplementary Stewardship Information or the design and operation of the internal control over the existence and completeness assertions related to key performance measures that might be reportable conditions.

In our fiscal year 2006 audit, we noted a reportable condition involving the design and operation of internal controls over the existence and completeness assertions related to key performance measures described in Exhibit II that, in our judgment, could adversely affect the USDA Forest Service's ability to collect, process, record, summarize and report performance measures in accordance with management's criteria. However, the reportable condition is not believed to be a material weakness as defined above.

COMPLIANCE AND OTHER MATTERS

Our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, as described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed noncompliance with appropriation law as described in Exhibit IV that is required to be reported under *Government Auditing Standards* and OMB Bulletin No. 06-03.

The majority of the deficiencies for noncompliance with appropriation law result from the USDA Forest Service's travel system limitations. The USDA Forest Service's current system does not allow them to obligate funds for travel.

The results of our tests of compliance with certain provisions of other laws and regulations, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 06-03.

The results of our tests of FFMIA disclosed instances, described in Exhibit IV, where the USDA Forest Service's financial management systems did not substantially comply with the three requirements discussed in the Responsibilities section of this report.

RESPONSIBILITIES

Management's Responsibilities. The United States Code Title 31 Sections 3515 and 9106 require agencies to report annually to Congress on their financial status and any other information needed to fairly present their financial position and results of operations. To meet these reporting requirements, the USDA Forest Service prepares and submits financial statements in accordance with OMB Circular No. A-136.



Management is responsible for the financial statements, including:

- Preparing the financial statements in conformity with U.S. generally accepted accounting principles;
- Preparing the Management Discussion and Analysis (including the performance measures), Required Supplementary Information, and Required Supplementary Stewardship Information;
- Establishing and maintaining effective internal controls; and
- Complying with laws, regulations, contracts, and grant agreements applicable to the USDA Forest Service, including FFMIA.

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

Auditors' Responsibilities. Our responsibility is to express an opinion on the fiscal year 2006 and 2005 financial statements of the USDA Forest Service based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 06-03. Those standards and OMB Bulletin No. 06-03 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal controls over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the USDA Forest Service's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

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

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

In planning and performing our fiscal year 2006 audit, we considered the USDA Forest Service's internal control over financial reporting by obtaining an understanding of the USDA Forest Service's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 06-03. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to provide assurance on the USDA Forest Service's internal controls over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin No. 06-03, in our fiscal year 2006 audit, we considered the USDA Forest Service's internal control over Required Supplementary Stewardship Information by obtaining an understanding of the USDA Forest Service's internal control, determining whether these internal controls had



been placed in operation, assessing control risk, and performing tests of controls. We limited our testing to those controls necessary to test and report on the internal controls over the Required Supplementary Stewardship Information in accordance with OMB Bulletin No. 06-03. However, our procedures were not designed to provide an opinion on internal control over the Required Supplementary Stewardship Information and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 06-03, in our fiscal year 2006 audit, with respect to internal controls related to performance measures determined by management to be key and reported in the Management Discussion and Analysis section, we obtained an understanding of the design of internal controls relating to the existence and completeness assertions and determined whether these internal controls had been placed in operation. We limited our testing to those controls necessary to test and report on the internal control over key performance measures in accordance with OMB Bulletin No. 06-03. However, our procedures were not designed to provide an opinion on internal control over reported performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether the USDA Forest Service's fiscal year 2006 financial statements are free of material misstatement, we performed tests of the USDA Forest Service's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 06-03, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to the USDA Forest Service. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 06-03 and FFMIA, we are required to report whether the USDA Forest Service's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

RESTRICTED USE

This report is intended for the information and use of the USDA Forest Service's management, the USDA Office of the Inspector General (OIG), OMB, the U.S. Government Accountability Office and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 10, 2006

INTRODUCTION

In FY 2004, the USDA Forest Service began a major transformation of business operations throughout the agency, beginning with two business functions. The first involved its Information Resources Management organization for which some segments were offered for competitive bid under OMB Circular No. A-76, *Performance of Commercial Activities*. Government employees in the USDA Forest Service were the successful bidders which resulted in a realignment of both organization and operations. The second was the effort to consolidate its finance and accounting operations from 153 accounting centers to the Albuquerque Service Center (ASC) in New Mexico. Significant work was accomplished in FY 2004 and 2005 to design and staff the new organization, re-engineer finance and accounting business processes, and migrate work from field locations. In FY 2006, new system design efforts were undertaken to accommodate for operational gaps identified in the new business structure.

In the current FY, the USDA Forest Service also began to consolidate its human capital management (HCM) operations from its field offices throughout the country to Albuquerque, New Mexico. Currently, HCM is undergoing business processing re-engineering and new system design efforts, and expects to be fully operational in FY 2007.

The USDA Forest Service is beginning to reap the benefits of consolidating its finance and accounting operations at the ASC through improvements in its financial management, strengthened internal controls, and consistency in the executing of its operations. Although the USDA Forest Service continues to make year over year progress in correcting several prior year noted weaknesses, we believe the depth of many weaknesses may require years to resolve. As with any major reorganization and/or implementation of new systems, some additional control weaknesses have been identified.

For each weakness identified, we believe we have performed appropriate substantive procedures as applicable to enable us to issue our opinion. In addition, we continue to recognize that certain recommended information technology (IT) control enhancements pertaining to the USDA Forest Service's operations cannot be implemented solely by the USDA Forest Service, because the USDA Forest Service's applications are in many cases hosted on USDA – managed systems. As a result, several IT control weaknesses identified in this report will require the combined effort of USDA and the USDA Forest Service management.

Exhibits I and II provide an update to prior year material weaknesses and reportable conditions, respectively, as of and for the year ended September 30, 2006, and include applicable new recommendations. Exhibit III summarizes the status of prior year recommendations. Exhibit IV provides an update of those instances of noncompliance with laws and regulations and other matters and applicable new instances of noncompliance. Exhibit V summarizes the status of prior year recommendations for noncompliance with laws and regulations. USDA Forest Service management's response is presented in Exhibit VI.

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MATERIAL WEAKNESSES

Number 1: The USDA Forest Service Needs to Continue to Improve its Financial Management and Reporting Process (*Repeat Condition*)

During FY 2005 the USDA Office of the Chief Financial Officer (OCFO) instructed its agencies, including the USDA Forest Service, that journal vouchers (JVs) could no longer be processed. Instead, USDA agencies had to request that new accounting entry IDs (ACCTEIDs) be established generally based on specific standard Treasury posting logic models. The USDA OCFO generally establishes these ACCTEIDs as standard vouchers (SVs) as SVs are generally used to correct errors, abnormal balances, and out-of-balance conditions.

Through the elimination of JVs and the consolidation effort discussed in the introduction section, the USDA Forest Service continues to make progress in improving its financial management and reporting activities. However, weaknesses continue to exist in the USDA Forest Service's ability to produce accurate financial information.

General Ledger Clean-up of Prior Year Non-routine Transactions is Necessary

During our current year testwork it was noted that the USDA Forest Service is not identifying, researching, and correcting adjusting entries that no longer belong in the general ledger. Specifically, 50 samples (i.e., Transaction codes JVs, YEs, SVs, and RCs) which related to prior FY activity were invalid. These documents were identified in general ledger accounts 4221, *Unfilled Customer Orders without Advance*, 2190, *Other Liabilities*, and 48XX, *Undelivered Orders*. The table below summarizes the dollar value of the exceptions by transaction code and general ledger account.

<i>Transcode</i>	<i>Standard General Ledger Account</i>			<i>Total</i>
	<i>4221</i>	<i>2190</i>	<i>48XX</i>	
JV	(\$84,645,944)	(\$5,675,243)	(\$10,939,034)	(\$101,260,221)
RC	-	(10,837,494)	-	(\$10,897,494)
SV	-	102,690	(97,888)	\$4,802
YE	-	14,172	(15,333)	(\$1,161)
Total	(\$84,645,944)	(\$16,455,875)	(\$11,052,255)	(\$112,154,074)

OMB Circular A-123, *Management Responsibility for Internal Control* states that financial reporting means that management can reasonably make the following assertions:

- All reported transactions actually occurred during the reporting period...; and
- All assets, liabilities, and transactions that should be reported have been included and no unauthorized transactions or balances are included...

Recommendation Number 1:

We recommend that the USDA Forest Service management assign the Treasury Symbol analysis team the responsibility to research and analyze all of the general ledger accounts to identify and remove potentially erroneous entries from the general ledger.

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Improvement in the Recording of Non-routine Transactions is Necessary to Improve the Accuracy of ULOs and Accruals

At the end of FY 2006, the USDA Forest Service continued to use mass general ledger entries, via an SV, for delivered orders and ULOs that were not recorded into the various sub-systems due to the early year-end cutoff. This policy was designed and implemented in FY 2005 to ensure completeness of data in the general ledger. In order to accommodate the volume of both undelivered and delivered orders to be entered, summary documents with detailed information were used to enter transactions.

As part of our non-routine year-end sampling, 17 ULO and 63 accrual transactions were selected as of September 30, 2006. Of this sample the following errors were noted:

- 14 of the 17 ULO transactions were for delivered orders and therefore not properly recorded in the general ledger, and
- 36 of the 63 accrual transactions were not valid accruals and therefore not properly recorded in the general ledger.

The USDA Forest Service has two over-arching internal control policies and procedures that should ensure the accuracy of the data entered into the general ledger. Those policies and procedures are as follows:

- The USDA Forest Service's general ledger contains security profiles and a system configuration that require two separate employees to enter and approve SV transactions.
- In addition, Chief Financial Officer (CFO) Bulletin 2002-010 *SV Documentation Policy* states "SV documents require approval by an approving official and will process similar to balance vouchers, internal vouchers, working capital fund vouchers and journal vouchers in that one individual will create the SV and another (approving official) will approve the document before it is accepted in the Foundation Financial Information System (FFIS). Approving the SV document means the approving official has reviewed the supporting documentation and agrees that the SV transaction is appropriate, adequately documented and should be made in the current accounting period."

Although the USDA Forest Service does have these internal controls in place, they are not operating effectively based on the errors cited above. As a result of the lack of adherence to the USDA Forest Service's policies and procedures for reviewing and approving period-end standard vouchers, erroneous ULO and accrual transactions existed.

Recommendation Number 2:

We recommend that the USDA Forest Service management develop a plan to improve the operating effectiveness of its review and approval of all period-end accrual adjustments.

Other Financial Reporting Issues

Although the USDA Forest Service has made significant improvements in its financial reporting process the following areas for improvement were noted:

- The USDA Forest Service did not perform timely research to determine the reasons for abnormal general ledger account balances, especially when abnormal balances were identified in general ledger flow

(Continued)

accounts (i.e., revenues, expenses and budgetary accounts that close). As a result, our testwork disclosed transactions that were identified as current year activity but in reality had a prior year effect.

- The USDA Forest Service needs to continue to refine its account relationship formulas to ensure that if variances exist, they are legitimate when taking into consideration standard general ledger account posting logic and the USDA Forest Service's business processes. For example, during our review of the formula for the account relationship entitled unexpended appropriations equals general ledger accounts 4450 through 4899, it was noted that general ledger account 4802, *Undelivered Orders – Obligations Prepaid/Advanced* is considered in the account relationship formula. However it should not be, because the unexpended appropriations account balance is not affected by advance transactions that are posted to general ledger account 4802.
- The USDA Forest Service needs to develop a process for analyzing its budget clearing, suspense and deposit funds at the end of each accounting period. At the end of the FY 2006, an abnormal balance of \$53 million was identified in general ledger account 2400, *Liability for Deposit Funds, Clearing Accounts, and Undeposited Collections*. This general ledger account is used to record transactions, often between other Federal agencies, when the offsetting obligation or other document attributes are not known and need to be researched by the USDA Forest Service. If timely research is not performed, liabilities are overstated and expenses and expended appropriations are understated.

Recommendation No. 3:

We recommend that the USDA Forest Service management develop a process for analyzing its budget clearing, suspense and deposit funds at the end of each accounting period.

Also, we continue to recognize the need for the USDA Forest Service to provide Standard General Ledger (SGL) training to employees; identify business processes that are causing irregularities in the general ledger and develop an expedited corrective action plan; and to perform an effective monthly review, identification, research and correction of all abnormal balance and account relationships as reported in the prior recommendations 3 and 8 of Audit Report No. 08401-3-FM.

Number 2: The USDA Forest Service Needs to Improve its General Controls Environment (*Repeat Condition*)

In response to previously reported weaknesses in this area, the USDA Forest Service has undertaken initiatives to improve its information technology functions. Specifically, as part of the business operations reorganization and consolidation, the USDA Forest Service recently established a contract-like relationship with Federal employees to manage the USDA Forest Service IT infrastructure functions and processes. As a result of the reorganization, the USDA Forest Service IT infrastructure functions and processes are currently being centralized and updated.

While we commend USDA Forest Service's efforts to centralize and improve its IT infrastructure functions, more actions are necessary to fully address the general control weaknesses identified in prior years, as well as to ensure an appropriate level of confidentiality, integrity, and availability of sensitive information systems and resources.

Specifically, eight prior general control recommendations remain open. A description of the eight issues comprising this material weakness follows. Furthermore, at the USDA level, the parent organization, the OIG has identified a security weakness related to IT general controls. Actions to resolve the USDA issue are incumbent upon resolution of the USDA Forest Service general control material weakness.

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The criteria for this finding is based on the guidance in the *Federal Information Security Management Act (FISMA)*, passed as part of the *Electronic Government Act of 2002*, which mandates that the Federal entities maintain IT security programs in accordance with the OMB and National Institute of Standards and Technology (NIST) guidance. OMB Circular A-130, *Management of Federal Information Resources*, and various NIST guidelines describe specific essential criteria for maintaining effective general IT controls.

The Entity-Wide Process for Assessing IT Risks Has Not Been Fully Implemented (Repeat Condition)

We previously reported that the USDA Forest Service did not have a formal risk assessment policy, procedure, or guidance to allow for appropriate and complete risk assessments (RAs). During fiscal year (FY) 2006, we reviewed the RAs for the USDA Forest Service Computer Base (FSCB), which is the USDA Forest Service General Support System (GSS); Paycheck 7; Automated Timber Sale Accounting (ATSA); All Service Receipts (ASR); and the Financial Transaction Request System (FTRS). The following weaknesses were noted:

Risk Assessment (RA) Conditions	Application
No RA existed	ASR FTRS
The RAs were not current	FSCB
The vulnerability lists did not classify risk levels for AIX (IBM Operating System)	ATSA PAYCHECK 7

We continue to recognize the need for the USDA Forest Service to ensure that controls are established to facilitate adherence to the USDA Forest Service’s risk assessment policies and procedures as reported in prior recommendation 20 of Audit Report No. 08401-3-FM.

System Security Plans and the Computer Incident Response Team Charter Are Incomplete (Repeat Condition)

We previously reported that the USDA Forest Service did not have policies to govern the development of system security plans (SSPs). In fiscal year 2006, we reviewed the SSPs for FSCB, Paycheck 7, Infrastructure (INFRA), ATSA, ASR and FTRS and noted the following weaknesses:

SSP Conditions	Application
The SSP was not updated after the reorganization and transition to the Information Solution Organization (ISO)	FSCB
There are no current SSPs	ASR FTRS
The SSP did not identify a system owner	INFRA
No Memorandums of Understandings (MOUs) are documented	ATSA PAYCHECK 7

(Continued)

Additionally, we noted that the Computer Incident Response Team (CIRT) charter, which grants the CIRT its authority, is still in draft.

Furthermore, we found that training for staff with specific information technology duties has not been provided.

We continue to recognize the need for the USDA Forest Service management to establish controls to facilitate adherence to USDA Forest Service SSPs as reported in prior recommendation 21 of Audit Report No. 08401-3-FM.

Access Controls at Data Processing Facilities Need Improvement (*Repeat Condition*)

We previously reported that there were weak logical and physical access controls across the USDA Forest Service entity-wide. Specifically, we found:

- Management had not periodically reviewed individual logical access privileges, unauthorized access attempts or audit logs.
- Standard forms were not used to document the approval of data sharing, archiving, and deletion.

During our FY 2006 general controls review, we noted that improvements were made, such as:

- System software access paths had been identified and documented; and
- Health and Human Services (HHS) Payment Management System (PMS) access reviews were performed and documented.

Although improvements were made to access controls, the following weaknesses still existed at the Washington Office, the ASC, regional office in Atlanta, and regional office in Portland:

- *Policies not communicated and enforced* – While policies and processes surrounding logical and physical access controls, wireless access, Intrusion Detection Software (IDS) or firewall software, audit logging, and resource classification were all established in July of 2006; we found that the USDA Forest Service had not established and finalized policies early enough in the fiscal year to allow for the policy to be properly disseminated and promulgated throughout the agency.
- *Unauthorized Remote Access to the USDA Forest Service Network* – Four (4) out of thirty (30) USDA Forest Service employees and contractors had remote access to the USDA Forest Service network without proper approval.
- *Weak logical access controls over system software and sensitive utilities* – USDA Forest Service does not have procedures in place for monitoring, logging, and reviewing system software access and system utility use. Furthermore, access to system software is controlled through root access. Root access is controlled through the Oracle “Password Application,” however; access to the password application is not documented and maintained, and quarterly system software access reviews are not documented and maintained. In addition, users have the ability to grant and remove access.
- *Weak logical access controls over servers* – All servers are not “hardened”, which means that users could gain root server access anonymously, and actions could not be tracked to individual users. Currently forty

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(40) percent of USDA Forest Service servers, maintaining applications such as the INFRA database and FFIS, have not been hardened.

- *No maintenance or review of audit trails* – Procedures and processes for enabling, maintaining, and reviewing audit logs have not been approved and disseminated. Currently, the USDA Forest Service is in the process of implementing audit logging, which is scheduled to be implemented in phases. Logging and monitoring of root access, remote access, Oracle Database (DBA) access, and network access is currently not in place to document successful and unsuccessful logins attempts.
- *Inadequate physical access controls over sensitive areas* – Physical access to sensitive areas is not restricted to individuals with pertinent job responsibilities. We found three (3) individuals out of forty-two (42) with inappropriate physical access to sensitive areas at the ASC. Furthermore, one individual did not have a documented access authorization form. We also noted that non-USDA Forest Service employees have access to the USDA Forest Service server room located in Portland, OR and access to the server room is not periodically reviewed. In addition, the authorization and periodic review of physical access to sensitive areas in Atlanta is not documented and maintained.
- *No safeguards for protecting sensitive personnel information* – The USDA Forest Service records and maintains sensitive personnel information within Office Personnel Folders (OPFs). The USDA Forest Service has established an MOU with the Office of Personnel Management (OPM) to scan all OPFs and convert them into electronic files (eOPF); however, no safeguards have been established to protect the confidentiality and sensitivity of the OPF data. Furthermore, physical access to the HCM building was not properly controlled as the badge entry system was not activated at the time of our review.
- *No assignment of ownership of shared resources* – USDA Forest Service has agreed to share resources with the Bureau of Land Management (BLM), however no agreement exists establishing controls and responsibilities for safeguarding resources and data.

We continue to recognize the need for the USDA Forest Service management to establish logical and physical access controls to data processing facilities as reported in prior recommendation 6 of Audit Report No. 08401-6-FM and prior recommendation 22 of Audit Report No. 08401-3-FM.

Network Account Management and Access Controls Needs Improvement (Repeat Condition)

We previously reported that USDA Forest Service has not established a formal password policy. Additionally, insufficient password parameters and login information existed across the USDA Forest Service. Weak password controls existed on a significant number of hosts within the USDA Forest Service information technology infrastructure. Specifically, several hosts were identified with weak administrator and other power user account passwords, including blank passwords.

An external assessment was completed and identified several File Transfer Protocol (FTP) servers that allowed anonymous users write access to the public directory, default FTP accounts, writable FTP directories, and several default user names and password combinations present for various FTP accounts.

During the FY 2006 general controls review, we conducted an internal vulnerability assessment of the Washington DC Office (WO), the ASC, and the regional office in Portland. The following weaknesses were noted during the review:

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- USDA Forest Service did not finalize Forest Service Manual (FSM) 6600 Chapter 6680 directive 6684.1, “Password Management,” until July 19, 2006. As a result, this policy was not effective for the majority of the fiscal year.
- At the WO we identified:
 - Four instances of a Microsoft Windows 2000 local administrator account password equal to the user account name.
 - Five instances of a blank Microsoft Windows 2000 local administrator account password.
 - Five instances of a Microsoft Windows 2000 power user account password equal to the user account name.
 - 98 instances of a Microsoft Windows 2000 local user account password equal to the user account name.
 - Two instance of a blank Microsoft SQL Server System Administrator (SA) password (Spida Worm).
 - Six instances of the Microsoft Windows 2000 Autologin feature in use.
- At the regional office in Portland we identified:
 - One instance of default Oracle database user name and password combinations present, including the user name Scott and the password Tiger.
 - 19 instances of a Microsoft Windows 2000 local user account password equal to the user account name.
 - One instance of a blank Microsoft SQL Server SA password (Spida Worm).
 - Two instances of the Oracle TNS Listener service with a blank password.
 - Five instances of the Microsoft Windows 2000 Autologin feature were in use.
 - Two instances of TELNET with a blank username and password.
- At the ASC we identified:
 - Seven instances of a Microsoft Windows 2000 local administrator account password equal to the user account name.
 - 22 instances of a Microsoft Windows 2000 local user account password equal to the user account name.
 - Two instances of the Oracle TNS brand listener service with a blank password.
 - 11 instances of TELNET brand access with a blank username and password.
- As part of the FY 2006 external vulnerability assessment of USDA Forest Service, the following prior year conditions were repeat conditions, including:
 - Three hosts were identified as having default user name and password combinations present for various FTP accounts, including oracle and anonymous.
 - Three hosts were identified as having a writable FTP root directory.

We continue to recognize the need for the USDA Forest Service to develop access controls and to improve the management of network accounts as reported in prior recommendation 7 of Audit Report No. 08401-6-FM.

Patch Management and Configuration Guidance is Not Complete and There is a Lack of General Policy Around System Software and Change Control (Repeat Condition)

We previously reported several findings in the area of system software and change control, and service continuity related to the operating system software. Additionally, we found:

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- The FSM 6600, *Systems Management*, subsection 6683.6, *Hardware Systems and Software Maintenance*, and the Configuration Management Board (CMB) charter were in draft; and
- No formal policy provides access restrictions over software code, change control, emergency change procedures, library management policies, or library access controls.

During the FY 2006 general control review, a lack of current formal policies and procedures still exists over the change control processes. Specifically, the following formal documents were not found to exist:

- Software/application distribution policy;
- Enterprise policies and procedures for controlling the movement of programs and data among program libraries;
- Procedures for logging and reviewing system software installations;
- Software change control forms;
- Procedures for scheduling and notifying system users of software installations; and
- Standard configuration for network software, links, and services.

We also identified the following control weaknesses during the change control and systems software review:

- Programmers are not trained on the System Development Life Cycle (SDLC) methodology;
- Management does not ensure that consistent change control standards are in place for all USDA Forest Service application changes;
- Management does not ensure that application developers are segregating production and test libraries and limiting access to software libraries to appropriate individuals;
- INFRA/I-Web developers have access to the production and development environment and are also able to grant access to users;
- Results of the testing performed for changes is not consistently documented and maintained; and
- Vendor maintenance of system software is not logged.

During the FY 2006 external and internal vulnerability assessment of the WO, Portland Regional Office, and the ASC, a significant number of issues were identified in four areas: outdated software; missing critical patches on various services and/or software; improperly configured services or software; and outdated or unnecessary services and/or software installed. The weaknesses included 59 instances of outdated software; 200 instances of hosts missing critical patches and/or updates; 33 instances of Oracle and 7 instances of Adobe Acrobat Reader buffer overflows; 5 instances of missing miscellaneous service updates; 1 instance of a Dell OpenManage web server with missing patches; 30 instances of improperly configured services; and 13 telnet and 20 remote procedure call (RPC) services were unnecessarily installed.

We continue to recognize the need for the USDA Forest Service to develop and implement a patch management policy and configuration management policy to strengthen change controls and system software controls as reported in prior recommendation 23 of Audit Report No. 08401-3-FM.

Weaknesses Still Exist in Continuity of Operations and Contingency Plans (Repeat Condition)

We previously reported service continuity control weaknesses at the USDA Forest Service indicating that policies and procedures did not exist for the IT contingency and disaster recovery planning, emergency procedures were not documented, a business impact analysis (BIA) was not performed for various regional offices, application contingency plans were weak, and backup site procedures and agreements are not documented.

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In our FY 2006 audit, we inspected the USDA Forest Service's continuity of operations plans (COOP) and disaster recovery documentation. COOPs provide procedures and capabilities to sustain an organization's essential, strategic functions at an alternate site. IT contingency plans provide procedures for recovering an application. We noted that, while improvements had been made over the last year, the following weaknesses were identified:

- *Policies and procedures* – USDA Forest Service did not finalize an IT recovery policy until July 19, 2006. As a result this policy was not in effect for most of the year. This policy covers critical areas of:
 - IT contingency planning,
 - IT restricted space,
 - Data backup and recovery, and
 - Information identification and classification.
- *USDA Forest Service IT Continuity of Operations Plans* – The COOP plans from Regions 5 and 6, both Network Operating Centers (NOC), and the ASC did not address the IT and telecommunication services needed to resume service continuity.
- *Procedures and agreements* – Procedures and agreements regarding regional office backup facilities had not been developed for instances where one region is the backup site for another region. Regional offices had not established service agreements for emergency telecommunication services.

We continue to recognize the need for the USDA Forest Service to develop and implement a COOP policy addressing IT contingency and disaster recovery planning as reported in prior recommendation 5 of Audit Report No. 08401-6-FM.

The Certification and Accreditation (C&A) Process for General Support Systems and Major Applications per the Requirements Set Forth in OMB Circular A-130 (Repeat Condition)

We previously reported that the USDA Forest Service did not have C&A policies and procedures for continuous monitoring of the systems or performing annual self-assessments. Additionally, major applications had incomplete C&A packages and one did not undergo C&A.

During our FY 2006 review, we identified that the USDA Forest Service did not have any pre-existing policy regarding C&As and self-assessments prior to the approval of the FSM 6600 on July 17, 2006. We noted that there was no time in the FY to implement the policy. As a result, we were not able to evaluate individual C&A packages.

We continue to recognize the need for the USDA Forest Service to develop and implement a C&A policy based on NIST Special Publication as reported in prior recommendation 19 of Audit Report No. 08401-3-FM.

REPORTABLE CONDITIONS

Number 1: USDA Forest Service Needs to Refine and Monitor its Expense Accrual

Statistical Accrual Model Needs Refinement

During FY 2006, USDA Forest Service developed a regression analysis model to determine a statistically derived amount for a component of its expense accrual. This model is used to determine an estimate of the amount of accrue on a macro level for many smaller dollar obligation transactions.

Regression analysis is a statistical tool that derives a mathematical relationship between two or more quantitative variable of interest (the dependent variable) can be estimated by one or more of the others (independent variable(s)). Typically, for regression models to produce valid and reasonably precise estimates, the sample data must cover a wide range of values for the independent variable(s), and must also have enough observations (i.e., data points) to ensure both the geometric shape and precision of the resulting estimates with a high degree of statistical confidence. The number of sample observations required for such validity and precision is generally accepted to be in excess of 50 plus the number of coefficients being estimated by the model employed. In the case of a simple two-variable straight line model, a sample size of 52 or more would be desirable; while with a more complex curvilinear model using two or more variables, a larger sample size would be appropriate.

Currently the USDA Forest Service is planning to use several different geometric models as derived from the currently available 33 data points. These different models incorporate both straight line and curvilinear mathematical functions with potentially different forms of the variables being employed as the format for the independent variable portion of the model. While it may be appropriate to have different geometric patterns for accrual estimating equations for the various broad range of obligations, it was noted that all of these models are producing wide ranges of variability around the estimating equations. The lack of precision (i.e., at the 95% confidence level) could be caused by either using the wrong geometric function or using the wrong form of the various variables being employed. However, with the current number of observations (i.e., data points), we are unable to tell whether those things are responsible for perhaps; there is some other root cause.

While these newly developed regression models appear to produce slightly better results overall then past methods for the various accrual estimates, there are issues that should be noted on a go forward basis. Some of these issues follow:

- *Lack of Sufficient Number of Data Points* –The USDA Forest Service uses 33 data points for establishing the accruals model at the end of the third quarter. Ideally a minimum of 52 or more data points should be used; however because the data are abased on time series, that goal will not be able to be achieved for another 19 plus months.
- *Correlation of ULO Balances and Payments*- The statistical models developed by USDA Forest Service use various geometric relationships between unliquidated obligations and payments; with payments being the dependent variable of interest in each of the models. In each case, a correlation is developed from the coefficient of determination (i.e., the ratio of the “explained variation” to the “total variation” of the payment data). Because the correlation coefficients are relatively high for all of the models constructed, the USDA Forest Service management has assumed that the models will be useful and precise enough to provide tight estimates of the actual amounts earned by contractors and grantees, but not yet paid. Various expert texts have shown that the correlation coefficient, while helpful in initially determining the strength of the possible relationship of the variables in an estimation model, may not be the final indicator

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of how appropriate and definitive a regression model might be. The paucity of data points might lead to an incorrect conclusion for future estimation of future amounts to be accrued.

- *The Use of Three Different Model Forms-* The USDA Forest Service analysis has produced three different geometric model forms; one for grant and agreements, one for construction contracts, and one for operations. While the use of different curve forms for regression estimates is to be expected because of the timing and billing differences implicit in the different types of obligations, it was noted that there appeared to be a lack of consistency of “goodness of fit” or precision of estimate even when comparing the models being used within a single type of obligation. Sometimes the curvilinear form is preferred; but in other time frames, the straight line format provides a more precise estimate. The USDA Forest Service management must plan to verify and validate the various models developed against data that are not part of that which was used to develop the models. In addition, they must arrive at the geometric form that is appropriate and consistently applied for each one of the three types of obligations. It is also possible that they will need to consider the use of a multiple regression model (i.e., one with two or more independent variables) in order to more fully describe the amount that needs to be accrued for a given obligation type.
- *ULO's above \$500,000-* The data used starting at the beginning of FY 2004 and forward to analyze the relationships between ULOs and payments, and to calculate the regression equations includes UDOs above \$500,000. However, the regression equations are then applied only to UDOs below \$500,000. This inconsistency might be responsible for some of the unexplained variation that is observed in the various models.

The book entitled *Regression Diagnostic* written by M.S. Younger and published by John Wiley & Sons, New York, NY 1977 suggests that model-building data sets for regression analysis should be sufficiently large so that a reliable model can be developed. This reference suggests that the model data set should contain at least 60 to 100 cases in order to identify a meaningful relationship between two variables. In addition, the author also states that the coefficient of determination (R squared) is not an adequate indicator of the usefulness of the regression relation; therefore, a combination of other statistical parameters and diagnostics plots should be considered when evaluating a regression model. The reference describes, in detail, diagnostic techniques and model-building characteristics that should be taken into consideration when developing a regression model.

The variability in the various models developed and the inconsistency of results in comparison with actual data results in a certain amount of uncertainty as to the reliability of the accrual estimates being made. Such determinations can only be made as more data are made available over time and Forest Service management verifies and validates the set of models that are finally arrived at for use in the accrual process. However, at this time with the available information, we do not believe the variability observed would cause a material misstatement in the USDA Forest Service’s financial statements.

Recommendation Number 4:

We recommend that USDA Forest Service management:

- Expand the number of data points in the various regression models to at least 52;
- Expand the number of variables to form multiple regression models and/or the types of analysis to include the use of seasonal indexes in order to account for the various changes in the payment patterns by fiscal quarter; and
- Test models with specific additional independent variables in some of the models may help to substantiate and better expose the true nature of the relationships between ULOs and payments in the various types of obligations.

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Continued Monitoring of Field Site Expense Accrual Estimates is Required

Although the USDA Forest Service made significant progress in developing an auditable accrual methodology, the accuracy of accruals and our subsequent disbursements testwork disclosed that not all transactions are properly reported as accruals at period-end.

Our testwork of accruals recorded as of 9/30/06 disclosed 27 exceptions out of 184 transactions. Of these 27 exceptions: nine related to goods and services that were received and paid for prior to 9/30/06, 12 related to goods and services that were not received as of 9/30/06, five lacked adequate supporting documentation, and one had an ULO that was liquidated prior to 9/30/06.

Our subsequent disbursements testwork of 94 transactions disclosed 11 transactions that were not accrued at year-end by field offices. Over 50 percent of these transactions related to temporary travel. The remainder of the transactions does not appear to have a consistent cause for the lack of an accrual and as a result are considered anomalies that would only be identified and minimized from a robust monitoring program.

During the last quarter of 2006, the USDA Forest Service developed a monitoring program at the ASC that should help minimize the conditions noted above. The USDA Forest Service has not had adequate time to fully implement this monitoring program.

We continue to recognize the need for the USDA Forest Service ASC to implement an adequate monitoring program for quarterly review of field compliance and accuracy with its methodology as reported in the prior recommendation 15 of Audit Report No. 08401-3-FM.

Number 2: Accountability for ULOs Needs Continued Improvement (*Repeat Condition*)

During FY 2005 the USDA Forest Service experienced a lack of compliance with its policies and procedures to review and certify the accuracy of ULOs. In response to the FY 2005 ULO material weaknesses, the USDA Forest Service revised its policies and procedures regarding its certification of undelivered orders. Although there was improvement in this area, internal control weakness still existed.

During FY 2006, an internal control sample of ULOs was selected from the USDA Forest Service's May 31, 2006 ULO certification report at each of the ten field sites reviewed during the audit. Of the 53 sample items tested, the following 14 were noted as exceptions:

- One ULO was not reviewed by the unit because the responsible party did not understand their responsibility to review the ULO as the funding unit.
- Four ULOs were identified as invalid, but were not de-obligated prior to the required 30 day de-obligation period subsequent to the certification.
- Eight ULOs were certified as valid, but were determined by our review to be invalid.
- One ULO did not have enough information to certify its validity. The ULO was subsequently identified to be invalid and de-obligated after the 30 day de-obligation period.

Additionally, during the initial implementation of the USDA Forest Service's new ULO certification policy, the USDA Forest Service prepared report, used to assign ULO transactions to responsible offices, divided the ULO balances into line balances rather than the transaction total for the ULO balance.

Because of the poor operating effectiveness of the internal controls over ULOs, the September 30, 2006 ULO extract was reviewed in detail. The review results disclosed 34 of 188 routine ULO transactions as exceptions.

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USDA Forest Service Directive 6500-218 states that for the months ending November 30, February 28, May 31 and August 31, all obligations that are:

- \$250,000 or greater regardless of age,
- \$100,000 to \$249,000 and 36 months or older, and
- Under \$100,000 and 60 months or older must be reviewed to determine that they are valid, accurate, and supported. Any unliquidated obligations found to be invalid or incorrectly stated must be reported to ASC Budget Execution to be de-obligated or adjusted no later than 15 days after the date of certification.

We continue to recognize the need for the USDA Forest Service management to continue to monitor its ULO certifications and if necessary modify exiting policies and procedures as noted in prior year recommendation 1 of Audit Report No. 08401-4-FM.

Number 3: The Review of Purchase Card Transactions and Monitoring of the Program Needs Continued Improvement (*Repeat Condition*)

The USDA Forest Service uses the purchase card to reduce administrative costs and allow its employees to procure supplies and services faster than through traditional government procurement regulations.

Although internal control improvements have been noted in this area, weaknesses continue to exist as found in the current year testwork. During our testwork over quarterly supervisory reviews of purchase card transactions, three quarterly reviews out of 20 samples did not have evidence of supervisory review.

In addition, during testwork over the authorization for the use of purchase cards, the following exceptions were noted in a sample of 121 cardholders:

- Six cardholders did not have their *Micro-Purchase & PCMS (Purchase Card Management System) System Training Certification Request* forms signed by the Local Agency Program Coordinator (LAPC).
- One *Micro-Purchase & PCMS System Training Certification Request* form was not provided.

Also, while performing purchase card reviews, we noted the following control weaknesses:

- The ASC could not provide a list of purchase card holders who transferred to the ASC but had not surrendered their purchase cards at the locations from which they were transferred.
- One cardholder had retired (approximately 18 months ago) but was still in the PCMS system.
- One cardholder did not have the same single purchase limit on the *Micro-Purchase & PCMS System Training Certification Request* form and in PCMS.

USDA Departmental Regulation 5013-6 requires that supervisors of purchase card holders monitor the purchasing activity of card holders in their units. Paragraph 18 of the Regulation states that all personnel must be trained to use PCMS before a card may be conferred, and individuals issued a card will certify that they have received the training, understand the regulations and procedures, and know the consequences of inappropriate actions. In addition, on June 30, 2003, the WO sent a letter to USDA Forest Service activities instructing them to have all USDA Forest Service cardholders authorized in writing by December 31, 2003 [and on a go-forward basis].

On April 19, 2004, the USDA Forest Service Director of Acquisition Management reminded the various USDA Forest Service activities of the emphasis placed on the supervisor's review of purchase card holders. A

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supervisory review checklist was provided to document the reviews starting with the second quarter review (January – March 2004). Documentation of these reviews should be maintained for three years.

Without effective quarterly supervisory reviews of PCMS transactions, the USDA Forest Service increases its risks for inaccurate and inappropriate purchase card transactions. In addition, without complete and accurate cardholder information in PCMS and adequate authorization/training records for PCMS cardholders, USDA Forest Service management can not effectively monitor purchase card holders and transactions incurred by its cardholders.

We continue to recognize the need for the USDA Forest Service management to reinforce its policies in this area and incorporate procedures to test reviews of purchase card transactions in its Acquisition Management reviews as reported in prior year recommendation 4 of Audit Report No. 08401-4-FM.

Number 4: Controls Related to Physical Inventories of Capital Assets Need Continued Improvement
(Repeat Condition)

The USDA Forest Service provides capitalized asset written physical inventory instructions to its reporting units. We reviewed the instructions and believe they are effectively designed. For economy and efficiency, the USDA Forest Service performs a physical inventory of personal property on a two-year cycle, preferably in the even years. The last inventory was performed in the current fiscal year. Real property inventory procedures were changed in FY 2002 to require inventories on a rolling basis every five years starting in FY 2003.

In our FY 2005 audit, we noted four types of deficiencies:

- Lack of Signatures and or Dates on Inventory Reports;
- Lack of Evidence of Segregation of Duties;
- Lost or Found Items Discovered during Physical Inventories were not Properly Documented and/or Corrected in the Property Systems; and
- Lack of Inventory of Level 1 and 2 Roads.

In our FY 2006 audit, we noted the previous four and one new deficiencies which were primarily caused by a lack of compliance by field units with the USDA Forest Service’s written inventory instructions.

- *Lack of Signatures and/or Annotations on Inventory Reports-* Inventory reports were either not signed or not annotated by the inventory takers for 18 of 167 inventory reports. This deficiency existed at 7 of 10 units visited. Unsigned and undated physical inventory lists could result in a misstatement of assets because the physical existence of assets is not verified and/or properly recorded.
- *Lack of AgLearn Training for Inventory Takers* – Documentation evidencing AgLearn training for inventory takers was not available for 4 of 220 inventory takers. This deficiency existed at 3 of 10 units visited. Lack of proper training of inventory takers can result in non-compliance with USDA Forest Service inventory instructions and thus causing the misappropriation or misstatement of assets.
- *Lack of Evidence of Segregation of Duties*— The inventory was conducted and the inventory reports were annotated only by the inventory taker. In other instances, the inventory taker was the accountable officer. This condition existed in 4 of 147 inventory reports at 2 of the 10 units visited. Lack of proper oversight of inventory can result in the misappropriation or misstatement of assets.

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- *Lost or Found Items Discovered during Physical Inventories were not Properly Documented and/or Corrected in the Property Systems* – Non-reconciling items discovered during the physical inventories were not corrected in the property systems. This condition existed in 7 of 95 lost or found items at 2 of the 10 units visited. The effect is a misstatement of assets because assets were not properly recorded in the property subsidiary ledgers.
- *Lack of Inventory of Level 1 and 2 Roads* – Level 1 and 2 roads were again not inventoried in FY 2006 and at the current rate of their inventorying, USDA Forest Service will not complete a 100% physical inventory of roads within the five years.

We recommend that the USDA Forest Service increase their monitoring of reporting units for compliance with the USDA Forest Service written physical inventory instructions and implement an appropriate inventory methodology for level 1 and 2 roads as reported in prior year recommendation 9 of Audit Report No. 08401-6-FM.

Number 5: The Design and/or Implementation of Controls Related to the Accurate Recording of Revenue-Related Transactions Need Improvement (*Repeat Condition*)

During our prior year audit, we noted that revenue transactions were not recognized in the correct month and/or year, were not sufficiently documented, or had values that were not supported by the documentation. We also noted for accounts receivable that unbilled receivables were not reduced upon the issuance of actual billings, and incorrect balances were caused by system transaction linking issues.

During our FY 2006 audit, we tested 208 timber revenue samples, 571 general revenue samples, 581 accounts receivable samples, 124 unfilled customer orders with advance samples, and 306 unfilled customer orders without advance samples and noted the following errors.

Timber Revenue

- Five samples, not accrued for in the prior FY, were recorded as a current economic event instead of a prior year event. All of these samples related to a court settlement in which the USDA Forest Service was aware of the \$8.4M settlement in August of FY 2005.
- Two samples resulted in a misstatement of revenue in the current year that were not corrected before 9/30/06.

General Revenue

- 40 samples, not accrued for in the prior FY, were recorded as current economic event instead of a prior year event. Of these, 12 were the result of the USDA Forest Service correcting an account balance that was misstated at the end of FY 2005. The corrections were posted to a revenue account in FY 2006 instead of to the prior period adjustments account due to USDA not permitting its subsidiary agencies to use that account.
- Three samples had insufficient documentation to support the sample amount.
- One sample recorded revenue in FY 2006 that had already been recognized in FY 2005.
- Two samples were recorded in FY 2007 however they should have been accrued in FY 2006.

Accounts Receivable

- 15 samples were collected, but the accounts receivable balance was not reduced.

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- 11 samples were prior years unbilled that were not adjusted against advance or reversed at time when bills were issued.
- Five samples were recorded as duplicate billings.
- Two samples were not valid receivables because prior period accrual entries had not been reversed.
- Two samples were still recorded as receivables even though the customers filed for bankruptcy and the USDA Forest Service had no chance of collection.
- One sample had documentation that did not tie to the sample amount.
- One sample did not have sufficient documentation to support the sampled amount.

Unfilled Customer Orders

- Eight samples had an agreement with an expired period of performance.
- One sample was a refund payment that was incorrectly posted.
- Two samples showed an abnormal balance.
- Ten samples had insufficient documentation to support the sample amount.
- Two samples had agreements with expired authority.
- One sample revealed activity on an agreement that had expired.
- Five samples had an agreement amount that did not tie to the documentation.
- One sample had an advance that had been collected.

The effect of these deficiencies results in an over or underestimate of revenue and an overstatement of unfilled customer orders.

We continue to recognize the need for the USDA Forest Service management to review and update its policies and procedures for accurate recording of revenue as reported in prior year recommendation 6 of Audit Report No. 08401-4-FM.

Number 6: The USDA Forest Service Needs to Continue to Improve its Internal Controls over its Reconciliation and Management of Fund Balances with Treasury (*Repeat Condition*)

Financial Management Service (FMS) 6652 Reconciliation Process

During FY 2006 control testing, 50 sample items were selected from the FMS 6652 reports reconciliation process. The test results disclosed that all 50 sample items were adequately researched and resolved. However, 25 sample items were not corrected timely. Of these items, 22 were not reconciled timely due to the backlog of credit card transaction processing at the USDA National Finance Center (NFC) Administrative Billing and Collection Office (ABCO).

Government-wide Accounting System Reports Reconciliation Process

During FY 2006 control testing, 38 sample items were selected for our control tests of the Government-wide Accounting System reports reconciliation process. The test results disclosed that all 38 sample items were adequately researched and resolved. However, 14 sample items were not corrected timely. While this demonstrates an improvement in the reconciliation process, the deficiencies noted in the prior years have not been fully corrected.

We continue to recognize the need for the USDA Forest Service to ensure adequate reconciliations of Fund Balance with Treasury as noted in prior year recommendation 27 of Audit Report No. 08401-3-FM.

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Number 7: The Design and/or Implementation of Controls Related to the Accurate Recording of Personal Property Transactions Needs Improvement (*Repeat Condition*)

The USDA Forest Service has improved its property internal controls during FY 2006, including monthly general ledger to property subsidiary ledger reconciliations and other corrective actions.

However during FY 2006 substantive testing of 340 samples, we identified immaterial errors where the recorded data did not agree with the supporting documentation. These errors included:

- 21 samples that related to FY 2005 or prior events that were recorded as FY 2006 activity;
- 13 samples that did not have sufficient supporting documentation;
- 13 samples with an overstatement in accumulated depreciation;
- Three samples with an overstated asset cost;
- Two samples with an understated asset cost; and
- One sample with understated accumulated depreciation.

Additionally, upon review of the year-end data downloads for the personal property sub-ledgers, Equipment Management Information System (EMIS), and Personal Property Computer System (PROP) we identified 536 items (i.e., 110 PROP and 426 EMIS items) that did not meet the capitalization threshold at the time these were placed in service. These items resulted in overstatement of asset cost by \$4,084,338 and accumulated depreciation of \$(1,508,572).

We continue to recognize the need for the USDA Forest Service to increase its monitoring of compliance with property recording policy as reported in prior recommendation 30 of Audit Report No. 08401-3-FM.

Number 8: The Compilation of Performance Measures Needs Improvement (*Repeat Condition*)

The USDA OIG identified, in a March 2005 report entitled *Forest Service Implementation of the Government Performance and Results Act*, certain significant deficiencies in internal control over reported performance measures that, in our judgment, could adversely affect the USDA Forest Service's ability to collect, process, record, summarize, and report performance measures in accordance with management's criteria. Specifically, the OIG reported the USDA Forest Service had not effectively implemented a comprehensive strategy for collecting and reporting performance data. The OIG report identified several examples of inconsistencies, errors, and omissions in measuring performance, and that the standards used to define performance varied between regions, forests, and even among the districts in a forest. The report further stated that definitions of performance measures were often vague and open to varied interpretation and were not always distributed timely to the field.

During our FY 2006 audit follow-up work, we reviewed several USDA Forest Service performance review reports and identified the following weaknesses:

- Accomplishment reporting databases were not integrated and some were not fully functional.
- There was an inconsistent application of performance management throughout the agency.
- Some business rules of work planning and accomplishment reporting appeared to be in conflict with on-the-ground efforts toward integrated work.
- No universal verification process had been followed. In addition, standards for documentation in support of reported accomplishments were not in place.
- At different levels of the organization there were varied perspectives on the number and kind of performance measures needed at the different levels of the organization.

(Continued)

- Primary purpose, in some areas, was not being followed. USDA Forest Service must follow primary purpose to comply with Congressional intent, maintain validity of the reported accomplishment, and ensure that the expenditure information is consistently reported.

In addition, we reviewed USDA Forest Service’s OMB Circular A-123 control evaluation documentation which stated that, “USDA Forest Service has not effectively implemented a comprehensive strategy for collecting and reporting performance data. The USDA Forest Service lacks an effective internal control system to ensure data quality.”

Representatives from the USDA Forest Service’s Strategic Planning and Resource Assessment Office stated that USDA Forest Service is moving forward with implementing the Performance Accountability System (PAS) to accurately, consistently, and timely report performance information. However, PAS is still under development and implementation is not scheduled until FY 2007.

Recommendation Number 5:

We recommend that the USDA Forest Service should:

- Refine its policies and procedures for gathering and verifying its performance measure data to ensure consistent reporting across all offices.
- Implement PAS and adequately train personnel in the operation and use of the system.
- Ensure that an adequate quarter (at least June 30 reporting) and year-end reporting process is in place to accurately and completely report its performance measures in the financial statements and Performance and Accountability Report (PAR).

Number 9: The Compilation of the USDA Forest Service’s Required Supplementary Information (RSI) Needs Improvement (*Repeat Condition*)

We noted that the USDA Forest Service does not have adequately designed controls to ensure the consistency of information compiled and reported in its RSI section of the financial statements.

AU Section 558, sub section .07, a. requires the auditor to inquire if the required supplementary information is (i) measured and presented within prescribed guidelines....and; b. The information is consistent with the audited financial statements.....

We continue to recognize the need for the USDA Forest Service to revise its current control structure for data collecting of RSI as reported in prior recommendation 37 of Audit Report No. 08401-3-FM.

Number 10: The Posting of Certain Transactions Needs to Contain the Proper Reference Data to Link Related Transactions (*Repeat Condition*)

The USDA Forest Service business processes require that relevant subsequent transactions (e.g., an expense) be linked to an initiating transaction (i.e., obligation) to provide for the transaction history and overall net affect of a transaction. This link facilitates the matching of related transactions, such as an advance and the draw down of that advance through subsequent payments, which results in a net balance. However, this required information is not always entered in the general ledger.

(Continued)

During our review of data extracts as of September 30, 2006 from the general ledger for accounts for 48XX and 2190, we noted that trans-codes BG, Z7, DG, and DH remained open and unlinked in our extracts. The following trans-codes and the respective balances were identified in each of the extracts:

Transcode	Standard General Ledger Account	
	48XX extract	2190 extract
BG	\$4,118,962	(\$2,623)
Z7	0	0
DG	(5,167,006)	(12,892,985)
DH	(54,133)	(3,799)
Totals	(\$1,102,177)	(\$12,899,407)

Although the extract as a whole is valued correctly, individual document transactions relating to undelivered orders and accruals are overstated as of September 30, 2006.

We continue to recognize the need for the USDA Forest Service to ensure adequate linking of its transactions as reported in prior recommendations 34, 35, and 36 of Audit Report No. 08401-3-FM.

Number 11: A Segregation of Duties Policy related to Electronic Data Processing (EDP) Must be Fully Implemented (*Repeat Condition*)

We previously reported that, although a number of the controls around segregation of duties related to IT were in place and new segregation of duties policy controls have been approved, weaknesses were still found:

- Management did not periodically review segregation of duties controls;
- Staff were unaware of a segregation of duties policy at all sites except the WO; and
- Segregation of duties training was not created or distributed to USDA Forest Service employees.

During our FY 2006 general controls review, we found that the weaknesses previously reported still exist. Although the segregation of duties policy documented was in existence for the entire fiscal year, there were no steps taken to implement this policy. Additionally, we found that performance plans and appraisals could not be located for all staff.

We continue to recognize the need for the USDA Forest Service to develop and implement a segregation of duties policy as reported in prior recommendation 10 of Audit Report No. 08401-6-FM.

Open Conditions In this Table are Referenced In Exhibit I and II		
USDA OIG Audit Report No. 08401-6-FM December 2005 (Replaced prior Audit Report: USDA OIG Audit Report No. 08401-5-FM)		
Reported Condition	Recommendation	Status
	reviews of fire and other incident accruals are performed accurately and completely and that such recorded accrual amounts are valid.	
The USDA Forest Service Needs to Improve its General Controls Environment (2006 Material Weakness; 2005 Material Weakness)	<p>5. We recommend that USDA Forest Service: Complete, approve, communicate, and document the enforcement of policies and procedures addressing IT contingency and disaster planning and protection of sensitive information and classification. These policies and procedures should include the removal and return of storage media and physical and environmental security.</p> <p>Additionally, USDA Forest Service should conduct a Business Impact Analysis at the WO, Fort Collins, CO – WO Detached, and Region 3 (supporting the ASC) data centers to assist in identifying the criticality and sensitivity of USDA Forest Service information, systems, and facilities. The COOP for the Regional headquarters, WO and Fort Collins – WO Detached need to be enhanced. Also, the contingency plan for ConnectHR/Paycheck7 needs to be enhanced. USDA Forest Service should establish controls to certify all COOP and contingency plans are tested annually and updated based on test results. Regional service level agreements or contracts with all backup site facilities and telecommunication services should be developed.</p> <p>Finally, we recommend that the USDA Forest Service develop materials and provide employees identified as occupying emergency roles with disaster recovery and continuity of operations training.</p>	Open
	<p>6. We recommend that USDA Forest Service management develop, communicate, and establish controls to facilitate adherence to entity-wide policies and procedures on access controls to address access key controls, including:</p> <ul style="list-style-type: none"> • A standardized process for requesting access to the USDA Forest Service network. Include procedures for changes to existing user accounts and requesting, granting, and removing temporary and emergency access; • Periodic management review of network account 	Open

(Continued)

Open Conditions In this Table are Referenced In Exhibit I and II		
USDA OIG Audit Report No. 08401-6-FM December 2005 (Replaced prior Audit Report: USDA OIG Audit Report No. 08401-5-FM)		
Reported Condition	Recommendation	Status
	<p>access listings for appropriateness, identifying and disabling inactive user accounts, and removing network access for separated employees;</p> <ul style="list-style-type: none"> • Requesting, granting, and removing access to system software, sensitive utilities, and database management utilities; • Periodic review of network, server operator, and remote access audit logs as required by USDA Forest Service Interim Directive 6680-2005-3, "Technical Controls." Include procedures and requirements for investigating suspicious user activity and reporting security violations; • Management approval for archiving, deleting, and sharing ATSA data; • Finalize the USDA Forest Service Manual 6683.2, "Physical and Environmental Security," and communicate requirements to FS personnel. Establish controls to facilitate adherence to policy; and • The USDA Forest Service needs to modify server settings on all USDA Forest Service servers to ensure that users cannot gain root server access anonymously. USDA Forest Service network audit functions must be configured to maintain a history of successful and unsuccessful login attempts and user activity for the USDA Forest Service network as required by USDA Forest Service Interim Directive 6680-2005-3, "Technical Controls." USDA Forest Service management should identify and document all access paths for the USDA Forest Service network and servers. Finally, USDA Forest Service needs to develop and implement a user access review policy and procedure for the Department of Health and Human Service's Payment Management System application. <p>7. We recommend that USDA Forest Service management:</p> <ul style="list-style-type: none"> • Update the USDA Forest Service Interim Directive 6680-2005-3 to include the USDA requirement that users change their password every 60 days and 30 days for system administrators; • Establish controls to facilitate entity-wide adherence 	Open

(Continued)

Open Conditions In this Table are Referenced In Exhibit I and II		
USDA OIG Audit Report No. 08401-6-FM December 2005 (Replaced prior Audit Report: USDA OIG Audit Report No. 08401-5-FM)		
Reported Condition	Recommendation	Status
	<p>to the USDA Forest Service Interim Directive 6680-2005-3; including the application of strong passwords to all user accounts identified as having a weak password during the vulnerability assessment, and the removal or disabling of all default, temporary, and guest user accounts; and</p> <ul style="list-style-type: none"> • Continue with the USDA Forest Service implementation of Microsoft Active Directory in order to enforce screen saver passwords, account lock-out after three invalid login attempts, and the minimum password requirements documented in the USDA Forest Service Interim Directive 6680-2005-3 for all FS network users. <p>8. We recommend that USDA Forest Service system owners, in cooperation with the USDA OCIO [Office of the Chief Information Officer] and in compliance with USDA and USDA Forest Service information security requirements:</p> <ul style="list-style-type: none"> • Complete, approve, communicate, and document the enforcement of policies and procedures, specifically addressing the conditions resulting from the new business operations organization; • Develop and implement a policy to include review of personnel with access to sensitive facilities, the appropriateness of FFIS and NFC access authorizations, and the network security status; • Install the latest software versions, service packs, and security patches (and remove out-dated versions); • Develop and implement software configuration standards for Windows, UNIX [operating system], and all other USDA Forest Service platforms with defined images that specify what software applications should be in use and on what kinds of machines these applications should be installed on; and • Use automated tools to detect and eliminate unused or unauthorized applications including the use of Internet Security Systems (ISS) Internet Scanner in accordance with USDA Cyber Security Policy CS-007. 	Open

(Continued)

Open Conditions In this Table are Referenced In Exhibit I and II		
USDA OIG Audit Report No. 08401-6-FM December 2005		
<i>(Replaced prior Audit Report: USDA OIG Audit Report No. 08401-5-FM)</i>		
Reported Condition	Recommendation	Status
Controls Related to Physical Inventories of Capital Assets Need Improvement <i>(2006 Reportable Condition; 2005 Reportable Condition)</i>	9. We recommend that the USDA Forest Service increase their monitoring of reporting units for compliance with the USDA Forest Service written physical inventory instructions and implement an appropriate inventory methodology for level 1 and 2 roads.	Open
A Segregation of Duties Policy related to EDP Must be Fully Implemented <i>(2006 Reportable Condition; 2005 Reportable Condition)</i>	10. We recommend that USDA Forest Service: <ul style="list-style-type: none"> • Establish controls to facilitate adherence to the segregation of duties policy and supporting procedures as well as develop, implement and document training so that employees are aware of the policy and their responsibilities. • Modify, approve, and communicate a policy to address periodic management review of segregation of duties. 	Open

Open Conditions In this Table are Referenced In Exhibit I and II		
USDA OIG Audit Report No. 08401-4-FM November 2004		
Reported Condition	Recommendation	Status
Accountability for Undelivered Orders is Lacking <i>(2006 Reportable Condition; 2005 Material Weakness; 2004 Material Weakness)</i>	1. We recommend that USDA Forest Service management: <ul style="list-style-type: none"> • Require all locations to fully comply with review and certification requirements and follow up to resolve questionable items. • Previously Closed. 	Open
The Review of Purchase Card Transactions Needs Improvement <i>(2006 Reportable Condition; 2005 Reportable Condition; 2004 Reportable Condition)</i>	4. We recommend that USDA Forest Service management reinforce its policies in this area and incorporate procedures to test the reviews of purchased transactions in its Acquisition Management reviews.	Open
The Internal Controls Related to Recording, Classification and Accounting for Information Related to Leases Need Improvement <i>(2006 Management Letter Comment; 2005 Reportable Condition; 2004 Reportable Condition)</i>	5. We recommend that USDA Forest Service management establish policies and procedures for the accurate recording of leases, appropriately train reporting unit personnel on such policies and procedures, and monitor reporting units for compliance with its policies and procedures.	Closed; Downgraded

(Continued)

Open Conditions In this Table are Referenced In Exhibit I and II		
USDA OIG Audit Report No. 08401-4-FM November 2004		
Reported Condition	Recommendation	Status
The Design and/or Implementation of Controls Related to the Accurate Recording of Revenue Related Transactions Need Improvement <i>(2006 Reportable Condition; 2005 Reportable Condition; 2004 Reportable Condition)</i>	6. We recommend that USDA Forest Service management review and update its policies and procedures for the accurate recording of revenue, appropriately train reporting unit personnel on such policies and procedures, and monitor reporting units for compliance with its policies and procedures.	Open

Open Conditions In this Table are Referenced In Exhibit I and II		
USDA OIG Audit Report No. 08401-3-FM January 2004		
The USDA Forest Service Needs to Improve its Financial Management and Accountability <i>(2006 Material Weakness; 2005 Material Weakness, 2004 Material Weakness, 2003 Material Weakness)</i>	1. We recommend that the USDA Forest Service provide SGL training to selected employees and appoint them to be “resident” SGL experts responsible for preparing as well as reviewing and approving the adjusting journal vouchers (AJVs).	Closed
	3. We recommend that the USDA Forest Service identify those business processes that are causing irregularities in the general ledger and develop an expedited corrective action plan to resolve and correct any deficiencies identified.	Open
	6. We recommend that the USDA Forest Service identify all revenue generating business processes that are currently maintained in the budget clearing accounts and work with OMB and U.S. Department of the Treasury to establish a separate receipt and expenditure Treasury symbol so that revenue collections will not reside in the 12F3875 clearing account.	Closed
	8. We recommend that the USDA Forest Service follow its procedures in order to perform monthly review, identification, research, and correction of all abnormal balances, and report the status of all abnormal balances of \$5 million or more to the USDA OCFO.	Open
	11. We recommend that the USDA Forest Service implement an effective monthly process to review general ledger account relationships. The process must include the research, reconciliation, and resolution of all significant differences in a timely manner.	Closed; Management Letter Comment

(Continued)

Open Conditions In this Table are Referenced In Exhibit I and II		
USDA OIG Audit Report No. 08401-3-FM January 2004		
	updates, configure servers and systems in accordance with Forest Service technical bulletins and federal criteria, and remove any unneeded services.	
The USDA Forest Service Needs to Continue to Improve its Internal Controls over its Reconciliation and Management of Fund Balance with Treasury <i>(2006 Reportable Condition; 2005 Reportable Condition; 2004 Reportable Condition; 2003 Reportable Condition)</i>	27. We recommend that the USDA Forest Service perform complete and timely resolution of reconciling items for all Fund Balance with Treasury accounts within 60 days of report [FMS 6652 and Government-wide Accounting System Reports] receipt.	Open
The Design and/or Implementation of Controls Related to the Accurate Recording of Personal Property Transactions Need Improvement <i>(2006 Reportable Condition; 2005 Reportable Condition; 2004 Reportable Condition; 2003 Reportable Condition)</i>	30. We recommend that the USDA Forest Service WO improve its monitoring of reporting units for compliance with the USDA Forest Service property transaction recording policies.	Open
Postings of Certain Transactions Needs to Contain the Proper Reference Data to Link Related Transactions <i>(2006 Reportable Condition; 2005 Reportable Condition; 2004 Reportable Condition; 2003 Reportable Condition)</i>	34. We recommend that the USDA Forest Service develop a methodology to link transactions that are currently in the financial systems.	Open
	35. We recommend that the USDA Forest Service work with the USDA and FFIS contractor to incorporate edit checks that would disallow processing of transactions that do not provide the required data.	Open
	36. We recommend that the USDA Forest Service establish direction and quality assurance protocols to ensure that appropriate data is entered in the system.	Open
Compilation of the USDA Forest Service's RSI Needs Improvement <i>(2006 Reportable Condition; 2005 Reportable Condition; 2004 Reportable Condition; 2003 Reportable Condition)</i>	37. We recommend that the USDA Forest Service revise its current control structure for data collection and reporting of RSI to ensure the timeliness and completeness of the reported information.	Open

(Continued)

Open Conditions In this Table are Referenced In Exhibit I and II		
<i>USDA OIG Audit Report No. 08401-3-FM January 2004</i>		
<p>The USDA Forest Service ATSA Application Controls Need Improvement (2005 Reportable Condition; 2004 Reportable Condition; 2003 Reportable Condition)</p>	<p>38. We recommend that USDA Forest Service management update the SSP for the ATSA system. SSP should be based on the ATSA Risk Assessment results; and be approved by management and reviewed and updated at least annually to reflect any changes to the current environment and the risks associated with those changes. USDA Forest Service management should incorporate in the ATSA SSP required management review of activity logs. Currently, the Security Plan identifies that audit trails exist but does not indicate the frequency with which they should be reviewed and who should review them. These reviews should be performed on a consistent basis regardless of whether potential unusual activity is detected. USDA Forest Service should also take steps to ensure required management reviews of ATSA activity logs are carried out and according to the updated security plan. Additionally, USDA Forest Service should modify the ATSA front end application to capture user activities.</p>	<p>Closed</p>

COMPLIANCE AND OTHER MATTERS

The USDA Forest Service Does Not Obligate all Transactions Required by Appropriations Law

Obligation testwork performed over approximately 183 transactions disclosed that 74 transactions¹ were not obligated as required by appropriation law prior to payment. The transactions that were not obligated included temporary travel and reoccurring utility type transactions.

Due to the USDA Forest Service's current system limitations, the USDA Forest Service can not obligate temporary travel without a consider effort that would exceed expected benefits. The USDA Forest Service is in process of migrating to a new travel system that will allow for the obligation of temporary travel transactions. For other transactions not obligated, several USDA Forest Service offices did not obligate these transactions because of the variability in determining the estimated cost for these types of transactions.

The Government Accountability Office (GAO), publication GAO/OGC-92-13, *Appropriations Law*, defines an obligation in very general terms as, "an action that creates a liability or definite commitment on the part of the government to make a disbursement at some later time. The obligation takes place when the definite commitment is made, even though the actual payment may not take place until the following fiscal year." Furthermore, GAO's *Appropriations Law* cites 9 criteria for recording obligations. When one criterion is met, the agency not only may, but also must record that transaction as an obligation. Criterion 7 addresses travel expenses. With regard to the timing, *Appropriation Law* states that, "the obligation is not incurred until the travel is actually performed or until the ticket is purchased." While the precise amount of the liability should be recorded, the precise amount is not always known immediately. When this takes place, "the obligation should be recorded on the basis of the agency's best estimate."

Without obligating all required transactions, obligations are understated at any one point in time. Also, as existing obligations are used in determining accruals, these types of unobligated transactions are not considered in the accrual determination process.

We continue to recognize the need for the USDA Forest Service to obligate all transactions as reported in prior year recommendation 8 of Audit Report No. 08401-4-FM.

The USDA Forest Service's Systems Do Not Comply with FFMIA of 1996

Federal Accounting Standards

Instances of FFMIA non-compliance relating to compliance with applicable Federal accounting standards were identified during the fiscal year 2005 audit.

The following table lists those *Statements of Federal Financial Accounting Concepts* (SFFAC) and *Statements of Federal Financial Accounting Standards* (SFFAS) that the USDA Forest Service did not comply with during the audit period.

¹ The 40% error rate would not be a true representation of the error rate to the population sampled. The 40% error rate is skewed as a result of the type of statistical sampling used for audit testwork.

(Continued)

FFMIA Non-compliance with Federal Accounting Standards	
SFFAS/SFFAC Number	Accounting Deficiencies Noted
SFFAC 2	<ul style="list-style-type: none"> ■ Unliquidated Obligation errors ■ Preparing proper note disclosures (e.g., dedicated collections, Statement of Budgetary Resources to President’s Budget reconciliation) ■ Not timely assessing the impact of abnormal balances
SFFAS 5	<ul style="list-style-type: none"> ■ Incorrect accruals
SFFAS 7	<ul style="list-style-type: none"> ■ Errors with recording timber and non-timber revenue
SFFAS 8	<ul style="list-style-type: none"> ■ Improper stewardship reporting

Although the USDA Forest Service continues to improve its accounting operations, deficiencies still exist in the processing of various transactions. The deficiencies noted in the above table resulted in additional time and effort of the USDA Forest Service to research and resolve the deficiency.

We continue to recognize the need for the USDA Forest Service to identify business process causes for noncompliance with accounting standards as reported in prior year recommendation 9 of Audit Report No. 8401-4-FM. In addition, we also recognize the need for the USDA Forest Service to develop a remediation plan as reported in prior year recommendation 10 of Audit Report No. 08401-4-FM.

Financial Management Systems

As noted in our material weakness on the general controls environment, the USDA Forest Service did not have policies and procedures for C&A until July 2006. Due to the late implementation of the C&A policies and procedures, we were not able to evaluate the current year C&A packages. During FY 2005 we noted that the USDA Forest Service did not fully comply with the requirements of OMB Circular No. A-130, *Management of Federal Information Resources*. The USDA Forest Service systems that were impacted by our FY 2005 testwork were Travel, Connect Human Resources (HR), INFRA, ATSA, and Paycheck 7 applications and their general support environment. A certification and accreditation that is fully compliant with OMB Circular A-130 is a requirement for systems to comply with FFMIA.

We continue to recognize the need for the USDA Forest Service to implement its issued policies and procedures to ensure that its system certification and accreditations are comprehensive and accurate as reported in prior recommendation 1 of Audit Report No. 08401-3-FM.

Compliance with the United States Standard General Ledger

During our FY 2006 audit, we noted the following deficiencies in the USDA Forest Service’s standard general ledger posting:

- EMIS is used to manage working capital fund equipment which consists of computer hardware and vehicles. The system does not record depreciation at the equipment transaction level using the SGL. It records depreciation by unit monthly at the summary level in the USDA Forest Service general ledger.

(Continued)

- USDA Forest Service capitalized lease and internal use software work in process transactions are not recorded in the general ledger at the transactional level. Instead transactions are summarized from EMIS and entered in the general ledger at the organizational level. Instead, they are maintained in off-line spreadsheets and then recorded in the general ledger only at year-end closing.
- During testwork over general ledger account series 57XX, it was note that the USDA Forest Service improperly debited 1010, *Fund Balance with Treasury*, and credited 3102, *Unexpended Appropriations-Transfers-In*, to record Non-expenditure financing sources. Instead, FS should have credited general ledger account 5755, *Non-expenditure Financing Sources-Transfers-In*.
- During testwork over expenditures, it was noted that for stewardship land acquisitions, the USDA Forest Services improperly debits 6100, *Operating Expenses/Program Expenses* instead of debiting 6908, *Stewardship Land Acquisition (Nonproduction Cost)*. At the end of the year FS transfers the total stewardship land activity from general ledger account 6100 to 6908. This occurs because USDA current doesn't have a posting model at the transactional level to accommodate this business process. Because this process requires manual involvement in increases the chances for human error. During FY 2006, USDA Forest Service did not move approximately \$2.2 million from general ledger account 6100 to 6908.

Recommendation Number 6:

We recommend that the USDA Forest Service develop posting models to appropriately record Non-expenditure financing sources-transfers-in and stewardship land acquisitions.

STATUS OF PRIOR YEAR’S NONCOMPLIANCE FINDINGS AND OTHER MATTERS

Open Conditions In this Table are Referenced In Exhibit I and II		
<i>USDA OIG Audit Report No. 08401-6-FM December 2005</i>		
<i>(Replaced prior Audit Report: USDA OIG Audit Report No. 08401-5-FM)</i>		
Reported Condition	Recommendation	Status
The USDA Forest Service May Not be in Compliance with 31 USC 1517	11. We recommend that the USDA Forest Service fully investigate the circumstances surrounding this issue and obtain appropriate legal advice from the USDA Office of the General Counsel.	Closed
The USDA Forest Service’s Systems Do Not Comply with the Federal Financial Management Improvement Act (FFMIA) <i>(2006 Non-compliance)</i>	12. We recommend that the USDA Forest Service comply with recommendation 1 of this report as well as develop systems and methodologies that comply with the SGL at the transactional level.	Open

(Continued)

Open Conditions In this Table are Referenced In Exhibit I and II		
<i>USDA OIG Audit Report No. 08401-4-FM November 2004</i>		
Reported Condition	Recommendation	Status
The USDA Forest Service Does not Obligate All Transactions as Required by Appropriation Law <i>(2006 non-compliance; 2005 non-compliance; 2004 non-compliance)</i>	8. We recommend that the USDA Forest Service management develop policy and procedures to obligate funds for transactions as required by Appropriations Law.	Open
Instances of Non-Compliance with FFMA were Identified Related to Federal Accounting Standards <i>(2006 non-compliance; 2005 non-compliance; 2004 non-compliance)</i>	9. We recommend that the USDA Forest Service management identify the business process causes for the noted instances of non-compliance, develop adequate policies and procedures, and if necessary, modify existing policies and procedures to ensure that transactions are processed and reported in accordance with Federal accounting standards.	Open
	10. We recommend that the USDA Forest Service management develop a remediation plan within the required time frames that includes extensive training of personnel specifically addressing the deficiencies noted above.	Open

Open Conditions In this Table are Referenced In Exhibit I and II		
<i>USDA OIG Audit Report No. 08401-3-FM January 2004</i>		
Reported Condition	Recommendation	Status
The USDA Forest Service Systems are Not Compliant with Federal Financial Management System Requirements <i>(2005 non-compliance; 2003 non-compliance)</i>	1. We recommend that the USDA Forest Service, working with the NFC, as necessary, take steps to certify and accredit the ATSA, and Paycheck 7 systems and their general support environment or replace these legacy systems.	Open



File Code: 14306500
Date: NOV 13 2006

KPMG LLP
Mr. Patrick Boyce
Senior Partner
2001 M. Street, NW, Suite 9134
Washington,, DC 20036

Dear Mr. Boyce:

We have reviewed KPMG's Independent Auditor's Report dated November 10, 2006, and generally agree with its contents. USDA Forest Service will develop an implementation plan to address the findings and recommendations identified during the audit. As we consider the required corrective actions, we will continue to work with KPMG and the Office of the Inspector General in identifying the specific actions that will assist us in successfully addressing the recommendations.

If you have any question or require additional information, please contact Jesse L. King at (202) 205-1321.

Sincerely,

JESSE L. KING
Chief Financial Officer

cc: Wanda Philippi, Regional Inspector General, Office of the Inspector General



**U.S. Department of Agriculture
Forest Service
CONSOLIDATED BALANCE SHEETS
As of September 30, 2006 and 2005
(in millions)**

	<u>2006</u>	<u>2005</u>
Assets:		
Intragovernmental:		
Fund Balance with Treasury (Note 2)	\$ 3,877	\$ 4,187
Investments	5	5
Accounts Receivable, Net (Note 3)	45	181
Total Intragovernmental	<u>3,927</u>	<u>4,373</u>
Cash and Other Monetary Assets	1	2
Accounts Receivable, Net (Note 3)	209	88
General Property, Plant, and Equipment (PP&E), Net (Note 4)	3,585	3,695
Other	19	13
Total Assets	<u>\$ 7,741</u>	<u>\$ 8,171</u>
Stewardship PP&E (Note 5)		
Liabilities:		
Intragovernmental:		
Federal Employee Benefits (Notes 6 & 7)	\$ 67	\$ 65
Other (Note 8)	137	279
Total Intragovernmental	<u>204</u>	<u>344</u>
Accounts Payable	55	134
Federal Employee Benefits (Notes 6 & 7)	331	341
Environmental and Disposal Liabilities	53	17
Other (Note 8)	1,684	1,190
Total Liabilities (Note 6)	<u>2,327</u>	<u>2,026</u>
Commitments and Contingencies (Note 8)		
Net Position:		
Unexpended Appropriations		1,792
Unexpended Appropriations - other funds	1,054	
Cumulative Results of Operations		4,353
Cumulative Results of Operations - earmarked funds (Note 10)	1,303	
Cumulative Results of Operations - other funds	3,057	
Total Net Position	<u>5,414</u>	<u>6,145</u>
Total Liabilities and Net Position	<u>\$ 7,741</u>	<u>\$ 8,171</u>

The accompanying notes are an integral part of these statements.

**U.S. Department of Agriculture
Forest Service
CONSOLIDATED STATEMENTS OF NET COST
For the years ended September 30, 2006 and 2005
(in millions)**

	<u>2006</u>	<u>2005</u>
Program Costs (Note 11):		
Total Gross Costs	\$ 6,937	\$ 5,831
Total Earned Revenue	<u>1,034</u>	<u>789</u>
Net Cost of Operations	<u>\$ 5,903</u>	<u>\$ 5,042</u>

The accompanying notes are an integral part of these statements.

**U.S. Department of Agriculture
Forest Service
CONSOLIDATED STATEMENTS OF CHANGES IN NET POSITION
For the years ended September 30, 2006 and 2005
(in millions)**

	FY 2006			FY 2005
	Earmarked Funds (Note 10)	All Other Funds	Consolidated Total	Consolidated Total
Cumulative Results of Operations:				
Beginning Balance	\$ 1,533	\$ 2,820	\$ 4,353	\$ 4,091
Budgetary Financing Sources:				
Appropriations Used	(2)	5,460	5,458	4,832
Non-Exchange Revenue	-	(16)	(16)	1
Donations and Forfeitures of Cash	-	-	-	1
Transfers - In/Out without Reimbursement	(28)	188	160	184
Other Financing Sources (Non-Exchange):				
Donations and Forfeitures Of Property	-	-	-	31
Transfers without Reimbursement	-	1	1	-
Imputed Financing	-	303	303	247
Other	4	-	4	8
Total Financing Sources	(26)	5,936	5,910	5,304
Net Cost of Operations	(204)	(5,699)	(5,903)	(5,042)
Net Change	(230)	237	7	262
Cumulative Results of Operations	1,303	3,057	4,360	4,353
Unexpended Appropriations:				
Beginning Balance	(2)	1,794	1,792	1,511
Budgetary Financing Sources:				
Appropriations Received	-	4,632	4,632	5,030
Appropriations Transfer - In/Out	-	96	96	146
Other Adjustments (rescissions, etc.)	-	(8)	(8)	(63)
Appropriations Used	2	(5,460)	(5,458)	(4,832)
Total Budgetary Financing Sources	2	(740)	(738)	281
Total Unexpended Appropriations	-	1,054	1,054	1,792
Net Position	\$ 1,303	\$ 4,111	\$ 5,414	\$ 6,145

The accompanying notes are an integral part of these statements.

**U. S. Department of Agriculture
Forest Service
COMBINED STATEMENTS OF BUDGETARY RESOURCES
For the years ended September 30, 2006 and 2005
(in millions)**

	2006	2005
Budgetary Resources:		
Unobligated balance, brought forward, October 1	\$ 2,429	\$ 1,738
Recoveries of prior year unpaid obligations	78	169
Budget authority:		
Appropriations	5,362	5,812
Spending Authority from offsetting collections:		
Earned:		
Collected	666	448
Change in receivables from Federal sources	(21)	12
Change in unfilled customer orders:		
Advance received	19	3
Without advance from Federal Sources	36	72
Expenditure transfers from trust funds	159	1
Subtotal	6,221	6,348
Nonexpenditure transfers, net	3	51
Permanently not available	(65)	(67)
Total Budgetary Resources (Note 14)	\$ 8,666	\$ 8,239
Status of Budgetary Resources:		
Obligations incurred: (Note 13)		
Direct	\$ 6,382	\$ 5,545
Reimbursable	475	265
Subtotal	6,857	5,810
Unobligated balance-apportioned	1,052	1,804
Unobligated balance not available	757	625
Total status of budgetary resources (Note 14)	\$ 8,666	\$ 8,239
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	\$ 1,979	\$ 1,827
Less: Uncollected customer payments from Federal sources, brought forward October 1	(418)	(334)
Total unpaid obligated balance, net	1,561	1,493
Obligations incurred net	6,857	5,810
Less: Gross outlays	(6,375)	(5,489)
Less: Recoveries of prior year unpaid obligations	(78)	(169)
Change in uncollected customer payments from Federal sources	(15)	(84)
Obligated balance, net, end of period		
Unpaid obligations (Note 15)	2,383	1,979
Less: Uncollected customer payments from Federal sources	(433)	(418)
Total, unpaid obligated balance, net, end of period	\$ 1,950	\$ 1,561
Net Outlays:		
Net Outlays:		
Gross outlays	\$ 6,375	\$ 5,489
Less: Offsetting collections	(844)	(451)
Less: Distributed offsetting receipts	(457)	(426)
Net Outlays	\$ 5,074	\$ 4,612

The accompanying notes are an integral part of these statements.

**U.S. Department of Agriculture
Forest Service
CONSOLIDATED STATEMENTS OF FINANCING
For the years ended September 30, 2006 and 2005
(in millions)**

	<u>2006</u>	<u>2005</u>
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
Obligations incurred	\$ 6,857	\$ 5,810
Less: Spending authority from offsetting collections and recoveries	937	705
Obligations net of offsetting collections and recoveries	5,920	5,105
Less: Offsetting receipts	457	426
Net obligations	5,463	4,679
Other Resources:		
Donations and forfeitures of property	-	31
Transfers in/out without reimbursement	1	-
Imputed financing from costs absorbed by others	303	247
Other	4	8
Net other resources used to finance activities	308	286
Total resources used to finance activities	5,771	4,965
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided	(89)	7
Resources that fund expenses recognized in prior periods	(85)	(29)
Other budgetary offsetting collections and receipts that do not affect net cost of operations	64	65
Resources that finance the acquisition of assets	(135)	(164)
Trust fund repayment	-	(149)
Other resources or adjustments to net obligated resources that do not affect the net cost of operations	(59)	(53)
Total resources used to finance items not part of the net cost of operations	(304)	(323)
Total resources used to finance the net cost of operations	5,467	4,642
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods (Note 16):		
Increase in annual leave liability	21	-
Increase in environmental and disposal liability	36	10
Increase in exchange revenue receivable from the public	(12)	-
Increase in accrued liability for payments to states	20	-
Other	7	29
Total components of Net Cost of Operations that will require or generate resources in future periods	72	39
Components not Requiring or Generating Resources:		
Depreciation and amortization	255	268
Revaluation of assets or liabilities	3	-
Allocation transfers (Note 17)	150	111
Bad debt expense and other	(44)	(18)
Total components of net cost of operations that will not require or generate resources	364	361
Total components of net cost of operations that will not require or generate resources in the current period	436	400
Net Cost of Operations	\$ 5,903	\$ 5,042

**U. S. Department of Agriculture
Forest Service
Notes to the Consolidated and Combined Financial Statements
For the years ended September 30, 2006 and 2005**

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

A. REPORTING ENTITY

The USDA Forest Service was established on February 1, 1905, as an agency of the United States Federal Government within the U.S. Department of Agriculture (USDA), for the purpose of maintaining and managing the Nation's forest reserves. It operates under the guidance of the Under Secretary for Natural Resources and Environment. The USDA Forest Service's policy is implemented through nine regional offices, six research offices, one State and Private Forestry area office, the Forest Products Laboratory and the International Institute of Tropical Forestry, with 868 administrative units functioning in 46 states, Puerto Rico, and the Virgin Islands.

The USDA Forest Service's mission includes the four major segments described below:

- National Forests and Grasslands - Protection and management of an estimated 193 million acres (unaudited) of National Forest System (NFS) land that includes 34.8 million acres (unaudited) of designated wilderness areas. In addition, the USDA Forest Service partners with other nations and organizations to foster global natural resource conservation and sustainable development of the world's forest resources;
- Forest and Rangeland Research - Research and development of forest and rangeland management practices to provide scientific and technical knowledge for enhancing and protecting the economic productivity and environmental quality of the 1.6 billion acres (unaudited) of forests and associated rangelands in the United States;
- State and Private Forestry – Cooperation with and assistance to state and local governments, tribal governments, forest industries, and private landowners to help protect and manage non-Federal forests and associated rangeland and watershed areas; and
- Wildland Fire Management – Protection of life, property, and natural resources on an estimated 193 million acres (unaudited) of NFS lands, and extending to an additional 20 million acres (unaudited) of adjacent state and private lands.

The accompanying consolidated and combined financial statements of the USDA Forest Service account for all funds under the USDA Forest Service's control. Substantially all assets are considered "entity assets" and are available for use in the USDA Forest Service's operations.

**U. S. Department of Agriculture
Forest Service
Notes to the Consolidated and Combined Financial Statements
For the years ended September 30, 2006 and 2005**

B. BASIS OF PRESENTATION AND ACCOUNTING

The consolidated balance sheets, statements of net cost, statements of changes in net position, and statements of financing, and the combined statements of budgetary resources (hereinafter referred to as the “financial statements”) were prepared to report the financial position, net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations of the USDA Forest Service. The financial statements have been prepared from the books and records of the USDA Forest Service in accordance with accounting principles generally accepted in the United States of America and in accordance with the Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*, revised July 24, 2006. All material intra-agency transactions and balances have been eliminated for presentation on a consolidated basis. However, the Statements of Budgetary Resources are presented on a combined basis in accordance with OMB Circular A-136.

These financial statements present proprietary and budgetary information. The accounting structure of Federal agencies is designed to reflect both accrual and budgetary accounting transactions. Under the accrual method of accounting, revenues are recognized when earned, and expenses are recognized when incurred, without regard to receipt or payment of cash. The budgetary accounting principles, on the other hand, are designed to recognize the obligation of funds according to legal requirements, which in many cases is prior to the occurrence of an accrual-based transaction. The recognition of budgetary accounting transactions is essential for compliance with legal constraints and controls over the use of Federal funds.

The USDA Forest Service recognizes budgetary resources as assets when cash (funds held by Treasury) is made available through the U.S. Department of the Treasury General Fund warrants and other transfers. In addition to appropriated funds, the USDA Forest Service is authorized by law to retain specific earned revenues primarily from sales of forest products and services and to spend these monies on resource management activities identified in the governing legislation. Some examples of the USDA Forest Service’s earned revenues are monies collected from timber sales or recreation fees. The USDA Forest Service, pursuant to OMB directives, prepares additional financial reports that are used to monitor and control the USDA Forest Service’s use of budgetary resources.

C. FUND BALANCE WITH THE U.S. TREASURY

The U.S. Department of the Treasury processes cash receipts and disbursements on behalf of the USDA Forest Service. Funds on deposit with the U.S. Department of the Treasury are primarily appropriated, trust and other fund types such as special funds that are available to pay current liabilities and finance authorized purchase commitments.

D. OTHER ASSETS

Payments made by the USDA Forest Service in advance of the receipt of goods and services are recorded as advances at the time of payment and recognized as expenditures/expenses when the related goods and services are received.

**U. S. Department of Agriculture
Forest Service
Notes to the Consolidated and Combined Financial Statements
For the years ended September 30, 2006 and 2005**

E. GENERAL PROPERTY, PLANT, AND EQUIPMENT

General property, plant, and equipment (PP&E) includes real and personal property used in normal business operations. Real and personal property is recorded at cost or estimated fair value and must have an estimated useful life of 2 years or more. The USDA Forest Service capitalization threshold for real and personal property is \$25 thousand or more. Internal use software is capitalized in accordance with Statement of Federal Financial Accounting Standard (SFFAS) No. 10, *Accounting for Internal Use Software*, if the fair value meets or exceeds \$100 thousand. The USDA Forest Service recognizes liabilities for capital leases in accordance with SFFAS No. 6 *Accounting for Property Plant and Equipment*. Under SFFAS No. 6 the cost of general PP&E acquired under a capital lease is equal to the amount recognized as a liability for the capital lease at its inception (net present value of the lease payments) unless the net present value exceeds the fair value of the asset.

F. LIABILITIES

Liabilities represent the amount of monies or other resources that are likely to be paid by the USDA Forest Service as a result of a transaction or event that has occurred. However, the USDA Forest Service cannot satisfy a liability without an appropriation. Liabilities for which there is no appropriation and for which there is no certainty that an appropriation will be enacted, are classified as unfunded liabilities. The U.S. government, acting in its sovereign capacity, can abrogate liabilities.

G. ENVIRONMENTAL AND DISPOSAL LIABILITIES

The USDA Forest Service's estimated government-related environmental liabilities are principally associated with the future remediation of certain landfills, buildings, and other related sites in accordance with all applicable federal, state and local laws. Such estimates do not consider the effect of future inflation, new technology, laws or regulations.

H. COMMITMENTS AND CONTINGENCIES

The USDA Forest Service is a party in various administrative proceedings, legal actions, environmental lawsuits, and claims. In the opinion of the USDA Forest Service management and its legal counsel, the ultimate resolution of most of these proceedings is currently indeterminable. Where determinable, the full value of probable amounts related to unsettled litigation and other claims against the USDA Forest Service is recognized as a liability and expense. Expected amounts related to litigation and other claims include amounts to be paid by the Department of the Treasury on behalf of the USDA Forest Service from a permanent appropriation for judgments and from other appropriations.

**U. S. Department of Agriculture
Forest Service
Notes to the Consolidated and Combined Financial Statements
For the years ended September 30, 2006 and 2005**

I. WORKERS' COMPENSATION LIABILITY

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to Federal civilian employees injured on the job, employees who have incurred a work related occupational disease and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Benefit claims incurred for the USDA Forest Service's employees under FECA are administered by the U.S. Department of Labor (DOL). The USDA uses USDA Forest Service funds to reimburse the DOL for FECA claims. Consequently, the USDA Forest Service recognizes a liability for this compensation comprised of: (1) an accrued liability that represents money owed for claims paid by the DOL through the current fiscal year and (2) an actuarial liability that represents the expected liability for USDA Forest Service approved compensation cases to be paid beyond the current fiscal year.

J. EMPLOYEE ANNUAL, SICK, AND OTHER LEAVE

Annual and other vested leave such as compensatory, credit hours, and restored leave is accrued as it is earned, and the accrual is reduced as leave is taken. Each quarter, the balance in the accrued annual leave account is adjusted to reflect the latest pay rates and unused hours of leave. Sick leave is generally nonvested. Funding will be obtained from future financing sources to the extent that current or prior year appropriations are not available to fund annual and other types of vested leave earned but not taken. Sick leave and other types of nonvested leave are expensed when used.

K. PENSION AND OTHER RETIREMENT BENEFITS

USDA Forest Service employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). The employees who participate in CSRS are beneficiaries of the USDA Forest Service's matching contribution, equal to 8.51 percent of pay, distributed to their annuity account in the Civil Service Retirement and Disability Fund.

FERS went into effect on April 1, 1987, pursuant to Public Law 99-335. FERS and Social Security automatically cover most employees hired after December 31, 1983. Employees hired prior to April 1, 1984 could elect to join FERS and Social Security, or to remain in CSRS. FERS offers a savings plan to which the USDA Forest Service automatically contributes one percent of pay and matches any employee contribution up to an additional four percent of pay. For FERS participants, the USDA Forest Service also contributes the employer's matching share for Social Security.

The USDA Forest Service recognizes the imputed cost of pension and other health and life insurance retirement benefits during the employees' active years of service. Office of Personnel Management (OPM) actuaries determine pension cost factors by calculating the value of pension benefits expected to be paid in the future and communicate these factors and information regarding the full cost of health and life insurance benefits to the USDA Forest Service for current period expense reporting.

U. S. Department of Agriculture
Forest Service
Notes to the Consolidated and Combined Financial Statements
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L. REVENUES AND OTHER FINANCING SOURCES

The USDA Forest Service is funded principally through Congressional appropriations and other authorizations in the Budget of the United States. The USDA Forest Service receives annual, multi-year and no-year appropriations that are used, within statutory limits, for operating and capital expenditures. Other funding sources are derived through reimbursements for services performed for other Federal and non-federal entities, sale of goods to the public, gifts from donors, cost-share contributions and interest on invested amounts.

Appropriations are used at the time the related program or administrative expenses are incurred or when the appropriations are expended for capital property and equipment. Other revenues are recognized as earned when goods have been delivered or services rendered.

In accordance with Federal government accounting guidance, the USDA Forest Service classifies revenue as either “exchange revenue” or “non-exchange revenue.” Exchange revenue arises from transactions that occur when each party to the transaction sacrifices value and receives value in return. An example of exchange revenue is the income from the sale of forest products. In some cases, the USDA Forest Service is required to remit exchange revenue receipts to the U.S. Department of the Treasury. In other instances the USDA Forest Service is authorized to use all, or a portion, of its exchange revenues for specific purposes. Non-exchange revenue is revenue the Federal government is able to demand or receive because of its sovereign powers. Penalties and cash donations received from private citizens and organizations are examples of non-exchange revenue.

The USDA Forest Service reports the full cost of products and services generated from the consumption of resources. Full cost is the total amount of resources used to produce a product or provide a service unless otherwise noted. In accordance with SFFAS No.7, *Accounting for Revenue and Other Financing Sources*, the USDA Forest Service’s pricing policies are set to recover full cost except where mandated by law or for the public good, such as in the case of grazing fees. Also, costs and exchange revenue are disclosed in Note 11 as intragovernmental or with the public based on the related source or customer, respectively.

M. IMPUTED FINANCING

The USDA Forest Service recognizes as imputed financing the amount of accrued pension and post-retirement benefit expenses for current employees. The assets and liabilities associated with such benefits are the responsibility of the administering agency, the OPM. Amounts paid from the Treasury Judgment Fund in settlement of claims or court assessments against the USDA Forest Service are also recognized as imputed financing. Imputed financing for the years ended September 30, 2006 and 2005 was \$303 million and \$247 million, respectively.

**U. S. Department of Agriculture
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Notes to the Consolidated and Combined Financial Statements
For the years ended September 30, 2006 and 2005**

N. STATEMENTS OF BUDGETARY RESOURCES

The USDA Forest Service receives four transfer allocations, as the child in a parent-child relationship, from appropriations of other agencies. The parent is the agency to which the funds were appropriated; the child is the agency receiving the funds from the parent to carry out some or all of the work. The parent agency has the budgetary reporting responsibility. The USDA Forest Service is the child for the four following accounts:

<u>Parent Agency</u>	<u>Treasury Symbol Name</u>
Department of Labor	Job Corps Civilian Conservation
Department of Transportation	Federal Aid to Highways
Department of Interior	Southern Nevada Public Land Management
Department of Interior	Permit Processing Fund

In accordance with OMB Circular A-136, the USDA Forest Service does not include these allocation transfers in its Statements of Budgetary Resources. However, as the transfer allocations are considered material, the proprietary financial activity is reported in the Balance Sheets, Statements of Net Cost, Statements of Changes in Net Position, and as a reconciling item in the Statements of Financing.

O. USE OF ESTIMATES

Management has made certain estimates and assumptions when reporting assets, liabilities, revenue, and expenses. Actual results could differ from these estimates. Significant estimates underlying the accompanying financial statements include the majority of accrued liabilities, environmental and disposal liabilities, and Federal Employee Benefits liabilities.

**U. S. Department of Agriculture
Forest Service
Notes to the Consolidated and Combined Financial Statements
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P. EARMARKED FUNDS

In accordance with SFFAS 27, *Identifying and Reporting Earmarked Funds*, which was effective in FY 2006, the USDA Forest Service has reported the earmarked funds for which it has program management responsibility, using the following three criteria:

1. A statute committing the Federal Government to use specifically identified revenues and other financing sources only for designated activities, benefits, or purposes;
2. Explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and
3. A requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguishes the earmarked fund from the Government's general revenues.

In accordance with SFFAS No. 27, the USDA Forest Service did not restate the prior period columns of the financial statements and related disclosures. Previous to FY 2006, these funds were considered to be dedicated collections.

See Note 10 for specific required disclosures related to the USDA Forest Service's earmarked funds as of and for the year ended September 30, 2006. See Note 18 for specific required disclosures related to the USDA Forest Service's dedicated collections as of and for the year ended September 30, 2005.

Q. RECLASSIFICATIONS

Certain reclassifications were made to the fiscal year 2005 statements to conform to the current year's presentation.

**U. S. Department of Agriculture
Forest Service
Notes to the Consolidated and Combined Financial Statements
For the years ended September 30, 2006 and 2005**

NOTE 2. FUND BALANCE WITH TREASURY

Funds with the U.S. Department of the Treasury are primarily appropriated (general and special funds), revolving (working capital fund), and trust funds that are available to pay current liabilities and finance authorized purchase commitments. The category of other fund types includes deposit and clearing accounts. It is the USDA Forest Service's policy to ensure the Fund Balance with Treasury reported on the Balance Sheets is consistent with the records of the U.S. Department of the Treasury.

Fund Balance with Treasury as of September 30, 2006 and 2005 consisted of the following:

	(in millions)	
	<u>2006</u>	<u>2005</u>
A. Fund Balances:		
(1) Trust Funds	\$451	\$676
(2) Revolving Funds	123	128
(3) Appropriated Funds	3,265	3,342
(4) Other Fund Types	38	41
Total	\$3,877	\$4,187
B. Status of Funds:		
(1) Unobligated Balance		
(a) Available	\$1,052	\$1,804
(b) Unavailable	757	625
(2) Obligated Balance not yet Disbursed	1,950	1,561
(3) Other Balances	118	197
Total	\$3,877	\$4,187

**U. S. Department of Agriculture
Forest Service
Notes to the Consolidated and Combined Financial Statements
For the years ended September 30, 2006 and 2005**

NOTE 3. ACCOUNTS RECEIVABLE, NET

Intragovernmental accounts receivable represent amounts due under reimbursable and cooperative agreements with Federal entities for services provided by the USDA Forest Service. An allowance for receivables deemed uncollectible is not established for these amounts because monies due from other Federal entities are considered fully collectible. As of September 30, 2006 and 2005, the intragovernmental accounts receivable balances were \$45 million and \$181 million, respectively.

Non-intragovernmental accounts receivable are comprised primarily of timber harvest and reimbursements and refunds owed to the USDA Forest Service for fire prevention and suppression activities. An allowance for receivables deemed uncollectible is established against outstanding non-federal accounts receivable, based on historical experience. Non-intragovernmental accounts receivable as of September 30, 2006 and 2005 consisted of the following:

	(in millions)	
	2006	2005
Accounts Receivable	\$227	\$158
Allowance for Doubtful Accounts	(18)	(70)
Accounts Receivable, Net	\$209	\$88

**U. S. Department of Agriculture
Forest Service
Notes to the Consolidated and Combined Financial Statements
For the years ended September 30, 2006 and 2005**

NOTE 4. GENERAL PROPERTY, PLANT, AND EQUIPMENT, NET

Depreciation of PP&E for the USDA Forest Service is recorded on the straight-line method based on the estimated useful lives listed below. Capitalization thresholds are provided in Note 1, Section E.

As of September 30, 2006 and 2005 the USDA Forest Service's PP&E consisted of the following:

September 30, 2006				
(in millions)				
Property Class	Estimated Useful Life (Years)	Cost	Accumulated Depreciation	Book Value
Personal Property				
Equipment	5 - 20	\$752	(\$563)	\$189
Internal Use Software	5	134	(113)	21
Internal Use Software in Development	n/a	7	-	7
Total Personal Property		893	(676)	217
Real Property				
Land and Land Rights	n/a	51	-	51
Improvements to Land	10 - 50	4,979	(2,705)	2,274
Construction in Progress	n/a	311	-	311
Buildings, Improvements and Renovations	30	803	(503)	300
Other Structures and Facilities	15 - 50	1,510	(1,115)	395
Assets Under Capital Lease	30	44	(16)	28
Leasehold Improvements	10	11	(2)	9
Total Real Property		7,709	(4,341)	3,368
Total		\$8,602	(\$5,017)	\$3,585

**U. S. Department of Agriculture
Forest Service
Notes to the Consolidated and Combined Financial Statements
For the years ended September 30, 2006 and 2005**

September 30, 2005				
(in millions)				
Property Class	Estimated Useful Life (Years)	Cost	Accumulated Depreciation	Book Value
Personal Property				
Equipment	5 - 20	\$821	(\$601)	\$220
Internal Use Software	5	133	(95)	38
Internal Use Software in Development	n/a	6	-	6
Total Personal Property		960	(696)	264
Real Property				
Land and Land Rights	n/a	50	-	50
Improvements to Land	10 - 50	4,952	(2,590)	2,362
Construction in Progress	n/a	226	-	226
Buildings, Improvements and Renovations	30	802	(480)	322
Other Structures and Facilities	15 - 50	1,508	(1,070)	438
Assets Under Capital Lease	30	40	(17)	23
Leasehold Improvements	10	11	(1)	10
Total Real Property		7,589	(4,158)	3,431
Total		\$8,549	(\$4,854)	\$3,695

**U. S. Department of Agriculture
Forest Service
Notes to the Consolidated and Combined Financial Statements
For the years ended September 30, 2006 and 2005**

NOTE 5. HERITAGE ASSETS AND STEWARDSHIP LANDS

This note provides information on certain resources entrusted to the USDA Forest Service and certain stewardship responsibilities assumed by the USDA Forest Service. These resources and responsibilities are required to be referenced in the USDA Forest Service's Balance Sheets and described below in accordance with SFFAS No. 29, *Heritage Assets and Stewardship Land*, which was effective in FY 2006.

Stewardship Property, Plant, and Equipment (Stewardship PP&E)

Stewardship PP&E are assets, the physical properties of which resemble those of the General PP&E that is traditionally capitalized in the financial statements. Due to the nature of these assets, however, valuation would be difficult and matching costs with specific periods would not be meaningful. Stewardship PP&E includes heritage assets and stewardship land.

The mission of the USDA Forest Service is to sustain the health, diversity, and productivity of the Nation's forests and grasslands to meet the needs of present and future generations. The USDA Forest Service also strives to achieve quality land management under the sustainable multiple-use management concept to meet the diverse needs of people.

Heritage Assets

Heritage assets are unique for their historical or natural significance, for their cultural, educational, or artistic importance, or for their significant architectural characteristics. The USDA Forest Service generally expects that these assets will be preserved indefinitely.

The USDA Forest Service's non-collection heritage assets are comprised primarily of historic and prehistoric sites located on national forest wilderness areas, primitive areas, national monument areas, and scenic river areas. Some heritage assets are listed on the National Register of Historic Places, and some are designated as National Historic Landmarks. Assets held at museums and universities are managed by those entities. Heritage assets that are not used for administrative or public purposes receive no annual maintenance.

The USDA Forest Service uses the Condition Assessment Survey (CAS) method to describe the condition of its heritage assets. The CAS method is based on a 5-point scale for condition, where 1 represents excellent; 2 is good; 3 is fair; 4 is poor; and 5 is very poor. Assets with a condition assessment level between 1 and 3 are defined as being suitable for public display. The USDA Forest Service's heritage assets are in poor to fair condition.

**U. S. Department of Agriculture
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Stewardship Land

Stewardship land consists primarily of the national forests and grasslands owned by the USDA Forest Service. Stewardship land is valued for its environmental resources, recreational and scenic value, cultural and paleontological resources, vast open spaces, and resource commodities and revenue provided to the Federal government, states, and counties.

**U. S. Department of Agriculture
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Notes to the Consolidated and Combined Financial Statements
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NOTE 6. LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

Liabilities not covered by budgetary resources as of September 30, 2006 and 2005 consisted of the following:

	(in millions)	
	<u>2006</u>	<u>2005</u>
Intragovernmental:		
Treasury Judgment Fund	\$14	\$9
Federal Employee Benefits (Note 7)	67	65
Total Intragovernmental	81	74
Federal Employee Benefits (Note 7)	331	341
Annual Leave Liability	194	173
Contingent Liabilities	5	28
Accrued Liability for Payments to States	398	378
Environmental and Disposal Liabilities	53	17
Total Liabilities Not Covered by Budgetary Resources	1,062	1,011
Total Liabilities Covered by Budgetary Resources	1,265	1,015
Total Liabilities	\$2,327	\$2,026

**U. S. Department of Agriculture
Forest Service
Notes to the Consolidated and Combined Financial Statements
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NOTE 7. FEDERAL EMPLOYEE BENEFITS

Federal Employees' Compensation Act Liabilities: Liabilities under the Federal Employees' Compensation Act (FECA) are incurred as a result of workers' compensation benefits that have accrued to employees but have not yet been paid by the USDA Forest Service.

Workers' compensation benefits include the current and expected future liability for death, disability, medical, and other approved costs. The U.S. Department of Labor (DOL) actuarially determines the expected future liability for the U.S. Department of Agriculture as a whole, including the USDA Forest Service. The USDA Forest Service is billed annually as its claims are paid by the DOL. Payments to the DOL are deferred for two years so that the bills may be funded through the budget. Payments to the DOL are also recognized as an expense when billed and recorded in the Statements of Net Cost. The amounts of unpaid FECA billings constitute the accrued FECA payable.

The total components of accrued FECA payable as of September 30, 2006 and 2005 consisted of the following:

	(in millions)	
	<u>2006</u>	<u>2005</u>
Intragovernmental Federal Employee Benefits (Note 6)	\$67	\$65
Federal Employee Benefits (Note 6)	331	341
Total	<u><u>\$398</u></u>	<u><u>\$406</u></u>

**U. S. Department of Agriculture
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Notes to the Consolidated and Combined Financial Statements
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NOTE 8. OTHER LIABILITIES

	(in millions)					
	<u>2006</u>			<u>2005</u>		
	Non-Current	Current	Total	Non-Current	Current	Total
Intragovernmental						
Employer Contributions & Payroll Tax	\$ -	\$ 14	\$ 14	\$ -	\$ -	\$ -
Accrued Liabilities	14	105	119	-	101	101
Advances from Others	-	24	24	-	-	-
Deposit Liabilities	-	(34)	(34)	-	87	87
Custodial Liabilities	-	14	14	-	57	57
Other	-	-	-	9	25	34
Total Intragovernmental	\$ 14	\$ 123	\$ 137	\$ 9	\$ 270	\$ 279
Other						
Accrued Liabilities	\$ -	\$ 916	\$ 916	\$ -	\$ 575	\$ 575
Advances from Others	-	44	44	-	-	-
Deposit Liabilities	-	73	73	-	-	-
Purchaser Road Credits	-	2	2	-	-	-
Accrued Liability for Payments to States	-	398	398	-	378	378
Annual Leave Liability	-	194	194	-	173	173
Contingent Liabilities	5	-	5	28	-	28
Custodial Liabilities	-	24	24	-	-	-
Capital Leases (Note 9)	26	2	28	21	2	23
Other	-	-	-	-	13	13
Total Other	\$ 31	\$ 1,653	\$ 1,684	\$ 49	\$ 1,141	\$ 1,190
Total Other and Intragovernmental Liabilities	\$ 45	\$ 1,776	\$ 1,821	\$ 58	\$ 1,411	\$ 1,469

As of September 30, 2006 and 2005, the USDA Forest Service's major components of other liabilities are as follows:

Accrued Liabilities: Intragovernmental accrued liabilities consist primarily of accruals for payroll and for receipt of goods and services.

Deposit Liabilities: Deposit liabilities consist primarily of collections deposited in deposit funds and clearing accounts, including suspense accounts, awaiting disposition or reclassification.

Custodial Liabilities: Custodial liabilities consist of amounts held in special receipt accounts that belong to non-USDA Forest Service entities.

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Accrued Liability for Payments to States: The Twenty-Five Percent Fund (Act of May 23, 1908, as amended) (16 U.S.C. 500), authorized the Payments to States, National Forest Fund program. This program requires revenue generated by the sale of goods and services on the national forests to be shared with the states for public schools and public roads in the county or counties in which the national forests are located.

Contingent Liabilities: As of September 30, 2006, the USDA Forest Service had several legal actions pending. Based on information provided by legal counsel, management believes some adverse decisions are probable and approximately \$5 million, related to such actions, has been accrued. The USDA Forest Service has a potential liability for approximately \$14 million, related to claims where the amount or probability of judgment is uncertain. There are no estimated obligations related to cancelled appropriations for which there is a contractual commitment for payment. In addition, there are no contractual arrangements which may require future financial obligations.

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NOTE 9. LEASE LIABILITIES

The USDA Forest Service enters into leasing agreements through the General Service Administration (GSA) and through leasing authority delegated by GSA for general facilities (buildings and office space), equipment and land. Leases may include renewal options for periods of one or more years. Most leases are subject to cancellation upon certain funding conditions. The USDA Forest Service's assets under capital lease as of September 30, 2006 and 2005 and future capital and operating lease agreement payments as of September 30, 2006, consisted of the following:

Capital Leases:	(in millions)	
	2006	2005
Summary of Assets Under Capital Leases		
Land, Buildings, Machinery, & Equipment	\$44	\$40
Accumulated Amortization	(16)	(17)
Total	\$28	\$23
Future Payments Due:		
	Land & Buildings, Machinery & Equipment	
Fiscal Year		
Year 1 (2007)	\$7	
Year 2 (2008)	7	
Year 3 (2009)	7	
Year 4 (2010)	7	
Year 5 (2011)	7	
After 5 Years	52	
Total Future Lease Payments	\$87	
Less: Imputed Interest	(54)	
Less: Executory Costs	(5)	
Subtotal	28	
Lease Liabilities covered by Budgetary Resources	\$28	
Lease Liabilities not covered by Budgetary Resources	-	

Operating Leases:	(in millions)	
Future Payments Due:		
	Land & Buildings, Machinery & Equipment	
Fiscal Year		
Year 1 (2007)	\$36	
Year 2 (2008)	35	
Year 3 (2009)	33	
Year 4 (2010)	32	
Year 5 (2011)	30	
After 5 Years	246	
Total Future Lease Payments	\$412	

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NOTE 10. EARMARKED FUNDS

In accordance with SFFAS 27, *Identifying and Reporting Earmarked Funds*, the USDA Forest Service administers certain earmarked funds, which are specifically identified revenues, often supplemented by other financing sources that remain available over time. These funds predominately finance the enhancement and maintenance of National Forest System lands including reforestation. Donations are handled on a cash basis and all other collections are accounted for on an accrual basis. The following is a list of earmarked funds and their base treasury symbols for which USDA Forest Service has program management responsibility.

Treasury Account Symbols and Titles

5004 Land Acquisition	5367 State, Private and International Forestry Land and Water Conservation Fund
5008 National Forest Fund Receipts	5462 Hardwood Technology Transfer and Applied Research Fund
5010 Recreation Fees for Collection Costs	5540 Stewardship Contracting Product Sales, Funds Retained
5072 Fees, Operation and Maintenance of Recreation Facilities	5573 Permit Processing Fund
5201 Payments to States, National Forest Fund	5896 Payments to Counties, National Grasslands
5202 Timber Roads Purchaser Election	8028 Cooperative Work, Forest Service
5203 Roads and Trails for States, National Forest Funds	8029 Mount Saint Helens Highway
5204 Timber Salvage Sales	8034 Gifts, Donations, and Bequests for Forest and Rangeland Research
5206 Expenses, Brush Disposal	8039 Land Between the Lakes Trust Fund
5207 Range Betterment Fund	8046 Reforestation Trust Fund
5208 Acquisition of Lands for National Forests, Special Acts	8083 Federal Highway Trust Fund
5212 Construction of Facilities or Land Acquisition	8203 Gifts and Bequests, Department of Agriculture
5213 Payments to Minnesota (Cook, Lake and St. Louis Counties), National Forest Funds	
5214 Licensee Program	
5215 Restoration of Forest Lands and Improvements	
5216 Acquisition of Lands to Complete Land Exchanges	
5217 Tongass Timber Supply Fund	
5219 Operation and Maintenance of Quarters	
5220 Resource Management Timber Receipts	
5223 Quinalt Special Management Area	
5224 Strawberry Valley Land Transfer	
5225 Pacific Yew, Forest Service	
5232 Southern Nevada Public Land Management	
5260 Federal Land Disposal Account	
5264 Timber Sales Pipeline Restoration Fund	
5268 Recreation Fee Demonstration Program	
5277 MNP Rental Fee Account	
5278 Midewin National Tallgrass Prairie Restoration Fund	
5360 Land Between the Lakes Management Fund	
5361 Administration of Rights-of-Way and Other Land Uses Fund	
5363 Valles Caldera Fund	

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The following earmarked funds are authorized by specific legislative acts as permanent indefinite appropriations to USDA Forest Service: Recreation Fee Collection Costs, Brush Disposal, License Programs for Smokey Bear and Woodsy Owl, Restoration of Forest Lands and Improvements, Roads and Trails for States, National Forest Fund, Timber Road Purchaser Elections, Timber Salvage Sale Operations and Maintenance of Quarters.

Financial information for the significant earmarked funds, identified by total asset value, is shown below:

Earmarked Funds

As of and for the year ended September 30, 2006

(in millions)

	Cooperative Work	Payments to States, National Forest Fund	Recreation Fee Demonstration Program	Other Funds	Total
ASSETS					
Fund Balance with Treasury	\$412	\$324	\$133	\$571	\$1,440
Investments	-	-	-	5	5
Accounts Receivable, Net	4	-	2	34	40
Advances To Others	-	-	-	3	3
General Property, Plant & Equipment, Net	18	4	4	89	115
TOTAL ASSETS	\$434	\$328	\$139	\$702	\$1,603
LIABILITIES					
Accounts Payable	\$1	\$1	\$1	\$1	\$4
Other Liabilities	56	200	3	37	296
TOTAL LIABILITIES	57	201	4	38	300
Total Net Position	377	127	135	664	1,303
TOTAL LIABILITIES AND NET POSITION	\$434	\$328	\$139	\$702	\$1,603
CHANGE IN NET POSITION					
Beginning Balances	\$594	\$101	\$131	\$705	\$1,531
Budgetary Financing Sources:					
Donations and Forfeitures of Cash	-	-	-	-	-
Transfers -in/out without Reimbursement	(159)	-	-	131	(28)
Other	-	-	-	4	4
Total Financing Sources	(159)	-	-	135	(24)
Revenue	115	271	54	179	619
Expenses	(173)	(245)	(50)	(355)	(823)
Net Cost of Operations	(58)	26	4	(176)	(204)
ENDING BALANCES	\$377	\$127	\$135	\$664	\$1,303

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Descriptions of the significant earmarked funds are as follows:

Cooperative Work

Cooperative contributions are deposited into Treasury account 12X8028 for disbursement in compliance with the terms and provisions of the agreement between the cooperator and the USDA Forest Service. Cooperators include timber purchasers, not-for-profit organizations, and local hunting and fishing clubs. The governing authorities are the Act of June 30, 1914 (16 U.S.C. 498), and the Knutson-Vandenberg Act.

Payments to States, National Forest Fund

The Payments to States, National Forest Fund Treasury account 12X5201 receives amounts from receipt account 125008, the National Forest Fund. These monies are generated by the sale of goods and services on the national forests. Annually, revenue-sharing payments are made to the States in which the national forests are located, for public schools and public roads in the county or counties in which the national forests are situated. The Act of May 23, 1908, as amended (16 U.S.C. 500), authorized the Payments to States, National Forest Fund program.

Recreation Fee Demonstration Program

The Recreation Fee Demonstration Program Treasury account 12X5268 receives deposits of recreation fees collected from projects that are part of the Recreation Fee Demonstration program. These monies are retained and used for backlog repair and maintenance of recreation areas, sites or projects. These funds are also used for interpretation, signage, habitat or facility enhancement, resource preservation, annual operation, maintenance, and law enforcement related to public use of recreation areas and sites. The Recreation Fee Demonstration Program is authorized by 16 U.S.C. 4601-6a.

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NOTE 11. SUBORGANIZATION PROGRAM COSTS/PROGRAM COSTS BY SEGMENT

The USDA Forest Service reflects costs through four primary responsibility segments: National Forests and Grasslands, Forest and Rangeland Research, State and Private Forestry, and Wildland Fire Management.

The following tables illustrate program costs by segment for the years ended September 30, 2006 and 2005.

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**Program Costs by Segment
For the year ended September 30, 2006**

(in millions)

	National Forests and Grasslands	Forest and Rangeland Research	State and Private Forestry	Wildland Fire Management	Total
Intragovernmental Gross Costs:					
Benefit Program Costs	\$ 366	\$ 1	\$ -	\$ 10	\$ 377
Imputed Costs	303	-	-	-	303
Reimbursable Costs	189	21	51	165	426
Total Intragovernmental Gross Costs	858	22	51	175	1,106
Less: Intragovernmental Earned Revenue	210	31	15	130	386
Intragovernmental Net Costs	648	(9)	36	45	720
Gross Costs With the Public:					
Grants and Indemnities	409	1	255	20	685
Stewardship Land Acquisition (Note 12)	69	-	-	-	69
Other:					
Operating Costs	1,868	299	93	2,302	4,562
Depreciation Expense	227	2	-	26	255
Reimbursable Costs	90	33	17	120	260
Total Other	2,185	334	110	2,448	5,077
Total Gross Costs with the Public	2,663	335	365	2,468	5,831
Less: Earned Revenues from the Public	503	3	6	136	648
Net Costs with the Public	2,160	332	359	2,332	5,183
Net Cost of Operations	\$ 2,808	\$ 323	\$ 395	\$ 2,377	\$ 5,903

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**Program Costs by Segment
For the year ended September 30, 2005**

(in millions)

	National Forests and Grasslands	Forest and Rangeland Research	State and Private Forestry	Wildland Fire Management	Total
Intragovernmental Gross Costs:					
Benefit Program Costs	\$ 364	\$ -	\$ -	\$ -	\$ 364
Imputed Costs	247	-	-	-	247
Reimbursable Costs	126	20	46	126	318
Total Intragovernmental Gross Costs	737	20	46	126	929
Less: Intragovernmental Earned Revenue	125	29	12	108	274
Intragovernmental Net Costs	612	(9)	34	18	655
Gross Costs With the Public:					
Grants and Indemnities	377	2	212	16	607
Stewardship Land Acquisition (Note 12)	71	-	-	-	71
Other:					
Operating Costs	1,879	276	118	1,461	3,734
Depreciation Expense	240	3	-	25	268
Reimbursable Costs	115	28	13	66	222
Total Other	2,234	307	131	1,552	4,224
Total Gross Costs with the Public	2,682	309	343	1,568	4,902
Less: Earned Revenues from the Public	477	3	-	35	515
Net Costs with the Public	2,205	306	343	1,533	4,387
Net Cost of Operations	\$ 2,817	\$ 297	\$ 377	\$ 1,551	\$ 5,042

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NOTE 12. COST OF STEWARDSHIP PP&E

Stewardship assets acquired through purchase in fiscal years 2006 and 2005 amounted to \$69 and \$71 million, respectively, and consisted of land, easements, and rights-of-way. Stewardship land is land and land rights owned by the Federal Government and is excluded from General Property, Plant, and Equipment. Examples of stewardship land include land used for forests, grazing, and wildlife.

Costs for stewardship land include all costs to acquire and prepare the land for its intended use.

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NOTE 13. APPORTIONMENT CATEGORIES OF OBLIGATIONS INCURRED

The Office of Management and Budget usually distributes budgetary resources in an account or fund by specific time periods, activities, projects, objects or a combination of these categories by a process called apportionments. Apportionments by fiscal quarters are classified as category A and all other apportionments are classified as category B. The funds on quarterly apportionment are National Forest System (12X1106) and Wildland Fire Management (12X1115). Presented below is the amount of direct and reimbursable obligations incurred by apportionment category for fiscal years 2006 and 2005.

**For the year ended September 30, 2006
(in millions)**

	Apportionment Category A	Apportionment Category B	Total
Obligations Incurred - Direct	\$3,901	\$2,481	\$6,382
Obligations Incurred - Reimbursable	413	62	475
Total Obligations Incurred	\$4,314	\$2,543	\$6,857

**For the year ended September 30, 2005
(in millions)**

	Apportionment Category A	Apportionment Category B	Total
Obligations Incurred - Direct	\$3,189	\$2,356	\$5,545
Obligations Incurred - Reimbursable	167	98	265
Total Obligations Incurred	\$3,356	\$2,454	\$5,810

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NOTE 14. EXPLANATION OF DIFFERENCES BETWEEN THE STATEMENT OF BUDGETARY RESOURCES AND THE BUDGET OF THE UNITED STATES GOVERNMENT

The differences between the fiscal 2005 Statement of Budgetary Resources (SBR) and the fiscal 2005 actual numbers presented in the fiscal 2007 Budget of the United States Government (Budget) are summarized in the table below. The material differences are explained in Note (a) below the table.

SBR Line Description	(in millions)				Note
	SBR Amount	Budget Amount	Dollar Variance	Percentage Variance	
Total Budgetary Resources/Status of Resources	\$ 8,237	\$ 8,243	\$ (6)	0%	
Total Status of Resources	8,239	8,243	(4)	0%	
New Budget Authority	5,812	5,807	5	0%	
Net transfers, current year authority	50	50	-	0%	
Unobligated Balance-Beginning of Year	1,738	1,726	12	1%	
Net transfers, prior year balances, actual	1	-	1	0%	
Offsetting Collections-Collected	448	450	(2)	0%	
Change in Uncollected Payments	86	87	(1)	-1%	
Recoveries of Prior Year Obligations	169	188	(19)	-10%	
Temporary/Permanently not Available	(67)	(65)	(2)	3%	
Total New Obligations	5,810	5,826	(16)	0%	
Unobligated Balance & Unobligated Balance not Available	2,429	2,417	12	0%	
Obligated Balance - Beginning of Year	1,493	1,492	1	0%	
Obligated Balance - End of Year	1,561	1,552	9	1%	
Net Outlays	5,039	5,037	2	0%	
Offsetting Receipts	426	595	(169)	-28%	(a)

Note (a) Of the \$169 million variance, \$167 million was for fire transfer payback which was properly not reported as a distributed offsetting receipt in the Statement of Budgetary Resources.

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NOTE 15. UNDELIVERED ORDERS

The undelivered orders included in unpaid obligations as of September 30, 2006 and 2005 are \$1,310 and \$1,226 million, respectively.

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NOTE 16. RELATIONSHIP BETWEEN LIABILITIES NOT COVERED BY BUDGETARY RESOURCES ON THE BALANCE SHEET AND THE CHANGE IN COMPONENTS REQUIRING OR GENERATING RESOURCES IN FUTURE PERIODS.

The change in liabilities not covered by budgetary resources should be the same as the change in components requiring or generating resources in future periods, except for other components requiring or generating resources in future periods that are reported separately. The components requiring or generating resources in future periods as reported on the Statement of Financing differ from the components requiring or generating resources in future periods reflected below for the portion of liabilities not covered by budgetary resources.

	(in millions)	
	<u>FY 2006</u>	<u>FY 2005</u>
Current year liabilities not covered by budgetary resources as disclosed in Note 6	\$ 1,062	\$ 1,011
Less: Prior year liabilities not covered by budgetary resources	1,011	998
Net increase in liabilities not covered by budgetary resources	51	13
Add back FY2006 net decreases in FECA Actuarial Liability and Contingent Liability	33	-
Add back FY2005 net decreases in FECA Actuarial Liability, Payments to States and Annual Leave Liability	-	26
Gross increase in liabilities not covered by budgetary resources	84	39
Less: increase in exchange revenue receivable from the public	12	-
Components requiring or generating resources in future periods, as reported on the Statement of Financing	\$ 72	\$ 39

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NOTE 17. OTHER STATEMENT OF FINANCING DISCLOSURES

In the event the funds appropriated to the Wildland Fire Management Fund are insufficient for current year operations related to fire suppression, the USDA Forest Service is permitted to borrow monies from other funds, which must be repaid in subsequent years. The FY05 Statement of Financing includes such a repayment of \$149 million to the Cooperative Work Trust Fund as resources used to finance items not part of the net cost of operations. This transaction represents a budgetary obligation for the Wildland Fire Management Fund in the Statement of Budgetary Resources but it does not represent an operating expense in the Statement of Net Cost. This conforms to Treasury guidance for making expenditure transfers from general fund expenditure accounts (Federal Funds Group) to trust funds (Trust Fund Group).

The USDA Forest Service has allocation transfers that are reconciling items on the Statement of Financing as explained in Note 1N.

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NOTE 18. DEDICATED COLLECTIONS

The USDA Forest Service administers certain dedicated collection funds, which as described in Notes 1 and 10 are reported as earmarked funds in FY 2006. Financial information for the largest dedicated collection funds, identified by asset value, for FY 2005 is shown below:

Dedicated Collections

As of and for the year ended September 30, 2005

(in millions)

	Cooperative Work	Payments to States, National Forest Funds	Recreation Fee Demonstration Program	Land Acquisition	Timber Salvage Sales	Other Funds	Total
ASSETS							
Fund Balance with Treasury	\$624	\$165	\$131	\$67	\$101	\$419	\$1,507
Investments	-	-	-	-	-	5	5
Accounts Receivable, Net	2	-	1	20	2	27	52
Advances To Others	-	-	-	-	-	-	-
General Property, Plant & Equipment, Net	17	3	3	48	1	22	94
TOTAL ASSETS	\$643	\$168	\$135	\$135	\$104	\$473	\$1,658
LIABILITIES							
Accounts Payable	\$ -	\$1	\$1	\$ -	-\$1	\$1	\$2
Other Liabilities	49	66	3	1	5	70	194
TOTAL LIABILITIES	49	67	4	1	4	71	196
Total Net Position	594	101	131	134	100	402	1,462
TOTAL LIABILITIES AND NET POSITION	\$643	\$168	\$135	\$135	\$104	\$473	\$1,658
CHANGE IN NET POSITION							
Beginning Balances	\$442	\$69	\$44	\$145	\$95	\$331	\$1,126
Budgetary Financing Sources:							
Transfers -in/out without Reimbursement	149	-	81	61	-	149	440
Total Financing Sources	149	-	81	61	-	149	440
Revenue	112	115	50	20	72	60	429
Expenses	(109)	(83)	(44)	(92)	(67)	(138)	(533)
Net Cost of Operations	3	32	6	(72)	5	(78)	(104)
ENDING BALANCES	\$594	\$101	\$131	\$134	\$100	\$402	\$1,462

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Descriptions for the first three dedicated collections are included in Note 10. Descriptions for the remaining significant dedicated collections for FY 2005 are as follows:

Land Acquisition

Each fiscal year the USDA Forest Service's Treasury account 12X5004 receives a transfer of recreation user fees from the Department of the Interior's Land and Water Conservation Fund, to be used for the acquisition of land or waters, or interest therein, including administrative expenses, to carry out the provisions of the Land and Water Conservation Fund Act of 1965, as amended (16 U.S.C. 4601-4-11), pertaining to the preservation of watersheds. The Land Acquisition program is authorized by the Interior and Related Agencies Appropriations Act of December 30, 1982 (96 Stat. 1983, Public Law 97-394).

Timber Salvage Sales

The Salvage Sale Fund, Treasury account 12X5204, was established to facilitate the timely removal of timber damaged by fire, wind, insects, diseases, or other events. Amounts collected from the sale of salvaged timber are used on other qualifying salvage sales to cover the cost of preparing and administering the sales. The Timber Salvage Sales program is authorized by 16 U.S.C. 472(a).

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NOTE 19. SEIZED PROPERTY

A seizure is the act of taking possession of goods in consequence of a violation of public law. Seized property may consist of monetary instruments, real property, tangible personal property and evidence. Until judicially or administratively forfeited, the USDA Forest Service does not legally own such property. Seized evidence includes cash, weapons, illegal drugs and non-monetary valuables. Pursuant to Federal Financial Accounting and Auditing Technical Release No. 4, *Reporting on Non-Valued Seized and Forfeited Property* (Release No. 4), property that is seized but not forfeited (e.g., weapons, chemicals, drug paraphernalia, gambling devices) is not included on the balance sheet. Also, the USDA Forest Service has not included seized financial and personal property in its balance sheets due to immateriality.

The USDA Forest Service has custody of illegal drugs and weapons seized as evidence for legal proceedings. Illegal drugs and weapons have no saleable value to the Federal government and are destroyed upon resolution of legal proceedings. Marijuana represents the major significant seized drug for the USDA Forest Service. As of September 30, 2006 and 2005, the amount of marijuana on hand was 32,504(kg) and 35,579(kg), respectively. Since the amount of seized property is deemed to be immaterial, a schedule of brought forward balances, additions, deletions and adjustments is not presented.