IV. REPORT OF THE OFFICE OF THE INSPECTOR GENERAL AND MANAGEMENT'S RESPONSE

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250

DATE: January 15, 2003

REPLY TO
ATTN OF: 50401-47-FM

SUBJECT: U.S. Department of Agriculture
Consolidated Financial Statements for Fiscal Year 2002

TO: Edward R. McPherson
Chief Financial Officer
Office of the Chief Financial Officer

This report presents the results of our audit of the U.S. Department of Agriculture's consolidated financial statements for the fiscal year ended September 30, 2002. The report contains an unqualified opinion and the results of our assessment of the Department's internal control structure and compliance with laws and regulations.

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

We appreciate the courtesies and cooperation extended to us during the audit.

Phyllis K. Fong

Phyllis K. Fong
Inspector General

USDA

U.S. Department of Agriculture
Office of Inspector General
Financial and IT Operations
Audit Report

U.S DEPARTMENT OF AGRICULTURE CONSOLIDATED FINANCIAL STATEMENTS FOR FISCAL YEAR 2002

OFFICE OF INSPECTOR GENERAL • USDA •

Report No.
50401-47-FM
January 2003

EXECUTIVE SUMMARY

U.S. DEPARTMENT OF AGRICULTURE CONSOLIDATED FINANCIAL STATEMENTS FOR FISCAL YEAR 2002

AUDIT REPORT NO. 50401-47-FM

PURPOSE

Our audit objectives were to determine whether (1) the financial statements present fairly, in all material respects, in accordance with generally accepted accounting principles, the assets, liabilities, and net position; net costs; changes in net position; budgetary resources; and reconciliation of net costs to budgetary obligations, (2) the internal control objectives were met, (3) the Department complied with laws and regulations for those transactions and events that could have a material affect on the financial statements, and (4) the information in the Management Discussion and Analysis and the Supplemental Financial Information sections was materially consistent with the information in the financial statements.

We conducted our audit at the financial offices of various U.S. Department of Agriculture (USDA) agencies and the Office of the Chief Financial Officer (OCFO) located in Washington, D.C., and its National Finance Center (NFC) located in New Orleans, Louisiana. We also performed site visits to selected agencies' field offices.

RESULTS IN BRIEF

In our opinion, USDA's fiscal year 2002 consolidated financial statements, including the accompanying notes, present fairly in all material respects, in conformity with generally accepted accounting principles, the assets, liabilities, and net position as of September 30, 2002; as well as net costs, changes in net position, budgetary resources, and reconciliations of net costs to budgetary obligations for the year then ended. This is the first year USDA has received an unqualified opinion because it overcame its previous inability to produce timely and accurate financial statements.

In addition to obtaining its first ever unqualified opinion, the Department achieved the following major accomplishments in improving its overall financial management during fiscal year 2002.

- The OCFO/NFC made significant progress in performing its Financial Management Service (FMS) Form 6653, "Undisbursed Appropriation Account Ledger," Fund Balance with Treasury (FBWT) reconciliations for its serviced agencies, increasing the reliability of the FBWT line-item. However, further work is needed to insure the FBWT is reconciled as of fiscal yearend.

- As of fiscal year 2003, all USDA agencies have been implemented into the Foundation Financial Information System, mitigating the financial management problems reported in the legacy Central Accounting System.

- Significant improvements were made by USDA's agencies in correcting long-standing real and personal property accounting deficiencies. Additional improvement is needed in the Forest Service.

In addition, other major initiatives are underway. Plans have been developed, contingent upon available funding, to address the (1) renovation of corporate administrative systems, (2) design of department-wide cost accounting standards, (3) improvement in the processes and procedures for accounting for real and personal property, and (4) enhancement of overall management accountability and control.

In our Report on the Internal Control Structure, we reported:

- The USDA and its agencies operate at least 80 program and administrative financial management systems. The Office of Inspector General, the General Accounting Office, and the Department have reported that USDA's financial system of records presents a high risk to the Department. The longstanding and material problems were caused, primarily, by the absence of corporate level oversight and planning when these legacy systems were initially developed and upgraded. The OCFO has taken action to address these problems and developed plans to review the legacy systems, and consolidate and update the systems, as appropriate, to meet present accounting standards and management needs. With assets totaling over $123 billion and program costs in excess of $72 billion, actions must continue to be taken to fully resolve these problems.

- We also noted that improvements are needed in the Department's Information Technology security.

In our Report on Compliance with Laws and Regulations, we continued to note where further actions are necessary related to improving financial management systems, including cost accounting for user fees.

KEY RECOMMENDATIONS

The OCFO has immediate and long term plans to address substantially all of the weaknesses in its and the agencies' financial management systems. The recommendation in this report was limited to developing guidance and providing assistance in implementing an effective quality control review program throughout the Department.

AGENCY POSITION

OCFO generally agreed with the findings and recommendation in this report. However, it does not consider the unreconciled balances within the FBWT and Treasury records to be material. The OCFO has also reported that it believes the Department is in substantial compliance with the Federal Financial Management Improvement Act. We disagree with the OCFO's position. We believe the nonconformances noted within the audits of USDA component agencies constitutes substantial noncompliance. We are committed to working with the OCFO to resolve this issue. Our rebuttals appear in the "Findings and Recommendations" sections of this report.

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

REPORT OF THE OFFICE OF INSPECTOR GENERAL

TO: Edward R. McPherson
Chief Financial Officer
Office of the Chief Financial Officer

We have audited the accompanying Consolidated Balance Sheet of the U.S. Department of Agriculture (USDA) as of September 30, 2002, and the related Consolidated Statements of Net Cost, Changes in Net Position and Financing, and the Combined Statement of Budgetary Resources for fiscal year then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with "Government Auditing Standards" issued by the Comptroller General of the United States, and the Office of Management and Budget (OMB) Bulletin 01-02, "Audit Requirements for Federal Financial Statements." Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provided a reasonable basis for our opinion.

In our opinion, the fiscal year 2002 financial statements referred to above, including the accompanying notes, present fairly in all material respects, in conformity with generally accepted accounting principles, the assets, liabilities, and net position as of September 30, 2002; as well as net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the year then ended. We issued a disclaimer of opinion on the fiscal year 2001 financial statements because the Department was unable to provide accurate financial statements in a timely manner.

Our audit was conducted for the purpose of forming an opinion on USDA's financial statements taken as a whole. The information in Management's Discussion and Analysis and Required Supplemental Information sections represent supplementary information required by OMB Bulletin 01-09, "Form and Content of Agency Financial

Statements." We 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.

We have also issued a report on the Department's internal controls, which cites six reportable internal control findings and a report on USDA's compliance with laws and regulations, which cites three instances of noncompliance with laws and regulations.

This report is intended solely for the information of the management of USDA, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Phyllis K. Fong

Phyllis K. Fong
Inspector General

January 7, 2003

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

REPORT OF THE OFFICE OF INSPECTOR GENERAL ON INTERNAL CONTROL STRUCTURE

TO: Edward R. McPherson
Chief Financial Officer
Office of the Chief Financial Officer

We audited the accompanying financial statements of the USDA, as of, and for the fiscal year ended September 30, 2002, and have issued our report thereon, dated January 7, 2003. In planning and performing our audit of the financial statements, we considered its internal controls over financial reporting by obtaining an understanding of the internal controls, determined whether the internal controls had been placed in operation, assessed control risk, and performed tests of control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control over financial reporting. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act (FMFIA) of 1982, such as those controls relevant to ensuring efficient operations. Consequently, we do not provide an opinion on internal controls.

Our consideration of the 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 (AICPA), reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation that, in our judgment, could adversely affect the agency'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 internal control components do not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. We believe the reportable conditions described in this report are material weaknesses.

MANAGEMENT'S RESPONSIBILITY FOR INTERNAL CONTROL STRUCTURE

The management of USDA is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the benefits and related costs of the internal control structure to provide management reasonable, but not absolute assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with the agency's prescribed basis of accounting. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In its fiscal year 2002 FMFIA report, the Secretary of Agriculture was able to provide reasonable assurance that for the first time in more than 10 years, the Department was in compliance with both Section 2, "Management Accountability and Control," and Section 4, "Financial Management Systems," except for 19 outstanding material internal control weaknesses and the financial system nonconformances noted in this report.

OIG'S EVALUATION OF USDA'S INTERNAL CONTROL STRUCTURE

For the purpose of this report, we have classified USDA's significant internal control structure policies and procedures into the following categories:

Administrative Costs – consists of policies and procedures associated with disbursing funds for salaries and administrative expenses.

Treasury – consists of policies and procedures associated with disbursing and collecting cash, reconciling cash balances, and managing debt.

Financial Reporting – consists of policies and procedures associated with processing accounting entries and preparing the USDA's annual financial statements.

Direct Loans and Grants – consists of policies and procedures associated with authorizing and disbursing loans and grants, accruing interest on loans, and collecting loan repayments.

Guaranteed Loans – consists of policies and procedures associated with authorizing and disbursing payments, authorizing guarantees, and accruing interest and collecting repayments on defaulted guaranteed loans.

Insurance Premiums and Claims – consists of policies and procedures associated with processing catastrophic risk program fees and reinsured company premiums and indemnities for these insurance policies.

Property and Inventory – consists of policies and procedures associated with acquisition, maintenance and disposition of property and/or inventory.

Food Stamp Redemption – consists of policies and procedures associated with coupons being redeemed and applied against the USDA's fund balance at the Treasury.

For each of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation. We assessed control risk and performed tests of USDA's internal control structure.

In making our risk assessment, we considered the Department's FMFIA reports, Office of the Inspector General (OIG) audits and other independent auditor reports on financial matters, and internal accounting control policies and procedures. We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the AICPA. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to have reasonable assurance that the following objectives are met:

(1) Reliability of financial reporting – transactions are properly recorded, processed, and summarized to permit the preparation of the Principal Statements and Required Stewardship Supplement Information (RSSI) in accordance with generally accepted accounting principals, and assets are safeguarded against loss from unauthorized acquisition, use or disposition;

(2) Compliance with applicable laws and regulations – transactions are executed in accordance with (a) laws governing the use of budget authority and other laws that could have a direct and material effect on the Principal Statements or RSSI, and (b) any other laws, regulations, and Government-wide policies identified by OMB in Appendix C of OMB Bulletin No. 01-02; and

(3) Reliability of performance reporting – transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

Matters that we consider to be reportable conditions are presented in the "Findings and Recommendations" section of this report.

FINDINGS AND RECOMMENDATIONS

I. USDA NEEDS TO CONTINUE ITS EFFORTS TO IMPLEMENT FINANCIAL MANAGEMENT IMPROVEMENTS AT A CORPORATE LEVEL

FINDING NO. 1

The USDA and its agencies operate at least 80 program and administrative financial management systems. The OIG, General Accounting Office (GAO), and the Department itself, have reported that USDA's financial system of record presents a high risk to the Department. The longstanding and material problems were caused, primarily, by the absence of corporate level oversight and planning when these legacy systems were initially developed and upgraded. The Office of the Chief Financial Officer (OCFO) has taken action to address these problems and developed plans to review the legacy systems, and consolidate and update the systems, as appropriate, to meet present accounting standards and management needs. With assets totaling over $123 billion and program costs in excess of $72 billion, actions must continue to be taken to fully resolve these problems.

During fiscal year 2002, the Department has achieved significant improvements in its overall financial management. The Foundation Financial Information System (FFIS) has been implemented for the entire Department. This system is Joint Financial Management Improvement Program (JFMIP) compliant and has eliminated many of the previous weaknesses we have reported in the past. However, some weaknesses continue to exist where further enhancements are needed. For example:

- The Property System, a subsidiary system of the general ledger, is reconciled with the general ledger; however, not on a timely basis. For example, as of January 3, 2003, yearend reconciliations had not been provided for at least three agencies with property balances (gross) totaling over $732 million, with unreconciled differences of about $10 million. Reconciliations are important procedures that ensure the validity and completeness of information feeding from one system into another.

- We continue to find inconsistent implementation of accounting processes in FFIS between agency applications. Table settings are used to set edits, interest rates, penalty amounts, etc. We found that field settings were inconsistent between the 13 agency applications we tested. Although table setting standards were sent out for comment, no formal guidance was implemented by October 2002. As a result, different accounting processes could affect consolidated financial information.

- We noted significant problems with the processes used to post adjustments to the general ledger. FFIS uses Journal Vouchers (JV) and Standard Vouchers (SV) to process adjustments. The SV uses predefined debits and credits based on business rules, while the JV requires the identification of the debits/credits to be used based on unique situations and poses a greater risk due to the potential for human error. We noted that about 40 percent (10 of 25) of the JV transactions reviewed and 28 percent (10 of 35) of the SV transactions reviewed were (1) calculated or researched incorrectly, (2) made to the wrong accounts, and/or (3) required to correct a previous adjustment. In addition, we could not determine if one of the SV adjustments in our sample was properly calculated because the support provided was not adequate.

  The types of problems that we found could have been avoided had (1) ACFO/FS established posting models to properly record OPAC chargeback transactions to the general ledger accounts that track OPAC disbursements and collections and (2) the agencies effectively implemented the controls outlined in the FFIS Bulletins 00-01, "Internal Controls Over Manual Adjustments in the FFIS," and 02-06, "Internal Controls Over Standard Vouchers in the FFIS," which establish overarching guidance for developing proper internal controls. We also noted that (1) evidence of important controls, such as supervisory review and agency approval, were more likely to be documented and (2) adequate supporting documentation was more likely to be provided for manual adjustments when a hard-copy form and/or National Finance Center (NFC) checklist was completed.

  Our review also disclosed that JV transactions were being used to perform routine processes. For example, 5 of the JVs in our sample were used to reclassify Office of Personnel Management benefit expenses, which is required on a recurring basis because the payroll system does not generate correct accounting. Since JV transactions generally present a greater risk to system integrity than SV transactions, we believe that posting models should be set up to accomplish routine transactions currently processed with JV transactions.

- The "Obligated Balance, Net-Beginning of Period" and "Unobligated Balance, Beginning of Period" on the fiscal year 2002 Statement of Budgetary Resources did not agree with the amount reported as the ending balance on last year's statement. These line items should equal or be reconciled. We were not provided with a reconciliation that explained the net decrease of $121 million.

- Material dollar amounts contained in Central Accounting System (CAS) have been identified as potentially invalid by some agencies. Prior to conversion into FFIS, agencies performed reviews to identify activity recorded in CAS that was not supported. This activity was converted into FFIS using "alternate" fund codes. During fiscal year 2002, we monitored agency efforts to clear alternate fund code balances by either transferring supported amounts to the correct fund code or adjusting erroneous balances, as appropriate. As of the end of fieldwork, about $105 million in unsupported prior year activity (absolute value) remained in these alternate fund codes, and was reported in the agency's financial statements. Also, cleanup of this alternate fund code activity fell far behind schedule at several agencies. The lack of timely research and resolution put audit timeframes in jeopardy. As the final two agencies convert to FFIS, effective October 1, 2002, it is imperative that they clean up the data converted to the alternate fund codes, in a timely manner.

- We noted, despite significant efforts to reconcile suspense activity, that corrective action on all outstanding balances could not be totally effected to the fiscal year 2002 account balances. An action plan has been developed to address this activity. We noted the following:

  OCFO/NFC uses Treasury symbol 12F3875, "Budget Clearing Suspense," without specific procedures for reconciling transactions posted to this Treasury symbol or ensuring that the transactions clear from the account.[1] Until suspense account transactions are posted to the proper appropriation account within the Department, there is the potential for incorrect accounting records, which could lead to anti-deficiency violations and other problems. Moreover, the reported balance in suspense accounts represent the netting of collections and

[1] Treasury budget clearing accounts are to be used as temporary holding accounts pending clearance to the applicable receipt or expenditure account in the budget. According to Treasury yearend closing procedures, budget clearing accounts along with Statements of Differences should be reconciled by the end of the fiscal year. In order to ensure that transactions are properly reconciled and cleared, transaction level detail must be maintained.

disbursements, thus understating the magnitude of the unrecorded amounts in suspense accounts. Based on our analysis of general ledger detail activity of related transactions for account balances as of September 30, 2002, the net unreconciled and/or uncleared differences in Treasury symbol 12F3875, was about $95.7 million for FFIS agencies and $(42) million for CAS agencies. Also, the CAS general ledger within the Treasury symbol was out-of-balance.

- Agencies were unable to provide complete explanations of abnormal balances, in a timely manner. Explanations were provided by agencies well beyond agreed upon timeframes and required considerable audit followup. Analysis of abnormal balances should be performed monthly to identify unusual and potentially erroneous financial activity.

The OCFO has immediate and long-term plans to address the weaknesses in its and the agencies' financial management systems. These actions include working with the business process owners to address the problems with the legacy feeder systems, with the objective to provide an improved integration of the financial management architecture within the Department. For example, we noted that the Department's systems have not been designed to enable them to provide sufficient and relevant data to meet the Statement of Federal Financial Accounting Standards (SFFAS) No. 4, "Managerial Cost Accounting Concepts and Standards," effective September 30, 1996. This statement is aimed at providing reliable and timely information on the full cost of Federal programs, activities, and outputs. This information can be used by Congress and Federal executives in making decisions about allocating resources, authorizing and modifying programs, evaluating program performance, and making managerial decisions to improve economy and efficiency.

These conditions hinder the ability to make informed decisions, in a timely manner, when the need for such information is a crucial factor for sound financial management. We believe the Department must continue to move forward in developing plans to integrate its program and administrative financial management systems. The objective is for USDA financial systems to produce annual financial statements and other information needed to manage day-to-day operations dependably and routinely. Achieving the reforms required by financial management legislation is essential because the Department needs accurate financial information and appropriate internal controls to effectively manage its vast resources.

We are making no additional recommendations in this report for prior recommendations that have not yet been management decided and/or are still open.

II. QUALITY CONTROL REVIEW PROCESSES NEED IMPROVEMENT

FINDING NO. 2

We noted that the OCFO had implemented a quality control review process on its deliverables prior to submitting the information for the consolidated audit. The information requested by OIG and provided by the agencies to OCFO was generally reviewed by the OCFO for accuracy and thoroughness. As a result, there were minimal follow up questions and requests for additional documentation. Without this process, we would not have been able to complete the audit within the legislatively mandated timeframes. However, this process was not always in place at some of the component agency audits. While agencies attempted to perform quality control reviews, there was not always enough time to provide for this important internal control and still meet the established deadlines. As a result, a significant amount of audit coverage needed to be performed and reperformed after material errors were identified and subsequently corrected. In effect, in many instances, the auditors performed the quality control reviews for the agencies. Given the accelerated timeframes imposed by OMB 01-09, there will not be an opportunity in future years for the auditors to detect these material errors and provide the agency with time to make necessary corrections. As a result, unless a Department-wide quality control process is implemented, there is a high-risk that the Department's opinion on its financial statements could deteriorate.

Some examples where quality control needs to be improved and/or established follow:

- Credit Reform estimates and reestimates needed to be recalculated and corrected subsequent to being provided for audit;
- Yearend accruals need to be calculated and posted prior to providing the financial statements for audit;
- Allowances for inventory write-offs and uncollectable accounts receivables needed to be calculated/recalculated and supported;
- Several subsidiary ledgers supporting material line-items on the financial statements needed to be created and analyzed; and
- Additional supporting documentation needed to be provided in numerous instances in order to support the financial statements.

These conditions occurred primarily because agencies lacked adequate lead-time to perform an effective quality review of the statements prior to submitting them to the OIG.

RECOMMENDATION NO. 1

OCFO should assist its component agencies in developing and implementing effective quality control reviews.

III. ADDITIONAL CORRECTIVE ACTIONS ARE NEEDED TO FULLY RECONCILE THE DEPARTMENT'S FUND BALANCE WITH TREASURY

FINDING NO. 3

We have reported since 1992 that the Fund Balance with Treasury (FBWT) account had not been properly reconciled with Treasury records. During the fiscal year 2002 audit we noted significant progress by the Department in improving its FBWT reconciliation processes. The Department was able to reconcile its FBWT Financial Management Service (FMS) Form 6652, "Statement of Differences," with the activity recorded at Treasury at the transaction level. We were able to remove our qualification for this material line-item. However, while significant progress was made, additional efforts are needed to resolve some continuing material internal control weaknesses.

The FBWT account is an asset account representing the future economic benefit of monies that can be spent for authorized transactions. At the agency level, Federal agencies accumulate their fund balance from numerous disbursement and receipt transactions, which they record in their Standard General Ledger (SGL) account 1010 and related sub accounts. For each accounting month, agencies are required to report their disbursement and receipt activities to Treasury on a Standard Form (SF) 224, "Statement of Transactions." FMS then compares the disbursements and receipts reported by agencies on the SF-224 to amounts reported by financial institutions (via lockboxes) on the Online Payment and Collection System, and by the Regional Finance Centers. FMS reports differences on the FMS Form 6652, "Statement of Differences," and requires that Federal agencies research and resolve differences between their receipts and their FBWT accounts as reported in their general ledgers and Treasury records. These reconciliations are critical internal controls, which improve the integrity of various U.S. Government financial reports and provide more accurate measurement of budget results. In addition, reconciliation and related verification of financial information ensure the integrity of the accounting system.

Treasury also requires agencies to reconcile their FMS Form 6653, "Undisbursed Appropriation Account Ledger." However, OCFO/NFC was only able to complete its FMS Form 6653 reconciliations at the transaction level through June 2002 for 73 percent of its Treasury symbols. The amounts reported by agencies as disbursements and collections per the monthly SF-224, "Statement of Transactions," are used by Treasury to increase/decrease the agency's FBWT and are reported back to the agency via the FMS Form 6653. If another agency or disbursing center makes a disbursement or collection affecting a specified Treasury symbol and reports that amount via the SF-224 process this increases/decreases the respective Treasury symbols as reported on the FMS Form 6653. In addition, non-expenditure transfers and current year authority are reflected on the FMS Form 6653. Therefore it is necessary for agencies to reconcile their general ledger FBWT with the amount being reported by Treasury. This reconciliation process should be at the transaction level to ensure that all transactions were properly recorded. Discrepancies between Treasury accounts and the agency's general ledger should be disclosed in the footnotes to the agency's financial statements along with an explanation of the causes for the discrepancies.

While the OCFO/NFC was performing some FMS Form 6653 reconciliations to the transaction level for agencies it services, the focus during fiscal year 2002 was to refine the process for current year activity. Prior year out-of-balance conditions had not yet been researched to the transaction level detail.

As noted above, FMS Form 6653 reconciliations were performed to the detail transaction level through June 2002 for 73 percent of its Treasury symbols. Only 34 percent of its Treasury symbols were reconciled at fiscal yearend. OCFO/NFC adjusted its records to agree with FMS Form 6653 for its serviced agencies without reconciling the differences. We found that over $(180) million, net, of yearend adjustments were not supported by transaction level detail.

These balances should not be adjusted without reconciling the details. In addition, for shared appropriations (more than one agency has authority to spend from the appropriation) there was no process in place to ensure that the total amount allocated was reconciled for purposes of reporting at the Treasury symbol level. USDA needs to comply with its procedures to ensure that the accounts are being properly reconciled.

OCFO indicated that, based on progress made to date, this weakness is no longer material. We believe the weakness is material because material misstatements could occur and not be detected in a timely manner by employees in a normal course of performing assigned duties. GAO Special Publication GAO/AIMD-97-104R, "Reconciliation of Fund Balances," states that auditors need to ensure that they determine the magnitude of the agencies unreconciled differences in absolute rather than net value. Unreconciled differences or unsupported adjustments represent potential misstatement of collection or disbursement data, which could materially affect the accuracy of various U.S. government-wide financial statements. This further supports our position that this weakness should remain material until reconciliations are completed at the transaction detail level in a timely manner.

The Department is continuing to work towards resolving these problems. We are making no further recommendations at this time.

IV. IMPROVEMENTS ARE NEEDED IN INFORMATION TECHNOLOGY (IT) SECURITY AND CONTROLS

FINDING NO. 4

RESULTS OF GOVERNMENT INFORMATION SECURITY REFORM ACT (GISRA) AUDIT

As part of our audits on the Department's information technology (IT) security and controls,[2] we identified widespread and serious weaknesses in the Department's ability to adequately protect (1) assets from fraud and misuse, (2) sensitive information from inappropriate disclosure, and (3) critical operations from disruption. Significant information security weaknesses were reported with inadequately restricted access to sensitive data being the most widely reported problem. This and other types of weaknesses identified place critical departmental operations, as well as the assets associated with these operations, at great risk of fraud, disruption, and inappropriate disclosures.

Our audits found that USDA had initiated actions to strengthen IT security in the Department. The Department, through its Chief Information Officer (CIO) had established a Department-wide security program, implemented a departmental security incident response program, and strengthened its oversight function through implementation of program reviews of agencies' security programs. Despite these actions, the Department had still not reached its goal of adequately securing its critical IT resources.

Our audits disclosed the following IT security weaknesses within the Department:

- The Department and its agencies are not in compliance with OMB Circular A-130, Appendix III, "Security of Federal Automated Information Resources," and Presidential Decision Directive (PDD) 63, "Policy on Critical Infrastructure Protection," including preparation of security plans for all their major applications, conducting risk assessments, establishing disaster recovery plans, and implementing a system certification/authorization process.

- Historically, USDA agencies and departmental staff offices have separately addressed their respective IT security and infrastructure needs. These isolated approaches have resulted in a broad array of technical and physical solutions that do not assure that complete

[2] Audit Report No. 50099-50-FM, "Government Information Security Reform Act – Fiscal Year 2002," dated, September 2002.

Department-wide security is obtained. The efforts of the Office of the Chief Information Officer (OCIO) and OIG in the past few years have heightened program management's awareness for the need to plan and implement effective IT security; however, much more is needed to ensure that the Department's critical IT resources are effectively managed and secured. The lack of agency management's involvement in their systems' security planning and implementation was a material weakness reported by both the OCIO and OIG in last year's GISRA report. And while most agencies have taken steps to begin improving their security programs, our reviews in fiscal year 2002 continue to show that continued program management involvement is needed to effectively implement a strong IT security program.

- Our audits continue to disclose that most agencies do not have adequate physical and logical access controls in place over their IT resources. Agencies have not ensured that critical network components are located in secured areas, that only properly authorized users have access to network resources, and that users' access authority is related to the performance of their job functions. In today's increasingly interconnected computing environment, inadequate access controls can expose an agency's information and operations to attacks from remote locations by individuals with minimal computer or telecommunications resources and expertise. As a result, confidential systems are vulnerable to potential fraud and misuse, inappropriate disclosure, and potential disruption.

- We continue to identify numerous vulnerabilities in agencies' systems despite the Department's purchase of a Department-wide license of a commercially available vulnerability scanner product. Using this software program we identified over 3,063 potentially high and medium-risk[3] vulnerabilities in 963 network components in 6 agencies scanned during our audits. While OCIO has reported to us that agencies have increased their use of the scanning tool, agencies need to incorporate the regular use of this tool in their security program. The lack of effective use of this tool leaves the Department's systems vulnerable to both internal and external threats, including Internet hackers, jeopardizing the integrity and confidentiality of the Department's critical program, financial, and economic data.

[3] High-risk vulnerabilities are those that provide access to the computer, and possibly the network of computers. Medium-risk vulnerabilities are those that provide access to sensitive network data that may lead to the exploitation of higher-risk vulnerabilities. Low-risk vulnerabilities are those that provide access to sensitive, but less significant network data.

FINDING NO. 5

RESULTS OF NATIONAL INFORMATION TECHNOLOGY CENTER (NITC) INTERNAL CONTROL AUDIT

Our audit resulted in a qualified opinion on the internal control structure of OCIO/NITC.[4] We concluded that, except for the deficiencies described below, the policies and procedures, as described, are suitably designed to provide reasonable assurance that the control objectives would be achieved if the described policies and procedures were complied with satisfactorily.

NITC continues to take actions toward complying with Federally mandated security requirements, but additional actions are needed. NITC has made a concerted effort toward completion of risk assessments, which is an important step toward improving security. With the completion of risk assessments imminent, NITC should be able to focus resources toward completion of other Federally mandated security requirements. Specifically, NITC had not:

- Addressed all security program planning requirements prescribed by OMB Circular A-130, Appendix III, "Security of Federal Automated Information Resources," dated November 30, 2000, and NIST Special Publication 800-18, "Guide for Developing Security Plans for Information Technology Systems," dated December 1998;

- updated contingency plans to reflect deficiencies identified during its testing process;

- documented system security check procedures to ensure all tests are performed consistently; and

- provided the training needed by its security staff to properly maintain and monitor its systems.

NITC had improved its controls over logical access to its systems, but additional actions are needed to ensure resource security. We noted instances where NITC had not:

- Removed separated employees' remote access accounts;

- followed departmental procedures for password settings;

- documented users with special access privileges;

[4] Audit Report No. 88099-4-FM, "National Information Technology Center – General Controls Review Fiscal Year 2002."

- documented security software parameters;
- developed and implemented security log monitoring policies and procedures; and
- completed the implementation of secure Internet access.

We also noted where NITC was not always following its current written policies in place for identifying, selecting, installing, and modifying system software, for both routine and emergency changes. For example, we noted the lack of an audit trail to support the approval and testing of system modifications. Generally, these conditions exist because NITC has allowed agencies to establish their own account restrictions, and because NITC has not placed a priority on documenting its system software changes.

The OCIO has informed us that it disagrees with the qualified opinion on NITC's internal control structure. OCIO asserted that, in its judgment, the weaknesses we cite were not material or significant to warrant a qualified opinion. We believe that our findings regarding noncompliance with OMB Circular A-130, logical access controls, and system software change controls are material weaknesses. While we recognize that improvements have been made in these areas, additional efforts are needed.

FINDING NO. 6

RESULTS OF NFC INTERNAL CONTROL AUDIT

Our audit of the OCFO/NFC internal control structure noted that while OCFO/NFC has made significant progress in addressing security weaknesses, its information security program still needs improvement.[5] We noted that: OCFO/NFC needs to update its network map and list of Internet Protocol (IP) addresses, implement system security plans for major applications, improve its monitoring of system accesses in selected applications, and improve controls over changes made to its applications. Senior program management needs to continue its involvement in the planning and implementation of overall system security. OCFO/NFC's ability to accomplish its mission could be jeopardized if it does not properly manage and secure its IT infrastructure.

The foundation for security over IT resources is found in OMB Circular A-130, Appendix III, "Security of Federal Automated Information Resources." This circular establishes a minimum set of controls for agencies' automated information security programs. Further, PDD 63,

[5] Audit Report No. 11401-13-FM, "Fiscal Year 2001 – 2002 National Finance Center Review of Internal Control Struture."

"Policy on Critical Infrastructure Protection," requires agencies to assess the risks to their networks and establish a plan to mitigate the identified risks.

Specifically, we noted the following.

- We conducted an internal security assessment of the OCFO/NFC network using a commercial off-the-shelf software product designed to identify vulnerabilities associated with various operating systems. The results were favorable and showed significant improvement from past security assessments. OCFO/NFC performs routine security scans and immediately corrects issues as identified. We did, however, note that OCFO/NFC does not have an updated network map or an updated list of IP addresses. We identified IP addresses that were active, but not on the list, and IP addresses that were inactive, but not removed from the network. OCFO/NFC had not made the maintenance of its map or IP address listing a top priority, because they relied on the on-line log for updated information. Without these control documents in place, unknown or unauthorized systems could be attached to its network, thereby hindering OCFO/NFC's ability to properly monitor and secure its network resources.

- We determined that OCFO/NFC performed risk assessments and developed annual security plans for its general support systems. However, OCFO/NFC had not developed individual system security plans for five of the major applications owned by OCFO/NFC. OCFO/NFC had interpreted the security plan guidance issued by USDA's Associate CIO for the Office of Cyber Security as only requiring the preparation of an overall plan and a plan for each of its general support systems. OCFO/NFC has since received clarification from OCIO, as a result of our audit, and has planned to develop the security plans. In addition, OCFO/NFC had not performed security risk assessments for these five systems. Without security plans for major applications, OCFO/NFC faces increased risk that its systems are not secured in a manner that adequately prevents inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction of the financial transaction data and personnel information.

- We continue to identify weak access controls in OCFO/NFC applications, including the payroll/personnel systems, the FFIS general ledger system, and an online database utility that allows overall access to OCFO/NFC applications.

  OCFO/NFC had not ensured that only properly authorized users have access to resources, and that users' access authority is related to the performance of their job functions. In today's increasingly interconnected computing environment, inadequate access controls can expose an agency's information and operations to attacks from remote locations by individuals with minimal computer or telecommunications resources and expertise. We noted where OCFO/NFC had not adequately restricted access to payroll transactions and sensitive personnel information in seven systems used to process payroll/personnel data because the systems were developed as "update only" systems and "read only" access was not available. OCFO/NFC has taken actions to mitigate this weakness.

- We found that OCFO/NFC needed to strengthen its controls over obtaining user approval of functional requirements, documenting software testing and performing acceptance testing. This testing determines if the software satisfies the requirements of the system owners, users, and operators. Also, OCFO/NFC had not sufficiently limited "emergency" changes, which are high-risk program modifications because full testing is waived prior to implementation.

This report is intended solely for the information and use of the management of USDA, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Phyllis K. Fong

Phyllis K. Fong
Inspector General

January 7, 2003

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

REPORT OF THE OFFICE OF INSPECTOR GENERAL ON COMPLIANCE WITH LAWS AND REGULATIONS

TO: Edward R. McPherson
Chief Financial Officer
Office of the Chief Financial Officer

We have audited the principal financial statements of USDA as of and for the fiscal year ended September 30, 2002, and have issued our report thereon, dated January 7, 2003. We conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in the "Government Auditing Standards," issued by the Comptroller General of the United States; and OMB Bulletin 01-02, "Audit Requirements for Federal Financial Statements." Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of USDA is responsible for compliance with laws and regulations applicable to it. As part of obtaining reasonable assurance about whether the principal financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin 01-02. We limited our tests of compliance and did not test compliance with all laws and regulations applicable to USDA. We tested compliance with:

- Anti-Deficiency Acts of 1906 and 1950;
- Budget and Accounting Procedures Act of 1950;
- Chief Financial Officers Act of 1990;
- Debt Collection Improvement Act of 1996;
- Federal Credit Reform Act of 1990;
- Federal Financial Management Improvement Act of 1996;
- Federal Managers' Financial Integrity Act of 1982;
- Government Management Reform Act of 1994; and
- Government Performance and Results Act of 1993.

As part of the audit, we reviewed management's process for evaluating and reporting on internal control and accounting systems, as required by the Federal Managers' Financial Integrity Act (FMFIA), and compared the most recent FMFIA reports with the evaluation we conducted of USDA's internal control structure. We also reviewed and tested policies, procedures, and systems for documenting and supporting financial, statistical, and other information presented in the Management Discussion and Analysis section. However, providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

Under the Federal Financial Management Improvement Act (FFMIA), we are required to report whether USDA's financial management systems substantially comply with Federal Financial Management Systems Requirements (FFMSR), applicable Federal accounting standards, and the U.S. Government SGL at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA, Section 803(a) requirements. The results of our tests disclosed instances where selected components of the overall financial management system did not substantially comply with these requirements.

Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in law or regulations that cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the financial statements, or the sensitivity of the matter would cause it to be perceived as significant by others. Material instances of noncompliance noted during our audit are presented in the "Findings" section of this report.

FINDINGS

V. USER FEE COST ACCOUNTING IMPROVEMENTS ARE IN PROCESS

FINDING NO. 7

USDA EFFORTS TO COMPLY WITH MANAGERIAL COST ACCOUNTING STANDARDS ARE ONGOING

In last year's audit we reported that the Department's systems were not designed to provide sufficient and relevant cost information required to comply with the SFFAS No. 4, "Managerial Cost Accounting Concepts and Standards," effective September 30, 1996. This statement is aimed at providing reliable and timely information on the full cost of Federal programs, activities, and outputs. This information can be used by Congress and Federal executives in making decisions about allocating resources, authorizing and modifying programs, evaluating program performance, and making managerial decisions to improve economy and efficiency. We reported that USDA was unable to provide reliable and timely cost information. Specifically, our review[6] of the accounting for user fees at two selected agencies disclosed that both agencies were not including the full costs of their user fee programs when determining fees. In addition, the Things of Value[7] as reported to the OCFO were reported at the summary level, in some cases, rather than individually.

In response to last year's audit, the Department commissioned an analysis of cost management and user fee practices in 11 of its agencies. The analysis noted strengths and weaknesses in USDA's current cost accounting capabilities. For example, the analysis found that through its ongoing cost accounting and user fee efforts, USDA is taking positive steps to develop management tools to support program managers in the delivery of their services. The analysis also noted "inconsistencies by agencies in how they conduct cost and user fee accounting."

According to its analysis, the Department plans to begin studying each agency's reporting structure and issuing consistent guidance on the system to use for managerial cost accounting and how the chosen system

[6] We reviewed the most current user fees review performed by the agencies.

[7] Things of Value are defined as tangible and intangible goods, services, benefits, commercial functions, programs, and reimbursable activities provided to nonfederal entities and people.

needs to be organized to produce useful information and reports. In addition, USDA plans to identify the specific cost elements that need to be captured.

Because of corrective actions currently underway, we are not making any additional recommendations in this report.

VI. SUBSTANTIAL NONCOMPLIANCE WITH FFMIA REQUIREMENTS

FINDING NO. 8

The Department has successfully implemented its Foundation Financial Information System, FFIS. As a result, it is now in substantial compliance with the requirements of FFMIA for its program and administrative functions within FFIS. However, USDA's financial management systems, taken as a whole, do not yet substantially comply with these FFMIA requirements. We continue to note that USDA's systems do not comply with FFMSR, Federal accounting standards, and the SGL at the transaction level. We concluded that USDA:

- Cannot rely on information produced directly from its general ledger to prepare its financial statements;
- does not have an integrated general ledger that conforms to SGL;
- lacks a subsidiary ledger for some of its material financial statement line-items; and
- lacks an effective audit trail from its general ledger back to some subsidiary detailed records and transaction source documents.

As a result, USDA's overall financial management systems cannot produce auditable financial statements and related disclosures that conform with generally accepted accounting standards without substantial compensating processes and significant adjustments. This lack of compliance is due to the use of disparate accounting systems that are not integrated as well as longstanding material internal control weaknesses. This noncompliance reduces the Department's ability to efficiently and effectively manage its day-to-day operations and provide accountability to taxpayers. The Department continues to make progress in achieving compliance with the Act.

The FFMIA provides that an agency of the Federal Government will be considered to be in substantial compliance with financial management system requirements if among other issues:

- Agency financial information systems meet the OMB Circular A-127 requirements.

- The agency can prepare audited financial statements in accordance with applicable accounting standards.
- The agency can comply with the SGL.

According to the FFMIA, substantial noncompliance with the requirements in any one or more of the three areas included in FFMIA would result in substantial noncompliance with the Act.

The USDA's financial management systems do not meet the OMB Circular A-127 requirement that each agency establish and maintain a single, integrated financial management system. The financial management systems also do not follow requirements published in JFMIP's FFMSR series, which prescribe the functions that must be performed by systems to capture information for financial statement preparation.

USDA's FFMIA Remediation Plan, dated September 30, 2002, identified agencies that are in need of substantial financial management system improvements, including areas of planned remedial actions, along with planned completion dates, to resolve their financial management problems. Last year's plan showed that remedial actions were to be completed by the end of fiscal year 2004. This date has been extended to the end of fiscal year 2006 in the current plan.

OCFO indicated that while improvements are needed, it believes that the Department, as a whole, substantially complies with FFMIA. We continue to believe that significant nonconformances noted with the audits of USDA component agencies constitute substantial noncompliance.[8] We are committed to working with OCFO to resolve this issue.

[8] Audit Report No. 05401-11-FM, "Risk Management Agency Federal Crop Insurance Corporation's Financial Statements for Fiscal Year 2002," Audit Report No. 06401-15-FM, "Commodity Credit Corporation's Financial Statements for Fiscal Year 2002," Audit Report No. 85401-5-FM, "Rural Development Financial Statements for Fiscal Year 2002," and Audit Report No. 08401-1-FM, "Forest Service Financial Statement Audit for Fiscal Year 2002."

VII. PROGRESS IN COMPLIANCE WITH DEBT COLLECTION IMPROVEMENT ACT REQUIREMENTS

FINDING NO. 9

The Debt Collection Improvement Act (DCIA) of 1996 provides (1) a requirement for Federal agencies to notify Treasury of eligible debts delinquent over 180 days for purposes of centralized administrative offset, (2) a requirement for agencies to refer such debts to Treasury for centralized collection action known as cross-servicing, and (3) authorization for agencies to administratively garnish the wages of delinquent debtors.

We noted that the Commodity Credit Corporation's (CCC) policy for monitoring receivables should be improved. CCC did not always convert receivables older than 60 days to claims status and subsequently refer such claims to a centralized debt servicing system and/or the Treasury offset program, when applicable.[9]

In February 2002, GAO reported that USDA's Rural Housing Service (RHS) had not yet fully implemented certain key provisions of the Act. For example, while RHS had ongoing initiatives to enhance its capacity to timely refer all delinquent debt, the agency's failure to make DCIA a priority since its enactment in 1996 had left several provisions of the Act not yet implemented. As of the end of fiscal year 2000, RHS had referred virtually no direct Single Family Housing loans to the Department of Treasury's FMS for cross servicing.

In its November 2002 testimony, GAO reported that RHS has worked to address system limitations that hampered it from promptly referring debts to Treasury for cross-servicing and is now, according to Treasury, referring all reported eligible debt.

GAO noted that for USDA to fully address all DCIA implementation problems it will take a sustained commitment and priority by top management. We are making no further recommendations at this time.

[9] Audit Report No. 06401-15-FM, "Commodity Credit Corporation's Financial Statements for Fiscal Year 2002."

We considered these material instances of noncompliance in forming our opinion on whether the fiscal year 2002 principal financial statements of USDA are presented fairly, in all material respects, and this report does not modify the unqualified opinion expressed in our report, dated January 7, 2003.

This report is intended solely for the information of the management of USDA, OMB and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Phyllis K. Fong

Phyllis K. Fong
Inspector General

January 7, 2003

ABBREVIATIONS

AICPA	American Institute of Certified Public Accountants
AWG	Administrative Wage Garnishment
CAS	Central Accounting System
CCC	Commodity Credit Corporation
CFO	Chief Financial Officers Act
CIO	Chief Information Officer
CO	Conservation Operation
DCIA	Debt Collection Improvement Act
DR	Departmental Regulation
FASAB	Federal Accounting Standards Advisory Board
FBWT	Fund Balance with Treasury
FFIS	Foundation Financial Information System
FFMIA	Federal Financial Management Improvement Act
FFMSR	Federal Financial Management Systems Requirements
FMFIA	Federal Managers' Financial Integrity Act
FMS	Financial Management Service
FS	Forest Service
FSDW	Financial Statement Data Warehouse
GAO	General Accounting Office
GISRA	Government Information Security Reform Act
GPRA	Government Performance and Results Act
IP	Internet Protocol
IT	Information Technology
JFMIP	Joint Financial Management Improvement Program
JV	Journal Voucher
MD&A	Management Discussion and Analysis
NFC	National Finance Center
NIST	National Institute of Standards and Technology
NITC	National Information Technology Center
OCFO	Office of the Chief Financial Officer
OCIO	Office of the Chief Information Officer
OIG	Office of the Inspector General
OMB	Office of Management and Budget

PDD	Presidential Decision Directive
PROP	Personal Property Management System
RHS	Rural Housing Service
RSSI	Required Stewardship Supplement Information
SF	Standard Form
SFFAS	Statement of Federal Financial Accounting Standards
SGL	Standard General Ledger
SV	Standard Voucher
USDA	U.S. Department of Agriculture

USDA

United States Department of Agriculture

Office of the Chief Financial Officer

1400 Independence Avenue, SW

Washington, DC 20250

JAN 17 2003

Phyllis K. Fong
Inspector General
United States Department of Agriculture
Office of Inspector General
Washington, DC 20250

Dear Ms. Fong,

This letter responds to the Office of Inspector General opinion on the Department of Agriculture's fiscal year 2002 consolidated financial statements, Report Internal Control Structure, and the Report on Compliance with Laws and Regulations. We concur with your findings and recommendations.

We are pleased that your report reflects an unqualified, or "clean," audit opinion for the Department.

We appreciate that the report documents that the Department has made notable progress in improving its overall financial management during fiscal year 2002. As you recommend, we will continue to implement our long-term plans to address the remaining weaknesses in the Department's financial management accountabilities.

I would like to thank your office for its continuing professionalism during the course of the audit.

Please direct any questions on our comments to Joseph B. Marshall, Associate Chief Financial Officer, Financial Policy and Planning at (202) 720-8345.

Sincerely,

Edward R. McPherson

Edward R. McPherson
Chief Financial Officer

AN EQUAL OPPORTUNITY EMPLOYER