Part B

FINANCIAL SECTION

Message From the Chief Financial Officer

The Forest Service, an agency of the U.S. Department of Agriculture (USDA), continued its high standard of financial management and reporting during the past fiscal year. As Chief Financial Officer for the Forest Service, I am proud to present the Fiscal Year 2008 results for our stewardship and management of the public funds entrusted to the Agency.

During FY 2008, the Forest Service took the steps necessary to ensure that

- Programs operate efficiently and effectively;
- Obligations and costs comply with applicable laws and regulations;
- Funds, property, and other assets are safeguarded against waste, loss, or mismanagement; and
- Revenues and expenditures are properly recorded and accounted for to permit the preparation of reliable financial and statistical reports and to maintain accountability over assets.

The Forest Service's annual evaluation, conducted at all levels throughout the agency, indicated that agency controls are achieving intended objectives. During FY 2008, internal controls provide reasonable assurance that the above-mentioned objectives have been met.

Our success has been a joint effort of Forest Service managers, employees, and partners as we strive for excellence in financial accountability. Highlights of major accomplishments in FY 2008 included:

- An unqualified opinion on the principal financial statements for a seventh consecutive year
- No material weaknesses
- Complied with OMB Circular A-123, Management's Responsibility for Internal Control for the third consecutive year

Although the Forest Service did not resolve all information security weaknesses as planned for FY 2008, the agency made significant progress in implementing the necessary corrective actions to resolve remaining deficiencies.

Highlights were in the areas of:

Vulnerability Assessment: Forest Service revamped the patch management process by formalizing procedures to identify and categorize vulnerabilities by severity. Once categorized, a risk-based approach to remediation occurs.

Change Control: The agency maintained documentation of policies and procedures, testing, approval, and logs.

Entity Wide Security: The agency made progress in completing Certification and Accreditation packages as required.

The Forest Service will continue with plans to complete the correction of deficiencies in information security controls in FY 2009. The Forest Service has and will continue to see improvements in its control systems. This is evidenced by the external auditor determination of improvements in controls, less substantive testing, and improved operating effectiveness of internal controls over financial reporting. In addition, the Forest Service's A-123 assessments support this conclusion.

JESSE L. KING
Chief Financial Officer

USDA

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

NOV 13 2008

REPLY TO
ATTN OF: 08401-9-FM

TO: Abigail Kimbell
Chief
Forest Service

ATTN: Sandy Coleman
Agency Liaison Officer
Forest Service

Jennifer McGuire
Branch Chief and Acting Audit Liaison Officer
Forest Service

FROM: Robert W. Young
Assistant Inspector General
for Audit

Robert W. Young

SUBJECT: Forest Service's Financial Statements for Fiscal Years 2008 and 2007

This report presents the auditors' opinion on Forest Service's (FS) consolidated financial statements for the fiscal years ending September 30, 2008, and 2007. The report also includes an assessment of FS' internal control structure and compliance with laws and regulations.

KPMG LLP (KPMG) an independent certified public accounting firm, conducted the audits. In connection with the contract, we reviewed KPMG's report and related documentation and inquired of its representatives. Our review, as differentiated from an audit in accordance with *Government Auditing Standards* (issued by the Comptroller General of the United States), was not intended to enable us to express, and we do not express, opinions on FS' financial statements, internal control or on whether FS' financial management systems substantially complied with the Federal Financial Management Improvement Act (FFMIA); or conclusions on compliance with laws and regulations. KPMG is responsible for the attached auditor's report, dated November 10, 2008, and the conclusions expressed in the report. However, our review disclosed no instances where KPMG did not comply, in all material respects, with generally accepted *Government Auditing Standards*, and the Office of Management and Budget Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

It is the opinion of KPMG, that the financial statements present fairly, in all material aspects, FS' financial position as of September 30, 2008, and 2007; and its net costs, changes in net position, and budgetary resources for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The KPMG report on FS' internal control structure over financial reporting identified eight significant deficiencies. Specifically, KPMG identified weaknesses in FS':

- General controls environment;
- policy and procedures for financial management and reporting of wildland fire activity;
- management review of credit card transactions and controls over the programs;
- physical inventory policies and procedures of pooled real property;
- accountability for unliquidated obligations;
- internal controls over its environment and disposal liabilities;
- internal controls for revenue related transactions; and
- the period-end accrual processes.

KPMG did not consider any of the above significant deficiencies to be material weaknesses.

KPMG's report on FS' laws and regulations disclosed instances of noncompliance with appropriation law, FFMIA and a follow up on a fiscal year 2006 Anti-Deficiency Act violation.

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's 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.

Independent Auditors' Report

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Two Park Square
6565 Americas Parkway NE
PO Box 3990
Albuquerque, NM 87190

Independent Auditors' Report

Chief, U.S. Forest Service and
Inspector General, United States Department of Agriculture:

We have audited the accompanying consolidated balance sheets of the United States (U.S.) Forest Service (an agency of the United States Department of Agriculture) as of September 30, 2008 and 2007 and the related consolidated statements of net cost, and changes in net position, and the combined statements of budgetary resources (hereinafter referred to as the "financial statements") for the years then ended. The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our fiscal year 2008 audit, we also considered the U.S. Forest Service's internal controls over financial reporting and tested the U.S. 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 U.S. Forest Service's financial statements as of and for the years ended September 30, 2008 and 2007, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the financial statements, in the year ended September 30, 2008, the U.S. Forest Service reclassified National Forest System (NFS) road assets (road prisms) from General Property Plant and Equipment (PP&E) to Stewardship PP&E.

As stated in our opinion on the financial statements, we concluded that the U.S. Forest Service's Required Supplementary Information related to deferred maintenance is lacking internal controls to ensure the accuracy, completeness, timeliness and consistency of the reported information.

Our consideration of internal controls over financial reporting resulted in the following conditions being identified as significant deficiencies. However, none of the significant deficiencies are believed to be material weaknesses.

- The U.S. Forest Service Needs to Continue to Improve its General Controls Environment
- The U.S. Forest Service Needs to Develop Comprehensive Policy and Procedures for Financial Management and Reporting of Wildland Fire Activity
- Management Review of Credit Card Transactions and Controls Over the Programs Need Continued Improvement
- Physical Inventory Policies and Procedures of Pooled Real Property Need to be Developed
- Accountability for Unliquidated Obligations (ULOs) Needs Continued Improvement

- The U.S. Forest Service Needs to Improve Internal Controls and Management Oversight for Environmental and Disposal Liabilities (EDL)
- The U.S. Forest Service Needs to Improve Internal Controls over Revenue Related Transactions
- The U.S. Forest Service Needs to Refine its Period-end Accrual Processes

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), 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. 07-04, *Audit Requirements for Federal Financial Statements*.

- The U.S. Forest Service Continues to Not Obligate all Transactions Required by Appropriations Law
- The Government Accountability Office Made a Final Determination as to the U.S. Forest Service's Fiscal Year 2006 Non-Compliance with 31 USC 1517

The results of our tests of FFMIA disclosed instances where the U.S. Forest Service's financial management systems did not substantially comply with Federal Financial Management System Requirements and the U.S. Standard General Ledger.

The results of our tests of FFMIA disclosed no instances in which the U.S. Forest Service's financial management systems did not substantially comply with applicable Federal Accounting Standards.

The following sections discuss our opinion on the U.S. Forest Service's financial statements, our consideration of the U.S. Forest Service's internal controls over financial reporting; our tests of the U.S. 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 U.S. Forest Service as of September 30, 2008 and 2007 and the related consolidated statements of net costs, and changes in net position, and the combined statements of budgetary resources (hereinafter referred to as the "financial statements") 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 U.S. Forest Service as of September 30, 2008 and 2007, and its net costs, changes in net position, and budgetary resources for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the financial statements, in the year ended September 30, 2008, the U.S. Forest Service reclassified National Forest System (NFS) road assets (road prisms) from General PP&E to Stewardship PP&E.

The information in the Management's Discussion and Analysis, Required Supplementary Information, and Required Supplementary Stewardship Information sections is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles. 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 is lacking internal controls to ensure the accuracy, completeness, timeliness and consistency of the reported information.

The information in the Other Accompanying Information section is presented for purposes of additional analysis and is not required as part of the financial statements. This information has not been subjected to auditing procedures and, accordingly, we express no opinion on it.

Internal Control Over Financial Reporting

Our consideration of the internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the U.S. Forest Service's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the U.S. Forest Service's financial statements that is more than inconsequential will not be prevented or detected by the U.S. Forest Service's internal control. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the U.S. Forest Service's internal control.

In our fiscal year 2008 audit, we consider the deficiencies described in Exhibit I to be significant deficiencies in internal control over financial reporting. However, we believe that none of the significant deficiencies described in Exhibit I are material weaknesses. Exhibit II presents the status of prior year significant deficiencies, including those open conditions on which we are making no further recommendations in this report.

We noted certain additional matters that we have reported to management of the U.S. Forest Service in a separate letter dated November 10, 2008.

Compliance and Other Matters

The results of certain of our tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996 (*FFMIA)*,* disclosed noncompliance with appropriation law, and a resolved 2006 violation of 31 U.S.C. 1517 as described in Exhibit III that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

The majority of the deficiencies for noncompliance with appropriation law result from the U.S. Forest Service's travel system limitations. The U.S. Forest Service's current system does not allow it to obligate funds for temporary duty travel.

The results of our other tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed no other instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04.

The results of our tests of FFMIA disclosed instances, described in Exhibit III, where the U.S. Forest Service's financial management systems did not substantially comply with Federal financial management system requirements and the U.S. Standard General Ledger at the transaction level. Exhibit IV provides the status of prior year's non-compliance findings and other matters, including those open conditions on which we are making no further recommendations in this report.

The results of our tests of FFMIA disclosed no instances in which the U.S. Forest Service's financial management systems did not substantially comply with applicable Federal Accounting Standards.

We noted certain additional matters that we have reported to management of the U.S. Forest Service in a separate letter dated November 10, 2008.

* * * * * * *

Responsibilities

Management's Responsibilities. Management is responsible for the financial statements; establishing and maintaining effective internal control; and complying with laws, regulations, contracts, and grant agreements applicable to the U.S. Forest Service.

Auditors' Responsibilities. Our responsibility is to express an opinion on the fiscal year 2008 and 2007 financial statements of the U.S. 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. 07-04. Those standards and OMB Bulletin No. 07-04 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 control 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 U.S. 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 2008 audit, we considered the U.S. Forest Service's internal control over financial reporting by obtaining an understanding of the U.S. Forest Service's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our audit procedures for the purpose of expressing our opinion on the financial statements. 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 express an opinion on the effectiveness of the U.S. Forest Service's internal controls over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the U.S. Forest Service's internal control over financial reporting.

As part of obtaining reasonable assurance about whether the U.S. Forest Service's fiscal year 2008 financial statements are free of material misstatement, we performed tests of the U.S. 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. 07-04, 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 U.S. 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.

The U.S. Forest Service's response to the findings identified in our audit is presented in Exhibit V. We did not audit the U.S. Forest Service's response and, accordingly, we express no opinion on it.

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

November 10, 2008

INTRODUCTION TO EXHIBITS

The U.S. Forest Service continues to make progress in closing out its prior year audit recommendations and minimizing new audit recommendations. During the fiscal year (FY) 2007 audit, a material weakness was reported in the U.S. Forest Service's information technology (IT) area. However during the FY 2008 audit, significant improvement was noticed in the IT area. Given the level of remediation that occurred prior to and during FY 2008, we have determined that the prior year material weakness will be downgraded to a significant deficiency. While the U.S. Forest Service has taken significant strides in its efforts to centralize and improve its IT functions, more actions are necessary to fully address the deficiencies identified as well as to ensure an appropriate level of confidentiality, integrity, and availability of critical information systems and resources.

We continue to recognize that certain recommended IT control enhancements pertaining to the U.S. Forest Service's operations cannot be implemented solely by the U.S. Forest Service, because the U.S. Forest Service's applications are in many cases hosted on United States Department of Agriculture (USDA) managed systems. As a result, several IT control deficiencies identified in this report will continue to require the combined effort of USDA and the U.S. Forest Service management.

Exhibit I presents the significant deficiencies as of and for the year ended September 30, 2008. Exhibit II of this report summarizes the current year status of prior year recommendations. Exhibit III provides an update of those instances of noncompliance with laws and regulations and other matters and applicable new instances of noncompliance. Exhibit IV summarizes the status of prior year recommendations for noncompliance with laws and regulations and other matters. The U.S. Forest Service management's response is presented in Exhibit V.

SIGNIFICANT DEFICIENCIES

Number 1: The U.S. Forest Service Needs to Continue to Improve its General Controls Environment (*Downgraded - Repeat Condition)*

During FY 2008, the U.S. Forest Service took positive steps to implement management, operational, and technical controls to help establish sound information security practices and address prior year findings. The agency has embarked on the final phase of a three-phased corrective action plan for addressing known weaknesses. In FY 2007, a number of control weaknesses were identified in the U.S. Forest Service's general control environment and were categorized as an overall material weakness because of the critical nature of the findings. However in FY 2008, a number of improvements in each of the four areas that comprised the prior year material weakness were noted.

- Vulnerability Assessment

The U.S. Forest Service has revamped its patch management process by formalizing procedures to identify and categorize vulnerabilities by severity. Once categorized, a risk-based approach to remediation occurs. The vulnerabilities identified this year were more recent in nature as compared to years past when a significant number of outdated patches were missing. Additionally, the total number of vulnerabilities identified decreased by 66% from FY 2007 to FY 2008.

The U.S. Forest Service's internet-facing external presence is very secure and 99% of the identified vulnerabilities would require an individual to be present on the internal network, which reduces the risk of exploitation. Finally, the U.S. Forest Service provided corrective action evidence for roughly half of the patch and configuration management issues identified this year.

- Change Control

All prior year issues were noted as being closed prior to the beginning of FY 2008. Additionally, no new issues were identified during audit testwork this year.

- Entity-wide Security

Most of the components of the certification and accreditation (C&A) packages were completed early during FY 2008. The U.S. Forest Service has had difficulties in obtaining the C&A packages for authorization by USDA because of missing components that are required by the department. The formalization process will be more efficient once the U.S. Forest Service has a firm grasp of the required components of the C&A packages. Finally, all prior-year issues that were initially noted as being open this FY have since been corrected during fieldwork.

- Segregation of Duties

The number of individuals with excessive access to the Oracle Password Database has decreased from 27 to 12. U.S. Forest Service management has stated that access to the operating system level password is a requirement for their database administrators to perform their job functions. U.S. Forest Service management is in the process of implementing Net Forensics, which is a tool that will track actions of users with privileged access. Once fully implemented, this tool will provide a compensating control to the segregation of duties issues identified.

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U.S. Forest Service Systems are Vulnerable to Unauthorized Access

During the vulnerability assessment phase of our audit, we noted the following high-level categories of findings:

Patch Management:

- 45 various buffer overflow, remote code execution, Denial of Service (DoS), and cross-site scripting vulnerabilities related to outdated and/or unpatched versions of software were identified on 85 hosts. During the audit, the U.S. Forest Service provided evidence of remediation indicating the correction of 34 vulnerabilities on 60 hosts.
- Four various DoS vulnerabilities related to outdated and/or unpatched versions of software were identified on four hosts. During the audit, the U.S. Forest Service provided evidence of remediation, indicating the correction of two DoS vulnerabilities on two hosts.
- Three various session hijacking or information leakage vulnerabilities related to outdated and/or unpatched versions of software were identified on 48 hosts. During the audit, the U.S. Forest Service provided evidence of remediation, indicating the correction of various session hijacking or information leakage vulnerabilities on 35 hosts.
- Five various cross-site scripting vulnerabilities related to outdated and/or unpatched versions of software were identified on 11 hosts. During the audit, the U.S. Forest Service provided evidence of remediation, indicating the correction of various cross-site scripting vulnerabilities on 2 hosts.

Configuration Management:

- Five instances of allowing anonymous access to information File Transfer Protocol (FTP), Trivial File Transfer Protocol (TFTP), X11, and Virtual Network Computing (VNC) servers were identified on 25 hosts. During the audit, the U.S. Forest Service provided evidence of remediation, indicating the correction of one instance of allowing anonymous access on 19 hosts.
- Five cross-site scripting vulnerabilities related to improper configuration of software were identified on 64 hosts (two identified through external review). During the audit, the U.S. Forest Service provided evidence of remediation, indicating the correction of two cross-site scripting vulnerabilities on 44 hosts.
- One man-in-the-middle vulnerability related to improper configuration of software was identified on 46 hosts. During the audit, the U.S. Forest Service provided evidence of remediation, indicating the correction of man-in-the-middle vulnerabilities on 14 hosts.
- One session hijacking or information leakage vulnerability related to improper configuration of software was identified on one host.
- Two buffer overflow, remote code execution, DoS, and cross-site scripting vulnerabilities related to improper configuration of software were identified on three hosts. During the audit, the U.S. Forest Service provided evidence of remediation for one vulnerability, indicating the correction of one buffer overflow, remote code execution, denial of service, and cross-site scripting vulnerability on two hosts.
- We identified FTP and/or telnet login screens that did not have government warning banners on 75 hosts. During the audit, the U.S. Forest Service provided evidence of remediation, indicating the correction of warning banners on 58 hosts.
- One vulnerability in which password policy was not configured in accordance with U.S. Forest Service policy on 75 hosts was identified. During the audit, the U.S. Forest Service provided evidence of remediation, indicating the correction of password compliance on four hosts.
- One vulnerability in which default passwords were configured on four hosts; and one vulnerability in which five hosts contained services with null passwords was identified. During the audit, the U.S. Forest Service

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provided evidence of remediation, indicating the correction of default passwords on four hosts, and the correction of null password on four hosts.

Although the U.S. Forest Service is currently conducting quarterly scans to identify vulnerabilities, we noted that systems are not being patched for all the significant identified vulnerabilities.

USDA Departmental Manual (DM) 3535-00, "C2 Controlled Access Protection," Part I, "USDA's C2 Level of Trust," Section 3a, states "A USDA mandatory minimum password length of 6-8 alphanumeric characters will be established. To comply with USDA's C2 Level of Trust, passwords for all general users of systems, applications or processes shall be changed every 60 days. Passwords issued to privileged users (system administrators, system managers, auditors and engineers) will be changed every 30 days. All passwords will be encrypted and dictionary words shall not be used for passwords."

The Office of Management and Budget (OMB) Circular A-130, Appendix III, "Security of Federal Automated Information Resources" states that the agency should implement "Security commensurate with the risk and magnitude of the harm resulting from the loss, misuse, or unauthorized access to or modification of information. This includes assuring that systems and applications used by the agency operate effectively and provide appropriate confidentiality, integrity, and availability, through the use of cost-effective management, personnel, operational, and technical controls." In addition Section 3 requires "Federal agencies to implement and maintain a program to assure that adequate security is provided for all agency information collected, processed, transmitted, stored, or disseminated. Where an agency's application promotes or permits public access, additional security controls shall be added to protect the integrity of the application and the confidence the public has in the application."

The patch management vulnerabilities noted above result from outdated and/or unpatched versions of software running on the servers. The configuration management issues are the result of software and passwords not being configured securely upon implementation. All of these issues stemmed from management not having adequate and timely (i.e., within one month of identification) patching procedures. However, the U.S. Forest Service is currently in the process of refining their patch management procedures, but this process has not yet matured.

The patch management vulnerabilities could potentially allow an attacker to execute arbitrary code with system-level privileges, facilitating the complete compromise of the affected systems. In addition, an attacker could potentially utilize the privileges granted to the affected servers in an attempt to compromise other servers and/or network devices within the U.S. Forest Service network, including financial servers.

In addition, without proper control of user accounts and the associated passwords, the potential exists for unauthorized users to access U.S. Forest Service systems. This risk is elevated when powerful accounts, such as system administration accounts, are assigned easily guessable, blank, or default passwords. These accounts could allow an unauthorized individual unlimited access to a system and cause a loss in availability or integrity of the system.

Finally, a user may execute a man-in-the-middle attack to seamlessly insert themselves into communication streams with the identified servers. The Cross Site Scripting vulnerabilities allow for the theft of cookies, sessions, or execution of malicious scripts appearing to originate from the U.S. Forest Service servers.

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Recommendation Number 1:

We recommend that the U.S. Forest Service management:

A. Improve patch management practices to establish a set frequency for reviewing system patch levels for security weaknesses.

B. Determine if vulnerability scanning procedures need to be refined in order to ensure future issues related to unpatched systems or improper configurations are identified and issues are remedied.

We continue to recognize the need for the U.S. Forest Service to:

- Update its system configuration management baseline and improve system configuration management practices as reported in prior year Recommendation 4 of Audit Report No. 08401-8-FM.
- Develop and implement a patch management policy and configuration management policy to strengthen change controls and system software controls as reported in prior year Recommendation 8 of Audit Report No. 08401-6-FM.
- Develop access controls to improve the management of network accounts as reported in prior year Recommendation 7 of Audit Report No. 08401-6-FM.

Security Planning Controls Need Continued Improvement

Five of 22 major applications and general support systems are operating in production without an Authority to Operate (ATO) or Interim ATO. The financial and non-financial systems without an ATO or Interim ATO follow:

- Application Hosting Environment (AHE);
- Fire Program Analysis System – Phase 2;
- Incident Business System (IBS);
- I-Suite; and
- Planning, Appeals, and Litigation System.

During the audit, the U.S. Forest Service implemented corrective actions for AHE and I-Suite during fieldwork by issuing the ATO in August and July, respectively.

Additionally, specific C&A components were not finalized for the following financial applications:

- Risk assessments for the following systems were noted as in draft and had not been finalized:
  - Financial Transaction Request System (FTRS);
  - IBS;
  - I-Suite; and
  - AHE.

During the audit, the U.S. Forest Service finalized the risk assessments for FTRS, IBS, I-Suite, and AHE. The risk assessment for FTRS was completed in March, I-Suite and AHE were completed in May and IBS was completed in August.

- System security plans for the following systems were noted as draft and had not been finalized:
  - FTRS;
  - IBS;
  - I-Suite; and
  - AHE.

During the audit, the U.S. Forest Service finalized these system security plans. The system security plans for FTRS and IBS were completed in March and August, respectively. System security plans for both I-Suite and AHE were completed in May.

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- Security Test and Evaluations (ST&E) has not been performed for the following systems:
  - IBS;
  - I-Suite; and
  - AHE.

During the audit, the U.S. Forest Service performed and finalized the ST&Es for the three systems noted above during the months of August, December, and May, respectively.

The Forest Service Manual (FSM) 6600, Chapter 6680 – Security of Information, Information Systems, and Information Technology, Section 6682.1 "Risk Management" addresses risk assessments and indicates that "For all information systems operated on behalf of the U.S. Forest Service a risk assessment must be performed…in accordance with direction provided in USDA DM [Department Manual] 3540-001, Risk Assessment Methodology."

FSM Section 6682.5 "System Security Plan" addresses system security plans and indicates that system security plans are to be developed for all general support systems or major applications. Additionally, the guidance indicates that the security plans are to be reviewed annually and updated as necessary in accordance with the National Institute of Standards and Technology (NIST) Special Publication (SP) 800-18, "Guide for Developing Security Plans for Information Technology Systems."

In addition, FSM section 6682.4, "Certification, Accreditation, and Security Assessments Policies and Procedures," states that all [U.S. Forest Service] general support systems and major applications must be certificated and accredited before the beginning of operation, before resuming operation after a major change and at least once every three years. Additionally, the policy states that C&A must be conducted in accordance with the current USDA C&A methodology and other current Federal, Departmental and [U.S. Forest Service] regulations.

NIST SP 800-37, "Guide for Certification and Accreditation of Federal Information Systems," page 1 & 2 states "The Security Certification Phase consists of two tasks: (i) security control assessment; and (ii) security certification documentation. The purpose of this phase is to determine the extent to which the security controls in the information system are implemented correctly, operating as intended, and producing the desired outcome with respect to meeting the security requirements for the system. Security accreditation is the official management decision given by a senior agency official to authorize operation of an information system and to explicitly accept the risk to agency operations, agency assets, or individuals based on the implementation of an agreed-upon set of security controls. Required by OMB Circular A-130, Appendix III, security accreditation provides a form of quality control and challenges managers and technical staffs at all levels to implement the most effective security controls possible in an information system, given mission requirements, technical constraints, operational constraints, and cost/schedule constraints. By accrediting an information system, an agency official accepts responsibility for the security of the system and is fully accountable for any adverse impacts to the agency if a breach of security occurs. Thus, responsibility and accountability are core principles that characterize security accreditation."

Once the C&A packages have been completed from the U.S. Forest Service perspective, the packages must undergo an USDA review. This further lengthens the time necessary to reach an accreditation decision. The U.S. Forest Service did not initiate this process in a timely enough manner in order to have the reviews completed by the time the applications were in the operational phase.

Without proper accreditations of major applications and general support systems, the system owners may not be aware of, or in acceptance of, the security risks posed by the use of the system. Therefore the owners cannot actively support and monitor the effectiveness of U.S. Forest Service security policies, which could further lead to unauthorized access, intentional or unintentional data destruction or misuse, and/or DoS. Without complete, well documented risk assessments, the accuracy of risk classifications and the implementation of appropriate solutions for mitigating risks and managing critical systems will not be consistent. This places the integrity of the financial data and information systems at risk. Without complete and documented system security plans, security controls may be inadequate, responsibilities unclear, and controls may be inconsistently applied. Such conditions lead to

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insufficient protection of sensitive or critical resources. Therefore, the integrity of the financial data and information systems may be at risk.

Recommendation Number 2:

We recommend that U.S. Forest Service management initiate the C&A process for all major applications in a timely enough manner in order to avoid having systems in production that are not appropriately certified.

We continue to recognize the need for the U.S. Forest Service to document and finalize a risk assessment for IBS and ensure a formalized ATO or interim ATO is in place for all major applications as reported in prior year Recommendation 1A and 1D of Audit Report No. 08401-08-FM.

Lack of Segregation of Duties Controls

During our FY 2008 audit, the following segregation of duties conflicts were identified:

- Some field unit Human Capital Management (HCM) employees have access to the Entry, Processing, Inquiry, and Correction (EPIC) system and also have access rights within Paycheck7 with the pay administrator role.
- In the Oracle Password Database, users with access to group 'KC', 'ABQ-DEV', 'Boulder', and 'FIA' combined with access to the 'ORACLE' group have access to both root-level operating system passwords and database administrator (DBA) passwords. As a result, there are 12 individuals with administrative-level access to both the databases and operating systems. This database is a central repository that contains all of the administrative-level passwords for U.S. Forest Service managed servers and databases.
- In the Oracle Password Database, one user had access to both the Oracle and Domino groups, which would give this user access to both root-level operating system and DBA passwords for Paycheck7.
- In Paycheck7, one employee had access to both administrative application-level access and DBA-level access.

During audit field work the last two bullet items (above) were corrected by U.S. Forest Service management by removing the individual's system access.

FSM 6600, Chapter 6680 – Security of Information, Information Systems, and Information Technology, section 6684.23, "Least Privilege," states "Configure the information system to enforce the most restrictive set of rights/privileges or accesses needed by users (or processes acting on behalf of users) for the performance of specified tasks." Additionally, section 6683.11, "Separation of Duties," states "Different individuals should perform each of the following actions for critical operational control functions: authorization/approval; system management; and monitoring or auditing."

NIST SP 800-53, "Recommended Security Controls for Federal Information Systems," control SI-9, "Information Input Restrictions," states "Restrictions on personnel authorized to input information to the information system may extend beyond the typical access controls employed by the system and include limitations based on specific operational/project responsibilities."

FS implemented the EmpowHR system, which would have addressed this segregation of duties issue by replacing EPIC. The U.S. Forest Service rolled back the implementation due to performance issues with EmpowHR. U.S. Forest Service management indicated that HCM resources and personnel are limited at many field site units. However, U.S. Forest Service management has granted access to these field site individuals in the Password Database based upon their job responsibilities until EmpowHR is re-implemented.

Additionally, U.S. Forest Service management stated that access to Oracle databases requires administrative operating system level access as well. To mitigate this risk, U.S. Forest Service management is in the process of implementing Net Forensics which will provide comprehensive reporting and monitoring over actions by privileged users.

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Without proper segregation of duties controls, there is increased risk that fraudulent data could be entered into EPIC and Paycheck7. Fraudulent personnel records and payroll payments could go undetected by the National Finance Center (NFC). In addition, individuals with privileged access to both the operating system and database can make unauthorized changes to application data and tamper with any audit trail that would track such an incident.

We continue to recognize the need for the U.S. Forest Service to establish, communicate and document the enforcement of policies and procedures which require quarterly management review of Paycheck7 access listings, ensure that proper segregation of duties principles are adhered to, and update the level of user access for all personnel based on the appropriate segregation of duties principles as reported in prior year Recommendations 3A, 3B, and 3D of Audit Report No 08401-8-FM.

Lack of Proper Audit Log Settings

During our FY 2008 audit, we noted the following audit log setting-related weaknesses:

- The Microsoft Windows default domain controller Group Policy Object (GPO) settings are not configured to audit actions of users with privileged authority. U.S. Forest Service management implemented corrective actions for this issue during fieldwork by enabling logging of privileged use in September.
- I-Web and IBS are not configured to audit system shutdowns/restarts, system maintenance, and actions of users with privileged authority.
- All Service Receipts (ASR) and Paycheck7 are not configured to audit unsuccessful logons, unsuccessful password change attempts, security policy changes, and system maintenance events.
- Actions of users with privileged access to both the operating system and database passwords housed in the Oracle Password Database are not consistently monitored or reviewed.

FSM 6600, Chapter 6680 – Security of Information, Information Systems, and Information Technology, Section 6684.31, “Auditable Events,” indicates “For systems that materially affect the ability of the agency to perform its mission, automatically generate audit records for, at a minimum, the following events: Unsuccessful logons; Unsuccessful password change attempts; Security policy changes; System shutdowns and restarts; System maintenance; All administrative / system actions of users with privileged authority (for example, system operators, administrators, security personnel); and Remote access to network devices.”

The NIST Special Publication (SP) 800-12, “An Introduction to Computer Security,” chapter 18, “Audit Trails,” states “Audit trails maintain a record of system activity both by system and application processes and by user activity of systems and applications. In conjunction with appropriate tools and procedures, audit trails can assist in detecting security violations, performance problems, and flaws in applications.”

U.S. Forest Service Management does not have procedures in place for monitoring the actions of individuals with privileged user accounts. However, management is currently implementing the Net Forensics tool, which will automate the review of audit logs.

By not maintaining all required audit logs, the risk is present that unauthorized system access or disruption of service may go undetected.

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Recommendation Number 3:

We recommend that U.S. Forest Service management:

A. Ensure that all required audit logging capabilities are turned on as required by FSM 6684.31.

B. Establish procedures to periodically review these audit logs for unauthorized activity.

Weaknesses in the IT Plan of Action and Milestones Process

Not all known IT weaknesses were being appropriately tracked via the Plan of Action and Milestones (POA&M) process. In addition, some POA&M issues were not corrected prior to their assigned due dates. Specifically:

- The Second Quarter FY 2008 POA&M did not list the results from the I-Suite ST&E efforts, which were finalized on December 20, 2007. This was corrected during audit fieldwork by U.S. Forest Service management.
- 41 of the 61 issues identified in the Third Quarter FY 2008 POA&M had their original assigned due dates extended. These due date extensions ranged from seven to 16 months for the noted task numbers.
- 23 of the 61 issues identified in the Third Quarter FY2008 POA&M had a planned due date indicated, but were not assigned an official due date.
- 16 of 154 POA&M tasks in the most recent POA&M documentation (August 13, 2008) were closed after their assigned due date.
- 127 of 476 milestones[1] identified in the most recent POA&M documentation (August 13, 2008) were still in an "open" status or were closed after their assigned due dates.

The OMB Memorandum M-07-19, "FY 2007 Reporting Instructions for the Federal Information Security Management Act and Agency Privacy Management," states that agency reports shall be based on the results of the annual system and program reviews, the agency's work in correcting weaknesses identified in their POA&M and any other work performed throughout the reporting period.

The OMB Memorandum M-04-25, "FY 2004 Reporting Instructions for the Federal Information Security Management Act and Agency Privacy Management, Pages 16-19" states that initial weakness and milestone completion dates should not be altered.

U.S. Forest Service management is not effectively estimating the level of time and effort necessary to remediate all POA&M issues. Although there is a process in place for tracking POA&Ms, management is not reviewing each quarterly POA&M to verify that original/planned completion dates assigned are accurate. Also, U.S. Forest Service management is not effectively analyzing all issues that are not corrected before their assigned due dates to determine the root cause. Additionally in March 2008, the U.S. Forest Service changed from using the Automated Security Self-Evaluation and Remediation Tracking (ASSERT) tool to track POA&M statuses, to the Cyber Security Assessment and Management (CSAM) tool. When converted the original due dates for POA&M tasks originally assigned using ASSERT, were not retained when the conversion to CSAM occurred.

By not effectively documenting and tracking all known weaknesses via the POA&M process, there is a risk that thorough remediation efforts will not be planned and initiated in a timely manner. Additionally, not correcting issues or achieving milestones prior to their assigned due dates allows for the extended presence of weaknesses that could result in the compromise of FS IT resources and divulgence of sensitive information.

[1] Milestones are the sub-tasks that must be completed in order to accomplish the overall objective of each POA&M task.

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Recommendation Number 4:

We recommend that U.S. Forest Service management:

A. List and document all known weaknesses in their POA&Ms, including ST&E results. Each POA&M and milestone documented should be checked for completeness and accuracy to verify that all issues are assigned an official due date and task number to allow for the effective tracking of issues.

B. Document the rationale behind all assigned due date extensions so that the root causes can be easily identified and addressed.

C. Develop POA&M-related metrics that can be updated and reviewed on a quarterly basis. These metrics would highlight inefficiencies so that they can be addressed immediately to help prevent date slippage from becoming a pervasive issue for numerous POA&M items.

Number 2: The U.S. Forest Service Needs to Develop Comprehensive Policy and Procedures for Financial Management and Reporting of Wildland Fire Activity

Wildland Fire Borrowing

The U.S. Forest Service currently utilizes Chief Financial Officer (CFO) Bulletin 2005-1, "Procedures to Borrow and Repay Funding for Wildland Fire Suppression" to account for and record Wildland Fire borrowings. As a result of audit testwork performed over this area, we noted that the policy does not address all fire borrowing scenarios that would allow the U.S. Forest Service to consistently record the transfer, expenditure, and repayment of appropriated funds borrowed to support its Wildland Fire Management program.

The U.S. Forest Service Wildland Fire program [i.e., Treasury account fund symbol (TAFS) 12X1115] receives, when necessary, expenditure and non-expenditure transfers (borrowings) from other U.S. Forest Service special, trust and revolving TAFS to fund fire suppression activities. Authority for these transfers is provided by Public Law (P.L.) 108-108, Appropriations for the Department of the Interior and related agencies…and for other purposes. Title II, Related Agencies, of P.L. 108-108 states "For necessary expenses for forest fire presuppression activities…, for emergency fire suppression…, and hazardous fuel reduction…funds, including unobligated balances…are available for repayment of advances from other appropriations accounts previously transferred for such purposes, *Provided further*, that not less than 50 percent of any unobligated balances remaining (exclusive of amounts for hazardous fuel reduction)…shall be transferred, as repayment for past advances that have not been fully repaid, to the fund established pursuant to section 3 of P.L. 71-319 [Knutson-Vandenberg]."

During FYs 2006, 2007 and 2008, the U.S. Forest Service used authority provided by P.L. 108-108, Department of the Interior and Related Agencies Appropriations Act, to process expenditure and non-expenditure transfers from other U.S. Forest Service special, deposit, and trust funds into the Wildland Fire fund. U.S. Forest Service financial reporting personnel used the CFO Bulletin 2005-1 as guidance to record the transfer into and subsequent repayment of borrowed funds.

However, CFO Bulletin 2005-1 does not provide comprehensive guidance to record fire borrowing transactions from federal funds (i.e., revolving or special funds). In addition CFO Bulletin 2005-1 does not provide U.S. Forest Service's policies or procedures related to the expenditure of funds based upon U.S. Forest Service's intent to repay borrowings. As a result, U.S. Forest Service inappropriately utilized appropriations used / expended appropriations (i.e., general ledger accounts 3107 and 5700, respectively) posting logic for federal fund borrowings which were not intended to be repaid from future appropriations in 12X1115.

The U.S. Forest Service utilized general ledger accounts 3107 and 5700 to record expenditure of funds other than general and thereby overstated appropriations used and expended appropriations and understated unexpended appropriations and cumulative results of operations by $60 million in its FY 2006 financial statements. Adjusting entries recorded to correct this error in FY 2008 reversed the appropriations used and unexpended appropriations

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posting logic (i.e., debited 5700, and credited 3107) and thereby understated FY 2008 appropriations used and expended appropriations by $60 million in the financial statements.

In addition, expenditures associated with FY 2008 borrowings obtained via non-expenditure transfers were reversed in FY 2008 thereby understating current year appropriations used and expended appropriations by an additional $56 million. This entry was subsequently corrected in accounting period 14 and the associated repayments from the Wildland Fire Fund were reclassified from appropriations transfers-out to non-expenditure transfers-out.

Recommendation Number 5:

We recommend that U.S. Forest Service management develop and implement comprehensive accounting policy and procedures related to:

A. Expenditure and non-expenditure transfers-in of funds to Wildland Fire fund (i.e., TAFS 12X1115) for wildfire suppression;

B. Utilization of expended approprations posting logic of transferred funds (both expenditure and non-expenditure) in Wildland Fire Fund (i.e., TAFS 12X1115) based upon management's intent to obtain appropriations to repay borrowed funds, and;

C. Record the repayment of these funds to the originating federal or non-federal funds treasury symbols.

Wildland Fire Expenditure Refund Receivables

The U.S. Forest Service does not have formal policy in place to account for "expenditure refund" receivables related to fire suppression costs incurred by the U.S. Forest Service on behalf of other governmental entities (e.g., state and local jurisdictions). Prior to FY 2008, these receivables were used to credit principal appropriations and offset costs when billed (i.e., when the receivable was established). The recognition of this receivable was allowable under the various laws relating to Wildland Fire Suppression.

However, during FY 2008 the U.S. Forest Service changed its accounting for such receivables to offset fire suppression costs incurred on behalf of government entities when the collection occurs from the governmental entity, not when billed. We believe this accounting to be more conservative given the year over year increasing costs of wildland fire and the budget constraints facing government entities. Both of these events cause the collectability of the receivable to stretch-out over several years and also introduce more uncertainty into the collectability of the receivable.

According to the Intergovernmental Cooperation Act of 1968 (as amended by the Intergovernmental Cooperation Act of September 13, 1982), the U.S. Forest Service has the authority to "deposit any payments or reimbursements of costs [incurred by the U.S. Forest Service on behalf of other government entities] to credit the principal appropriation or the account to which the costs are to be charged or from which the costs have been paid."

The Intergovernmental Cooperation Act, as amended September, 13, 1982 and Forest Service Manual (FSM) 1584.15 state "Deposit [of] any payments or reimbursements received for the costs of [fire suppression] services to the credit of the principal appropriation or the account to which the costs are to be charged or from which the costs have been paid."

In addition, expenditure refund receivables billed in FYs 2006 and 2007 were used to credit appropriations and offset costs in FYs 2006 and 2007. However, approximately $13 million of these receivables was uncollected as of September 30, 2008. As a result, prior year appropriations used and expended appropriations were understated and unexpended appropriations were overstated in fiscal years 2006 and 2007 by approximately $13 million.

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Recommendation Number 6:

We recommend that U.S. Forest Service management develop and implement formal policies and procedures to credit principal appropriations and offset costs incurred by the U.S. Forest Service on behalf of other governmental entities when expenditure refund receivables are collected in compliance with the Intergovermental Cooperation Act.

Number 3: Management Review of Credit Card Transactions and Controls Over the Programs Need Continued Improvement *(Repeat Condition)*

During the FY 2008 audit, we noted control deficiencies in the purchase and fleet card programs. The U.S. Forest Service uses purchase cards to reduce administrative costs and allow its employees to procure supplies and services faster than through traditional government procurement regulations. In addition, the U.S. Forest Service also uses fleet cards to purchase automotive related services without going through traditional government procurement regulations.

Purchase Card Monitoring Needs Improvement

During our testwork over second and third quarter 2008 quarterly supervisory reviews of purchase card transactions, we noted that 247 out of 384 quarterly reviews were not performed or were not performed timely. In addition, 14 of 64 second and third quarter supervisory reviews that were re-performed were either not being performed completely or correctly, not performed on a timely basis, had missing supporting documentation or contained inconsistent documentation.

In addition, during testwork over the authorization for the use of purchase cards, the *Micro-Purchase & PCMS System Training Certification Request* forms were not provided for 11 out of 140 cardholder samples.

USDA Departmental Regulation 5013-6 requires that supervisors of purchase card holders monitor the purchasing activity of card holders in their units quarterly. 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 Washington Office (WO) sent a letter to U.S. Forest Service units instructing them to have all U.S. Forest Service cardholders authorized in writing by December 31, 2003 [and on a go-forward basis].

Forest Service Handbook (FSH) 6309.32, Part 4G13.301-73 requires delegation of micro-purchase authority for use of the purchase card to be documented on form FS-6300-53.

On April 19, 2004, the U.S. Forest Service Director of Acquisition Management reminded the various U.S. Forest Service units of the emphasis placed on the supervisor’s review of purchase card holders. A 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 U.S. Forest Service increases its risks for inaccurate transactions, split transactions, and inappropriate purchase card transactions. In addition, without complete and accurate cardholder information in PCMS and adequate authorization/training records for purchase card holders, U.S. Forest Service management can not effectively monitor purchase card holders and transactions incurred by its cardholders.

We continue to recognize the need for the U.S. 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.

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<u>Controls over Fleet Cards Need Improvement</u>

During a prior year review of the U.S. Forest Service fleet card program, the USDA OIG noted that U.S. Forest Service lacks controls over fleet card transactions.

USDA OIG identified the following deficiencies:

- U.S. Forest Service did not review fleet credit card operations;
- U.S. Forest Service's controls over fleet credit card transactions were found to be inadequate; and
- U.S. Forest Service needs to reconcile its active fleet credit cards to the vehicles it operates.

In addition to this report, during our FY 2008 testwork over fleet card transactions, we were not able to identify and test any national level controls that the U.S. Forest Service has consistently implemented in the program. In addition for our FY 2008 samples, the U.S. Forest Service was unable to provide supporting documentation outside of system screen prints.

The WO issued Directive 7130/1430 on June 1, 2007, which states, "U.S. Forest Service controls over fleet card transactions need strengthening, the review of fleet card operations is inadequate, and the U.S. Forest Service needs to reconcile active card inventories to vehicle inventories."

The March 2007 USDA OIG Report entitled *Controls Over Forest Service Vehicle Fuel and Maintenance Costs* states "The USDA OIG reviewed U.S. Forest Service's controls over fleet credit cards for fiscal years 2004 and 2005 to determine if controls were adequate and if charges were for allowable and appropriate expenses. The USDA OIG found that the U.S. Forest Service could not fully support over $48 million in transactions charged to its fleet credit cards. Of this $48 Million, $3.7 million of those charges were determined to be fully unsupported. The U.S. Forest Service has approximately 24,000 vehicles, each of which has a fleet credit card assigned to it. According to the USDA OIG report dated March 30, 2007, users of fleet credit cards were able to charge $3.7 million in unsupported expenses during FY 2004 and FY 2005. Of the $3.7 million, $200 thousand was for prohibited premium and mid-grade fuel purchases. U.S. Forest Service management has no reasonable assurance that unsupported expenses are being used to accomplish the U.S. Forest Service's mission."

Without national level internal controls in place and documented, the U.S. Forest Service increases its risk for fraud, waste and abuse in the fleet card program.

We continue to recognize the need for the U.S. Forest Service management to implement the WO Directive 7130/1430 and to require receipts for purchases, where feasible, as reported in prior year Recommendation 10 of Audit Report No. 08401-8-FM.

Number 4: Physical Inventory Policies and Procedures of Pooled Real Property Need to be Developed (*Repeat Condition*)

As a result of the FY 2007 audit recommendation, during FY 2008 the U.S. Forest Service agreed to provide documentation of its compensating and/or mitigating controls that provided them with reasonable assurance that the September 30, 2007 pooled real property population existed, was complete and accurately recorded. The U.S. Forest Service was not able to adequately demonstrate that these compensating and/or mitigating controls were in place and operational.

In addition, U.S. Forest Service agreed to develop and implement in FY 2008 a plan to improve the quality of the 5-year pooled real property physical inventories. We determined that no plan has yet been developed for inventory pooled assets during the 5-year period FY 2008-2012.

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The Agriculture Property Management Regulations, Chapter 110-84 Annual Real Property Inventories Supplementing PART 102-84; and PART 104-51 Property Accountability and Control Section 104-51.106 (a) (2) Real Property states that "Physical inventories of all real property, except land, shall be taken by each agency every five years."

Recommendation Number 7:

We recommend that U.S. Forest Service management develop and implement in FY 2009 a plan to improve the quality of the 5-year pooled real property physical inventories.

Number 5: Accountability for Unliquidated Obligations (ULOs) Needs Continued Improvement *(Repeat Condition)*

U.S. Forest Service is not in compliance with FS Directive 6500-218 which requires the certification of ULOs as valid as of 7/31/08. During test of design procedures, we identified two of three ULOs that were certified by field management as valid using "Option #4-Other" but did not provide sufficient information to determine if the ULO was truly valid or invalid. Subsequently, U.S. Forest Service management certified all ULOs to the USDA on 9/2/08 as valid, but this certification included the above mentioned obligations that were not definitively determined to be valid ULOs.

In addition, during our substantive testwork over the ULO balance as of August 31, 2008 and over activity during the period of September 1 to 30, 2008, we noted 17 routine samples in which the ULO balance did not appear to be valid, or accurate, and should have been identified as such during the certification review as of 7/31/08. We further noted 5 samples that would have been determined invalid or inaccurate if a review had been performed for the time period subsequent to the certification period and the end of the fiscal year, which did not appear to be valid and no evidence of management review was noted.

The Review of Unliquidated Obligations (Form FS-6500-218) contains an option #4, which can be completed with any language by the preparer. At the WO option 4 was selected for two of three ULOs and the description stated that the agreement could not be found, and the state point of contact had not responded to the request for certification by the due date. Although the WO approved the outstanding ULOs contained on Form FS-6500-218 as of July 31, 2008, the ULOs were not valid and should not have been certified as such; therefore, the U.S. Forest Service is not in compliance with the review policy (Directive 6509.11k).

U.S. Forest Service Directive 6509.11k requires the certification of ULOs as valid in the following sections:

56.03: "Annually, no later than August 31, the Forest Service is required to submit to the Department Associate Chief Financial Officer – Financial Operations (ACFO-FO), a certification that shows annual reviews were performed and unliquidated obligations, existing as of July 31, are valid based on the review."

56.04d: "Each deputy chief, regional forester, station, Area, International Institute of Tropical Forestry (IITF), and Job Corps director is responsible for the unliquidated obligation review and must:

1. Ensure that the obligations for respective units have been reviewed monthly and that obligated balances are valid, and

2. Comply with the policy and documentation requirements for the annual certification, quarterly and monthly review of unliquidated obligations"

56.04g: "As the obligating official for all procurement requests, the procurement official is responsible to provide validity of all obligations they manage to the budget officer or DABC. This should be coordinated with the Contracting Officer's Representative (COR) or program personnel."

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56.06: "The Forest Service is required to certify an annual review of unliquidated obligation balances, for the period ending July 31. Quarterly reviews and annual certification are necessary to certify the validity of obligated balances."

The following procedures apply to the obligating official who must conduct the review of each selected unliquidated obligation to determine:

1. Whether delivery or performance of goods or services has occurred or is expected to occur; and

2. If accounting corrections are necessary to the data in the accounting system.

The validity of unliquidated obligations is not only a legal requirement but critical to budget execution and good funds management. Amounts inappropriately recorded as unliquidated obligations represent missed opportunities to pursue other funding needs.

- The obligating official or their designees should consider, if applicable:
- The period of fund availability;
- The timeliness of delivery or performance;
- The completeness and accuracy of information provided by grant or contract parties;
- Whether funds have been expended in a manner which is consistent with the percentage of completion;
- Whether remaining funds are sufficient to complete the order in accordance with specifications;
- Justifications for amendments to funding levels;
- Reasons for lack of activity, such as litigation or delay in contract closeout;
- Any provisions of the agreement or contract that may permit or prohibit deobligation or reprogramming; and
- Supporting documentation exists for recorded unliquidated obligations, and any other relevant factors, when making a determination."

Although the U.S. Forest Service certified the reviews of all administrative units as of July 31, 2008, reviews of ULOs were performed for each administrative unit and were certified containing invalid and inaccurate ULOs; and therefore, is not in compliance with the certification policy (Directive 6509.11k). There is not a review policy in place to review ULOs for the period 8/1/08 through 9/30/08; therefore, the balance of ULOs may be misstated during the last two months of the fiscal year. In addition, non-routine ULOs were not effectively reviewed to prevent improper journal entries.

The U.S. Forest Service is not in compliance with FS Directive 6509.11k, and as a result may be overstating its ULO balances by not performing a comprehensive review of outstanding ULOs, and Non-Routine ULO entries, during the entire year and certifying ULOs that do not meet certification criteria.

Recommendation Number 8:

We recommend that U.S . Forest Service management:

A. Strengthen the ULO review process and monitor the validity and accuracy of outstanding ULO balances at the local and national levels,

B. Perform additional review of ULO activity occurring between 8/1/08 and 9/30/08 for validity and accuracy; and

C. Perform review of all Non-Routine ULOs to determine validity and accuracy as of year-end.

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We continue to recognize the need for U.S. Forest Service management to continue to train its personnel on performing and approving ULO certifications, consider removing option #4 from the ULO certification, and follow-up on any option 4 responses provide to the administrative units and regions as noted in prior year Recommendation 9 of Audit Report 08401-8-FM.

In addition, we continue to recognize the need for the U.S. 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 6: The U.S. Forest Service Needs to Improve Internal Controls and Management Oversight for Environmental and Disposal Liabilities (EDL) ***(Repeat Condition)***

Accountability of EDL Needs Improvement

During our testwork over EDL, we identified the following control deficiencies in the U.S. Forest Service's EDL process:

- The U.S. Forest Service was not properly classifying its EDL transactions between the categories of Government Related (GR) and Government Acknowledged (GA). In addition, there were amounts included as GR or GA liabilities that did not meet the definition of an accrual, as specified in Statement of Federal Financial Accounting Standard (SFFAS) Number (No.) 5 – Accounting for Liabilities of the Federal Government.
- The U.S. Forest Service does not have adequate documentation requirements when supporting its EDL estimates. As a result, we received substandard documentation for all 11 GR samples tested.
- Although there was communication and collaboration between all related parties involved in the determination of the EDL balance, the managerial reviews as required by the FSH 6509.11m were not performed in full compliance with such policy and were not effectively executed.

SFFAS No. 5 "Accounting for Liabilities of the Federal Government" establishes the criteria necessary for the classification of GR and GA in the paragraphs below:

a. "Government-related events are non transaction based events that involve interaction between federal entities and their environment. The event may be beyond the control of the entity. A liability is recognized for a future outflow of resources that results from a government-related event when the event occurs if the future outflow of resources is probable and measurable (see paragraphs 33 and 34 for the definitions of probable and measurable, respectively) or as soon thereafter as it becomes probable and measurable…
    - 33 "Probable" refers to that which can reasonably be expected or is believed to be more likely than not on the basis of available evidence or logic. The probability of a future outflow or other sacrifice of resources is assessed on the basis of current facts and circumstances. These current facts and circumstances include the law that provides general authority for federal entity operations and specific budget authority to fund programs. If budget authority has not yet been provided, a future outflow or other sacrifice of resources might still meet the probability test if (1) it directly relates to ongoing entity operations and (2) it is the type for which budget authority is routinely provided. Therefore, the definition applies both to liabilities covered by budgetary resources and to liabilities not covered by budgetary resources. [FN 24: See Statement of Federal Financial Accounting Standards Number 1, "Accounting for Selected Assets and Liabilities", (March 30, 1993), app. A, p. 25.]
    - 34 "Measurability" means that an item has a relevant attribute that can be quantified in monetary units with sufficient reliability to be reasonably estimable. Liabilities reported in the financial report are measured by different attributes specified by various accounting standards. Several different measurement attributes are used for different items in present practice (e.g., fair market value, current cost, present value, expected value, settlement value, and historical cost).

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b. Government-acknowledged events are events that are of financial consequence to the federal government because it chooses to respond to the event. A liability is recognized for a future outflow of resources that results from a government-acknowledged event when and to the extent that the federal government formally acknowledges financial responsibility for the event and a non-exchange or exchange transaction has occurred. The liability for a non-exchange transaction should be recognized for any unpaid amounts due as of the reporting date and the liability for an exchange transaction should be recognized when goods or services have been provided..."

The Federal Accounting Standards Advisory Board (FASAB), Technical Release No. 2 requires the following factors to be considered in the estimate:

1. Completion of a Remedial Investigation/Feasibility Study (RI/FS) or Other Study. The first test in determining whether costs are reasonably estimable is to ascertain whether there is a completed study upon which to base an estimate.

2. Experience with Similar Site and/or Conditions. If there is a similar site or condition with experience gained (through actual cleanup and/or a completed study to compare), the estimate for recognizing a liability for a site could be based on the similar experience or conditions. In addition, the estimated cost of a future study (if required) should be recognized. Future studies could result in improved estimates.

3. Availability of Remediation Technology. Assuming a study has been completed, or an agency or other entity has experience with a similar site and/or condition as noted above, the next test is whether there is technology available to remediate a site. If no remediation technology exists, then remediation costs would not be reasonably estimable, but the agency would be required to recognize the costs to contain the contamination and any other relevant costs, such as costs of future studies.

FSH 6509.11m states that during the accrual of environmental cleanup liabilities the following activities occur during the accrual process:

1. Manually, WO Engineering segregates all Abandoned Mine Land (AML) cleanup sites costs. These estimates are not included in the EDL accrual because [U.S. Forest Service] has no financial responsibility for the estimated cleanup. AML would be designated as GA if the Federal government acknowledged them.
2. WO Engineering submits the Center for Environmental Excellence (CEE) inventory report spreadsheet to ASC-Budget and Finance payment staff, in addition to the known amounts of projects funded by either ECAP appropriated NFMG or USDA Hazardous Materials Management Division (HMMD) reimbursable agreements. WO Engineering provides the CEE inventory report spreadsheet to the ASC-B&F team by the 1st day of the last month in each fiscal quarter. The amount accrued is the sum of unfunded and funded cleanup work, less the amount of expenditures made on the funded projects. ASC-B&F Financial Reporting and Reconciliation Branch (FR&R) personnel prepares the service-wide estimated accruals for environmental clean-up costs…
3. ASC-B&F Internal Quality Assurance performs periodic analysis, at least annually, of accrual methodologies to determine necessary adjustments for more reliable estimates of accruals.

A thorough and comprehensive review of the requirements for SFFAS 5 and FSH 6509.11m and other related guidance is not occurring prior to the recording of EDL transactions.

The completeness and accuracy of the EDL as of September 30, 2008 may be misstated and incomplete since estimates are unsupported. In addition, the CEE database may not contain information for which the field believes it will not receive funding, causing the liability to be further understated in the financial statements.

(Continued)

Recommendation Number 9:

We recommend that U.S. Forest Service management:

A. Implement a process whereby both the environmental engineers and ASC – B&F review the EDL transactions recorded in CEE for compliance with SFFAS No. 5 on a quarterly basis. This review would be to determine the validity of recorded balances as well as the proper classification of such liability.

B. Develop a standard for documentation for all EDL estimates to ensure compliance with documentary evidence requirements.

C. Revise and implement the FSH policy to comply with applicable technical accounting literature cited above to ensure accurate reporting.

D. Revise, implement, and assess the efficiency of the control environment for developing the EDL accrual.

E. Require regional engineers to fully document and support all EDL accrual estimates and to provide this supporting documentation to both WO Engineering and ASC-B&F for review of reasonableness and compliance with technical accounting literature. The review by both WO Engineering and ASC-B&F should take place on at least a quarterly basis and evidence of such review should be documented and maintained.

<u>Improvements are Needed in Financial Disclosure of EDLs</u>

The June 30, 2008 U.S. Forest Service financial statements did not include all information required by OMB A-136 "Financial Reporting Requirements". As of June 30, 2008, financial statement Note 8, Environmental and Disposal Liabilities, did not include the following information.

- Sources of cleanup requirements (i.e., applicable laws and regulations governing the cleanup and accrual of an Environmental and Disposal Liability - RCRA, CERCLA, SFFAS 5 and 6, SFFAS Technical Release No. 2, etc.)

In addition, financial statement Note 6, Liabilities Not Covered by Budgetary Resources, contained the entire accrued amount reported in Note 8. Based on SFFAS No. 5, GA environmental cleanup liabilities must be funded by appropriations for inclusion in the EDL accrual. The funded portion of the GR balance was also included within Note 6. The amount of GA liabilities and the funded portion of GR liabilities should not have been included within Note 6.

In accordance with OMB A-136, "Financial Reporting Requirements-Revised 06/03/08" requires the disclosure of environmental hazards resulting from ongoing operations. The following information must be disclosed in a note to the financial statements:

a. sources (i.e., applicable laws and regulations) of clean-up requirements;

b. method for assigning estimated total cleanup costs to current operating periods (e.g., physical capacity versus passage of time);

c. unrecognized portion of estimated total cleanup cost associated with general property, plant and equipment (PP&E);

d. material changes in total estimated cleanup costs due to changes in laws, technology, or plans, and the portion of the change in estimate that relates to the prior period operations; and

e. the nature of estimates, and the disclosure of information regarding possible changes due to inflation, deflation, technology, or applicable laws and regulations.

U.S. Forest Service was not in compliance with OMB A-136, "Financial Reporting Requirements –Revised 06/03/08" for the completion of the notes to the financial statements (6 and 8) as of June 30, 2008.

(Continued)

Information in the Environmental and Disposal Liabilities Note 8 and the Liabilities Not Covered by Budgetary Resources Note 6 at June 30, 2008 are not disclosed in accordance with OMB A-136, "Financial Reporting Requirements - Revised 06/03/08".

Recommendation Number 10:

We recommend that U.S. Forest Service management:

A. Ensure that future note disclosures relating to EDL comply with OMB Circular A-136.

B. Identify an individual within the FR&R Branch that would be responsible for completing the following tasks in a timely manner:

- Identifying and researching new and existing financial reporting standards, and OMB policies;
- Determining if existing accounting policies and procedures are in compliance with promulgated standards.

Number 7: The U.S. Forest Service Needs to Improve Internal Controls for Revenue Related Transactions *(Partial Repeat Condition)*

Residual Deposits in the Liability for Deposit Funds, Clearing Accounts, and Undeposited Collections Need to be Identified and Properly Posted *(Repeat Condition)*

During our FY 2008 audit we noted prior year deposit transactions that resided in general ledger (GL) account 2400, Liability for Deposit Funds, Clearing Accounts, and Undeposited Collections. These deposits reside in GL 2400 because the final destination of the transaction has not been determined.

The United States Standard Government Ledger (USSGL) Definition of GL 2400, Liability for Deposit Funds, Clearing Accounts and Undeposited Collections is "Amounts offsetting undeposited collections and collections deposited in deposit funds and clearing accounts, including suspense accounts, awaiting disposition or reclassification."

As part of our audit work we selected 90 samples for testing. Of these 90 samples, 13 deposits were noted as errors. Specifically:

- Four samples were not supported with documentation;
- One sample did not have sufficient documentation;
- One sample was understated in the general ledger;
- Three samples were overstated in the general ledger;
- Three samples did not belong in GL 2400; and
- One sample was incorrectly recorded.

In addition to the above samples, a timber revenue transaction was improperly recorded as current year revenue but related to a prior year economic event. This error occurred due to lawsuit settlements where the money was received by U.S. Forest Service in FY 2004 but was not transferred out of GL 2400 and into the proper revenue account until FY 2008.

The primary cause for the prior year deposits relates to the U.S. Forest Service's prior year issues with reconciling Fund Balance with Treasury. As a result of these exceptions, an overstatement of approximately $19.7 million in the Liability for Deposit Funds, Clearing Accounts and Undeposited Collections account exists. This amount was not corrected in the current year financial statements.

(Continued)

We continue to recognize the need for the U.S. Forest Service management to devote the necessary resources to identify, research, and resolve prior year residual deposits in GL 2400 as noted in prior year Recommendation 5 of Audit Report No. 08401-8-FM.

Classification of Revenue Transactions between Federal and Non-Federal Needs Improvement

During our FY 2008 substantive testwork over other revenue transactions (GL 5900), we identified approximately $96 million in GL 5900 which was improperly coded as Federal related revenue. This amount was corrected in the current year financial statements. A majority of this amount relates to non-Federal mineral royalties that were coded as Federal because they were obtained from Mineral Management Service (MMS).

In addition, GL 2400 has approximately $1.8 million misclassified as federal deposit transactions and approximately $5.9 million misclassified as non-federal deposit transactions. These amounts were not corrected in the current year financial statements.

The United States Treasury accounts that are used for these transactions are the National Forest Fund Receipts and the National Grassland Receipts, Unavailable. Both of these accounts state that revenues are only derived from non-Federal sources. In addition, GL 2400 had transactions coded as federal that resided in non-federal accounts and vice-versa.

Recommendation Number 11:

We recommend that U.S. Forest Service management record mineral royalty revenues obtained from MMS as non-Federal and ensure that deposits held in GL 2400 are properly classified between federal and non-federal.

Internal Controls over the Reimbursable Agreement Close-out Process Need Improvement

During our substantive testing over balances as of June 30, 2008 and activity covering the period July 1, 2008 through September 30, 2008 for unfilled customer orders without advance (GL 4221), we noted 15 exceptions out of 106 sample items during our testwork. For all 15 exceptions the period of performance had expired but unfilled customer orders without advance remain recorded in the GL.

In addition, during our substantive testing over balances as of June 30, 2008 and activity for the period of July 1, 2008 through September 30, 2008 for advances from others (GL 2310) we noted 18 exceptions out of 86 sample items during our testwork. For all 18 exceptions, an advance remained on the U.S. Forest Service's books although the period of performance had expired.

FSH, Section 6509.11k, Chapter 50, paragraph 56.82i, *Reimbursable Agreements* states that "The Reimbursable and Advance Collection Agreements (RACA) Branch, ASC, is responsible for: Closing out agreements within 90 days of last activity."

The U.S. Forest Service is not closing out its agreements within 90 days of the last activity/expiration date of the agreement. Untimely closeouts of agreements can cause an overstatement in advances from others and unfilled customer orders without advance.

Recommendation Number 12:

We recommend that U.S. Forest Service management:

A. Comply with the FSH Section 6509.11k, and

B. Periodically monitor the age and activity of agreements within FFIS.

(Continued)

Number 8: The U.S. Forest Service Needs to Refine its Period-end Accrual Processes *(Partial Repeat Finding)*

Statistical Expense Accrual Model Needs Refinement (Repeat Finding)

During FY 2008, the U.S. Forest Service used 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 to 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 variables of interest. The dependent variable can be estimated by one or more of the others (independent variable(s)). The U.S. Forest Service regression uses aggregated unliquidated obligation balances as of the single independent variable and subsequent month payments as the dependent variable. 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 the current U.S. Forest Service model, with one independent and one dependent variable that would mean a minimum of 52 data points. For a more complex curvilinear model more data points would be appropriate. The U.S. Forest Service universe currently contains a population of 60 monthly data points.

The current U.S. Forest Service model contains three discreet data universes for three mutually exclusive category estimates. Each category uses a unique curvilinear calculation based on its own universe of data points. While it may be appropriate to have different geometric patterns for accrual estimating equations for the various broad ranges 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.

While these newly developed regression models appear to produce slightly better results overall than past methods for the various accrual estimates we have not been able to validate some of the U.S. Forest Service's key assumptions used in the estimation model.

- *Correlation of ULO Balances and Payments* – The statistical models developed by the U.S. Forest Service uses different independent variable forms but consistent geometric models for the separate category calculation (i.e., the relationship between using 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 U.S. 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 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 U.S. Forest Service analysis has produced three different variations of a single geometric model form, one each for grants ang agreements, construction and operations related expenditures. 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. The U.S. Forest Service management must plan to verify

(Continued)

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.

- *Adequacy of Tail* – The model is used to estimate payments in each category for approximately 30 days after period end. A review is performed for each category to evaluate the adequacy of the 30-day period. Other work on accruals associated with procurement expenses observed by auditors at other Federal agencies indicates that it usually takes up to 90 days to receive billings, process invoices and make payments for about 90% of the work performed by vendors. The 30-day period being used by U.S. Forest Service may be too truncated for reliable results. This should be further researched by U.S. Forest Service.

- *Seasonality in the Model* – We recognize that the U.S. Forest Service model contains a seasonality adjustment after the raw calculation of the estimate is completed. However it would make sense to incorporate seasonality as dummy variables directly in the model.

- *ULOs 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 ULOs above $500,000. The use of single regression might be responsible for some of the unexplained variation that is observed.

The book entitled *Regression Diagnostic* written by M.S. Younger and published by John Wiley & Sons, New York, NY 1977 suggests that the 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 U.S. Forest Service has implemented the regression procedure to estimate amounts to accrue for the three types of obligations. For the reasons cited above, the U.S. Forest Service may not be able to calculate its accrual estimates with adequate statistical confidence and precision to ensure reasonable and repeatable estimates.
We noted ULOs greater than $500 thousand are included in the model; however, these transactions maybe reacting differently from the remaining ULO data causing more variability. The variability (i.e., the large standard deviation) 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 the U.S. Forest Service management verifies and validates the above assumptions and set of models that are finally arrived at for use in the accrual process. However, at this time with the available information, and because some improvements appear to have been made and explained by the U.S. Forest Service, we do not believe the variability observed would cause a material misstatement in the U.S. Forest Service's financial statements.

Recommendation Number 13:

We recommend that the U.S. Forest Service management:

A. 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;

(Continued)

B. Test models with specific additional independent variables in some of the models which may help substantiate and better expose the true nature of the relationships between ULOs and payments in the various types of obligations;

C. Test the adequacy of a 30 day tail and attempt a 90 day tail;

D. Use Box – Jenkins technique to reduce out (and further explain) some of the model variability that may be due to temporal effects [see text by G&P, Box and Gulliam Jenkins]; and

E. Stratify plot data – ULOs greater than $500,000 vs. ULOs less than or equal to $500,000.

Accrual of Real and Personal Property Needs Improvement

During substantive testing of FY 2008 we noted that personal and real property was not being accrued for properly at year-end. Specifically:

- 18 out of 151 personal property samples should have been recorded (i.e., accrued) in the prior FY. These errors amounted to $15.8 million.
- 35 out of 226 real property samples should have been recorded (i.e., accrued) in the prior FY. These errors amounted to $5.3 million. Further analysis was performed on the entire population and the amount in error was determined to be $7.4 million. This amount was proposed and passed as an audit adjustment.

The U.S. Forest Service does not have a formal policy to accrue for property transactions at period-end. As a result, property balances and depreciation expense are understated at period-end.

Recommendation Number 14:

We recommend that U.S. Forest Service management establish formal policies and procedures to accrue for property at period-end and train personnel on those policies and procedures.

Period-end Analytical Procedures Need Development

During the U.S. Forest Service's implementation of a change in accounting principle that reclassified capitalized roadbeds to non-capitalized stewardship land, we noted the following:

- In August 2007, the U.S. Forest Service reclassified roadbeds from general PP&E to stewardship PP&E. In doing this the U.S. Forest Service wrote off the historical cost, accumulated depreciation and some other FY 2007 related costs for roadbeds in the general ledger.
- During FY 2007 accounting period 14 (October 2007), the U.S. Forest Service decided to postpone its decision to reclassify roadbeds due to implement justification for the reclassification. As a result, the Forest Service reversed all the previous entries and additionally capitalized the roadbed activity for August and September 2007 in the general ledger.
- In July 2008, the U.S. Forest Service completed its justification for the reclassification and proceeded to implement its earlier decision to reclassify roadbeds.

In summary, the U.S. Forest Service should not have reversed the entries relating to operating expenses and depreciation, amortization, and depletion expense because at year end they are closed into cumulative results of operations.

If U.S. Forest Service had a comprehensive analytical procedure to review the reasonableness of period-end financial amounts, the variance in depreciation expense would have been identified, researched and resolved.

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OMB Circular No. A-123, *Management's Responsibility for Internal Control* states "Reliability of financial reporting means that management can reasonably make the following assertions:

1…All assets and liabilities exit as of the reporting date.

2…All assets, liabilities, and transactions that should be reported have been included and no unauthorized transactions or balances are included …."

The reversal of entries in operating expense (GL 6100) and depreciation, amortization, and depletion (GL 6710) expenses amounts caused an understatement of GL 6710 of $84,989,294 and overstatement of GL 6100 of $22,562,169.

Recommendation Number 15:

We recommend that U.S. Forest Service management develop and perform a robust analytical whereby depreciation expense would be analytically reviewed for reasonableness and consistency with management expectations on at least a quarterly basis. We believe this review would help identify unusual or unexpected variances such that any necessary correcting adjustments could be processed in a timely manner.

STATUS OF PRIOR YEAR'S SIGNIFICANT DEFICIENCIES/MATERIAL WEAKNESSES

As required by *Government Auditing Standards* and OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements,* we have reviewed the status of the prior year's significant deficiencies. The following table summarizes these issues and provides our assessment of the progress U.S. Forest Service made in correcting these significant deficiencies. We have also provided the OIG report where the issue is monitored for audit follow-up. These tables contain only those audit reports that are open. In addition, only those recommendations that remain open or were closed in the current year are noted in the tables.

Open Conditions In this Table are Referenced In Exhibit I		
USDA OIG Audit Report No. 08401-8-FM November 2007		
Material Weakness/ Significant Deficiency	**Recommendation**	**Status**
The U.S. Forest Service Needs to Continue to Improve its General Controls Environment *[2008 Significant Deficiency; 2007 Material Weakness]*	1. We recommend that U.S. Forest Service management:	
	A. Document and finalize a risk assessment in accordance with the FSM 6682.1 and NIST SP 800-30 for IBS [I-Suite and FTRS – Components Closed].	Open
	B. Finalize a system security plan in accordance with FSM 6682.5 and NIST SP 800-18 for IBS/I-Suite and FTRS.	Closed
	C. Perform and document a ST&E in accordance with FSM 6682.07b and NIST SP 800-37 for IBS/I-Suite.	Closed
	D. Ensure that a formalized ATO [or an interim ATO] is in place for all major applications prior to implementation in accordance with FSM 6682.4.	Open
	2. We recommend that U.S. Forest Service management:	
	A. Communicate and enforce an agency-wide change control process for all change management personnel to follow.	Closed
	B. Create and maintain formal testing documentation and approvals for all major applications.	Closed
	3. We recommend that U.S. Forest Service management:	
	A. Establish, communicate, and document the enforcement of policies and procedures which require quarterly management review of Paycheck7 access listings and EPIC access listings to verify that access is appropriate and in compliance with policy.	Open
	B. Ensure that proper segregation of duties principles are adhered to when assigning roles in EmpowHR (the new HCM personnel system), since this system will ultimately replace EPIC.	Open
	C. Update the "Identifying and Establishing a Separation of Duties and Maintaining Least Privilege for Users" document to include specific segregation of duties guidelines for system administrators and DBAs.	Open
	D. Update the level of user access for all personnel based on the appropriate segregation of duties principles. If this current level of access is warranted, then mitigating	

(Continued)

Open Conditions In this Table are Referenced In Exhibit I		
USDA OIG Audit Report No. 08401-8-FM November 2007		
Material Weakness/ Significant Deficiency	**Recommendation**	**Status**
	controls must be implemented to appropriately track user actions. 4. We recommend that U.S. Forest Service management: A. Update its system configuration management baselines, as necessary, to reflect the most recent software versions and patch levels to ensure consistency within the environment, when implementing new systems. B. Improve system configuration management practices by raising system administrator awareness of the requirements for maintaining secure system configurations, including software versions, patches, and changing vendor default settings as necessary.	Open Open Open
The U.S. Forest Service Needs to Continue to Improve its Financial Management and Reporting Process *[2008 Significant Deficiency; 2007 Significant Deficiency]*	5. We recommend that the U.S. Forest Service management devote the necessary resources to identify, research, and resolve prior year residual deposits in GL 2400. 6. We recommend that U.S. Forest Service management ensure that existing review and approval procedures are adequate, communicate the policy to its management, and ensure its management is adequately trained on the policy as well as on other technical areas that they are responsible for at the ASC.	Open Closed
The U.S. Forest Service Needs to Refine and Monitor its Expense Accrual *[2008 Significant Deficiency; 2007 Significant Deficiency]*	7. We recommend that U.S. Forest Service management: A. Expand the number of variables to form multiple regression models and/or the types of analysis to include the use of the obligation paid, duration, percentage of time remaining in the obligation and percentage of time passed indexes in order to account for the various changes in the payment patterns by fiscal quarter. B. Consider implementing more robust statistical software which will increase the accuracy of the U.S. Forest Service's statistical accrual. 8. We recommend that U.S. Forest Service management: A. Discontinue use of the statistical model to estimate U.S. Forest Service's Federal Government liability. B. Materially comply with TFM Bulletin 2007-03 and maintain adequate supporting documentation of reconciliation and confirmation with each material Federal entity that conducts business with the U.S. Forest Service.	Open Closed Closed Closed

(Continued)

Open Conditions In this Table are Referenced In Exhibit I		
USDA OIG Audit Report No. 08401-8-FM November 2007		
Material Weakness/ Significant Deficiency	**Recommendation**	**Status**
Accountability for Unliquidated Obligations (ULOs) Needs Continued Improvement *[2008 Significant Deficiency; 2007 Significant Deficiency]*	9. We recommend that U.S. Forest Service management: A. Continue to train its personnel on performing and approving ULO certifications, and B. Consider removing option #4 from Part II of the ULO certification, or C. Follow up on any option #4 responses provided by the administrative units and regions. D. Work with the USDA to refine the Green Book process for USDA agreements to ensure that the ULO balances are valid and should remain obligated or be deobligated.	Open Open Open Closed
Review of Credit Card Transactions and Controls Over the Programs Need Continued Improvement *[2008 Significant Deficiency; 2007 Significant Deficiency]*	10. We recommend that U.S. Forest Service management: A. Implement the WO Directive 7130/1430 by providing detailed policies and procedures, adequate training on those policies and procedures, and monitor compliance to ensure appropriate use of the U.S. Forest Service funds. B. Require receipts for all purchases, where feasible, and ensure that they are maintained and reviewed by the Local Fleet Program Coordinator or Area Fleet Program Coordinator.	Open Open
The U.S. Forest Service Needs to Improve Internal Controls over its Environmental and Disposal Liabilities Process *[2008 Significant Deficiency; 2007 Significant Deficiency]*	11. We recommend that U.S. Forest Service management: A. Implement a system that requires engineers to designate sites as government related or government acknowledged and generates the necessary information for financial reporting purposes; and B. Implement controls to review EDL estimates to ensure that adequate supporting documentation exists to support the balances reported in the financial statements. 12. We recommend that U.S. Forest Service management: A. Comply with the disclosure requirements in the GAO disclosure checklist for interim and final financial statements, and B. Ensure that the financial statements are updated to include the required information for environmental and disposal liabilities.	Reissued; Closed Reissued; Closed Reissued; Closed Reissued; Closed
Controls Related to Physical Inventories of Pooled Real Property Need Continued Improvement *[2008 Significant Deficiency; 2007 Significant Deficiency]*	13. We recommend that U.S. Forest Service management: A. Resolve the FY 2007 issues by December 31, 2007, by conducting a review of the pooled assets annotated in the FY 2003-2007 inventory cycle and providing evidence of line officer certification, satisfactory PMO review (signatures), segregation of duties, and recording and	Reissued; Closed

(Continued)

Open Conditions In this Table are Referenced In Exhibit I		
USDA OIG Audit Report No. 08401-8-FM November 2007		
Material Weakness/ Significant Deficiency	**Recommendation**	**Status**
	reconciliation of corrections in the sub-ledger and the general ledger. B. Ensure that the FY 2008-2012 inventories are conducted correctly, by assembling a multi-discipline team of all affected parties to design and put in operation a more effective and efficient process for the next 5-year physical inventory cycle, by no later than March 31, 2008 for fiscal year 2008 implementation.	Reissued; Closed
The U.S. Forest Service Needs to Improve Its Business Process for Revenue Transactions *[2007 Significant Deficiency]*	14. We recommend U.S. Forest Service management: A. Utilize posting logic which complies with Treasury guidance and SFFAS 7. B. Implement policies and procedures to ensure funds are timely returned to the Treasury in accordance with P.L. 106-393.	Closed Closed
Process Improvements are Needed over Personal Property Transactions *[2007 Significant Deficiency]*	15. We recommend that U.S. Forest Service management establish policies and procedures for recording, monitoring and accounting for internal use software and internal use software work in processes; train personnel on such polices and procedures, and monitor compliance with the policies and procedures.	Closed
The Compilation of Performance Measures Needs Continued Improvement *[2007 Significant Deficiency]*	16. We recommend that U.S. Forest Service management: A. Continue to refine its policies and procedures for gathering, verifying and reporting performance measure data. B. Continue to refine its definitions of measures and accomplishments, and adequately communicate and train personnel to improve their understanding of performance reporting. C. Ensure that an interim and year-end reporting process is in place to completely and accurately report its performance measures.	Closed Closed Closed

Open Conditions In this Table are Referenced In Exhibit I		
USDA OIG Audit Report No. 08401-7-FM November 2006		
Material Weakness/ Significant Deficiency	**Recommendation**	**Status**
The U.S. Forest Service Needs to Continue to Improve its Financial Management and Reporting Process *(2007 Significant Deficiency;*	2. We recommend that the U.S. Forest Service management develop a plan to improve the operating effectiveness of its review and approval of all period-end accrual adjustments.	Closed

(Continued)

Open Conditions In this Table are Referenced In Exhibit I		
USDA OIG Audit Report No. 08401-7-FM November 2006		
Material Weakness/ Significant Deficiency	**Recommendation**	**Status**
2006 Material Weakness)		
U.S. Forest Service Needs to Refine and Monitor Its Expense Accrual *(2008 Significant Deficiency; 2007 Significant Deficiency; 2006 Significant Deficiency)*	4. We recommend that U.S. Forest Service management: • Expand the number of data points in the various regression models to at least 52; • 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.	Closed Open
The Compilation of Performance Measures Needs Improvement *(2007 Significant Deficiency; 2006 Significant Deficiency)*	5. We recommend that the U.S. 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 [Performance Accountability System] 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.	Closed Closed Closed

Open Conditions In this Table are Referenced In Exhibit I		
USDA OIG Audit Report No. 08401-6-FM December 2005 *(Replaced prior Audit Report: USDA OIG Audit Report No. 08401-5-FM)*		
Material Weakness/ Significant Deficiency	**Recommendation**	**Status**
Accountability for Unliquidated Orders (ULOs) is Lacking *(2007 Significant Deficiency; 2006 Significant Deficiency; 2005 Material Weakness)*	2. In addition to the prior year Recommendation 1 of Audit Report No. 08401-4-FM, we recommend that the U.S. Forest Service develop a plan to improve the operating effectiveness of its review and approval of all period-end accrual adjustments.	Closed
The U.S. Forest Service Needs to Improve its General Controls Environment *(2008 Significant Deficiency; 2007 Material Weakness;*	5. We recommend that U.S. Forest Service network audit functions be configured to maintain a history of successful and unsuccessful login attempts and user activity for the U.S. Forest Service network as required by U.S. Forest Service Interim Directive 6680-2005-3, "Technical	Open

(Continued)

Open Conditions In this Table are Referenced In Exhibit I		
USDA OIG Audit Report No. 08401-6-FM December 2005 (Replaced prior Audit Report: USDA OIG Audit Report No. 08401-5-FM)		
Material Weakness/ Significant Deficiency	**Recommendation**	**Status**
2006 Material Weakness; 2005 Material Weakness)	Controls." 7. We recommend that U.S. Forest Service management establish controls to facilitate entity-wide adherence to the U.S. 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 8. We recommend that U.S. Forest Service system owners, in cooperation with the USDA OCIO [Office of the Chief Information Officer] and in compliance with USDA and U.S. Forest Service information security requirements: • Install the latest software versions, service packs, and security patches (and remove out-dated versions)	Open Open

Open Conditions In this Table are Referenced In Exhibit I		
USDA OIG Audit Report No. 08401-4-FM November 2004		
Material Weakness/ Significant Deficiency	**Recommendation**	**Status**
Accountability for Undelivered Orders is Lacking *(2008 Significant Deficiency; 2007 Significant Deficiency; 2006 Reportable Condition; 2005 Material Weakness; 2004 Material Weakness*)	1. We recommend that U.S. Forest Service management: • Require all locations to fully comply with review and certification requirements and follow up to resolve questionable items.	Open
The Review of Purchase Card Transactions Needs Improvement *(2008 Significant Deficiency; 2007 Significant Deficiency; 2006 Reportable Condition; 2005 Reportable Condition; 2004 Reportable Condition)*	4. We recommend that U.S. 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

(Continued)

Open Conditions In this Table are Referenced In Exhibit I		
USDA OIG Audit Report No. 08401-3-FM January 2004		
Material Weakness/ Significant Deficiency	**Recommendation**	**Status**
The U.S. Forest Service Needs to Improve Its General Controls Environment *(2008 Significant Deficiency; 2007 Material Weakness; 2006 Material Weakness; 2005 Material Weakness; 2004 Material Weakness; 2003 Material Weakness)*	19. [Additionally,] U.S. Forest Service management should review all systems for the presence of outdated software or services, missing critical patches and/or updates, and improperly configured servers or systems. Forest Service should then proceed to update or delete any identified outdated software, test and install applicable patches or updates, configure servers and systems in accordance with Forest Service technical bulletins and federal criteria, and remove any unneeded services.	Open
The Design and/or Implementation of Controls Related to the Accurate Recording of Personal Property Transactions Need Improvement *(2008 Control Deficiency; 2007 Significant Deficiency; 2006 Reportable Condition; 2005 Reportable Condition; 2004 Reportable Condition; 2003 Reportable Condition)*	30. We recommend that the U.S. Forest Service WO improve its monitoring of reporting units for compliance with the U.S. Forest Service property transaction recording policies.	Open

COMPLIANCE AND OTHER MATTERS

The U.S. Forest Service Continues to Not Obligate all Transactions Required by Appropriations Law *(Repeat Condition)*

Obligation testwork performed on 172 transactions disclosed that 80 transactions were not obligated as required by appropriation law prior to payment. The transactions that were not obligated consisted of TDY and recurring utility type transactions.

Due to the U.S. Forest Service's current system limitations, the U.S. Forest Service can not obligate TDY travel without a considerable effort that would exceed expected benefits. The U.S. Forest Service is in the process of migrating to a new travel system that will allow for the obligation of TDY travel transactions. For other transactions not obligated, several U.S. Forest Service offices did not obligate these transactions because of the variability in determining the estimated cost for these types of transactions. During FY 2008 testwork, U.S. Forest Service management informed us that they do obligate utility type transactions, however as of the end of the FY 2008 audit, such evidence has not been provided.

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 nine criteria for recording obligations. When one criterion is met, the agency not only may, but also must record that transaction as an obligation. Criterion seven 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 U.S. Forest Service to obligate all transactions as reported in prior year Recommendation 8 of Audit Report No. 08401-4-FM.

The U.S. Forest Service's Systems Do Not Comply with FFMIA of 1996 (Repeat Condition)

Financial Management Systems

During our engagement we noted instances described in more detail in Exhibit I, Significant Deficiency 1, where the U.S. Forest Service's financial management systems did not comply with federal financial management systems requirements of the Federal Information Systems Management Act of 2002. Specifically, we identified control deficiencies related to risk assessments, security plans and security testing and evaluation. In addition, numerous vulnerabilities existed with regards to weak access controls and system patches not being updated in the IT general controls environment that support the U.S. Forest Service's financial management systems.

We continue to recognize the need for the U.S. Forest Service to address the significant deficiency recommendations noted in this report.

(Continued)

<u>Compliance with the US Standard General Ledger (SGL)</u>

During our FY 2008 audit, we noted the following deficiencies in the U.S. Forest Service's SGL ledger posting:

- Equipment Management Information System is used to manage working capital fund equipment which consists of aircraft 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 U.S. Forest Service general ledger.
- U.S. Forest Service capitalized lease transactions and internal use software work in process are not recorded in the general ledger at the transaction level. Instead, they are maintained in off-line spreadsheets and then recorded in the general ledger quarterly.
- The U.S. Forest Service does not use proper posting logic to record losses on the disposition of real property assets. Losses are not appropriately recorded in account 7210, *Losses on Disposition of Assets – Other*. Instead they are recorded as negative gains in account 7110, *Gains on Disposition of Assets - Other*.
- During testwork over the first three quarters of FY 2008, it was noted that for stewardship land acquisitions, the U.S. Forest Service improperly debited 6100, *Operating Expenses/Program Expenses* instead of debiting 6908, *Stewardship Land Acquisition (Nonproduction Cost)*. At the end of the year U.S. Forest Service transferred the total stewardship land activity (for which title has transferred) from general ledger account 6100 to 6908. The USDA did not have a posting model at the transactional level to accommodate this business process. U.S. Forest Service obtained posting logic during the fourth quarter of FY 2008 to appropriately record stewardship land acquisitions. However, because the prior business process required manual involvement and did not reclassify these expenses until the title had transferred there was an increased chance for human error. As a result, the U.S. Forest Service overstated general ledger account 6908 by approximately $2.5 million.

We continue to recognize the need for the U.S. Forest Service to develop SGL compliant posting logic for stewardship land acquisitions as noted in Recommendation 6 of Audit Report No. 08401-7-FM.

The Government Accountability Office Made a Final Determination as to the U.S. Forest Service's Fiscal Year 2006 Non-Compliance with 31 USC 1517

In the FY 2007 audit report, number 08401-8-FM dated November 2007, it was reported that the U.S. Forest Service exceeded by $17 million an OMB footnote limitation of $100 million on the Schedule of Apportionment and Reapportionment (SF-132) for TAFS 12X1115. In July 2007, this footnote limitation was considered by the USDA Office of General Counsel to be a violation of the Anti-Deficiency Act (i.e., 31 USC 1517). However, U.S. Forest Service management believed that it had emergency authority to exceed the limitation on this TAFS when protecting "life and land" and requested an opinion from the GAO. As of the issuance of the FY 2007 audit report the GAO opinion had not yet been received.

In February 2008, the U.S. Forest Service received an opinion from the GAO stating that the U.S. Forest Service was in violation of the Anti-Deficiency Act. USDA (and the U.S. Forest Service) reported this violation in 2008 in accordance with OMB A-11 and determined not to impose any administrative discipline for this violation. During 2008 the U.S. Forest Service improved its controls over the apportionment monitoring process.

STATUS OF PRIOR YEAR'S NONCOMPLIANCE FINDINGS AND OTHER MATTERS

Open Conditions In this Table are Referenced In Exhibit III		
USDA OIG Audit Report No. 08401-8-FM November 2007		
Reported Condition	**Recommendation**	**Status**
The U.S. Forest Service Continues to Not Obligate all Transactions Required by Appropriations Law *(2007 Non-compliance)*	17. We recommend that U.S. Forest Service management: A. Develop guidance and provide training to grant and agreement specialists informing them that obligations are timely recorded in FFIS. B. Develop and implement procedures to query the I-WEB system to determine the aging of grants which are in the award process, but have not yet been obligated (i.e., identify grants for which award letters have been issued, but not processed into FFIS).	Closed Closed
The U.S. Forest Service May Not Have Been in Compliance with 31 USC 1517 during Fiscal Year 2006 *(2007 Non-compliance)*	18. We recommend that U.S. Forest Service management: A. Refine its method to monitor and ensure compliance with SF-132 footnote limitations. B. Ensure reasonable timeframes for U.S. Forest Service Budget and Program Analysis Staff and USDA Office of Budget and Program Analysis are established to timely submit requests for apportionments. C. Continue to pursue GAO's opinion.	Closed Closed Closed
The U.S. Forest Service's Systems Do Not Comply with FFMIA of 1996 *(2007 Non-compliance)*	19. We recommend that the U.S. Forest Service develop SGL compliant posting models to appropriately record the recognition of exchange revenue once and then treat subsequent movements of the revenue as transfers of funds.	Closed

Open Conditions In this Table are Referenced In Exhibit III		
USDA OIG Audit Report No. 08401-7-FM November 2006		
Reported Condition	**Recommendation**	**Status**
The USDA Forest Service's Systems Do Not Comply with the Federal Financial Management Improvement Act (FFMIA) *(2007 Non-compliance; 2006 Non-compliance)*	6. We recommend that the U.S. Forest Service develop posting models to appropriately record non-expenditure financing sources-transfers-in and stewardship land acquisitions.	Closed

(Continued)

Open Conditions In this Table are Referenced In Exhibit III		
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**
The U.S. Forest Service's Systems Do Not Comply with the Federal Financial Management Improvement Act (FFMIA) *(2007 Non-compliance; 2006 Non-compliance)*	12. We recommend that the U.S. 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

Open Conditions In this Table are Referenced In Exhibit III		
USDA OIG Audit Report No. 08401-4-FM November 2004		
Reported Condition	**Recommendation**	**Status**
The U.S. Forest Service Does not Obligate All Transactions as Required by Appropriation Law *(2007 non-compliance; 2006 non-compliance; 2005 non-compliance; 2004 non-compliance)*	8. We recommend that the U.S. Forest Service management develop policies and procedures to obligate funds for transactions as required by Appropriations Law.	Open

USDA **United States Department of Agriculture** **Forest Service** **Washington Office** **1400 Independence Avenue, SW Washington, DC 20250**

File Code: 1430/6500
Date: NOV 1 9 2008

KPMG LLP
Mr. Brian J. Grega
Partner
6565 Americas Parkway NE
Two Park Square, Suite 700
Albuquerque, NM 87110

Dear Mr. Grega:

We have reviewed KPMG's Independent Auditor's Report dated November 10, 2008, 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 questions or require additional information, please contact Donna Carmical at (505) 563-7103.

Sincerely,

Donna Carmical

for JESSE L. KING
Chief Financial Officer

cc: Wanda Philippi, Office of the Inspector General, Luana Harris, Office of the Inspector General

U.S. Department of Agriculture
Forest Service
CONSOLIDATED BALANCE SHEETS
As of September 30, 2008 and 2007
(in millions)

	2008	2007
Assets:		
Intragovernmental:		
Fund Balance with Treasury (Note 2)	$ 4,066	$ 3,641
Investments	9	6
Accounts Receivable, Net (Note 3)	59	43
Total Intragovernmental	4,134	3,690
Cash and Other Monetary Assets	1	1
Accounts Receivable, Net (Note 3)	244	177
General Property, Plant, and Equipment (PP&E), Net (Note 4)	1,375	3,458
Other	21	13
Total Assets	$ 5,775	$ 7,339
Stewardship PP&E (Note 5)		
Liabilities:		
Intragovernmental:		
Federal Employee Benefits (Notes 6 & 7)	$ 67	$ 66
Other (Note 9)	85	132
Total Intragovernmental	152	198
Accounts Payable	52	64
Federal Employee Benefits (Notes 6 & 7)	339	317
Environmental and Disposal Liabilities (Note 6 & 8)	18	97
Other (Note 9)	1,522	1,385
Total Liabilities (Note 6)	2,083	2,061
Commitments and Contingencies (Note 9)		
Net Position:		
Unexpended Appropriations - earmarked funds (Note 11)	1	-
Unexpended Appropriations - other funds	1,969	1,307
Cumulative Results of Operations - earmarked funds (Note 11)	1,179	1,125
Cumulative Results of Operations - other funds	543	2,846
Total Net Position	3,692	5,278
Total Liabilities and Net Position	$ 5,775	$ 7,339

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, 2008 and 2007
(in millions)

	2008	2007
Program Costs (Note 12):		
Total Gross Costs	$ 6,711	$ 6,315
Total Earned Revenue	865	598
Net Cost of Operations	$ 5,846	$ 5,717

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, 2008 and 2007
(in millions)

	FY 2008			FY 2007		
	Earmarked Funds (Note 11)	All Other Funds	Consolidated Total	Earmarked Funds (Note 11)	All Other Funds	Consolidated Total
Cumulative Results of Operations:						
Beginning Balance	$ 1,125	$ 2,846	$ 3,971	$ 1,244	$ 3,055	$ 4,299
Adjustment						
Change in Accounting Principle (Note 19)	(14)	(2,071)	(2,085)	-	-	-
Beginning Balance, as Adjusted	1,111	775	1,886	1,244	3,055	4,299
Budgetary Financing Sources:						
Appropriations Used	-	5,172	5,172	-	4,896	4,896
Non-Exchange Revenue	-	-	-	-	7	7
Donations and Forfeitures of Cash	1	-	1	1	-	1
Transfers - In/Out without Reimbursement	160	(36)	124	67	85	152
Other Financing Sources (Non-Exchange):						
Transfers without Reimbursement	(32)	33	1	-	-	-
Imputed Financing	-	331	331	-	328	328
Other	85	(32)	53	5	-	5
Total Financing Sources	214	5,468	5,682	73	5,316	5,389
Net Cost of Operations	(146)	(5,700)	(5,846)	(192)	(5,525)	(5,717)
Net Change	68	(232)	(164)	(119)	(209)	(328)
Cumulative Results of Operations	**1,179**	**543**	**1,722**	**1,125**	**2,846**	**3,971**
Unexpended Appropriations:						
Beginning Balance	-	1,307	1,307	-	1,030	1,030
Budgetary Financing Sources:						
Appropriations Received	-	5,790	5,790	-	5,180	5,180
Appropriations Transferred - In/Out	1	(3)	(2)	-	(2)	(2)
Other Adjustments	-	47	47	-	(5)	(5)
Appropriations Used	-	(5,172)	(5,172)	-	(4,896)	(4,896)
Total Budgetary Financing Sources	1	662	663	-	277	277
Total Unexpended Appropriations	**1**	**1,969**	**1,970**	-	**1,307**	**1,307**
Net Position	**$ 1,180**	**$ 2,512**	**$ 3,692**	**$ 1,125**	**$ 4,153**	**$ 5,278**

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, 2008 and 2007
(in millions)

	2008	2007
Budgetary Resources:		
Unobligated Balance, Brought Forward, October 1	$ 1,671	$ 1,809
Recoveries of Prior Year Unpaid Obligations	78	111
Budget Authority:		
Appropriations	6,310	5,586
Spending Authority from Offsetting Collections:		
Earned:		
Collected	561	525
Change in Receivables	38	(44)
Change in Unfilled Customer Orders:		
Advance Received	(7)	5
Without Advance	3	(5)
Expenditure Transfers from Trust Funds	4	
Subtotal	6,909	6,067
Nonexpenditure Transfers, net	(2)	21
Permanently Not Available	(71)	-
Total Budgetary Resources (Note 15)	$ 8,585	$ 8,008
Status of Budgetary Resources:		
Obligations Incurred: (Note 14)		
Direct	$ 6,055	$ 6,048
Reimbursable	360	289
Subtotal	6,415	6,337
Unobligated Balance-Apportioned (Note 2)	982	840
Unobligated Balance Not Available (Note 2)	1,188	831
Total Status of Budgetary Resources (Note 15)	$ 8,585	$ 8,008
Change in Obligated Balance:		
Obligated Balance, net		
Unpaid Obligations, Brought Forward, October 1	$ 2,243	$ 2,383
Less: Uncollected Customer Payments, Brought Forward October 1	(384)	(433)
Total Unpaid Obligated Balance, net	1,859	1,950
Obligations Incurred net	6,415	6,337
Less: Gross Outlays	(6,448)	(6,366)
Less: Recoveries of Prior Year Unpaid Obligations, actual	(78)	(111)
Change in Uncollected Customer Payments	(41)	49
Obligated Balance, net, End of Period		
Unpaid Obligations	2,132	2,243
Less: Uncollected Customer Payments	(425)	(384)
Total, Unpaid Obligated Balance, net, End of Period (Note 2)	$ 1,707	$ 1,859
Net Outlays:		
Net Outlays:		
Gross Outlays	$ 6,448	$ 6,366
Less: Offsetting Collections	(558)	(531)
Less: Distributed Offsetting Receipts	(514)	(500)
Net Outlays	$ 5,376	$ 5,335

The accompanying notes are an integral part of these statements.

U. S. Department of Agriculture
Forest Service
Notes to the Consolidated and Combined Financial Statements
For the years ended September 30, 2008 and 2007

NOTE 1: SIGNIFICANT ACCOUNTING POLICIES

A: REPORTING ENTITY

The U.S. Department of Agriculture (USDA) Forest Service (Forest Service) was established on February 1, 1905, as an agency of the United States Federal Government within the Department of Agriculture, 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. Forest Service policy is implemented through nine regional National Forest System (NFS) offices, one State and Private Forestry (S&PF) area office, five research (R&D) offices, the Forest Products Laboratory (FPL) and the International Institute of Tropical Forestry (IITF), functioning in nearly all States, Puerto Rico, and the Virgin Islands.

The Forest Service's mission includes the following four major segments:

National Forests and Grasslands - Protection and management of an estimated 193 million acres (unaudited) of NFS land that includes 34.8 million acres (unaudited) of designated wilderness areas. In addition, the Forest Service partners with other nations and organizations to foster global natural resource conservation and sustainable development of the worlds 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 NFS lands, extending to an estimated additional 20 million acres (unaudited) of adjacent State and private lands.

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

B: BASIS OF PRESENTATION AND ACCOUNTING

The Consolidated Balance Sheets (BS), Statements of Net Cost (SNC), Statements of Changes in Net Position (SCNP), and the Combined Statements of Budgetary Resources (SBR) (hereinafter referred to as the “financial statements”) were prepared to report the financial position, net costs, changes in net position, and budgetary resources of the Forest Service. The financial statements have been prepared from the books and records of the 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 June 3, 2008. All material intra-agency transactions and balances have been eliminated for presentation on a consolidated basis. However, the SBR is 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 Forest Service recognizes budgetary resources as assets when cash (funds held by Treasury) is made available through the U.S. Department of the Treasury (Treasury) General Fund warrants and other transfers. In addition to appropriated funds, the 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 Forest Service's earned revenues are monies collected from timber sales or recreation fees.

C: FUND BALANCE WITH THE U.S. TREASURY

The Treasury processes cash receipts and disbursements on behalf of the Forest Service. Funds on deposit with 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 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.

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 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 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. There are no restrictions on the use or convertibility of general PP&E.

See Note 5 for specific disclosures related to multi-use Heritage Assets.

F: STEWARDSHIP PP&E

Stewardship PP&E includes assets such as heritage assets and stewardship land and due to their unique nature would be difficult to value. In accordance with SFFAS No. 29, *Heritage Asset and Stewardship Land*, all heritage assets and stewardship land information has been reclassified as basic, except for condition information, which is reclassified as required supplementary information (RSI).

See Note 5 for specific disclosures related to Stewardship PP&E.

G: LIABILITIES

Liabilities represent the amount of monies or other resources that are likely to be paid by the Forest Service as a result of a transaction or event that has occurred. However, the 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.

H: ENVIRONMENTAL AND DISPOSAL LIABILITIES

The Forest Service's estimated government-related and government-acknowledged 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.

See Note 8 for specific disclosures related to cleanup costs for ongoing operations.

I: COMMITMENTS AND CONTINGENCIES

The Forest Service is a party in various administrative proceedings, legal actions, environmental lawsuits, and claims. In the opinion of the 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 Forest Service is recognized as a liability and expense. Expected amounts related to litigation and other claims include amounts to be paid by Treasury on behalf of the Forest Service from a permanent appropriation for judgments and from other appropriations.

J: 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 Forest Service's employees under FECA are administered by the U.S. Department of Labor (DOL). The USDA uses Forest Service funds to reimburse the DOL for FECA claims. Consequently, the 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 Forest Service approved compensation cases to be paid beyond the current fiscal year.

K: 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.

L: PENSION AND OTHER RETIREMENT BENEFITS

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 Forest Service's matching contribution, equal to 7.0 percent of pay, distributed to their annuity account in the Civil Service Retirement and Disability Fund.

FERS went into effect on January 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 January 1, 1984 could elect to join FERS and Social Security, or to remain in CSRS. FERS offers a savings plan to which the Forest Service automatically contributes 1.0 percent of pay and matches any employee contribution up to an additional 4.0 percent of pay. For FERS participants, the Forest Service also contributes the employer's matching share for Social Security.

The 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 Forest Service for current period expense reporting.

M: REVENUES AND OTHER FINANCING SOURCES

The Forest Service is funded principally through Congressional appropriations and other authorizations in the Budget of the United States. The 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 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 Forest Service is required to remit exchange revenue receipts to the Treasury. In other instances, the 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 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 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 12 as intragovernmental or with the public based on the related source or customer, respectively.

N: IMPUTED FINANCING

The 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 Forest Service are also recognized as imputed financing. Imputed financing for the years ended September 30, 2008 and 2007 was $331 million and $328 million, respectively.

O: PARENT/CHILD REPORTING REQUIREMENTS

The Forest Service is a party to allocation transfers with other federal agencies as both a transferring (parent) entity and/or a receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. Effective October 1, 2006, in accordance with OMB Circular A-136, all financial activity related to these allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations and budget apportionments are derived. The Forest Service allocates funds, as the parent, to the Department of Transportation, Department of Interior, Department of the Army, Department of the Navy, Department of the Air Force, and the Corp of Engineers, Civil. The Forest Service receives allocation transfers, as the child, from the Department of Labor, Department of Transportation, and Department of Interior.

P: 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 and federal employee benefits liabilities.

Q: EARMARKED FUNDS

The Forest Service reports the earmarked funds for which it has program management responsibility, using the following three criteria:

- A statute committing the Federal government to use specifically identified revenues and other financing sources only for designated activities, benefits, or purposes;
- 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
- 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 Federal government's general revenues.

R: CHANGE IN ACCOUNTING PRINCIPLE

In accordance with SFFAS *21, Reporting Correction of Errors and Changes in Accounting Principles*, the Forest Service has implemented a voluntary change in accounting principle to reclassify National Forest System (NFS) Road (road prism) assets from General PP&E to Stewardship PP&E. This change removes capitalized road prism values from the Balance Sheet and expenses the related costs, as reflected in an adjustment to the beginning balance of Cumulative Results of Operations (CRO) in the Statement of Changes in Net Position.

See Note 19 for additional information.

NOTE 2: FUND BALANCE WITH TREASURY

Funds with 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 suspense accounts. It is the Forest Service's policy to ensure the Fund Balance with Treasury (FBWT) reported on the Balance Sheets is consistent with the records of the Treasury.

The Forest Service has known discrepancies with Treasury in FBWT, suspense accounts 12F3875 and 12F3885, as of September 30, 2008. "F" accounts have been discontinued effective July 31, 2008. The USDA and the Forest Service have elected not to obtain an "F" waiver, which would permit the entity to continue using suspense accounts. Treasury has stopped accepting new activity in "F" accounts from entities without an "F" waiver, but certain Intragovernmental activity is still mapped to 12F3875 and 12F3885, resulting in balances recorded to the general ledger, but not reported to Treasury, per Treasury guidance. The difference in the FBWT balance as of September 30, 2008, is $3.8 million.

Fund Balance with Treasury as of September 30, 2008 and 2007 consisted of the following:

	(in millions)	
A. Fund Balances:	**2008**	**2007**
(1) Trust Funds	$313	$354
(2) Special Funds	908	767
(3) Revolving Funds	146	136
(4) General Funds	2,628	2,305
(5) Other Fund Types	71	79
Total	$4,066	$3,641
B. Status of Funds:		
(1) Unobligated Balance		
(a) Available	$982	$840
(b) Unavailable	1,188	831
(2) Obligated Balance not yet Disbursed	1,707	1,859
(3) Other Balances	189	111
Total	$4,066	$3,641

NOTE 3: ACCOUNTS RECEIVABLE, NET

Intragovernmental accounts receivable represent amounts due under reimbursable and cooperative agreements with Federal entities for services provided by the 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, 2008 and 2007, the intragovernmental accounts receivable balances were $59 million and $43 million, respectively.

Non-intragovernmental accounts receivable are comprised primarily of timber harvest and reimbursements and refunds owed to the 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. The historical percentage is calculated by comparing open accounts receivable against the total accounts receivable. The historical percentage is then applied to total receivables. This approach is used to estimate the allowance for uncollectible accounts and recording receivables at net realizable value.

Non-intragovernmental accounts receivable as of September 30, 2008 and 2007 consisted of the following:

	(in millions)	
	2008	**2007**
Accounts Receivable	$254	$187
Allowance for Doubtful Accounts	(10)	(10)
Accounts Receivable, Net	$244	$177

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

Depreciation of General PP&E for the 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. Additional information on the reduction in real property book value due to a voluntary change in accounting principle is provided in Note 19.

As of September 30, 2008 and 2007 the Forest Service's PP&E consisted of the following:

September 30, 2008
(in millions)

Property Class	Estimated Useful Life (Years)	Cost	Accumulated Depreciation	Book Value
Personal Property				
Equipment	5 - 20	$ 710	$ (524)	$ 186
Internal Use Software	5	186	(142)	44
Internal Use Software in Development	n/a	11	-	11
Total Personal Property		**907**	**(666)**	**241**
Real Property				
Land and Land Rights	n/a	51		51
Improvements to Land	10	690	(582)	108
Construction in Progress	n/a	170		170
Buildings, Improvements, and Renovations	30	890	(547)	343
Other Structures and Facilities	15 - 50	1,632	(1,211)	421
Assets Under Capital Lease	5 - 30	63	(32)	31
Leasehold Improvements	10	14	(4)	10
Total Real Property		**3,510**	**(2,376)**	**1,134**
Total		**$ 4,417**	**$ (3,042)**	**$ 1,375**

September 30, 2008
(in millions)

Property Class	Estimated Useful Life (Years)	Cost	Accumulated Depreciation	Book Value
Personal Property				
Equipment	5 - 20	$ 739	$ (550)	$ 189
Internal Use Software	5	130	(121)	9
Internal Use Software in Development	n/a	7	-	7
Total Personal Property		**876**	**(671)**	**205**
Real Property				
Land and Land Rights	n/a	52		52
Improvements to Land	10 - 50	5,021	(2,817)	2,204
Construction in Progress	n/a	184	-	184
Buildings, Improvements, and Renovations	30	874	(529)	345
Other Structures and Facilities	15 - 50	1,589	(1,165)	424
Assets Under Capital Lease	5 - 30	70	(34)	36
Leasehold Improvements	10	11	(3)	8
Total Real Property		**7,801**	**(4,548)**	**3,253**
Total		**$ 8,677**	**$ (5,219)**	**$ 3,458**

NOTE 5: STEWARDSHIP PP&E

This note provides information on certain resources entrusted to and stewardship responsibilities assumed by the Forest Service. These resources and responsibilities are referenced in accordance with SFFAS No. 29, *Heritage Assets and Stewardship Land* on the Forest Service's Balance Sheet.

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

Stewardship PP&E are assets whose physical properties resemble those of the General PP&E that are 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 Forest Service reports its physical units of Stewardship PP&E by site. Sites include National Forests, National Grasslands, other Forest Service-managed sites, and non Forest Service- managed sites such as museums and university laboratories. The protection of these lands and resources is a fundamental Forest Service responsibility.

The mission of the 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 Forest Service strives to achieve quality land management under the sustainable multiple-use management concept to deliver the necessary products and services that are essential for enhancing natural resource stewardship and to meet the diverse needs of people.

Heritage Assets

Heritage assets, as defined in SFFAS 29, are PP&E that are unique for one or more of the following reasons:

- Historical or natural significance
- Cultural, educational, or artistic (e.g. aesthetic) importance
- Significant architectural characteristics

Heritage assets can include non-collection type assets, such as historic or prehistoric sites, monuments, and buildings, or collection type assets, such as objects gathered and maintained for exhibition.

Some heritage assets may also be classified as multi-use heritage assets if they serve two purposes—a heritage function and a general government operations function, such as a forest guard station building. The building may be listed on the National Register of Historic Places, but it serves primarily as an administrative site; hence, it is considered a "multi-use" heritage asset. Multi-use heritage assets are capitalized as General PP&E. Physical units of multi-use heritage assets are included in Stewardship PP&E.

	FY 2008 (as of 09/30/2008)
HERITAGE ASSET SITES	
National Forests	155
National Grasslands	20
Other	22
TOTAL SITES	**197**

Stewardship Land

Stewardship land consists primarily of the national forests and grasslands owned by the 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.

National Forests

The national forests are formally established and permanently set aside and reserved for national forest purposes.

National Grasslands

National grasslands are designated by the Secretary of Agriculture and permanently held by the USDA under Title III of the Bankhead-Jones Farm Tenant Act.

Research and Experimental Areas

Research and experimental areas are reserved and dedicated by the Secretary of Agriculture for forest and range research experimentation. Areas reported are located outside the exterior boundaries of a National Forest or National Grassland.

National Preserves and Other Areas

National preserves are units established to protect and preserve scientific, scenic, geologic, watershed, fish, wildlife, historic, cultural, and recreational values; and provide for multiple use and sustained yield of its renewable resources. Other areas include areas administered by the Forest Service that are not included in one of the above groups.

The NFS sites reported by major category as of September 30, 2008, are as follows:

	FY 2008 (as of 09/30/2008)
STEWARDSHIP LAND ASSET SITES	
National Forests	155
National Grasslands	20
Research and Experiment Areas	3
National Preserves and Other Areas	3
TOTAL SITES	**181**

NOTE 6: LIABILITIES NOT COVERED BY BUDGETARY RESOURCES

Liabilities not covered by budgetary resources as of September 30, 2008 and 2007 consisted of the following:

	(in millions)	
	2008	2007
Intragovernmental:		
Treasury Judgment Fund	$17	$15
Federal Employee Benefits (Note 7)	67	66
Total Intragovernmental	84	81
Federal Employee Benefits (Note 7)	339	317
Annual Leave Liability	199	193
Contingent Liabilities	14	11
Accrued Liability for Payments to States	531	394
Environmental and Disposal Liabilities	10	97
Total Liabilities Not Covered by Budgetary Resources	1,177	1,093
Total Liabilities Covered by Budgetary Resources	906	968
Total Liabilities	$2,083	$2,061

NOTE 7: FEDERAL EMPLOYEE BENEFITS

Liabilities under the Federal Employees' Compensation Act (FECA) are incurred as a result of accrued workers' compensation benefits not yet paid by the 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 USDA as a whole, including the Forest Service. The 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. The amounts of unpaid FECA billings constitute the accrued FECA payable.

The total components of accrued FECA payable as of September 30, 2008 and 2007 consisted of the following:

	(in millions)	
	2008	**2007**
Intragovernmental Federal Employee Benefits (Note 6)	$67	$66
Federal Employee Benefits (Note 6)	339	317
Total	$406	$383

NOTE 8: ENVIRONMENTAL AND DISPOSAL LIABILITIES

Forest Service discloses the following information related to cleanup costs for environmental hazards, in accordance with SFFAS No. 5, *Accounting for Liabilities of the Federal Government,* and SFFAS No. 6*, Accounting for Property, Plant and Equipment.*

The Forest Service recognizes two categories of environmental hazards. Government-related events are damages caused by such factors as ongoing operations or natural forces. The resulting liability is recognized in the period the event occurs or as soon thereafter as it becomes probable and measurable.

Government-acknowledged events are non-transaction events that are of financial consequence to the Forest Service because it chooses to respond to the event, and a primary responsible party cannot be located. Clean up costs associated with events such as toxic waste damage caused by nonfederal entities or natural disasters, may ultimately become the responsibility of the Forest Service. However these costs do not meet the definition of a "liability" until, and to the extent that financial responsibility is acknowledged by the Forest Service, Congress has appropriated resources, and an exchange or non-exchange transaction has occurred.

Forest Service project managers confer with the appropriate States, the Office of General Counsel (OGC), and occasionally, EPA and local governments. The agency follows cleanup requirements from the legislative sources in Appendix I of Federal Financial Accounting and Auditing, Technical Release No. 2, including the Comprehensive Environmental Response Compensation and Liability Act of 1980 (CERCLA), the Resource Conservation and Recovery Act (RCRA), other Federal or State regulations and USDA or Forest Service policy, as necessary.

Cleanup cost estimates—usually immaterial to the total project cost for the majority of demolitions, deconstructions, or renovations—are included in PP&E operations and maintenance costs (O&M). When contamination occurs that is not addressed under regular O&M, the agency develops a cost estimate for the total cleanup and, to the extent it is probable and reasonable to estimate, records the cost to cleanup any contaminated PP&E. Professional judgment and prior experience is often the basis for cost estimates. If the agency has no previous similar experience, the staff performs other comparable technical reviews or derives estimates using standard cost estimating guides.

Exceptions occur when a *previous* activity results in release or potential release of a hazardous substance, and if contamination migrates offsite from a *current* operation. In these instances, the total reasonably estimable costs are recognized when the exception is discovered.

Forest Service cleanup cost estimates are based on the current total cost for a contaminated site according to laws, technology and inflation/deflation. Forest Service updates cost estimates, including changes relating to prior period operations, for government-related liabilities at least annually, to reflect changes in laws or regulations, technology, and inflation or deflation.

Environmental and disposal liabilities for the year ended September 30, 2008, for government-related and government-acknowledged events were $11 million and $7 million respectively. This amount reflects a decrease of $79 million as compared to FY 2007. An OGC Memorandum on Potential Forest Service Liabilities, indicates that abandoned mine land (AML) sites should not be considered as government-related liabilities. The reduced liability reflects this finding.

NOTE 9: OTHER LIABILITIES

(in millions)

	2008			2007		
	Non-Current	Current	Total	Non-Current	Current	Total
Intragovernmental						
Employer Contributions & Payroll Tax	$ -	$ 24	$ 24	$ -	$ 14	$ 14
Accrued Liabilities	17	27	44	15	43	58
Advances from Others	-	19	19	-	24	24
Deposit Liabilities	-	(11)	(11)	-	27	27
Custodial Liabilities	-	9	9	-	9	9
Total Intragovernmental	$ 17	$ 68	$ 85	$ 15	$ 117	$ 132
Other						
Accrued Liabilities	$ -	$ 567	$ 567	$ -	$ 654	$ 654
Grant Liabilities	-	5	5	-	-	-
Advances from Others	-	47	47	-	49	49
Deposit Liabilities	-	124	124	-	46	46
Purchaser Road Credits	-	1	1	-	2	2
Accrued Liability for Payments to States & Counties	-	531	531	-	394	394
Annual Leave Liability		199	199	-	193	193
Contingent Liabilities	14	-	14	11	-	11
Custodial Liabilities	-	3	3	-	-	-
Capital Leases (Note 10)	28	3	31	32	4	36
Total Other	$ 42	$ 1,480	$ 1,522	$ 43	$ 1,342	$ 1,385
Total Other and Intragovernmental Liabilities	$ 59	$ 1,548	$ 1,607	$ 58	$ 1,459	$ 1,517

As of September 30, 2008 and 2007, the Forest Service's major components of other liabilities are as follows:

Accrued Liabilities: Accrued liabilities consist primarily of accruals for payroll and for receipt of goods and services. Accrued liabilities for occupancy agreements between U.S. General Services Administration (GSA) and the Forest Service are also included. Approximately 30.0 percent of the accrued liabilities total is calculated by a mathematical model based on a regression between open obligation balances and subsequent payments.

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. 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. The Secure Rural School and Community Self Determination Act of 2000, (P.L. 106-393) as amended by §601 of The Emergency Economic Stabilization Act of 2008, (H.R. 1424) (P.L. 110-343) also provides for roads and schools, Forest Service projects and emergency services. In addition, the Payments to Counties, Bankhead-Jones Farm Tenant Act of 1937 requires 25.0 percent of the net revenues from each national grassland or land utilization project to be paid to the counties in which such lands are located.

Annual Leave Liability: 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. 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.

Contingent Liabilities and Commitments: As of September 30, 2008, the Forest Service had several legal actions pending. Based on information provided by legal counsel, management believes some adverse decisions are probable and approximately $14 million related to such actions has been accrued. The Forest Service has a potential liability for approximately $206 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.

NOTE 10: LEASE LIABILITIES

The Forest Service enters into leasing agreements 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 Forest Service's assets under capital leases as of September 30, 2008 and 2007 and future capital and operating lease agreement payments as of September 30, 2008 consisted of the following:

		(in millions)	
Capital Leases:		**2008**	**2007**
Summary of Assets Under Capital Leases			
Land, Buildings, Machinery, & Equipment		$63	$70
Accumulated Amortization		(32)	(34)
Total		$31	$36
Future Payments Due:			
		Land & Buildings, Machinery & Equipment	
	Year 1 (2009)	10	
	Year 2 (2010)	10	
	Year 3 (2011)	10	
	Year 4 (2012)	9	
	Year 5 (2013)	9	
	After 5 Years	50	
Total Future Lease Payments		$98	
Less: Imputed Interest		48	
Less: Executory Costs		19	
Subtotal		31	
Lease Liabilities covered by Budgetary Resources		$31	
Lease Liabilities not covered by Budgetary Resources		-	

Operating Leases:		**(in millions)**
Future Payments Due:		
	Fiscal Year	Land & Buildings, Machinery & Equipment
	Year 1 (2009)	$42
	Year 2 (2010)	40
	Year 3 (2011)	38
	Year 4 (2012)	35
	Year 5 (2013)	33
	After 5 Years	272
Total Future Lease Payments		$460

NOTE 11: EARMARKED FUNDS

In accordance with SFFAS 27, *Identifying and Reporting Earmarked Funds*, the 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 NFS 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 the Forest Service has program management responsibility. Those with an asterisk are authorized by specific legislative acts as permanent indefinite appropriations.

Treasury Account Symbols and Titles

5004 Land Acquisition
5008 National Forest Fund Receipts
5010 Recreation Fees for Collection Costs
5072 Fees, Operation and Maintenance of Recreation Facilities
5201 Payments to States, National Forest Fund
*5202 Timber Roads Purchaser Election
*5203 Roads and Trails for States, National Forest Funds
*5204 Timber Salvage Sales
*5206 Expenses, Brush Disposal
5207 Range Betterment Fund
5208 Acquisition of Lands for National Forests, Special Acts
5212 Construction of Facilities or Land Acquisition
*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 (Funds EXSL and EXSC)
5217 Tongass Timber Supply Fund
*5219 Operation and Maintenance of Quarters
*5220 Resource Management Timber Receipts
*5223 Quinault Special Management Area
*5224 Strawberry Valley Land Transfer
*5225 Pacific Yew, Forest Service
*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
5367 State, Private and International Forestry Land and Water Conservation Fund
*5462 Hardwood Technology Transfer and Applied Research Fund
*5540 Stewardship Contracting Product Sales, Funds Retained
*5896 Payments to Counties, National Grasslands
*8028 Cooperative Work, Forest Service
8029 Mount Saint Helens Highway
8034 Gifts, Donations, and Bequests for Forest and Rangeland Research
8039 Land Between the Lakes Trust Fund
8046 Reforestation Trust Fund
*8203 Gifts and Bequests, Department of Agriculture

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, 2008
(in millions)

	Cooperative Work	Restoration of Forest Lands and Improvements	Recreation Fee Demonstration Program	State, Private, & International Forestry Land & Water Conservation Fund	Other Funds	Total
ASSETS						
Fund Balance with Treasury	$ 296	$ 113	$ 147	$ 107	$ 557	$ 1,220
Investments	-	-	-	-	9	9
Accounts Receivable, Net	3	41	1	-	17	62
Advances To Others	-	-	-	4	1	5
General Property, Plant & Equipment, Net	17	-	3	-	88	108
TOTAL ASSETS	$ 316	$ 154	$ 151	$ 111	$ 672	$ 1,404
LIABILITIES						
Accounts Payable	$ 3	$ -	$ 1	$ -	$ 2	$ 6
Other Liabilities	50	-	3	5	160	218
TOTAL LIABILITIES	53	-	4	5	162	224
Total Net Position	263	154	147	106	510	1,180
TOTAL LIABILITIES AND NET POSITION	$ 316	$ 154	$ 151	$ 111	$ 672	$ 1,404
CHANGE IN NET POSITION						
Beginning Balances, as adjusted	$ 301	$ 51	$ 151	$ 100	$ 508	$ 1,111
Budgetary Financing Sources:						
Appropriations Transfer - in/out	-	-	-	1	-	1
Donations and Forfeitures of Cash	-	-	-	-	1	1
Transfers -in/out without Reimbursement	(4)	-	-	52	112	160
Other Financing Sources:						
Transfers-in/out without Reimbursement	-	-	-	-	(32)	(32)
Other	-	-	-	-	85	85
Total Financing Sources	(4)	-	-	53	166	215
Revenue	105	108	61	-	210	484
Expenses	(139)	(5)	(65)	(47)	(374)	(630)
Net Cost of Operations	(34)	103	(4)	(47)	(164)	(146)
ENDING BALANCES	$ 263	$ 154	$ 147	$ 106	$ 510	$ 1,180

Earmarked Funds
As of and for the year ended September 30, 2007
(in millions)

	Cooperative Work	Recreation Fee Demonstration Program	Payments to States, National Forest Fund	State, Private, & International Forestry Land & Water Conservation Fund	Other Funds	Total
ASSETS						
Fund Balance with Treasury	$ 338	$ 150	$ 146	$ 101	$ 387	$ 1,122
Investments	-	-	-	-	6	6
Accounts Receivable, Net	4	1	-	-	38	43
Advances To Others	-	-	1	2	-	3
General Property, Plant & Equipment, Net	20	3	4	-	89	116
TOTAL ASSETS	$ 362	$ 154	$ 151	$ 103	$ 520	$ 1,290
LIABILITIES						
Accounts Payable	$ 3	$ 1	$ 2	$ -	$ 3	$ 9
Other Liabilities	55	2	73	3	23	156
TOTAL LIABILITIES	58	3	75	3	26	165
Total Net Position	304	151	76	100	494	1,125
TOTAL LIABILITIES AND NET POSITION	$ 362	$ 154	$ 151	$ 103	$ 520	$ 1,290
CHANGE IN NET POSITION						
Beginning Balances, as adjusted	$ 377	$ 135	$ 128	$ 84	$ 520	$ 1,244
Budgetary Financing Sources:						
Donations and Forfeitures of Cash	-	-	-	-	1	1
Transfers -in/out without Reimbursement	-	13	-	57	(3)	67
Other	-	-	-	-	5	5
Total Financing Sources	-	13	-	57	3	73
Revenue	97	60	(21)	-	192	328
Expenses	(170)	(57)	(31)	(41)	(221)	(520)
Net Cost of Operations	(73)	3	(52)	(41)	(29)	(192)
ENDING BALANCES	$ 304	$ 151	$ 76	$ 100	$ 494	$ 1,125

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 Forest Service. Cooperators include timber purchasers, not-for-profit organizations, and local hunting and fishing clubs. The governing authorities are the Cooperative Funds Act of June 30, 1914 (16 U.S.C. 498), and the Knutson-Vandenberg Act.

Restoration of Forest Lands and Improvements

The Restoration of Forest Lands and Improvements Acts (16 U.S.C. 579c) states, any moneys received by the United States with respect to lands under the administration of the Forest Service (a) as a result of the forfeiture of a bond or deposit by a permittee or timber purchaser for failure to complete performance of improvement, protection, or rehabilitation work required under the permit or timber sale contract or (b) as a result of a judgment, compromise, or settlement of any claim, involving present or potential damage to lands or improvements, shall be deposited into the Restoration of Forest Lands and Improvements Account – 12X5215 and made available until expended to cover the cost of any improvement, protection, or rehabilitation work on lands under the administration of the Forest Service rendered necessary by the action which led to the forfeiture, judgment, compromise, or settlement, provided that any portion of the moneys so received in excess of the amount expended in performing the work necessitated by the action which led to their receipt shall be transferred to miscellaneous receipts.

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 §315 of Title III General Provisions of Public Law 104-134: Recreation Fee Demonstration Program 16 U.S.C. 4601-6a.

State, Private, and International Forestry, Land and Water Conservation Fund

The Fiscal Year 2004 Department of Interior and Related Agencies Appropriation Act (Public Law 108-108) authorizes the Forest Service to receive a transfer of receipts from Department of Interior's Land and Water Conservation Fund to finance the existing Forest Legacy Program, funded previously by State and Private Forestry general appropriation, 12X1105. To accommodate the new financing arrangement and at OMB's request, the Department of Treasury established a new special fund, 12X5367, "State, Private and International Forestry Land and Water Conservation Fund". The program expenditures include grants and an occasional land purchase but no real property will be procured or constructed.

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 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.

NOTE 12: SUBORGANIZATION PROGRAM COSTS/PROGRAM COSTS BY SEGMENT

The 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, 2008 and 2007.

Program Costs by Segment
For the year ended September 30, 2008
(in millions)

	National Forests and Grasslands	Forest and Rangeland Research	State and Private Forestry	Wildland Fire Management	Total
Intragovernmental Gross Costs:					
Benefit Program Costs	$ 534	$ 1	$ -	$ 12	$ 547
Imputed Costs	331	-	-	-	331
Reimbursable Costs	138	21	12	175	346
Total Intragovernmental Gross Costs	1,003	22	12	187	1,224
Less: Intragovernmental Earned Revenue	50	26	23	150	249
Intragovernmental Net Costs	953	(4)	(11)	37	975
Gross Costs With the Public:					
Grants and Indemnities	550	8	275	22	855
Stewardship Land Acquisition (Note 13)	42	-	-	-	42
Other:					
Operating Costs	1,499	276	100	2,206	4,081
Depreciation Expense	132	2	-	34	168
Reimbursable Costs	83	26	20	212	341
Total Other	1,714	304	120	2,452	4,590
Total Gross Costs with the Public	2,306	312	395	2,474	5,487
Less: Earned Revenues from the Public	531	3	1	81	616
Net Costs with the Public	1,775	309	394	2,393	4,871
Net Cost of Operations	$ 2,728	$ 305	$ 383	$ 2,430	$ 5,846

Program Costs by Segment
For the year ended September 30, 2007
(in millions)

	National Forests and Grasslands	Forest and Rangeland Research	State and Private Forestry	Wildland Fire Management	Total
Intragovernmental Gross Costs:					
Benefit Program Costs	$ 361	$ 1	$ 1	$ 9	$ 372
Imputed Costs	328	-	-	-	328
Reimbursable Costs	186	18	18	277	499
Total Intragovernmental Gross Costs	875	19	19	286	1,199
Less: Intragovernmental Earned Revenue	69	37	17	12	135
Intragovernmental Net Costs	806	(18)	2	274	1,064
Gross Costs With the Public:					
Grants and Indemnities	444	8	229	19	700
Stewardship Land Acquisition (Note 13)	73	-	-	-	73
Other:					
Operating Costs	1,595	247	114	1,924	3,880
Depreciation Expense	223	2	-	21	246
Reimbursable Costs	67	26	16	108	217
Total Other	1,885	275	130	2,053	4,343
Total Gross Costs with the Public	2,402	283	359	2,072	5,116
Less: Earned Revenues from the Public	362	3	-	98	463
Net Costs with the Public	2,040	280	359	1,974	4,653
Net Cost of Operations	$ 2,846	$ 262	$ 361	$ 2,248	$ 5,717

NOTE 13: COST OF STEWARDSHIP PP&E

Stewardship PP&E acquired through purchase in FYs 2008 and 2007 amounted to $42 and $73 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 PP&E. 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.

NOTE 14: APPORTIONMENT CATEGORIES OF OBLIGATIONS INCURRED

The OMB 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 FY 2008 and 2007.

For the year ended September 30, 2008
(in millions)

	Apportionment Category A	Apportionment Category B	Total
Obligations Incurred - Direct	$3,900	$2,155	$6,055
Obligations Incurred - Reimbursable	285	75	360
Total Obligations Incurred	**$4,185**	**$2,230**	**$6,415**

For the year ended September 30, 2007
(in millions)

	Apportionment Category A	Apportionment Category B	Total
Obligations Incurred - Direct	$3,785	$2,263	$6,048
Obligations Incurred - Reimbursable	218	71	289
Total Obligations Incurred	**$4,003**	**$2,334**	**$6,337**

NOTE 15: EXPLANATION OF DIFFERENCES BETWEEN THE STATEMENT OF BUDGETARY RESOURCES AND THE BUDGET OF THE UNITED STATES GOVERNMENT

The differences between the fiscal 2007 Statement of Budgetary Resources (SBR) and the fiscal 2007 actual numbers presented in the fiscal 2009 Budget of the United States Government (Budget) are summarized in the table below.

The President's Budget with the actual numbers for the current fiscal year is not yet available and should be published in February 2009. The publication can be located at http://www.whitehouse.gov/omb.

(in millions)

SBR Line Description	SBR Amount	Budget Amount	Dollar Variance	Percentage Variance	
Total Budgetary Resources/Status of Resources	$ 8,008	$ 8,008	$ -	0%	
Total Status of Resources	8,008	8,008	-	0%	
Unobligated Balance-Beginning of Year	1,809	1,693	116	7%	(a)
Recoveries of Prior Year Obligations	111	112	(1)	-1%	
New Budget Authority	5,586	5,699	(113)	-2%	(a)
Spending Authority from Offsetting Collections	481	482	(1)	0%	
Non Expenditure Transfers	21	22	(1)	-5%	
Total New Obligations	6,337	6,335	2	0%	
Unobligated Balance & Unobligated Balance not Available	1,671	1,673	(2)	0%	
Obligated Balance - Beginning of Year	1,950	1,948	2	0%	
Obligated Balance - End of Year	1,859	1,857	2	0%	
Net Outlays	5,335	5,332	3	0%	
Offsetting Receipts	500	500	-	0%	

Note (a): Receipts returned to Treasury were reclassified in FACTS II to reflect the amount of new budget authority received.

NOTE 16: UNDELIVERED ORDERS AT THE END OF THE PERIOD

The undelivered orders included in unpaid obligations as of September 30, 2008 and 2007 are $1,458 and $1,481 million, respectively.

NOTE 17: 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 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.

The 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 Forest Service. As of September 30, 2008 and 2007, the amount of marijuana on hand was 32,627 (kg) and 34,021(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.

NOTE 18: RECONCILIATION OF NET COST OF OPERATIONS (PROPRIETARY) TO BUDGET (FORMERLY THE STATEMENT OF FINANCING)

	(in millions) 2008	2007
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
Obligations Incurred	$ 6,415	$ 6,337
Less: Spending Authority from Offsetting Collections and Recoveries	677	592
Obligations Net of Offsetting Collections and Recoveries	5,738	5,745
Less: Offsetting Receipts	514	500
Net Obligations	5,224	5,245
Other Resources:		
Transfers in/out Without Reimbursement	1	-
Imputed Financing from Costs Absorbed by Others	331	328
Other	53	5
Net Other Resources Used to Finance Activities	385	333
Total resources used to finance activities	**5,609**	**5,578**
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	16	(159)
Resources that Fund Expenses Recognized in Prior Periods	(84)	(80)
Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations		
Change in Unfilled Orders	26	26
Decrease in Exchange Revenue Receivable from the Public	-	1
Other	(30)	(23)
Resources that Finance the Acquisition of Assets	(101)	(128)
Other Resources or Adjustments to Net Obligated Resources that do not Affect the Net Cost of Operations	29	196
Total Resources Used to Finance Items not Part of the Net Cost of Operations	(144)	(167)
Total Resources Used to Finance the Net Cost of Operations	**5,465**	**5,411**
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		
Increase in Annual Leave Liability	6	-
Increase in Environmental and Disposal Liability	-	44
Increase in Exchange Revenue Receivable from the Public	(18)	-
Increase in Accrued Liability for Payments to States	137	-
Other	76	1
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	201	45
Components not Requiring or Generating Resources:		
Depreciation and Amortization	168	246
Revaluation of Assets or Liabilities	5	3
Other Components not Requiring or Generating Resources		
Bad Debt Expense	6	-
Other	1	12
Total Components of Net Cost of Operations that will not Require or Generate Resources	180	261
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	381	306
Net Cost of Operations	**$ 5,846**	**$ 5,717**

This note is intended to be a bridge between the entity's budgetary and financial (proprietary) accounting. This reconciliation first identifies total resources used by an entity during the period (budgetary and other) and then makes adjustments to the resources based upon how they were used to finance net obligations or cost. The budgetary information used to calculate net obligations (the first four lines) must be presented on a combined basis to enable a direct tie to the Statement of Budgetary Resources. The reconciliation then explains the difference between the budgetary net obligations and the proprietary net cost of operations by setting forth the items that reconcile the two amounts. The budgetary net obligations and the proprietary net cost of operations are different in that (1) the net cost of operations may be financed by non-budgetary resources; (2) the budgetary and non-budgetary resources used by an agency may finance activities which are not components of the net cost of operations; and (3) the net cost of operations may contain components which do not use or generate resources in the period.

NOTE 19: CHANGE IN ACCOUNTING PRINCIPLE

Effective October 1, 2007, the Forest Service implemented a voluntary change in accounting principle to reclassify its road prism assets from General PP&E to Stewardship PP&E. This change removes the capitalized road prism assets, with a net book value of $2,085 million as of September 30, 2007, from the Balance Sheet as reflected in the adjustment to the fiscal year 2008 beginning balance of Cumulative Results of Operations in the Statement of Changes in Net Position.

This change was adopted to more accurately reflect the stewardship nature of these assets, consistent with other federal land management agencies.