USDA

U.S. Department of Agriculture

Office of Inspector General
Financial and IT Operations

Audit Report

U.S. Department of Agriculture Forest Service's Financial Statements for Fiscal Years 2003 and 2002

Report No. 08401-3-FM
January 2004

Report of the Office of Inspector General.

DATE: January 26, 2004

REPLY TO
ATTN OF: 08401-3-FM

SUBJECT: U.S. Department of Agriculture Forest Service's
Financial Statements for Fiscal Years 2003 and 2002

TO: Dale Bosworth
Chief
Forest Service

ATTN: Sandy Coleman
Agency Liaison Officer
Forest Service

This report presents the auditors' opinion on the Forest Service's principal financial statements for the fiscal years ending September 30, 2003 and 2002. The report also includes an assessment of Forest Service's internal control structure and compliance with laws and regulations.

KPMG, LLP (KPMG), an independent certified public accounting firm, conducted the audit. KPMG is responsible for the auditors' report dated December 18, 2003. We monitored the progress of the audit at all key points, reviewed KPMG's report and reviewed selected working papers and performed other procedures, as we deemed necessary. Our review, as differentiated from an audit in accordance with the Government Auditing Standards, was not intended to enable us to express, and we do not express, an opinion on Forest Service's financial statements, conclusions about the effectiveness of internal controls, conclusions on whether Forest Service's financial management systems substantially complied with the three requirements of the Federal Financial Management Improvement Act of 1996, or conclusions on compliance with laws and regulations. Our review to date has disclosed no instances where KPMG did not comply, in all material respects, with the Government Auditing Standards.

It is the opinion of KPMG that the financial statements present fairly, in all material aspects, the Forest Service's financial position as of September 30, 2003 and 2002, and its net costs, changes in net position, budgetary resources, and reconciliation of net cost to budgetary obligations for the years then ended, in conformity with generally accepted accounting principles. KPMG's report on Forest Service's internal control structure over financial reporting identified four material internal control weaknesses. Specifically, KPMG identified material weaknesses in Forest Service's:

- Financial Management and Accountability;
- Yearend Accrual Methodology;

- Controls in its Purchasing Applications over Data Input, Reconciliation, Integrity, and Segregation of Duties; and

- General Controls Environment.

KPMG's report on Forest Service's laws and regulations contains one instance of noncompliance with the Federal Financial Management Improvement Act.

These weaknesses in controls over the financial reporting process resulted in Forest Service not (1) being able to prepare timely and reliable financial statements without extensive manual procedures and (2) having current and reliable ongoing information to support management decisions. Also, the weaknesses in computer security controls resulted in an increased risk of unauthorized individuals being allowed to access, alter, or abuse proprietary Forest Service programs and electronic data. These material weaknesses in internal controls may adversely affect any decision by Forest Service's management and other decision makers that is based, in whole or in part, on information that is inaccurate because of these weaknesses.

Most of the issues identified by KPMG are longstanding and pervasive weaknesses impacting the Forest Service's ability to accurately and timely report to the Congress and the public what it accomplishes with appropriated funds and to be fully accountable for those funds. As discussed in Note 12 to the financial statements, Forest Service restated its fiscal year 2002 financial statements as a result of errors in the underlying accounting records or errors in the application of accounting standards. The Forest Service corrected its fiscal year 2002 financial statements to:

- Record $18 million of property, plant and equipment received but not accrued for as of September 30, 2002;

- properly align budgetary and proprietary account relationships and correct certain related budgetary and proprietary posting errors in the Wildland Fire Management fund, the Knutson-Vandenberg fund and other various funds;

- account for budgetary resources received by the Trust & Special funds and Deposit & Clearing funds that had previously been accounted for as General funds;

- properly record the prior year $110 million expenditure transfer to the Wildland Fire Management fund and the subsequent payback during fiscal year 2002;

- correct $22 million of errors in recording obligations for the Wildland Fire Management fund;

- exclude certain funds received from the Department of Labor-Job Corps that had previously been included in the Statement of Financing;

- adjust offsetting receipts by approximately $412 million to reflect only those offsetting receipts determined to be distributed as required by Office of Management and Budget Bulletin 01-09, Form and Content of Agency Financial Statements;

- record $79 million of revenue from the National Recreation Reservation System and Map sales that had not been recognized during the fiscal year ended September 30, 2002;
- record liabilities of $120 million that had been incorrectly recognized as reductions of operating cost during the fiscal year ended September 30, 2002; and
- adjust for certain other errors noted in the Statement of Financing.

The Forest Service does not operate as an effective, sustainable, and accountable financial management organization, as evidenced by the restatement of the fiscal year 2002 financial statements and the extensive ad hoc effort to achieve the fiscal year 2003 unqualified audit opinion. For the Forest Service to make meaningful progress in correcting its weaknesses, major changes are needed in its financial management infrastructure. These changes include (1) developing Forest Service-wide financial policies that all finance and program offices are required to implement, (2) ensuring that sufficient resources are available to monitor compliance with the policies and that responsible individuals/offices are held accountable for non-compliance, (3) providing training to finance and program personnel to ensure they understand and effectively implement the Federal Government's and Forest Service's financial management policies and procedures. These changes in Forest Service's financial management infrastructure are essential and critical for Forest Service and the U.S. Department of Agriculture to meet the mandatory accelerated reporting deadlines for fiscal year 2004 and also to provide agency managers with meaningful and accurate financial data throughout the year when it is needed to administer its programs and operations.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned, including the timeframes, on the recommendations in this report. 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.

Robert W. Young

Robert W. Young
Assistant Inspector General
for Audit

UNITED STATES DEPARMENT OF AGRICULTURE
FOREST SERVICE

September 30, 2003

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INDEPENDENT AUDITORS' REPORT

Report of the Office of Inspector General.

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

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

We have audited the accompanying consolidated balance sheets of the United States Department of Agriculture (USDA) Forest Service as of September 30, 2003 and 2002 and the related consolidated statements of net costs, changes in net position, and financing and combined statements of budgetary resources for the years then ended, hereinafter referred to as the "financial statements". The objective of our audits was to express an opinion on the fair presentation of these financial statements. In connection with our audits, we also considered the USDA Forest Service's internal control over financial reporting and tested the USDA Forest Service's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

SUMMARY

As stated in our opinion on the financial statements, we concluded that the USDA Forest Service's financial statements as of and for the years ended September 30, 2003 and 2002 are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 12 to the financial statements, the USDA Forest Service restated its fiscal year 2002 financial statements.

Our consideration of internal control over financial reporting resulted in the following reportable conditions. The first four are considered material weaknesses.

- The USDA Forest Service Needs to Improve its Financial Management and Accountability
- Implementation of the USDA Forest Service Accrual Methodology Needs Strengthening
- Controls Over PONTIUS and PRCH Data Access, Input, Integrity, and Segregation of Duties Need Improvement
- The USDA Forest Service Needs to Improve Its General Controls Environment
- The USDA Forest Service Needs to Continue to Improve its Internal Controls over its Reconciliation and Management of Fund Balance with Treasury
- The Design and/or Implementation of Controls Related to the Accurate Recording of Personal Property Transactions Need Improvement
- Controls Related to Physical Inventories of Capitalized Assets Need Improvement

- Posting of Certain Transactions Needs to Contain the Proper Reference Data to Link Related Transactions
- Compilation of the USDA Forest Service's Required Supplementary Information and Required Supplementary Stewardship Information Needs Improvement
- The USDA Forest Service Application System Controls Need Improvement

The results of our tests of compliance with certain provisions of laws and regulations, exclusive of the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed no material instances of noncompliance that are required to be reported herein under *Government Auditing Standards,* issued by the Comptroller General of the United States, or Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements.*

The results of our tests of FFMIA disclosed instances where the USDA Forest Service financial management systems did not substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, or the United States Government Standard General Ledger at the transaction level.

The following sections discuss our opinion on the USDA Forest Service's financial statements, our consideration of the USDA Forest Service's internal control over financial reporting, our tests of the USDA Forest Service's compliance with certain provisions of applicable laws and regulations, and management's and our responsibilities.

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying consolidated balance sheets of the USDA Forest Service as of September 30, 2003 and 2002 and the related consolidated statements of net costs, changes in net position, and financing and combined statements of budgetary resources for the years then ended.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the USDA Forest Service as of September 30, 2003 and 2002 and its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 12 to the financial statements, the USDA Forest Service restated its fiscal year 2002 financial statements.

The information in the Management Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information sections is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements.* We did not audit this information and, accordingly, express no opinion on it. However, we have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurement and presentation of the supplementary information. As a result of such limited procedures, we believe that the Required Supplementary Stewardship Information and the Required Supplementary Information related to deferred maintenance is not in accordance with guidelines established by the Federal Accounting Standards Advisory Board because the information is not presented as of September 30, 2003.

KPMG

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

In our fiscal year 2003 audit we noted certain matters, described in Exhibits I and II, involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that the reportable conditions presented in Exhibit I are material weaknesses. Exhibit II presents the other reportable conditions.

A summary of the status of prior year reportable conditions is included as Exhibit III.

We also noted other matters involving internal control over financial reporting and its operation that we will report to the management of USDA Forest Service in a separate letter.

INTERNAL CONTROL OVER REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION

We noted certain significant deficiencies in internal control over Required Supplementary Stewardship Information that, in our judgment, could adversely affect the USDA Forest Service's ability to collect, process, record, and summarize Required Supplementary Stewardship Information. Specifically, we determined that preparation controls had not been effectively designed to ensure the timeliness of the reported information. The information related to stewardship property, plant and equipment is not presented as of September 30, 2003.

COMPLIANCE WITH LAWS AND REGULATIONS

The results of our tests of compliance with certain provisions of laws and regulations described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

The results of our tests of FFMIA disclosed instances, described in Exhibit IV, where the USDA Forest Service's financial management systems did not substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, or the United States Government Standard General Ledger at the transaction level.

RESPONSIBILITIES

Management's Responsibilities

Management is responsible for the financial statements, including:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
- Establishing and maintaining internal controls over financial reporting, and preparation of the Management's Discussion and Analysis (including the performance measures), required supplementary information, and required supplementary stewardship information; and
- Complying with laws and regulations, including FFMIA.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies. Because of inherent limitations in internal control, misstatements due to error or fraud may nevertheless occur and not be detected.

Auditors' Responsibilities

Our responsibility is to express an opinion on the fiscal year 2003 and 2002 financial statements of the USDA Forest Service based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards,* and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- 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 2003 audit, we considered the USDA Forest Service's internal control over financial reporting by obtaining an understanding of the USDA Forest Service's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and *Government Auditing Standards.* We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.

OMB Bulletin No. 01-02 requires auditors to consider the USDA Forest Service's internal control over Required Supplementary Stewardship Information by obtaining an understanding of the USDA Forest Service's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. We did not perform these procedures on the Required Supplementary Stewardship Information because, as discussed in our opinion on the financial statements, the information is not presented as of September 30, 2003.

As further required by OMB Bulletin No. 01-02, with respect to internal control related to performance measures determined by management to be key and reported in the Management Discussion and Analysis, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether the USDA Forest Service's fiscal year 2003 financial statements are free of material misstatement, we performed tests of the USDA Forest Service's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, 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 and regulations applicable to the USDA Forest Service. Providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 01-02 and FFMIA, we are required to report whether the USDA Forest Service's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

DISTRIBUTION

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

KPMG LLP

December 18, 2003

INTRODUCTION

The internal control weaknesses discussed in this report, and the progress made by the United States Department of Agriculture (USDA) Forest Service toward correcting these weaknesses, are discussed in the context of the USDA Forest Service's existing decentralized organizational structure. Although USDA Forest Service has made some progress in correcting prior year weaknesses, we believe the decentralized nature of the existing organizational structure makes it difficult to implement sustainable corrective action for certain weaknesses due to the large number of separate reporting units.

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

Exhibits I and II describe the material weaknesses and reportable conditions, respectively, as of and for the year ended September 30, 2003, and our recommendations. Exhibit III summarizes prior year reportable conditions and Exhibit IV describes instances of noncompliance with laws and regulations.

MATERIAL WEAKNESSES

Material Weakness Number 1: The USDA Forest Service Needs to Improve its Financial Management and Accountability

The USDA Forest Service continues to make progress in improving its financial management and reporting activities. However, significant weaknesses continue to exist in its ability to provide accurate and timely information. During the fiscal year (FY) 2003 audit, the USDA Forest Service made a significant number of closing adjustments to its financial data. In addition, delays were encountered during the USDA Forest Service's closing process that specifically resulted from inadequate data quality. This material weakness will have a significant impact on the USDA Forest Service's ability to meet the earlier mandatory OMB reporting deadline in fiscal year 2004.

Excessive Adjusting Journal Vouchers Delayed Year-end Close

The USDA Forest Service prepared excessive adjusting journal entries (AJV's) during its fiscal year 2003 year-end closing process. The number of entries processed contributed significantly to delays in the completion of the audit. The table on the next page summarizes the number of AJV's by accounting period and the absolute dollar value of the AJV's processed for each period.

Accounting Period	Approximate Number of AJV's	Absolute Dollar Value of AJV's Affecting Budgetary Accounts	Absolute Dollar Value of AJV's Affecting Proprietary Accounts
13	610	$25.2 Billion	$5.8 Billion
14	130	$11.5 Billion	$16.4 Billion
CSXE (On-Top)	60	$5.7 Billion	$2.9 Billion

These adjustments corrected general ledger accounts with abnormal balances, previously posted erroneous AJVs, GL posting model inaccuracies, financial information system generated errors, and enabled the USDA Forest Service to pass its required year-end reporting to Treasury.

These numerous closing entries were required for the following primary reasons:

- Certain USDA Forest Service business operations do not occur as planned causing certain initial transactions that should have been recorded to not exist in the system.
- Some AJV entries were entered twice or incorrectly, which created additional anomalies (e.g., abnormal general ledger account balances).
- The USDA Forest Service personnel who prepare adjusting journal entries do not always prepare the entries correctly due to inadequate research or the preparers' inadequate knowledge of USSGL guidance.
- The approval of AJV's is performed by a myriad of individuals, who also sometimes lack detailed knowledge of the subject matter that would prevent inaccuracies.

OMB Circular Number (No.) A-127, *Financial Management Systems* states that an agency's financial management system shall be able to provide financial information in a timely and useful fashion to (1) support management's fiduciary role; (2) support the legal, regulatory and other special management requirements of the agency; (3) support budget formulation and execution functions; (4) support fiscal management of program delivery and program decision making, (5) comply with internal and external reporting requirements, including, as necessary, the requirements for financial statements prepared in accordance with the form and content prescribed by OMB and reporting requirements prescribed by Treasury; and (6) monitor the financial management system to ensure the integrity of financial data.

The USDA Forest Service personnel are required to develop and manually post AJVs into the general ledger. Due to human error and the potential lack of understanding, incorrectly posted AJVs could result in significant misstatements to the general ledger. Incorrect AJVs is one of the primary causes for the restatement of the FY 2002 financial statements. In addition, the excessive number of AJVs caused significant delays in the completion of the USDA Forest Service's FY 2003 audit.

Recommendation Number 1:

We recommend that the USDA Forest Service provide Standard General Ledger (SGL) training to selected employees and appoint them to be "resident" SGL experts responsible for preparing as well as reviewing and approving the AJVs.

Recommendation Number 2:

We recommend that the USDA Forest Service modify its AJV form to specifically identify management personnel responsible for reviewing and approving certain aspects of each AJV.

Recommendation Number 3:

We recommend that the USDA Forest Service identify those business processes that are causing irregularities in the general ledger and develop an expedited corrective action plan to resolve and correct any deficiencies identified.

Recommendation Number 4:

We recommend that the USDA Forest Service strive to limit the use of AJVs to only those accounting situations that require their use.

The Management of the Budget Clearing Accounts Needs to be Improved

The USDA Forest Service maintains budget clearing accounts (i.e., U.S. Treasury accounts 12F3875 and 12F3885) as part of its Fund Balance with Treasury (FBWT). These accounts are used to temporarily record cash collections, as well as, revenue and expense transactions that have not been researched and resolved for final disposition in its general ledger. Transactions recorded in these FBWT budget clearing accounts have an off-setting amount recorded in a liability account (i.e., general ledger account 24XX). Depending on the nature of the recorded transaction, amounts may or may not legitimately reside in the budget clearing account and the corresponding liability account at period-end.

During our analysis of the USDA Forest Service's propriety of its budget clearing accounts and the corresponding liability account, we noted that the USDA Forest Service did not timely research and transfer amounts nor did they timely recognize (i.e., a revenue or expense) the transaction in the correct general ledger accounts.

Treasury symbol 12F3875 contained the following balances at September 30, 2003:

Treasury Symbol	Fund Code	Job Code	Job Code Description	Net Amount ($ Million)	Revenue/Deferred Revenue or Expense Recognized
12F3875	BCBC	Blank	None	$109	No
	BCBC	879###	IPAC – should be in 12F3885	(9)	Yes
	BCBC	884###	PRV Hauling/Damages Awaiting Litigation	14	No
	BCBC	887###	NRRS	18	Yes
	BCBC	890###	Map Sales	6	Yes
	LXBX	LXB###	Lockbox	1	Yes
	TDTD	Various	Timber Sale Deposit	65	Yes
	Various	Various	Misc. Amounts	1	Yes
		Total		$205	

All balances in cash and the corresponding liability were supported by appropriate documentation, except for the first and third amounts.

For Treasury account 12F3875, the USDA Forest Service recorded $120 million of FBWT as of September 30, 2002 to agree with Treasury and the USDA Forest Service has not researched, determined the proper disposition, nor transferred the funds out as of September 30, 2003. Such amounts are included in the $109 million in the above table.

Also, for Treasury account 12F3875, the USDA Forest Service recorded during FY 2003, but not timely:

- $18 million of revenue for the National Recreation Reservation System (NRRS) for the USDA Forest Service and concessionaries proceeds, United States Army Corp of Engineers contractor (Reserve America) customer refunds, and fees and taxes collected for other government agencies;
- $9.5 million of Interagency Payment and Collection (IPAC) expense transactions in 12F3875 which should have been recorded in 12F3885; and
- $5 million of revenue for map sales.

For Treasury account 12F3885, the USDA Forest Service did not timely adjust $33 million of expenses for IPAC transactions.

OMB Circular No. A-123, *Management Accountability and Control*, states that transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports. The documentation for transactions, management controls, and other significant events must be clear and readily available for examination.

The *TFM* Sections 2-3100 and 2-3300 state that the records of a Federal agency (i.e., the USDA Forest Service's general ledger) must agree with the records of the U.S. Treasury. Any differences must be identified, reclassified into a budget clearing account, and resolved timely. In addition, the *TFM* Volume I, Section 4, Chapter 7000, states that reconciling items in budget clearing accounts must be resolved expeditiously.

The USDA Annual Close Guide, Section 10, states that all budget clearing accounts must reflect a zero balance in the general ledger at year-end.

The USDA Forest Service has not devoted substantial resources to resolving and clearing items in its clearing accounts due to the efforts spent on developing and implementing the FMS 6652 and 6653 reconciliation processes. In addition, the revenue collections resided in the suspense and clearing account for two primary reasons: (1) the USDA Forest Service did not have a separate receipt and expenditure account at Treasury to record these transactions and, (2) the USDA Forest Service did not fully understand or explore the reporting implications associated with all of its business processes.

The effect is cash payments to agencies can be inappropriately withdrawn from the USDA Forest Service's FBWT accounts; undelivered orders are overstated at any given point in time due to unreconciled transactions; and expenses and/or revenues are understated.

Recommendation Number 5:

We recommend that the USDA Forest Service analyze the composition of its budget clearing accounts and make proper disposition at least on a quarterly basis.

Recommendation Number 6:

We recommend that the USDA Forest Service identify all revenue generating business processes that are currently maintained in the budget clearing accounts and work with OMB and U.S. Department of the Treasury to establish a separate receipt and expenditure Treasury symbol so that revenue collections will not reside in the 12F3875 clearing account.

Improper Use of SGL Accounts in Special and Non-Revolving Trust Funds

During the audit, we determined that the USDA Forest Service erroneously recognized special and non-revolving trust fund resources as "unexpended appropriations" (GL 3100 series) even though it had not received appropriations or allocation transfers related to such resources. The USDA Forest Service was not aware that it was erroneously processing special and non-revolving trust fund resources via an invalid general ledger entry.

The United States Treasury, *United States Standard General Ledger, Supplement No. S2 Treasury Financial Manual* recommends that agencies use entry number A184 to record in the expenditure account the amount of appropriated receipts from an agency's unavailable receipt account. As a result of using the correct entry, the USDA Forest Service would be crediting 5740 Appropriated Earmarked Receipts – Transfers-In instead of crediting 3100 Appropriations Received.

The overall effect of its erroneous posting overstated unexpended appropriations received and understated cumulative results of operations. This error totaled approximately $735 million as of September 30, 2002, which was corrected as a prior period adjustment in the FY 2003 financial statements.

Recommendation Number 7:

We recommend that the USDA Forest Service revise its posting model for special and non-revolving trust funds to appropriately recognize these resources as transfers-in instead of appropriations received, in accordance with SGL guidance.

Abnormal General Ledger Account Review Procedures Need Improvement

The USDA requires each of its bureaus to periodically (monthly or quarterly) review the accuracy of abnormal balances and report those balances that are $5 million or higher as well as the required corrective action to USDA Office of the Chief Financial Officer (OCFO).

The June 30 trial balance by Treasury account disclosed that the USDA Forest Service had 69 abnormal balances valued at $3 million or higher. Additional analysis disclosed that the USDA Forest Service did not report, as required, 35 of the 69 abnormal balances valued at $5 million or higher to the USDA OCFO. However, the USDA Forest Service did not report these 35 abnormal balances because either the USDA Forest Service was aware of the required corrective action which could be completed quickly or that the abnormal balance was legitimate. These 35 abnormal balances had an absolute value of approximately $1.5 billion. Due to significant general ledger account adjustments that were posted during the fourth quarter of FY 2003, the USDA Forest Service believed it would be correcting many of the June 30 abnormal balances.

The adjusted September 30 trial balance by Treasury account disclosed that the USDA Forest Service had 54 abnormal general ledger account balances valued at $3 million and higher, with an absolute value of $2.2 billion. Although, the number of September 30 abnormal balances decreased slightly when compared to the balances identified at June 30, this decrease only occurred after a significant number of accounting period 13 and 14 entries being made to correct these abnormal balances. Of the 54 items, 46 were above $5 million with an absolute dollar value of $2.2 billion.

Many of the abnormal balances were caused by deficiencies in the USDA Forest Service's business processes as well as erroneous posting of AJV's to the general ledger.

Because the USDA Forest Service does not have an adequate and timely process to review, reconcile, adequately support, and, if necessary, correct abnormal balances, completion of the 2003 audit was delayed.

The *USDA FY 2003 Annual Close Guide*, Financial Analysis and Standards of General Ledger, General Guideline for Trial Balance Report Analysis, Section 7.2.5. states that "A verification of the general account balances should be included as part of a periodic (monthly or quarterly) analysis of the trial balance report...[and] during a trial balance analysis, if a general ledger account carries an account balance different than its normal balance, the balance should be considered abnormal." It goes on to say that, "Further review and transaction analysis should be conducted to determine the nature of the error and necessary steps should be taken to correct the error."

In addition, the *USDA, Forest Service, Sustained and Effective Financial Management Performance*, Executive Level Action Plan (Plan), Section 2B, dated March 24, 2003, states abnormal account balances may be an indication of improper recording of the USDA Forest Service financial transactions. The Plan further lists the following actions to be completed by the USDA Forest Service personnel on a monthly basis:

- "Identification by financial account of what should be a "normal balance" including which accounts should typically have a debit balance versus a credit balance and assess reasonableness of account balances at month-end, quarter-end and year-end.
- Prepare a monthly trial balance review of each account and investigate and resolve any abnormal account balances on a timely basis.
- Prepare preliminary SF133s (Treasury Reports) so that the budget and financial management staff can jointly and pro-actively identify program fund issues that may require further action. This process also resolves problems such as the recent Department of Labor (DOL), Job Corps issues.
- Review, resolve or explain abnormal financial account balances and abnormal program fund balances to ensure the integrity of the USDA Forest Service financial data and financial statements."

This plan was communicated to OMB in the second quarter of fiscal year 2003, to inform OMB of the corrective actions the USDA Forest Service was planning in order to improve its financial management and accountability.

Uncorrected abnormal balances may significantly misstate financial statement line items. After receipt of the September 30 abnormal listings (including accounting period 13) the USDA Forest Service made adjusting entries that amounted to a net of $158 million or an absolute value of $2.3 billion. Our review of the USDA Forest Service adjusting entries resulted in 4 additional adjusting entries with an absolute dollar value of approximately $121 million.

Recommendation Number 8:

We recommend that the USDA Forest Service follow its procedures in order to perform monthly review, identification, research and correction of all abnormal balances and report the status of all abnormal balances of $5 million or more to the OCFO.

Recommendation Number 9:

We recommend that the USDA Forest Service ensure proper entries, especially AJV's, at the Treasury Symbol level for all adjustments so as not to cause abnormal balances in related GL accounts.

Recommendation Number 10:

We recommend that the USDA Forest Service institute an effective management review of the USDA Forest Service identified and corrected abnormal balances.

Proprietary and Budgetary Account Relationship Review Procedures Need Improvement

During our review of the USDA Forest Service's June 30, 2003 GL account relationship analysis, several GL account relationships were not in agreement and the USDA Forest Service did not prepare adequate reconciliations to support the differences. Due to significant general ledger account adjustments that were posted during the fourth quarter of FY 2003, the USDA Forest Service ended its account relationship reconciliation efforts using June 30 general ledger data and re-performed the account relationship reconciliation using September 30 general ledger data. However, in reviewing the preliminary account relationships using September 30 general ledger data, there was no significant improvements from the account relationships prepared using the June 30 general ledger data.

Specifically, differences existed or were not adequately explained for the following general ledger account relationships:

- *Cumulative Results of Operations* to *Unexpended Appropriation* per the Statement of Changes in Net Position,
- Budgetary to proprietary *Advances from Others*,
- *Expended Authority* to *Appropriations Used,*
- Budgetary to proprietary *Reimbursable Revenue,*
- Budgetary to proprietary *Accounts Receivable – Governmental*,
- Budgetary to proprietary *Accounts Payable*, and
- Budgetary to proprietary *Advances to Others.*

The incomplete and unreconciled proprietary and budgetary analysis is attributable to the following three primary causes:

- The USDA Forest Service is not routinely reviewing, researching, adequately reconciling, and, if necessary, correcting account relationships.
- The USDA Forest Service is not performing the required research to understand the full impact that the USDA Forest Service's business processes have on the proprietary and budgetary account relationships.
- Historically, the USDA Forest Service has incorrectly used general ledger accounts in journal vouchers, as well as improperly posted (i.e., fiscal year posting, reversing, and non-reversing) such journal vouchers.

The *USDA FY 2003 Annual Close Guide*, Financial Analysis and Standards of General Ledger, General Rules for Reviewing an Agency's Financial Information, Section 7.2.4. states that relationships between the budgetary and proprietary general ledger accounts should be reviewed while performing financial analysis. This financial analysis should be performed on a monthly basis, with particular attention given at year-end, and should include the review of the Federal Financial Information System (FFIS) Trial Balance. In addition, the *General Rules for Reviewing an Agency's Financial Information, Section 7.2.4*, further lists six account relationships that should be maintained on the agencies trial balance.

In addition, the USDA Forest Service's *Executive Level Action Plan,* Section 2E, 4th bullet states "Ensure coordination between budgetary and proprietary activities to maintain reconciled balances."

Failures in general ledger account relationships may significantly misstate the accuracy of both budgetary and proprietary financial statement line items. Furthermore, the USDA Forest Service year-end review of account relationships does not readily respond to deviations that may occur at any other time during the fiscal year.

Recommendation Number 11:

We recommend that the USDA Forest Service implement an effective monthly process to review general ledger account relationships. The process must include the research, reconciliation, and resolution of all significant differences in a timely manner.

Recommendation Number 12:

We recommend that the USDA Forest Service require an effective documented manager review and quality assurance review of the account relationship analysis.

Material Weakness Number 2: Implementation of the USDA Forest Service Accrual Methodology Needs Strengthening

During FY 2003, the USDA Forest Service developed a new accrual methodology (methodology), which was distributed to reporting units via the USDA Forest Service CFO Bulletin and implemented during the third and fourth quarters of FY 2003.

Although the USDA Forest Service made significant progress in developing an auditable accrual methodology, a review of the USDA Forest Service's June 2003 implementation disclosed discrepancies in the application of the methodology by reporting units. These discrepancies included significant use of the least favorable accrual estimation method, the straight line calculation, instead of using the other more favorable accrual estimation methods, including third party confirmations and the USDA Forest Service project manager estimates. As a result of the implementation weaknesses noted, the USDA Forest Service issued additional guidance to reporting units in August 2003.

Implementation Deficiencies of Accrual Methodology Existed

Although reporting units did improve their compliance with the methodology as of September 30, 2003, significant implementation deficiencies still existed as follows:

- A lack of an adequate understanding of the methodology resulted in the reporting of no accruals and "negative" accruals.
- Accruals were posted without adequate supporting documentation.
- Accrual data spreadsheets, that are used by the USDA Forest Service's Washington Office (WO) personnel to determine implementation progress, were altered or not used in a manner that was consistent with the methodology.

The above deficiencies existed because the reporting units lacked a clear understanding of the accrual process and the WO developed spreadsheet allowed for the reporting of a "negative" amount to be entered, when "Cumulative Payments Made" exceeded "Cumulative Expected Costs".

In addition to the reporting unit deficiencies, USDA Forest Service WO personnel did not perform an adequate review and analysis of the reporting unit accrual data, which resulted in multiple errors in WO consolidating the individual reporting unit's accrual data.

In addition to the CFO Bulletin, OMB Circular No. A-123, *Management Accountability and Control* provides that transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports. The documentation for transactions, management controls and other significant events must be clear and readily available for examination.

The incorrect application of the methodology and inadequate WO monitoring of the implementation of the methodology resulted in an adjustment to increase the accrual by approximately $2.1 million.

Recommendation Number 13:

We recommend that the USDA Forest Service WO Office of Finance revise the accrual spreadsheet to prevent the USDA Forest Service units from changing data fields or recording "negative" accruals.

Recommendation Number 14:

We recommend that the USDA Forest Service WO Office of Finance provide adequate communication and/or training of the accrual methodology, as well as, a summary of lessons learned from the fiscal year 2003 audit to all of the USDA Forest Service reporting units.

Recommendation Number 15:

Perform WO management oversight of the accrual methodology through analysis and follow up on large or unusual items, as well as the USDA Forest Service units that do not report any data.

The USDA Forest Service's Implementation of the Accrual Methodology was not Complete

To determine the completeness of the USDA Forest Service accrual, a review was performed of material disbursement transactions processed subsequent to September 30, 2003. The disbursement reviewed were processed in the FFIS from October 1 to October 17, 2003. As a result of this review, 10 of 61 disbursement sample items should have been accrued prior to October 1, 2003 but were not and as a result, were considered exceptions. The value of these 10 accrual exceptions amounted to an accrual understatement of approximately $11.7 million. The USDA Forest Service had not recorded an accrual for these transactions using its accrual methodology even though the documentation for receipt and acceptance of goods or the period of performance for the service indicated that the transaction should have been accrued as of September 30, 2003.

Because of the large number of exceptions discovered during the October 1 to October 17, 2003 period, the USDA Forest Service was requested to investigate the causes as well as review its material disbursement transactions processed during the period October 18 to November 15, 2003. As a result of this review, 12 of 64 sample items were noted as exceptions. The value of these 12 accrual exceptions amounted to an accrual understatement of approximately $5.7 million. The USDA Forest Service also had not recorded an accrual for these transactions using its accrual methodology even though the documentation for receipt and acceptance of goods or the period of performance for the service indicated that the expenses should have been accrued as of September 30, 2003.

In addition, the USDA Forest Service WO did not review rejected accrual transactions and certain reporting units did not follow up with the USDA Forest Service WO to resolve their rejected transactions, the USDA Forest Service was requested to provide the value of the rejected transactions as of September 30, 2003. It was determined that the USDA Forest Service had not accrued for 519 rejected transactions in the amount of approximately $24.5 million.

As a result of the USDA Forest Service analysis, the understatement of the accrual was attributable to the following reasons:

- The USDA Forest Service WO did not provide adequate accrual training to the reporting units.
- Reporting units did not provide adequate documentation for certain sample items.
- All accruals were not entered into FFIS due in part to the fact that FFIS was unavailable on the last day of the fiscal year to input accrual data.
- The USDA Forest Service WO did not establish a policy to manually review rejected accrual transactions to determine the validity of the transactions and certain reporting units did not follow up with the USDA Forest Service WO to resolve the rejected transactions.

The USDA Forest Service CFO Bulletin 2003-006 states that each reporting unit must maintain sufficient supporting documentation to allow the audit community to arrive at the same conclusions and accrual amounts.

In addition, the USDA Forest Service *Incident Accrual and Payment Matrix,* which is used by the USDA Forest Service reporting units to record fire accruals, indicates that by the close of business:

- September 23rd, the Incident Team provide an estimate for the remaining days in the month to the delegated incident unit.
- September 24th, the delegated incident unit update accruals in FFIS for the remaining days of the quarter or year.

Because of the lack of adequate year-end accruals and follow up by the USDA Forest Service WO and reporting units, the USDA Forest Service recorded an adjustment to increase the accrual by approximately $41.9 million for the items discussed above.

Recommendation Number 16:

We recommend that the USDA Forest Service WO Office of Finance establish and implement policies and procedures to perform period end reviews of rejected transactions to ensure that all transactions that are in reject status are corrected, recorded, and properly reflected in the general ledger.

Recommendation Number 17:

We recommend that the USDA Forest Service WO Office of Finance and the USDA Forest Service reporting units perform a comprehensive review of its accrual implementation efforts during the second quarter of fiscal year 2004 to identify and resolve any additional deficiencies in the accrual methodology.

Material Weakness Number 3: Controls Over PONTIUS and PRCH Data Access, Input, Integrity, and Segregation of Duties Need Improvement

The Purchase Order Normal Tracking and Inventory System (PONTIUS) is the front end to the Purchase Order System (PRCH). Controls over data access, input, integrity, and segregation of duties play a crucial role in the accuracy and integrity of data stored in these systems. Internal control weaknesses in these areas were noted in PONTIUS and PRCH.

Due to the sensitive nature of the issues identified, we provided the USDA Forest Service with a separate, limited-distribution report which contains the detailed findings along with specific recommendations.

Material Weakness Number 4: The USDA Forest Service Needs to Improve Its General Controls Environment

During our audit, we identified the following conditions in the design and operation of the USDA Forest Service's general controls environment:

- General support and financial application systems have not been subjected to the certification and accreditation process per the requirements set-forth in OMB Circular No. A-130.
- An entity-wide process for assessing information technology security risks has not been instituted.
- Information technology security plans at some regional offices and national forests are missing, outdated, and/or incomplete.
- Internet access controls need improvement.
- Controls over software management need improvement.
- Identification of critical data/operations and current backup and recovery procedures and continuity of operations planning needs improvement.
- The USDA Forest Service has not executed an effective memorandum of understanding with the National Information Technology Center.
- The USDA Forest Service has not executed an effective memorandum of understanding with the National Finance Center.

Due to the sensitive nature of the issues identified, we provided the USDA Forest Service with a separate, limited-distribution report which contains the detailed findings along with specific recommendations. Although the separate, limited-distribution report classifies certain of the findings listed above as material weaknesses and the remaining ones as reportable conditions, we believe that, when considered together, the findings qualify as a material weakness.