



U.S. Department of Agriculture

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Office of Inspector General  
Financial & IT Operations

# Audit Report

## Natural Resources Conservation Service's Financial Statements for Fiscal Year 2008

Report No. 10401-2-FM  
November 2008

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



November 13, 2008

REPLY TO

ATTN OF: 10401-2-FM

TO: Arlen Lancaster  
Chief  
Natural Resources Conservation Service

ATTN: Diane Gelburd  
Operations Management and Oversight Division  
Natural Resources Conservation Service

FROM: Robert W. Young /s/  
Assistant Inspector General  
for Audit

SUBJECT: Natural Resources Conservation Service's Financial Statements  
for Fiscal Year 2008

This report presents the auditors' disclaimer of opinion on the Natural Resources Conservation Service's (NRCS) consolidated financial statements for the fiscal year ending September 30, 2008. Reports on NRCS's internal control structure and its compliance with laws and regulations are also provided.

KPMG LLP (KPMG), an independent certified public accounting firm, was engaged to conduct the audit. 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, an opinion on NRCS's financial statements; internal control; whether NRCS's 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 12, 2008, and the conclusions expressed in the report. However, our review disclosed no instances where KPMG did not comply, in all material respects, with *Government Auditing Standards* and the Office of Management and Budget Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended, except for as disclosed in KPMG's report.

KPMG reported that NRCS was unable to provide sufficient evidential matter in support of transactions and account balances, as presented in the NRCS consolidated financial statements as of and for the year ended September 30, 2008, particularly with respect to obligations, including accrued expenses and undelivered orders, and unfilled customer orders. NRCS was not able to complete corrective actions and make adjustments, as necessary, to these and other financial statement amounts, prior to the completion of NRCS's Fiscal Year 2008 Financial Statements.

It was impracticable for KPMG to extend their audit procedures sufficiently to determine the extent to which NRCS's consolidated financial statements as of September 30, 2008, may have been affected by the matters discussed in the preceding paragraph, accordingly, the scope of KPMG's work was not sufficient to enable the auditors to express an opinion on the consolidated financial statements of the NRCS as of September 30, 2008.

KPMG's report on NRCS's internal control structure over financial reporting identified seven significant deficiencies. Specifically, KPMG identified weaknesses in NRCS's:

- Accounting and controls over undelivered orders;
- accounting and controls for unfilled customer orders;
- accounting and controls for accrued expenses;
- accounting and controls for property, plant, and equipment;
- controls over financial reporting;
- general controls environment; and
- controls over purchase and fleet card transactions.

KPMG considered the first five significant deficiencies to be material weaknesses. The results of KPMG's tests of compliance with laws and regulations disclosed instances of noncompliance with appropriations law and FFMIA.

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 the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from report issuance.

**United States Department of Agriculture  
Natural Resources Conservation Service  
Audit Report  
For the Year Ended September 30, 2008**

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**KPMG LLP**  
2001 M Street, NW  
Washington, DC 20036

## **Independent Auditors' Report**

Chief, Natural Resources Conservation Service and  
Inspector General, United States Department of Agriculture:

We were engaged to audit the accompanying consolidated balance sheet of the Natural Resources Conservation Service (NRCS) (an agency of the United States Department of Agriculture (USDA)) as of September 30, 2008, and the related consolidated statements of net cost and changes in net position, and combined statement of budgetary resources (hereinafter referred to as the "consolidated financial statements") for the year then ended. In connection with our engagement, we were also engaged to consider NRCS's internal controls over financial reporting and to test NRCS's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on its consolidated financial statements.

### **Summary**

As stated in our report on the consolidated financial statements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on NRCS's consolidated financial statements as of and for the year ended September 30, 2008.

Our consideration of internal control over financial reporting resulted in the following conditions being identified as significant deficiencies:

1. Improved Accounting and Controls Needed Over Undelivered Orders
2. Improved Accounting and Controls Needed for Unfilled Customer Orders
3. Improved Accounting and Controls Needed for Accrued Expenses
4. Improved Accounting and Controls Needed for Property, Plant and Equipment
5. Improved Controls are Needed over Financial Reporting
6. NRCS and USDA Information Technology Services (ITS) Need to Improve their General Controls Environment
7. Improved Controls Are Needed Over Purchase and Fleet Card Transactions

We consider the significant deficiencies 1 through 5, above, to be material weaknesses.

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, disclosed the following instances of noncompliance or other matters that are required to be reported 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*:

8. NRCS does not Obligate all Transactions Required by Appropriation Law
9. NRCS does not substantially comply with the *Federal Financial Management Improvement Act of 1996* (FFMIA)



Had we been able to perform all of the procedures necessary to express an opinion on NRCS's fiscal year 2008 consolidated financial statements, other internal control matters and other instances of noncompliance may have been identified and reported.

The following sections discuss the reasons why we are unable to express an opinion on NRCS's consolidated financial statements; our consideration of NRCS's internal controls over financial reporting; our tests of NRCS's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements; and management's and our responsibilities.

### **Report on the Consolidated Financial Statements**

We were engaged to audit the accompanying consolidated balance sheet of NRCS as of September 30, 2008, and the related consolidated statements of net cost and changes in net position, and the combined statement of budgetary resources for the year then ended.

NRCS was unable to provide sufficient evidential matter in support of transactions and account balances, as presented in the NRCS consolidated financial statements as of and for the year ended September 30, 2008, particularly with respect to obligations, including accrued expenses and undelivered orders, and unfilled customer orders. NRCS was not able to complete corrective actions and make adjustments, as necessary, to these and other financial statement amounts, prior to the contractually required completion of the NRCS Fiscal Year 2008 Financial Statements.

It was impracticable to extend our audit procedures sufficiently to determine the extent to which NRCS's consolidated financial statements as of and for the year ended September 30, 2008, may have been affected by the matters discussed in the preceding paragraph, accordingly, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying consolidated financial statements of the Natural Resources Conservation Service as of and for the year ended September 30, 2008.

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.

### **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 NRCS'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 NRCS's consolidated financial statements that is more than inconsequential will not be prevented or detected by NRCS'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 consolidated financial statements will not be prevented or detected by NRCS's internal control.

We consider the deficiencies, described in Exhibits I and II, to be significant deficiencies in internal control over financial reporting. However, of the significant deficiencies described in Exhibits I and II, we believe that the significant deficiencies presented in Exhibit I are material weaknesses.

We noted certain additional matters that we will report to management of NRCS in a separate letter.

### **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 FFMIA, disclosed one instance of noncompliance or other matters that is required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, and is described in Exhibit III.

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 instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

The results of our tests of FFMIA disclosed instances, described in Exhibit III, where NRCS's financial management systems did not substantially comply with Federal Financial Management System Requirements, the United States Standard General Ledger, and applicable Federal Accounting Standards.

\* \* \* \* \*

### **Responsibilities**

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

**Auditors' Responsibilities.** As discussed in the report on the consolidated financial statements section, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying consolidated financial statements of NRCS as of and for the year ended September 30, 2008.

In connection with our engagement, we considered NRCS's internal control over financial reporting by obtaining an understanding of NRCS'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 procedures. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. Further, had we been able to perform all of the procedures necessary to express an opinion on the consolidated financial statements of NRCS as of and for the year ended September 30, 2008, other matters involving internal control over financial reporting may have been identified and reported. The objective of our engagement was not to express an opinion on the effectiveness of the NRCS's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of NRCS's internal control over financial reporting.

In connection with our engagement, we performed tests of NRCS'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 the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions





referred to in Section 803(a) of 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 NRCS. Had we been able to perform all of the procedures necessary to express an opinion on the consolidated financial statements of NRCS as of and for the year ended September 30, 2008, other matters involving compliance with laws, regulations, contracts and grant agreements may have been identified and reported. Providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our engagement and, accordingly, we do not express such an opinion.

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NRCS's response to the findings identified in our audit are presented in Exhibit IV. We did not audit NRCS's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of NRCS's management, the USDA's Office of Inspector General, 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.

*KPMG LLP*

November 12, 2008

## MATERIAL WEAKNESSES

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### **Number 1: Improved Accounting and Controls Needed Over Undelivered Orders**

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In testing undelivered order (UDO) balances, we noted numerous exceptions including amounts that should have been accrued, were not valid due to an expired period of performance, and were not fully supported by valid obligation documents. We also noted that certain obligations were not recorded timely and the state offices were not adequately reviewing open obligation balances.

Our testwork of downward adjustments identified numerous liquidations of obligations during FY 2008 that should have occurred in prior fiscal years; therefore, overstating the current year recoveries.

We were unable to conclude on the results of our testwork due to the materiality of identified audit differences.

The proper recording of obligations is required by law, OMB Circulars, and Generally Accepted Accounting Principles (GAAP). The quarterly certification is required by NRCS policy and annual certification is required by USDA policy.

#### **Recommendation 1:**

We recommend that NRCS management implement procedures and controls that ensure:

- UDO balances are valid at period end;
- Delivered orders are accrued regularly;
- Obligations are properly recorded on a timely basis; and
- Quarterly certifications are properly performed.

Also, we recommend that NRCS establish a fund certification policy to ensure funding is available and appropriate prior to obligation.

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### **Number 2: Improved Accounting and Controls Needed for Unfilled Customer Orders**

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In testing unfilled customer order balances, we noted numerous exceptions including amounts that should not have been recognized as unfilled customer orders because the balances were with non-Federal vendors or were not related to a valid reimbursable agreement. Additionally, NRCS was not recording the full amount of the unfilled customer order with Federal vendors. We also noted that the state offices were not recording unfilled customer orders or liquidating them when a bill was sent or a collection was made.

We were unable to conclude on the results of our testwork due to completeness issues related to the recording of unfilled customer orders.

The proper recording of unfilled customer orders is required by law, OMB Circulars, and GAAP.

**Recommendation 2:**

We recommend that NRCS management implement procedures and controls that ensure:

- Unfilled customer orders are complete and valid at period end;
- Unfilled customer orders are recorded for the appropriate amount and only for Federal vendors; and
- Balances are liquidated appropriately when vendors are billed or payments are collected.

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**Number 3: Improved Accounting and Controls Needed for Accrued Expenses**

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In testing accrued expenses as of September 30, 2007, we found that a significant number of disbursements made in FY 2008 were not properly accrued (expensed) as of September 30, 2007. These exceptions included transactions below NRCS's accrual threshold.

Our September 30, 2008 accrual testwork disclosed a large number of accruals that were not properly supported. Our subsequent disbursement testwork determined that the accrual population as of September 30, 2008 was incomplete. We were unable to conclude on the results of our testwork due to the materiality of identified audit differences.

The proper recording of accrued expenses is required by GAAP.

**Recommendation Number 3:**

We recommend that NRCS management:

- Determine the appropriateness of the NRCS policy to not review open obligations of less than \$100,000;
- Develop and provide guidance and training regarding policy and procedures over preparing, reviewing and recording accruals, and
- Develop and implement new procedures or strengthen existing procedures to ensure that the state offices are recording accruals for all obligations.

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**Number 4: Improved Accounting and Controls Needed for Property, Plant, and Equipment**

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In testing property, plant and equipment, we noted that:

- Capital leases were not identified and accounted for as required;
- Internal use software under development was not capitalized as required;
- Personal and real property balances are not supported by appropriate documentation and/or a physical inventory; current policy does not provide sufficient guidance regarding the transfer of Office of the Chief Information Officer (OCIO) IT equipment at the state offices to the OCIO property records; and
- Bulk purchases of personal property are capitalized even if the individual assets are below the capitalization threshold. NRCS's policy does not allow for the capitalization of bulk purchases.

We could not conclude on the completeness and accuracy of the capital lease balance as of September 30, 2008. We did not receive adequate documentation for internal use software and work in progress balances as of September 30, 2008; therefore, we could not conclude on this testwork.

The proper acquisition, safeguarding, maintenance, and disposal of property is required by law, GAAP, and OMB.

**Recommendation 4:**

We recommend that NRCS management implement procedures and controls that ensure:

- Capital leases are identified and accounted for as required;
- Internal use software under development is capitalized as required;
- Personal and real property balances are supported by appropriate documentation and/or a physical inventory;
- Sufficient guidance regarding the transfer of Office of the Chief Information Officer (OCIO) IT equipment at the state offices to the OCIO inventory listings; and
- Bulk purchases of personal property are not capitalized.

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**Number 5: Improved Controls are Needed Over Financial Reporting**

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We noted the following issues within NRCS's financial reporting process:

- Financial statements were not appropriately prepared and reviewed to ensure compliance with GAAP;
- Non-routine journal entries were not reviewed and approved prior to entry into the financial system.
- An individual could modify and approve a transaction in the financial system. This weakness has been corrected;
- Account relationship tests were not completed over Fund Balance with Treasury; and
- NRCS made frequent reclassification entries to status of budgetary resource accounts. This issue resulted in initially misstated status of budgetary resource balances as of September 30, 2008.

NRCS's financial statements are required to be prepared in accordance with GAAP. OMB Circular A-123, *Management's Responsibility for 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.

**Recommendation Number 5:**

We recommend that NRCS management:

- Ensure employees preparing the financial statements have the appropriate training and that financial statements are reviewed and approved by management to ensure compliance with GAAP;
- Ensure the agency has the appropriate accounting expertise throughout the agency, especially at the state level, to appropriately and completely record transactions.

- Develop and implement procedures to review and approve all adjusting entries prior to their entry into FFIS;
- Strengthen existing controls to ensure adequate segregation of duties exists for origination, approval, and entry into FFIS of all adjusting entries;
- Strengthen existing controls to ensure that adequate supporting documentation exists and is reviewed for all adjusting entries prior to their entry into FFIS; and
- Develop procedures to routinely perform account relationship tests over Fund Balance with Treasury.

## SIGNIFICANT DEFICIENCIES

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### Number 6: NRCS and USDA ITS Needs to Improve their General Controls Environment

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At the Department level, the USDA OIG has identified a significant deficiency related to the IT general controls environment that is managed by Information Technology Services (ITS), a service organization within USDA. ITS manages the network/server infrastructure that supports major applications for several USDA agencies, including NRCS. The USDA OIG noted the following NRCS-related findings:

- Vulnerabilities identified on the ITS network were not consistently remedied according to Departmental policy and patches were not effectively applied.
- Change records were not consistently maintained.
- Adequate security clearances for ITS employees and contractors were not consistently obtained.
- ITS policy governing user access to systems was not adhered to.
- Backup/recovery policies and procedures did not adequately address all required elements, including on-site backup tape storage, the method for transporting data off-site, and off-site storage locations.

Actions to resolve the conditions noted in the ITS IT general controls environment are incumbent upon ensuring the protection of critical NRCS applications and resources. Since NRCS does not have the ability to implement changes to the ITS general controls environment, no further action is needed by the agency other than to monitor the progress of ITS.

In addition to the ITS issues identified above, we noted the following conditions within the NRCS-managed IT general controls environment:

- Lack of adherence to the change control process;
- Lack of adherence to certification and accreditation (C&A) requirements;
- Lack of periodic access review; and
- Applications for access were not maintained.

Although NRCS addressed some of our findings relating to the change control process and C&A requirements during FY 2008, the corrections were not in place and operating effectively during the entire year.

The aforementioned issues are required by National Institute of Standards and Technology (NIST), NRCS policy, and USDA policy and handbooks.

#### **Recommendation Number 6:**

We recommend that NRCS management:

- Create and maintain formal testing documentation and approvals related to change management for all applications changes. Prior to approving for migration, the approving authority should first verify that the change was successfully tested.
- Adhere to segregation of duties best practices when assigning roles within the Collaborative Software Development Laboratory (CoLab) so that individuals are not granted excessive privileges.

- Perform a review of user roles within CoLab on a periodic basis (i.e. quarterly) to ensure that there are no segregation of duties issues between developers and those who can implement changes.
- Determine the cost/benefit of revising the WebTCAS Risk Assessment to account for all NIST 800-30 control areas and revising the WebTCAS System Security Plan to account for all NIST 800-18 control areas.
- Adhere to consistent methodology that incorporates all NIST requirements for all future C&A efforts.
- Conduct a training exercise with individuals responsible for authorizing user access and performing the monthly reviews to familiarize them with the process and ensure that it is followed.
- Perform a detailed review of authorizations granted prior to April 2008 to ensure user access rights are commensurate with the level of each individual's job function.

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**Number 7: Lack of Controls Over Purchase and Fleet Card Transactions**

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In testing controls over purchase card (PCMS) transactions, we noted that quarterly reviews were not conducted over all cardholders. We also found that employees do not retain support for fleet card transactions.

USDA regulations require cardholder supervisors to monitor purchase activity of cardholders in their units. Federal regulations require transactions to be adequately supported with appropriate documentation.

Without proper review of PCMS transactions, a purchase cardholder has the ability to purchase improper goods and services or make purchases in excess of daily or maximum dollar limits. This increases the risk of unauthorized and unnecessary expenses to be incurred and the misuse of NRCS funds.

By not requiring the retention of receipts to substantiate its fleet card fuel purchases, NRCS is not able to adequately support its disbursements for all of its fuel card purchases.

**Recommendation Number 7:**

We recommend that NRCS management:

- Develop and implement training for supervisors to emphasize the need for adhering to the policy and procedures over reviewing cardholder transaction reports.
- Develop and implement policies and procedures for requiring the retention of all receipts for all fleet card purchases, including fuel and "non-fuel" purchases.

**COMPLIANCE AND OTHER MATTERS**

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**Number 8: NRCS Does Not Obligate all Transactions Required by Appropriations Law**

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We noted that contracts, purchase orders, travel expenses, and various other transactions were not obligated prior to payment.

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

NRCS does not have a policy or procedure in place to ensure that an obligation is recorded for all future outlay transactions prior to expenditure. Without obligating all required transactions, obligations are understated at any one point in time. The untimely obligations result in non-compliance with appropriation law. The financial system allows for the processing of payments without referencing an obligation.

**Recommendation Number 8:**

We recommend that NRCS management:

- Strengthen existing procedures to ensure that an obligation is recorded for all future outlay transactions prior to expenditure;
- Work to ensure that a control is implemented to the financial system to ensure that it does not allow for processing of payments without referencing an obligation;
- Continue with plans to implement the new travel system that will obligate individual travel authorizations once approved.

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**Number 9: NRCS’s Does Not Substantially Comply with FFMIA of 1996**

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**Compliance with Federal Financial Management System Requirements**

During our engagement, we noted instances described in more detail in finding number 6 in Exhibit II, where NRCS’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 weaknesses related to access control, change control, and patch management in the IT general controls environment that supports NRCS’s financial management systems.



**Compliance with Applicable Federal Accounting Standards**

During our engagement, we determined that internal use software, including work in progress, obligations, unfilled customer orders, expense accruals, and capital leases were not properly recorded in accordance with Federal accounting standards. These issues were addressed through recommendations in Exhibits I and II.

**Compliance with the United States Standard General Ledger (USSGL)**

During our engagement, we noted the following deficiencies in the standard general ledger posting:

- NRCS inappropriately used posting models for stewardship land, cumulative results of operations for non-appropriated funds, and advances to others.
- Non-linked transactions exist in the general ledger.

**Recommendation Number 9:**

We recommend that NRCS management:

- Obtain USSGL compliant posting models to appropriately record transactions without reclassification; and
- Devote the necessary resources to identify, research, and correct unlinked transactions. NRCS should ensure that related account balances are complete and accurate.



Natural Resources Conservation Service  
P.O. Box 2890  
Washington, D.C. 20013

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November 12, 2008

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

Dear Mr. Boyce:

We have reviewed KPMG's Independent Auditor's Report dated November 12, 2008, and generally agree with its contents.

As we consider the required corrective actions, we will continue to work with KPMG and the Office of the Inspector General in identifying the specific actions that will assist us in successfully addressing the recommendations.

If you have any questions or require additional information, please contact me at (202) 720-5904.

Sincerely,

A handwritten signature in black ink, appearing to read "E. Steven Butler", is written over a horizontal line.

E. STEVEN BUTLER  
Chief Financial Officer  
11/12

cc:

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

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Fiscal Year 2008  
Financial Statements

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# Management's Discussion and Analysis (Unaudited)

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The Management's Discussion and Analysis (MD&A) serves as an unaudited high-level overview of the fiscal year (FY) 2008 financial and non-financial performance for the Natural Resources Conservation Service (NRCS), an agency of the U.S. Department of Agriculture (USDA).

The MD&A discusses the agency's compliance with legal and regulatory requirements, including the Federal Managers' Financial Integrity Act (FMFIA), the Federal Financial Management Improvement Act (FFMIA), the Inspector General Act, and other key legal and regulatory requirements.

### ***MISSION AND ORGANIZATIONAL STRUCTURE***

#### **Mission Statement**

The mission statement of NRCS is "*Helping People Help the Land*".

Consistent with that mission, NRCS provides products and services that enable people to be good stewards of the Nation's soil, water, and related natural resources on non-Federal lands. With our help, people are better able to conserve, maintain, or improve their natural resources. As a result of our technical and financial assistance, land managers and communities take a comprehensive approach to the use and protection of natural resources in rural, suburban, urban, and developing areas. NRCS has partnered with conservation districts and others throughout the U.S. to help landowners, as well as Federal, State, Tribal, and local government and community groups in accomplishing our mission.

#### **Organizational Structure**

NRCS operates under the direction of the USDA Under-Secretary for Natural Resources and Environment. The NRCS mission is carried out across three Regions which cover all 50 States, Puerto Rico, the Pacific Basin Area, 3 National Technology Support Centers, and 11 National Centers.

NRCS is structured in a line organization. Reporting to the Chief are the deputy areas of Management, Programs, Science and Technology, Soil Surveys and Resource Assessment, Strategic Planning and Accountability, and Financial Management. The Agency has recently reorganized and a current organizational chart is not available.

#### ***Mission Goals***

NRCS has six strategic goals that relate to four USDA objective goals in support of USDA's strategic goal 6 to Protect and Enhance the Nation's Natural Resource Base and Environment. The NRCS goals in its 5-year strategic plan are:

- High quality, productive soils
- Clean and abundant water
- Healthy plant and animal communities
- Clean air
- An adequate energy supply
- Working farm and ranch lands

NRCS distributes costs across the first three goals and no costs are attributed to the other three.

To achieve the strategic goals, NRCS implemented the following strategies:

- Cooperative conservation: seeking and promoting cooperative efforts in local communities to achieve conservation goals.
- Watershed approach: providing information and assistance to the public to encourage and enable locally-led, watershed-scale conservation.
- Market-based approach: facilitating the growth of market-based opportunities that encourage the public sector to invest in conservation of private lands.



## Management's Discussion and Analysis (Unaudited)

### Mission Goal 1: High Quality, Productive Soils

These activities and programs are designed to help people ensure the quality of intensively used soils is maintained or enhanced to enable sustained production of a safe, healthy, and abundant food supply. Soil quality refers to the capacity of a soil to sustain plant and animal productivity, maintain or enhance water and air quality, and support human health and habitation. High quality soils are the foundation of productive croplands, forest lands, and grasslands, and a vibrant and productive agriculture.

| High Quality, Productive Soils Performance Measure and Programs                            | Trend          |                |                | FY 2008 |        |
|--|----------------|----------------|----------------|---------|--------|
|  | FY 2005 Actual | FY 2006 Actual | FY 2007 Actual | Target  | Actual |
| Reduction in the acreage of cropland soils damaged by erosion,(million acres) <sup>1</sup> |                |                |                |         |        |
| Conservation Technical Assistance (CTA)  | 3.9            | 3.9            | NA             | NA      | NA     |
| Environmental Quality Incentives Program (EQIP)  | 1.5            | 1.7            | NA             | NA      | NA     |
| <sup>1</sup> This measure was discontinued in FY 2007.                                     |                |                |                |         |        |

Table 1. Performance measures and programs for High Quality, Productive Soils.

| High Quality, Productive Soils Performance Measure and Programs   | Trend          |                |                | FY 2008 |        |
|---|----------------|----------------|----------------|---------|--------|
|   | FY 2005 Actual | FY 2006 Actual | FY 2007 Actual | Target  | Actual |
| Cropland with conservation applied to improve soil quality (millions of acres) <sup>1</sup>   |                |                |                |         |        |
| Conservation Technical Assistance (CTA)   | 6              | 6.4            | 7.3            | 7       | 8.3    |
| Environmental Quality Incentives Program (EQIP)   | 2.2            | 3.4            | 5.3            | 5.5     | 5.6    |
| Conservation Security Program   | 7.2            | 1.4            | 0.14           | 1.4     | 1.3    |
| <sup>1</sup> This measure was new for the Agency in FY 2007. It relates to the prior measure for Cropland Soils Protected from Excessive Erosion. This measure has been designed to provide a better indicator of soil quality and includes all cropland and hay land on which USDA assisted producers to apply conservation measures to maintain or enhance soil quality and enable sustained production of a safe, healthy, and abundant food supply. Performance data for FY 2006 and FY 2005 have been provided to indicate prior year performance had this measure been employed at that time. |                |                |                |         |        |

Table 2: Performance measures and programs for High Quality, Productive Soils.

### Mission Goal 2: Clean and Abundant Water

Activities and programs are designed to help people ensure that: 1) the quality of surface waters and groundwater are improved and maintained to protect human health, support a healthy environment, and encourage a productive landscape; and 2) water is conserved and protected to ensure an abundant and reliable supply for the Nation.

The Nation's freshwater resources provide drinking water, food, energy, and recreation. Agricultural and forest lands are the dominant land uses in the Nation's watersheds. Well-cared-for watersheds are fundamental to ensuring clean and abundant water resources to meet the Nation's needs.

| Clean and Abundant Water Performance Measure and Programs | Trend          |                |                | FY 2008 |        |
|---|----------------|----------------|----------------|---------|--------|
|   | FY 2005 Actual | FY 2006 Actual | FY 2007 Actual | Target  | Actual |
| Comprehensive nutrient management plans applied, (number) |                |                |                |         |        |
| Conservation Technical Assistance (CTA)                   | 2,421          | 2,269          | 1,911          | 1,550   | 1,745  |
| Environmental Quality Incentives Program (EQIP)           | 2,032          | 2,774          | 2,490          | 2,300   | 2,520  |

Table 3: Performance measures and programs for Clean and Abundant Water.

### Mission Goal 3: Healthy Plant and Animal Communities

Activities and programs are designed to help people ensure that: 1) grassland, rangeland, and forest ecosystems are productive, diverse, and resilient; 2) working lands and waters provide habitat for diverse and healthy wildlife, aquatic species, and plant communities; and 3) wetlands provide a quality habitat for migratory birds and other wildlife, protect water quality, and reduce flood damages.

## Management's Discussion and Analysis (Unaudited)

Healthy plant and animal communities provide economic and aesthetic benefits and are essential to people's quality of life. Sustaining plant and animal communities is accomplished through a web of interacting relationships between plant and animal species within a given ecosystem, and their relationship to the physical features and processes of their environment to maintain the health and vigor of the system.

| Healthy Plant and Animal Communities<br>Performance Measure and Programs                        | Trend   |         |         | FY 2008 |        |
|---|---------|---------|---------|---------|--------|
|   | FY 2005 | FY 2006 | FY 2007 | Target  | Actual |
| Grazing land with conservation applied to treat the resource base, (million acres) <sup>1</sup> |         |         |         |         |        |
| Conservation Technical Assistance (CTA)   | 13.2    | 12      | NA      | NA      | NA     |
| Environmental Quality Incentives Program (EQIP)   | 10.3    | 13.6    | NA      | NA      | NA     |

<sup>1</sup>This measure was discontinued in FY 2007.

Table 4: Performance measures and programs for Healthy Plant and Animal Communities

| Healthy Plant and Animal Communities<br>Performance Measure and Programs  | Trend   |         |         | FY 2008 |        |
|---|---------|---------|---------|---------|--------|
|   | FY 2005 | FY 2006 | FY 2007 | Target  | Actual |
| Grazing lands and forestland with conservation applied to protect the resource base and environment, Conservation Technical Assistance, and Environmental Quality Incentives Program (millions of acres) <sup>1</sup> |         |         |         |         |        |
| Conservation Technical Assistance (CTA)   | 7.5     | 11.8    | 14.2    | 12      | 16.0   |
| Environmental Quality Incentives Program (EQIP)   | 8       | 12.2    | 16.5    | 12.3    | 16.9   |

<sup>1</sup> This measure was re-defined and expanded in FY 2007 to include all private grazing or forest land on which the Department assisted producers to apply conservation measures to maintain or improve long-term vegetative condition and protect the resource base. Lands on which conservation measures may be applied include grazed range, grazed forest, native and naturalized pasture, and forest. Performance data for FY 2006 and FY 2005 have been provided to indicate prior year performance had this measure been employed at that time.

Table 5: Performance measures and programs for Healthy Plant and Animal Communities

| Healthy Plant and Animal Communities<br>Performance Measure and Programs | Trend   |         |         | FY 2008 |         |
|--|---------|---------|---------|---------|---------|
|  | FY 2005 | FY 2006 | FY 2007 | Target  | Actual  |
| Wetlands created, restored or enhanced, (acres)                          |         |         |         |         |         |
| Conservation Technical Assistance (CTA)                                  | 53,498  | 65,345  | 62,092  | 51,300  | 72,806  |
| Wetland Reserve Program (WRP)  | 180,358 | 181,979 | 149,326 | 100,000 | 128,860 |

Table 6: Performance measures and programs for Healthy Plant and Animal Communities

Management's Discussion and Analysis  
(Unaudited)

**Performance Scorecard for FY 2008**

The following scorecard displays NRCS's accomplishments as reported for USDA's Strategic Plan, Goal 6, "Protect and Enhance the Nation's Natural Resource base and environment."

| Performance Scorecard for FY 2008 Annual Performance Goals                               |  |   |          |
|--|--|---|----------|
| Strategic Goal 6: Protect and Enhance the Nation's Natural Resource Base and Environment |  |   |          |
| Objectives   |  |   | Result   |
| 6.1  | Protect watershed health to ensure clean and abundant water                            | 6.1.1 Comprehensive nutrient management plans applied (number of plans)   |          |
|  |  | Conservation Technical Assistance   | Exceeded |
|  |  | Environmental Quality Incentives Program  | Met      |
| 6.2  | Enhance Soil Quality to Maintain a Productive Cropland Base                            | 6.2.1 Cropland with conservation applied to improve soil quality (millions of acres)                                  |          |
|  |  | Conservation Technical Assistance   | Exceeded |
|  |  | Environmental Quality Incentives Program  | Met      |
|  |  | Conservation Security Program   | Met      |
| 6.3  | Protect Forests and Grazing Lands  | 6.3.1 Grazing land forest land with conservation applied to protect and improve the resource base (millions of acres) |          |
|  |  | Conservation Technical Assistance   | Exceeded |
|  |  | Environmental Quality Incentives Program  | Exceeded |
| 6.4  | Protect and Enhance Wildlife Habitat to Benefit Desired, At-Risk And Declining Species | 6.4.1 Wetlands created, restored or enhanced (acres)  |          |
|  |  | Conservation Technical Assistance   | Exceeded |
|  |  | Wetland Reserve Program   | Exceeded |

Table 7: Performance Scorecard for FY 2008

| Annual performance Goals and Indicators  | Fiscal Year 2008 |                     |                       |
|--|------------------|---------------------|-----------------------|
|  | Target           | Actual <sup>1</sup> | Result                |
| 6.1.1 Comprehensive Nutrient Management Plans applied (number of plans)  |                  |                     |                       |
| Conservation Technical Assistance  | 1,550            | 1,745               | Exceeded <sup>2</sup> |
| Environmental Quality Incentives Program   | 2,300            | 2,520               | Met <sup>3</sup>      |
| <sup>1</sup> Actual performance as of September 15, 2008.  |                  |                     |                       |
| <sup>2</sup> Data assessment metrics to meet the target allow for an actual number in the range 1,395 – 1,705. |                  |                     |                       |
| <sup>3</sup> Data assessment metrics to meet the target allow for an actual number in the range 2,070 – 2,530. |                  |                     |                       |

Table 8: Summary of the performance goals, objectives, and results for FY 2008

## Management's Discussion and Analysis (Unaudited)

| Annual Performance Goals and Indicators  | Fiscal Year 2008 |                     |                       |
|--|------------------|---------------------|-----------------------|
|  | Target           | Actual <sup>1</sup> | Result                |
| 6.2.1 Cropland with conservation applied to improve soil quality (millions of acres)   |                  |                     |                       |
| Conservation Technical Assistance Program  | 7.0              | 8.3                 | Exceeded <sup>2</sup> |
| Environmental Quality Incentives Program   | 5.5              | 5.6                 | Met <sup>3</sup>      |
| Conservation Security Program  | 1.4              | 1.3                 | Met <sup>4</sup>      |
| <sup>1</sup> Actual performance as of September 15, 2008.<br><sup>2</sup> Data assessment metrics to meet the target allow for an actual number in the range 6.3– 7.7.<br><sup>3</sup> Data assessment metrics to meet the target allow for an actual number in the range 5.0 – 6.1.<br><sup>4</sup> Data assessment metrics to meet the target allow for an actual number in the range 1.3 – 1.5. |                  |                     |                       |

Table 9: Enhanced Soil Quality

| Annual Performance Goals and Indicators  | Fiscal Year 2008 |                     |                       |
|--|------------------|---------------------|-----------------------|
|  | Target           | Actual <sup>1</sup> | Result                |
| 6.3.1 Grazing and forest land with conservation applied to protect and improve the resource base, (millions of acres)  |                  |                     |                       |
| Conservation Technical Assistance  | 12.0             | 16.0                | Exceeded <sup>2</sup> |
| Environmental Quality Incentives Program   | 12.3             | 16.9                | Exceeded <sup>3</sup> |
| <sup>1</sup> Actual performance as of September 15, 2008<br><sup>2</sup> Data assessment metrics to meet the target allow for an actual number in the range of 10.8 – 13.2.<br><sup>3</sup> Data assessment metrics to meet the target allow for an actual number in the range of 11.1 – 13.5. |                  |                     |                       |

Table 10: Sustainable Non-federal Forests and Grasslands

| Annual Performance Goals and Indicators  | Fiscal Year 2008 |                     |                       |
|--|------------------|---------------------|-----------------------|
|  | Target           | Actual <sup>1</sup> | Result                |
| 6.4.1 Wetlands created, restored or enhanced (acres)   |                  |                     |                       |
| Conservation Technical Assistance  | 51,300           | 72,806              | Exceeded <sup>2</sup> |
| Wetlands Reserve Program   | 100,000          | 128,860             | Exceeded <sup>3</sup> |
| <sup>1</sup> Actual performance as of September 15, 2008.<br><sup>2</sup> Data assessment metrics to meet the target allow for an actual number in the range 46,170 – 56,430.<br><sup>3</sup> Data assessment metrics to meet the target allow for an actual number in the range 90,000 – 110,000. |                  |                     |                       |

Table 11: Improved Wildlife Habitat

### ***Business Lines and Resources***

#### **Business Lines**

To fulfill its mission, NRCS provides technical and financial assistance to land owners and managers. This technical and financial assistance is delivered through five business lines. Business lines are groups of similar products and services that Agency employees deliver to external customers.

#### **1. Conservation planning and technical consultation**

NRCS provides data, information, and technical expertise that help people collect and analyze information to identify natural resource problems and opportunities; clarify their objectives; and formulate and evaluate alternatives.

#### **2. Conservation implementation**

NRCS helps people install conservation practices and systems that meet established technical standards and specifications.

## Management's Discussion and Analysis (Unaudited)

### **3. Natural resource inventory and assessment**

NRCS assesses, acquires, develops, interprets, analyzes, and delivers natural resource data and information to enable knowledge-based natural resource planning and decision making at all landscape scales.

### **4. Natural resource technology transfer**

NRCS develops, documents, and distributes a wide array of technology pertaining to resource assessment, conservation planning, and installation and evaluation of conservation systems.

### **5. Financial assistance**

NRCS provides financial assistance to encourage the adoption of conservation practices that have been proven to provide significant public benefits. Financial assistance is provided to participants who voluntarily enter into contracts, easements, and agreements to conserve natural resources.

### ***Natural Resource Inventory and Assessment***

NRCS assesses, acquires, develops, interprets, analyzes, and delivers natural resource data and information to enable knowledge-based natural resource planning and decision making at all landscape scales. We develop data gathering protocols to ensure that reliable natural resource data is acquired and delivered. Our protocols are used by other Federal, State, and local agencies and organizations, ensuring that data compiled is of consistent quality. We develop and maintain databases and deliver data in a wide variety of media and formats. We conduct assessments and analyses, including modeling and interpretation of natural resource data, to better inform decision makers and facilitate policy development.

Natural resource inventory and assessments to support all agency programs are conducted by NRCS's Conservation Operations and Water Resources programs. Many inventory and assessment activities provide information for multiple natural resource issues and support achievement of multiple conservation objectives. Major inventories include the Soil Survey, Snow Surveys and Water Supply Forecasting, and the National Resources Inventory (NRI). The NRI is a longitudinal, statistical sample survey of natural resource conditions and trends on non-Federal lands in the United States. Data and analysis from the NRI supply information to design conservation programs and policy. New data collection protocols and tools incorporating updated technology have been developed for use at the 3 Remote Sensing Laboratories. A major assessment effort is the Conservation Effects Assessment Project (CEAP). CEAP is a multi-agency effort to quantify the environmental benefits associated with conservation practices implemented under the 2002 Farm Bill and other related programs.

### ***Analysis of Financial Statements and Stewardship Information***

NRCS produces a series of financial statements on a quarterly basis to summarize the activity and associated financial position of the agency. The four principal statements are as follows:

- Balance Sheet
- Statement of Net Cost
- Statement of Changes in Net Position
- Statement of Budgetary Resources

NRCS is reporting total assets of \$4,974 million that are made up of fund balance with Treasury, pre-paid advances or advances to others and general property plant and equipment with receivables due to the agency comprising a very small part of the asset value. Total liabilities amount to \$319 million. This presents NRCS with a sound net position of \$4,655 million as of September 30, 2008.

NRCS strives to provide relevant, reliable, and accurate financial information related to agency activities in producing the financial statements. The tables below reflect the comparative amounts for FY 2008 and FY 2007.

### ***Assets***

NRCS reported \$4,974 million in assets as of September 30, 2008, representing an increase of 13 percent from the FY 2007 amounts. The increase is due to additional funding received for the Emergency Watershed Program and Farm Bill Programs. Capital leases have been recognized in general property, plant, and equipment, which resulted in a \$33 million increase.

## Management's Discussion and Analysis (Unaudited)

| Asset<br>(in millions)   | FY 2008        | FY 2007        | Difference   | Difference<br>(Percentage) |
|--|----------------|----------------|--------------|----------------------------|
| Fund balance with Treasury                                       | \$4,801        | \$4,227        | \$574        | 14%                        |
| Accounts Receivable, Intragovernmental and Non-Intragovernmental | 23             | 32             | (9)          | -28%                       |
| General Property, Plant and Equipment                            | 53             | 20             | 33           | 165%                       |
| <b>Total Major Categories</b>                                    | <b>4,877</b>   | <b>4,279</b>   | <b>598</b>   | <b>14%</b>                 |
| Other Asset Categories   | 97             | 113            | (16)         | -14%                       |
| <b>Grand Total Assets</b>  | <b>\$4,974</b> | <b>\$4,392</b> | <b>\$582</b> | <b>13%</b>                 |

Table 12: Asset Table (\$ in millions)

Fund balance with Treasury (FBWT) is an asset account that represents the amount in the entity's accounts with Treasury that is available only for the purposes for which the funds were appropriated, as discussed in Statements of Federal Financial Accounting Concepts (SFFAC) 2, Paragraph 84. According to SFFAC 1, Paragraph 31, this is the aggregate amount for which the entity is authorized to make expenditures and pay liabilities. For NRCS, this account includes general funds, which are funds appropriated by Congress and funds transferred from Commodity Credit Corporation (CCC) from borrowing authority, special funds, trust funds, deposit funds, clearing accounts, and miscellaneous receipt accounts.

General PP&E (GPP&E) consists primarily of NRCS owned land and land rights, buildings, other structures and facilities, equipment, and internal-use software. GPP&E includes \$33 million for capital leases to be paid in future periods. GPP&E also includes the value of heritage assets, but not of stewardship assets.

Other Assets consist primarily of funds advanced to CCC to make payments to farmers and landowners under the Grassland Reserve Program of the Farm Bill.

### **Liabilities**

NRCS reported \$319 million in liabilities as of September 30, 2008. The 20% increase is primarily due to prior year emergency projects that were completed during FY 2008 and capital lease activity.

The major liability amounts for Unfunded Leave and Federal Employees' Compensation Act (FECA) benefits, Intragovernmental and Non-Intragovernmental liabilities, funded payroll and leave, travel and transportation for other liabilities appear in the table below.

| Liabilities<br>(in millions)                            | FY 2008      | FY 2007      | Difference  | Difference<br>(Percentage) |
|---|--------------|--------------|-------------|----------------------------|
| Intragovernmental and Non-Intragovernmental liabilities | \$33         | \$4          | \$29        | 725%                       |
| Unfunded Leave and FECA Benefits                        | 117          | 113          | 4           | 4%                         |
| <b>Total Major Categories</b>                           | <b>150</b>   | <b>117</b>   | <b>33</b>   | <b>28%</b>                 |
| Capital Lease Liability                                 | 33           | 0            | 33          | 0%                         |
| Other Liabilities Categories                            | 136          | 148          | (12)        | -8%                        |
| <b>Grand Total Liabilities</b>                          | <b>\$319</b> | <b>\$265</b> | <b>\$54</b> | <b>20%</b>                 |

Table 13: Liabilities Table (\$ in millions)

By law, Federal agencies cannot make outlays unless Congress has authorized and appropriated the funds and OMB has provided an apportionment. A portion of liabilities reported on the Balance Sheet are currently not funded. Examples include unfunded employee annual leave earned but not yet taken and FECA benefits that are accrued to cover liabilities associated with employees' death, disability, medical, and other approved costs that have not yet been appropriated. These liabilities will be disbursed at the time the event occurs and will be expended from the current appropriations available at that time.

The majority of the liabilities generated by NRCS are for contracts and agreements entered into with producers and other landowners to provide technical and financial assistance for conservation programs. A number of these are long-term contracts and agreements covering 10 years or longer, depending on authority.

## Management's Discussion and Analysis (Unaudited)

### **Net Position**

NRCS reported a net position of \$4,655 million as of September 30, 2008, representing an increase of 13 percent from the FY 2007 balance. The increase is primarily attributed to increased funding received for Emergency Watershed Operations in FY 2008.

Net position represents unexpended appropriations consisting of undelivered orders, as well as unobligated funds, and the cumulative results of operations.

Unexpended appropriations reflect the spending authority made available by appropriation or transfer-in that is not currently obligated, or has been obligated but not disbursed and therefore is unavailable for new obligations. Cumulative results of operations reflect the cumulative effect of financing in excess of expenditures and non expenditure transfers from CCC.

| Net Position<br>(in millions)    | FY 2008        | FY 2007        | Difference   | Difference<br>(Percentage) |
|----------------------------------|----------------|----------------|--------------|----------------------------|
| Unexpended Appropriations        | \$976          | \$721          | \$255        | 35%                        |
| Cumulative Results of Operations | 3,679          | 3,406          | 273          | 8%                         |
| <b>Total Net Position</b>        | <b>\$4,655</b> | <b>\$4,127</b> | <b>\$528</b> | <b>13%</b>                 |

Table 14: Net Position Table (\$ in millions)

### **Net Cost of Operations**

NRCS's net cost of operations was \$3,029 million as of September 30, 2008, representing an increase of 1 percent from FY 2007.

| Net Cost of Operations<br>(in millions) | FY 2008        | FY 2007        | Difference  | Difference<br>(Percentage) |
|---|----------------|----------------|-------------|----------------------------|
| Gross Cost                              | \$3,176        | \$3,150        | \$26        | 1%                         |
| Total Earned Revenue                    | 147            | 152            | (5)         | -3%                        |
| <b>Total Net Cost of Operations</b>     | <b>\$3,029</b> | <b>\$2,998</b> | <b>\$21</b> | <b>1%</b>                  |

Table 15: Net Cost of Operations

Earned revenue from the public includes cost-share agreements entered into with State and local government agencies, colleges and universities, Tribes, and other individuals to share in the cost of performing conservation activities. NRCS also enters into reimbursable agreements with other Federal agencies for providing technical assistance under the Economy Act and other authorities.

### **Expenses**

NRCS program costs are \$3,176 million as of September 30, 2008, representing a 1 percent increase from FY 2007. The increase relates to projects completed under the Watershed Rehabilitation Program during FY 2008.

### **Budgetary Resources**

NRCS's total budgetary resources were \$5,083 million in FY 2008 and \$4,204 million in FY 2007. Total budgetary resources in fiscal year 2008 reflected a net increase of \$879 million. Current year funding in year 2008 increased \$490 million for Emergency Watershed over fiscal year 2007. The remaining differences are attributed to several other programs and reimbursable activity.

| Budgetary Resources<br>(in millions)                | FY 2008 | FY 2007 | Difference | Difference<br>(Percentage) |
|---|---------|---------|------------|----------------------------|
| Budgetary Resources & Status of Budgetary Resources | \$5,083 | \$4,204 | \$879      | 21%                        |

Table 16: Budgetary Resources

## Management's Discussion and Analysis (Unaudited)

### ***Analysis of Systems, Controls and Legal Compliance***

#### **FY 2008 Financial Statement Audit Report Results**

In FY 2008, KPMG LLP, an independent audit firm was engaged to audit the financial statements for NRCS. KPMG indicated that the scope of their work was not sufficient to enable them to express, and they did not express, an opinion on NRCS's consolidated financial statements as of and for the year ended September 30, 2008. The auditors have identified internal control deficiencies resulting in five (5) material weaknesses, two (2) significant deficiencies, and two (2) findings of non-compliance with laws and regulations.

#### **Federal Managers' Financial Integrity Act (FMFIA) of 1996**

FMFIA requires Federal agencies to conduct ongoing evaluations regarding the adequacy of the systems of internal accounting and administrative control and to report all material weaknesses identified through management and auditor evaluations. Federal agencies are required to provide reasonable assurance that the following objectives are being met:

- 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.

During FY 2008, NRCS took steps to ensure that evaluations of the system of internal controls for the agency were conducted in accordance with Office of Management and Budget (OMB) guidelines and the standards prescribed by the Government Accountability Office (GAO).

Financial reporting evaluations included assessments regarding whether the financial management systems, internal accounting, and administrative controls were in compliance with the standards prescribed by OMB Circular A-123 Appendix A.

Management has conducted its annual evaluations of internal control and financial systems pursuant to Section 2 and Section 4 of FMFIA, respectively.

Based on the results of the evaluations, NRCS determined that the designs for internal controls must be re-evaluated.

Material weaknesses include:

- Improved accounting and control needed over undelivered orders.
- Improved accounting controls needed for unfilled customer orders.
- Improved accounting controls needed for accrued expenses.
- Improved accounting controls needed for property, plant, and equipment.
- Improved controls are needed over financial reporting.

Significant deficiencies are:

- NRCS and USDA Information Technology Services (ITS) need to improve their general controls environment.
- Improved controls are needed over purchase and fleet card transactions.

Non-Compliance with Laws and Regulations include that:

- NRCS does not obligate all transactions required by Appropriation Law.
- NRCS does not substantially comply with FMFIA.

Within USDA's prescribed timeframe, NRCS will submit the required Corrective Action Plans (CAPs) and continue required reporting under FMFIA and FFMIA.



## Management's Discussion and Analysis (Unaudited)

### Federal Managers' Financial Integrity Act Action Plans

The following chart describes the status of the FMFIA Action Plan reported as complete in August 2008. This issue has subsequently been identified as a material weakness.

| Identifier   | Short Title           | Weakness Category (MW, SD) | Year Identified | Original Estimated Completion Date | Actual Completion Date |
|--|-----------------------|----------------------------|-----------------|------------------------------------|------------------------|
| Section 2: Internal Control  |                       |                            |                 |                                    |                        |
| 10.2007.FMFIA.00<br>1  | Unliquidated Balances | SD                         | 2007            | 07/31/2008                         | 08/15/2008             |
| CD = Control Deficiency SD = Significant Deficiency MW = Material Weakness |                       |                            |                 |                                    |                        |

Table 17: Federal Managers' Financial Integrity Act Action Plans

### Federal Information Security Management Act (FISMA)

FISMA provides the framework for securing the Federal Government's information technology. Departments covered by the Paperwork Reduction Act must implement the requirements of FISMA, reporting annually to OMB and Congress on the effectiveness of the agency's security programs and independent OIG evaluations.

Security audit findings, security deficiencies identified in systems certifications and accreditations process, and security deficiencies identified in self-assessments are listed and tracked in the FISMA Plan of Actions and Milestones, which is updated monthly and reported to USDA quarterly for inclusion in its FISMA Report to OMB.

The following condition was identified and corrected in FY 2008:

Two development staff members have write access to four ancillary ProTracts databases on the server called Frigate. Two of the four databases cannot affect production data in any way. The other two could have an inconsequential effect. A corrective action plan was developed and is in progress.

### Federal Financial Management Improvement Act (FFMIA)

FFMIA requires Federal agencies to implement and maintain financial management systems that substantially comply with the following:

1. Federal financial management system requirements;
2. Applicable Federal Accounting Standards; and
3. The U.S. Standard General Ledger (SGL) at the transaction level.

NRCS management evaluated its financial management systems under FFMIA for the period ended September 30, 2008. Based on the results of the evaluation, we concur with the findings of the auditors regarding non-compliance with Federal Financial Management System Requirements, and applicable accounting standards for internal use software (including work in progress), undelivered orders, unfilled customer orders, expense accruals, capital leases, and the proper use of the United States Standard General Ledger (USSGL).

FFMIA remediation plans will be developed to correct deficiencies regarding Federal financial systems including recording accruals in the ProTracts system, proper use of standard general ledger accounting for stewardship lands, and recording of obligations at the individual transactional level.

### Improper Payments Information Act (IPIA)

The IPIA requires each Federal agency to assess all programs and identify which, if any, program(s) may be subject to high risk with respect to improper payments. Agencies are also required to implement corrective measures. For 2008, NRCS was required to perform a statistical sample on the Farm Security and Rural Investment program. The testing resulted in zero improper payments.

| Program                       | CSP          | EQIP         | EQIP GSW    | WHIP       | WRP        | Grand Total  |
|-------------------------------|--------------|--------------|-------------|------------|------------|--------------|
| Sample Amount                 | \$128,368.63 | \$781,514.19 | \$20,975.30 | \$9,314.92 | \$7,664.00 | \$947,837.04 |
| Number of Transactions Tested | 27           | 56           | 4           | 5          | 3          | 95           |

Table 18: Statistical Sample Breakdown

Management's Discussion and Analysis  
(Unaudited)

| Three Year Trend (in millions)   |                        |                        |                              |
|--|------------------------|------------------------|------------------------------|
|  | Reported in FY<br>2006 | Reported in FY<br>2007 | To be Reported in<br>FY 2008 |
| <b>Outlays</b>   | \$1,375                | 227 <sup>1</sup>       | \$1,138                      |
| <b>Improper Payment Rate (%)</b>   | 0.22%                  | 0.47%                  | 0.00%                        |
| <b>Improper Payments (\$)</b>  | 3                      | 1                      | 0                            |
| <b>Year of data sampled</b>  | 2005                   | 2006                   | 2007                         |
| <sup>1</sup> In 2007 NRCS tested only one program in the Farm Security and Rural Investment program, the Conservation Security Program, as high risk. This year we tested all Farm Bill Programs as High Risk. |                        |                        |                              |

Table 19: Three Year Trend

**Internal Controls over Financial Reporting (OMB Circular A-123, Appendix A)**

NRCS implemented the revised requirements of OMB's Circular A-123 *Management's Responsibility for Internal Controls, and Appendix A, Internal Controls over Financial Reporting*. NRCS identified 140 controls within 5 cycles that were applicable for assessment under these requirements. During FY 2008, USDA Department required testing of all cycles with the exception of Funds Control Management (5 controls) and Funds Management (5 controls). As of FY 2008, the responsibility for testing HRM EmpowHR was turned over to the Department.

The five cycles tested included Financial Reporting, Grants Management, HRM (WebTCAS), Reimbursable Agreements, and General Computer Controls. Each process was mapped and evaluated for internal control design effectiveness.

The results for the cycles tested for the 2008 Assurance Year ending June 30 are listed in the table below.

| Count of Control<br>Cycle  | Status of Controls |         |         |      |             |
|--|--------------------|---------|---------|------|-------------|
|  | MW                 | Fail CD | Fail SD | Pass | Grand Total |
| <b>Financial Reporting</b>   | 0                  | 1       | 1       | 23   | 25          |
| <b>Grants Management</b>   | 0                  | 2       | 0       | 24   | 26          |
| <b>HRM (WebTCAS)</b>   | 0                  | 3       | 0       | 5    | 8           |
| <b>Reimbursable Agreements</b>   | 0                  | 2       | 0       | 10   | 12          |
| <b>General Computer Controls</b>   | 0                  | 1       | 0       | 68   | 69          |
| <b>Grand Total</b>   | 0                  | 9       | 1       | 130  | 140         |
| CD = Control Deficiency    SD = Significant Deficiency    MW = Material Weakness |                    |         |         |      |             |

Table 20: Cycles Tested for FY 2008

Ten controls failed as noted above. A Corrective Action Plan was developed and is in progress for failed controls.

**Anti-Deficiency Act**

NRCS does not currently have any Anti-Deficiency Act violations to report for fiscal year 2008.

**Inspector General Act Amendments of 1988**

The Inspector General Act requires management to complete all final actions on audit recommendations within one year of the date of the Inspector General's final audit report.

During the 4th quarter, the following audits were initiated during this reporting period:

- GAO-360980 – Status of Endangered Species Act
- GAO-360978 – USDA Biofuel Efforts

Management's Discussion and Analysis  
(Unaudited)

**NRCS 4th Quarter GAO/OIG Active Audits Summary Report - FY 2008.**

The GAO/OIG Active Audits Summary report contains comments and updates provided by the Deputy Area point of contact (POC) received in response to a SPA/OMOD September 2008 request. This quarterly report provides an overview of the current external audit activities in progress within the Agency. The reports and NRCS actions are as follows:

| Audit Number/Name   | Business Line/Mgt Initiative                 | Start Date | Final Report Date | Deputy Chief             | Audit Status | Agency Point of Contact | Status of Audit   |
|---|--|------------|-------------------|--------------------------|--------------|-------------------------|---|
| OIG-10099-10-KC-Homeland Security, NRCS Protection of Federal Assets  | Improving Internal Mgmt (Mgmt)               | 4/1/2002   | 9/1/2003          | Deputy Chief, Management | Red          | Marcus McDaniel         | Completed background checks for Recommendation 1 (Theresa Hood). Recommendation 6 remains open pending issuance of firearms policy/guidance. (50% completed).   |
| OIG-10001-1-HY Review Contract Administration at NRCS   | Financial Assistance (Mgmt)                  | 1/1/2006   | 3/1/2007          | Deputy Chief, Management | Red          | Juliette White          | Closure was requested, however, OCFO is requesting additional documentation which is being prepared.  |
| GAO-360644-USDA Funding for EQIP-USDA Should Improve Its Process for Allocating Funds to States for EQIP (GAO-06-969) | Improving Internal Mgmt (Prgms)              | 10/1/2005  | 9/1/2006          | Deputy Chief, Programs   | Red          | Tim Beard               | GAO team had a series of communications with NRCS to follow-up on the status of recommendations 1 and 2. Based on those discussions, it was GAO's professional judgment that it was too early to close the recommendations. The new EQIP allocation formula is in draft form. The final approval awaits the Chief and is expected in October 2008.  |
| OIG-50099-11-SF-Crop Base Acres on Conservation Easement Lands  | Financial Assistance (Prgms)                 | 5/3/2005   | 8/1/2007          | Deputy Chief, Programs   | Red          | Ross Lahren             | OCFO has reviewed the additional information NRCS provided for closure of Recommendation 1. OCFO accepted final action and no further reporting is necessary for this audit. Closure for the remaining recommendations is assigned to Farms Services Agency (FSA).  |
| OIG-50601-10-Hq-Chesapeake Bay Restoration - Agricultural Impact on Water Quality                                     | Natural Resource Technology Transfer (Prgms) | 5/13/2005  | 10/1/2006         | Deputy Chief, Programs   | Red          | Daniel Lawson           | Recommendation 6 - A letter to OIG, dated September 4, 2008 was signed by the Chief requesting a change in management decision that would institute a phased approach in the development and implementation of outcome-based performance measurement using CEAP. This phased approach would expedite the process for achieving outcome-based performance measurements in the Chesapeake Bay Restoration. Recommendation 7 - Preparing solution options for OIG. |

Red - Management Actions more than 1 yr, Yellow - Mgmt Actions within 4 months of year anniversary, Green - Review has final report and progressing on actions, Blue - Waiting for Final Report

**Management's Discussion and Analysis  
(Unaudited)**

| <b>Audit Number/Name</b>  | <b>Business Line/Mgt Initiative</b>             | <b>Start Date</b> | <b>Final Report Date</b> | <b>Deputy Chief</b>                  | <b>Audit Status</b> | <b>Agency Point of Contact</b> | <b>Status of Audit</b>   |
|---|---|-------------------|--------------------------|--------------------------------------|---------------------|--------------------------------|--|
| OIG-50601-12-KC-Hurricane Relief Initiative (NRCS and FSA)  | Financial Assistance (Prgms)                    | 11/7/2005         | 10/1/2007                | Deputy Chief, Programs               | Red                 | Gus Jordan                     | Requested closure from OCFO on Recommendation 1 10/9/08. Requested closure from OCFO on Recommendation 2 8/15/08.  |
| OIG-10099-4-SF-Wetlands Reserve Program Restoration Compliance  | Financial Assistance (Prgms)                    | 1/1/2006          | 8/1/2008                 | Deputy Chief, Programs               | Green               | Ross Lahren                    | All but Recommendation 7 is completed. NRCS is requesting closure on the remaining 7 recommendations.  |
| OIG-50099-52-TE-AGI Limitations   | Improving Internal Mgmt (Mgmt)                  | 8/1/2006          |                          | Deputy Chief, Programs               | Blue                | Jon Vrana                      | In progress. Entrance conference held 8/06.  |
| OIG-10601-04-KC-NRCS Conservation Security Program (CSP)  | Financial Assistance (Prgms)                    | 11/1/2006         |                          | Deputy Chief, Programs               | Blue                | Dwayne Howard                  | In progress. Field work completed and NRCS is waiting on the draft report from OIG.  |
| OIG-10601-1-AT-Flood Control Dam Rehabilitation   | Financial Assistance (Prgms)                    | 12/1/2006         |                          | Deputy Chief, Programs               | Blue                | Gus Jordan                     | In progress. On-going field investigations.  |
| OIG-50601-18-TE-Pasture, Rangeland, and Forage Pilot Program  | Financial Assistance (Prgms)                    | 3/24/2008         |                          | Deputy Chief, Programs               | Blue                | Tim Beard                      | Risk Management Agency (RMA) has the lead. OIG requested contact information from NRCS on 8/4/08 for Texas and South Dakota. OIG needed the information to perform an audit on NRCS programs and the RMA Pasture, Ranch Land and Forage Pilot Program. The contact information was provided on 8/4/08. No findings have been reported to NRCS. No additional information is needed at this time. RMA will provide NRCS the status of closeout. |
| GAO-360980-Status of Endangered Species Act Issues  | Natural Resource Inventory and Assessment (S&T) | 8/7/2008          |                          | Deputy Chief, Science and Technology | Blue                | Matthew Harrington             | In progress. Forest Service has the lead for this audit.   |
| GAO-360978-USDA Biofuel Efforts   | Improving Internal Mgmt (Prgms)                 | 9/29/2008         |                          | Deputy Chief, Science and Technology | Blue                | Chuck Zelek                    | In progress. Entrance conference held October 14, 2008   |
| Red - Management Actions more than 1 yr, Yellow - Mgmt Actions within 4 months of year anniversary, Green - Review has final report and progressing on actions, Blue - Waiting for Final Report |   |                   |                          |                                      |                     |                                |  |

**Management's Discussion and Analysis  
(Unaudited)**

| <b>Audit Number/Name</b>  | <b>Business Line/Mgt Initiative</b> | <b>Start Date</b> | <b>Final Report Date</b> | <b>Deputy Chief</b>                               | <b>Audit Status</b> | <b>Agency Point of Contact</b> | <b>Status of Audit</b>  |
|---|-------------------------------------|-------------------|--------------------------|---|---------------------|--------------------------------|---|
| OIG-10601-5-CH-Review of Controls Over Technical Service Providers  | Improving Internal Mgmt (Prgms)     | 10/18/2007        | 9/1/2008                 | Deputy Chief, Science and Technology              | Green               | Angel Figueroa                 | Final report issued 9/08. OIG has reached management decision on this audit. NRCS is requesting closure.                  |
| GAO-320572-Provincial Reconstruction Team (PRT) staffing in Iraq and Afghanistan  | Natural Resources Inventory         | 1/30/2008         |                          | Deputy Chief, Soil Survey and Resource Assessment | Blue                | Melvin Westbrook               | In progress. Foreign Agricultural Service (FAS) has the lead. Entrance conference held 2/6/08.                            |
| GAO-120696-Global Positioning System  | Natural Resources Inventory         | 5/1/2008          |                          | Deputy Chief, Soil Survey and Resource Assessment | Blue                | Mike Rasher                    | In progress. Entrance conference held 5/13/08.  |
| GAO-360777-USDA Civil Rights Performance  | Ensuring Civil Rights (Mgmt)        | 11/1/2006         |                          | Office of the Chief (OOC)                         | Blue                | Joseph Hairston                | In progress. Entrance conference held 11/06.  |
| GAO-450241-Review of Administrative Remedies in the Federal Employee EEO Complaint Process  | Ensuring Civil Rights (Mgmt)        | 2/9/2007          |                          | Office of the Chief (OOC)                         | Blue                | Joseph Hairston                | In progress.  |
| OIG-508-1-TE-Urban Resources Partnership Program (URP)  | Financial Assistance (Mgmt)         | 6/1/1998          | 11/1/1999                | Office of the Chief (OOC)                         | Red                 | Steve Butler                   | Request for closure was denied. Agency is seeking to meet with OCFO to provide clarification of supporting documentation. |
| OIG-50601-04-HY-Adequacy of Internal Controls Over Travel Card Expenditures Follow-up   | Improving Internal Mgmt (Mgmt)      | 11/1/2006         | 9/1/2008                 | Office of the Chief (OOC)                         | Green               | Linda Washington               | This is a follow-up audit to 50601-05-HQ 6/03. Final report issued 9/08. It was found that NRCS has adequate controls.    |
| Red - Management Actions more than 1 yr, Yellow - Mgmt Actions within 4 months of year anniversary, Green - Review has final report and progressing on actions, Blue - Waiting for Final Report |                                     |                   |                          |   |                     |                                |   |

## Financial Statements

### FINANCIAL STATEMENTS

#### ***LIMITATIONS OF FINANCIAL STATEMENTS***

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C. 3515 (b).

While the NRCS's financial statements have been prepared from the books and records in accordance with Generally Accepted Accounting Principles (GAAP) for Federal entities and the formats prescribed by The Office of Management and Budget (OMB), the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

These statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

## Financial Statements



### CONSOLIDATED BALANCE SHEET

As of September 30, 2008  
(in millions)

|  |              |                |
|--|--------------|----------------|
| <b>Assets:</b>   |              |                |
| Intragovernmental:   |              |                |
| Fund balance with Treasury                                       | Note 2       | \$4,801        |
| Accounts receivable  | Note 3       | 16             |
| Other  | Note 6       | 95             |
| <b>Total intragovernmental</b>                                   |              | <b>4912</b>    |
| Accounts receivable, net   | Note 3       | 7              |
| General property, plant and equipment, net                       | Notes 4 & 9  | 53             |
| Other  | Note 6       | 2              |
| <b>Total assets</b>  |              | <b>\$4,974</b> |
| Stewardship PP&E   | Notes 5 & 13 |                |
| <b>Liabilities:</b>  |              |                |
| Intragovernmental:   |              |                |
| Other  | Note 8       | \$33           |
| <b>Total intragovernmental</b>                                   |              | <b>33</b>      |
| Accounts payable   |              | 10             |
| Federal employee & veterans benefits                             | Notes 7 & 8  | 36             |
| Other  | Notes 8 & 9  | 240            |
| <b>Total liabilities</b>   |              | <b>319</b>     |
| Commitments and contingencies                                    | Note 10      |                |
| <b>Net position:</b>   |              |                |
| Unexpended appropriations  |              | 976            |
| Cumulative results of operations                                 |              | 3,679          |
| <b>Total net position</b>  |              | <b>4,655</b>   |
| <b>Total liabilities and net position</b>                        |              | <b>\$4,974</b> |
| The accompanying notes are an integral part of these statements. |              |                |

Unaudited – See accompanying auditors’ report

## Financial Statements



### CONSOLIDATED STATEMENT OF NET COST

For the Year ended September 30, 2008

(in millions)

| Program costs:   | Notes 11,12 & 14 |                |
|--|------------------|----------------|
| <b>High Quality, Productive Soils</b>                            |                  |                |
| Gross costs  |                  | \$652          |
| Less: earned revenue   |                  | 20             |
| <b>Net Program Cost</b>  |                  | <b>632</b>     |
| <b>Clean and Abundant Water</b>                                  |                  |                |
| Gross costs  |                  | 1,619          |
| Less: earned revenue   |                  | 95             |
| <b>Net Program Cost</b>  |                  | <b>1,524</b>   |
| <b>Healthy Plant and Animal Communities</b>                      |                  |                |
| Gross costs  |                  | 905            |
| Less: earned revenue   |                  | 32             |
| <b>Net Program Cost</b>  |                  | <b>873</b>     |
| <b>Total Gross costs:</b>  |                  | <b>3,176</b>   |
| <b>Less: Total earned revenue</b>                                |                  | <b>147</b>     |
| <b>Net cost of operations</b>                                    |                  | <b>\$3,029</b> |
| The accompanying notes are an integral part of these statements. |                  |                |



## Financial Statements



### CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Year ended September 30, 2008

(in millions)

|  | <b>Total</b>   |
|--|----------------|
| <b>Cumulative Results of Operations:</b>                         |                |
| Beginning Balance  | \$3,405        |
| <b>Budgetary Financing Sources:</b>                              |                |
| Appropriations used  | 1,173          |
| Transfers in/out without reimbursement                           | 1,956          |
| <b>Other Financing Sources (Non-Exchange):</b>                   |                |
| Imputed financing  | 174            |
| Total Financing Sources  | 3,303          |
| Net Cost of Operations   | (3,029)        |
| Net Change   | 274            |
| <b>Cumulative Results of Operations</b>                          | <b>\$3,679</b> |
| <b>Unexpended Appropriations:</b>                                |                |
| Beginning Balance  | \$721          |
| <b>Budgetary Financing Sources:</b>                              |                |
| Appropriations received  | 1,434          |
| Other adjustments  | (6)            |
| Appropriations used  | (1,173)        |
| Total Budgetary Financing Sources                                | 255            |
| <b>Total Unexpended Appropriations</b>                           | <b>\$976</b>   |
| <b>Net Position</b>  | <b>\$4,655</b> |
| The accompanying notes are an integral part of these statements. |                |

Unaudited – See accompanying auditors’ report

# Financial Statements



## COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Year Ended September 30, 2008

(in millions)

|  |                |
|--|----------------|
| <b>Budgetary Resources:</b>  |                |
| Unobligated balance, brought forward, October 1                                | \$1,046        |
| Recoveries of prior year unpaid obligations                                    | 491            |
| <b>Budget Authority:</b>   |                |
| Appropriations   | 1,434          |
| <b>Spending authority from offsetting collections</b>                          |                |
| <b>Earned</b>  |                |
| Collected  | 148            |
| Change in receivables from Federal sources                                     | (9)            |
| <b>Change in unfilled customer orders</b>                                      |                |
| Advance received   | (3)            |
| Without advance from Federal sources   | 27             |
| Subtotal   | 1,597          |
| Nonexpenditure transfers   | 1,956          |
| Permanently not available  | (7)            |
| <b>Total budgetary resources:</b>  | <b>\$5,083</b> |
| <b>Status of Budgetary Resources:</b>  |                |
| <b>Obligations incurred:</b>   |                |
| Direct   | \$3,173        |
| Reimbursable   | 117            |
| <b>Subtotal</b>  | <b>3,290</b>   |
| <b>Unobligated balance:</b>  |                |
| Apportioned  | 517            |
| Unobligated balance not available  | 1,276          |
| <b>Total status of budetary resources</b>                                      | <b>\$5,083</b> |
| <b>Change in obligated balance:</b>  |                |
| <b>Obligated balance, net</b>  |                |
| Unpaid obligations, brought forward, October 1                                 | \$3,244        |
| Uncollected customer payments from Federal sources, brought forward, October 1 | (68)           |
| <b>Total Unpaid obligated balance, net</b>                                     | <b>3,176</b>   |
| Obligations incurred net   | 3,290          |
| Gross outlays  | (2,951)        |
| Recoveries of prior year unpaid obligations                                    | (491)          |
| Change in uncollected customer payments from Federal sources                   | (18)           |
| Obligated balance, net, end of period  |                |
| Unpaid obligations   | 3,092          |
| Uncollected customer payments from Federal sources                             | (86)           |
| <b>Total Unpaid obligated balance net, End of period</b>                       | <b>\$3,006</b> |
| <b>Net Outlays:</b>  |                |
| Gross outlays  | \$2,951        |
| Offsetting collections   | (145)          |
| Distributed offsetting receipts  | 3              |
| <b>Net Outlays</b>   | <b>\$2,809</b> |
| The accompanying notes are an integral part of these statements.               |                |

## Financial Statements

### ***Notes to the Consolidated Financial Statements for the year ended September 30, 2008***

#### **Note 1 – Significant Accounting Policies**

##### ***A. Reporting Entity***

The Natural Resources Conservation Service (NRCS) is a technical agency within the United States Department of Agriculture (USDA). NRCS combines the authorities formerly assigned to the Soil Conservation Service (SCS) and additional programs that provide financial assistance for natural resource conservation. SCS was established in 1935 to carry out a continuing program of soil and water conservation in partnership with local conservation districts. In 1994, the Secretary of Agriculture reorganized SCS by establishing NRCS and delegating broadened responsibilities, using the authority provided in the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994.

Most of the nearly 12,000 NRCS employees work in approximately 2,900 field offices across the Nation, providing services directly to our customers. Field office employees provide the technical expertise that enables land managers to balance their economic goals with the needs of the natural environment, creating sustainable systems to produce abundant crops and livestock, and a quality environment. Field office staff work side-by-side with employees of the local conservation district and State conservation agency. Natural resource technology is developed and delivered through national centers (cartography and geospatial; design, construction and soil mechanics; plant data; soil survey; water management; and water and climate), and National Technology Support Centers (NTSC). The NTSCs develop and maintain national technical standards and other technological procedures and references.

NRCS operates under the guidance of the USDA Under Secretary for Natural Resources and Environment. The NRCS mission is carried out across 3 regions covering all 50 States, Puerto Rico, and the Pacific Basin Area, 3 National Technology Support Centers, and 11 National Centers. The centers were established to provide focus on national initiatives and provide coordination and assistance for conservation work across all 50 states.

NRCS receives discretionary funding to provide technical and financial assistance under five major programs: Conservation Operations, Resources Conservation and Development, Watershed and Flood Prevention, Healthy Forest Reserve Program, and Watershed Rehabilitation Program. Program categories under the Conservation Operations program include Conservation Technical Assistance, Soil Surveys, Snow Surveys and Water Supply Forecasting, and Plant Materials Centers. Program categories under the Watershed and Flood Prevention program include PL-534 Flood Prevention Operations, PL-566 Small Watershed Operations, and Emergency Watershed Protection. The Emergency Watershed Protection program is only funded when natural disasters occur and Congress appropriates supplemental funding. NRCS received funding for these discretionary programs of \$1,434 million in FY 2008.

##### **Farm Bill Programs**

The FY 2002 and 2008 Farm Bills provide that NRCS is responsible for administering program activities with funding provided through Commodity Credit Corporation (CCC) borrowing authority. Generally, the Farm Bill authority expires after five years and a new Farm Bill is enacted. The FY 2002 Farm Bill expired at the end of FY 2007. In order to prevent discontinuing the services provided under the Farm Bill, several extensions were granted by Congress through continuing resolution authorities. On June 18, 2008, Congress passed the FY 2008 Farm Bill.

NRCS receives mandatory funding for the 2008 Farm Bill to provide technical and financial assistance under 10 major programs: Wetlands Reserve Program, Klamath Basin, Farm and Ranch Lands Protection Program, Environmental Quality Incentives Program, Wildlife Habitat Incentives Program, Conservation Security Program, Grassland Reserve Program, Ground and Surface Water Conservation, Agricultural Management Assistance, and Conservation Reserve Program. The funding for these programs is received from CCC through quarterly non-expenditure transfers for the estimated obligations incurred through the end of each quarter.

Authorized funding for the Farm Bill Programs approximated \$1.96 billion for FY 2008.

##### ***B. Basis of Presentation and Accounting***

This is the first year that NRCS is preparing stand-alone financial statements for USDA and the Office of Management and Budget (OMB). A waiver was requested from OMB through the USDA, for non-comparative financial statements. OMB granted the waiver for FY 2008 Financial Statements for NRCS and recommends that comparative statements be prepared as a best practice in future years.

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The Consolidated Balance Sheet (BS), Consolidated Statement of Net Cost (SNC), Consolidated Statement of Changes in Net Position (SCNP), and the Combined Statement of Budgetary Resources (SBR) (hereinafter referred to as the "consolidated financial statements") were prepared to report the financial position, net costs, changes in net position, and budgetary resources of NRCS. The consolidated financial statements have been prepared from the books and records of NRCS in accordance with accounting principles generally accepted in the United States of America and in accordance with OMB Circular A-136, *Financial Reporting Requirements*, revised June 3, 2008.

The consolidated financial statements present both 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. Budgetary accounting principles, on the other hand, are designed to recognize the obligation of funds on a cash basis, 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.

### *C. Fund Balance with the U.S. Treasury*

The U.S. Treasury processes cash receipts and disbursements on behalf of NRCS. Funds on deposit with Treasury include discretionary appropriations, non-expenditure transfers, and special funds that are available to pay liabilities and finance authorized expenditures.

### *D. Other Assets*

Payments made on behalf of NRCS 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. The most significant advance by NRCS is for the Grasslands Reserve Program (GRP) as a part of the Farm Bill. The funding for GRP is transferred to NRCS from CCC as a non-expenditure transfer once the apportionment schedule is approved by OMB. NRCS immediately advances the funds back to CCC to make payments to the landowners in the program on behalf of NRCS. CCC reports the expenditures to NRCS monthly and adjustments are made to decrease the advance appropriately as NRCS maintains administrative responsibility for the program.

### *E. General Property, Plant, and Equipment*

General property, plant, and equipment (PP&E) includes real and personal property used in normal business operations including NRCS's only heritage asset. Real and personal property are recorded at cost and must have an estimated useful life of 2 years or more. NRCS capitalization threshold for real and personal property is \$25,000 or more. Internal use software is capitalized if the cost meets or exceeds \$100,000.

NRCS is also reporting capital lease assets and liabilities in conformance with Office of Management and Budget (OMB) Circular A-11 and Statements of Federal Financial Accounting Standards Nos. 5 and 6.

### *F. Liabilities*

Liabilities represent the probable and measurable future outflow of funds or other resources arising from past transactions or events that are likely to be paid by NRCS. In general, funds cannot be withdrawn from the U.S. Treasury without an appropriation from Congress. 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.

### *G. 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 NRCS's employees under FECA are administered by the U.S. Department of Labor (DOL). NRCS reimburses DOL for FECA claims. Consequently, NRCS 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 NRCS approved compensation cases to be paid beyond the current fiscal year.

### *H. Employee Annual, Sick, and Other Leave*

Annual and other vested leave such as compensatory time earned, 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

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## Financial Statements

annual and other types of vested leave earned but not taken. Sick leave and other types of non-vested leave are expensed when incurred.

### *I. Pension and Other Retirement Benefits*

NRCS 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 NRCS'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 remain in CSRS. FERS offers a savings plan to which NRCS automatically contributes one percent of pay and matches an employee contribution up to an additional four percent of pay. For FERS participants, NRCS also contributes the employer's matching share for Social Security.

NRCS recognizes the imputed cost of pension, 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 communicates these factors and information regarding the full cost of health and life insurance benefits to NRCS for the current period expense reporting.

### *J. Revenues and Other Financing Sources*

NRCS has two major funding sources, Congressional appropriations for the discretionary funds and non-expenditure transfers of Farm Bill funds from CCC borrowing authority. NRCS receives annual, multi-year, and no-year appropriations that are used, within statutory limits, for operating expenditures. Other funding sources include reimbursable agreements with other Federal agencies, State and local governments, colleges and universities, and private individuals for technical services or for cost-share agreements.

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

In accordance with Federal government accounting guidance, NRCS 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 providing technical advice on controlling erosion on a stream bank. NRCS is authorized to use all or a portion of its exchange revenue 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.

NRCS 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. The NRCS pricing policies are set to recover full costs except where mandated by law or for the public good.

### *K. Imputed Financing*

NRCS recognizes the amount of accrued pension and post-retirement benefit expenses for current employees as imputed financing. The assets and liabilities associated with such benefits are the responsibility of the administering agency, OPM. Any amounts paid from the Treasury Judgment Fund in settlement of claims or court assessments against NRCS are also recognized as imputed financing.

### *L. Use of Estimates*

Management has made certain estimates and assumptions in reporting assets, liabilities, revenue, and expenses. Actual results could differ from these estimates. Significant estimates underlying the accompanying financial statements include the majority of liabilities, revenue, and the allowance for bad debt expense.

### *M. Transactions with Related Organizations*

During FY 2008, NRCS received \$1.96 billion from CCC for various conservation programs and technical assistance. The 2002 and 2008 Farm Bill's authorizing language specified that the funds, facilities, and authorities of CCC are to be used to administer various conservation programs.

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### Note 2 - Fund Balance with Treasury

Funds with Treasury are primarily general (appropriated and transferred-in) and trust funds that are available to pay liabilities and finance authorized purchase commitments. The category of other fund types includes clearing accounts for the proceeds of personal property sales. It is NRCS's policy to ensure the Fund Balance with Treasury reported on the Balance Sheet is consistent with the records of the Treasury.

| Fund Balance with Treasury (in millions) |                | Status of Fund Balance with Treasury (in millions) |                |
|--|----------------|--|----------------|
| Fund Balances:                           |                | Unobligated Balance:                               |                |
| Trust Fund                               | \$3            | Available  | \$517          |
| General Funds                            | 4,796          | Unavailable  | 1,276          |
| Other Fund Types                         | 2              | Obligated balance not yet disbursed                | 3,006          |
|  |                | Non-budgetary FBWT:                                |                |
|  |                | Clearing Account Balance                           | 2              |
| <b>Total</b>                             | <b>\$4,801</b> | <b>Total</b>                                       | <b>\$4,801</b> |

Table 21: Fund Balance with Treasury (in millions), as of September 30, 2008

### Note 3 – Accounts Receivable, Net

Intragovernmental accounts receivable represent amounts due under reimbursable and cooperative agreements with Federal entities for services provided by NRCS. An allowance for receivables deemed uncollectible is not established for these amounts because monies due from other Federal entities are considered fully collectible.

Non-intragovernmental accounts receivable are comprised primarily of cost share agreements with State and local governments owed to NRCS for providing technical assistance on conservation projects. An allowance for receivables deemed uncollectible is established against outstanding non-Federal accounts receivable, based on historical experience.

| Accounts Receivable (in millions) |             |
|-----------------------------------|-------------|
| Accounts Receivable, Gross        |             |
| Intragovernmental                 | \$16        |
| With the Public                   | 8           |
| Allowance                         |             |
| Intragovernmental                 | 0           |
| With the Public                   | (1)         |
| Accounts Receivable, Net          |             |
| Intragovernmental                 | 16          |
| With the Public                   | 7           |
| <b>Total</b>                      | <b>\$23</b> |

Table 22: Accounts receivable, (in millions) as of September 30, 2008

## Financial Statements

### Note 4 – General Property, Plant, and Equipment, Net

Depreciation of General PP&E for NRCS is recorded using the straight-line method based on the estimated useful life in years as listed below. There are no restrictions on use or convertibility of general PP&E.

| General Property, Plant, and Equipment, Net<br>(in millions) | Estimated Useful Life<br>(Years) | Cost         | Accumulated Depreciation | Book Value  |
|--|----------------------------------|--------------|--------------------------|-------------|
| Personal Property:   |                                  |              |                          |             |
| Equipment  | 5 – 20                           | \$100        | (\$92)                   | \$8         |
| Internal Use Software  | 5 – 8                            | 5            | (4)                      | 1           |
| <b>Total Personal Property</b>                               |                                  | <b>105</b>   | <b>(96)</b>              | <b>9</b>    |
| Real Property:   |                                  |              |                          |             |
| Land and Land Rights   |                                  | 3            |                          | 3           |
| Buildings, Improvements and Renovations                      | 15 – 30                          | 9            | (6)                      | 3           |
| Other Structures & Facilities                                | 15 – 30                          | 3            | (2)                      | 1           |
| Assets under Capital Leases                                  | 20                               | 79           | (46)                     | 33          |
| <b>Total Real Property</b>                                   |                                  | <b>94</b>    | <b>(54)</b>              | <b>40</b>   |
| Other General PP&E   | 5 – 15                           | 4            | 0                        | 4           |
| <b>Total</b>   |                                  | <b>\$203</b> | <b>(\$150)</b>           | <b>\$53</b> |

Table 23: General PP&E, (in millions) as of September 30, 2008

### Note 5 – Stewardship PP&E

The objective of Federal stewardship reporting is to report an entity's stewardship PP&E, along with certain responsibilities that cannot be measured in traditional financial reports. NRCS reports stewardship PP&E for heritage assets, which is a historically significant property, and stewardship land, primarily easements, which is land other than that acquired for, or in connection with, general PP&E. These resources and responsibilities do not meet the criteria for assets and liabilities reported in the financial statements, but are important for understanding the overall operations and financial condition of NRCS.

NRCS's mission objectives in administering the conservation easement programs are to provide landowners financial and technical assistance in return for maintaining and improving high quality productive soils, clean and abundant water, healthy plant and animal communities, clean air, an adequate energy supply, and working farm and ranch land.

NRCS's objective in managing, monitoring and enforcing the terms and conditions of easement deeds is 1) to ensure that the taxpayers investments are properly used in accordance with the intent of the program; 2) to ensure that the agency is a good steward of the land; and 3) to be a good neighbor to adjacent landowners. The specific uses for the land are identified under each program. Withdrawals from the programs are not allowed.

Stewardship resources involve substantial investment by the NRCS for long-term benefits for the American public to help people help the land. The purpose of purchasing easements is to restore or enhance wetlands, protect farmland, restore and protect grassland, restore and protect forest ecosystems, and to restore, protect, maintain, and enhance the functions of the floodplain.

#### *Conservation Easements*

NRCS, on behalf of USDA, administers and owns conservation easements on private lands through five different programs. For the purpose of stewardship asset reporting in the financial statements, all easements where NRCS is the grantee of the easements are included as stewardship assets. Also included are easements that are administered by NRCS on behalf of other USDA agencies. As of September 30, 2008, NRCS has 10,431 conservation easements considered to be stewardship land.

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### *Heritage Assets*

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

NRCS currently owns one heritage asset, the Tucson Plant Materials Center (TPMC) which is included in General PP&E. It was listed in the National Register of Historic Places (NRHP) on July 2, 1997. The TPMC develops and evaluates native plants and addresses an array of resource issues in the areas of rangeland, mined land, urban lands, cropland riparian areas, and desert lands. It provides technical assistance to NRCS field offices, Resource Conservation and Development (RC&D) groups, conservation districts, Federal, State, and Tribal agencies, and private landowners through the greater Southwest.

| Stewardship PP&E<br>(in numbers) | 2008<br>Balance |
|----------------------------------|-----------------|
| <b>Heritage Assets</b>           |                 |
| Research Centers                 | 1               |
| Total                            | 1               |
| <b>Stewardship Land</b>          |                 |
| Conservation Easements           | 10,431          |
| Total                            | 10,431          |

Table 24: Stewardship easements as of September 30, 2008

### **Note 6 - Other Assets**

Other Assets – Intragovernmental is comprised of funds advanced to other Federal agencies. Most of this balance is represented by the funds advanced to CCC to make payments to landowners under the Grassland Reserve Program. The balance of Other Assets with the public is comprised of funds advanced to State and local governments and non-Federal business entities through grants.

| FY 2008 - Other Assets<br>(in millions) |             |
|---|-------------|
| Intragovernmental                       | \$95        |
| With the Public                         | 2           |
| <b>Total</b>                            | <b>\$97</b> |

Table 25: Balance of Other Assets, (in millions) as of September 30, 2008

### **Note 7 - Liabilities Not Covered by Budgetary Resources**

Other intragovernmental liabilities not covered by budgetary resources are primarily comprised of Federal Employee Compensation Act (FECA) accruals.

Other liabilities with the public not covered by budgetary resources are primarily comprised of future indemnity costs for unfunded leave.



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| Liabilities not Covered by Budgetary Resources<br>(in millions) |              |
|---|--------------|
| Intragovernmental:  |              |
| FECA  | \$7          |
| Custodial Liabilities   | 1            |
| <b>Subtotal Intragovernmental</b>                               | <b>8</b>     |
| With the Public:  |              |
| Unfunded Leave  | 81           |
| Federal Employee & Veterans Benefits                            | 36           |
| <b>Subtotal With the Public</b>                                 | <b>117</b>   |
| Total not Covered by Budgetary Resources                        | 125          |
| Total Covered by Budgetary Resources                            | 194          |
| <b>Total Liabilities</b>  | <b>\$319</b> |

Table 26: The balance of liabilities not covered by budgetary resources (in millions) as of September 30, 2008

### Note 8 - Other Liabilities

The balance of other liabilities intragovernmental is comprised of Employer Contributions and Payroll Taxes of \$8 million, Unfunded FECA liability of \$7 million, suspense deposit and clearing fund accounts of \$3 million, Custodial Liabilities of \$1 million, and Other Accrued Liabilities of \$14 million entered at the State office level.

The balance of other liabilities with the public is comprised of unfunded leave of \$81 million, other accrued liabilities of \$126 million entered at the State office level and capital lease liability of \$33 million.

| Other Liabilities<br>(in millions)   | Fiscal Year 2008 |              |              |
|--|------------------|--------------|--------------|
|  | Non-Current      | Current      | Total        |
| Intragovernmental:   |                  |              |              |
| Other Accrued Liabilities  | \$13             | \$1          | \$14         |
| Clearing accounts, employee contributions & payroll taxes  | 10               | 1            | 11           |
| Unfunded FECA Liability  | 7                | 0            | 7            |
| Custodial Liability  | 0                | 1            | 1            |
| <b>Total Intragovernmental</b>   | <b>\$30</b>      | <b>\$3</b>   | <b>\$33</b>  |
| With the Public:   |                  |              |              |
| Other Accrued Liabilities  | \$0              | \$126        | \$126        |
| Unfunded Leave   | 79               | 2            | 81           |
| Capital Lease Liability  | 20               | 13           | 33           |
| <b>Total With the Public</b>   | <b>\$99</b>      | <b>\$141</b> | <b>\$240</b> |
| Other accrued liabilities consist primarily of accruals for payroll and for receipt of goods and services. |                  |              |              |

Table 27: Other Liabilities as of September 30, 2008

### Note 9 – Leases

NRCS has entered into leasing agreements with the General Services Administration (GSA) and other parties through leasing authority delegated by GSA for general facilities (buildings and office space), equipment, and land for Plant Materials Centers and other sources. Leases may include renewal options for periods of one or more years. Most leases are subject to cancellation upon certain funding conditions. NRCS's assets (in millions) under capital leases as of September 30, 2008 and future capital and operating lease agreement payments as of September 30, 2008, consisted of the following:

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| Capital Leases<br>(in millions)        | Fiscal Year<br>2008 |
|--|---------------------|
| Summary of Assets Under Capital Leases |                     |
| Land and Buildings                     | \$79                |
| Less: Accumulated Amortization         | 46                  |
| <b>Total</b>                           | <b>\$33</b>         |

Table 28: Capital Leases Summary

| (in millions)                      | Buildings   |
|------------------------------------|-------------|
| Year 1 (2009)                      | \$11        |
| Year 2 (2010)                      | 10          |
| Year 3 (2011)                      | 9           |
| Year 4 (2012)                      | 7           |
| Year 5 (2013)                      | 4           |
| After 5 Years                      | 7           |
| Total Future Lease Payments        | 48          |
| ▪ Less: Lease Renewal Options      | (15)        |
| <b>Net Capital Lease Liability</b> | <b>\$33</b> |

Table 29: Capital Leases Future Payments

| Operating Leases - Future Payments Due:<br>(in millions) | Land and<br>Buildings |
|--|-----------------------|
| Year 1 (2009)  | \$13                  |
| Year 2 (2010)  | 11                    |
| Year 3 (2011)  | 9                     |
| Year 4 (2012)  | 6                     |
| Year 5 (2013)  | 3                     |
| After 5 Years  | 7                     |
| <b>Net Operating Lease Liability</b>                     | <b>\$49</b>           |

Table 30: Total Operating Leases Future Payments

All capital leases are funded with budget authority.

### **Note 10 – Commitments and Contingencies**

NRCS is subject to claims and contingencies related to lawsuits as well as commitments under contractual and other commercial obligations. No amount has been accrued in the September 30, 2008 consolidated financial statements because there are no lawsuits where the probability of judgment against NRCS is considered by management to be more than remote.

### **Note 11 – Intragovernmental Costs and Exchange Revenue**

NRCS accomplishes its mission through the goals and objectives for High Quality, Productive Soils, Clean and Abundant Water, and Healthy Plant and Animal Communities. Activities in these areas are with both Federal and non-federal partners. Costs and exchange revenue are disclosed as intragovernmental or with the public based on the related source or customer, respectively. The following table depicts the cost and exchange revenue by mission goal for the year ended September 30, 2008.

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| <b>Intragovernmental Costs and Exchange Revenue</b><br>(in millions) |                |
|--|----------------|
| <b>Intragovernmental Costs</b>                                       |                |
| High Quality, Productive Soils                                       | \$118          |
| Clean and Abundant Water   | 286            |
| Healthy Plant and Animal Communities                                 | 157            |
| <b>Public Costs</b>  |                |
| High Quality, Productive Soils                                       | 534            |
| Clean and Abundant Water   | 1,333          |
| Healthy Plant and Animal Communities                                 | 748            |
| <b>Total Program Costs</b>   | <b>\$3,176</b> |
| <b>Intragovernmental Earned Revenue</b>                              |                |
| High Quality, Productive Soils                                       | \$10           |
| Clean and Abundant Water   | 48             |
| Healthy Plant and Animal Communities                                 | 17             |
| <b>Public Earned Revenue</b>   |                |
| High Quality, Productive Soils                                       | 10             |
| Clean and Abundant Water   | 47             |
| Healthy Plant and Animal Communities                                 | 15             |
| <b>Total Program Earned Revenue</b>                                  | <b>\$147</b>   |

Table 31: Costs Incurred to Protect Natural Resources as of September 30, 2008

### **Note 12 – Suborganization Program Costs/Program Costs by Segment**

NRCS reflects costs under five program responsibility segments: Conservation Operations, Watershed Programs, Resource Conservation & Development, Farm Bill and other. The following table illustrates these costs by program for the year ended September 30, 2008.

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| Program Costs                             | Gross Costs    | Earned Revenue | Net Cost       |
|---|----------------|----------------|----------------|
| Conservation Operations:                  |                |                |                |
| Conservation Technical Assistance         | \$945          | (\$36)         | \$909          |
| Soil Surveys                              | 96             | (8)            | 88             |
| Snow Surveys & Water Supply Forecast      | 11             | (1)            | 10             |
| Plant Materials                           | 14             | (2)            | 12             |
| Total Conservation Operations             | 1,066          | (47)           | 1,019          |
| Watershed Programs:                       |                |                |                |
| Watershed Surveys and Planning            | 1              | 0              | 1              |
| Flood Prevention Operations (PL-534)      | 4              | (1)            | 3              |
| Emergency Watershed Protection            | 144            | (1)            | 143            |
| Watershed Operations (PL-566)             | 80             | (32)           | 48             |
| Watershed Rehabilitation Program          | 33             | 0              | 33             |
| Total Watershed Programs                  | 262            | (34)           | 228            |
| Resource Conservation & Development:      |                |                |                |
| Resource Conservation & Development       | 52             | 0              | 52             |
| Total Resource Conservation & Development | 52             | 0              | 52             |
| Farm Bill:                                |                |                |                |
| Environmental Quality Incentives Program  | 1,043          | (2)            | 1,041          |
| Wildlife Habitat Incentives Program       | 47             | 0              | 47             |
| Agricultural Management Assistance        | 5              | 0              | 5              |
| Conservation Reserve Program              | 65             | (64)           | 1              |
| Conservation Security Program             | 310            | 0              | 310            |
| Farm & Ranch Lands Protection Program     | 72             | 0              | 72             |
| Grasslands Reserve Program                | 15             | 0              | 15             |
| Wetlands Reserve Program                  | 237            | 0              | 237            |
| Total Farm Bill                           | 1,794          | (66)           | 1,728          |
| Other:                                    |                |                |                |
| Healthy Forest Reserve Program            | 1              |                | 1              |
| Trust                                     | 1              |                | 1              |
| Total Other                               | 2              | 0              | 2              |
| <b>Totals</b>                             | <b>\$3,176</b> | <b>(\$147)</b> | <b>\$3,029</b> |

Table 32: Costs by Program as of September 30, 2008

### Note 13 - Cost of Stewardship PP&E

The 2008 costs of administering the program for stewardship land amounted to \$186 million and consisted primarily of easements.

Costs for stewardship land include all costs to acquire and prepare the land for its intended use for the purpose of assisting landowners in becoming better stewards of the Nation's soil, water, and related natural resources.

### Note 14 – Exchange Revenues

NRCS collects exchange revenue under reimbursable agreements for our technical services from Federal and non-Federal sources. An estimate is determined and agreed upon through a reimbursable agreement to cover the full cost of the services to be provided. Bills are prepared and sent for actual costs in accordance with the terms of the agreements for Federal customers. At month-end, accruals are recorded for the earned, unbilled portion of each agreement. At quarter-end, an entry is recorded to estimate an allowance for possible uncollectible amounts from non-Federal sources based on the historical aging of receivables. Non-federal customers should be billed in advance for the entire amount of the agreement. Work should only begin once

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the funds are received (unless we have specific authorization to treat the non-federal entity as a reimbursable). Note 12 provides more detail related to intragovernmental and public revenues earned.

### **Note 15 - Apportionment Categories of Obligations Incurred**

OMB normally distributes budgetary resources in an account or fund by specific time periods, activities, projects, objects or a combination of these categories through the apportionment process. Trust fund apportionments are classified as category A and all others are category B for NRCS. Category A apportionments distribute budgetary resources by fiscal quarter. Category B apportionments typically distribute budgetary resources by activities, projects or objects. NRCS had no category A apportionments during FY 2008.

| Direct and Reimbursable<br>Obligations Incurred<br>(in millions) | Direct         | Reimbursable | Total FY 2008  |
|--|----------------|--------------|----------------|
| Apportionment (Category B)                                       | \$3,173        | \$117        | \$3,290        |
| <b>Total Obligations Incurred</b>                                | <b>\$3,173</b> | <b>\$117</b> | <b>\$3,290</b> |

Table 33: Direct and reimbursable obligations incurred (in millions) as of September 30, 2008.

### **Note 16 - Legal Arrangements Affecting Use of Unobligated Balances**

NRCS has been granted extended authority for Treasury symbol 1213322 under Section 2106 of Public Law 109-234 (enacted on June 15, 2006), which states that "funds made available for the Wildlife Habitat Incentive Program established under Section 1240N of the Food Security Act of 1985 (16 U.S.C. 1420 note) and Section 820 of the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriation Act, 2001 (Public Law 106-387: 114 Stat. 1549A-59) shall remain available until expended to carry out obligations made for FY 2001 and are not available for new obligations". The amount of obligations as of September 30, 2008 is \$205,000. Once cancelled, the unobligated balances were returned to Treasury.

NRCS has also been granted extended authority for Treasury symbols 1221004, 1231004, 1241004, and 1251004 under Section 766 of Public Law 108-447 (enacted on December 8, 2004), which states that "funds made available under Section 1240I and Section 1241(a) of the Food Security Act of 1985 in fiscal years 2002, 2003, 2004, and 2005 shall remain available until expended to cover obligations made in fiscal years 2002, 2003, 2004, and 2005, respectively, and are not available for new obligations". The amount of obligations as of September 30, 2008 is \$605 million. Once cancelled, the unobligated balances were returned to Treasury.

### **Note 17 - Explanation of Differences between the Statement of Budgetary Resources and the Budget of the United States Government**

The President's Budget with actual numbers for the current fiscal year has not yet been published and the future date is not known. This information can be found at <http://www.whitehouse.gov/omb>.

### **Note 18 – Undelivered Orders at the End of the Period**

Budgetary resources obligated for undelivered orders as of September 30, 2008, is \$2,997 million.

### **Note 19 - Reconciliation of Net Cost of Operations (Proprietary) to Budget (formerly the Statement of Financing)**

This note is intended to bridge NRCS's budgetary and financial (proprietary) accounting. This reconciliation identifies total resources used by an entity during the period (budgetary and other) and 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) is presented on a combined basis to enable a direct tie to the Statement of Budgetary Resources. The reconciliation explains the difference between budgetary net obligations and 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.

The Reconciliation of Net Cost of Operations (proprietary) to Budget for the year ended September 30, 2008 is provided in the following table.

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**Reconciliation of Net Cost of Operations  
(Proprietary) to Budget**

(Formerly the Statement of Financing)

For Year Ended September 30, 2008

(in millions)

| <b>Resources Used to Finance Activities:</b>  |                |
|---|----------------|
| Budgetary Resources Obligated   |                |
| Obligations Incurred  | \$3,290        |
| Less: Spending authority from offsetting collections and recoveries   | 654            |
| Obligations net of offsetting collections and recoveries  | 2,636          |
| Less: Offsetting receipts   | (3)            |
| Net Obligations   | 2,639          |
| Other Resources   |                |
| Imputed financing from costs absorbed by others   | 174            |
| <b>Total resources used to finance activities</b>   | <b>2,813</b>   |
| <b>Resources Used to Finance Items not Part of the Net Cost of Operations:</b>                                      |                |
| Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided               | 229            |
| Change in Unfilled Customer Orders  | 24             |
| Decrease in exchange revenue receivable from public   | (1)            |
| Other   | (6)            |
| Resources that finance the acquisition of assets  | (3)            |
| Other resources or adjustments to net obligated resources that do not affect net cost of operations                 | (35)           |
| Total resources used to finance items not part of the net cost of operations  | 208            |
| <b>Total resources used to finance the net cost of operations</b>   | <b>3,021</b>   |
| <b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:</b>  |                |
| <b>Components Requiring or Generating Resources in Future Periods:</b>  |                |
| Increase in annual leave liability  | 2              |
| Other   | 1              |
| Total components of Net Cost of Operations that will require or generate resources in future periods                | 3              |
| <b>Components not Requiring or Generating Resources:</b>  |                |
| Depreciation and amortization   | 4              |
| <b>Other components not requiring or generating resources</b>   |                |
| Bad Debt Expense  | 1              |
| Total components of Net Cost of Operations that will not require or generate resources:                             | 5              |
| <b>Total components of Net Cost of Operations that will not require or generate resources in the current period</b> | <b>8</b>       |
| <b>Net Cost of Operations</b>   | <b>\$3,029</b> |

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### ***Required Supplementary Stewardship Information***

#### **Human Capital**

NRCS's investment in human capital is expensed each year and is primarily for education and training programs intended to: (1) increase or maintain national economic productive capacity and (2) produce outputs and outcomes that provide evidence of maintaining or increasing national productive capacity.

As the Nation's conservation agenda continues to become more complex, the need for technical information and advice will increasingly exceed the capacity of the Federal workforce to respond timely. NRCS is expanding the capacity of its workforce through three strategies:

1. Relying on non-Federal entities to provide technical assistance to participants in NRCS conservation programs. Under authority of the 2002 Farm Bill, NRCS established processes to certify individual Technical Service Providers (TSP's) and to enter into agreements with governmental and non-governmental entities to provide services.

In FY 2007 NRCS signed agreements or renewed the certification of 375 individual TSP's and 35 businesses. There are now more than 1,100 individual TSPs and 102 businesses certified and available to help program participants apply conservation. Since the passage of the 2002 Farm Bill, NRCS has obligated over \$248 million to acquire technical services.

Web-based orientations and proficiency statements have been developed to help ensure that TSPs have the necessary technical competencies to carry out NRCS's programs.

2. Acquiring the services of experienced workers on a temporary basis. NRCS is acquiring the expertise of older workers through the Agricultural Conservation Enrollees/Seniors (ACES) project conducted in partnership with the National Older Worker Career Center. This project evolved from and complements the TSP initiative to leverage conservation technical assistance capacity and help landowners meet conservation goals. NRCS has filled 300 ACES positions across the country including 260 at the field level.
3. Using the time, talent, and energy of volunteers. Since the organization of local conservation districts in the 1930's, people have volunteered their time and talent to help get conservation on the land. In 1981, using new authority enacted by Congress, NRCS established the National Volunteer Program. In 1985 that program became the Earth Team. During FY 2007, over 70,000 Earth Team Volunteers donated over 1 million hours. Their time was valued at \$19 million.

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### **Required Supplementary Information**

NRCS has no deferred maintenance to report and does not measure this condition on easements. Therefore this information is not provided.

Following is the information regarding the Statement of Budgetary Resources by major budget account:

| Statement of Budgetary Resources by Major Budget Account<br>(in millions)     |                         |              |                |                                     |            |                |
|---|-------------------------|--------------|----------------|-------------------------------------|------------|----------------|
| Budgetary Resources:  | Conservation Operations | Watershed    | Farm Bill      | Resource Conservation & Development | Other      | Total          |
| Unobligated balance, brought forward, October 1:                              | \$30                    | \$193        | \$807          | \$1                                 | \$15       | \$1,046        |
| Recoveries of prior year unpaid obligations                                   | 22                      | 57           | 410            | 0                                   | 2          | 491            |
| Budget authority:   |                         |              |                |                                     |            |                |
| Appropriations  | 840                     | 541          | 0              | 51                                  | 2          | 1,434          |
| Spending authority from offsetting collections:                               |                         |              |                |                                     |            |                |
| Earned:   |                         |              |                |                                     |            |                |
| Collected   | 46                      | 39           | 63             | 0                                   | 0          | 148            |
| Change in receivables from Federal sources                                    | (5)                     | (5)          | 1              | 0                                   | 0          | (9)            |
| Change in unfilled customer orders:   |                         |              |                |                                     |            |                |
| Advance received  | (2)                     | (1)          | 0              | 0                                   | 0          | (3)            |
| Without advance from Federal sources  | 57                      | (31)         | 1              | 0                                   | 0          | 27             |
| <b>Subtotal</b>   | <b>936</b>              | <b>543</b>   | <b>65</b>      | <b>51</b>                           | <b>2</b>   | <b>1,597</b>   |
| Nonexpenditure transfers, net   | 0                       | 0            | 1,956          | 0                                   | 0          | 1,956          |
| Permanently not available   | (7)                     | 0            | 0              | 0                                   | 0          | (7)            |
| <b>Total Budgetary Resources</b>  | <b>981</b>              | <b>793</b>   | <b>3,238</b>   | <b>52</b>                           | <b>19</b>  | <b>5,083</b>   |
| <b>Status of Budgetary Resources:</b>   |                         |              |                |                                     |            |                |
| Obligations Incurred:   |                         |              |                |                                     |            |                |
| Direct  | 867                     | 230          | 2,026          | 50                                  | 0          | 3,173          |
| Reimbursable  | 42                      | 9            | 66             | 0                                   | 0          | 117            |
| <b>Subtotal</b>   | <b>909</b>              | <b>239</b>   | <b>2,092</b>   | <b>50</b>                           | <b>0</b>   | <b>3,290</b>   |
| Unobligated balance-apportioned   | 124                     | 351          | 15             | 2                                   | 25         | 517            |
| Unobligated balance not available   | 212                     | 2            | 1,061          | 0                                   | 1          | 1,276          |
| <b>Total status of budgetary resources</b>                                    | <b>1,245</b>            | <b>592</b>   | <b>3,168</b>   | <b>52</b>                           | <b>26</b>  | <b>5,083</b>   |
| <b>Change in Obligated Balances:</b>  |                         |              |                |                                     |            |                |
| Obligated balance, net  |                         |              |                |                                     |            |                |
| Unpaid obligations, brought forward, October 1                                | 230                     | 348          | 2,646          | 10                                  | 10         | 3,244          |
| Uncollected customer payments from Federal sources, brought forward October 1 | (16)                    | (43)         | (9)            | 0                                   | 0          | (68)           |
| <b>Total unpaid obligated balance, net</b>                                    | <b>214</b>              | <b>305</b>   | <b>2,637</b>   | <b>10</b>                           | <b>10</b>  | <b>3,176</b>   |
| Obligations incurred net  | 909                     | 238          | 2,091          | 50                                  | 2          | 3,290          |
| Gross outlays   | (866)                   | (260)        | (1,770)        | (52)                                | (3)        | (2,951)        |
| Recoveries of prior year unpaid obligations                                   | (22)                    | (57)         | (410)          | 0                                   | (2)        | (491)          |
| Change in uncollected customer payments from Federal sources                  | (9)                     | (7)          | (2)            | 0                                   | 0          | (18)           |
| Obligated balance, net, end of period   |                         |              |                |                                     |            |                |
| Unpaid obligations  | 252                     | 270          | 2,558          | 8                                   | 4          | 3,092          |
| Uncollected customer payments from Federal sources                            | (68)                    | (7)          | (11)           | 0                                   | 0          | (86)           |
| <b>Total, unpaid obligated balance, net, end of period</b>                    | <b>184</b>              | <b>263</b>   | <b>2,547</b>   | <b>8</b>                            | <b>4</b>   | <b>3,006</b>   |
| Net Outlays:  |                         |              |                |                                     |            |                |
| Gross outlays:  | 866                     | 260          | 1,770          | 52                                  | 3          | 2,951          |
| Offsetting collections  | (44)                    | (38)         | (63)           | 0                                   | 0          | (145)          |
| Distributed offsetting receipts   | 3                       | 0            | 0              | 0                                   | 0          | 3              |
| <b>Net Outlays</b>  | <b>\$825</b>            | <b>\$222</b> | <b>\$1,707</b> | <b>\$52</b>                         | <b>\$3</b> | <b>\$2,809</b> |

Unaudited – See accompanying auditors' report