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

U.S. Department of Agriculture

Office of Inspector General
Financial and IT Operations

Audit Report

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

Report No. 50401-51-FM
January 2004

USDA

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250

DATE: JAN 26 2004

REPLY TO
ATTN OF: 50401-51-FM

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

TO: Patricia E. Healy
Acting Chief Financial Officer
Office of the Chief Financial Officer

ATTN: Kathy Donaldson
Agency Liaison Officer
Office of the Chief Financial Officer

This report presents the results of our audit of the U.S. Department of Agriculture's consolidated financial statements for the fiscal years ending September 30, 2003 and 2002. The report contains an unqualified opinion and the results of our assessment of the Department's internal control structure and compliance with laws and regulations.

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

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

Phyllis K. Fong

Phyllis K. Fong
Inspector General

Executive Summary

U.S. Department of Agriculture's Consolidated Financial Statements for Fiscal Years 2003 and 2002 (Report No. 50401-51-FM)

Purpose

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

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

Results in Brief

In our opinion, the USDA consolidated financial statements for fiscal years 2003 and 2002, including the accompanying notes, present fairly in all material respects, the assets, liabilities, and net position of USDA, as of September 30, 2003 and 2002; and its net costs, changes in net position, budgetary resources, and reconciliations of net costs to budgetary obligations for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 19 and 23 to the financial statements, USDA restated its fiscal year 2002 consolidated financial statements primarily because Forest Service needed to:

- Align budgetary and proprietary account relationships and correct posting errors in the Wildland Fire Management fund, the Knutson-Vandenberg fund and other funds;
- account for budgetary resources received by trust, special, deposit, and clearing funds that had previously been accounted for as General funds;
- record revenue from the National Reservation System and Map sales that had been recorded as a liability as of September 30, 2002; and

- record liabilities that had been incorrectly recognized as reductions of operating costs.

Correction of these errors increased the beginning balances of Cumulative Results of Operations by $883 and $1,027 million and decreased Unexpended Appropriations by $876 and $677 million for fiscal years 2003 and 2002, respectively.

In addition, Forest Service recorded $18 million to the Balance Sheet for Plant, Property and Equipment received but not recognized as of September 30, 2002; recorded a prior year $110 million expenditure transfer to the Wildland Fire Management fund and the subsequent payback during fiscal year 2002 on the Statement of Changes in Net Position; corrected $23 million of errors in recording obligations for the Wildland Fire Management fund and adjusted offsetting receipts by approximately $413 million to reflect only distributed offsetting receipts on the Statement of Budgetary Resources; and excluded certain funds received from the U. S. Department of Labor Job Corps that had previously been included in the Statement of Financing.

In our Report on Internal Control Over Financial Reporting, we reported that continued improvements are needed in financial management at the corporate level, including quality control, and continued improvements are needed in information technology (IT) security.

In our Report on Compliance with Laws and Regulations, we continued to note where further actions are necessary related to improving financial management systems and the reporting of material IT security weaknesses. We also noted a potential Anti-Deficiency Act violation.

Key Recommendations

The OCFO has immediate and long term plans to address substantially all of the weaknesses in its financial management systems. The recommendations in this report were limited to requiring further improvements in quality control and enhancing the reporting and tracking of weaknesses within financial management and information technology.

Agency Position

OCFO generally agreed with the findings and recommendations in this report.

Abbreviations Used in This Report

APHIS	Animal and Plant Health Inspection Service
CCC	Commodity Credit Corporation
CFO	Chief Financial Officers Act
DR	Departmental Regulation
FBWT	Fund Balance with Treasury
FCIC	Federal Crop Insurance Corporation
FFIS	Foundation Financial Information System
FFMIA	Federal Financial Management Improvement Act
FFMSR	Federal Financial Management Systems Requirements
FISMA	Federal Information Security Management Act
FMFIA	Federal Managers' Financial Integrity Act
FS	Forest Service
FSA	Farm Service Agency
GAO	General Accounting Office
GIPSA	Grain Inspection, Packers and Stockyards Administration
IT	Information Technology
NFC	National Finance Center
NITC	National Information Technology Center
OCFO	Office of the Chief Financial Officer
OCIO	Office of the Chief Information Officer
OIG	Office of the Inspector General
OMB	Office of Management and Budget
PAR	Performance and Accountability Report
PROP	Personal Property Management System
RD	Rural Development
RMA	Risk Management Agency
RSSI	Required Supplemental Stewardship Information
SGL	U.S. Government Standard General Ledger
SV	Standard Voucher
USDA	U.S. Department of Agriculture

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UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

Report of the Office of Inspector General

To: Patricia E. Healy
Acting Chief Financial Officer
Office of the Chief Financial Officer

We have audited the accompanying consolidated balance sheets of the U.S. Department of Agriculture (USDA) as of September 30, 2003 and 2002, and the related consolidated statements of net cost, changes in net position, and financing, and the combined statements of budgetary resources (hereinafter referred to as the "consolidated financial statements") for the fiscal years then ended. The consolidated financial statements are the responsibility of the USDA's management. Our responsibility is to express an opinion on the consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements." Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance that the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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

As discussed in Notes 19 and 23 to the financial statements, USDA restated its fiscal year 2002 consolidated financial statements primarily because Forest Service needed to:

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

We have also issued reports on our consideration of USDA's internal control over financial reporting and its compliance with certain provisions of laws and regulations. These reports are an integral part of an audit performed in accordance with Government Auditing Standards, and, in considering the results of the audit, these reports should be read in conjunction with this report.

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

Phyllis K. Fong

Phyllis K. Fong
Inspector General

January 26, 2004

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UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20250

Report of the Office of Inspector General on Internal Control Over Financial Reporting

To: Patricia E. Healy
Acting Chief Financial Officer
Office of the Chief Financial Officer

We have audited the accompanying consolidated balance sheets of the U.S. Department of Agriculture (USDA) as of September 30, 2003 and 2002, and the related consolidated statements of net cost, changes in net position, and financing, and the combined statements of budgetary resources (hereinafter referred to as the "consolidated financial statements"), and have issued our report thereon dated January 26, 2004. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

In planning and performing our audits, we considered USDA's internal control over financial reporting by obtaining an understanding of the internal controls, determining whether the internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and Government Auditing Standards. We did not test all internal controls as defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA). The objective of our audit was not to provide assurance on USDA's internal control. Consequently, we do not provide an opinion on internal control over financial reporting.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the consolidated financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more internal control components do not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the consolidated financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected.

We noted certain matters described in the "Findings and Recommendations," Sections 1 and 2 of this report involving the internal control over financial reporting and its operation that we consider to be reportable conditions. In addition, we believe that the reportable conditions in Section 1 are material weaknesses. These material weaknesses were not always identified and consequently reported in USDA's FMFIA report.

Additional Other Procedures

As required by OMB Bulletin No. 01-02, we considered USDA's internal control over Required Supplemental Stewardship Information (RSSI) by obtaining an understanding of the internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over such RSSI; accordingly, we do not provide an opinion on such controls.

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

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

Phyllis K. Fong

Phyllis K. Fong
Inspector General

January 26, 2004

UNITED STATES DEPARTMENT OF AGRICULTURE
OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20250

Report of the Office of Inspector General on Compliance with Laws and Regulations

To: Patricia E. Healy
Acting Chief Financial Officer
Office of the Chief Financial Officer

We have audited the consolidated balance sheets of the U.S. Department of Agriculture (USDA) as of September 30, 2003 and 2002, and the related consolidated statements of net cost, changes in net position, and financing, and the combined statements of budgetary resources (hereinafter referred to as the "consolidated financial statements"), and have issued our report thereon dated January 26, 2004. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

The management of USDA is responsible for complying with laws and regulations applicable to it. As part of obtaining reasonable assurance about whether the consolidated financial statements are free of material misstatement, we performed tests of USDA compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provision of other laws and regulations specified in OMB Bulletin No. 01-02, including certain requirements referred to the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to the provisions described in the preceding sentence and did not test compliance with all laws and regulations applicable to USDA. However, providing an opinion on compliance with laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests of compliance disclosed two instances of noncompliance with other laws and regulations discussed in the second paragraph of this report, exclusive of FFMIA, that are required to be reported under Government Auditing Standards and OMB Bulletin No. 01-02. (See "Findings and Recommendations," Section 3, "Compliance With Laws and Regulations.")

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

Phyllis K. Fong

Phyllis K. Fong
Inspector General

January 26, 2004

Findings and Recommendations

Section 1. Internal Control Over Financial Reporting – Material Weaknesses

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

Finding 1 — Continued Improvements are Needed in Financial Management at the Corporate Level

The USDA and its agencies operate at least 80 program and administrative financial management systems. The Office of Inspector General (OIG), General Accounting Office (GAO), and the Department itself, have reported that USDA's financial system of record presents a high risk to the Department. The longstanding and material problems were caused, primarily, by the absence of corporate level oversight and planning when these legacy systems were initially developed and upgraded. The Office of the Chief Financial Officer (OCFO) has taken action to address these problems and developed plans to review the legacy systems, and consolidate and update the systems, as appropriate, to meet present accounting standards and management needs. With assets totaling over $118 billion and program costs in excess of $83 billion, actions must continue to be taken to fully resolve these problems.

During fiscal year 2003, the Department continued to make significant improvements in its overall financial management. However, we noted areas where further improvements are needed. For example:

- We noted that certain relationships should exist when sound financial management is practiced. The activity of certain proprietary general ledger accounts should be equal to that of certain budgetary general ledger accounts. For example, accounts receivable between budgetary and proprietary balances should equal. Similar relationships between the Fund Balance With Treasury (FBWT) and other accounts should also exist. In addition, many accounts within a general ledger normally have a debit or credit balance. When accounting relationships do not exist or abnormal balances are noted, immediate research should be performed to identify the cause and correct the condition. While this research improved during fiscal year 2003, much of the corrective action did not occur until after fiscal year end. As a result, while we expected minimal adjustments to be made after the annual close of agency ledgers, there were over 5,500 period 13 (final closing) adjustments made that totaled over $12.6 billion. This yearend activity could prevent USDA from receiving an unqualified audit opinion for fiscal year 2004 because of the expedited reporting timeframes. It also distorts the correctness of balances and diminishes the utility of financial data to managers during the year when it is needed to administer programs and operations.

- We continue to find inconsistent implementation of accounting processes in Foundation Financial Information System (FFIS) between agency applications. Table settings are used to set edits, interest rates, penalty amounts, etc. We found that field settings were inconsistent between the 15 agency applications we tested. As a result, inconsistent accounting processes could materially effect the consolidated financial information.

- FFIS uses standard vouchers (SV) to process adjustments to the general ledgers. The SV uses predefined debits and credits based on business rules. We noted that 20 of 44 SVs reviewed were (1) not entered correctly, (2) not calculated/researched correctly, (3) required to correct a previous adjustment, and/or (4) caused by system weaknesses or errors. The types of problems that we found could have been avoided had the agencies effectively implemented the controls outlined in the FFIS Bulletin 02-06, "Internal Controls Over Standard Vouchers in the FFIS," which establishes overarching guidance for developing proper internal controls.

- Accountants need to improve their knowledge of financial system and process operations. Additional training is needed for personnel responsible for posting accounting entries in accordance with the U.S. Government Standard General Ledger (SGL). We noted where billions of dollars worth of accounting entries had to be researched, corrected, and/or reversed in order to produce reliable financial statements.

- We also noted the lack of financial management systems and processes that are capable of fully monitoring and controlling budgetary resources for all programs. This occurred, primarily, because the Commodity Credit Corporation (CCC) and the Forest Service (FS) do not yet have integrated financial systems to track and govern the status of obligations and administrative limitations established by legislation or agency policy and are dependent upon manual processes. This subjects overall funds control to significant risk. Funds control is a vital component of any Federal Government operation.

- In addition, improvements are needed in budgetary accounting and reporting policies and procedures. We noted that CCC and FS personnel do not fully understand the mechanics of budgetary accounting. This makes it difficult to track the status of budgeted resources and maintain funds control. It also increases the risk of inaccurate presentation and disclosure of budgetary resources and the status of budgetary resources in the financial statements. We also noted where budgetary transactions were not always recorded in a timely manner.

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

The OCFO has immediate and long-term plans to address the weaknesses in its and the agencies' financial management systems. These actions include working with the business process owners to address the problems with the legacy feeder systems, with the objective to provide an improved integration of the financial management architecture within the Department.

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

Finding 2 — Quality Control Review Process Needs Improvement

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

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

- We found significant errors made in credit reform reestimates at the Farm Service Agency (FSA). These errors occurred because (1) documented agency and OMB guidance for completing the reestimates was not followed; and (2) the quality control review performed was inadequate. As a result adjustments in excess of $400 million were needed to the Balance Sheet.[1]

- Yearend accruals need to be accurately calculated and posted prior to providing the financial statements for audit;

- needed subsidiary detail supporting material line-items on the financial statements did not always exist;

- additional supporting documentation needed to be provided in numerous instances in order to support the financial statements; and

- errors and inconsistencies existed in the draft USDA PAR submitted to us for audit. For example, we noted a reclassification error that exceeded $44 billion.

[1] These adjustments would also impact the Statement of Net Cost, Statement of Changes in Net Position, Statement of Financing and the Credit Reform Footnote.

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

Recommendation No. 1

OCFO should continue to improve implementation of quality control processes Department-wide.

Finding 3 **Improvements are Needed in Information Technology (IT) Security and Controls**

Historically, USDA agencies and departmental staff offices have independently addressed their respective IT security and infrastructure needs. This resulted in a broad array of technical and physical solutions that do not provide assurance that Department-wide security is obtained. The efforts of the Office of the Chief Information Officer (OCIO) and OIG in the past few years have heightened program management's awareness of the need to plan and implement effective IT security. However, based on our reviews, USDA management must remain involved and committed toward implementing an effective security program within the Department. Agency managers are ultimately responsible and should be held accountable for committing the appropriate resources to ensure compliance (see Finding 6).

The Department and most of its agencies' security staffs have taken significant actions in the past few years to improve the security over their IT resources; however, significant progress is still needed toward establishing an effective security program within the Department. Specifically, we continue to find that the Department and its agencies are not in compliance with the OMB Circular A-130, Appendix III, "Security of Federal Automated Information Resources," and Presidential Decision Directive 63, including the preparation of security plans for all major systems, conducting risk assessments, establishing executable disaster recovery plans, and implementing a system certification and accreditation process.

Additionally, we continue to identify numerous vulnerabilities in agencies' systems despite the purchase of a Department-wide license of a commercially available vulnerability scanner product. Using this software program, we identified over 750 potentially high and 2,100 potentially medium-risk[2] vulnerabilities in over 1,400 network components in 9[3] of the 10 agencies scanned during our audits. Agencies need to incorporate the regular use of this tool in their security program. The lack of effective use of this tool leaves the Department's systems vulnerable to both internal and external threats, including Internet hackers, jeopardizing the integrity and confidentiality of the Department's critical program, financial, and economic data.

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

Finally, our reviews identified weaknesses in agencies' ability to properly manage the development of their applications. This occurred because agencies did not have formal change control procedures in place; or, in some cases, agency controls were not operating as intended. As a result, agencies cannot be assured that their applications are processing data as intended or that the data residing on and extracted from those systems are reliable.

USDA's OCIO has initiatives in process or planned to address many of these weaknesses. During the current fiscal year, OCIO has issued 16 policies and guidance documents, awarded contracts for agencies to obtain security planning and risk advisory services, and begun processes to implement disaster recovery planning and certification and accreditation programs. However, only after agency management involvement is obtained and agencies have adopted and implemented OCIO's leadership direction can the Department be assured that all necessary controls are in place and that its mission-critical and sensitive systems are properly secured.

We also performed IT general control reviews at two major USDA computing centers that provide services to all USDA agencies and staff

[2] High-risk vulnerabilities are those that provide access to the computer, and possibly the network of computers. Medium-risk vulnerabilities are those that provide access to sensitive network data that may lead to the exploitation of higher-risk vulnerabilities. Low-risk vulnerabilities are those that provide access to sensitive, but less significant, network data.
[3] We did not perform our own scans at one agency because we concluded that the agency had established effective controls over its own scanning process.

offices. The reviews adhered to the GAO Federal Information Systems Control Audit Manual. Specifically, we noted the following.

OCIO/National Information Technology Center (NITC)

OCIO/NITC continues to take actions toward complying with Federally-mandated security requirements. However, the necessary corrective actions are long-term in nature and continued actions are needed. OCIO/NITC has made a concerted effort toward completion of risk assessments, which is an important step toward improving security. We found that OCIO/NITC needs to prepare security plans and contingency plans for its general support systems and complete the system certification and accreditation process for its critical systems. Corrective action is scheduled to be completed in early calendar year 2004.

OCIO/NITC has improved its controls over logical access to its systems, but additional actions are needed to ensure the confidentiality and integrity of its resources. Specifically, we noted instances where OCIO/NITC had not removed separated employees' remote access accounts, completed documentation of users with special access privileges, completed its review and documentation of security software parameters, implemented policies and procedures outlining monitoring of security logs, and completed its implementation of secure Internet access. OCIO/NITC is implementing corrective actions.

Finally, OCIO/NITC has strengthened and continues to improve its system change management process. However, since not all of its improved controls were in place throughout the fiscal year, we continued to find that approval, testing, and implementation documentation was not always maintained. Without proper change management controls, OCIO/NITC's systems are at risk of processing irregularities that could occur or security features that could be inadvertently or deliberately omitted or rendered inoperable. OCIO/NITC plans to correct the change management process by July 2004.

OCFO/National Finance Center (NFC)

We identified weaknesses in the control structure of the OCFO/NFC that could jeopardize the confidentiality, integrity, and availability of the data it processes. Specifically, OCFO/NFC was not always protecting information from improper access on its mainframe and network systems. While OCFO/NFC had implemented a program to promptly detect attempts by outside individuals to gain unauthorized access, the center was not consistently reviewing access activity on its mainframe or network systems to identify and investigate unusual or suspicious activity once access was obtained. These access control weaknesses existed mainly because certain OCFO/NFC procedures were not adequately designed and/or operating effectively. As a result, OCFO/NFC systems are at an increased risk of inadvertent or deliberate misuse without detection.

Our audit also disclosed that OCFO/NFC had not fully complied with the security management requirements included in the Federal Information Security Management Act (FISMA) and further described in OMB Circular A-130, Appendix III, "Security of Federal Automated Information Resources." Specifically, OCFO/NFC had not:

- Finalized security plans or the underlying risk assessments for its general support systems and major applications, or
- certified and accredited its general support systems.

Finally, we found that system software change controls required improvement. OCFO/NFC had not always adequately tested system software changes or evaluated the security impact resulting from system software changes. We also found that OCFO/NFC had not established adequate controls over the configuration of its mainframe operating system. Until OCFO/NFC addresses these issues, it faces increased risk that system software will not be configured and maintained in a manner that affords proper protection to its systems and the sensitive financial and personnel data that is maintained on those systems.

OCFO/NFC concurred with the findings and recommendations and has either implemented or is in process of implementing corrective actions.

The recommendations we made to correct the deficiencies identified in this evaluation are made in agency reports. Therefore, we are not making additional recommendations related to those conditions in this report.

Section 2. Internal Control Over Financial Reporting – Reportable Condition

Reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the consolidated financial statements.

Finding 4 — USDA Has Made Significant Improvements In Financial Management

Fund Balance With Treasury (FBWT)

We noted that significant progress was made in reconciling the FBWT. As of September 2003 over 80 percent of all FBWT activity processed for the Department through June 30, 2003, was reconciled between Treasury and the general ledger at the transaction level. However, our review disclosed that additional efforts are needed to fully reconcile some FBWT transactions. For example:

- Our review disclosed that differences still exist between departmental and Treasury records for FBWT activity that occurred prior to fiscal year 2002. For 6 of 35 Treasury Symbols reviewed, old differences between departmental and Treasury records had not been resolved at the transaction level. For example, we identified one Treasury Symbol with over $18 million of letter of credit activity processed for the Department prior to fiscal year 2002, but not reflected in its general ledger.

- We continued to note that the reconciliation of FBWT activity for shared Treasury Symbols (i.e., more than one agency has authority to spend from the Treasury Symbol) did not occur for the total amount of funds allocated. This occurred because one agency is not always assigned an overall responsibility for ensuring that all differences are resolved. Rather, pieces of the reconciliation are performed by multiple agencies.

- We identified net differences of about $23 million in the July 2003 reconciliations of cash adjustments not supported by transaction level detail. Roughly $14 million was attributable to prior year adjustments that had not been reversed in a timely manner and $9 million was associated with unidentified differences.

The Department is committed to enhancing cash reconciliation processes. It also has automated an additional key reconciliation process. Additionally, officials indicated that the Department plans to complete research and make appropriate adjustments as needed for pre-fiscal year 2002 differences.

Budget Clearing Suspense Activity

We noted, despite significant efforts to reconcile suspense activity, that corrective action on all outstanding balances could not be totally effected to the fiscal year 2003 account balances. An action plan has been developed to address this activity. Specifically, we noted that until fiscal year 2003, Treasury symbol 12F3875, "Budget Clearing Suspense," was used without specific procedures for reconciling transactions posted to this Treasury symbol or ensuring that the transactions clear from the account.[4] Until suspense account transactions are posted to the proper appropriation account within the Department, there is the potential for incorrect accounting records, which could lead to anti-deficiency violations and other problems. Moreover, the reported balances in suspense accounts represent the netting of collections and disbursements, thus understating the magnitude of the unrecorded amounts in suspense accounts. During fiscal year 2003, standardized reports were developed to identify and age the detailed transactions supporting the FFIS balances in this Treasury symbol. However, the balances remaining in the legacy accounting system are not supportable and will need to be adjusted and/or written off.

Personal Property System

During the fiscal year 2003 audit, we noted that the Property Reconciliation team had implemented a sustained process for reconciling the subsidiary property accounts with the general ledger in a timely manner. However, the corresponding depreciation accounts were not reconciled. Other minor issues noted during the audit were:

- The reconciliation contains unreconciled categories that were not continuously reviewed and decreased, and
- other categories that contain "unidentified" items force numbers to reconcile.

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

Based on the progress made, we believe these conditions, while reportable, are no longer material.

Recommendation No. 2

Pursue making any necessary adjustments/write offs to eliminate all unsupported activity in the legacy accounting system.

Recommendation No. 3

Ensure that the temporary adjustments made to accounts for yearend reconciling items between departmental and Treasury records are appropriately recorded and then reversed in a timely manner.

Recommendation No. 4

Assign a designated agency representative responsible for the review of reconciliations in total to ensure that all differences, including those in shared Treasury Symbols, are appropriately identified and resolved.

Recommendation No. 5

Reconcile the depreciation accounts. Identify and implement solutions to the systemic problems noted on the reconciliations and eliminate the unreconciled amounts. Discontinue the use of "unidentified" categories that force the numbers to reconcile.

Section 3. Compliance with Laws and Regulations

The management of USDA is responsible for complying with laws and regulations applicable to it. As part of obtaining reasonable assurance about whether the consolidated financial statements are free of material misstatement, we performed tests of USDA compliance with certain provisions of laws and regulations, 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. 01-02, including certain requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA).

Finding 5 Substantial Noncompliance with FFMIA Requirements

The FFMIA and other financial management reform legislation have emphasized the importance of improving financial management across the Government. The primary purpose of the FFMIA is to ensure that agencies' financial management systems routinely generate timely, accurate, and useful information. With such information, Government leaders will be better positioned to invest resources, reduce costs, oversee programs and hold agency managers accountable for the way they run Government programs. For fiscal year 2003, we found USDA's core financial management system, FFIS, to be substantially compliant with the FFMIA. However, overarching security weaknesses identified outside of the FFIS could impact the integrity of financial information flowing into the system. The security weaknesses are discussed in Finding 6. We concluded that USDA's financial management systems, as a whole, do not yet substantially comply with the requirements of FFMIA.

FFMIA does not establish financial system requirements. However, it does establish a statutory requirement for agency-heads to assess, on an annual basis, whether their financial management systems comply substantially with (1) Federal financial management system requirements (FFMSR), (2) applicable Federal accounting standards, and (3) the SGL at the transaction level. The recently enacted FISMA adds a fourth category requiring each agency to report significant information security deficiencies, relating to financial management systems, as a lack of substantial compliance under the FFMIA.[5]

[5] The FISMA (Title III, U.S.C. 3544(c)(3)), dated December 17, 2002, requires agencies to report any significant deficiency in a policy, procedure, or practice identified [in Agency reporting] – (A) as a material weakness in reporting under section 3512 of title 31; and (B) if relating to financial management systems, as an instance of a lack of substantial compliance under the FFMIA (31 U.S.C. 3512(a)(2)(E)).

OMB's Revised Implementation Guidance for the FFMIA, dated January 4, 2001 also recognizes OMB Circular A-127, "Financial Management Systems," as a reference document for Government-wide financial management systems. OMB Circular A-127 provides that agency financial management systems shall conform to existing applicable functional requirements as defined in the FFMSR series issued by the Joint Financial Management Improvement Program. OMB Circular A-127 also incorporates by reference compliance with OMB Circular A-123, "Management Accountability and Control," and OMB Circular A-130, "Management of Federal Information Resources."

Agencies whose systems do not comply with one or all of the FFMIA requirements are considered in substantial non-compliance and must develop a remediation plan that describes the findings or analysis of noncompliance and identifies the resources, remedies, and milestones for achieving substantial compliance. Agencies are also required to include their remediation plans in their annual budget submissions to OMB. Agency heads are responsible for agency progress towards resolving identified deficiencies and such progress should be discussed in the agency's remediation plan; however, progress towards resolving the deficiencies should not be construed as compliance with FFMIA.

USDA's component agencies' FFMIA Remediation Plan submissions to OCFO, dated September 30, 2003, reported that their financial management systems continued to be out of substantial compliance with two of the three requirements of the FFMIA during fiscal year 2003. Agencies reported at least five instances relating to nonconformance with FFMSR and two instances relating to nonconformance with the SGL at the transaction level. Specifically, USDA's financial management systems did not meet the OMB Circular A-127 requirement that each agency establish and maintain a single, integrated financial management system, and all financial management systems have not been certified to ensure compliance with the requirements of OMB Circular A-130 and the FFMSR. Additionally, USDA systems needed updates to improve controls over general ledger postings and general ledger reconciliations to its feeder systems. We believe these deficiencies and the corresponding remediation plans should be included in the Department's budget submissions to OMB.

In addition to the noncompliance reported by the component agencies, we noted other instances during our fiscal year 2003 financial statement audit where agencies' financial management systems did not comply with the requirements of the FFMIA (as enhanced by the FISMA). See exhibit A for a listing of these audits. The recommendations to correct the deficiencies at the component agencies are made in stand-alone agency reports; therefore, we are making no additional recommendations related to those conditions in this report. These deficiencies include the following:

- OIG noted significant deficiencies in information system security at OCFO/NFC requiring strengthening access controls, finalizing security plans and risk assessments and certifying its general support systems, performing background investigations and improving controls over system software changes and configuration of the mainframe operating system.

- Risk Management Agency/Federal Crop Insurance Corporation (RMA/FCIC) auditors reported (1) ineffective, inappropriate, and excessive user access controls and inadequate control of physical security to the data center; (2) deficient application program change controls involving inappropriate access capabilities and inadequate test environments, segregation of duties and version controls; and (3) that RMA/FCIC management has not implemented a continuous monitoring effort to ensure its financial management systems comply with the FFMSR and has not completed a financial management systems five-year plan, as required by OMB Circular A-127.

- Aside from Rural Development's (RD) lack of compliance with OMB Circular A-130, already acknowledged by RD, we reported material weaknesses involving (1) ineffective logical access controls, (2) ineffective controls to ensure vulnerabilities are timely identified and corrected, (3) inadequate and ineffective policies regarding change controls and segregation of duties, and (4) inadequate oversight of IT security controls at RD's remote State and county offices.

- Farm Service Agency/Commodity Credit Corporation (FSA/CCC) financial auditors reported the lack of a complete information security management program that can be applied to its general support and financial systems, along with the need for establishing and maintaining sustainable and repeatable information security and contingency planning controls. Auditors also continue to find FSA/CCC needs to improve its financial system functionality and related processes, including financial and budgetary accounting and reporting policies and procedures.

- Additionally, Forest Service (FS) auditors have reported that the FS financial management system does not substantially comply with the requirements of FFMIA and FISMA. Forest Service did not comply with the FFMIA because it did not (1) perform certifications and accreditations on its selected computer applications; (2) recognize certain revenues, (3) account for its budgetary resources received by its special and non-revolving trust funds in accordance with SGL requirements; (4) ensure that its proprietary and budgetary general ledger accounts were continuously synchronized; and (5) ensure that its posting models and manual accounting entries complied with SGL requirements.

The Department continues its effort to achieve compliance with the FFMIA requirements. It has been working with the component agencies to accelerate completion of corrective actions previously estimated to extend into fiscal year 2006. Currently, all completion dates are targeted for fiscal year 2004. Issues regarding modernization of systems continue to be and will remain significant challenges in fiscal year 2004. These are complex areas and significant efforts will be needed to accomplish the target dates without extending timeframes. Modern financial systems are needed to produce reliable data for competitive sourcing and congressional decisions on the budget, as well as managing day-to-day operations. Financial management systems' compliance with FFMSR, applicable accounting standards, and the SGL are building blocks to help achieve these goals.

Recommendation No. 6

Continue to work with component Agencies to resolve the existing and newly-identified instances of FFMIA noncompliance reported during the fiscal year 2003 financial statement audits, and fully disclose these deficiencies, along with the agencies' corrective action plans, in the Department's annual budget submissions to OMB.

Finding 6 — Improvements Needed in Oversight of Agencies' Procedures for Reporting Material Information Security Weaknesses

While the Department and most of its agencies' security staffs have taken considerable actions in the past few years to improve the security over their IT resources, significant progress is still needed toward establishing an effective security program. During our fiscal year 2003 audit, we found that Department management needs to strengthen its oversight of component agencies' procedures for reporting material information security weaknesses in accordance with the requirements of the FMFIA, the FFMIA, and the more recent FISMA. Specifically, we found that despite the extensive number of security weaknesses we have continued to report over the past several years, USDA component agencies' fiscal year 2003 FMFIA Statements of Assurance and FFMIA Remediation Plan submissions to the OCFO do not include the wide-range of information security weaknesses identified in USDA's financial management systems.

USDA Departmental Regulation (DR) 1110-2, "Management Accountability and Control", dated February 23, 1999, requires that the OCFO, on behalf of the Secretary, provide oversight to component agencies to ensure that material deficiencies are identified and reported, and evaluate deficiencies reported by USDA agencies to determine materiality from a departmental perspective. Appendix A, states that all material weaknesses identified in audit reports are to be considered for inclusion in the agency's FMFIA Statements of Assurance reports. It also identifies deficiencies that "significantly weaken safeguards against waste, loss, unauthorized use or misappropriation of funds, property or other assets" as a material weakness under Section 2 of the FMFIA. The "USDA Management Control Manual" (Departmental Manual 1110-002), dated November 29, 2002, further states that these weaknesses should be reported to OMB and Congress.

Also, the recently enacted FISMA provides additional detail regarding the reporting of significant deficiencies under the FFMIA. While the FFMIA did not explicitly require weaknesses in information security to be reported as a separate finding, in the past, such weaknesses were to have been taken into account in the overall analysis of financial systems and determination of compliance under the Act. The FISMA, however, now specifically requires each agency to report "any significant deficiency in an information security policy, procedure, or practice, if relating to financial management systems, as an instance of a lack of substantial compliance under FFMIA." Accordingly, agency heads must now consider such significant deficiencies when providing assurance on controls, both, under the FMFIA and when determining compliance with the FFMIA.

The component agencies were not reporting these weaknesses under the FFMIA because it was not a requirement in the past, but they were also not reporting them under FMFIA because the OCIO reports a Department-wide material information security weakness. In its fiscal year 2003 FMFIA Assurance Statement, the OCIO reports an overarching information security deficiency in the Department's ability to protect its assets from fraud, misuse, disclosure, and disruption. The OCIO states that "extensive and wide-ranging weaknesses" within USDA information security programs are present, and while much progress has been achieved, many problems remain. The remedies provided in the FMFIA Assurance Statement are high-level management actions and are not agency specific, identifying only the OCIO, instead of each agency head that is responsible for that specific agency's progress towards resolving their information security weaknesses.

We believe that improving the overall management and security of IT resources should be a top priority in the Department. However, we believe that agency managers are ultimately responsible and should also be held accountable for committing the appropriate resources to implement an effective security program within their agencies.

Recommendation No. 7

Ensure that component agency managers report material information security weaknesses identified in audit reports and internal reviews in the agencies' FMFIA Statements of Assurance and FFMIA Remediation Plans submitted to the OCFO, along with detailed and agency-specific corrective action plans that can be tracked and monitored for timely resolution.

Finding 7 Potential Anti-Deficiency Violation

We noted a potential Anti-Deficiency Act [6] violation where an obligation and payment were made in excess of the funding available. Our accounting adjustment samples included a transaction that was processed to move a purchase order for $957,245 from budget fiscal year 2002 to budget fiscal year 2003. Upon our request, agency officials investigated why the purchase order was moved and discovered a potential Anti-Deficiency Act violation.

Agency officials told us that in September 2002, the Animal and Plant Health Inspection Service (APHIS), on behalf of the Grain Inspection, Packers and Stockyards Administration (GIPSA), issued a purchase order to purchase computers. At the time the purchase order was issued by the APHIS contracting officer, GIPSA records indicated that GIPSA had sufficient funds to purchase the computers using fiscal year 2002 funds. Later, APHIS reported that GIPSA did not have sufficient fiscal year 2002 funds to make the purchase. Consequently, APHIS advised and GIPSA accepted the decision to purchase the computers using fiscal year 2003 funds. APHIS and GIPSA officials were operating under the assumption that the fiscal year 2002 purchase was cancelled and a new fiscal year 2003 purchase order was issued. However, this did not occur. When investigating our questions about an accounting adjustment related to this purchase, APHIS and GIPSA officials discovered that the fiscal year 2002 purchase order was not cancelled and a fiscal year 2003 purchase order was not issued. As a result, funds were both obligated and disbursed in excess of the amount available.

[6] 31 U.S.C. 1341, 1349-1351, 1501-1557

Recommendation No. 8

Request an Office of General Counsel opinion about whether an Anti Deficiency Act violation occurred, and if so the head of the agency should report immediately to the President and Congress all relevant facts and provide a statement of corrective actions taken.

Exhibit A – Audit Reports Issued During Fiscal Year 2003

AUDIT NUMBER	AUDIT TITLE	RELEASE DATE
50099-52-FM	Fiscal Year 2003 Federal Information Security Management Act Report	September 2003
88099-5-FM	National Information Technology Center General Controls Review-Fiscal Year 2003	October 2003
05401-12-FM	Federal Crop Insurance Corporation/Risk Management Agency's Financial Statements for Fiscal Years 2003 and 2002	November 2003
06401-16-FM	Commodity Credit Corporation's Financial Statements for Fiscal Years 2003 and 2002	November 2003
08401-3-FM	Forest Service's Financial Statement Audit for Fiscal Year 2003 and 2002	January 2004
11401-15-FM	Fiscal Year 2003 National Finance Center Review of Internal Controls	November 2003
15401-4-FM	Rural Telephone Bank's Financial Statements for Fiscal Years 2003 and 2002	November 2003
85401-9-FM	U.S. Department of Agriculture Rural Development's Financial Statements for Fiscal Years 2003 & 2002	November 2003

USDA

United States Department of Agriculture

Office of the Chief Financial Officer

1400 Independence Avenue, SW

Washington, DC 20250

JAN 26 2004

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

Dear Ms. Fong:

This letter responds to the Office of Inspector General opinion on the Department of Agriculture's fiscal year 2003 consolidated financial statements, Report Internal Control Structure, and the Report on Compliance with Laws and Regulations. We concur with your findings and recommendations.

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

We appreciate that the report documents that the Department has made notable progress in improving its overall financial management during fiscal year 2003. As you recommend, we will continue to implement our long-term plans to address the remaining weaknesses in the Department's financial management accountabilities.

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

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

Sincerely,

Patricia E. Healy
Acting Chief Financial Officer