



United States Department of Agriculture
Office of Inspector General





United States Department of Agriculture
Office of Inspector General
Washington, D.C. 20250



DATE: November 9, 2012

AUDIT
NUMBER: 10401-0002-11

TO: David White
Chief
Natural Resources Conservation Service

ATTN: Stephen M. Kunze
Chief Financial Officer

Leon Brooks
Director of Compliance

FROM: Gil H. Harden
Assistant Inspector General for Audit

SUBJECT: Natural Resources Conservation Service's Financial Statements for
Fiscal Year 2012

This report presents the results of the engagement to audit Natural Resources Conservation Service's (NRCS) financial statements for the fiscal year ended September 30, 2012. The report contains a disclaimer of opinion on the financial statements, as well as an assessment of NRCS's internal controls over financial reporting and compliance with laws and regulations.

Kearney & Company, P.C. (Kearney), an independent certified public accounting firm, was engaged to conduct the audit. In connection with the contract, we reviewed Kearney'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 of 1996 (FFMIA); or conclusions on compliance with laws and regulations. Kearney is responsible for the attached auditor's report, dated November 7, 2011, and the conclusions expressed in the report. However, our review disclosed no instances where Kearney did not comply, in all material respects, with government auditing standards and the Office of Management and Budget Bulletin 07-04, *Audit Requirements for Federal Financial Statements*, as amended, except as disclosed below.

Kearney reported that NRCS was unable to provide timely and competent evidential material to enable Kearney to perform audit procedures to determine that the amounts included in the NRCS financial statements as of and for the year ended September 30, 2012, are complete and free of material misstatement. This includes beginning balances, current year activity, and associated disclosures related to accounts receivable, easements, advances, accounts payable and accruals, benefit liabilities, capital lease liability, net position, unobligated balances, budgetary transfers, and property, plant and equipment. Kearney audit work identified issues related to processes and internal controls supporting key account balances and financial reports. As a result of these limitations, Kearney was unable to obtain sufficient evidential support for the amounts presented in the fiscal year 2012 financial statements.

Since NRCS did not provide timely and competent evidential material and Kearney was not able to apply other auditing procedures to satisfy themselves as to the matters discussed in the preceding paragraph, the scope of their work was not sufficient to enable Kearney to express an opinion on the financial statements of NRCS as of and for the year ended September 30, 2012.

Kearney's report identified seven deficiencies. Specifically, Kearney identified weaknesses in NRCS's:

- General accounting operations;
- financial reporting;
- property, plant and equipment;
- accrued expenses;
- reimbursable agreements;
- information technology; and
- undelivered orders and new obligations.

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

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned, and timeframes for implementing the recommendations for which management decisions have not been reached. Please note that the regulation requires management decision to be reached on all recommendations within 6 months from report issuance, and final action to be taken within 1 year of each management decision to prevent being listed in the Department's annual Agency Financial Report. For agencies other than Office of Chief Financial Officer (OCFO), please follow your internal agency procedures in forwarding final action correspondence to OCFO.

**United States Department of Agriculture
Natural Resources Conservation Service
Audit Report
For the Year Ended September 30, 2012**

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INDEPENDENT AUDITOR'S REPORT

To the Chief of the Natural Resources Conservation Service and the Inspector General of the United States Department of Agriculture

We were engaged to audit the accompanying balance sheet of the Natural Resources Conservation Service (NRCS) as of September 30, 2012, and the related statements of net cost, changes in net position, and budgetary resources (hereinafter referred to as the "financial statements") for the year then ended. These financial statements are the responsibility of NRCS's management. The financial statements of NRCS as of September 30, 2011 were engaged to be audited by other auditors whose report, dated November 4, 2011, did not express an opinion on those statements.

NRCS was unable to provide timely and competent evidential material to enable us to perform audit procedures to satisfy ourselves that the amounts included in the NRCS financial statements as of and for the year ended September 30, 2012 are complete and free of material misstatement. This includes beginning balances, current year activity, and associated disclosures related to accounts receivable, easements, advances, accounts payable and accruals, benefit liabilities, capital lease liability, net position, unobligated balances, budgetary transfers, and property, plant, and equipment. Our audit work identified issues related to processes and internal controls supporting key account balances and financial reports. As a result of these limitations, we were unable to obtain sufficient evidential support for the amounts presented in the fiscal year (FY) 2012 financial statements.

Since NRCS did not provide timely and competent evidential material and we were not able to apply other auditing procedures to satisfy ourselves as to the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, Required Supplementary Information, and Required Supplementary Stewardship Information be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*, and the Federal Accounting Standards Advisory Board (FASAB), who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an

opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted information on Deferred Maintenance, Stewardship Land, and American Recovery and Reinvestment Act activities that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by OMB Circular A-136, *Financial Reporting Requirements*, and FASAB, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. Other Accompanying Information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

In accordance with *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended, we have also issued reports, dated November 6, 2012, on our consideration of NRCS's internal control over financial reporting and on our tests of NRCS's compliance with certain provisions of laws, regulations, and other matters for the year ended September 30, 2012. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance as well as the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance and other matters. Those reports are an integral part of our disclaimer of opinion on the financial statements and should be considered in assessing the results of our work.



Alexandria, Virginia
November 6, 2012

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL

To the Chief of the Natural Resources Conservation Service and the Inspector General of the United States Department of Agriculture

We were engaged to audit the financial statements of the Natural Resources Conservation Service (NRCS) as of and for the year ended September 30, 2012, and have issued our report thereon dated November 6, 2012. Except as discussed in our report, we conducted our audit in accordance with auditing standards generally accepted in the United States of America; 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. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. The management of NRCS is responsible for establishing, maintaining, and assessing internal control related to financial reporting and compliance, and assessing internal control to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act of 1982 (FMFIA) are met.

In planning and performing our work, we considered NRCS's internal control over financial reporting and compliance by obtaining an understanding of the design effectiveness of NRCS's internal control, determining whether controls had been placed in operation, assessing control risk, and performing tests of NRCS's controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, and not to provide an opinion on the internal controls. Accordingly, we do not express an opinion on the effectiveness of NRCS's internal control over financial reporting and compliance or on management's assertion on internal control included in Management's Discussion and Analysis.

We limited our internal control testing to those controls necessary to achieve the OMB Bulletin No. 07-04, as amended, control objectives that provide reasonable, but not absolute, assurance that: (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP), and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in compliance with laws governing the use of budget authority, Government-wide policies and laws identified in Appendix E of OMB Bulletin No. 07-04, as amended, and other laws and regulations that could have a direct and material effect on the financial statements. We did not test all internal controls relevant to operating objectives, as broadly defined by FMFIA, such as those controls relevant to ensuring efficient operations.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraphs and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. Therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal

control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. We consider the following deficiencies in NRCS's internal control to be material weaknesses.

Material Weaknesses

I. General Accounting Operations

For an extended period of time during the fiscal year (FY), we noted several instances in which internal controls ceased to operate and certain transactions could not be posted in the financial system. Specifically, we noted the following:

- The Accounts Receivable billing module is not functioning properly. On May 1, billing ceased to allow for a transition of billing modules. Activity did not resume until mid-August. Continuous system errors caused NRCS to cease billing again as of September 18, 2012 for all receivables, to include reimbursable agreements (RA). As a result, NRCS has a backlog of billings ranging from May 1, 2012 to present. The unprocessed accounts receivable bills totaled approximately \$85.3 million as of September 30, 2012. In addition, there is a backlog of new agreements and modifications, with unallocated budget authority over \$43.5 million. NRCS posted a revenue accrual and an adjusting entry for unfilled customer orders at year end as a result of these delays
- As of June 30, advances were not being properly liquidated. When liquidating the advances, the financial system was sending out duplicate payments. This resulted in a \$12 million manual adjustment to liquidate advances at year end
- Capital lease depreciation/amortization for May and June 2012 was not recorded in the financial system
- NRCS was unable to provide an aged listing of the 12F3885 suspense account for Fund Balance with Treasury (FBWT). Without this detail, NRCS could not document that the suspense items clear within 60 days, as mandated by the Department of the Treasury. At September 30, 2012, the net suspense balance for FBWT was approximately \$15 million
- Due to delays related to the financial system conversion, NRCS did not timely perform the following control activities required by NRCS policy:
 - The June 30 quarterly Accounts Receivable, General Ledger, and Accounts Receivable Aging Reconciliations
 - The June 30 quarterly Open RA Review
 - The June 30 quarterly Undelivered Order (UDO) Review.

Recommendation 1:

We recommend that NRCS focus on strengthening its internal control environment and ensuring that system components are fully operational. We also recommend that NRCS identify the underlying impediments causing errors in the Accounts Receivable billing module, proper liquidation of advances, and posting of depreciation/amortization. In addition, NRCS should continue to implement procedures over the FBWT process, to include procedures for ensuring that unprocessed items are cleared from the suspense account in a timely manner. NRCS should complete a thorough review of the FBWT suspense account to identify older reconciling items, and take the appropriate actions to clear these items.

II. Financial Reporting (Repeat Condition)

We identified the following exceptions from required disclosures and internal inconsistencies in NRCS's financial statements and footnotes:

- The FBWT footnote was not presented in accordance with OMB Circular A-136, *Financial Reporting Requirements*. NRCS corrected this error after auditor identification
- NRCS did not provide a footnote disclosure for the Conservation Stewardship Liability, which is a material liability as of September 30, 2012. NRCS included a disclosure regarding the Conservation Stewardship Liability after auditor identification; however, the disclosure did not substantially discuss the nature of the liability
- The Reconciliation of Net Cost of Operations to Budget footnote disclosure did not reconcile to the Statement of Net Cost, Statement of Budgetary Resources (SBR), or Statement of Changes in Net Position. NRCS corrected this error after auditor identification
- The Obligations Incurred amount in the SBR to the President's Budget Reconciliation footnote did not correspond with the prior year's published SBR. NRCS corrected this error after auditor identification
- The Required Supplementary Information disclosures regarding Deferred Maintenance and Stewardship Land were incomplete per OMB Circular A-136 requirements and Statement of Federal Financial Accounting Standards (SFFAS) No. 29, *Heritage Assets and Stewardship Land*
- Management's Discussion and Analysis (MD&A) needed additional information regarding performance and American Recovery and Reinvestment Act (ARRA) activities in order to be in compliance with the reporting requirements of OMB Circular A-136. In addition, the MD&A lacked a clear explanation of how annual performance measures link to strategic performance measures. NRCS included additional performance information after auditor identification, but did not include a discussion regarding ARRA.

We also noted that NRCS is not in full compliance with FMFIA due to internal control deficiencies in UDOs, accounts payable, general ledger adjustments, accrual validations, real and personal property, personnel documentation, general and application access controls, and reimbursable activity, which are further detailed in this report.

NRCS was also not in full compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA), Federal financial management systems requirements, Federal accounting standards, and United States Standard General Ledger (USSGL) at the transaction level. NRCS was not able to provide Kearney with sufficient, appropriate evidence to validate balances and activity for easements, leases, revenue, accruals for accounts payable and grants, or property, plant, and equipment (PP&E), as described herein. As a result, Kearney could not verify whether the financial reporting of these line items was appropriate and compliant with GAAP or USSGL. In addition, Kearney also noted user access control weaknesses related to the information technology (IT) control environment, as further detailed in this report.

NRCS acknowledged in its annual assurance statement that it was not in full compliance with FMFIA or FFMIA. NRCS was able to only provide qualified assurance that internal controls over financial reporting are operating effectively. NRCS has not completed OMB Circular A-123 testing over its internal controls since certain cycles are still under remediation.

Recommendation 2:

We recommend that NRCS perform the following corrective actions to address this issue:

- Continue to implement a comprehensive financial management system strategy to ensure compliance with Federal financial management systems requirements
- Enforce accounting entries that are consistent with those prescribed by the USSGL
- Develop policies to ensure all relevant Federal accounting standards are followed
- Improve the communication and implementation of policies and procedures regarding the preparation of financial statements, MD&A, footnote disclosures, and Required Supplementary Information
- Ensure all qualitative information reported in footnote disclosures, including supplementary information, is accurate and current
- Continue to develop remediation plans to address FMFIA and FFMIA noncompliance.

III. Property, Plant, and Equipment (Repeat Condition)

NRCS is currently in the process of conducting PP&E remediation efforts, scheduled to be completed during FY 2013. As a result, NRCS could not provide sufficient, appropriate evidence to support PP&E beginning balances, valuation and completeness of its owned real property assets, the personal property balance as of June 30, 2012, and related personal property depreciation amounts and gain/loss information. Specific PP&E deficiencies are outlined below.

- NRCS could not provide Kearney with sufficient, appropriate evidence to support the real property beginning balance, as well as the valuation and completeness of its owned real property assets
- NRCS does not have procedures for capitalizing costs related to improvements of leased and owned real property. NRCS has not previously capitalized improvement costs and is not currently capitalizing such costs. In addition, NRCS has not initiated a process to identify past improvement costs and assign those costs to related assets. NRCS has

prepared a draft Leasehold Improvement Policy; however, the policy is under review and has not been fully implemented

- NRCS did not have sufficient, appropriate evidence to support the beginning personal property balance, the June 30, 2012 personal property balance, and related depreciation amounts and gain/loss information
- NRCS has not fully implemented a process to determine deferred maintenance costs. As a result, NRCS was not able to accurately disclose deferred maintenance costs in its financial statements
- While performing personal property site visit testing, which was conducted at seven states for a total of eight state offices, we noted the following:
 - Twelve of 57 tested personal property items contained an incorrect physical address in the Personal Property System (PROP), NRCS's asset management tool
 - One of 36 items physically observed at the field offices was not recorded in the accounting records. NRCS subsequently identified the root cause and corrected this error
 - We reviewed seven inventory certifications and identified one transferred asset for which the location was not updated in PROP.

Recommendation 3:

We recommend that NRCS complete the PP&E remediation efforts as soon as possible to ensure that real property and personal property information is provided in a timely manner.

Remediation efforts should include completion of the real property and personal property physical inventories, and review of budget object codes currently assigned to personal property. We also recommend that NRCS finalize its efforts to implement the "Methodology for Condition Assessment Surveys and Determining Deferred Maintenance" to track deferred maintenance, and suggest that NRCS continue to develop and implement effective steps and related policies and procedures to track improvements to leased and owned assets.

IV. Accrued Expenses (Repeat Condition)

NRCS was not able to provide adequate documentation to support accruals and several disbursements selected for testing. Specifically, we noted the following:

- NRCS does not have consistent accrual policies across all states to perform a comprehensive validation of the accounts payable accrual estimate, and the grants and agreements accrual estimate. Specifically, NRCS could not provide evidence (historical data supporting the accrual assumptions, sampling plan, or analysis performed to determine if the percentage error rate noted is reasonable or if the accrual methodology should be adjusted for future periods) to support that accrual validations were performed. In addition, we identified the following two errors, totaling \$4,196,762, in the recorded year-end accruals:
 - NRCS recorded an incorrect amount related to one interagency agreement
 - NRCS could not provide support that an item represented a valid accrual

- From a sample of 94 accounts payable procurement transactions, with a recorded value of \$161,759,892 as of June 30, 2012, we identified the following errors in 12 of 19 Intra-governmental Payment and Collection (IPAC) transactions included in the sample. The errors totaled \$31,395,260, with a statistically projected error of \$115,383,940
 - Eleven IPAC transactions did not have evidence that the charges were valid, or that the goods and/or services were received
 - One IPAC transaction was an advance that was erroneously charged to expenses
- From a sample of 14 accounts payable procurement transactions, with a recorded value of \$103,829,127 as of September 30, 2012, two IPACs for \$5,658,490 did not have evidence that the charges were valid, or that the goods and/or services were received
- We identified errors of \$2,158,738 in the September 30, 2012 accounts payable sub-ledgers. These errors related to vendor balances that had been erroneously reduced to less than zero.

Recommendation 4:

We recommend that NRCS finalize and implement steps to regularly review the accounts payable accrual methodology, and grants and agreements accrual methodology against actual results to validate their predictive reliability. In addition, we recommend that NRCS develop a process for accruals and disbursements, including IPAC transactions, to properly document that the related accrual or disbursement is appropriate. NRCS should also research and remediate current debit vendor balances.

V. Reimbursable Agreements (Modified Repeat Condition)

NRCS maintains a database that is not integrated with the financial system to track the execution and billing of RAs. RA execution requires a budgetary entry, and RA billing requires both a budgetary entry and a proprietary entry. We noted an overall lack in RA internal controls to help ensure timely and accurate preparation of RA invoices, and proper recording of RAs in the financial system, as described below.

- We determined an overall unfilled customer order (UCO) account overstatement of \$20.6 million due to the following:
 - NRCS was unable to verify the cause of a \$22.8 million variance between the year-end balance in the UCO general ledger (GL) and the RA spreadsheet
 - NRCS could only provide documentation to support \$67,992,823 of the recorded \$70,157,225 Conservation Reserve Program RA accrual. NRCS stated that the \$2,164,402 variance was an error and was subsequently corrected; however, NRCS was unable to provide support for the correction
- We tested a sample of 27 RAs and noted the following issues:
 - An RA in the amount of \$17 million was incorrectly entered into the financial system as \$1.7 million, causing a \$15 million understatement to RAs and budget authority
 - \$2 million of an \$80 million RA was not timely allocated in the financial system in accordance with NRCS policy

- NRCS did not request budget limitation until several months after the approval of an RA, causing the budget authority to be loaded into the financial system in a FY subsequent to the RA's approval. This caused a beginning balance understatement of \$100,000
- For one RA, NRCS was unable to provide evidence that the state-level budget allocation was recorded in the financial system
- Three RA Financial Information Checklists were missing signatures required by NRCS policy, and one RA was missing the RA Financial Information Checklist
- One RA's initial limitation was entered into the RA Tracker prior to approval of the agreement.

Recommendation 5:

We recommend that NRCS perform the following corrective actions to address these issues:

- Continue to implement sustainable internal controls to verify the completeness and accuracy of UCOs for future FYs
- Continue to conduct analysis of current UCO balances to determine if they are complete
- Continue to review open UCO balances for validity and accuracy
- Continue to provide comprehensive training, instruction, and support to the personnel responsible for recording and monitoring RAs
- Continuously monitor the effectiveness of RA controls
- Confirm the accurate conversion of UCO balances for beginning balances in FY 2013.

* * * * *

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance. We consider the following deficiencies in NRCS's internal control to be significant deficiencies.

Significant Deficiencies

I. Information Technology (Modified Repeat Condition)

NRCS's IT control environment included user access controls and user access administration weaknesses that, when combined, are considered to be a significant deficiency, as summarized below.

- NRCS's control structure contains weaknesses related to user access controls. Specific to the Local Area Network/Wide Area Network (LAN/WAN) login authenticator guidelines, we identified the following weaknesses and inconsistencies between the LAN/WAN authentication in operation and NRCS's policies:
 - Password length, age, and re-use restrictions were not consistently applied among LAN/WAN servers

- Passwords were not the appropriate level of complexity
- Password re-use was permitted after seven initial uses
- Formal procedures for requesting access and reviewing access have not been established for zRoles, the NRCS tool used to manage all roles for ProTracts/Fund Manager and the Web-Based Total Cost and Accounting System (WebTCAS)
- We noted the following exceptions with User Access Request Forms:
 - Three of 15 LAN/WAN User Access Request Forms sampled were not properly approved or available
 - Two of 45 User Access Request Forms sampled for the National Easement Staging Tool (NEST) application were not signed or dated by a Designated Approving Signatory
- We identified several issues related to user access administration, as follows:
 - NRCS did not identify and deactivate accounts for separated users in a timely manner in Active Directory, NEST, and EmpowHR, as required by NRCS policy. Several separated user accounts maintained an active account status in the following applications:
 - 12 Active Directory accounts (LAN/WAN)
 - 18 NEST accounts (used to manage easement grant activities from application through grant completion)
 - 26 EmpowHR accounts
- NRCS did not identify and deactivate inactive accounts in a timely manner in EmpowHR. We noted that 374 users had not logged into the system in 120 days or more, and 237 users did not have a sign-on date
 - Five generic Active Directory accounts had not been removed as required by NRCS policy
 - The EmpowHR document for the annual review of user accounts is not a formal procedure. The document lacks management approval and version control, which is not representative of a formally documented and controlled procedure
 - Five users in EmpowHR had a last password change date set at December 31, 2049, effectively making the passwords never expire.

Recommendation 6:

We recommend that NRCS take the following actions to correct the user access control issues:

- Apply the password parameters stated in NRCS eDirectives across the entire network environment
- Establish formal procedures for requesting and reviewing user access for zRoles
- Reengineer, enhance, or otherwise better enforce the existing User Access Request Form processes to ensure the appropriate review and storage of User Access Request Forms for all NRCS systems.

We recommend that NRCS take the following actions to correct the user access administration control issues:

- Implement a process to ensure that inactive, separated, and generic user accounts are disabled and removed from NRCS systems in a timely manner
- Complete a formal procedure for the complete review and recertification of EmpowHR user accounts
- Enforce a password maximum age limit of 60 days per NRCS eDirectives NB.270.8.5
- Apply the password parameters stated in NRCS eDirectives across the entire network environment.

II. Undelivered Orders and New Obligations (Repeat Condition)

Based on the procedures performed during interim and final testing over budgetary resources, we noted the following exceptions related to new obligations, upward adjustments, and UDOs.

- We selected a statistical sample of 250 new obligations and upward adjustments as of June 30, 2012. We identified the following errors, which totaled \$2 million and had a statistically projected error of \$3.8 million
 - An obligation document did not match the obligation amount recorded in the financial system, for an error in the amount of \$30,000
 - An obligation was not properly supported with appropriate documentation matching the sample amount, for an error in the amount of \$2,000
 - An obligation was approved using FY 2011 funds but was actually obligated using FY 2012 funds, for an error in the amount of \$2 million
- We noted the following control weaknesses related to travel obligations:
 - Two travel instances occurred during the financial system conversion, when no obligations were being posted. Therefore, there is a timing lag between the obligation approval date and the date the obligation was entered in the financial system
 - Three obligations were approved after travel occurred, which is not in accordance with NRCS policy
- We selected a statistical sample of 129 UDOs as of June 30, 2012 and identified a \$1 million obligation that should have been liquidated. This resulted in a statistically projected error of \$3 million
- We selected a judgmental sample of 32 UDOs as of September 30, 2012 and noted the following exceptions:
 - For one sample, the obligating document/authorized contract was not provided. Further, Kearney noted that the last date of activity for this item was in FY 2006, and considered this amount to be invalid. The error amount totaled \$200,000
 - Kearney noted a difference of \$225,000 between a UDO sample amount and the amount supported by the appropriate documentation.

Recommendation 7:

We recommend that NRCS perform the following corrective actions to address these issues:

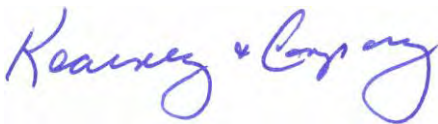
- Continue to provide comprehensive training, instruction, and support to the personnel responsible for recording and monitoring obligations in the proper period and for the proper amount
- Reinforce controls over travel authorizations that must be entered and approved in GovTrip prior to incurring travel
- Monitor UDO activity on open obligations to ensure that all invalid open obligations are identified and downward adjustments are negated in a timely manner
- Monitor open obligations, to include performing timely UDO reviews, to ensure that UDOs are valid and recorded in the appropriate period.

During the audit, we noted certain other matters that we will report to NRCS's management in a separate letter.

NRCS's management has provided its response to our findings in a separate memorandum attached to this report. We did not audit management's response and, accordingly, we do not express an opinion on it.

* * * * *

This report is intended solely for the information and use of NRCS's management, those charged with governance and others within NRCS, the United States Department of Agriculture's Office of the Inspector General, the Government Accountability Office, OMB, the Department of the Treasury, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.



Alexandria, Virginia
November 6, 2012

APPENDIX A: Status of Prior Year Material Weaknesses and Significant Deficiencies

The Natural Resources Conservation Service's (NRCS) fiscal year (FY) 2011 Report on Internal Control noted five material weaknesses and two significant deficiencies¹. The table below presents a summary of the current year status of these issues.

Prior Year Material Weaknesses and Significant Deficiencies

Control Deficiency	2011 Status	2012 Status
Undelivered Orders Accounting and Controls	Material Weakness	Significant Deficiency
Accrued Expenses Accounting and Controls	Material Weakness	Material Weakness
Financial Reporting Controls	Material Weakness	Material Weakness
Property, Plant, and Equipment Accounting and Controls	Material Weakness	Material Weakness
Information Technology General and Application Access Controls	Material Weakness	Significant Deficiency
Unfilled Customer Orders Accounting and Controls	Significant Deficiency	Material Weakness
Purchase and Fleet Card Transaction Controls	Significant Deficiency	Management Letter Comment

* * * * *

This report is intended solely for the information and use of NRCS's management, those charged with governance and others within NRCS, the United States Department of Agriculture's Office of the Inspector General, the Government Accountability Office, the Office of Management and Budget, the Department of the Treasury, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

¹ *Independent Auditor's Report on the Natural Resources Conservation Service 2011 Financial Statements.*

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND OTHER MATTERS

To the Chief of the Natural Resources Conservation Service and the Inspector General of the United States Department of Agriculture

We were engaged to audit the financial statements of the Natural Resources Conservation Service (NRCS) as of and for the year ended September 30, 2012, and have issued our report thereon dated November 6, 2012. Except as discussed in our report, we conducted our audit 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. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. The management of NRCS is responsible for compliance with laws and regulations.

As part of obtaining reasonable assurance about whether NRCS's financial statements are free of material misstatement, we performed tests of NRCS's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin No. 07-04, as amended, that we determined were applicable. As part of our work, we performed tests of compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA), Section 803(a) requirements. We limited our tests of compliance to these provisions; we did not test compliance with all laws and regulations applicable to NRCS. Providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests of compliance described in the preceding paragraph disclosed no instances of noncompliance exclusive of FFMIA, or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 07-04, as amended.

Under FFMIA, we are required to report whether NRCS's financial management systems substantially comply with Federal financial management system requirements, applicable Federal accounting standards, and the United States Standard General Ledger (USSGL) at the transaction level. We noted certain instances, described below, in which NRCS's financial management systems and related controls did not substantially comply with certain Federal system requirements, applicable Federal accounting standards, USSGL at the transaction level, and the Improper Payments Elimination and Recovery Act (IPERA).

Federal Financial Management System Requirements

- We noted user access control weaknesses, inconsistencies between financial system operations and NRCS policies, and segregation of duties conflicts for several NRCS financial management systems

- We noted system issues preventing the routine processing of transactions. Continuous system errors caused NRCS to cease billings for accounts receivable, and advances were not being properly liquidated. When liquidating the advance, the financial system was sending out duplicate payments. This resulted in a \$12 million manual adjustment to liquidate advances at year end.

Applicable Federal Accounting Standards

- NRCS was unable to timely provide sufficient, appropriate evidence to support testing over several account balances, including easements, leases, and revenue. In addition, NRCS could not provide evidence of its real and personal property balances, including improvements, or validation of accrual methodology for accounts payable and grants. As a result, we could not verify whether the financial reporting of these line items was appropriate and compliant with generally accepted accounting principles
- In some instances, financial statement footnotes and required supplementary information were not in compliance with OMB Circular A-136.

USSGL at the Transaction Level

- Because of a lack of sufficient documentation, we could not verify that transactions for the easements, leases, revenue, real property, and personal property cycles mentioned above were posted in accordance with the USSGL
- Financial data could not be appropriately and directly matched to the financial statements and OMB and Treasury reports from the USSGL codes
- Reconciliations provided in the financial statement footnotes did not tie to the financial statements
- Financial statement line items did not reconcile to the USSGL crosswalk
- NRCS could not provide support for several general ledger adjustments related to abnormal balances, and was unable to identify the causes of the abnormal balances.

IPERA

- The United States Department of Agriculture's (USDA) Office of Inspector General (OIG) identified in a prior fiscal year certain elements of noncompliance with IPERA, with which NRCS's management has concurred. Remediation and efforts are ongoing in the current fiscal year.

NRCS's management provided its response to our findings in a separate memorandum attached to this report. We did not audit management's response and, accordingly, we do not express an opinion on it.

* * * * *



This report is intended solely for the information and use of NRCS's management, those charged with governance and others within NRCS, USDA's OIG, the Government Accountability Office, OMB, the Department of the Treasury, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in blue ink that reads "Kearney & Company". The signature is stylized and cursive.

Alexandria, Virginia
November 6, 2012

United States Department of Agriculture



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

November 6, 2012

Mr. William J. Kubistal, Partner
Kearney & Company, P.C.
1701 Duke Street, Suite 500
Alexandria, VA 22314

Dear Mr. Kubistal:

We have reviewed Kearney & Company, P.C. Independent Auditor's Report of NRCS' Fiscal Year (FY) 2012 Financial Statements and generally agrees with its contents.

In FY 2012, NRCS continued to focus on financial management improvements as evidenced by Kearney & Company (Kearney) downgrading the material weakness related to undelivered orders accounting and controls to a significant deficiency and the elimination of the significant deficiency for purchase and fleet cards. NRCS updated policies; sampled, reviewed and verified quarterly obligations; and conducted a variety of training. This was a collaborative effort between the State Offices, and the Acquisitions, Finance, and Programs organizations.

In addition, NRCS converted from the USDA Foundation Financial Information System (FFIS) to the Financial Management Modernization Initiative (FMMI) system on May 1, 2012. The conversion required a commitment of significant financial management staff hours to plan, test, train, and deploy. FMMI is an integrated real time system providing improved functionality, accountability, and internal controls, while streamlining financial processes. As a role-based application, access to the transactions and data provides for greater data integrity, reliability, and sharing across USDA.

NRCS did make progress in correcting previously reported problems. Key accomplishments in FY 2012 included:

Accruals and ULOs:

- Issued National Instruction on Prompt Payment Act Compliance
- Issued reference guide on monitoring unliquidated obligations and advances, and accrual documentation
- Performed sample testing on undelivered orders, advances, accruals, subsequent payments, Prompt Payment Act compliance and NHQ grants and agreements
- Performed A-123 testing on the Grants Management cycle (including Accruals)

Purchase and Fleet Cards

- Issued a policy to review active card holders on a quarterly basis
- Developed quarterly scorecards to track purchase and fleet card compliance with NRCS policies and procedures

Helping People Help the Land

An Equal Opportunity Provider and Employer

- Issued purchase and fleet card training

Application and Access Controls:

- Developed formal review procedures for Zroles and CLab.
- Installed anti-virus software on Linux servers
- Developed a process to ensure that the sufficient number of licenses are available to perform vulnerability scanning
- Implemented a process to document, assign and remediate critical vulnerabilities

Property

- Developed detailed lease liability amortization procedures
- Implemented a process to issue monthly notifications to states regarding upcoming lease expirations
- Completed testing to correct personal property items that were incorrectly capitalized or expenses through September 30, 2011

Unfilled Customer Orders

- Completed A -123 testing for Reimbursable Agreements
- Performed a review of 2Q completeness certifications
- Developed a scorecard to track compliance

NRCS will continue its audit remediation efforts in FY2013. The remediation will involve senior management commitment to corrective action plans and development of its financial management team. For audit weaknesses and areas of non-compliance identified in this year's audit, NRCS will create corrective action plans (CAPS), with obtainable milestones and target completion dates. NRCS is committed to the audit remediation process and the actions needed to obtain an unqualified opinion.

Sincerely,

/s/

Stephen M Kunze
Chief Financial Officer

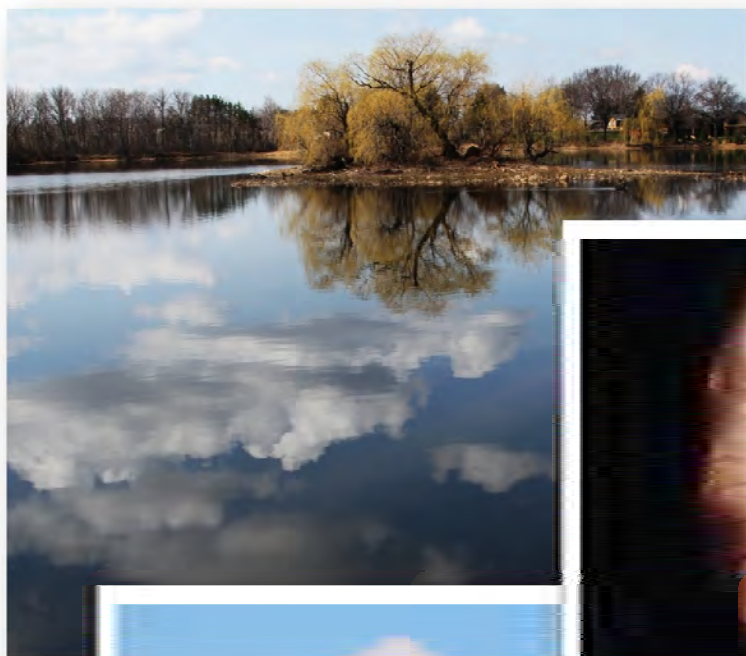
cc: Tracy LaPoint
Office of the Inspector General



Natural Resources Conservation Service

Fiscal Year 2012

Agency Financial Report



Message from the Chief



I am pleased to present the Natural Resources Conservation Service's (NRCS) 2012 Financial Report. NRCS draws on a long history of helping people help the land. For more than 75 years, NRCS and its predecessor agencies have worked in close partnerships with farmers and ranchers, local and State governments, and other Federal agencies to maintain healthy and productive working landscapes. NRCS financial management is designed to support the agency's mission and vision, and this report demonstrates that support.

During the past fiscal year, NRCS faced new challenges. The greatest challenge was the implementation of a full financial system conversion known as Financial Management Modernization Initiative (FMMI). The conversion required a commitment of significant financial management staff hours to plan, test, train, and deploy.

As with the majority of system conversions, ours did not occur without challenges. FMMI modules did not always operate as expected and this affected processing billings, advances, depreciation/amortization, and reconciliation of accounts in a timely manner. With the conversion now complete, NRCS can utilize new functionality, a more robust set of internal controls, and enhanced integration of business processes for fiscal year (FY) 2013.

NRCS has over 2,700 offices and a decentralized operating environment. This model serves the mission to put people on the ground to support NRCS programs. With hundreds of financial system users and unique business opportunities in each location, process standardization, monitoring, and tracking is a challenge. NRCS implemented scorecards to monitor and track each NRCS office's ability to maintain its obligations and agreements, purchase cards, and easements. This baseline will provide NRCS information to assess its operating model and make improvements as we move into next year.

While NRCS had financial management challenges in FY 2012, it also had successes. During the FY 2012 implementation of FMMI, NRCS' Chief Financial Officer instituted a FMMI working group for all NRCS financial management offices. The group provides a central focal point for open discussion of FMMI issues. Each office uses their FMMI point of contact to bring up issues and questions. The FMMI user group promotes participation, communication, and knowledge transfer to ensure issues are identified and resolved timely.

NRCS successfully recruited several experienced government accountants/financial specialists to join its financial reporting, accounting operations, and internal control staffs. This influx of

permanent accounting staff will increase the knowledge base of financial management within NRCS. In the upcoming fiscal year, NRCS will rededicate itself to audit remediation activities, develop and implement policies and procedures to improve financial data, and continue to develop a robust internal control program over financial management activities.

NRCS understands its fiduciary responsibility to the American people and is dedicated to improving its financial management, continuing to support the agency's mission, and improving the health of our Nation's natural resources while sustaining the productivity of American agriculture. We help people help the land.

A handwritten signature in cursive script that reads "Dave White". The signature is written in dark ink and is positioned above the printed name and title.

Dave White
Chief
Natural Resources Conservation Service

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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 a high-level overview of the fiscal year (FY) 2012 financial and non-financial performance for the Natural Resources Conservation Service (NRCS), an agency of the United States 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.

NRCS has chosen to produce an Agency Financial Report (AFR) and Annual Performance Report (APR). NRCS will include its FY 2012 Annual Performance Report with its Congressional Budget Justification and will be posted with the 2014 President's Budget in February 2013, with data also available in the AFR-APR, posted on the USDA public web site at www.usda.gov.

MISSION AND ORGANIZATIONAL STRUCTURE

Mission Statement

"NRCS improves the health of our Nation's natural resources while sustaining and enhancing the productivity of American agriculture. We achieve this by providing voluntary assistance through strong partnerships with private landowners, managers, and communities to protect, restore, and enhance the lands and waters upon which people and the environment depend."

As stated in the Mission Statement, NRCS works with landowners and producers on America's working farm and ranch lands to identify, document and correct environmental concerns in a way that maintains a sustainable highly productive agricultural land base, improves the economic viability of rural communities, improves the nation's water quality and quantity, and restores or enhances wildlife habitat through efficient and effective management of the nation's non-Federal agricultural crop, hay, forest and grazing lands.

Business Lines

To fulfill its mission, NRCS provides technical and financial assistance to landowners. This technical and financial assistance is delivered through six business lines. Business lines are groupings of similar products and services that NRCS employees deliver to external customers.

1. **Conservation Planning and Technical Assistance** results in the transfer of data, information, or a conservation plan that helps customers protect, and conserve natural resources (soil, water, air, plant, animal, and energy) within their social and economic interests. The planning process identifies natural resource problems and opportunities, determines objectives, inventories resources, analyzes data, and formulates and evaluates alternatives.
2. **Conservation Implementation** assists operators and landowners in installing conservation treatments, management measures, and management systems that result in improved treatment of the resources. Implementation of landscape scale approaches and adoption of reengineered processes enhance implementation effectiveness by getting enough conservation applied on the land in a geographic unit to achieve measurable improvements and meet the needs of the individuals and local groups.

Conservation implementation includes environment improvement payments and monetary incentives through program contracts, easements, or other means to qualified program participants who participate in authorized USDA NRCS conservation programs. Financial assistance helps motivate producers to treat natural resource problems and to help sustain natural resources.
3. **Natural Resources Inventory** is the acquisition and development of natural resource data and information for natural resource planning, decision-making, and program and policy development at multiple scales. Natural Resource inventory includes strengthening cooperation with other Federal agencies, State agencies, and partners to collect natural resource data. Data collected is utilized at varying scales and compatible with data generated by other entities.
4. **Natural Resources Assessment** is the interpretation and delivery of natural resource data and information for natural resource planning, decision making, and program and policy development at multiple scales. This includes strengthening cooperation with other Federal agencies, State agencies, and partners to analyze natural resource data. Data collected is usable at varying scales and compatible with data generated by other entities.

Management's Discussion and Analysis (Unaudited)

5. **Natural Resources Technology Transfer** acquires, develops, evaluates, and transfers conservation tools, techniques, and standards based on research and new technologies. It includes the production and delivery of technical tools used in resource assessment, conservation planning and implementation, conservation standards and guidance documents, and the development and delivery.

NRCS focuses on ensuring that appropriate technology is usable and easily accessible to internal and external customers. For internal customers, the highest priority is the integration of field level tools into a user-friendly system that better supports the conservation planning process. For external customers, NRCS works to translate science and technology into tools that are easy to understand and easy to use.

6. **Conservation Operations** is the ongoing cyclical activities involved in the running of the Agency to fulfill the mission to get conservation on the ground. It includes information technology, human resources and services, financial management, and operational management. NRCS works to increase reliability and productivity of Agency resources and operations to deliver conservation.

Organizational Structure

NRCS operates under the direction of the USDA Under-Secretary for Natural Resources and Environment. The NRCS mission is carried out across 4 Regions, which cover all 50 states, the Caribbean and Pacific Basin Areas, 3 National Technology Support Centers, and 9 National Centers.

NRCS is a line and staff organization from field office through the State office to the Chief. Five deputy areas support agency operations and report directly to the Chief: Management, Strategic Planning and Accountability, Soil Science and Resource Assessment, Programs, and Science and Technology.

Strategic Planning and Accountability Framework

The Strategic Planning and Accountability framework is comprised of three major functional components: planning the work (strategically and annually), managing the work, and evaluating the work completed. The work is inclusive of two major components – the actual activities to be conducted and the funding used to do them (budget). It is an ongoing cyclical process. The Annual Performance Measures as outlined in the Annual Budget are tied directly to the Strategic Plan measures, and tracked through the Accountability Information Management System (AIMS). AIMS components include tools to collect performance data, program data, workload data, and time cost allocation. The Performance Results System (PRS), is the performance measurement component of AIMS, which mines on-the-ground data from the National Conservation Planning database, Customer Service Toolkit, ProTracts (Program Contracting System) and summarizes information based on business rules and queries reviewed, calculated, and locked on an annual basis. For more details on data quality assurance methodology, see Page 8). All functionality in the Strategic Planning and Accountability Framework is undergoing significant investment to provide continued improvement in accountability, performance, and efficiency. Maximizing agency success requires adaptive management strategies to include systematically and accurately assessing work processes and making improvements. Key features of adaptive management require a feedback system to improve conservation solutions and monitor success in order to achieve efficient investments in conservation. The feedback system NRCS uses includes performance measures and program evaluation methods and connecting scientific evidence to conservation outcomes. The key components of the adaptive management strategy for measuring and evaluating programs include:

- Developing a variety of performance measures and performance metrics that align with the purpose and success factors of the program;
- Monitoring evidence of efficient program design and results (outputs and outcomes) on a regular basis;
- Developing, maintaining, and auditing internal controls for program compliance; and
- Making evidence-based and targeted program improvements on an on-going basis.

To implement the long-term adaptive management strategy, there are three main efforts planned for 2014 that are integrated into a consolidated data reporting structure for an estimated cost of \$3 million:

- Improving data integrity and analysis;
- Incorporating business intelligence and methodology along with process improvement techniques; and
- Linking agency scientific inventory and assessments to agency key performance metrics.

The timeline for these improvements is FY 2013 – 2014 to establish and transition to new tools and business models.

Management's Discussion and Analysis (Unaudited)

PERFORMANCE GOALS, OBJECTIVES, AND RESULTS

Mission Goal: Get More Conservation on the Ground

NRCS's core mission is delivered through one fundamental Strategic Goal: Get More Conservation on the Ground. This one mission goal encompasses all agency investments and impacts, as reflected in the Statement of Net Cost (SNC) table. The NRCS strategic goal directly supports USDA Strategic Goal 2: Ensure Our National Forests and Private Working Lands are Conserved, Restored, and Made More Resilient to Climate Change, While Enhancing our Water Resources. The strategic plan identifies six long-term Strategic Performance Measures. These performance measures are tracked annually using Key Performance Measures (KPMs) and targets. KPMs provide a direct indication of progress in achieving the Strategic Plan measures identified for the NRCS Strategic Goal and are used in the Budget and Annual Performance Plan (APP) and reported in the MD&A. The long-term Strategic Performance Measures and the annual KPMs, are shown below, excerpted from NRCS 2011-2015 Strategic Plan Implementation & Appendices.

Long-term Strategic Performance Measures	Key Performance Measures (KPM)
Maintain productive working farms and ranches	Cropland with conservation applied to improve soil quality, acres
	Grazing and forest land with conservation applied to protect and improve the resource base, acres
	Prime, unique and important farmland protected from conversion to non-agricultural uses by conservation easements, acres
Eliminate and reduce impairments to water bodies and help prevent the designation of additional water bodies to the "impaired" list	Land with conservation applied to improve water quality, acres
	Wetlands created, restored or enhanced, acres
	Priority landscapes with high impact, targeted conservation practices applied to improve water, acres
Decrease threats to "candidate" and threatened/endangered species	Non-Federal land with conservation applied to improve fish and wildlife habitat quality, acres
	Wetlands created, restored or enhanced, acres
Increase number of conservation practice standards that address emerging issues (such as energy)	In Development
Increase conservation treatments in critical areas	Priority landscapes with high impact, targeted conservation practices applied to improve water, acres
	Non-Federal land with conservation applied to improve fish and wildlife habitat quality, acres
	Wetlands created, restored or enhanced, acres
Increase number of agreements to provide agricultural producers "certainty" that they will comply with Federal environmental regulations	In Development

Table 1: Key Performance Measures (KPM)

Management's Discussion and Analysis (Unaudited)

Performance Goals and Results

The following scorecards display NRCS's key performance measure accomplishments as related to the NRCS Strategic Plan, Mission Goal: Get More Conservation on the Ground. The Key Performance Measures in the second column are the USDA measures, under the USDA Strategic Goal 2: Ensure Our National Forests and Private Working Lands are Conserved, Restored, and Made More Resilient to Climate Change, While Enhancing our Water Resources.

Performance Scorecard for Fiscal Year 2012								
USDA Objectives	Key Performance Measures	Trend ¹				Fiscal Year 2012		
		FY 2008	FY 2009	FY 2010	FY 2011	Target	Actual	Result ²
2.1 Restore and Conserve the Nation's Forests, Farms, Ranches, and Grasslands	2.1.2 Cropland with conservation applied to improve soil quality (Conservation Technical Assistance (CTA) - millions of acres)	8.3	7.6	8.2	8.2	7.3	8.7	Exceeded
	2.1.3 Cropland with conservation applied to improve soil quality (Environmental Quality Incentive Program (EQIP) - millions of acres)	5.6	4.8	4.8	4.6	4.8	4.6	Met
	2.1.4 Grazing land and forest land with conservation applied to protect and improve the resource base (CTA, millions of acres)	16.5	16.0	17.6	17.1	15.1	17.1	Exceeded
	2.1.5 Grazing land and forest land with conservation practices applied to protect and improve the resource base (EQIP, millions of acres)	16.9	17.2	17.5	16.3	16.2	17.2	Met
	2.1.6 Prime, unique, or important farmland protected from conversion to nonagricultural uses by conservation easements (Farm and Ranchlands Protection Program (FRPP), thousands of acres)	27.4	38.3	53.9	51.5	45.0	45.2	Met
	2.1.7 Non-Federal land with conservation applied to improve fish and wildlife habitat quality (WHIP, thousands of acres)	316.9	335.4	876.9	1,279.0	700.0	887.0	Exceeded
	2.1.8 Non-Federal land with conservation applied to improve fish and wildlife habitat quality (EQIP), millions of acres	4.8	5.2	6.0	4.8	5.0	6.2	Exceeded
2.2 Protect and enhance America's water Resources	2.2.1 Land with conservation applied to improve water quality (CTA, millions of acres)	8.7	20.5	22.3	24.0	20.0	23.8	Exceeded
	2.2.2 Land with conservation applied to improve water quality (EQIP millions of acres)	14.8	14.5	14.2	14.5	16.0	13.6	Unmet ⁴
	2.2.3 Wetlands created, restored or enhanced - Wetlands reserve Program (WRP, millions of acres)	128.9	106.4	129.1	131.8	175.0	189.0	Met
	2.2.4 Critical and / or impaired watersheds with high impact targeted conservation practices applied to improve water quality CTA (millions of acres)	N/A	N/A	1.9	1.8	1.7	1.5	Met
¹ The sources of data for all performance measures are the National Conservation Planning Database (NCP), the Program Contracts Database (Pro Tracts) and the Performance Results System (PRS).								
² Rationale for Met Range: Estimated performance October 1, 2011 through September 30, 2012. Data assessment metrics to meet the target allow for an actual number in the range of 90%- 110% of the target.								
³ Critical and / or impaired watersheds with high impact targeted conservation practices applied to improve water quality was new in 2010.								
⁴ Description of Actions and Schedules In FY2012, USDA met its target for helping producers apply conservation practices to improve water quality for the CTA program, but did not meet the target for EQIP. While the Department did assist producers with implementing estimated 13.6 million EQIP conservation acres to improve water quality, it was short by 2.4 million acres, which was only 85 percent of the projected performance. USDA is expected to achieve its fiscal target for EQIP overcoming the barriers including seasonality of conservation applications and impacts of drought. Several factors contributed to the shortfall this year. Drought conditions and projected reduced income for producers were impediments to conservation practice implementation during the 2012 crop season. Not only were producers focused on the urgent production needs such as irrigation management and other operational issues related to the drought, they also have a requirement that a portion of the costs to establish the conservation practices. With the projected decreased crop income, practice implementation is being delayed. In addition, many of the vegetative practices that did not establish due to lack of rainfall will need to be reseeded, and delay additional practice implementation as well.								

Table 2: Performance Scorecard for FY 2012 - Trends, Targets and Results

Management's Discussion and Analysis (Unaudited)

Performance Data Verification and Validation

NRCS regularly collects program performance data through the Accountability Information Management System (AIMS). AIMS is a set of data collection tools, processes, and related software that provides information on a routine basis to support the agency's strategic and performance planning, budget formulation, workforce planning, and accountability activities. NRCS tracks and evaluates field and state level conservation planning efforts and practice implementation through the Performance Results System (PRS).

- **Completeness of Data** – The reported performance measures are based on data reported through September 30, 2012. Numerous data quality mechanisms within PRS ensure the completeness of each performance record entry. Each performance record must adhere to a set of quality assurance requirements during the upload process. Business rules, definitions, and internal controls enforce accountability policies or business requirements and diagnose potential entry errors. Error reports are generated for managers at multiple levels to review for completeness or rejected entries, including the Strategic Planning and Accountability Deputy Area staff. On an annual basis the State Conservationists certify that the data is complete.
- **Reliability of Data** – The data reported for performance measures was determined within PRS based on information validated and received from the National Conservation Planning (NCP) database and the Program Contracts System (ProTracts). ProTracts is a web-enabled application used to manage NRCS conservation program applications, cost share contracts, and program fund management. Conservation plans are developed in consultation with the customer, created with the Customer Service Toolkit (Toolkit), and warehoused in the NCP. Applied conservation practices are date-stamped, geo-referenced, and linked to employee ID, enabling detailed quality-assurance reviews. Periodic reviews are conducted by state office and headquarters personnel to assess the accuracy of reported data.
- **Quality of Data** – The data is reported by field staff located where the conservation is occurring. Field staff are trained and skilled in conservation planning and application suited to the local resource conditions. Error checking enhancements and reports within the PRS application maintain data quality by allowing users at local, state, and national levels to monitor data inputs. NRCS designates key personnel, at both the state and national levels, to conduct quality assurance reviews periodically throughout the year to ensure the data is reliable and accurate. At the end of the fiscal year, each State Conservationist signs and certifies that the PRS data is valid, complete, and reliable.
- **Linking Performance to Programs** – To ensure program accountability and evaluate program efficiency, data on performance measures for conservation applied must be linked to the program that funded the staff time needed to carry out each activity. Where more than one program is used to apply practices on the same land unit, each program is credited under the performance measure. The chief sources of data for these performance measures are NCP, ProTracts, and PRS.
- **Limitations Associated with Performance Management Reporting** – Problems with performance management reporting are typically caused by errors in data entry. NRCS developed a number of software controls within PRS to ensure such errors are minimized.

Management's Discussion and Analysis (Unaudited)

Analysis of Entity's 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 \$7,057 million and total liabilities of \$1,077 million.

NRCS strives to provide relevant, reliable, and accurate financial information related to agency activities in producing the financial statements. The following tables reflect the comparative amounts as of September 30, 2012 and September 30, 2011.

Assets

NRCS reported \$7,057 million in assets as of September 30, 2012, representing a change of \$739 million compared with assets reported in FY 2011. Fund Balance with Treasury (FBwT) increased due to reduced spending for conservation practices primarily due to drought conditions and projected reduced income for producers. The Farm Bill's ending unobligated balance also increased by \$514 million in FY12. NRCS converted to USDA Financial Management Modernization Initiative (FMMI) in FY 2012. The accounts receivable module was not consistently available in the fourth quarter resulting in a large revenue accrual. The General Property, Plant and Equipment, net increase is caused by an increase in internal use software in development.

Assets (in millions)	FY 2012	FY 2011	Difference	Difference (Percentage)
Fund Balance with Treasury	\$6,638	\$5,970	\$668	11%
Accounts Receivable, Intragovernmental and Non-Intragovernmental, Net	118	40	78	195%
General Property, Plant and Equipment, Net	47	41	6	15%
Total Major Categories	\$6,803	\$6,051	\$752	12%
Other Asset Categories	\$254	\$267	(13)	(5%)
Total Assets	\$7,057	\$6,318	\$739	12%

Table 3: Assets as of September 30, 2012

Fund balance with Treasury is an asset account that represents the amount in the Agency'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 the SFFAC, FBWT is the aggregate amount for which the Agency is authorized to make expenditures and pay liabilities. This account includes general funds, which are funds appropriated by Congress, trust funds, clearing accounts and funds transferred from the Commodity Credit Corporation (CCC) using borrowing authority.

General Property, Plant, & Equipment, net (PP&E) consists of NRCS owned land and land rights, buildings, other structures and facilities, equipment, capital leases and internal use software. General PP&E includes the book value of one heritage asset, the Tucson Plant Materials Center in Tucson, Arizona, which is classified as a multi-use asset used in government operations.

Other assets include advance payments made to other entities in support of conservation. Active monitoring resulted in a reduction in advances.

Management's Discussion and Analysis (Unaudited)

Liabilities

NRCS reported \$1,077 million in liabilities as of September 30, 2012, representing a change of \$173 million over FY 2011. The increase in Accrued Liabilities for Grants is primarily due to a \$180 million increase in the Conservation Stewardship Program.

The major liability amounts are provided below.

Liabilities (in millions)	FY 2012	FY 2011	Difference	Difference (Percentage)
Intragovernmental Other Liabilities	\$70	\$63	\$7	11%
Accounts Payable	33	22	11	50%
Federal Employees and Veteran's Benefits	39	38	1	3%
Accrued Liabilities for Other Services	36	32	4	13%
Accrued Liabilities for Land and Structure	11	34	(23)	(68%)
Accrued Liabilities for Grants	745	560	185	33%
Accrued Payroll and Leave	128	139	(11)	(8%)
Other Liabilities	15	16	(1)	(6%)
Total Liabilities	\$1,077	\$904	\$173	19%

Table 4: Liabilities as of September 30, 2012

By law, Federal agencies cannot make outlays unless Congress has authorized and appropriated the funds and the Office of Management and Budget (OMB) has provided an apportionment. A portion of liabilities reported on the Balance Sheet is currently not funded by budgetary resources. Examples include unfunded employee costs for annual leave earned but not yet taken, and FECA benefits that are accrued to cover liabilities associated with employee deaths, disabilities, medical, and other approved costs for which funds have not yet been appropriated. These liabilities will be paid at the time the event occurs and will be expended from the current appropriations available at that time.

Net Position

NRCS reported a net position of \$5,980 million for the year ended September 30, 2012, representing a change of \$565 million over FY 2011. Net position represents unexpended appropriations consisting of undelivered orders as well as unobligated funds, and the cumulative results of operations.

The \$565 million is spread across all major NRCS programs including Conservation Operations, Farm Bill, and Watershed programs. Cumulative results of operations reflect the cumulative effect of financing in excess of expenditures and non-expenditure transfers from CCC.

Net Position (in millions)	FY 2012	FY 2011	Difference	Difference (Percentage)
Unexpended Appropriations	\$681	\$634	\$47	7%
Cumulative Results of Operations	5,299	4,781	518	11%
Total Net Position	\$5,980	\$5,415	\$565	10%

Table 5: Net Position for the year ended September 30, 2012

Management's Discussion and Analysis (Unaudited)

Net Cost of Operations

NRCS's net cost of operations were \$4,067 million for the year ended September 30, 2012, representing a decrease of \$243 million from September 30, 2011.

Net Cost of Operations (in millions)	FY 2012	FY 2011	Difference	Difference (Percentage)
Gross Cost	\$4,229	\$4,487	(\$258)	(6%)
Less: Total Earned Revenue	162	177	(15)	(8%)
Total Net Cost of Operations	\$4,067	\$4,310	(\$243)	(6%)

Table 6: Net Cost of Operations for the year ended September 30, 2012

Costs

NRCS program costs were \$4,229 million for the year ended September 30, 2012, representing a decrease of \$258 million from September 30, 2011. The decrease was largely due to reduced spending for conservation practices resulting from drought conditions and landowners' anticipated reductions in income.

Revenue

Earned revenue was \$162 million for the year ended September 30, 2012, including reimbursable agreements with other Federal agencies under the Economy Act as well as non Federal partners for providing technical assistance.

Budgetary Resources

NRCS's total budgetary resources were \$7,040 million for the year ended September 30, 2012, representing a change of \$776 million from September 30, 2011. The increase is due to reduced spending for conservation practices primarily due to drought conditions and projected reduced income for producers. The Farm Bill's ending unobligated balance also increased by \$514 million in FY12.

Budgetary Resources (in millions)	FY 2012	FY 2011	Difference	Difference (Percentage)
Budgetary Resources	\$7,040	\$6,264	\$776	12%

Table 7: Budgetary Resources for the year ended September 30, 2012

Management's Discussion and Analysis (Unaudited)

Analysis of Entity's Systems, Controls and Legal Compliance

FY 2012 Financial Statement Audit Report Results

In FY 2012 Kearney and Company, an independent auditing firm was engaged to audit the financial statements of NRCS. The auditors identified internal control deficiencies resulting in five material weaknesses, two significant deficiencies, and one finding on non-compliance with laws and regulations. Since Kearney and Company did not receive timely and competent evidential material, they did not express an opinion on these financial statements. They identified issues with beginning balances, current year activity, and associated disclosures related to accounts receivable, easements, advances, accounts payable and accruals, benefit liabilities, capital lease liability, net position, unobligated balances, budgetary transfers, and property, plant and equipment.

Management Assurances

Federal Managers' Financial Integrity Act (FMFIA) of 1982

NRCS management is responsible for developing and maintaining effective internal controls to ensure the efficiency and effectiveness of operations, reliability of financial reporting, compliance with applicable laws and regulations, and the safeguarding of assets. Internal control encompasses accounting and administrative controls. Such controls include program, operational, and administrative areas, as well as accounting and financial management.

In FY 2012, NRCS's independent auditors, Kearney and Company, reported the following Material Weaknesses in internal controls relating to:

- Financial Reporting,
- Property, Plant and Equipment,
- General Accounting Operations
- Accrued Expenses, and
- Reimbursable Agreements.

Additionally, Kearney and Company reported the following significant deficiencies: Undelivered Orders and Information Technology.

Management has conducted its annual evaluations of internal control and financial systems, pursuant to Section 2 and Section 4 of FMFIA, respectively, for the period ended September 30, 2012.

Given the material weaknesses noted above and based on the results of the evaluations, NRCS management provides qualified assurance that internal controls are operating effectively as of September 30, 2012. However, management asserts that improvements have been made in the following areas:

- **Unliquidated Obligations:** Significant improvements in the validity and accuracy of unliquidated obligations were achieved as a result of quarterly reviews using the Review of Open Obligations Tool (ROOT) as well as oversight and monitoring from National Headquarters. This audit finding was reduced from a material weakness to a significant deficiency.
- **Purchase and Fleet Cards:** Significant improvements were achieved for this prior audit finding which was fully remediated during FY 2012. Actions taken by the agency included new procedures, training, and monitoring to ensure adherence to requirements.

Federal Managers' Financial Integrity Act Action Plans

NRCS management has dedicated resources to remediating all audit findings. Findings under remediation relate to the validity of open obligations and accruals; internal controls over financial reporting; the completeness of reimbursable agreements; accuracy and completeness of leases and owned property.

Management's Discussion and Analysis (Unaudited)

The following table provides information regarding the status of all existing material weaknesses and significant deficiencies.

Identifier	Weakness Category	Year Identified	Original Estimated Completion Date	Actual Completion Date	Revised Completion Date
Section 2: Internal Controls					
Undelivered Orders					
OIG Audit: 10401-4-FM	MW	2010	11/30/2013		
OIG Audit: 10401-1-11	MW	2011			
OIG Audit: 10401-1-12	SD	2012			
General Accounting Operations					
OIG Audit: 10401-1-12	MW	2012	TBD		
Reimbursable Agreements / Unfilled Customer Orders					
OIG Audit: 10401-2-FM	MW	2008	9/30/2009		11/30/2013
OIG Audit: 10401-3-FM	MW	2009			
OIG Audit: 10401-4-FM	MW	2010			
OIG Audit: 10401-1-11	SD	2011			
OIG Audit: 10401-1-12	MW	2012			
Accrued Expenses					
OIG Audit: 10401-3-FM	MW	2009	9/15/2010		11/30/2013
OIG Audit: 10401-4-FM	MW	2010			
OIG Audit: 10401-1-11	MW	2011			
OIG Audit: 10401-1-12	MW	2012			
Financial Reporting					
OIG Audit: 10401-2-FM	MW	2008	7/31/2009		11/30/2013
OIG Audit: 10401-3-FM	MW	2009			
OIG Audit: 10401-4-FM	MW	2010			
OIG Audit: 10401-1-11	MW	2011			
OIG Audit: 10401-1-12	MW	2012			
Property Management / PP & E					
OIG Audit: 10401-2-FM	MW	2008	9/30/2009		11/30/2013
OIG Audit: 10401-3-FM	MW	2009			
OIG Audit: 10401-4-FM	MW	2010			
OIG Audit: 10401-1-11	MW	2011			
OIG Audit: 10401-1-12	MW	2012			
General & Application Access Controls					
OIG Audit: 10401-4-FM	MW	2010	9/30/2012		9/30/2013
OIG Audit: 10401-1-11	MW	2011			
OIG Audit: 10401-1-12	SD	2012			
Purchase Card Management / Fleet Card Transactions					
OIG Audit: 10401-1-11	SD	2011	3/31/2012		11/30/2012
Weakness Categories: SD = Significant Deficiency MW= Material Weakness					

Table 8: Federal Managers' Financial Integrity Act Action Plans

Management's Discussion and Analysis (Unaudited)

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

In FY 2012, NRCS completed an assessment of the effectiveness of internal controls over financial reporting. The assessment included an evaluation of entity level controls, risk assessments, process descriptions and flowcharts, documentation of key controls, an assessment of the design of key controls, tests of operating effectiveness of properly designed controls, summary of deficiencies, and the development of corrective action plans for control deficiencies. Key controls in the following cycles/processes were identified and reviewed: Grants Management, Human Resources, Reimbursable Agreements, Funds Control and Funds Control Management. Financial reporting was not tested this year as NRCS is in the process of redefining the business processes for preparing and reviewing financial reports. NRCS received Department concurrence for not testing financial reporting in FY 2012. The Department will require this area to be tested in FY 2013.

Additionally, various Information Technology access, personnel security and account activity controls were reviewed and tested. Our testing revealed deficiencies related to the award and close out processes for grants, monitoring advances, payroll master file maintenance, access control, configuration management and personnel security.

The following table outlines the deficiencies noted in FY 2012 and the status of the corrective action plans reported to the Department as part of the A-123 process.

Management's Discussion and Analysis (Unaudited)

Identifier	Short Title	Weakness Category	Year Identified	Original Estimated Completion Date	Actual Completion Date	Revised Completion Date
Section 2:						
Financial Reporting						
CAP Ref # 2011.10.09.001	Other Proprietary and Budgetary Reporting; User Access and GL Maintenance; Journal Entry Processing; Monitoring Period End Reporting; Significant Management Estimates	MW	2008	02/28/2012		11/30/2013
Human Resources						
CAP Ref # 2011.10.03.002	Reporting and Monitoring	SD	2011	9/30/2011		11/30/2013
CAP Ref # 2012.10.03.005	Personnel and Payroll Master Filed Maintenance- SINQ Report	SD	2012	09/30/2013		
CAP Ref # 2012.10.03.006	Time and Attendance Leave Balances	SD	2012	12/31/2012		
CAP Ref # 2012.10.03.007	Time and Attendance Leave Balances	SD	2012	12/31/2012		
CAP Ref # 2012.10.03.008	Personnel and Payroll Master Filed Maintenance- Access Profile	SD	2012	09/30/2013		
Funds Control Management						
CAP Ref # 2011.10.02.001	Allowances - Initial and Transfer	SD	2011	09/30/2012		09/30/2013
CAP Ref # 2012.10.02.001	Budget Authority	MW	2012	09/30/2013		
Grants Management						
CAP Ref # 2012.10.07.001	Awards/Obligations	SD	2012	09/30/2013		
CAP Ref # 2012.10.07.004	Closeout- Non-Protracts	SD	2012	09/30/2013		
CAP Ref # 2012.10.07.003	Advance Payments - Non Protracts	SD	2012	09/30/2013		
Section 4:						
Tracking Audit Findings						
POAM ID # 11529	General Computer Controls- Audit Monitoring, Analysis and Reporting (ProTracts)	CD	2009	11/30/2010		09/30/2012
POAM ID # 13538	General Computer Controls- Audit Monitoring, Analysis and Reporting (WebTCAS)	CD	2010	09/30/2011		09/30/2012
POAM ID # 15120	General Computer Controls - Lack of NFR Tracking	CD	2010	09/30/2011		09/30/2012
POAM ID # 17980	General Computer Controls - Audit Generation	CD	2012	09/30/2013		

Management's Discussion and Analysis (Unaudited)

Identifier	Short Title	Weakness Category	Year Identified	Original Estimated Completion Date	Actual Completion Date	Revised Completion Date
Section 4:						
Access Control						
POAM ID # 11536	General Computer Controls-Account Management	CD	2009	12/31/2011		12/31/2012
POAM ID # 11541	General Computer Controls-Account Management	CD	2009	11/15/2011		11/15/2012
POAM ID # 11555	General Computer Controls-Account Management	CD	2009	10/31/2011	05/07/2012	
POAM ID # 15115	General Computer Controls-Account Management	CD	2010	09/30/2011		12/30/2012
POAM ID # 13189	General Computer Controls-Account Management	CD	2011	09/30/2011	08/27/2011	
POAM ID # 13192	General Computer Controls-Supervision and Review of Access Controls	CD	2011	09/30/2011	11/04/2011	
POAM ID # 13204	General Computer Controls-Access Control Policies and Procedures	CD	2011	12/31/2011	10/13/2011	
POAM ID # 13440	General Computer Controls-Remote Access Reviews	CD	2010	09/30/2011	5/17/2012	
POAM ID # 13975	General Computer Control- Multi Factor Authentication	CD	2010	09/30/2011		12/30/2013
POAM ID # 15111	General Computer Controls - Supervision and Review of Access Controls	CD	2010	09/30/2011		12/30/2012
POAM ID # 15112	General Computer Controls - User ID and Authentication	CD	2010	09/30/2011		12/30/2013
POAM ID # 15113	General Computer Controls-Access Control Policies and Procedures	CD	2010	09/30/2011	9/10/2012	
POAM ID # 15114	General Computer Controls-External Information System Services	CD	2010	09/30/2011		11/30/2012
POAM ID # 16012	General Computer Controls-Timeliness of Employee Separation Actions	CD	2010	09/30/2011		11/30/2012
POAM ID # 16569	General Computer Controls-Access Management	CD	2010	09/30/2012		11/30/2012
POAM ID # 17991	General Computer Controls-Access Management	CD	2012	09/30/2013		
POAM ID # 17992	General Computer Controls-Access Management	CD	2012	09/30/2013		

Management's Discussion and Analysis (Unaudited)

Identifier	Short Title	Weakness Category	Year Identified	Original Estimated Completion Date	Actual Completion Date	Revised Completion Date
Section 4:						
Configuration Management						
POAM ID # 17981	General Computer Controls-Configuration Change Control	CD	2012	09/30/2013		
POAM ID # 17988	General Computer Controls-Configuration Change Control	CD	2012	09/30/2013		
POAM ID # 17989	General Computer Controls-Access Restriction for Change	CD	2012	09/30/2013		
Personnel Security						
POAM ID # 15116	General Computer Controls - Personnel Security Policy and Procedures	CD	2010	09/30/2011		11/30/2012
POAM ID # 15117	General Computer Controls - Personnel Screening	CD	2010	09/30/2011		11/30/2012
POAM ID # 15118	General Computer Controls - Security Accreditation	CD	2010	09/30/2011	9/28/2011	
POAM ID # 15119	General Computer Controls - Security Accreditation	CD	2010	09/30/2011	9/28/2011	
POAM ID # 17914	General Computer Controls - Personnel Transfer	CD	2012	09/30/2013		
POAM ID # 17983	General Computer Controls - Personnel Termination	CD	2012	09/30/2013		
POAM ID # 17990	General Computer Controls - Personnel Transfer	CD	2012	09/30/2013		
Tracking Account Activity						
POAM ID # 11531	General Computer Controls-Auditable Events	CD	2009	08/30/2011	10/28/2011	
POAM ID # 13211	General Computer Controls-Auditable Events	CD	2010	09/30/2011	8/27/2012	
POAM ID # 17980	General Computer Controls-Audit Generation	CD	2012	09/30/2013		
Tracking Vulnerabilities						
POAM ID # 16613	General Computer Controls - System Communication and Protection (WebtCAS)	CD	2012	09/30/2012	09/20/2012	
POAM ID # 16666	General Computer Controls - Incident Response - Month to Month Vulnerability Without Remediation	CD	2012	09/30/2012	09/29/2012	
Weakness Categories: SD = Significant Deficiency MW=Material Weakness CD = Control Deficiency						

Table 9: Deficiencies and Corrective Action Plan Status

Management's Discussion and Analysis (Unaudited)

Federal Financial Management Improvement Act (FFMIA) of 1996

NRCS management evaluated its financial management systems under FFMIA for the period ended September 30, 2012. Based on the results of our evaluation, we have disclosed instances where NRCS' financial management systems did not substantially comply with Federal Financial Management System Requirements, Federal accounting standards, and the United States Standard General Ledger (USSGL) at the transaction level as of September 30, 2012.

Information, Security, Policies, Procedures and Practices deficiencies have been noted in FY 2012 related to user access administration, user access privileges, user access controls and multi-factor authentication for remote access.

The following table outlines the deficiencies noted and the status of the corrective action plans.

Identifier	Year Identified	Original Estimated Completion Date	Actual Completion Date	Revised Completion Date
Section 1: Federal Financial Management Systems Requirements				
Non Compliance with Federal Financial Management Systems Requirements				
OIG-10401-2-FM	2008	07/31/2009		11/30/2013
OIG-10401-3-FM	2009			
OIG-10401-4-FM	2010			
OIG-10401-1-11	2011			
OIG-10401-2-11	2012			
Section 2: Applicable Federal Accounting Standards				
Non Compliance with Federal Accounting Standards				
OIG-10401-2-FM	2008	07/31/2009		11/30/2013
OIG-10401-3-FM	2009			
OIG-10401-4-FM	2010			
OIG-10401-1-11	2011			
OIG-10401-2-11	2012			
Stewardship Reporting				
OIG-10401-2-FM	2008	07/31/2009		11/30/2013
OIG-10401-3-FM	2009			
OIG-10401-4-FM	2010			
OIG-10401-1-11	2011			
OIG-10401-2-11	2012			

Management's Discussion and Analysis (Unaudited)

Identifier	Year Identified	Original Estimated Completion Date	Actual Completion Date	Revised Completion Date
Section 3: Standard General Ledger at the Transaction Level				
Non Compliance with USSGL				
OIG-10401-2-FM	2008	07/31/2009		11/30/2013
OIG-10401-3-FM	2009			
OIG-10401-4-FM	2010			
OIG-10401-1-11	2011			
OIG-10401-2-11	2012			
Section 4: Information Security, Policies, Procedures and Practices				
General and Application Access Controls				
OIG-10401-4-FM	2010	09/30/2012		11/30/2013
OIG-10401-1-11	2011			
OIG-10401-2-11	2012			

Table 10: FFMIA Table of Deficiencies and Status of Corrective Action Plans

Compliance with Laws and Regulations

The FY 2012 audit noted that NRCS is not substantially complying with FFMIA. NRCS was unable to provide sufficient evidential matter to support certain transactions and account balances, as presented in the NRCS financial statements as of, and for the year ended September 30, 2012, particularly with respect to compliance with Federal accounting standards for easements, leases, revenue, real and personal property, and validation of accrual methodology for accounts payable and grants. In addition, some transactions were not recorded at the transaction level in accordance with USSGL. NRCS was unable to complete corrective actions and make adjustments, as necessary, to these and other financial statement amounts prior to the contractually required completion date of the engagement.

Federal Information Security Management Act (FISMA) of 2002

FISMA provides the framework for securing the Federal Government 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 Office of Inspector General evaluations. NRCS's security deficiencies are tracked in FISMA Plan of Actions and Milestones (POAM), which is updated monthly and reported to USDA quarterly for inclusion in its FISMA Report to OMB.

FY 2012 audit noted deficiencies for related to user access administration, user access privileges, user access controls.

Improper Payments Elimination and Recovery Act (IPERA)

Improved financial performance through the reduction of improper payments continues to be a key financial management focus for the Federal government. The IPERA 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. Per guidance provided by USDA, agency programs deemed high risk are required to be tested on an annual basis. Programs deemed low risk are required to be tested on a rotational basis.

All of NRCS's Farm Security and Rural Investment Act of 2002 and the Food Conservation and Energy Act of 2008 (Farm Bill) financial assistance payments are considered to be high risk and require testing every year. NRCS's Farm Bill technical assistance payments and payments related to other non-Farm Bill programs (ex. Soil Survey programs) are considered low risk and are tested on a rotational basis.

Management's Discussion and Analysis (Unaudited)

Per Department guidance, all Farm Bill financial assistance (high risk) and Watershed program (low risk) payments were statistically sampled and tested in FY 2012. As a result of this testing, one high risk overpayment totaling \$276 was identified. High risk improper payments were extrapolated to the entire high risk population. The extrapolated high risk payments totaled \$390,774. Additionally, low risk improper payments totaling \$38,156 were identified. The extrapolated low risk payments totaled \$776,918.

Improper payments are also identified by the Office of the Inspector (OIG) program audits. In FY 2012, an OIG audit investigation disclosed that an entity knowingly submitted false claims and caused overpayments by NRCS totaling \$716,563. NRCS referred the matter to the Department of Justice (DOJ) to expedite any criminal and/or civil prosecution that may be required. DOJ settled the case and recovered \$63,050 on NRCS's behalf.

Additionally, NRCS identifies improper payments through self reporting by states/centers. On a quarterly basis, states/centers are required to report all improper payments and recoveries of improper payments. Self-reported improper payments include payments made regarding ineligible land, duplicate payments, and payments made to the wrong payee.

NRCS actively pursues improper payments. If improper payments are discovered, NRCS takes aggressive steps to recover the funds. A demand letter is sent to participants explaining that an improper payment has been made and requesting that the funds be returned to NRCS. As a follow-up to the demand letter, a bill is sent to the participant requesting payment within 30 days. Participants may appeal, but if the appeal efforts prove unsuccessful, the participant must repay the amount in full. If the debt is not paid within 180 days, the debt will be referred to the U.S. Department of Treasury's Treasury Offset Program for collection. Once this happens, before a debtor receives a payment from any federal source (e.g., tax refunds), the debt will be withheld from the federal payment and returned to NRCS.

The chart below is a summary of NRCS's improper payments and related recoveries as of September 30, 2012:

Improper Payments and Recoveries as of September 30, 2012		
Source	Improper Payment Amount Identified Current Year	Improper Payment Amount Recovered Current Year
Statistical Samples	\$38,432	\$0
Self reported by states/centers	\$4,741,567	\$4,009,006
OIG & GAO Audits	\$716,563	\$63,050
Total	\$5,496,562	\$4,072,056

Table 11: Improper Payments and Recoveries

Anti-Deficiency Act

The Antideficiency Act prohibits federal employees from :

- making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation or fund in excess of the amount available in the appropriation or fund unless authorized by law;
- involving the government in any obligation to pay money before funds have been appropriated for that purpose, unless otherwise allowed by law;
- accepting voluntary services for the United States, or employing personal services not authorized by law, except in cases of emergency involving the safety of human life or the protection of property; and
- making obligations or expenditures in excess of an apportionment or reappropriation, or in excess of the amount permitted by agency regulations.

Management's Discussion and Analysis (Unaudited)

Federal employees who violate the Anti-deficiency Act are subject to two types of sanctions: administrative and penal. Employees may be subject to appropriate administrative discipline including, when circumstances warrant, suspension from duty without pay or removal from office. In addition, employees may also be subject to fines, imprisonment, or both.

No violations of the Anti-Deficiency Act have been identified or reported in FY 2012.

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.

Management's Discussion and Analysis (Unaudited)

GAO/OIG Active Audits

A summary of Government Accountability Office (GAO)/OIG active audits listed below provides an overview of the current external audit activities in progress within the agency. After the final report has been provided to NRCS, NRCS may have several audit recommendations to complete before the audit is officially closed.

GAO/OIG Active Audits for the year ended September 30, 2012			
Active Audit Number/Name	Start Date	Final Report Date	Audit Status
OIG-10099-3-CH Controls over the Farm and Ranch Lands Program	3/16/2010	9/14/2011	CLOSED
GAO- 450909 Protection of Federal Workforce in a Pandemic Influenza	8/2/2011		OPEN
OIG 10024-1-11 Fiscal Year 2011 NRCS Improper Payment Review	6/16/2011	5/18/2012	OPEN
OIG-10704-1-32 - Migratory Bird Habitat Initiative: NRCS' Response to Issues Caused by the Deepwater Horizon/BP (British Petroleum) Oil Spill	1/13/2011		OPEN
OIG-10099-6-SF - Farm and Ranch Lands Protective Program - Review of Non-Governmental Organizations	5/1/2007	7/6/2009	CLOSED
OIG-10601-6-KC - Disaster Assistance EWP	1/12/2009	4/5/2011	OPEN
GAO-360644 - USDA Funding for EQIP	10/1/2005	9/1/2006	OPEN
OIG-10601-04-KC - Conservation Security Program	11/1/2006	6/1/2009	OPEN
OIG-50601-18-Te - Pasture, Rangeland, and Forage Pilot Program	3/24/2008	9/29/2010	OPEN
GAO-440979- Equal Access to Justice Act (EAJA)	5/26/2011		CLOSED
OIG-10401-2-FM - NRCS Financial Statement Audit FY08	1/10/2008	11/13/2008	OPEN
OIG-10401-3-FM - NRCS Financial Statement Audit FY09	10/1/2009	11/10/2009	OPEN
OIG-10401-4-FM - NRCS Financial Statement Audit FY 2010	1/1/2010	11/18/2010	OPEN
OIG-10401-1-11 - NRCS Financial Statement Audit FY11	2/28/2011	11/8/2011	OPEN
OIG-10401-2-11 - NRCS Financial Statement Audit FY12	3/6/2012		OPEN
GAO-361318 Federal Farm Program Direct Payment	7/26/2011		OPEN
GAO- 361251 -Nonpoint Source Water Pollution	11/29/2010		OPEN
OIG 50501-2-12 Federal Information Security Management Act	6/16/2011		CLOSED
GAO-361185 - Renewable Energy Initiatives	4/5/2010		CLOSED
OIG-10601-0001-22 Oversight and Compliance Activities	8/1/2011		OPEN
OIG 10703-1-AT - ARRA - Rehabilitation of Flood Control Dams	9/1/2010		OPEN

Management's Discussion and Analysis (Unaudited)

GAO/OIG Active Audits for the year ended September 30, 2012			
Active Audit Number/Name	Start Date	Final Report Date	Audit Status
OIG-10703-4-KC - Watershed Protection and Flood Prevention Operations Program -Phase II (Field Communications)	7/15/2010		OPEN
OIG-10703-1-KC - ARRA Emergency Watershed Protection Program (phase 1)	4/2/2009	9/1/2010	OPEN
OIG 10703-5-KC - NRCS American Recovery Reinvestment Act- Emergency Watershed Protection Program Floodplain Easements - Phase II (Field Communications)	7/15/2010		OPEN
OIG-10703-3-KC - ARRA Emergency Watershed Protection Program (phase 2)	1/22/2010	3/14/2012	OPEN
OIG-50024-0001-11 - Improper Payment Elimination and Recovery Act Compliance Review	11/21/2011	5/18/2012	OPEN
GAO-361397 USDA Payments to the Deceased	4/2/2012		OPEN
GAO-361418 - USDA Implementation of adjusted gross income limitation for Farm Programs	6/7/2012		OPEN
GAO-361379 - Federal Wind Energy Initiatives	2/3/2011		OPEN
GAO-310974 - Implementing Provisions of the E-Government Act of 2002	1/9/2012		OPEN
GAO-541085 - Trends Federal Vehicle Fleets	2/22/2012		OPEN
GAO-361351 - USDA Civil Rights Progress	11/30/2011		OPEN
OIG-50024-0002-11 Calendar Year 2011 Executive Order 13520, Reducing Improper Payments, High-Dollar Report Review	11/21/2011		OPEN
GAO-361388 - Energy Water Nexus Capping	2/27/2012		OPEN
GAO-361356 - Duplication in Federal Invasion Species Programs	12/1/2011		OPEN
GAO-361361 - Climate Change Adaptation in Natural Resources	12/5/2011		OPEN
OIG-10703-0001-31 - American Recovery and Reinvestment Act-Emergency Watershed Protection Program-Floodplain Easements and Watershed Operations Program-Phase III	2/9/2012		OPEN
GAO-830842 - Cost Savings in Federal Government Satellite Programs	5/3/2012		OPEN

Management's Discussion and Analysis (Unaudited)

GAO/OIG Active Audits for the year ended September 30, 2012			
Active Audit Number/Name	Start Date	Final Report Date	Audit Status
GAO-320886 - Feed the Future Initiative	1/6/2012		OPEN
GAO-361404 - Great Lakes Restoration Initiatives	7/6/2012		OPEN
OIG- 50703-02-DA - Analysis of Jobs Reported for American Recovery and Reinvestment Act-USDA FederalReporting.gov Data Quality Review	1/19/2012		OPEN
GAO -541098- Federal Vehicle Fleet Management	8/29/2012		OPEN
GAO - 544182- Remanufactured Vehicle Parts	8/28/2012		OPEN

Table 12: GAO/OIG Active Audits Summary Report - as of September 30, 2012

Management's Discussion and Analysis (Unaudited)

Other Management Information, Initiatives, and Issues

Financial Management Initiative

NRCS management focused resources to remediate audit weaknesses and deficiencies. Key elements of the agency audit remediation plan include:

- A detailed project plan to define and monitor required actions;
- NRCS senior executives assigned to serve as Executive Sponsors for each of the material weaknesses and significant deficiencies;
- State Conservationists assigned as members of Sounding Boards for Material Weakness teams;
- NRCS Team Leaders and additional personnel assigned for each material weakness and significant deficiency;
- Weekly status reports produced for each material weakness;
- Weekly status meetings with the NRCS Chief Financial Officer to identify and resolve issues and barriers to completing planned actions on schedule; and
- Monthly status meetings conducted by NRCS Chief Financial Officer with Executive Sponsors and Team Leaders to review progress and ensure accomplishment of planned actions.

NRCS is committed to establishing a sound internal control environment, remediating audit findings and being a good steward of taxpayer dollars along with helping people help the land.

Streamlining Conservation Delivery

In early 2009, NRCS initiated the Conservation Delivery Streamlining Initiative (CDSI) with the purpose of implementing a more effective, efficient, and sustainable business model for delivering conservation (both technical and financial assistance) across the Nation. The CDSI has three overarching objectives:

- Simplify Conservation Delivery – The new business model will be easier for customers and employees.
- Streamline Business Processes – New streamlined business processes will increase operating efficiency and deliver technical and financial assistance in a fully integrated manner.
- Ensure Science-based Assistance – The new business model will enhance NRCS's ability to deliver science-based products and services.

CDSI is organized and staffed in the Office of the NRCS Chief to ensure an integrated approach rather than a stove-piped Agency-wide approach. Five major initiatives are being implemented during 2010-2015 that will allow field staff to spend as much as 75% of their time in the field with clients, minimize duplicate or excessive data entry for staff and clients, reduce administrative workload burden from the field planners, provide clients web-enabled access to USDA conservation programs, ensure sound conservation plans support all financial assistance, significantly shorten the administrative time for program delivery, and strengthen financial management of Farm Bill programs.

During 2012, NRCS conducted two major pilot efforts to evaluate streamlined and standardized business processes, as well as prototype business tools to implement those processes. These pilots included: (1) an evaluation in 8 states of a web-based portal (called Client Gateway) that allowed customers to work with NRCS 24/7, applying for programs, viewing contracts, checking on payments, and much more on-line; and (2) a pilot in 17 states of a new application that provisioned financial assistance support specialists with an application (called the Financial Assistance Desktop) that automated workflow and business processes between clients, NRCS technical staff in the field, and administrative staff – reducing the amount of time technical employees spend on program administration and streamlining program participation for clients. Both pilots were successful helping to guide the future of a more streamlined, integrated conservation delivery in NRCS. In addition to significant efficiencies for NRCS staff, CDSI estimates that implementing its streamlined processes and tools will save clients over 750,000 hours of time per year.

In March of 2012, NRCS leadership approved a new strategy to move forward establishing programs support specialist positions in states during 2012-2013 to ensure a more consistent organizational approach to performing program administration tasks and removing this non-technical burden from field technical staff. These staff would utilize the applications being developed through CDSI to ensure consistent streamlined business processes are used nationwide.

Management's Discussion and Analysis (Unaudited)

In February 2013, the Conservation Desktop will be released, with a phased implementation and testing approach that will allow national deployment across all 2700 field offices for the FY 2014 program year.

The first version of the Conservation Desktop focuses on enhancing technical assistance, with new functionality that integrates multiple existing tools, reduces data entry, improves the science behind NRCS' planning, and simplifies the products provided to clients. While enhancements to financial assistance processes are limited in version 1, a major new feature will include automated tasking and workflows between NRCS' technical employees and financial assistance programs support staff to increase the consistency, efficiency, and timeliness of NRCS business processes for delivering programs.

In addition to wider piloting of the Conservation Desktop during 2013, NRCS will be finalizing the requirements for version 2 of the Desktop, which will include full integration of financial assistance processes and the replacement of the current contract management application, Protracts.

The second version of the Desktop, as well as the Client Gateway application, will be deployed in mid- 2014.

Financial Management Modernization Initiative (FMMI)

NRCS converted from the USDA Foundation Financial Information System (FFIS) to the Financial Management Modernization Initiative (FMMI) system on May 1, 2012. FMMI is an integrated real time system providing improved functionality, accountability, internal controls, while streamlining financial processes. As a role-based application, access to the transactions and data provides for greater data integrity, reliability, and sharing across USDA.

Limitations of Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the NRCS, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with GAAP for Federal entities and the formats prescribed by 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



Natural Resources Conservation Service

Balance Sheet

As of September 30, 2012
(in Millions)

Assets (Note 2):		
Intragovernmental:		
Fund Balance with Treasury	Note 3	\$6,638
Accounts Receivable	Note 4	113
Other	Note 7	236
Total Intragovernmental		\$6,987
Accounts Receivable, Net	Note 4	5
General Property, Plant and Equipment, Net	Note 5	47
Other	Note 7	18
Total Assets		\$7,057
Stewardship PP&E	Notes 6 & 14	
Liabilities:		
Intragovernmental:		
Other	Notes 8 & 9	70
Total Intragovernmental		\$70
Accounts Payable		33
Federal Employee and Veteran's Benefits	Note 8	39
Accrued Liabilities for Other Services	Note 9	36
Accrued Liabilities for Grants	Note 9	745
Accrued Payroll and Leave	Note 9	128
Accrued Liabilities for Land and Structure	Note 9	11
Other	Note 9, 10	15
Total Liabilities		\$1,077
Commitments and Contingencies	Note 11	
Net Position:		
Unexpended Appropriations		681
Cumulative Results of Operations		5,299
Total Net Position		\$5,980
Total Liabilities and Net Position		\$7,057
The accompanying notes are an integral part of these statements.		

Unaudited – See accompanying independent auditors' report

Financial Statements



Natural Resources Conservation Service

Statement of Net Cost

for the Year Ended September 30, 2012
(in Millions)

Program costs:	Notes 12,13, 14, 15, and 20	
Get More Conservation on the Ground		
Gross Costs		\$4,229
Less: Earned revenue		162
Net Program Costs		\$4,067
Total Gross Costs:		\$4,229
Less: Total Earned Revenue		\$162
Net Cost of Operations		\$4,067
The accompanying notes are an integral part of these statements.		

Unaudited – See accompanying independent auditors' report

Financial Statements



Natural Resources Conservation Service

Statement of Changes in Net Position

for the Year Ended September 30, 2012
(in millions)

Cumulative Results of Operations:	
Beginning Balance	\$4,781
Beginning Balances, as adjusted	4,781
Budgetary Financing Sources:	
Appropriations used	1,001
Donations and forfeitures of cash and cash equivalents	1
Transfers in/out without reimbursement	3,425
Other Financing Sources (Non-Exchange):	
Imputed financing	158
Other	0
Total Financing Sources	4,585
Net Cost of Operations	(4,067)
Net Change	518
Cumulative Results of Operations	5,299
Unexpended Appropriations:	
Beginning Balance	\$634
Beginning Balance, as adjusted	\$634
Budgetary Financing Sources:	
Appropriations received	\$1,067
Other adjustments	(19)
Appropriations used	(1,001)
Total Budgetary Financing Sources	47
Total Unexpended Appropriations	681
Net Position	\$5,980
The accompanying notes are an integral part of these statements.	

Unaudited – See accompanying independent auditors' report

Financial Statements



Natural Resources Conservation Service

Statement of Budgetary Resources

for the Year Ended September 30, 2012
(in Millions)

Budgetary Resources:	
Unobligated balance, brought forward, October 1	\$1,873
Unobligated balance brought forward, October 1, as adjusted	1,873
Recoveries of prior year unpaid obligations	464
Other changes in unobligated balance	(13)
Unobligated balance from prior year budget authority, net	2,324
Appropriations (discretionary and mandatory)	4,484
Spending authority from offsetting collections (discretionary and mandatory)	232
Total budgetary resources	\$7,040
Status of Budgetary Resources:	
Obligations Incurred (Note 16,17,18,19,and 20)	\$4,602
Unobligated balance, end of year	
Apportioned	425
Unapportioned	2,013
Total unobligated balance, end of year	\$2,438
Total budgetary resources	\$7,040
Change in obligated balance:	
Unpaid obligations, brought forward, October 1 (gross)	\$4,254
Uncollected customer payments from Federal sources, brought forward, October 1	(159)
Obligated balance, start of year (net), before adjustments	4,095
Obligated balance, start of year (net), as adjusted	4,095
Obligations incurred	4,602
Outlays (gross)	(3,878)
Change in uncollected customer payments from Federal sources	(147)
Recoveries of prior year unpaid obligations	(464)
Obligated balance, end of year:	
Unpaid obligations, end of year (gross)	4,514
Uncollected customer payments from Federal sources, end of year	(306)
Obligated balance, end of year (net)	\$4,208
Budget Authority and Outlays, Net:	
Budget authority, gross (discretionary and mandatory)	\$4,716
Actual offsetting collections (discretionary and mandatory)	(85)
Change in uncollected customer payments from Federal sources (discretionary and mandatory)	(147)
Budget authority, net (discretionary and mandatory)	\$4,484
Outlays, gross (discretionary and mandatory)	\$3,878
Actual offsetting collections (discretionary and mandatory)	(85)
Outlays, net (discretionary and mandatory)	3,793
Distributed offsetting receipts	13
Agency outlays, net (discretionary and mandatory)	\$3,806
The accompanying notes are an integral part of these statements.	

Unaudited – See accompanying independent auditors' report

Notes to the Financial Statements

Notes to the Financial Statements for the year ended September 30, 2012

Note 1 – Significant Accounting Policies

A. Reporting Entity

The NRCS is a technical service agency within the 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 broadened its 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 2,700 field offices across the nation, providing services directly to our customers. Field office employees provide the technical expertise that helps enable land managers to balance their economic goals with the needs of the natural environment, while creating sustainable systems to produce abundant crops, livestock, and a quality environment. Field office staff work side by side with employees of the local conservation districts and state conservation agencies. Natural resource technology is developed and delivered through national centers (that focus on areas including 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 4 regions covering all 50 States, Caribbean Area (Puerto Rico), and the Pacific Basin Area; 3 National Technology Support Centers, and 9 National Centers. The centers provide focus on national initiatives and provide coordination and assistance for conservation work on a functional basis in support of all 50 states. The number of Regions was increased from three to four in FY 2012 when the East Region was subdivided into two separate Regions, Northeast and Southeast. These are in addition to the West and Central Regions. As line officers, State Conservationists report to their respective Regional Conservationists who report to the Chief.

Discretionary Programs

NRCS has discretionary funding appropriated by Congress to provide technical and financial assistance under four major programs: Conservation Operations, 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 Public Law (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.

Funding for the Resources Conservation and Development (RC&D) program was eliminated and closed out in FY 2011.

Farm Bill Programs

The 2002 and 2008 Farm Bills authorized NRCS to be responsible for administering program activities with funding provided through CCC borrowing authority. The CCC is a Government-owned and operated entity that was created to stabilize, support, and protect farm income and prices. The authorizing language in the 2008 Farm Bill specified that the funds, facilities, and authorities of CCC be used to administer various conservation programs.

NRCS receives mandatory funding from the 2008 Farm Bill to provide technical and financial assistance for the following programs: Wetlands Reserve Program, Healthy Forest Reserve Program, Farm and Ranchlands Protection Program, Environmental Quality Incentives Program which includes Agricultural Water Enhancement Program, Wildlife Habitat Incentives Program, Conservation Stewardship Program, Grassland Reserve Program, Agricultural Management Assistance Program, Conservation Reserve Program and the Chesapeake Bay Watershed Initiative. The funding for these programs is received from CCC through quarterly non-expenditure transfers for the estimated obligations to be incurred through the end of each quarter. Funding for Ground & Surface Water and Conservation Security Program was not reauthorized in the 2008 Farm Bill; however payments continue to be made for open obligations.

Unaudited – See accompanying independent auditors' report

Notes to the Financial Statements

In addition to the programs mentioned above, NRCS has four other initiatives. Three are authorized through the Farm Bill (Cooperative Conservation Partnership Initiative (CCPI), Conservation of Private Grazing Land (CPGL) and Socially Disadvantaged Ranchers and Beginning Farmers (SDRBR)). Conservation Innovation Grant (CIG) is funded through Environmental Quality Improvement Program (EQIP) and is a voluntary program which enables NRCS to work with other public and private entities to accelerate technology transfer and adoption of promising technologies and approaches to address some of the Nation's most pressing natural resource concerns. Under CCPI, NRCS enters into partnership agreements with eligible entities that want to enhance conservation outcomes on agricultural and nonindustrial private forest lands. CPGL is not currently funded. The CPGL initiative will ensure technical, educational, and related assistance is provided to those who own private grazing lands. SDRBR is funded through EQIP and CSP and provides voluntary participation, offers incentives, and focuses on the equity in accessing USDA programs and services.

Authorized funding for the Farm Bill Programs approximated \$3.4 billion for FY 2012.

B. Basis of Presentation and Accounting

The Balance Sheet (BS), Statement of Net Cost (SNC), Statement of Changes in Net Position (SCNP), and the Statement of Budgetary Resources (SBR) (hereinafter referred to as the "financial statements") were prepared to report the assets, liabilities and financial position; net costs; changes in net position; and budgetary resources of NRCS. The financial statements have been prepared from the books and records of NRCS in accordance with U.S. generally accepted accounting principles and in accordance with OMB Circular A-136, *Financial Reporting Requirements*, revised August 3, 2012, with the exception that the statements are not presented comparatively.

The 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. Budgetary accounting principles are designed to recognize the obligation of funds when actions occur that require the Government to make a payment in the future. The recognition of budgetary accounting transactions is essential for compliance with legal constraints and controls over the use of Federal funds.

NRCS converted from the USDA Foundation Financial Information System (FFIS) to the Financial Management Modernization Initiative (FMMI) system on May 1, 2012. FMMI is an integrated real time system providing improved functionality, accountability, internal controls, while streamlining financial processes. As a role-based application, access to the transactions and data provides for greater data integrity, reliability, and sharing across USDA.

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 general funds and discretionary appropriations, non-expenditure transfers, a clearing account, deposit fund, and trust funds that are available to pay liabilities and finance authorized expenditures.

D. Accounts Receivable

Accounts receivable transactions were processed under two different control environments in FY 2012 as a result of the conversion to the FMMI system. From October 1, 2011 through April 30, 2012, billings were initiated by NRCS personnel and billings and collections were processed by National Finance Center (NFC) Administrative Billings and Collections (ABCO) staff. ABCO established receivables, generated billing statements, managed aging activities, accrued interest and penalty charges, assessed administrative fees, and processed collections. Beginning on May 1, 2012, NRCS records amounts owed to NRCS in the FMMI system, issues billing documents, and manages the accounts receivable activity. The collections are deposited at a USDA lockbox managed by the USDA Office of the Chief Financial Officer, Comptroller Operations Division (OCFO/COD). An allowance for doubtful accounts is recorded quarterly for receivables with the public for the amount of receivables determined to be uncollectible based on historical experience.

E. General Property, Plant, and Equipment, Net

General PP&E includes real and personal property used in normal business operations, including NRCS's one multi-use heritage asset, the Tucson Plant Material Center (see note 6). Real and personal property are recorded at cost and have an estimated useful life of 2 years or more. NRCS's capitalization threshold for real and personal property is \$25,000. Internal use software is capitalized if the cost meets or exceeds \$100,000 and has a 2 year (or greater) useful life. NRCS scores capital leases in conformance with OMB Circular A-11: *Preparation, Submission, and Execution of the Budget and SFFAS No. 5, Accounting for Liabilities for the Federal Government and SFFAS No. 6, Accounting for Property, Plant and Equipment*. Under SFFAS No. 6 the cost of

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Notes to the Financial Statements

general PP&E acquired under a capital lease is equal to the amount recognized as a liability for the capital lease at its inception (net present value of the lease payments) unless the net present value exceeds the fair value of the asset.

F. Other Assets

Payments made in advance of the receipt of goods and services are recorded by NRCS 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 for GRP back to CCC to make payments to the landowners in the program on behalf of NRCS. CCC reports the actual GRP expenditures to NRCS on a monthly basis and NRCS makes appropriate adjustments to record the expense and decrease the advance because NRCS maintains administrative responsibility for the program.

G. Liabilities

Liabilities represent the probable and measurable future outflow of funds or other resources arising from past transactions or events. 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. The U.S. government acting in its sovereign capacity can abrogate liabilities. NRCS does not know of any limitations on the government's ability to abrogate liabilities.

H. 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.

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

J. Pension and Other Retirement Benefits

NRCS employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). FERS went into effect on January 1, 1987, pursuant to PL 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's 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.

K. Revenues and Other Financing Sources

NRCS has two major funding sources: Congressional appropriations for 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 and financial assistance

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Notes to the Financial Statements

payments to landowners. Other funding sources include reimbursable agreements with other Federal agencies, State and local governments, tribal agencies and the public.

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

In accordance with Federal government accounting guidance, NRCS classifies revenue as either "exchange revenue" or "non-exchange revenue". Exchange revenue arises from transactions where each party to the transaction gives 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. Unless otherwise noted, full cost is the total amount of direct and indirect resources used to produce a product or provide a service. NRCS pricing policies are set to recover full costs.

L. Imputed Financing

NRCS recognizes the amount of accrued pension and post-retirement benefit expenses for current employees as imputed financing costs. The assets and liabilities associated with such benefits are the responsibility of the administering agency, Office of Personnel Management (OPM). Any amounts paid from the Treasury Judgment Fund in settlement of claims or court assessments against NRCS are also recognized as imputed financing. Additionally, NRCS recognizes imputed financing of \$158 million as of September 30, 2012 for USDA headquarters allocations, Treasury Judgment Fund, and OPM.

M. Use of Estimates

Management has made certain estimates and assumptions when reporting assets, liabilities, revenue, and expenses. Actual results could differ from these estimates. Significant estimates underlying the accompanying financial statements include the majority of accrued liabilities and Federal employee benefits liabilities.

Note 2 – Non-entity Assets

The accompanying consolidated and combined financial statements of NRCS account for all funds under NRCS's control. Substantially all assets are considered "entity assets" and are available for use in NRCS operations. Non-Entity collections are on behalf of the Department of Treasury for receipt of interest, fines, miscellaneous receipts, and deposit accounts.

Notes to the Financial Statements

Note 3 - 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. Non-budgetary funds with Treasury consist of proceeds from vehicle sales, Intragovernmental Payment and Collections (IPAC), and funds on deposit from non-Federal entities. There are no reportable differences between Treasury and the agency's general ledger. NRCS has no unused funds in expired appropriations that have not been returned to the U.S. Treasury. See note 18 which describes NRCS's extended disbursing authority for Farm Bill Funds.

Fund Balance with Treasury (in millions)	2012
Fund Balances:	
Trust Funds	\$1
General Funds	6,645
Other Fund Types	(8)
Total	\$6,638

Status of Fund Balance with Treasury (in millions)	2012
Unobligated Balance:	
Available	\$425
Unavailable	2,013
Obligated balance not yet disbursed	4,208
Non-budgetary FBWT:	(8)
Total	\$6,638

Table 13: Fund Balance with Treasury as of September 30, 2012

Notes to the Financial Statements

Note 4 – Accounts Receivable, Net

Intragovernmental accounts receivable represent amounts due under reimbursable and cooperative agreements with Federal entities for services provided by NRCS under the Economy Act, U.S. Code 1535. An allowance for receivables deemed uncollectible is not established for these amounts because monies due from other Federal entities are considered fully collectible.

Accounts receivable with the public is 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 based on historical experience.

Accounts Receivable (in millions)	2012
Accounts Receivable, Gross	
Intragovernmental	\$113
With the Public	6
Allowance	
Intragovernmental	\$0
With the Public	1
Accounts Receivable, Net	
Intragovernmental	\$113
With the Public	5
Total	\$118

Table 14: Accounts receivable as of September 30, 2012

Note 5 – General Property, Plant, and Equipment, Net

Depreciation of general PP&E 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 (in millions)	Estimated Useful Life (Years)	Cost	Accumulated Depreciation and Amortization	Net Book Value
Personal Property:				
Equipment	5 – 20	\$65	\$50	\$15
Internal Use Software	5	49	24	25
Total Personal Property		114	74	40
Real Property:				
Land and Land Rights		3	0	3
Buildings, Improvements and Renovations	15 – 30	9	7	2
Other Structures & Facilities	15 - 50	3	3	0
Assets under Capital Leases	Varies	7	5	2
Total Real Property		22	15	7
Total		\$136	\$89	\$47

Table 15: General PP&E as of September 30, 2012

Notes to the Financial Statements

Note 6 - 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. Stewardship PP&E includes stewardship land and one historically significant heritage asset.

Stewardship Land

The stewardship land for NRCS consists of conservation easements. NRCS's mission objectives in administering the conservation easement programs are to provide landowners with 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 objectives in managing, monitoring and enforcing the terms and conditions of easement deeds are to ensure that: (1) taxpayer investments are properly used in accordance with the intent of the program; (2) the agency is a good steward of the land; and (3) the land is properly maintained.

Stewardship resources involve substantial investment in order to gain long-term benefits for the American public and help the Agency satisfy its mission. The purpose of purchasing easements is to restore or enhance wetlands, protect farmland, restore and protect grassland, restore and protect forest ecosystems, and restore, protect, maintain, and enhance the functions of floodplains.

NRCS, on behalf of USDA, administers and owns conservation easements on private lands through five different programs. Stewardship resources involve substantial investment in order to gain long-term benefits for the American public and help the Agency satisfy its mission. NRCS's mission objectives in administering the conservation easement programs are to provide landowners with 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 lands. Easements are purchased to restore or enhance wetlands, protect farmland, restore and protect grassland, restore and protect forest ecosystems, and restore, protect, maintain, and enhance the functions of floodplains. The specific uses for the land are identified under each program. Landowners are not allowed to withdraw from the programs; however termination or expiration may occur. NRCS manages, monitors and enforces the terms and conditions of easement deeds to ensure that: (1) taxpayer investments are properly used in accordance with the intent of the program; (2) the agency is a good steward of the land; and (3) the land is properly maintained.

For the purpose of reporting, all easements where NRCS is listed as grantee of the easement are included in the agency's stewardship land count. Also included are easements that are administered by NRCS on behalf of other USDA agencies. As of June 30, 2012, NRCS had 14,736 stewardship land easements. Review and reconciliation of stewardship land easement balances is ongoing.

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 heritage assets will be preserved indefinitely.

Notes to the Financial Statements

NRCS currently owns one heritage asset, the Tucson Plant Materials Center (TPMC) which is included in general PP&E as a multi-use asset. 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. The TPMC 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 (in numbers)	Ending Balance 2011	Adjustments to 2011 Balance	Beginning Balance 2012	Additions +	Expiration / Termination –	2012 Balance
Heritage Assets						
Research Centers	1	0	1	0	0	1
Stewardship Land						
Conservation Easements	13,977	0	13,977	759	0	14,736

Table 16: Stewardship easements as of June 30, 2012

Note 7 - 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. Other Assets with the Public is comprised of funds advanced to state and local governments and non-Federal business entities, and the public through conservation plans and easements.

Other Assets (in millions)	2012
Intragovernmental	\$236
With the Public	18
Total	\$254

Table 17: Balance of Other Assets as of September 30, 2012

Note 8 – Liabilities Not Covered by Budgetary Resources

Other Intragovernmental Liabilities Not Covered by Budgetary Resources are primarily comprised of Federal FECA accruals.

Other Liabilities with the Public Not Covered by Budgetary Resources are primarily comprised of future indemnity costs for unfunded employee leave and retirement benefits.

Liabilities Not Covered by Budgetary Resources (in millions)	2012
Intragovernmental:	
FECA	\$7
Custodial liabilities	1
Subtotal Intragovernmental	8
With the Public:	
Unfunded leave	80
Federal employee & veterans benefits	39
Custodial liabilities	(1)
Subtotal with the public	118
Total liabilities not covered by budgetary resources	126
Total liabilities covered by budgetary resources	951
Total liabilities	\$1,077

Table 18: The balance of liabilities not covered by budgetary resources as of September 30, 2012

Notes to the Financial Statements

Note 9 - Other Liabilities

Other liabilities include but are not limited to payables for cooperative agreements, advances and prepayments from others, and accrued liabilities. NRCS's other liabilities include intragovernmental and those with the public as presented in table below. NRCS's largest liability, Conservation Stewardship, is captured in Accrued Liabilities for Grants.

Other Liabilities (in millions)	Fiscal Year 2012		
	Non-Current	Current	Total
Intragovernmental:			
Accrued Liabilities for Other Services		\$59	\$59
Employee contributions & payroll taxes		12	12
Unfunded FECA Liability		7	7
Liabilities for Deposit Funds and Clearing Accounts		(9)	(9)
Custodial Liability		1	1
Total Intragovernmental	\$0	\$70	\$70
With the Public:			
Accrued Liabilities for Other Services		\$36	\$36
Accrued Liabilities for Land and Structure		11	11
Accrued Liabilities for Grants		745	745
Accrued Payroll and Leave		128	128
Other Liabilities	1	14	15
Total With the Public	\$1	\$934	\$935
Total Other Liabilities	\$1	\$1,004	\$1,005

Table 19: Other Liabilities as of September 30, 2012

Notes to the Financial Statements

Note 10 – Leases

NRCS has entered into leasing agreements with the GSA and other parties through leasing authority delegated by GSA for general facilities (buildings and office space), equipment and land for its Plant Materials Centers and other operations across the Nation. Leases may include renewal options for periods of one or more years. Most leases are subject to cancellation upon certain funding conditions and all are covered by budgetary resources. Capital lease assets and future payment information for capital and operating leases are shown in the tables below. NRCS enters into operating leases primarily for office space and all equipment. The lease arrangements generally range from five to ten years.

Entity as Lessee: Capital Leases	FY 2012 (in millions)
Summary of Assets Under Capital Leases	
Land and Buildings	\$7
Accumulated Amortization	\$5

Table 20: Capital Leases Summary as of September 30, 2012

Capital Leases - Future Payments Due:	Land and Buildings (in millions)
Year 1 (2013)	\$2
Year 2 (2014)	1
Year 3 (2015)	1
Year 4 (2016)	1
Year 5 (2017)	1
After 5 Years	1
Total Future Lease Payments	\$7
Less: Imputed Interest	2
Less: Executory Costs	2
Net Capital Lease Liability	\$3
Lease liabilities covered by budgetary resources	

Table 21: Total Capital Leases Future Payments

Operating Leases - Future Payments Due:	Land and Buildings (in millions)
Year 1 (2013)	\$18
Year 2 (2014)	16
Year 3 (2015)	15
Year 4 (2016)	13
Year 5 (2017)	10
After 5 Years	18
Total Future Lease Payments	\$90
All leases covered by budgetary resources	

Table 22: Total Operating Leases Future Payments

Notes to the Financial Statements

Note 11 – Commitments and Contingencies

NRCS is subject to claims and contingencies related to lawsuits as well as commitments under contractual and other commercial obligations as of September 30, 2012. NRCS has no reportable claims for lawsuits for FY 12. NRCS is not aware of any known obligations related to cancelled appropriations for contractual agreements which may require future financial obligations.

Note 12 – Intragovernmental Costs and Exchange Revenue

NRCS has one goal to accomplish its mission: Get More Conservation on the Ground. 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 as of September 30, 2012.

Intragovernmental Costs and Exchange Revenue (in millions)	FY 2012
Costs	
Intragovernmental	\$637
Public	3,592
Total Program Costs	\$4,229
Earned Revenue	
Intragovernmental	\$162
Public	0
Total Program Earned Revenue	\$162

Table 23: Costs Incurred to Protect Natural Resources for the year ended September 30, 2012

Note 13 – Suborganization Program Costs/Program Costs by Segment

NRCS reflects costs four major responsibility segments: Conservation Operations, Watershed Operations and Rehabilitation, and Farm Bill. The following tables illustrate actual costs by program for the year ended September 30, 2012.

Program Costs	Gross Costs	Earned Revenue	Net Cost
Conservation Operations	\$1,000	\$43	\$957
Watershed Operations & Rehabilitation	201	18	\$183
Farm Bill	3,026	101	\$2,925
Other	2	0	\$2
Totals	\$4,229	\$162	\$4,067

Table 24: Costs by Program for the year ended September 30, 2012

Note 14 - Cost of Stewardship PP&E

The FY 2012 costs of administering the program for stewardship land amounted to \$470 million which consists primarily of easement, acquisition costs, and restoration.

Costs for stewardship land is a combination of 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.

Notes to the Financial Statements

Note 15 – Exchange Revenues

NRCS collects exchange revenue under reimbursable agreements for technical services provided to Federal and non-Federal sources at the full cost of the services to be provided. Bills are issued for actual costs in accordance with the terms of the agreements. At quarter-end, accruals are recorded for the earned, unbilled portion of each agreement. An entry is recorded to estimate an allowance for possible uncollectible amounts from non-Federal sources based on the historical aging of receivables.

Note 16 - Apportionment Categories of Obligations Incurred: Direct Versus Reimbursable Obligations

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. Apportionments by fiscal quarters are classified as category A and all other apportionments are classified as category B. Presented below are the amounts of direct and reimbursable obligations incurred by apportionment category for the year ended September 30, 2012.

Obligations Incurred	Apportionment Category A	Apportionment Category B	Total
Obligations Incurred - Direct	\$1	\$4,435	\$4,436
Obligations Incurred - Reimbursable	0	166	166
Obligations Exempt from Apportionment	0	0	0
Totals	\$1	\$4,601	\$4,602

Table 25: Apportionment Categories of Obligations Incurred for the year ended September 30, 2012

Note 17 – Undelivered Orders at the End of the Period

Budgetary resources obligated for undelivered orders as of September 30, 2012 is \$3.8 billion.

Note 18 - Legal Arrangements Affecting Use of Obligated Balances

NRCS has been granted extended authority for treasury symbols 1221004, 1231004, 1241004, 1251004, 1261004, and 1271004 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 majority of the unobligated balances in 1213322, 1221004, and 1231004 were returned to Treasury in FY 2009. Beginning in FY 2009, the unobligated balance for treasury symbols with extended disbursing authority were not canceled at the end of the fifth expired year; instead the unobligated balance remains in an expired status until the treasury symbol is closed or expended in accordance with OMB Circular A-11.

Note 19 - Explanation of Differences between the SBR and the Budget of the US Government

The differences between the FY 2011 SBR and the FY 2011 actual numbers presented in the FY 2013 Budget of the United States Government are summarized in the table below. The President's Budget with actual numbers for FY 2012 has not yet been published, and is expected to be published in February of 2013, and to be made available at <http://www.whitehouse.gov/omb>. OMB Circular A-136 states that the note should "identify and explain material differences between amounts reported in the SBR and actual amounts reported in the Budget of the United States Government as required by U.S. GAAP." The Department's threshold for explaining material variances is \$25 million and 10%. No variances meet this threshold.

Budget Reconciliation	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
Statement of Budgetary Resources	\$6,264	\$4,391	(\$3)	\$3,827
Reconciling Items				
Expired Accounts	(1,664)	(66)	0	0
Distributed Offsetting Receipts			3	3
Other	(1)			(1)
Totals	\$4,599	\$4,325	\$0	\$3,829

Table 26: Differences between the Statement of Budgetary Resources and the Budget of the United States Government

Notes to the Financial Statements

Note 20 – 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. It is a reconciliation that 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 costs. 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, 2012 is provided in the following table.

Notes to the Financial Statements



Reconciliation of Net Cost of Operations (Proprietary) to Budget for the year ended September 30, 2012 (in millions)

Reconciliation of Net Cost of Operations (Proprietary) to Budget for the year ended September 30, 2012 (in millions)		2012
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred		\$4,602
Less: Spending authority from offsetting collections and recoveries		696
Obligations net of offsetting collections and recoveries		3,906
Less: Offsetting receipts		(13)
Net Obligations		3,919
Imputed financing from costs absorbed by others		158
Net other resources used to finance activities		158
Total resources used to finance activities		\$4,077
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		(\$54)
Resources that fund expenses recognized in prior periods		(8)
Budgetary offsetting collections and receipts that do not effect net cost of operations		
Change in Unfilled Customer Orders		67
Decrease in exchange revenue receivable from public		(4)
Resources that finance the acquisition of assets		(12)
Other resources or adjustments to net obligated resources that do not affect net cost of operations		(12)
Total resources used to finance items not part of the net cost of operations		(23)
Total resources used to finance the net cost of operations		\$4,054
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
Increase in annual leave liability		\$4
Increase in exchange revenue receivable from the public		
Other		2
Total components of Net Cost of Operations that will require or generate resources in future periods		6
Components not Requiring or Generating Resources:		
Depreciation and amortization		6
Revaluation of assets or liabilities		1
Other components not requiring or generating resources		
Bad Debt Expense		1
Other		(1)
Total components of Net Cost of Operations that will not require or generate resources:		7
Total components of Net Cost of Operations that will not require or generate resources in the current period		\$13
Net Cost of Operations		\$4,067

Table 27: Reconciliation of Net Cost of Operations (Proprietary) to Budget for the year ended September 30, 2012

Unaudited – See accompanying independent auditors' report

Required Supplementary Stewardship Information

Required Supplementary Stewardship Information

Human Capital

NRCS's investment in human capital 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. Investment in human capital is expensed each year as incurred.

National Volunteer Program

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 in a timely manner. Volunteering began with the organization of conservation districts in 1937. In recognition of the interest and skills many Americans have in conservation, Congress passed legislation - Section 1526 of PL97-98, Food and Agriculture Act – in 1981 permitting NRCS to use volunteers. In 1985, the volunteer effort was organized as the Earth Team. The primary purpose of the Earth Team is to expand NRCS services by using volunteer time, talent and energy to help accomplish the NRCS mission. Total investment in the training of NRCS Volunteers was \$183.09 for FY 2012.

Resource Conservation and Development

The NRCS also invested in education and training of the public for Resource Conservation and Development as shown in the following table. The program was discontinued in FY 2011 and NRCS conducted an orderly close-out of the program.

Resource Conservation and Development (in millions)	2008	2009	2010	2011	2012	Total Investment
Resource Conservation and Development	\$52	51	52	22	0	\$177

Table 28: NRCS Investments in Human Capital as of September 30, 2012

The Resource Conservation and Development (RC&D) Program was developed under the Soil Conservation and Domestic Allotment Act, (16 U.S.C. 590a-590f), the Bankhead-Jones Farm Tenant Act, (16 U.S.C. 1010 and 1011), and the Food and Agriculture Act of 1962, and was authorized under subtitle H, title XV of the Agriculture and Food Act of 1981. The RC&D was reauthorized in the Farm Security and Rural Investment Act of 2008.

The purpose of the RC&D program was to accelerate the conservation, development and utilization of natural resources, improve the general level of economic activity, and to enhance the environment and standard of living in designated RC&D areas. It improved the capability of state, tribal and local units of government and local nonprofit organizations in rural areas to plan, develop and carry out programs for resource conservation and development. The program also established or improved coordination systems in rural areas. This program, which has since been officially discontinued, focused on improvement of quality of life achieved through natural resources conservation and community development which leads to sustainable communities, prudent land use, and the sound management and conservation of natural resources.

Research and Development

Research and development investments in accordance with OMB Circular A-136, *Financial Reporting Requirements*, "are expenses included in the calculations of net costs to support the search for new or refined knowledge or ideas for the application or use of such knowledge and ideas for the development of new or improved products and processes with the expectation of maintaining or increasing national economic productive capacity or yielding other future benefits."

Plant Materials Centers

NRCS Plant Materials Centers (PMC) are research farms engaging in (1) applied research and (2) development, as defined in SFFAS No. 8. Overall efforts of PMCs include the selection of plants and the development of plant technology used by NRCS and conservation partners for the application of vegetation to solve natural resource issues on private and public lands.

Applied research includes the plant selection and technology development activities of PMCs. PMC plant selection involves the assembly and evaluation of plants for specific attributes. These plant assemblies may undergo several cycles of crossing and evaluation. Replicated plantings and the use of statistical analysis may be involved in the evaluations. The product is a new conservation plant released to

Unaudited – See accompanying independent auditors' report

Required Supplementary Stewardship Information

commercial growers for large-scale production and sale to customers (landowners) for natural resource conservation projects. PMCs develop the technology needed to grow these plant selections, which includes propagation, seed and plant production, and seed and plant processing. Commercial growers use this information in order to more efficiently produce the millions of pounds of seed and millions of plants needed for conservation projects each year. PMCs also develop technology for the application of plants used in conservation projects, including seeding technology, novel establishment methods, and management methods. NRCS field staff, conservation partners, and landowners use this information to improve the efficiency or long-term success of conservation plantings.

Development includes the production of Foundation seed and plants of PMC plant selections and activities which promote PMC plants and technology. Foundation seed production involves the increase of first generation plant materials from the breeding stock of PMC plant selections. Foundation seed production is critical in that it provides the starter material needed by commercial growers for large-scale production of these conservation plants. The promotion of PMC plants and technology through field plantings, demonstration sites, tours, and presentations is important to improve awareness and gain widespread acceptance of new plants and plant information developed by NRCS.

NRCS Plant Materials Center expenses reported below include the costs of applied research efforts, development activities, administrative costs, and the costs associated with operating the facilities. The majority of these costs are incurred directly by NRCS, though two non-NRCS PMCs are funded through grants or agreements with non-Federal partners.

Research and Development Investment (in millions)	2008	2009	2010	2011	2012	Total Investment
Plant Materials Centers	\$13	\$12	\$13	\$8	\$11	\$57
Total Invested Each Year	\$13	\$12	\$13	\$8	\$11	\$57

Table 29: NRCS Investments in Research and Development as of September 30, 2012

Required Supplementary Information

Required Supplementary Information

Deferred Maintenance and Repairs

The NRCS owns, builds, purchases, and contracts services for assets such as office buildings, greenhouses, warehouse/storage, roads, bridges, and other constructed structures. These assets are utilized and maintained in support of NRCS' mission to work with landowners and land managers to protect natural resources on private lands.

The NRCS portfolio of assets includes 34 sites with owned land or buildings, though several of these sites are in the disposal process. There are 24 PMCs which are research farms consisting of an office building, greenhouse, service buildings, and warehouses/storage facilities. Other features of PMCs typically include electrical and domestic water distribution, irrigation water wells, pumps or distribution systems, paved or gravel surfaces, and fuel storage and pumps. Four other active sites include a small NRCS field office, a small storage facility, and two unmanned relay stations for snow survey and climate data. Each of these sites include just one building.



Maintenance of NRCS assets includes preventive maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve the asset so that it continues to provide acceptable service and achieve its expected life. Maintenance excludes activities aimed at expanding the capacity of an asset or otherwise upgrading it to service needs different from, or significantly greater than, those originally intended. When maintenance is not completed on assets as needed or scheduled and is delayed into the future, it is defined as deferred maintenance. Deferred maintenance represents a cost that the Federal Government has elected not to fund and, therefore, the costs are not reflected in the financial statements.

Deferred maintenance is reported for general PP&E as the amount of maintenance needed to return each asset to its acceptable operating condition. The "below acceptable" condition of an asset component is defined as repair or replacement required in the near term due to current physical condition and/or estimated remaining useful life; when repair or replacement is required immediately due to failure; or when there is a safety, health or security deficiency which requires immediate attention. Asset components are classified as critical and noncritical depending on the importance of the component to the asset function.

Critical – a maintenance need that poses a threat to: (a) the strategic goals and objectives of the NRCS; (b) the health and safety of the public or NRCS employees; (c) the agency's function, mission, or major process; and (d) emergency services for national/local security purposes (i.e. an Emergency Relocation Facility (ERF)). Examples of critical components include: major structural features; heating/cooling systems; electrical, plumbing, and waste disposal systems; building code violations; Americans with Disability Act (ADA) compliance; and significant safety, health and security items.

Noncritical - a maintenance need that repairs a physical condition of building systems and related components, and is not critical to the function or mission of the asset. Examples of noncritical components include: painting; floor coverings; energy efficiency; and aesthetic maintenance.

The NRCS uses condition surveys to estimate deferred maintenance on all major classes of its PP&E. During FY 2012, the NRCS, with assistance from the GSA Office of Real Property Utilization and Disposal, initiated facility assessments of all NRCS owned facilities to collect detailed data on infrastructure condition and maintenance needs. The NRCS is about 25 percent through this process, with different phases of facility assessments currently underway at 20 of its sites. The agency is working closely with the GSA to complete these comprehensive assessments on all owned real property by March 2013.

NRCS is committed to sustaining a manageable level of infrastructure — disinvesting in infrastructure that can no longer be managed to appropriate standards, rightsizing its asset portfolio, and eliminating the backlog of deferred maintenance.

Unaudited – See accompanying independent auditors' report

Required Supplementary Information

Estimated Deferred Maintenance

Deferred maintenance estimates for the assets are based on condition surveys performed on a 5-year maximum revolving schedule. Private sector professionals, under GSA and NRCS guidance, are conducting condition surveys of all NRCS owned assets from September 2011 through March 2013. NRCS maintains an inventory and description of all owned facilities and structures in USDA's Corporate Property Automated Information System (CPAIS). NRCS uses third party software to maintain detailed information on asset components, maintenance schedules, and maintenance costs. NRCS reviews information in both databases annually for accuracy and completeness.

During FY 2012, NRCS completed condition surveys for three NRCS facilities located in Beltsville, MD; Brooksville, FL; and Americus, GA. The dollar amount in *Table 31, Deferred Maintenance Totals by Asset Class*, include costs in millions to return assets at the three NRCS facilities to acceptable conditions. The agency's deferred maintenance estimate for the remaining 31 sites, including the heritage asset, is scheduled to be completed during FY 2013.

Asset Class	Overall Condition	Critical Maintenance	Noncritical Maintenance	Cost to Return to Acceptable Condition
Office Buildings	fair	31,422	2,558	33,980
Greenhouses	fair	326	0	326
Service Buildings	fair-good	45,385	11,206	56,591
Warehouse/Storage Buildings	poor-good	88,573	17,525	106,098
Other Buildings	fair	55,154	8,967	64,121
Irrigation Systems	good	14,807	0	14,807
Other Constructed Structures and Features	fair-good	7,760	11,442	19,202
Total		\$243,427	\$51,698	\$295,125

Table 30: Deferred Maintenance Totals by Asset Class as of September 30, 2012 in dollars

In FY 2012, professionals in the private sector completed condition surveys for all major classes of PP&E at the three facilities presented above using accepted industry standards. Interviews with property management staff, review of available maintenance procedures, available drawings, and other documentation, and examination of the property's systems and components for their present condition were used for determining the condition and useful life of facilities and facility components. Estimated costs for replacement, repair, or maintenance of all classes of PP&E were based on the probable or actual extent of the observed defect, inclusive of the cost to design, procure, construct, and manage the replacement, repair, or maintenance. These estimates were based on invoice or bid documents provided by the facility and on construction costs developed from construction resources and industry standards such as *R.S. Means and Marshall & Swift*, along with the contractor's experience with past costs for similar properties, city cost indexes, and assumptions regarding future economic conditions.

The overall condition of major asset classes varies depending on the location, age, and type of property. The condition of all buildings and significant structures of the three facilities where condition surveys were completed in FY 2012 ranged from poor to good, with approximately six percent needing significant repairs or renovation, approximately 30 percent in fair condition, and 64 percent of the facilities in good condition.

NRCS manages its buildings in compliance with regulations and guidance from GSA, USDA, and Executive Orders. Buildings shall also comply with code compliance (e.g., National Life Safety Code, Occupational Safety Health Administration, Architectural Barriers Act Accessibility Standards, etc.) and other regulatory or compliance requirements as determined by condition surveys. NRCS applies these regulations and guidance consistently to all major classes of PP&E. Guidelines used may vary from the norm based on the mission of each facility and use of each asset. For example, all NRCS roadways are farm roads (paved or gravel) located on Plant Materials Centers. The public does not use these roadways, and therefore they are not required to meet the standards of Federal Highways Administration regulations.

NRCS is continuing to develop additional policy, procedure, and guidance relative to required standards for its facilities and ongoing monitoring of facility condition as the remainder of the facility assessments are completed during FY 2013.

Unaudited – See accompanying independent auditors' report

Required Supplementary Information

Condition of Heritage Assets and Stewardship Lands

Heritage Assets

In 1996, the Tucson Plant Materials Center in Tucson, Arizona was placed on the National Register of Historic Places. The TPMC service area encompasses the Sonoran, Chihuahuan, and Mohave deserts in areas of Arizona, California, Nevada, New Mexico, and Utah. Major land uses in this area include irrigated farmland, rangeland, and minelands. The Center develops and evaluates adapted plant materials and technologies for needs throughout the service area. Because this asset is used in general government operations as well as being designated as a heritage asset, it is classified as a multi-use heritage asset in accordance with Statement of Federal Financial Accounting Standards 29. The condition of this heritage asset will be determined as part of the FY 2013 facility assessments.



Stewardship Land

The Stewardship land for NRCS consists of conservation easements acquired under the NRCS Conservation Stewardship Program. NRCS's mission objectives in administering the conservation easement programs are to provide landowners with 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.

Required Supplementary Information

The Required Supplementary Information, Statement of Budgetary Resources, restates the totals expressed in the Statement of Budgetary Resources broken out by major program.



Statement of Budgetary Resources

Year ended September 30, 2012
(in Millions)

Budgetary Resources:	Conservation Operations	Watershed	Farm Bill	Other	Total
Unobligated balance, brought forward, October 1	\$64	\$169	\$1,624	\$16	\$1,873
Unobligated balance brought forward, October 1, as adjusted	64	169	1,624	16	1,873
Recoveries of prior year unpaid obligations	35	22	406	1	464
Other changes in unobligated balance	(11)		0	(2)	(13)
Unobligated balance from prior year budget authority, net	88	191	2,030	15	2,324
Appropriations (discretionary and mandatory)	828	231	3,424	1	4,484
Spending authority from offsetting collections (discretionary and mandatory)	40	23	169	0	232
Total budgetary resources	\$956	\$445	\$5,623	\$16	\$7,040
Status of Budgetary Resources:					
Obligations Incurred (Note 18)	\$849	\$260	\$3,485	\$8	\$4,602
Unobligated balance, end of year					
Apportioned	70	170	181	4	425
Unapportioned	37	15	1,957	4	2,013
Total unobligated balance, end of year	107	185	2,138	8	2,438
Total budgetary resources	\$956	\$445	\$5,623	\$16	\$7,040
Change in Obligated Balances:					
Unpaid obligations, brought forward, October 1 (gross)	\$288	\$299	\$3,664	\$3	\$4,254
Uncollected customer payments from Federal sources, brought forward, October 1	(35)	(49)	(75)	0	(159)
Obligated balance, start of year (net), before adjustments	253	250	3,589	3	4,095
Obligated balance, start of year (net), as adjusted	253	250	3,589	3	4,095
Obligations incurred	849	260	3,485	8	4,602
Outlays (gross)	(857)	(204)	(2,815)	(2)	(3,878)
Change in uncollected customer payments from Federal sources	(18)	(9)	(120)	0	(147)
Recoveries of prior year unpaid obligations	(35)	(22)	(406)	(1)	(464)
Obligated balance, end of year					0
Unpaid obligations, end of year (gross)	245	333	3,928	8	4,514
Uncollected customer payments from Federal sources, end of year	(53)	(58)	(195)	0	(306)
Obligated balance, end of year (net)	\$192	\$275	\$3,733	\$8	\$4,208
Budget Authority and Outlays, Net:					
Budget authority, gross (discretionary and mandatory)	\$868	\$254	\$3,593	\$1	\$4,716
Actual offsetting collections (discretionary and mandatory)	(22)	(14)	(49)	0	(85)
Change in uncollected customer payments from Federal sources (discretionary and mandatory)	(18)	(9)	(120)	0	(147)
Anticipated offsetting collections (discretionary and mandatory)					
Budget authority, net (discretionary and mandatory)	\$828	\$231	\$3,424	\$1	\$4,484
Outlays, gross (discretionary and mandatory)	857	204	2,815	2	3,878
Actual offsetting collections (discretionary and mandatory)	(22)	(14)	(49)	0	(85)
Outlays, net (discretionary and mandatory)	835	190	2,766	2	3,793
Distributed offsetting receipts					13
Agency outlays, net (discretionary and mandatory)	\$835	\$190	\$2,766	\$2	\$3,806

Table 31: Statement of Budgetary Resources by Major Budget Account

Unaudited – See accompanying independent auditors' report

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