USDA United States Department of Agriculture

Office of Inspector General

# Natural Resources Conservation Service's Financial Statements for Fiscal Year 2013

10401-0003-11

December 2013

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

DATE: December 9, 2013

AUDIT NUMBER: 10401-0003-11

TO: Jason Weller
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 2013

This report presents the results of the engagement to audit the Natural Resources Conservation Service's (NRCS) financial statements for the fiscal year ended September 30, 2013. The report contains a disclaimer of opinion on the financial statements, as well as an assessment of NRCS' internal controls over financial reporting and compliance with laws and regulations.

KPMG LLP, an independent certified public accounting firm, was engaged to conduct the audit. In connection with the contract, we reviewed KPMG LLP'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' 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. KPMG LLP is responsible for the attached auditor's report, dated December 6, 2013, and the conclusions expressed in the report. However, our review disclosed no instances where KPMG LLP did not comply, in all material respects, with government auditing standards and the Office of Management and Budget Bulletin 14-02, *Audit Requirements for Federal Financial Statements*, except as disclosed below.

KPMG LLP reported that NRCS was unable to provide sufficient evidential matter in support of certain transactions and account balances, as presented in the NRCS financial statements as of and for the year ended September 30, 2013, particularly with respect to beginning net position balances and current year activity; obligations incurred, including accrued expenses and undelivered orders; real and personal property; recoveries of prior year unpaid obligations; advances to others; accrued revenue, accounts receivable and unfilled customer orders. 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. As a result of these limitations, KPMG LLP was unable to obtain sufficient evidential support for the amounts presented in the fiscal year 2013 financial statements.

It was impracticable for KPMG LLP to extend their audit procedures sufficiently to determine the extent to which NRCS's financial statements as of and for the year ended September 30, 2013, may have been affected by the matters discussed in the preceding paragraph. Accordingly, the scope of KPMG LLP's work was not sufficient to enable the auditors to express an opinion on the accompanying financial statements as of and for the year ended September 30, 2013.

KPMG LLP's report identified five deficiencies. Specifically, KPMG LLP identified weaknesses in NRCS':

- Accounting and controls over undelivered orders;
- Controls over financial reporting;
- Accounting and controls over expenses;
- Accounting and controls over revenue and accounts receivable; and
- Accounting and controls for property, plant, and equipment.

KPMG LLP considered the first four deficiencies to be material weaknesses and the last one to be a significant deficiency. The results KPMG LLP's tests of compliance with laws and regulations disclosed instances of noncompliance with the Federal Financial Management Improvement Act (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.

We appreciate the courtesies and cooperation extended during this audit. This report contains publicly available information and will be posted in its entirety to our website http://www.usda.gov/oig in the near future.

**United States Department of Agriculture**
**Natural Resources Conservation Service**
**Independent Auditors' Report**
**As Of and For the Year Ended September 30, 2013**

## Table of Contents

**KPMG LLP**
Suite 12000
1801 K Street, NW
Washington, DC 20006

# Independent Auditors' Report

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

## Report on the Financial Statements

We were engaged to audit the accompanying financial statements of the Natural Resources Conservation Service (NRCS), which comprise the balance sheet as of September 30, 2013, and the related statement of net cost, changes in net position, and combined statement of budgetary resources for the year then ended, and the related notes to the financial statements (herein referred to as "financial statements").

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on the financial statements we were engaged to audit. We were engaged to conduct an 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. 14-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 14-02 require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Because of the matter described in the Basis for Disclaimer of Opinion paragraph, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### *Basis for Disclaimer of Opinion*

NRCS was unable to provide sufficient evidential matter in support of certain transactions and account balances, as presented in the NRCS financial statements as of and for the year ended September 30, 2013, particularly with respect to beginning net position balances and current year activity; obligations incurred, including accrued expenses and undelivered orders; real and personal property; recoveries of prior year unpaid obligations; advances to others; accrued revenue, accounts receivable and unfilled customer orders.

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.

It was impracticable to extend our audit procedures sufficiently to determine the extent to which NRCS's financial statements as of and for the year ended September 30, 2013 may have been affected by the matters discussed in the preceding paragraph; accordingly, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying financial statements as of and for the year ended September 30, 2013.

***Disclaimer of Opinion***

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraphs, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

***Other Matters***

*Required Supplementary Information*

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis, Required Supplementary Information, and Required Supplementary Stewardship Information section be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board 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. 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 financial statements, and other knowledge we obtained while we were engaged. 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.

*Other Information*

Our engagement was conducted for the purpose of forming an opinion on the financial statements as a whole. The other information is presented for purposes of additional analysis and is not a required part of the financial statements.

The other information has not been subjected to the auditing procedures, and accordingly, we do not express an opinion or provide any assurance on it.

**Other Reporting Required by *Government Auditing Standards***

***Internal Control Over Financial Reporting***

In planning and performing the engagement, we considered the NRCS's internal control over financial reporting (internal control) to determine the procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the NRCS's internal control. Accordingly, we do not express an opinion on the effectiveness of the NRCS's internal control. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in Exhibits I and II, we identified certain deficiencies in internal control that we consider to be material weaknesses and a significant deficiency.

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 a 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 deficiencies described in Exhibit I and the related findings to be material weaknesses.

A significant deficiency is a deficiency, or a 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 deficiencies described in Exhibit II and the related findings to be a significant deficiency.

***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether the NRCS's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 14-02. However, providing an opinion on compliance with those provisions was not an objective of our engagement, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 14-02.

We also performed tests of its compliance with certain provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). Providing an opinion on compliance with FFMIA was not an objective of our engagement, and accordingly, we do not express such an opinion.

The results of our tests of FFMIA disclosed instances, as described in Exhibit III, in which the NRCS's financial management system did not substantially comply with applicable Federal accounting standards and the United States Government Standard General Ledger at the transaction level. The results of our tests of FFMIA disclosed no instances in which the NRCS's financial management system did not substantially comply with federal financial management system requirements.

***NRCS's Response to Findings***

The NRCS's response to the findings identified in our engagement is described in Exhibit VI. The NRCS's response was not subjected to the auditing procedures applied in this engagement and, accordingly, we express no opinion on the response.

***Purpose of the Other Reporting Required by* Government Auditing Standards**

The purpose of the communication described in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the NRCS's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Washington, DC
December 6, 2013

## INTRODUCTION TO EXHIBITS

The Natural Resources Conservation Service continues to make progress to improve its accounting functions; however, more corrective actions are necessary to fully address the material weaknesses and significant deficiency identified. Exhibits I and II of this report present the material weaknesses and significant deficiency, respectively, as of and for the year ended September 30, 2013. Exhibit III of this report presents compliance with laws and regulations as of and for the year ended September 30, 2013. Exhibit IV of this report summarizes the current year status of prior year recommendations. Exhibit V of this report summarizes the current year status of prior year recommendations for noncompliance with laws and regulations and other matters. The NRCS management's response is presented in Exhibit VI.

## MATERIAL WEAKNESSES

### Number 1: Improved Accounting and Controls are Needed Over Undelivered Orders (Repeat Condition)

During our internal control and substantive testing of undelivered orders (UDOs)/ unliquidated obligations (ULOs) in fiscal year (FY) 2013, we noted that:

- Obligations and advances were not recorded timely;
- Abnormal balances were not adequately supported;
- Obligations expired prior to 9/30/13 and the corresponding funds were not deobligated.

When testing the undelivered orders balance as of September 30, 2013, we identified 28 exceptions in 76 sampled items consisting of obligations expiring prior to September 30, 2013 that were not deobligated, sample items not supported by adequate documentation and inadequately supported abnormal balances. During our testing of the advances to others balance as of September 30, 2013, we identified 19 exceptions in 21 sampled items, including sample items that were inadequately supported and balances that should have been liquidated. In testing upward and downward adjustments of budgetary activity during FY 2013, we identified 189 exceptions in 376 sampled items, consisting of sample items that were not supported by adequate documentation and invalid adjustments. We were unable to conclude on the results of our testing due to the materiality of identified misstatements. Further, the control errors noted in our testing increase the risk of an Anti-Deficiency Act violation.

The Government Accountability Office's (GAO) Standards for Internal Control in the Federal Government (Standards) states that, "internal controls and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. All documentation and records should be properly managed and maintained." Additionally, with regard to accountability for records and resources, "Periodic comparison of resources with the recorded accountability should be made to help reduce the risk of errors, fraud, misuse, or unauthorized alteration."

**Recommendation 1:**
We recommend that NRCS management:

A. Continue to monitor activity in U.S. Standard General Ledger (USSGL) accounts 4801, 4871 and 4881 to ensure that invalid upward and downward adjustments are identified and negated in a timely manner and that balances are appropriate;
B. Continue to monitor open obligations to ensure that upward and downward adjustments are recorded in the appropriate period and liquidated timely; and,
C. Provide adequate training to personnel related to the documentation requirements for support.

**Number 2: Improved Controls are Needed Over Financial Reporting (Repeat Condition)**

During our FY 2013 internal control and substantive testing over financial reporting, we noted that:

- Journal entries lacked sufficient supporting documentation;
- Generally accepted accounting standards were not adhered to, which contributed to significant misstatements in the revenue accounts;
- Misstatements were identified that were individually greater than materiality;
- Supporting documentation for deferred maintenance costs lacked support for estimated costs.

During our testing of 59 FY 2013 journal entries (including period 13), we identified 19 exceptions, primarily due to a lack of supporting documentation. When testing revenue transactions, we identified 27 exceptions out of 92 sampled items that were incorrectly recorded during FY 2013. Six factual misstatements identified were individually greater than materiality related to the accounts of upward and downward adjustments of budgetary activity, non-payroll disbursements, revenue, and undelivered orders. Ten projected misstatements identified were individually greater than materiality related to the accounts of upward and downward adjustments of budgetary activity, non-payroll disbursements, revenue, undelivered orders and accrued expenses. As a result, we were unable to conclude on the results of our testing due to the materiality of the identified misstatements.

In accordance with the Statements of Federal Financial Accounting Standards (SFFAS) No. 21: *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*, section 10 states:

> "Errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared." When errors are discovered after the issuance of financial statements, and if the financial statements would be materially misstated absent correction of the errors, corrections should be made as follows:
>
> (a) If only the current period statements are presented, then the cumulative effect of correcting the error should be reported as a prior period adjustment. The adjustment should be made to the beginning balance of cumulative results of operations, in the statement of changes in net position.

In accordance with Office of Management and Budget (OMB) Circular No. A-123, *Management's responsibility for Internal Control*, in the introduction section notes the requirements of the Federal Managers' Financial Integrity Act (FMFIA) of 1982: "The agency head must establish controls that reasonably ensure that …iii. Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets."

**Recommendation 2:**
We recommend that NRCS management:

A. Identify and document transactions that, when required, are recorded in accordance with the guidance found in SFFAS No. 21: *Reporting Correction of Errors and Changes in Accounting Principles, Amendment of SFFAS 7, Accounting for Revenue and Other Financing Sources*;
B. Implement procedures to reduce the need to record a large volume of misstatements at year end;
C. Establish policies/guidelines that assist accounting personnel in properly determining the type of sufficient supporting documentation for journal entries and deferred maintenance; and
D. Enhance the management review of journal entries to include use of appropriate posting models and obtaining and inspecting supporting documentation.

## Number 3: Improved Accounting and Controls are Needed Over Expenses (Repeat Condition)

During our internal control and substantive testing over FY 2013 expenses, we noted that:

- Supporting documentation was not always provided for sampled amounts; and
- Supporting documentation was provided; however, it could not be determined if the budget officer certified funds availability prior to the execution of the obligating document.

When testing FY 2013 agreement transactions, we identified 74 exceptions in 213 sampled items, consisting of items recorded in the incorrect fiscal year and a lack of adequate supporting documentation. In testing the accrued expense balance as of September 30, 2013, we noted 21 exceptions in 39 sampled items resulting from unsupported accrual amounts and adjustments recorded as accruals that should have been recorded as obligations. During testing of easement transactions, we identified 28 exceptions in 51 sampled items, consisting of items recorded in the incorrect fiscal year and other items lacked supporting documentation. We were unable to conclude on the results of our testing due to the materiality of identified misstatements.

Per SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, paragraphs 19 and 25, "A liability for federal accounting purposes is a probable future outflow or other sacrifice of resources as a result of past transactions or events. General purpose federal financial reports should recognize probable and measurable future outflows or other sacrifices of resources arising from (1) past exchange transactions, (2) government-related events, (3) government-acknowledged events, or (4) non-exchange transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date."

U. S. Code Title 31, Section 1501 states that, "an amount shall be recorded as an obligation of the United States Government only when (1) supported by documentary evidence of a binding agreement between an agency and another person (including an agency) that is (a) in writing, in a way and form, and (b) for a purpose authorized by law and executed before the end of the period of availability for obligation of the appropriation or fund used for specific goods to be delivered, real property to be bought or leases, or work or service to be provided."

The Government Accountability Office's (GAO) Standards for Internal Control in the Federal Government (Standards) states that, "internal controls and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. All documentation and records should be properly managed and maintained." Additionally, with regard to accountability for records and resources, "Periodic comparison of resources with the recorded accountability should be made to help reduce the risk of errors, fraud, misuse, or unauthorized alteration."

**Recommendation 3:**
We recommend that NRCS management:

A. Provide guidance and/or training to employees on policies and procedures to ensure purchase transactions have adequate supporting documentation (e.g., purchase requisitions, purchase orders, invoices, etc.) to determine if they are accurate and exist;
B. Enhance monitoring controls over payment approvals to determine whether appropriate documentation is provided to support the disbursement; and
C. Enhance procedures to determine if accrued expenses are complete, accurate, and exist at quarter-ends and are properly supported.

## Number 4: Improved Accounting and Controls are Needed Over Revenue and Accounts Receivable (Repeat Condition)

During our internal control and substantive testing of revenue, accounts receivable, and unfilled customer orders during FY 2013, we noted the following:

- Supporting documentation was not provided for all sample items;
- Reimbursable agreements were expired, but were not liquidated; and
- Billing documents did not agree to the sample amount.

When testing accounts receivable transactions as of September 30, 2013, we identified 18 exceptions in 21 sampled items, primarily relating to a lack of supporting documentation. While testing unfilled customer orders, we identified 17 exceptions out of 56 sampled items which related to a lack of support provided to determine the unfilled customer orders balance. We were unable to conclude on the results of our testing due to the materiality of identified misstatements.

Statement of Federal Financial Accounting Standards (SFFAS) No.7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, states that properly classifying these revenues according to their nature, "provides the basis for applying different accrual accounting principles. In addition, proper classification is essential to constructing financial statements that meet the federal financial reporting objectives."

OMB Circular No. A-123 states that, "revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets." Additionally, "management has a fundamental responsibility to develop and maintain effective internal control."

**Recommendation 4:**
We recommend that NRCS management:

A. Continue to improve documentation that will support revenue, accounts receivable, and unfilled customer orders transactions in accordance with OMB Circular No. A-123; and
B. Review and liquidate invalid unfilled customer orders.

**SIGNIFICANT DEFICIENCY**

**Number 5: Improved Accounting and Controls are Needed Over Property, Plant and Equipment (Downgraded - Repeat Condition)**

During our FY 2013 internal control and substantive testing over general property, plant and equipment (PP&E), we noted the following:

- Omitted and duplicative personal property items in the Personal Property System (PROP);
- The PROP system was not complete;
- Personal property items did not have identifiable information (i.e., serial number) that agreed to the PROP system;
- Internal use software in development costs related to inactive/terminated projects were still recorded in the subsidiary ledger; and
- The adjusted internal use software sub-ledger was not in agreement with the trial balance.

During our internal control and substantive testing of 101 personal property items, we identified 14 exceptions, including seven items that were not listed in PROP or did not have identifiable information. While testing internal use software under development, we identified four exceptions in a sample of five projects tested. These exceptions related to the recording of software development costs to the sub-ledger for inactive or terminated projects. We were unable to conclude on the results of our testing due to the materiality of identified misstatements.

SFFAS No. 10, *Accounting for Internal Use Software*, provides requirements for the impairment of software development costs. Impairment should be recognized and measured when one of the following occurs and is related to post-implementation/operational software and/or
modules thereof:

- The software is no longer expected to provide substantive service potential and will be removed from service or;
- A significant reduction occurs in the capabilities, functions, or uses of the software (or a module thereof).

OMB A-123, *Management's Responsibility for Internal Control* states that management has a fundamental responsibility to develop and maintain effective internal control. It continues, "Application control should be designed to ensure that transactions are properly authorized and processed accurately and that the data is valid and complete. General and application control over information systems are interrelated, both are needed to ensure complete and accurate information processing." Additionally, it states, "all assets, liabilities, and transactions that should be reported have been included and no unauthorized transactions or balances are included (completeness)." Lastly, it states, "All reported transactions actually occurred during the reporting period and all assets and liabilities exist as of the reporting date (existence and occurrence).

**Recommendation 5:**
We recommend that NRCS management:

A. Design, implement, and document additional policies, procedures, and internal controls that will help ensure the PP&E recorded in the general ledger is complete and accurate;
B. Strengthen personal property inventory controls so that related items are properly identified and recorded; and

C. Remove fully depreciated property plant and equipment when the asset no longer has economic benefit to NRCS.

**COMPLIANCE WITH LAWS AND REGULATIONS**

**Number 6: NRCS Did Not Substantially Comply with the Federal Financial Management Improvement Act of 1996 (Repeat Condition)**

**Compliance with Applicable Federal Accounting Standards**
We determined that beginning net position balances and current year activity; obligations incurred, including accrued expenses and undelivered orders; real and personal property; recoveries of prior year unpaid obligations; advances to others; accrued revenue, accounts receivable, and unfilled customer orders were not properly recorded in accordance with Federal accounting standards. These issues were addressed through our recommendations in Exhibits I and II.

**Compliance with the United States Standard General Ledger (USSGL)**
We noted that NRCS did not use USSGL appropriate posting models for recoveries of prior year obligations paid and unpaid, and nonproduction costs. These issues were addressed through our recommendations in Exhibit I.

**Exhibit IV**

**STATUS OF PRIOR YEAR MATERIAL WEAKNESSES AND SIGNIFICANT DEFICIENCIES**

| Control Deficiency | 2012 Status | 2013 Control Deficiency | 2013 Status |
|---|---|---|---|
| Undelivered Orders Accounting and Controls | Significant deficiency | Improved Accounting and Controls are Needed Over Undelivered Orders | Material weakness |
| Accrued Expenses Accounting and Controls | Material weakness | Improved Accounting and Controls are Needed Over Expenses | Material weakness |
| General Accounting Operations | Material weakness | ---- * | ---- * |
| Financial Reporting Controls | Material weakness | Improved Controls are Needed Over Financial Reporting | Material weakness |
| Property, Plant, and Equipment Accounting and Controls | Material weakness | Improved Accounting and Controls are Needed Over Property, Plant and Equipment | Significant deficiency |
| Information Technology General and Application Access Controls | Significant deficiency | Improved Accounting and Controls are Needed Over Information Technology | Management letter comment |
| Unfilled Customer Orders Accounting and Controls | Material weakness | Improved Accounting and Controls are Needed Over Revenue and Accounts Receivable | Material weakness |

* Certain items in this control environment were incorporated into Improved Controls are Needed Over Financial Reporting.

**Exhibit V**

## STATUS OF PRIOR YEAR NON-COMPLIANCE FINDINGS

| Reported Condition in FY 2012 | Status in FY 2013 |
| --- | --- |
| NRCS Does Not Substantially Comply with Federal Financial Management Improvement Act of 1996 | Open/ Comment Repeated in FY 2013 |

Exhibit VI

## NRCS MANAGEMENT'S RESPONSE

NRCS

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

December 5, 2013

Mr. Brian J. Grega
KPMG LLP
1801 K Street, N.W., Suite 1200
Washington, D.C.  20006

Dear Mr. Grega:

We have reviewed KPMG LLP Independent Auditor's Report of NRCS' fiscal year (FY) 2013 Financial Statements and generally agree with its contents.

In FY 2013, the Natural Resources Conservation Service (NRCS) continued to focus its efforts on financial management improvements as evidenced by the downgrading of the material weakness related to Property, Plant, and Equipment to a significant deficiency and the elimination of the significant deficiency related to Information Technology.  This was a collaborative effort between the State offices and the Acquisition, Finance, Programs, and Information Technology organizations.

In addition, NRCS completed the valuation assessments and related reports for Real Property, the data quality evaluation for stewardship land, and related deployment of the National Easement Staging Tool (NEST).  This gave NRCS the opportunity to assert to the completeness of stewardship land.  NRCS also increased its efforts to improve financial reporting by making significant improvements to eliminate differences related to the Fund Balance with Treasury and successfully conducted its first internal control review of the Financial Statements.

NRCS made progress in correcting the previously reported problems listed below.  Key accomplishments in FY 2013 include:

General Accounting Operations -- Made significant progress in stabilizing the new financial system, FMMI, improving our reporting capability, and resolving a long-standing statement of difference for the Fund Balance with Treasury.

Financial Reporting -- Conducted and passed its first internal control review for financial reporting.  In addition, NRCS asserted to its stewardship lands and reported deferred maintenance on our real property.

Property, Plant, and Equipment -- Conducted a real property review and documented the results. Adjustments to real property balances were made, when appropriate, and reporting of deferred maintenance was included in this year's report.

Reimbursable Agreements -- Conducted a full reconciliation of unfilled customer's orders to ensure that beginning balances, current year billing and collections, and ending balances were accurate. Improvements to the processes were made, and the new system, FMMI, is ensuring the continuity of agreements.

Information Technology -- Completed phase one of the automation of the Access Control Management for granting, reviewing, and removing access to Financial and other critical resources, while maintaining a 100 percent quarterly manual review of all new, existing, and terminated accesses. NRCS also started building a sustainable IT environment by establishing an IT Internal Controls and Audit program.

NRCS will continue its audit remediation efforts in FY 2014. The remediation will involve senior management commitment to corrective action plans (CAPs) and development of its financial management team. For audit weaknesses and areas of non-compliance identified in this year's audit, NRCS will create CAPs with attainable milestones and target completion dates. NRCS is committed to the audit remediation process and the actions needed to obtain a clean audit opinion.

Sincerely,

Stephen M. Kunze
Chief Financial Officer

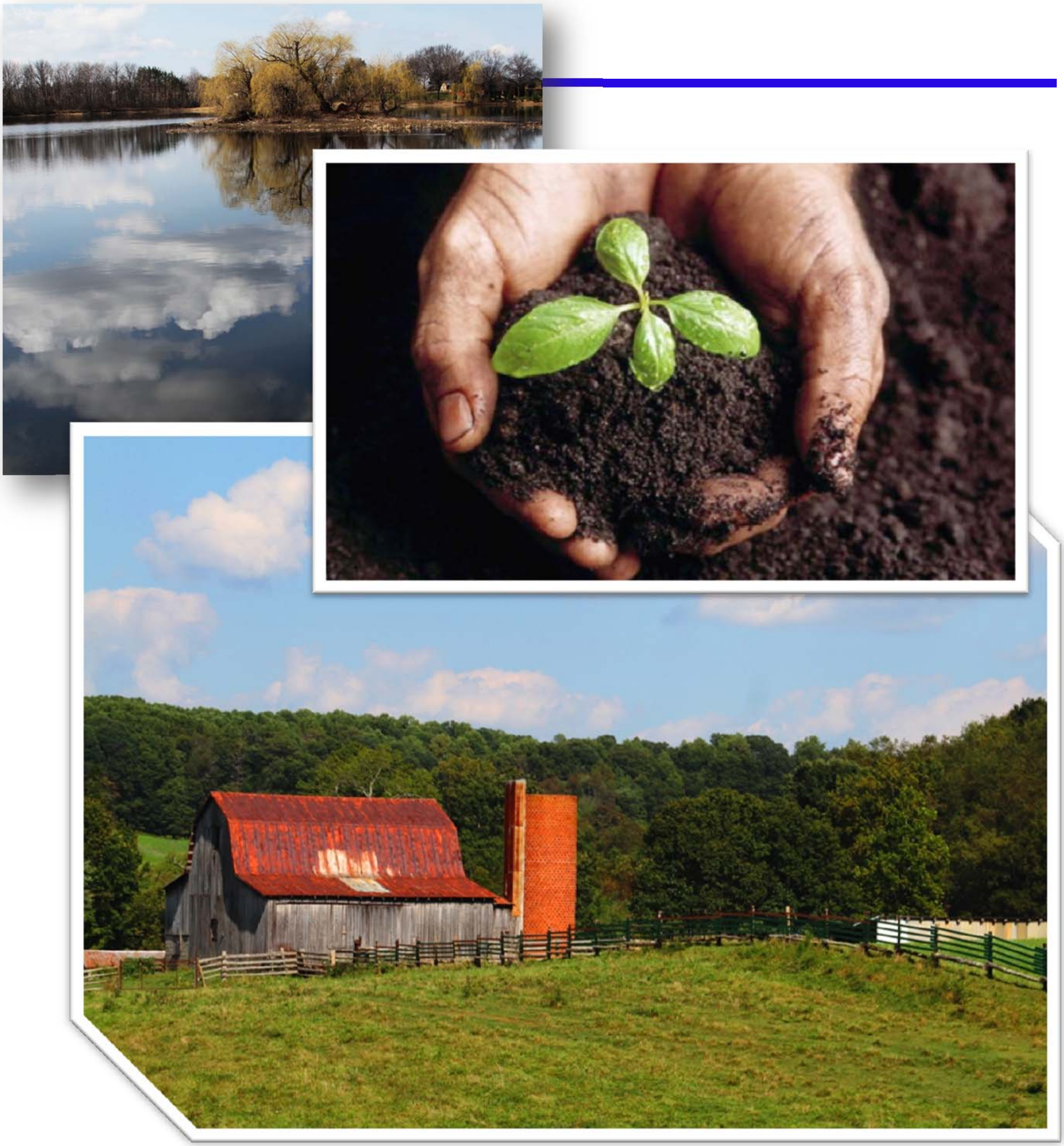
cc:
Tracey LaPoint, Office of the Inspector General, Washington, D.C.

NRCS

Natural Resources Conservation Service

# Fiscal Year 2013

# Agency Financial Report



# Message from the Chief

I respectfully submit the fiscal year (FY) 2013 Agency Financial Report. In accordance with Departmental guidelines and as required by the Federal Manager's Financial Integrity Act of 1982 (FMFIA) and the Office of Management and Budget Circular A-123, Management's Responsibility for Internal Control, the Natural Resources Conservation Service (NRCS) evaluated its internal controls and financial management systems.

While we have material weaknesses, we continue to remediate and implement corrective actions to improve our financial reporting. Further details on these weakness and the corrective actions planned may be found in the Management's Discussion and Analysis section of our report. NRCS understands its fiduciary responsibility to the American people, and is dedicated to improving its financial management.

This fiscal year has been monumental for NRCS for agriculture and for conservation.

The Nation invested more than $4.1 billion in financial and technical assistance for agricultural conservation purposes in FY 2013. With that investment, we helped producers become more productive, more successful, and more sustainable -- both economically and environmentally.

Roughly 70 percent of land in the lower 48 States is in the hands of private landowners and land managers. These stewards of the land help to sustain and improve the health of our natural resources and environment through their conservation decisions.

The conservation assistance that NRCS delivers – everything from conservation practices to manage nutrients to practices that improve soil health – is helping to protect natural resources, while at the same time benefitting farms, ranches, and forest operations. We work to help these operators and landowners protect the land in concert with agricultural productivity and rural economic growth.

Through our Landscape Conservation Initiatives we are strategically targeting limited resources in important landscapes. Through the Sage Grouse Initiative, for example, we are working with ranchers to conserve the habitat of this rare bird, and we have worked with the U.S. Fish and Wildlife Service to secure a predictability framework that provides assurances to ranchers that they can continue their operations even if the sage grouse is added to the endangered species list. With conservation easements in place on more than 240,000 acres, grazing systems on more than 2.1 million acres, and more than 500 miles of fence marked or removed, we are making a big difference.

Our Conservation Effects Assessment Project studies are helping to build the evidence base for the impact of voluntary conservation. In the Mississippi River Basin, our Conservation Effects Assessment Projects study showed that conservation on cropland prevents an estimated 243 million tons of sediment, 2.1 billion pounds of nitrogen, and 375 million pounds of phosphorus from leaving fields each year, and conservation has resulted in an estimated 17 percent reduction in nitrogen and 22 percent reduction in phosphorus entering the Gulf of Mexico annually.

We are reaching underserved communities across the country through the StrikeForce for Rural Growth and Opportunity initiative.  Starting off in just three States, in a few short years the initiative has grown to include more than 400 counties and reservations in 16 States across the country.  In some StrikeForce counties, in about 2 years we saw a 200 percent increase in participation of historically underserved communities.

Healthy soils have been at the foundation of NRCS' work from the beginning and are the foundation of sustainable agriculture.  In order to develop systems capable of meeting the world food needs and protecting the environment, there needs to be an emphasis on enhancing our soil resources.  Right now, we are putting a renewed focus on soil health -- showing producers, partners, and the public just why it's so important.  We are bringing our programs and technical assistance together to help more American farmers and ranchers implement soil health management systems.

We are supporting development of emerging environmental markets for carbon, water quality, wetlands, and biodiversity – markets that can become an economic driver for conservation while at the same time generating new sources of income for our rural communities.  And, we are developing new tools and processes that will transform the way we do business at NRCS – improving service to our customers and accelerating our ability to put conservation on the ground.  Through the Conservation Delivery Streamlining Initiative we are building technology that will get more of our staff back into the field providing world-class conservation assistance to the farmers and ranchers we serve.

American farmers are among our first and finest conservationists.  They understand better than anyone that clean water, clear air, and healthy soil are the raw materials for agricultural production.  They will face pressure to increase production in the future in the face of mounting global challenges – to feed and support an increasing world population while sustaining our natural resources.  NRCS will be there to help producers in these efforts, using proven conservation practices and the latest science and research to help secure positive outcomes for agriculture and the environment.

Jason A. Weller
Chief
Natural Resources Conservation Service

## Management's Discussion and Analysis

The Management's Discussion and Analysis (MD&A) serves as a high-level overview for the year ended September 30, 2013 of financial and non-financial performance for the Natural Resources Conservation Service (NRCS), an agency of the United States Department of Agriculture (USDA).

NRCS has chosen to produce an Agency Financial Report (AFR) and Annual Performance Report (APR). NRCS will include its FY 2013 Annual Performance Report with its Congressional Budget Justification and it will be posted with the 2015 President's Budget in February 2014, 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.

#### Major Program and Business Lines

To fulfill its mission, NRCS provides technical and financial assistance to landowners. This technical and financial assistance is delivered through one overarching major program that supports the strategic goal of "Getting More Conservation on the Ground." This goal through technical and financial assistance is delivered through six business lines. Business lines are groupings of similar products and services that NRCS employees deliver under the single strategic goal. These six business lines account for all agency Discretionary and Mandatory programs within the Statement of Net Cost (SNC).

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. **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.

3. **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.

4. **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.

5. **Conservation Operations** are the ongoing cyclical activities involved in managing NRCS 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.

6. **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.

   Business lines 1-5 are supported by our three major discretionary programs: Conservation Operations, Watershed and Flood Prevention, and Watershed Rehabilitation Programs. Business line 6 is supported by the Farm Bill Program (see Note 1A of the financial statements for a discussion of major programs).

## Organizational Structure

NRCS operates under the direction of the USDA Under Secretary for Natural Resources and Environment. The NRCS mission is carried out across four Regions, which cover all fifty states, the Caribbean and Pacific Basin Areas, three National Technology Support Centers, and nine National Centers.

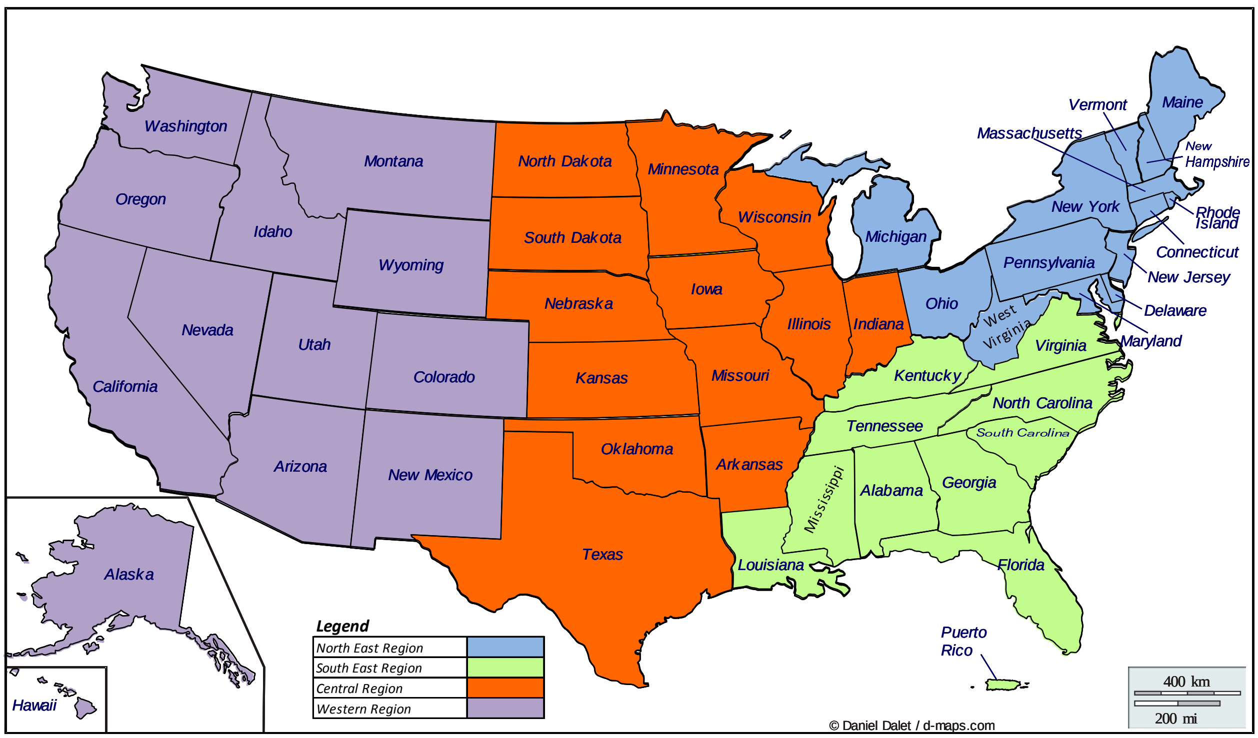



Table 1: NRCS Organizational Map of Regions

NRCS is a line and staff organization from Field office through the State Conservationist to Regional Conservationist to the Chief. There are four Regions organized geographically as Northeast, Southeast, Central, and West. In addition at Headquarters there are two Associate Chiefs, one for Operations and one for Conservation. The Associate Chief for Operations supervises the Deputy Chief for Management, Chief Information Officer, Chief Financial Officer, Deputy Chief for Strategic Planning and Accountability, and Enterprise Business Initiatives. The Associate Chief for Conservation supervises the Deputy Chief for Soil Science and Resource Assessment, Deputy Chief for Programs, Deputy Chief for Science and Technology, and Strategic Natural Resources Initiatives.

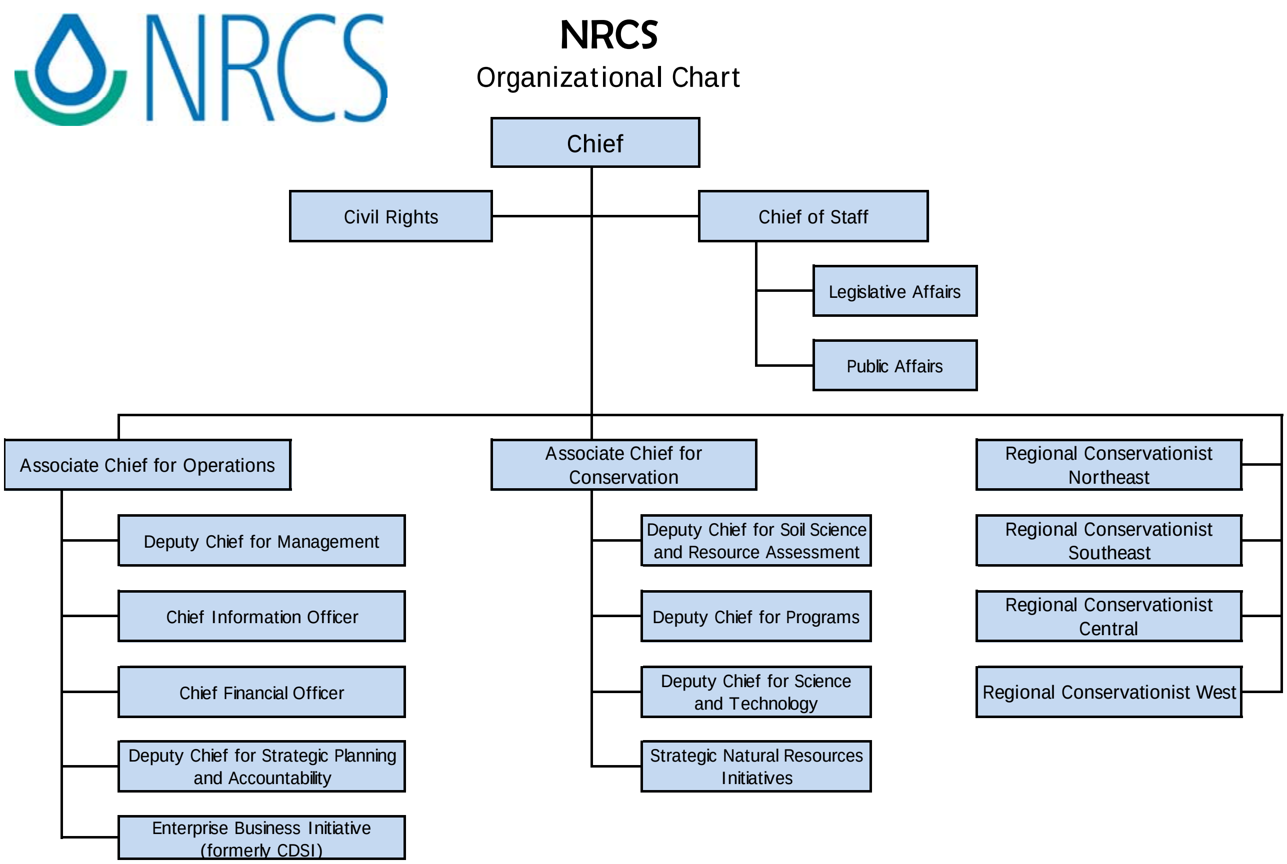



Table 2: NRCS Organizational Chart

## 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 9. 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 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 continuing improvements, there are three main efforts planned for 2014 that are integrated into a consolidated data reporting structure:

- Improve data integrity and analysis;
- Incorporate business intelligence and methodology along with process improvement techniques; and
- Link 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.

In conjunction with these efforts, NRCS implemented the Financial Management Modernization Initiative (FMMI) system in May 2012. The objective of the FMMI system is to improve financial management performance by providing a modern, core financial management system that provides maximum support to the agency's mission.

In FY 2013 the NRCS worked with the Department to enhance the functionality and value of the FMMI system by implementing internal control improvements in the following areas:

- Billing accounts receivable
- Liquidating advances
- Recording capital lease depreciation and amortization
- Recording stewardship land
- Controlling budget availability, and
- Detecting and correcting invalid upward and downward spending adjustments.

We implemented the desired enhancements for receivables, advances, stewardship land, and spending adjustments and are currently evaluating them.

## *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). 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.

| NRCS Long term Strategic Performance Measures | NRCS Key Performance Measures (KPM) | USDA KPM |
|---|---|---|
| Maintain productive working farms and ranches | Cropland with conservation applied to improve soil quality, acres | Yes |
| | Grazing and forest land with conservation applied to protect and improve the resource base, acres | Yes |
| | Prime, unique and important farmland protected from conversion to non-agricultural uses by conservation easements, acres | Yes |
| 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 | Yes |
| | Wetlands created, restored or enhanced, acres | Yes |
| | Priority landscapes with high impact, targeted conservation practices applied to improve water, acres | Yes |
| Decrease threats to "candidate" and threatened/endangered species | Non-Federal land with conservation applied to improve fish and wildlife habitat quality, acres | Yes |
| | Wetlands created, restored or enhanced, acres | Yes |
| Increase conservation treatments in critical areas | Non-Federal land with conservation applied to improve fish and wildlife habitat quality, acres | Yes |
| | Wetlands created, restored or enhanced, acres | Yes |

Table 3: Key Performance Measures (KPM)

## 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. Most FY 2013 targets are lower compared to recent years due to the sequestration of funds in FY 2013.

| Performance Scorecard for Fiscal Year 2013 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| USDA Objectives | Key Performance Measures | Trend[1] | | | | As of September 30, 2013 | | |
| | | FY 2009 | FY 2010 | FY 2011 | FY 2012 | 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) | 7.6 | 8.2 | 8.2 | 8.7 | 8.0 | 8.4 | Met |
| | 2.1.3 Cropland with conservation applied to improve soil quality Environmental Quality Incentive Program (EQIP) - (millions of acres) | 4.8 | 4.8 | 4.6 | 4.6 | 4.6 | 4.2 | Met |
| | 2.1.4 Grazing land and forest land with conservation applied to protect and improve the resource base (CTA), (millions of acres) | 16.0 | 17.6 | 17.1 | 17.1 | 16.0 | 16.6 | Met |
| | 2.1.5 Grazing land and forest land with conservation practices applied to protect and improve the resource base (EQIP), (millions of acres) | 17.2 | 17.5 | 16.3 | 17.2 | 16.2 | 17.9 | 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) | 38.3 | 53.9 | 51.5 | 45.2 | 50.0 | In-Progress[3] | - |
| | 2.1.7 Non-Federal land with conservation applied to improve fish and wildlife habitat quality (Wildlife Habitat Incentive Program), (thousands of acres) | 335.4 | 876.9 | 1,279.0 | 887.0 | 700.0 | 400.0 | Unmet |
| | 2.1.8 Non-Federal land with conservation applied to improve fish and wildlife habitat quality (EQIP), (millions of acres) | 5.2 | 6.0 | 4.8 | 6.2 | 2.5 | 2.0 | Unmet |
| 2.2 Protect and enhance America's water Resources | 2.2.1 Land with conservation applied to improve water quality (CTA), (millions of acres) | 20.5 | 22.3 | 24.0 | 23.8 | 22.0 | 22.4 | Met |
| | 2.2.2 Land with conservation applied to improve water quality (EQIP), (millions of acres) | 14.5 | 14.2 | 14.5 | 13.6 | 12.8 | 13.0 | Met |
| | 2.2.3 Wetlands created, restored or enhanced - Wetlands Reserve Program (WRP), (millions of acres) | 106.4 | 129.1 | 131.8 | 189.0 | 212.3 | 164.0 | Unmet |
| | 2.2.4 Priority landscapes with high-impact targeted conservation practices applied to improve water quality (CTA), (millions of acres) | N/A | 1.9 | 1.8 | 1.8 | 1.7 | 1.4 | Unmet |

[1] The sources of data for all performance measures are the National Conservation Planning Database (NCP), the Program Contracts Database (ProTracts) and the Performance Results System (PRS).
[2] Rationale for Met Range: Estimated performance October 1, 2012 through September 30, 2013. Data assessment metrics to meet the target allow for an actual number in the range of 90% - 110% of the target.
[3] In-progress: Final data processing, quality assurance and certification progress was delayed due to the shutdown of the government; performance data expected to be reported in November, 2013.

Table 4: Performance Scorecard for FY 2013 Trends, Targets and Results

## 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, 2013. 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 staffs 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.

## *Analysis of Entity's Financial Statements and Stewardship Information*

NRCS produces four principal financial statements on a quarterly basis to summarize the activity and associated financial position of the agency:

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

NRCS strives to provide relevant, reliable, and accurate financial information related to agency activities. The following tables reflect the comparative amounts as of September 30, 2013, and September 30, 2012.

### Assets

NRCS reported $7,606 million in assets for the year ended September 30, 2013, representing an increase of $550 million compared with assets reported in FY 2012.

| Assets (in millions) | FY 2013 | FY 2012 | Difference | Difference (Percentage) |
|---|---|---|---|---|
| Fund Balance with Treasury | $7,238 | $6,638 | $600 | 9% |
| Accounts Receivable, Net | 31 | 114 | (83) | (73%) |
| Other | 258 | 233 | 25 | 11% |
| **Total Intragovernmental** | **$7,527** | **$6,985** | **$542** | **8%** |
| Accounts Receivable, Net | 5 | 5 | 0 | 0% |
| General Property, Plant and Equipment, Net | 54 | 47 | 7 | 15% |
| Other | 20 | 19 | 1 | 5% |
| **Total Assets** | **$7,606** | **$7,056** | **$550** | **8%** |

Table 5: Assets as of September 30, 2013

Fund balance with Treasury (FBwT) 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.

Significant differences in asset balances compared to FY 2012 include receivables with other federal agencies, which decreased 73 percent. The reason for the decrease is due to NRCS converting to a new financial system midway through FY 2012. We experienced some challenges which caused a delay in recording all receivables until year end. We have since improved our processing of these transactions and balances are at a more normal level.

Other asset balances include advances made to other agencies. The balances increased by 11 percent due to increased activity in the Grassland Reserve Program which supports conservation efforts.

PP&E balances increased 15 percent due to audit remediation activities in this area and recognizing work in process for internally developed software as a new asset category.

## Liabilities

NRCS reported $1,108 million in liabilities for the year ended September 30, 2013, representing an increase of 3 percent over FY 2012.

The major liability amounts are provided in the table below.

| Liabilities (in millions) | FY 2013 | FY 2012 | Difference | Difference (Percentage) |
|---|---|---|---|---|
| Intragovernmental Accounts Payable | $1 | $0 | $1 | 100% |
| Intragovernmental Other Liabilities | 44 | 71 | (27) | (38%) |
| Accounts Payable | 23 | 33 | (10) | (30%) |
| Federal Employee Health Benefits | 40 | 39 | 1 | 3% |
| Environmental and Disposal Liabilities | 2 | 0 | 2 | 100% |
| Other | 998 | 935 | 63 | 7% |
| **Total Liabilities** | **$1,108** | **$1,078** | **$30** | **3%** |

Table 6: Liabilities as of September 30, 2013

Other Liabilities and Accounts Payable decreased by 38 and 30 percent respectively, over the past year, primarily because of improved processing of payables and other liabilities in the new financial system. For the first time in FY 2013 we are recognizing a potential environmental liability for asbestos abatement in our older buildings, which explains the increase in this category.

## Net Position

NRCS reported a net position of $6,498 million for the year ended September 30, 2013, representing a change of 9 percent over FY 2012. Net position represents unexpended appropriations consisting of undelivered orders as well as unobligated funds, and the cumulative results of operations.

| Net Position (in millions) | FY 2013 | FY 2012 | Difference | Difference (Percentage) |
|---|---|---|---|---|
| Unexpended Appropriations - Other Funds | $757 | $681 | $76 | 11% |
| Cumulative Results of Operations | 5,741 | 5,296 | 445 | 8% |
| **Total Net Position** | **$6,498** | **$5,977** | **$521** | **9%** |

Table 7: Net Position for the Year Ended September 30, 2013

Unexpended appropriations increased 11 percent over the past fiscal year. This is due to two large funds transfers from other federal agencies for Hurricane Sandy disaster relief.

## Net Cost of Operations

NRCS's net cost of operations were $3,988 million for the for the year ended September 30, 2013, representing a 2 percent decrease from September 30, 2012.

| Net Cost of Operations (in millions) | FY 2013 | FY 2012 | Difference | Difference (Percentage) |
|---|---|---|---|---|
| Gross Cost | $4,121 | $4,232 | ($111) | (3%) |
| Less: Total Earned Revenue | 133 | 163 | (30) | (18%) |
| **Total Net Cost of Operations** | **$3,988** | **$4,069** | **($81)** | **(2%)** |

Table 8: Net Cost of Operations for the Year Ended September 30, 2013

Earned revenues declined 18 percent during FY 2013 due to adjustments made to correct inadvertent billings during FY 2012. We have since improved our processing of these transactions and balances are at a more normal level.

### Budgetary Resources

NRCS's total budgetary resources were $7,503 million for the Year Ended September 30, 2013, representing a modest increase of 7 percent from September 30, 2012.

| Budgetary Resources (in millions) | FY 2013 | FY 2012 | Difference | Difference (Percentage) |
|---|---|---|---|---|
| Budgetary Resources | $7,503 | $7,040 | $463 | 7% |

Table 9: Budgetary Resources for the Year Ended September 30, 2013

Although appropriations were of a lesser amount in FY 2013 due to the sequestration, NRCS carried forward an unobligated balance of $565 million from FY 2012.

## *Analysis of Entity's Systems, Controls and Legal Compliance*

### FY 2013 Financial Statement Audit Report Results

In FY 2013, KPMG, an independent auditing firm, was engaged to audit the financial statements of NRCS. The auditors identified internal control deficiencies resulting in four material weaknesses, one significant deficiency and one finding on non-compliance with laws and regulations.

## *Management Assurances*

United States Department of Agriculture

NRCS

Natural Resources Conservation Service
Post Office Box 2890
Washington, D.C. 20013

**OMB A-123, Management's Responsibility for Internal Control Appendix A, Internal Control over Financial Reporting**

**Statement of Qualified Assurance**

The Natural Resources Conservation Service (NRCS) management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA). NRCS is able to provide a qualified statement of assurance that the internal controls and financial management systems meet the objectives of FMFIA, with the exception of four material weaknesses, one significant deficiency, and one finding of non-compliance with laws and regulations. The details of the exceptions are provided in Table 10.

The agency conducted its assessment of the effectiveness of internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*. Based on the results of this evaluation, NRCS identified no new material weaknesses in its internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of September 30, 2013. Other than the exceptions noted in the Compliance with Laws and Regulations section of this document, the internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal controls.

In addition, NRCS conducted its assessment of the effectiveness of internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular A-123. Based on the results of this evaluation, NRCS identified no new material weaknesses in its internal control over financial reporting, as of June 30, 2013. Other than the exceptions noted in Table 11, the internal controls were operating effectively, and no new material weaknesses were found in the design or operation of the internal control over financial reporting.

Richard Sims for

Jason A. Weller
Chief

*Helping People Help the Land*

An Equal Opportunity Provider and Employer

## 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. Such controls include program, operational, and administrative areas, as well as accounting and financial management.

In FY 2013, NRCS's independent auditors, KPMG, reported the following Material Weaknesses in internal controls relating to:

- Undelivered Orders;
- Financial Reporting;
- Expenses/Accrued Expenses; and
- Revenue and Accounts Receivable.

Additionally, KPMG reported a significant deficiency in internal controls related to Property, Plant and Equipment.

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, 2013. 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, 2013. However, management asserts that improvements have been made in the following areas:

- **Financial Reporting –** Significant improvements have been made regarding stewardship reporting, deferred maintenance reporting, and the effectiveness of internal controls in compliance with OMB Circular A-123.
- **Fund Balance with Treasury –** Significant improvements have been made to decrease monthly differences and clearing suspense items with other federal partners.
- **Annual Financial Report Preparation –** Significant improvements have been made in the quality of the disclosures and other supplemental information in order increase compliance with OMB Circular A-136.
- **Property, plant and equipment –** Significant improvements have been made in the areas of real property, leases and personal property. This audit finding was reduced from a material weakness to a significant deficiency.
- **Information Technology General and Access Controls –** Significant progress has been made regarding automating access management to NRCS critical resources, keeping access control procedures up to date and performing quarterly access and entitlement reviews. This audit finding was reduced from a significant deficiency to a management comment.

### 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; and the accuracy and completeness of leases and owned property.

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

| Identifier | Weakness Category (MW / SD / CD) | 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 | | 3/31/2014 |
| OIG Audit: 10401-1-12 | SD | 2012 | | | |
| OIG Audit: 10401-3-11 | MW | 2013 | | | |
| **General Accounting Operations** | | | | | |
| OIG Audit: 10401-1-12 | MW | 2012 | 6/30/2013 | | 3/31/2014 |
| **Reimbursable Agreements / Unfilled Customer Orders** | | | | | |
| OIG Audit: 10401-3-FM | MW | 2009 | 9/15/2010 | | 3/31/2014 |
| OIG Audit: 10401-4-FM | MW | 2010 | | | |
| OIG Audit: 10401-1-11 | SD | 2011 | | | |
| OIG Audit: 10401-1-12 | MW | 2012 | | | |
| OIG Audit: 10401-3-11 | MW | 2013 | | | |
| **Accrued Expenses** | | | | | |
| OIG Audit: 10401-3-FM | MW | 2009 | 9/15/2010 | | 3/31/2014 |
| OIG Audit: 10401-4-FM | MW | 2010 | | | |
| OIG Audit: 10401-1-12 | MW | 2012 | | | |
| OIG Audit: 10401-3-11 | MW | 2013 | | | |
| **Financial Reporting** | | | | | |
| OIG Audit: 10401-2-FM | MW | 2008 | 8/31/2009 | | 2/28/2014 |
| 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 | | | |
| OIG Audit: 10401-3-11 | MW | 2013 | | | |
| **Property Management / PP & E** | | | | | |
| OIG Audit: 10401-2-FM | MW | 2008 | 9/30/2009 | | 4/30/2014 |
| 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 | | | |
| OIG Audit: 10401-3-11 | SD | 2013 | | | |
| **General & Application Access Controls** | | | | | |
| OIG Audit: 10401-4-FM | MW | 2010 | 9/30/2012 | | 12/31/2014 |
| OIG Audit: 10401-1-11 | MW | 2011 | | | |
| OIG Audit: 10401-1-12 | SD | 2012 | | | |
| Weakness Categories: SD = Significant Deficiency MW = Material Weakness | | | | | |

Table 10: Federal Managers' Financial Integrity Act Action Plans

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

In FY 2013, 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, and Financial Reporting.

Based on the results of the assessment, NRCS can provide qualified assurance that internal controls over financial reporting are operating effectively.

Additionally, various Information Technology access, personnel security and account activity controls were reviewed and tested.

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

| Identifier | Short Title | Weakness Category (MW / SD / CD) | Year Identified | Original Estimated Completion Date | Actual Completion Date | Revised Completion Date |
|---|---|---|---|---|---|---|
| **Section 2:** | | | | | | |
| **Financial Reporting** | | | | | | |
| CAP Ref # 2011.10.09.001 | Financial Reporting Business Subcategories:<br>- Other Proprietary and Budgetary Reporting<br>- User Access and GL Maintenance<br>- Journal Entry Processing<br>- Monitoring<br>- Period End Reporting (Unliquidated Obligations)<br>- Significant Management Estimates | MW | 2008 | 02/28/2012 | 07/10/2013 | |
| **Human Resources** | | | | | | |
| CAP Ref # 2011.10.03.002 | Reporting and Monitoring | SD (reassessed to CD) | 2011 | 9/30/2011 | | 01/31/2014 |
| CAP Ref # 2012.10.03.005 | Personnel and Payroll Master Filed Maintenance- SINQ Report | SD | 2012 | 11/30/2013 | | |
| CAP Ref # 2012.10.03.006 | Time and Attendance Leave Balances | SD (reassessed to CD) | 2012 | 11/30/2013 | | |
| CAP Ref # 2012.10.03.007 | Time and Attendance Leave Balances | SD (reassessed to CD) | 2012 | 11/30/2013 | | |
| CAP Ref # 2012.10.03.008 | Personnel and Payroll Master Filed Maintenance- Access Profile | SD (reassessed to CD) | 2012 | 11/30/2013 | | |
| **Funds Control Management** | | | | | | |
| CAP Ref # 2011.10.02.001 | Allowances - Initial and Transfer | SD (reassessed to CD) | 2011 | 09/30/2012 | | 01/31/2014 |
| CAP Ref # 2012.10.02.001 | Budget Authority | SD (reassessed to CD) | 2012 | 09/30/2013 | | 01/31/2014 |
| **Grants Management** | | | | | | |
| CAP Ref# 2011.10.07.002 | Grants Management / Cooperative Agreements | MW | 2009 | 09/30/2012 | 08/21/2013 | |
| CAP Ref # 2013.10.07.001 | Closeout/Non-ProTracts | SD | 2013 | 03/31/2014 | | |
| CAP Ref # 2012.10.07.001 | Awards / Obligations | SD (reassessed CD) | 2012 | 11/30/2013 | | |
| Weakness Categories: SD = Significant Deficiency MW = Material Weakness CD = Control Deficiency | | | | | | |

| Identifier | Short Title | Weakness Category (MW / SD / CD) | Year Identified | Original Estimated Completion Date | Actual Completion Date | Revised Completion Date |
|---|---|---|---|---|---|---|
| **Section 4:** | | | | | | |
| **Access Control** | | | | | | |
| POAM ID # 11536 | General Computer Controls –Access Management | CD | 2009 | 12/31/2011 | | 12/30/2013 |
| POAM ID # 15115 | General Computer Controls –Access Management | CD | 2010 | 09/30/2011 | 09/09/2013 | |
| POAM ID # 17991 | General Computer Controls –Access Management | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 17992 | General Computer Controls –Access Management | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 17984 | General Computer Controls –Access Management | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 11541 | Account Management | CD | 2009 | 11/15/2011 | 12/20/2012 | |
| POAM ID # 15111 | Supervision and Review | CD | 2010 | 09/30/2011 | 09/24/2013 | |
| **Configuration Management** | | | | | | |
| POAM ID # 17988 | General Computer Controls –Configuration Change Control | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 17981 | General Computer Controls –Configuration Change Control | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 17989 | General Computer Controls –Access Restriction for Change | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 17982 | General Computer Controls – Access Restriction for Change | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 15114 | External Information System Services | CD | 2010 | 09/30/2011 | 10/17/2012 | |
| POAM ID # 13975 | Configuration Management | CD | 2010 | 09/30/2011 | 12/17/2012 | |
| **Personnel Security** | | | | | | |
| POAM ID # 16012 | General Computer Controls – Timeliness of Employee Separation Actions | CD | 2010 | 09/30/2011 | 08/02/2013 | |
| POAM ID # 17983 | General Computer Controls – Personnel Termination | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 17914 | General Computer Controls – Personnel Transfer | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 17990 | General Computer Controls – Personnel Transfer | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 15116 | Personnel Security Policy and Procedures | CD | 2010 | 09/30/2011 | 08/02/2013 | |
| POAM ID # 15117 | Personnel Screening | CD | 2010 | 09/30/2011 | 08/02/2013 | |
| POAM ID # 16569 | Background Investigations | CD | 2011 | 10/18/2012 | 07/16/2013 | |

Weakness Categories: SD = Significant Deficiency MW = Material Weakness CD = Control Deficiency

| Identifier | Short Title | Weakness Category (MW / SD / CD) | Year Identified | Original Estimated Completion Date | Actual Completion Date | Revised Completion Date |
|---|---|---|---|---|---|---|
| **Section 4:** | | | | | | |
| **Access Control** | | | | | | |
| POAM ID # 11536 | General Computer Controls –Access Management | CD | 2009 | 12/31/2011 | | 12/30/2013 |
| POAM ID # 15115 | General Computer Controls –Access Management | CD | 2010 | 09/30/2011 | 09/09/2013 | |
| POAM ID # 17991 | General Computer Controls –Access Management | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 17992 | General Computer Controls –Access Management | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 17984 | General Computer Controls –Access Management | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 11541 | Account Management | CD | 2009 | 11/15/2011 | 12/20/2012 | |
| POAM ID # 15111 | Supervision and Review | CD | 2010 | 09/30/2011 | 09/24/2013 | |
| **Configuration Management** | | | | | | |
| POAM ID # 17988 | General Computer Controls –Configuration Change Control | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 17981 | General Computer Controls –Configuration Change Control | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 17989 | General Computer Controls –Access Restriction for Change | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 17982 | General Computer Controls – Access Restriction for Change | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 15114 | External Information System Services | CD | 2010 | 09/30/2011 | 10/17/2012 | |
| POAM ID # 13975 | Configuration Management | CD | 2010 | 09/30/2011 | 12/17/2012 | |
| **Personnel Security** | | | | | | |
| POAM ID # 16012 | General Computer Controls – Timeliness of Employee Separation Actions | CD | 2010 | 09/30/2011 | 08/02/2013 | |
| POAM ID # 17983 | General Computer Controls – Personnel Termination | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 17914 | General Computer Controls – Personnel Transfer | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 17990 | General Computer Controls – Personnel Transfer | CD | 2012 | 12/28/2012 | | 12/30/2013 |
| POAM ID # 15116 | Personnel Security Policy and Procedures | CD | 2010 | 09/30/2011 | 08/02/2013 | |
| POAM ID # 15117 | Personnel Screening | CD | 2010 | 09/30/2011 | 08/02/2013 | |
| POAM ID # 16569 | Background Investigations | CD | 2011 | 10/18/2012 | 07/16/2013 | |
| Weakness Categories: SD = Significant Deficiency MW = Material Weakness CD = Control Deficiency | | | | | | |

Table 11: Deficiencies and Corrective Action Plan Status

## Federal Financial Management Improvement Act (FFMIA) of 1996

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 | 10/31/2013 | |
| 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 | | 02/28/2014 |
| OIG-10401-3-FM | 2009 | | | |
| OIG-10401-4-FM | 2010 | | | |
| OIG-10401-1-11 | 2011 | | | |
| OIG-10401-2-11 | 2012 | | | |
| OIG-10401-3-11 | 2013 | | | |
| **Stewardship Reporting** | | | | |
| OIG-10401-2-FM | 2008 | 07/31/2009 | 10/31/2013 | |
| OIG-10401-3-FM | 2009 | | | |
| OIG-10401-4-FM | 2010 | | | |
| OIG-10401-1-11 | 2011 | | | |
| OIG-10401-2-11 | 2012 | | | |
| **Section 3: Standard General Ledger at the Transaction Level** | | | | |
| **Non Compliance with USSGL** | | | | |
| OIG-10401-2-FM | 2008 | 07/31/2009 | | 02/28/2014 |
| OIG-10401-3-FM | 2009 | | | |
| OIG-10401-4-FM | 2010 | | | |
| OIG-10401-1-11 | 2011 | | | |
| OIG-10401-2-11 | 2012 | | | |
| OIG-10401-3-11 | 2013 | | | |
| **Section 4: Information Security, Policies, Procedures and Practices** | | | | |
| **General and Application Access Controls** | | | | |
| OIG-10401-4-FM | 2010 | 09/30/2012 | 10/31/2013 | |
| OIG-10401-1-11 | 2011 | | | |
| OIG-10401-2-11 | 2012 | | | |

Table 12: FFMIA Table of Deficiencies and Status of Corrective Action Plans

## Compliance with Laws and Regulations

The FY 2013 audit noted that NRCS is not substantially complying with FFMIA. It was noted that beginning net position balances and current year activity; obligations incurred, including accrued expenses and undelivered orders; real and personal property; recoveries of prior year unpaid obligations; advances to others; and accrued revenue, accounts receivable, and unfilled customer orders were not properly recorded in accordance with Federal accounting standards. Additionally, it was noted that NRCS did not use the USSGL appropriate posting models for recoveries of prior year obligations paid and unpaid and nonproduction costs.

## 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.

NRCS took a number of actions to improve information security during FY 2013, including:

- reviewing and updating system access control procedures, documenting procedures for requesting and reviewing access, and conducting access reviews based upon an effective design of role-based access controls. NRCS management validated the effective operation of these controls,
- completing phase one of a centralized system to automate the access administration process which will serve to manage access requests, perform access reviews, and update and terminate access as required,
- performing three access reviews for all new, existing and prior users of the financial system,
- implementing the password 60 day age limit within the EmpowrHR System or ensuring the existence of compensating controls,
- completing the first phase of implementing internal control and audit environments for information technology, and
- completing testing and deliverables according to the requirements of OMB Circular A123.

## Antideficiency 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 reapportionment, or in excess of the amount permitted by agency regulations.

Federal employees who violate the Antideficiency 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 Antideficiency Act have been identified or reported in FY 2013.

## 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.

## GAO/OIG Active Audits

A summary of 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, 2013 | | | |
|---|---|---|---|
| **Active Audit Number/Name** | **Start Date** | **Final Report Date** | **Audit Status** |
| OIG- NRCS's Administration of Easement Programs in Wyoming- 10099-0001-31 | 3/1/2013 | 9/27/2013 | OPEN |
| 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 | 11/9/2012 | OPEN |
| OIG-10601-6-KC - Disaster Assistance EWP | 1/12/2009 | 4/5/2011 | OPEN |
| OIG-10601-0001-22 Oversight and Compliance Activities | 8/1/2011 | 2/7/2013 | OPEN |
| OIG - Environmental Quality Incentives Program -10601-0001-31 | 12/18/2012 | | OPEN |
| OIG- NRCS Conservation Easement Compliance -- 10601-2-31 | 5/28/2013 | | OPEN |
| OIG- Controls Over Land Valuations for Conservation Easements - 10601-0001-23 | 9/20/2013 | | OPEN |
| GAO- Feed the Future Initiative-320969 | 1/1/2012 | 9/17/2013 | CLOSED |
| GAO- Climate Change Adaptation in natural Resources-361361 | 12/1/2011 | 5/31/2013 | CLOSED |
| GAO- Remanufactured Vehicle Parts-544182 | 8/1/2012 | 3/7/2013 | CLOSED |
| OIG-10601-04-KC - Conservation Security Program | 11/1/2006 | 6/1/2009 | OPEN |
| OIG 10703-1-AT - ARRA - Rehabilitation of Flood Control Dams | 9/1/2010 | 3/25/2013 | OPEN |
| OIG- (Phase I) - ARRA Emergency Watershed Protection Program - 10703-1-KC | 4/2/2009 | 9/1/2010 | OPEN |
| OIG- Recovery Act-Emergency Watershed Protection Program-Floodplain Easements and Watershed Operations Program-Phase III - 10703-0001-31 | 2/9/2012 | 3/14/2013 | OPEN |
| OIG- ARRA-EWP-Floodplain Easements (Phase 2) - 10703-3-KC | 1/22/2010 | 3/14/2012 | OPEN |
| OIG- (Phase 2) Watershed Protection and Flood Prevention Operations Program Phase II Field Confirmations- 10703-4-KC | 7/15/2010 | 7/24/2012 | OPEN |

| GAO/OIG Active Audits Year ended September 30, 2013 | | | |
|---|---|---|---|
| **Active Audit Number/Name** | **Start Date** | **Final Report Date** | **Audit Status** |
| OIG- (Phase II) ARRA Emergency Watershed Protection Program Floodplain Easement 10703-5-KC | 7/15/2010 | 3/14/2013 | 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 | 8/9/2012 | OPEN |
| OIG Calendar Year 2012 Executive Order 13520, Eliminating Improper Payments, High-Dollar Overpayments Report Review - 50024-0003-11 and | 12/6/2012 | 8/22/2013 | OPEN |
| Improper Payment Elimination and recovery Act of 2010 (IPERA) Compliance Review for FY 2012 - 50024-0004-11 | 12/6/2012 | 3/14/2013 | OPEN |
| OIG- Fiscal Year 2013 Federal Information Security Management Act (FISMA) - 50501-4-12 | 4/23/2013 | | OPEN |
| OIG- Analysis of Jobs Reported for American Recovery and Reinvestment Act-USDA FederalReporting.gov Data Quality -Review - 50703-02-13 Revised case no. - 50703-02-DA. | 1/19/2012 | | OPEN |
| GAO-360644 - USDA Funding for EQIP | 10/1/2005 | 9/1/2006 | OPEN |
| GAO- 361251 -Nonpoint Source Water Pollution | 11/29/2010 | 7/3/2012 | OPEN |
| GAO- Federal Wind Energy Initiatives - 361379 | 2/3/2011 | 3/11/2013 | OPEN |
| GAO- USDA Payments to the Deceased - 361397 | 4/2/2012 | 6/28/2013 | OPEN |
| GAO- Great Lakes Restoration Initiatives - 361404 | 7/6/2012 | | OPEN |
| GAO- USDA Implementation of Adjusted Gross Income Limitations for Farm Programs, 361418 | 6/7/2012 | 8/29/2013 | OPEN |
| GAO - Missouri River Flood of 2011 -- 361435 | 11/14/2012 | | OPEN |
| GAO - Human Capital Mgmt. & Restructuring Efforts at USDA -- 361444 | 10/26/2012 | | OPEN |
| GAO - Review of Non-Medical Radiological Sources -- 361452 | 11/14/2012 | | OPEN |
| GAO - Freshwater Supply Update - 361454 | 11/1/2012 | | OPEN |
| GAO - Potential Overlap and Duplication Among Federal Farm Safety Net Programs, 361465 | 2/26/2013 | | OPEN |
| GAO- Federal Vehicle Fleet Management, 541098 | 8/29/2012 | 7/31/2013 | CLOSED |
| GAO - Federal Facilities Space Use -- 542215 | 2/13/2013 | | OPEN |

Table 13: GAO/OIG Active Audits Summary Report as of September 30, 2013

## *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 initiative supports the NRCS mission of getting more conservation on the ground. 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 NRCS' Associate Chief for Operations to ensure an integrated approach rather than a stove-piped Agency-wide approach. CDSI staff has implemented and continues to implement five major initiatives during the 2011-2015 time period 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 in 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. In October 2012, NRCS began testing the Conservation Desktop application-version 1. NRCS deployed version 1 as a beta release to four states in March 2013. Upon completion of the four-state beta test, additional assessments were performed that included agency quality assurance tests and an independent assessment from a leading information technology research and advisory firm. Based on these tests and assessments NRCS decided to revise its deployment timeline and path forward.

NRCS worked closely with USDA and the Office of Management and Budget between May 2013 and October 2013 to finalize the path forward including a revised timeline. In July 2013, the "CDSI Path Forward and Corrective Action Plan (CAP)" was prepared by NRCS to address lessons learned and to apply best practices as CDSI moves forward. It included:

- Lessons learned and mitigation strategies;
- An improved strategy for a modular development approach that splits Conservation Desktop into three separate releases;
- Development of the CD and Mobile Planning Tool under one contract;
- Complete Re-planning/re-baselining of the CDSI investment;

- CDSI Action plan for mitigating risks;
- Creation of a CDSI Leadership Oversight Board;
- Creation of a CDSI Technical Advisory Team; and
- Contract with Gartner Group for continuous consultation and assessment.

The new path forward was approved by NRCS leadership, USDA-OCIO, and OMB in September 2013 and will be implemented in 2014 and 2015. The first nationwide release of the Conservation Desktop is now tentatively planned for the first half of calendar year 2015.

*American Recovery and Reinvestment Act of 2009 (ARRA)*
The President signed the American Recovery and Reinvestment Act of 2009 (Recovery Act) on February 17, 2009. NRCS received $145 million for the Floodplain Easements component of its Emergency Watershed Protection Program and $145 million for the Watershed Protection and Flood Prevention Operations Program (Watershed Operations). Detailed information can be found at Recovery.Gov.

The focus of the Floodplain Easement component is to restore, protect, maintain, and enhance the functions of the floodplain, including safeguarding lives and property from floods and the products of erosion. NRCS will utilize ARRA funds designated for the Floodplain Easement program through grants and agreements with individual landowners. These financial awards will be structured to create jobs, stimulate the economy, and accomplish high priority work on flood-prone lands.

Watershed Operations is a voluntary program which provides assistance to sponsoring local organizations of authorized watershed projects, planned and approved under the authority of the Watershed Protection and Flood Prevention Act of 1954 (P.L. 83-566), and 11 designated watersheds authorized by the Flood Control Act of 1944 (P.L. 78-534). NRCS provides technical and financial assistance to States, local governments, and Tribes (project sponsors) to implement authorized watershed project plans for purposes including: watershed protection; flood mitigation; water quality improvements; soil erosion reduction; rural, municipal, and industrial water supply; irrigation water management; sediment control; fish and wildlife enhancement; and wetlands and wetland function creation and restoration. ARRA-funded watershed projects are prioritized to jumpstart the economy, create jobs, and invest in our nation's public infrastructure.

## *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.

*Message from the CFO*

This has been an exciting and rewarding year for the financial community of NRCS. We have worked hard to stabilize our new financial system, improve reporting, and create efficiencies in financial processing.

I am pleased to present the fiscal year (FY) 2013 financial statements, the independent public accounting firm of KPMG LLP was engaged to audit, with oversight by the USDA, Office of the Inspector General. We have made continued improvement in financial management operations, our internal controls, and in the financial systems used to run our conservation operations.

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.

We continue to work closely with our State and local offices to improve financial management, streamline operations, and create efficiencies to put more conservation on the ground. Resolving our material weaknesses is paramount to our ability to provide conservation to our Nation. As we move into FY 2014, I am confident that our continued efforts and dedication will provide a path towards achieving a clean audit opinion.

I would like to take this opportunity to express my appreciation for the continued dedication and professionalism of the financial management community to improve our financial operations and reporting. I look forward to our continued work together and achieving a clean opinion for NRCS.

Stephen M. Kunze
Chief Financial Officer

Natural Resources Conservation Service

## Balance Sheet

As of September 30, 2013
(in Millions)

| | |
|---|---|
| **Assets (Note 2):** | |
| Intragovernmental: | |
| Fund Balance with Treasury (Note 3) | $7,238 |
| Accounts Receivable (Note 4) | 31 |
| Other (Note 7) | 258 |
| Total Intragovernmental | $7,527 |
| Accounts Receivable, Net (Note 4) | 5 |
| General Property, Plant and Equipment, Net (Note 5) | 54 |
| Other (Note 7) | 20 |
| **Total Assets** | **$7,606** |
| Stewardship PP&E (Notes 6 and 16) | |
| **Liabilities:** | |
| Intragovernmental: | |
| Accounts Payable | $1 |
| Other (Notes 8 and 10) | 44 |
| Total Intragovernmental | $45 |
| Accounts Payable | 23 |
| Federal Employee and Veteran Benefits (Note 8) | 40 |
| Environmental and Disposal Liabilities (Notes 8 and 9) | 2 |
| Other: (Note 10) | |
| Accrued Liabilities for Other Services | 888 |
| Unfunded Leave (Note 8) | 77 |
| Accrued Payroll and Leave | 18 |
| Liabilities for Deposit Funds and Clearing Accounts | 11 |
| Other | 4 |
| Total Other: | 998 |
| **Total Liabilities** | **$1,108** |
| Commitments and Contingencies (Note 12) | |
| **Net Position:** | |
| Unexpended Appropriations | $757 |
| Cumulative Results of Operations - from Dedicated Collections (Note 13) | 1 |
| Cumulative Results of Operations - Other Funds | 5,740 |
| **Total Net Position** | **$6,498** |
| **Total Liabilities and Net Position** | **$7,606** |

The accompanying notes are an integral part of these statements.

Natural Resources Conservation Service

## Statement of Net Cost

for the Year Ended September 30, 2013
(in Millions)

| | |
|---|---|
| **Gross Program Costs:** | |
| **Get More Conservation on the Ground** | |
| Gross Costs (Notes 14, 15, 16, and 22) | $4,121 |
| Less: Earned Revenue | 133 |
| **Net Program Costs** | **$3,988** |
| | |
| **Total Gross Costs:** | $4,121 |
| **Less: Total Earned Revenue (Note 17)** | $133 |
| **Net Cost of Operations** | **$3,988** |

The accompanying notes are an integral part of these statements.

Unaudited – See accompanying independent auditors' report

Natural Resources Conservation Service

## Statement of Changes in Net Position

for the Year Ended September 30, 2013

(in millions)

| Cumulative Results of Operations: | Funds from Dedicated Collections (Note 13) | All Other Funds | Total |
|---|---|---|---|
| Beginning Balance | $1 | $5,298 | $5,299 |
| Adjustments | | | |
| Changes in accounting principles (Notes 1 and 9) | 0 | (2) | (2) |
| Beginning Balance, as adjusted | $1 | $5,296 | $5,297 |
| **Budgetary Financing Sources:** | | | |
| Other adjustments | $0 | ($166) | ($166) |
| Appropriations used | 0 | 929 | 929 |
| Transfers in/out without reimbursement | 0 | 3,521 | 3,521 |
| **Other Financing Sources (Non-Exchange):** | | | |
| Imputed financing | $0 | $151 | $151 |
| Other | 0 | (3) | (3) |
| **Total Financing Sources** | 0 | 4,432 | 4,432 |
| **Net Cost of Operations** | 0 | (3,988) | (3,988) |
| **Net Change** | 0 | 444 | 444 |
| **Cumulative Results of Operations** | $1 | $5,740 | 5,741 |
| **Unexpended Appropriations:** | | | |
| Beginning Balance | $0 | $681 | $681 |
| **Budgetary Financing Sources:** | | | |
| Appropriations received | $0 | $911 | $911 |
| Appropriations transferred in/out | 0 | 180 | 180 |
| Other adjustments | 0 | (86) | (86) |
| Appropriations used | 0 | (929) | (929) |
| **Total Budgetary Financing Sources** | 0 | 76 | 76 |
| **Total Unexpended Appropriations** | $0 | $757 | $757 |
| **Net Position** | **$1** | **$6,497** | **$6,498** |

The accompanying notes are an integral part of these statements.

Natural Resources Conservation Service

## Combined Statement of Budgetary Resources

for the Year Ended September 30, 2013
(in Millions)

| | |
|---|---|
| **Budgetary Resources:** | |
| Unobligated balance, brought forward, October 1 | $2,438 |
| Recoveries of prior year unpaid obligations | 550 |
| Other changes in unobligated balance | (9) |
| Unobligated balance from prior year budget authority, net | 2,979 |
| Appropriations (discretionary and mandatory) | 4,370 |
| Spending authority from offsetting collections (discretionary and mandatory) | 154 |
| Total budgetary resources | $7,503 |
| **Status of Budgetary Resources:** | |
| Obligations Incurred (Note 18,19,20,21 and 22) | $4,452 |
| **Unobligated balance, end of year:** | |
| Apportioned | 665 |
| Unapportioned | 2,386 |
| Total unobligated balance, end of year | $3,051 |
| Total budgetary resources | $7,503 |
| **Change in obligated balance:** | |
| **Unpaid obligations:** | |
| Unpaid obligations, brought forward, October 1 | $4,514 |
| Obligations incurred | 4,452 |
| Outlays (gross) | (3,991) |
| Recoveries of prior year unpaid obligations | (550) |
| Unpaid obligations, end of year (Note 19) | 4,425 |
| **Uncollected Payments:** | |
| Uncollected payments, Federal sources, brought forward, October 1 | (306) |
| Change in uncollected payments, Federal sources | 68 |
| Uncollected payments, Federal sources, end of year | (238) |
| **Memorandum (non-add) entries:** | |
| Obligated balance, start of year | $4,208 |
| Obligated balance, end of year | $4,187 |
| **Budget Authority and Outlays, Net:** | |
| Budget authority, gross (discretionary and mandatory) | $4,525 |
| Actual offsetting collections (discretionary and mandatory) | (223) |
| Change in uncollected customer payments from Federal sources (discretionary and mandatory) | 68 |
| Budget authority, net (discretionary and mandatory) | $4,370 |
| Outlays, gross (discretionary and mandatory) | $3,991 |
| Actual offsetting collections (discretionary and mandatory) | (223) |
| Outlays, net (discretionary and mandatory) | 3,769 |
| Distributed offsetting receipts | (9) |
| Agency outlays, net (discretionary and mandatory) | $3,760 |

The accompanying notes are an integral part of these statements.

## *Notes to the Financial Statements for the Year ended September 30, 2013*

### 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, the 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 and areas. The Regions include two East Regions, the Northeast Region and the Southeast Region. 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 three major programs: Conservation Operations, Watershed and Flood Prevention, 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.

*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.

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 is approximated at $3,521 million for FY 2013.

*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 October 21, 2013 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 revised the presentation of its liabilities on the balance sheet in FY 2013, primarily those line items that comprise the Other liabilities section. For 2013, NRCS reported intragovernmental accounts payable and payables with the public as separate line items. The Accrued Liabilities for Other Services line item now includes the FY 2012 line items for Accrued Liabilities for Grants and Liabilities for Land and Structure. This year, Unfunded Leave is reported in its own line item, distinct from Accrued Payroll and Leave, whereas in FY 2012, these liabilities were combined on the balance sheet. NRCS added new line items for Environmental and Disposal Liabilities (see the note below and note 9) and Liabilities for Deposit Funds and Clearing Accounts (see note 10) in FY 2013.

NRCS has a change in accounting principle to report for FY 2013. USDA agencies are now disclosing information related to probable cleanup costs for environmental hazards in accordance with Statements of Federal Financial Accounting Standards (SAFFAS) No. 5, Accounting for Liabilities of the Federal Government, SFFAS No. 6, Accounting for Property, Plant and Equipment, and Federal Financial Accounting and Auditing Technical Release No. 2. The disclosure is found in Note 9 of these statements. Since NRCS is not preparing comparative statements we are not restating prior year financial information. As a result of the change in accounting principle, liabilities on the Balance Sheet increased by $2 million, and cumulative results of operations on the Balance Sheet and the beginning balance in cumulative results of operations of the Consolidated Statement of Changes in Net Position both decreased by $2 million.

*C. Fund Balance with 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*

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 estimated 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 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. Pursuant to Public Law 112-96, employees hired on or after January 1, 2013 will pay 2.3 percent more for FERS retirement coverage than employees hired earlier. Federal agencies will contribute 2.3 percent less to the retirement fund.

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 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. Finally, USDA allocates a portion of its headquarters office space, operations, and maintenance costs to each USDA agency. NRCS recognized imputed financing of $151 million for the year ended September 30, 2013 for the Treasury Judgment Fund, accrued pension and post-retirement benefit expense, and the USDA headquarters allocation.

*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.

*N. Funds from Dedicated Collections*

NRCS reports Funds from Dedicated Collections for which it has program management responsibility using the following three criteria:

- A statute committing the Federal Government to use specifically identified revenues and other financial sources only for designated activities, benefits, or purposes.
- Explicit authority for the Funds from Dedicated Collections to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes.
- A requirement to account for and report on the receipt use and retention of the revenues and other financing sources that distinguishes the Funds from Dedicated Collections from the Federal Government’s general revenues.

## Note 2 - Non-Entity Assets

Non-entity assets include receipts collected and accounts receivable recorded on behalf of the U.S. Treasury and other USDA agencies. These collections and billings are primarily for interest, fines, penalties, and miscellaneous receipts and deposits.

| Non Entity Assets: (in millions) | 2013 |
|---|---|
| Accounts Receivable | $1 |
| Total Non-Entity Assets | 1 |
| Total Entity Assets | 7,605 |
| **Total Assets** | **$7,606** |

Table 14: Non-Entity Assets as of September 30, 2013

## 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, Intragovenmental 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) | 2013 |
|---|---|
| Fund Balances: | |
| General Funds | $7,237 |
| Trust Funds | 1 |
| **Total** | **$7,238** |

| Status of Fund Balance with Treasury (in millions) | 2013 |
|---|---|
| Unobligated Balance: | |
| Available | $665 |
| Unavailable | 2,386 |
| Obligated balance not yet disbursed | 4,187 |
| **Total** | **$7,238** |

Table 15: Fund Balance with Treasury as of September 30, 2013

### 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) | 2013 |
|---|---|
| Accounts Receivable, Gross | |
| Intragovernmental | $31 |
| With the Public | 6 |
| Allowance | |
| With the Public | 1 |
| Accounts Receivable, Net | |
| Intragovernmental | $31 |
| With the Public | 5 |
| **Total** | **$36** |

Table 16: Accounts Receivable as of September 30, 2013

### 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. The largest category of PP&E consists of internally developed program and information systems that are developed by contractors or NRCS employees after undergoing a detailed and structured investment review process to determine if the need for the system cannot be met through an existing product and if the benefits of the new system are worth the cost. General office and field equipment is the second largest category, followed by buildings used in field operations.

| 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 | $64 | $50 | $14 |
| Internal Use Software | 5 | 25 | 24 | 1 |
| Internal Use Software in Development | 0 | 31 | 0 | 31 |
| Total Personal Property | | 120 | 74 | 46 |
| Real Property: | | | | |
| Land and Land Rights | | 1 | 0 | 1 |
| Buildings, Improvements and Renovations | 15 – 30 | 13 | 9 | 4 |
| Other Structures & Facilities | 15 - 50 | 4 | 3 | 1 |
| Assets under Capital Leases | Varies | 6 | 4 | 2 |
| Total Real Property | | 24 | 16 | 8 |
| **Total** | | **$144** | **$90** | **$54** |

Table 17: General PP&E as of September 30, 2013

## 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. 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.

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 September 30, 2013, NRCS had 16,253 stewardship land easements. Monitoring 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.

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 2012 | Adjustments to 2012 Balance | Beginning Balance 2013 | Additions + | Expiration / Termination | 2013 Balance |
|---|---|---|---|---|---|---|
| **Heritage Assets** | | | | | | |
| Research Centers | 1 | 0 | 1 | 0 | 0 | 1 |
| **Stewardship Land** | | | | | | |
| Conservation Easements | 14,736 | 349 | 15,085 | 1,168 | 0 | 16,253 |

Table 18: Stewardship easements as of September 30, 2013

## 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) | 2013 |
|---|---|
| Intragovernmental | $258 |
| With the Public | 20 |
| **Total** | **$278** |

Table 19: Other Assets as of September 30, 2013

## Note 8 - Liabilities Not Covered by Budgetary Resources

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.

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) | 2013 |
|---|---|
| Intragovernmental: | |
| FECA | $7 |
| Custodial liabilities | 0 |
| **Total Intragovernmental** | **7** |
| Unfunded leave | 77 |
| Federal employee & veterans benefits | 40 |
| Environmental and disposal liabilities | 2 |
| Custodial liabilities | 1 |
| Total liabilities not covered by budgetary resources | 127 |
| Total liabilities covered by budgetary resources | 981 |
| **Total liabilities** | **$1,108** |

Table 20: Liabilities not covered by budgetary resources as of September 30, 2013

## Note 9 - Environmental and Disposal Liabilities

For the first time in FY 2013, NRCS discloses information related to probable cleanup costs for environmental hazards in accordance with Statements of Federal Financial Accounting Standards (SFFAS) No. 5, Accounting for Liabilities of the Federal Government, SFFAS No. 6, Accounting for Property, Plant and Equipment, and Federal Financial Accounting and Auditing Technical Release No. 2. This is a change in accounting principle (see note 1B)

NRCS's primary environmental liability stems from the potential cost for treatment and removal of asbestos containing materials in buildings owned by the agency. Application of asbestos containing materials as a fire retardant was a common practice in the building industry through the late 1970s. As these buildings are remodeled, rehabilitated, or torn down, asbestos abatement and removal is necessary to prevent human ingestion of air borne asbestos particles.

The Department of Agriculture (USDA) established a cost rate for estimating asbestos treatment costs for all USDA agencies. The rate was computed by totaling actual asbestos treatment costs incurred by USDA agencies and dividing the cost by the square footage of the area treated. The current rate is $6.59 per square foot.

NRCS estimated its asbestos cleanup liability by applying this cost rate to the square footage of buildings that were built during the era when use of asbestos was prevalent. Accordingly, the NRCS has recognized an estimated liability for asbestos abatement in the amount of $2 million for the year ended September 30, 2013.

## Note 10 - Other Liabilities

Other liabilities include but are not limited to payables for cooperative agreements, advances and prepayments from others, and accrued liabilities. The liability for deposit funds and clearing accounts reflects the amount that offsets collections awaiting disposition or reclassification. NRCS's other liabilities include intragovernmental and those with the public as presented in table below.

| Other Liabilities (in millions) | Fiscal Year 2013 | | |
|---|---|---|---|
| | Non Current | Current | Total |
| Intragovernmental: | | | |
| Accrued Liabilities for Other Services | $0 | $41 | $41 |
| Employee contributions & payroll taxes | 0 | 5 | 5 |
| Unfunded FECA Liability | 6 | 0 | 6 |
| Liabilities for Deposit Funds and Clearing Accounts | 0 | (8) | (8) |
| **Total Intragovernmental** | **$6** | **$38** | **$44** |
| Accrued Liabilities for Other Services | $0 | $888 | $888 |
| Unfunded Leave | 77 | 0 | 77 |
| Accrued Funded Payroll and Leave | 0 | 18 | 18 |
| Liabilities for Deposit Funds and Clearing Accounts | 0 | 11 | 11 |
| Liability for Advances | 0 | 2 | 2 |
| Liability for Capital Leases | 2 | 0 | 2 |
| **Total Other Liabilities** | **$85** | **$957** | **$1,042** |

Table 21: Other Liabilities as of September 30, 2013

## Note 11 - 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 some equipment. The lease arrangements generally range from five to ten years.

| Entity as Lessee: Capital Leases | FY 2013 (in millions) |
|---|---|
| Summary of Assets Under Capital Leases | |
| Land and Buildings | $6 |
| Accumulated Amortization | $4 |

Table 22: Capital Leases Summary as of September 30, 2013

| Capital Leases Future Payments Due: | Land and Buildings (in millions) |
|---|---|
| Year 1 (2014) | $2 |
| Year 2 (2015) | 1 |
| Year 3 (2016) | 1 |
| Year 4 (2017) | 1 |
| Year 5 (2018) | 0 |
| After 5 Years | 0 |
| **Total Future Lease Payments** | **$5** |
| Less: Imputed Interest | 1 |
| Less: Executory Costs | 2 |
| **Net Capital Lease Liability** | **$2** |
| Lease liabilities covered by budgetary resources | 2 |

Table 23: Total Capital Leases Future Payments

| Operating Leases - Future Payments Due: | Land and Buildings (in millions) |
|---|---|
| Year 1 (2014) | $19 |
| Year 2 (2015) | 17 |
| Year 3 (2016) | 15 |
| Year 4 (2017) | 12 |
| Year 5 (2018) | 10 |
| After 5 Years | 17 |
| **Total Future Lease Payments** | **$90** |

Table 24: Total Operating Leases Future Payments

## Note 12 - 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, 2013. NRCS has no reportable claims for lawsuits for FY 2013. NRCS is not aware of any known obligations related to cancelled appropriations for contractual agreements which may require future financial obligations.

## Note 13 - Funds from Dedicated Collections

NRCS recognizes Treasury account 12X8210, Miscellaneous Contributed Funds, as Funds from Dedicated Collections in compliance with Statement of Federal Financial Accounting Standard 27. Funds from Dedicated Collections are financed by specifically identified revenues which remain available over time. These specifically identified revenues are required by 7 USC 450b to be used for work under cooperative agreements for soil survey, watershed protection, and resource conservation and development activities. Financial information for the Miscellaneous Contributed Funds account is separately presented for the current and prior year, as required by Federal reporting requirements. Since these funds are used to finance work by cooperators, they are very few, if any costs or expenses associated with this account. Therefore, a Statement of Net Cost is not shown as part of the following information.

| Balance Sheet (in millions) | 2013 |
|---|---|
| Intragovernmental: | |
| Fund Balance with Treasury | $1 |
| Total Intragovernmental | 1 |
| **Total Assets** | **$1** |
| Cumulative Results of Operation | 1 |
| Total Net Position | 1 |
| **Total** | **$1** |

Table 25: Balance Sheet as of September 30, 2013

| State of Changes in Net Position (in millions) | 2013 |
|---|---|
| Cumulative Results of Operations: | |
| Beginning Balance | $1 |
| Beginning Balance, As Adjusted | 1 |
| Cumulative Results of Operations | 1 |
| **Net Position** | **$1** |

Table 26: Statement of Changes in Net Position as of September 30, 2013

## Note 14 - 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, 2013.

| Intragovernmental Costs and Exchange Revenue (in millions) | FY 2013 |
|---|---|
| **Costs** | |
| Intragovernmental | $648 |
| Public | 3,473 |
| **Total Program Costs** | **$4,121** |
| **Earned Revenue** | |
| Intragovernmental | $127 |
| Public | 6 |
| **Total Program Earned Revenue** | **$133** |

Table 27: Costs Incurred to Protect Natural Resources for the Year Ended September 30, 2013

## Note 15 - Suborganization Program Costs/Program Costs by Segment

NRCS reflects costs through four major programs: the Farm Bill, Conservation Operations, Watershed and Flood Prevention, and Watershed Rehabilitation programs. The following tables illustrate actual costs by program for the year ended September 30, 2013.

| Program Costs | Gross Costs | Earned Revenue | Net Cost |
|---|---|---|---|
| Farm Bill Programs | $2,992 | $88 | $2,904 |
| Conservation Operations | 961 | 24 | 937 |
| Watershed and Flood Prevention | 138 | 21 | $117 |
| Watershed Rehabilitation | 10 | 0 | 10 |
| Other | 20 | 0 | 20 |
| **Totals** | **$4,121** | **$133** | **$3,988** |

Table 28: Costs by Program for the Year Ended September 30, 2013

## Note 16 - Cost of Stewardship PP&E

The FY 2013 costs of administering the program for stewardship land amounted to $379 million which consists primarily of easement acquisition costs, the costs associated with the acquisition (closing services, surveys and due diligence activities) 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 preserving land resources and assisting landowners in becoming better stewards of the Nation's soil, water, and related natural resources.

## Note 17 - 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. Federal Policy requires that non-federal customers be billed in advance for the entire amount of the agreement. NRCS has no specific statutory authority to use anticipated budgetary resources for non-federal entities. 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 18 - Apportionment Categories of Obligations Incurred: Direct vs. 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, 2013.

| Obligations Incurred | Apportionment Category A | Apportionment Category B | Total |
|---|---|---|---|
| Obligations Incurred - Direct | $0 | $4,304 | $4,304 |
| Obligations Incurred - Reimbursable | 0 | 148 | 148 |
| **Totals** | **$0** | **$4,452** | **$4,452** |

Table 29: Apportionment Categories of Obligations Incurred for the Year Ended September 30, 2013

## Note 19 - Undelivered Orders at the End of the Period

Budgetary resources obligated for undelivered orders as of September 30, 2013 is $4.4 billion.

## Note 20 - Legal Arrangements Affecting the Use of Unobligated Balances

NRCS has been granted extended authority for treasury symbols 1221004, 1231004, 1241004, 1251004, 1261004, 1271004, and 1281004 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 21 - Explanation of Differences Between the SBR and the Budget of the US Government

The differences between the FY 2012 SBR and the FY 2012 actual numbers presented in the FY 2014 Budget of the United States Government are summarized in the table below. The President’s Budget with actual numbers for FY 2013 has not yet been published, and is expected to be published in February of 2014, and 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 | $7,040 | $4,602 | $12 | $3,805 |
| **Reconciling Items** | | | | |
| Expired Accounts | 2,088 | 111 | 0 | 0 |
| Distrubuted Offsetting Receipts | 0 | 0 | (12) | (12) |
| Other | 8 | 1 | 0 | 0 |
| **Budget of the U.S. Government** | **$9,136** | **$4,714** | **$0** | **$3,793** |

Table 30: Explanation of differences between the Statement of Budgetary Resources and the Budget of the United States Government

## Note 22 - Reconciliation of Net Cost of Operations (proprietary) to Budget

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, 2013 is provided in the following table.

Natural Resources Conservation Service

**Reconciliation of Net Cost of Operations (Proprietary) to Budget**
for the Year Ended September 30, 2013
(in millions)

| Reconciliation of Net Cost of Operations (Proprietary) to Budget for the Year Ended September 30, 2013 (in millions) | 2013 |
|---|---|
| **Resources Used to Finance Activities:** | |
| Obligations Incurred | $4,452 |
| Less: Spending authority from offsetting collections and recoveries | 705 |
| Obligations net of offsetting collections and recoveries | 3,747 |
| Less: Offsetting receipts | 9 |
| Net Obligations | 3,738 |
| Imputed financing from costs absorbed by others | 151 |
| Other | (3) |
| Net other resources used to finance activities | 148 |
| **Total resources used to finance activities** | **$3,886** |
| **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 | $84 |
| Resources that fund expenses recognized in prior periods | 1 |
| Budgetary offsetting collections and receipts that do not effect net cost of operations | |
| Change in unfilled customer orders | 16 |
| Resources that finance the acquisition of assets | (15) |
| Other resources or adjustments to net obligated resources that do not affect net cost of operations | 10 |
| Total resources used to finance items not part of the net cost of operations | 96 |
| **Total resources used to finance the net cost of operations** | **$3,982** |
| **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 | ($3) |
| Other | (1) |
| Total components of Net Cost of Operations that will require or generate resources in future periods | (4) |
| Components not Requiring or Generating Resources: | |
| Depreciation and amortization | 8 |
| Revaluation of assets or liabilities | 1 |
| Other components not requiring or generating resources | |
| Bad debt expense | 1 |
| Total components of Net Cost of Operations that will not require or generate resources: | 10 |
| **Total components of Net Cost of Operations that will not require or generate resources in the current period** | $6 |
| **Net Cost of Operations** | **$3,988** |

Table 31: Reconciliation of Net Cost of Operations (Proprietary) to Budget for the Year Ended September 30, 2013

Unaudited – See accompanying independent auditors' report

## *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.

#### *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) | 2009 | 2010 | 2011 | 2012 | 2013 | Total Investment |
|---|---|---|---|---|---|---|
| Resource Conservation and Development | $51 | $52 | $22 | $0 | $0 | $125 |
| **Total Invested Each Year** | **$51** | **$52** | **$22** | **$0** | **$0** | **$125** |

Table 32: NRCS Investments in Human Capital as of September 30, 2013

### 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 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) | 2009 | 2010 | 2011 | 2012 | 2013 | Total Investment |
|---|---|---|---|---|---|---|
| Plant Materials Centers | $13 | $12 | $12 | $10 | $6 | $53 |
| **Total Invested Each Year** | **$13** | **$12** | **$12** | **$10** | **$6** | **$53** |

Table 33: NRCS Investments in Research and Development as of September 30, 2013

***Soil Survey Research***

NRCS's Soil Science Division (SSD) conducts soil survey research and provides leadership for the National Cooperative Soil Survey (NCSS), which is responsible for the soils inventory of the United States and interpreting this information to "help people help the land" through natural resource conservation.

Research scientists engage in research and development projects to discover new information and apply existing technologies for improvement of the soil survey. NRCS scientists collaborate with colleagues in other federal and state agencies and universities on research and development projects. The types of research include soil geochemistry, soil geomorphology, soil quality, soil change, soil mineralogy, soil nutrient relationships, and soil organic carbon dynamics. Research results improve the efficiency and quality of spatial and tabular soil survey data and its interpretation and application for natural resource conservation. End products include technical documents, scientific journal articles, soil data bases, technical presentation, and training provided to NRCS soil scientists, other scientists and end users of soil survey information.

NRCS soil survey research expenses reported below include scientist salaries and specific research project funding through cooperative agreements with universities and federal and state agencies.

| Research and Development Investment (in millions) | 2009 | 2010 | 2011 | 2012 | 2013 | Total Investment |
|---|---|---|---|---|---|---|
| Soil Survey Research | $1 | $2 | $2 | $2 | $2 | $9 |
| **Total Invested Each Year** | **$1** | **$2** | **$2** | **$2** | **$2** | **$9** |

Table 34: Soil Survey Research and Development Costs as of September 30, 2013

Soil survey research outputs are primarily technical documents prepared for the scientific community and other customers and are disclosed in SSD and NSSC annual reports. Soil survey research outputs relate to the NRCS Strategic Plan Goal, High Quality Productive Soils. Outcomes from these outputs directly and indirectly relate to the efficiency and quality of the soil survey and its use for natural resource conservation activities.

We summarize our technical and scientific publications for the last 5 years in the following table. This does not include publications by cooperators related to cooperative agreements. There is no direct correlation between funds expended and technical and scientific publications prepared for customers. There are many variations in the complexity of research projects and the more complex projects may take multiple years to complete.

| Fiscal Year | Technical and Scientific Publications |
|---|---|
| 2009 | 18 |
| 2010 | 20 |
| 2011 | 10 |
| 2012 | 17 |
| 2013 | 13 |

Table 35: Soil Survey Technical and Scientific Publications as of September 30, 2013

## Required Supplementary Information

### Deferred Maintenance and Repairs

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

The NRCS portfolio of assets includes 33 sites with owned land or buildings, though several of these sites are in the disposal process. There are 24 Plant Materials Centers (PMC) which are research farms consisting of an office building, greenhouse, service buildings, and warehouses/storage facilities. Other features of PMCs typically include equipment shelters, 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.

NRCS uses condition surveys to estimate deferred maintenance on all major classes of its PP&E. During FY 2013, the NRCS with assistance from the GSA Office of Real Property Utilization and Disposal completed facility assessments for all 28 actively used NRCS owned facilities to collect detailed data on infrastructure condition and maintenance needs. NRCS did not complete facility assessments for the five owned facilities which the agency plans to dispose. NRCS is working closely with the USDA Office of Procurement and Property Management and the GSA Office of Real Property Utilization and Disposal to expedite this process.

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.

### 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, conducted condition surveys of all NRCS owned assets from September 2011 through May 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 2013, NRCS completed remaining condition surveys for all 28 actively used NRCS facilities. The dollar amount in the following table, Deferred Maintenance Totals by Asset Class, includes costs to return assets with deferred maintenance at the 28 NRCS facilities to acceptable conditions.

| Asset Class | Overall Condition | Critical Maintenance | Noncritical Maintenance | Cost to Return to Acceptable Condition |
|---|---|---|---|---|
| Office Buildings | poor-good | $260,081 | $24,561 | $284,642 |
| Greenhouses | poor-good | 51,388 | 2,220 | 53,608 |
| Service Buildings | poor-good | 139,214 | 52,036 | 191,250 |
| Warehouse/Storage Buildings | critical-good | 234,448 | 57,786 | 292,234 |
| Other Buildings | critical-good | 98,925 | 11,194 | 110,119 |
| Irrigation Systems | poor-good | 14,337 | 0 | 14,337 |
| Other Constructed Structures and Features | critical-good | 48,834 | 29,437 | 78,271 |
| **Total** | | **$847,227** | **$177,234** | **$1,024,461** |

Table 36: Deferred Maintenance Totals by Asset Class as of September 30, 2013 in dollars

In the facility assessments conducted during FY 2012-2013, professionals in the private sector completed condition surveys for all major classes of PP&E at the 28 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 following table demonstrates how NRCS currently defines asset condition on the basis of critical maintenance needed in the current year and the percent of assets in each category.

| Condition Index | Condition Rating | Number of NRCS Assets |
|---|---|---|
| >95.00 | Good | 389 |
| 90.00-94.99 | Satisfactory | 25 |
| 70.00-89.99 | Poor | 17 |
| <70.00 | Critical | 8 |
| **Total** | | **439** |

Table 37: Asset condition definition and characterization of assets

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 has put into place and is continuing to develop additional policy, procedure, and guidance relative to required standards for its facilities and ongoing monitoring of facility condition during FY 2013.

## *Condition of Heritage Assets and Stewardship Lands*

### Heritage Assets


In 1997, the Tucson Plant Materials Center in Tucson, Arizona was placed on the National Register of Historic Places. The Tucson PMC 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 and deferred maintenance of this heritage asset is included with general PP&E assets above.

### 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.

The following chart depicts the condition status of NRCS's 16,253 easements as of September 30, 2013 (see note 6 for more information about easement assets).

| Stewardship Easements Condition Status | | | |
|---|---|---|---|
| **Condition** | **Description** | **Easements Meeting the Condition** | **Percentage** |
| Green | Easements are being maintained in accordance with all terms and conditions | 11,345 | 70% |
| Yellow | Easements with minor administrative issues requiring corrective actions to fully comply with all terms and conditions | 1,933 | 12% |
| Red | Easements with documented violations that require corrective actions. | 382 | 2% |
| Not Assessed | Easements that did not require monitoring, were not assessed at the time of this report, or closed in FY 2013 | 2,593 | 16% |
| **Total** | | 16,253 | 100% |

Table 38: Stewardship Easements Condition Status as of September 30, 2013

Natural Resources Con:

## Statement of Budgetary Resources by Major Budget Account

for the year ended September 30, 2013

(in Millions)

| Budgetary Resources: | Farm Bill | Conservation Operations | Watershed & Flood Prevention | Watershed Rehabilitation | Other Programs | Total |
|---|---|---|---|---|---|---|
| Unobligated balance, brought forward, October 1 | $2,138 | $107 | $166 | $6 | $21 | $2,438 |
| Recoveries of prior year unpaid obligations | 470 | 31 | 37 | 8 | 4 | 550 |
| Other changes in unobligated balance | 0 | (9) | 0 | 0 | 0 | (9) |
| Unobligated balance from prior year budget authority, net | 2,608 | 129 | 203 | 14 | 25 | 2,979 |
| Appropriations (discretionary and mandatory) | 3,354 | 767 | 235 | 14 | 0 | 4,370 |
| Spending authority from offsetting collections (discretionary and mandatory) | 45 | 50 | 58 | 0 | 1 | 154 |
| Total budgetary resources | $6,007 | $946 | $496 | $28 | $26 | $7,503 |
| **Status of Budgetary Resources** | | | | | | |
| Obligations Incurred (Note 16,17,18,19,and 20) | $3,461 | $846 | $129 | $16 | $0 | $4,452 |
| **Unobligated balance, end of year:** | | | | | | |
| Apportioned | 209 | 67 | 379 | 6 | 4 | 665 |
| Unapportioned | 2,337 | 33 | (12) | 6 | 22 | 2,386 |
| Total unobligated balance, end of year | $2,546 | $100 | $367 | $12 | $26 | $3,051 |
| Total budgetary resources | $6,007 | $946 | $496 | $28 | $26 | $7,503 |
| **Change in obligated balance:** | | | | | | |
| **Unpaid obligations:** | | | | | | |
| Unpaid obligations, brought forward, October 1 | $3,928 | $245 | $242 | $49 | $50 | $4,514 |
| Obligations incurred | 3,461 | 846 | 129 | 16 | 0 | 4,452 |
| Outlays (gross) | (2,962) | (841) | (142) | (18) | (28) | (3,991) |
| Recoveries of prior year unpaid obligations | (470) | (32) | (37) | (7) | (4) | (550) |
| Unpaid obligations, end of year | 3,957 | 218 | 192 | 40 | 18 | 4,425 |
| **Uncollected Payments:** | | | | | | |
| Uncollected payments, Federal sources, brought forward, October 1 | (195) | (53) | (58) | 0 | 0 | (306) |
| Change in uncollected payments, Federal sources | 106 | (4) | (34) | 0 | 0 | 68 |
| Uncollected payments, Federal sources, end of year | (89) | (57) | (92) | 0 | 0 | (238) |
| **Memorandum (non-add) entries:** | | | | | | |
| Obligated balance, start of year | $3,733 | $192 | $184 | $49 | $50 | $4,208 |
| Obligated balance, end of year | $3,868 | $161 | $100 | $40 | $18 | $4,187 |
| **Budget Authority and Outlays, Net:** | | | | | | |
| Budget authority, gross (discretionary and mandatory) | $3,400 | $817 | $293 | $14 | $1 | $4,525 |
| Actual offsetting collections (discretionary and mandatory) | (151) | (47) | (24) | 0 | (1) | (223) |
| Change in uncollected customer payments from Federal sources (discretionary and mandatory) | 106 | (4) | (34) | 0 | 0 | 68 |
| Budget authority, net (discretionary and mandatory) | $3,355 | $766 | $235 | $14 | $0 | $4,370 |
| Outlays, gross (discretionary and mandatory) | $2,962 | $841 | $142 | $18 | $28 | $3,991 |
| Actual offsetting collections (discretionary and mandatory) | (151) | (47) | (25) | 0 | 0 | (223) |
| Outlays, net (discretionary and mandatory) | 2,811 | 794 | 118 | 18 | 28 | 3,769 |
| Distributed offsetting receipts | 0 | 0 | 0 | 0 | (9) | (9) |
| Agency outlays, net (discretionary and mandatory) | $2,811 | $794 | $118 | $18 | $19 | $3,760 |

The accompanying notes are an integral part of these statements.

Table 39: Statement of Budgetary Resources by Major Program

## Other Information

### Schedule of Spending

The Schedule of Spending (SOS) presents an overview of how and where the NRCS is spending money. The data used to populate this schedule are the same underlying data used to populate the SBR. The following SOS presents total budgetary resources, gross outlays, and total obligations incurred for the year ended September 30, 2013.

Natural Resources Conservation Service

**Schedule of Spending**

for the Year Ended September 30, 2013
(in millions)

| Schedule of Spending for the Year Ended September 30, 2013 (in millions) | Budgetary |
|---|---|
| **What Money is Available to Spend?** | |
| Total resources used to finance activities | $7,503 |
| Less Amount Available but Not Agreed to be Spent | 665 |
| Less Amount Not Available to be Spent | 2,386 |
| **Total Amounts Agreed to be Spent** | **$4,452** |
| **How was the Money Spent / Issued?** | |
| Ensure Our National Forests and Private Working Lands Are Conserved, Restored, and Made More Resilient to Climate Change, While Enhancing Our Water Resources: | |
| Personnel Compensation and Benefits | $988 |
| Travel and transportation | 41 |
| Rent, Communications, and Utilities | 47 |
| Other Contractual Services | 466 |
| Supplies and Materials | 24 |
| Equipment, Land, and Structures | 425 |
| Grants, Subsidies, and Contributions | 2,460 |
| Insurance Claims and Indemnities | 1 |
| **Total** | **$4,452** |
| **Total Amounts Agreed to be Spent** | **$4,452** |
| Who did the Money go to? | |
| **Federal** | $539 |
| **Non Federal** | $3,913 |
| **Total Amounts Agreed to be Spent** | **$4,452** |

Table 40: Schedule of Spending for the Year Ended September 30, 2013

Unaudited – See accompanying independent auditors' report

# Other Information

## *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. Improper payment legislation has evolved since 2002. The most recent improper payment legislation was passed in January 2013 as the Improper Payments Elimination and Recovery Improvement Act (IPERA). Agencies are required to annually review all programs and activities that could be susceptible to significant improper payments. Each Federal agency must assess all of its 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 and establish targets. Additionally, agencies are required to utilize the Do Not Pay database managed by the Department of Treasury during pre-award, pre-payment and post-payment business processes. NRCS is currently utilizing Treasury's Do Not Pay portal to identify potential improper payments.

**Fiscal Year 2013 Results**

NRCS's Farm Bill programs reported an improper payment rate of 6.93%.

The root causes of NRCS's improper payments can be summarized into the categories of verification, authentication, and administrative. Verification errors relate to verifying such recipient information such as income. Authentication errors relate to authenticating the accuracy of qualifying for program specific requirements. Administrative errors relate to the accuracy of the program staff's entry, classification or processing of information associated with applications, supporting documents or payments.

For FY 2013, the root causes of NRCS's improper payments were categorized as:

- Approximately 97 percent attributable to administrative error; and
- Approximately 3 percent attributable to verification error.

Root causes of improper payments included:

- Modifications to extend period of performance were not executed timely;
- Entity participants were not registered in the System for Award Management (SAMS);
- Funds were released to closing agents too early;
- Payments were made for conservation practices on land that was not controlled by the participant; and
- Payments were made to participants that were not in compliance with Adjusted Gross Income (AGI) Requirements.

In FY 2013, NRCS took the following actions to address improper payments:

- Completed quarterly reporting to the Department for all improper payments made and recovered;
- Completed risk assessments for 4 low risk programs per the schedule defined by the Department;
- Performed improper payment testing for high risk and one low risk program;
- Began utilizing the Do Not Pay portal to identify potential improper payments;
- Conducted training regarding advance payments and period of performance monitoring;
- Began an easement open obligation review to prevent period of performance expirations; and
- Drafted revised easement policies to address advance payments.

NRCS's FY 2014 actions planned to address improper payments include:

- Striving to meet its annual improper payment reduction targets;
- Working with the Department to ensure that the period of performance data element is available for all payment types;
- Developing an easement payment checklist that includes checking the status of obligations prior to payment;
- Publishing revised easement policies;
- Conducting training on revised easement policies;
- Continuing to perform programmatic quality assurance reviews; and
- Continuing to work with FSA and the IRS to identify non- compliant AGI participants.

# Other Information

**Risk Assessment**

The Department issues detailed guidance for the risk assessment process. Programs with larger outlays were required to perform more detailed assessments than smaller programs.

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 (e.g., Soil Survey programs) are considered low risk and are tested on a rotational basis.

The risk assessment process includes the following:

- Amount of improper payments needed to meet the reporting standards;
- Description of the program including purpose and basic eligibility requirements;
- Definition of improper payments specific to the program;
- Program vulnerabilities linked to improper payments;
- Internal controls designed to offset the program vulnerabilities;
- Internal controls testing for selected programs;
- Listing of significant reviews and audits;
- Final determination of risk level;
- Planned future enhancements; and
- Description of how improper payments are recovered.

**Statistical Sampling Process**

In FY 2013, Farm Bill financial assistance (high risk) and Conservation Technical Assistance program (low risk) payments were statistically sampled and tested based on FY 2012 outlays. 628 samples were tested. This included 268 Conservation Technical Assistance (CTA) program samples and 360 Farm Bill financial assistance samples. As a result of this testing, high risk overpayments totaling $16,474,851 were identified. High risk improper payments were extrapolated to the entire high risk population. The extrapolated high risk payments totaled $157,858,279. Additionally, low risk improper payments totaling $71,437 were identified. The extrapolated low risk payments totaled $2,421,758

Testing criteria was applied to verify the following:

- Contracts were approved and funds certified as available prior to being obligated;
- Receipt of goods and services were acknowledged;
- Payments were supported by adequate program specific documentation;
- Goods and services were delivered or performed within the contract period of performance; and
- Amounts paid were in accordance with contract terms.

## Other Information

### Improper Payment Reporting

In addition to annual testing, NRCS also 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. Improper payments are also identified by the Office of the Inspector (OIG) and Government Accountability Office (GAO) program audits. In FY 2013, OIG audits did not disclose any improper payments. GAO investigations revealed potential improper payments related to adjusted gross income non-compliance and payments made to deceased individuals. The final reports related to these audits are still under review.

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 the 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 charts below provide information regarding improper payments made and recovered.

The following chart is a summary of NRCS's improper payments and related recoveries as of September 30, 2013:

| Improper Payments and Recoveries | | |
|---|---|---|
| **How Identified** | **Improper Payment Amount Identified Current Year** | **Improper Payment Amount Recovered Current Year** |
| Annual Testing | $16,546,288 | $0 |
| Self Reported by States / Centers | $4,256,822 | $3,057,878 |
| Reported by participant | $260,442 | $115,746 |
| OIG & GAO Audits | $0 | $0 |
| **Total** | **$21,063,552** | **$3,173,624** |

Table 41: Improper Payments and Recoveries as of September 30, 2013

The chart below depicts NRCS's improper payment rate in FY 2012 and FY 2013 ($ in millions):

| | FY 2012 | | | FY 2013 | | |
|---|---|---|---|---|---|---|
| **Program** | **Outlays** | **IP%** | **IP$** | **Outlays** | **IP%** | **IP$** |
| Farm Security and Rural Investment Act Programs | $2,088 | 0.02% | $0.4 | $2,277 | 6.93% | $158 |

Table 42: Improper Payment rates ($ in millions)

The following chart provides a detailed breakout of improper payments ($ in millions)

| Detailed Breakout of Improper Payments Reporting for FY 2013 | | |
|---|---|---|
| **Improper Payments** | **Percentage %** | **Amount $** |
| Incorrect Disbursement | 0.43% | $10 |
| Incomplete Paperwork | 6.50% | $148 |
| Total Improper Payments | 6.93% | $158 |
| Over-Payments | 6.93% | $158 |
| Under Payments | 0.00% | $0 |
| **Total** | **6.93%** | **$158** |

Table 43: Detail Improper Payments as of September 30, 2013

The next chart depicts future year outlays and improper payment estimates for NRCS's high risk program:

| | FY 2014 | | | FY 2015 | | | FY 2016 | | |
|---|---|---|---|---|---|---|---|---|---|
| Program | Outlays | IP% | IP$ | Outlays | IP% | IP$ | Outlays | IP% | IP$ |
| Farm Security and Rural Investment Act Programs | $2,844 | 6.70% | $191 | $2,759 | 6.50% | $179 | $3,084 | 6.20% | $191 |

Table 44: Improper Payments Reduction Outlook ($ in millions)

**Accountability**

NRCS ensures that agency managers are held accountable for reducing and recovering improper payments. NRCS incorporated specific language regarding the prevention, identification and recovery of improper payments into the current State Conservationists' performance plans.

**Barriers**

Verification of eligibility continues to be an ongoing challenge for NRCS. AGI eligibility has been delegated to FSA and NRCS has successfully coordinated with FSA to implement FSA's validation of AGI certifications so that any FSA changes in eligibility determinations are immediately effective for NRCS conservation program payments. However, while FSA is working to be more current in their validation process, improper payments related to AGI non-compliance cannot be avoided if participants misrepresent their income.

Additionally, NRCS's Conservation Security Program must pay participants in advance of the implementation of conservation practices. NRCS's is statutorily required to pay participants at the beginning of the fiscal year in which the conservation practice is scheduled to be implemented. Since these payments are made in advance, improper payments are sometimes detected via annual quality assurance reviews but cannot always be prevented. The Conservation Security Program has now been replaced by the Conservation Stewardship Program. Under the Stewardship program, payments are not made in advance of performance.

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