United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

September 28, 2000

INDEPENDENT AUDITORS REPORT

Memorandum

To: Director, U.S. Geological Survey

Subject: Independent Auditors Report on U.S. Geological Survey Financial Statements for Fiscal Years 1999 and 1998 (No. 00-I-708)

SUMMARY

In our audit of the U.S. Geological Survey's (USGS) financial statements for fiscal years 1999 and 1998, we found the following:

- The principal financial statements were fairly presented in all material respects. USGS's principal financial statements consist of the Consolidated Balance Sheet as of September 30, 1999 and September 30, 1998; the Consolidated Statement of Net Cost and Consolidated Statement of Changes in Net Position for the fiscal years ended September 30, 1999 and September 30, 1998; and the Combined Statement of Budgetary Resources and Combined Statement of Financing for the fiscal year ended September 30, 1999.

- Our tests of internal controls identified material weaknesses in the areas of accounts receivable/advances, unliquidated obligations, and accrued liabilities.

- Our tests of compliance with laws and regulations identified noncompliance with Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Standards."

Our conclusions are detailed in the sections that follow.

OPINION ON PRINCIPAL FINANCIAL STATEMENTS

In accordance with the Chief Financial Officers Act of 1990, we audited USGS's principal financial statements for the fiscal years ended September 30, 1999 and September 30, 1998 as contained in USGS's accompanying Annual Financial Report for fiscal year 1999. These financial statements are the responsibility of USGS, and our responsibility is to express an opinion, based on our audit, on these principal financial statements.

Our audit was conducted in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States, and with Office of Management and Budget Bulletin 98-08, "Audit Requirements for Federal Financial Statements," as amended. These audit standards require that we plan and perform the audit to obtain reasonable assurance as to whether the accompanying principal financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures contained in the principal financial statements and the accompanying notes. An audit also includes assessing the accounting principles used and the significant estimates made by management. We believe that our audit work provides a reasonable basis for our opinion.

In our opinion, the principal financial statements (pages 11-15) present fairly, in all material respects, the financial position of USGS, its consolidated net cost, and its changes in net position as of and for the years ended September 30, 1999 and September 30, 1998 and its combined statement of budgetary resources and statement of financing for the fiscal year ended September 30, 1999 in conformance with generally accepted accounting principles.

As discussed in Note 1G to USGS's financial statements, in fiscal year 1999 the capitalization threshold for personal property was increased from $5,000 to $15,000, resulting in a decrease to equipment and related accumulated depreciation. In addition, as discussed in Note 10 and in the Report on Internal Controls section, fiscal year 1998 liabilities were increased and unexpended appropriations were decreased by about $69 million for accrued liabilities that had not been recognized.

Our audit was conducted for the purpose of forming an opinion on the consolidated and combined principal financial statements taken as a whole. The accompanying consolidating and combining information is presented for purposes of additional analysis of the consolidated and combined principal financial statements. The consolidating and combining financial statements for fiscal year 1999 (pages 16-18) were subject to auditing procedures applied in the audit of the consolidated and combined principal financial statements and, in our opinion, are fairly stated in all material respects in relation to the consolidated and combined principal financial statements taken as a whole.

In addition, the deferred maintenance and supplementary stewardship information that follows the financial statements (pages 27-32) is not a required part of the principal financial statements but is supplementary information required by the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, including discussions with management, on the methods of measurement and presentation of the supplementary information. However, we did not audit the information and therefore do not express an opinion on this supplementary information.

REPORT ON INTERNAL CONTROLS

Our audit was conducted in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States, and with Bulletin 98-08.

USGS management is responsible for establishing and maintaining an internal control structure which provides reasonable assurance that the following objectives are met:

- Transactions are properly recorded, processed, and summarized to permit the preparation of the principal financial statements and the required supplementary stewardship information in accordance with Federal accounting standards.

- Assets are safeguarded against loss from unauthorized acquisition, use, or disposition.

- Transactions are executed in accordance with (1) laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the principal financial statements and (2) any other laws, regulations, and Governmentwide policies identified by the Office of Management and Budget.

- Transactions and other data that support reported performance measures are properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

Because of inherent limitations in any internal control structure, errors or fraud may occur and not be detected. Also, projections of any evaluation of the internal controls over financial reporting to future periods are subject to the risk that the internal controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

In planning and performing our audit, we considered USGS's internal controls over financial reporting by obtaining an understanding of USGS's internal controls, determined whether these internal controls had been placed in operation, assessed control risks, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing an opinion on the principal financial statements and the supplemental statements of net cost and changes in net position and not to provide assurance on the internal controls over financial reporting. Consequently, we do not express an opinion on internal controls.

Our consideration of the internal controls over financial reporting would not necessarily disclose all matters in the internal control structure over financial reporting that might be reportable conditions. Under standards established by the American Institute of Certified Public Accountants and by Bulletin 98-08, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal controls that, in our judgment, could adversely affect USGS's ability to record, process, summarize, and report financial data consistent with the assertions made by management in the principal financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted matters concerning internal controls and their operation that we consider to be material weaknesses.

Material Weaknesses

We identified material weaknesses as discussed in the paragraphs that follow.

A. USGS Needs Improved Controls Over its Advances From Others and Unbilled Accounts Receivable

USGS did not establish adequate internal control procedures to ensure that its advances from others and unbilled accounts receivable were fairly stated in the subsidiary ledgers. USGS made adjustments after year-end to correct the account balances. The adjustments were made for the following reasons:

- Advances from others and unbilled accounts receivable were increased by over $20 million because negative unbilled accounts receivable should have been recorded as advances. These negative unbilled receivables occurred because (1) the system does not allow intrabureau collections to be recorded as advances and (2) the system does not reestablish the advance when costs allocated to a customer are reduced.

- Advances from others and unbilled accounts receivable were decreased by about $4.9 million because the system did not always liquidate advances based on earnings. This resulted in both advances from others and unbilled accounts receivable being overstated.

- Advances from others and unbilled accounts receivable were decreased by about $6.4 million because collections were not matched to the correct budget fiscal year of the agreement.

In addition, in reviewing the adjustments we noted that adjustments for working capital fund accounts receivable unbilled and advances from others were made twice: (1) as a journal voucher posted to the pre-closing trial balance and (2) as an adjustment in Hyperion after closing. When we brought these matters to management's attention, they made an adjustment of about $8.9 million.

We have reported controls over advances from others and unbilled accounts receivable as a reportable condition in previous years' audit reports; however, because of the continuing problems in this area, we have reclassified it as a material weakness. We are not making recommendations related to advances from others and unbilled accounts receivable because recommendations have been made on this issue in prior years' reports.

USGS Response: In the August 11, 2000, response (Appendix 1) to the draft report, the Acting Chief, Office of Program Support, indicated that the office would address the first two reported conditions by providing us with documentation of the "work around" procedures for the Project Cost Accounting System deficiency.

Office of Inspector General Reply: Based on the response, we anticipate that the work-around procedures will be effective and that this finding will not be reported in fiscal year 2000. However, all of the procedures were not officially in effect for fiscal year 1999. The documentation of the procedures in fiscal year 1999 was limited to a memorandum from the Chief of Accounts Receivable Branch to an office accountant outlining the procedures. The procedure to provide Crystal reports to the divisions for them to review for unnatural unbilled accounts receivable/advance balances was not discussed in this memorandum. In addition, the $20 million adjustment was made more than 2 months after the end of the fiscal year. Furthermore, the adjustment made to correct the third condition was made based on information received from our audit. As noted in the finding and not addressed in the response, the adjustments to correct the working capital accounts receivable and advance accounts were made twice. Based on these facts, it is our opinion that this finding meets the definition of a material weakness.

As you requested, we changed the wording of the third condition to reflect your determination of the cause of this condition.

B. USGS Needs Improved Controls Over its Accrued Liabilities and Expenses

USGS did not establish adequate internal controls to ensure that liabilities and expenses were properly accrued at year-end for fiscal years 1998 and 1999. In our testing of 74 expenses for fiscal year 1999, we identified 16 items that should have been expensed in prior years. In our testing of 127 undelivered orders as of September 30, 1999, we identified 36 items where the amount of the undelivered orders should have been reduced and a liability should have been established because the goods or services had been received. This occurred because USGS had not implemented adequate policies and procedures to recognize liabilities for which an obligation had been recognized for goods or services received but for which an invoice had not been received. As a result, liabilities were understated and undelivered orders were overstated. When we informed management of this condition, they made an adjustment of about $69 million to accrued liabilities, undelivered orders, and related accounts for both fiscal years 1999 and 1998 based on a statistical sample of undelivered orders.

In addition, our testing of accrued expenses at year-end identified 3 of 26 items that were not valid expenses. When we brought this matter to management's attention, they made an adjustment of about $2 million.

Recommendation

We recommend that the Director, USGS, establish policies and procedures for recognizing accruals.

USGS Response: In the August 11, 2000 response (Appendix 1) to the draft report, the Acting Chief, Office of Program Support, agreed with this recommendation.

C. USGS Needs Improved Controls Over its Unliquidated Obligations/Undelivered Orders

USGS did not establish adequate internal control procedures to ensure that the undelivered orders subsidiary ledger was fairly stated. Our testing of 127 undelivered orders as of September 30, 1999 identified 7 items that were invalid orders and that therefore should have been deobligated. When we informed management of this condition, they made an adjustment of about $8.9 million to undelivered orders based on a statistical sample of undelivered orders.

Recommendation

We recommend that the Director, USGS, implement procedures to assess the validity of undelivered orders and deobligate the order when needed.

USGS Response: In the August 11, 2000 response (Appendix 1) to the draft report, the Acting Chief, Office of Program Support, agreed with the recommendation.

STEWARDSHIP AND PERFORMANCE MEASURES

We considered USGS's internal controls over the required supplementary stewardship information (pages 27-31) by obtaining an understanding of USGS's internal controls relating to the preparation of the required supplementary stewardship information to determine whether these internal controls had been placed in operation and performed tests of these controls as required by Bulletin 98-08. However, providing assurance on these internal controls was not an objective of our audit, and accordingly, we do not provide assurance on such controls.

With respect to the internal controls related to the performance measures reported in USGS's Performance Measurement section (pages 37-40), we obtained an understanding of the design of significant internal controls related to the existence and completeness assertions as required by Bulletin 98-08. Our procedures were not designed to provide assurance on internal controls over reported performance measures, and accordingly, we do not provide an opinion on such controls.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

Our audit was conducted in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States, and with Office of Management and Budget Bulletin 98-08.

USGS management is responsible for complying with laws and regulations applicable to that agency. As part of obtaining reasonable assurance as to whether USGS's principal financial statements are free of material misstatement, we performed tests of USGS's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statements amounts and certain other laws and regulations specified in Bulletin 98-08, including the requirements referred to in the Federal Financial Management Improvement Act of 1996. However, providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests of compliance with laws and regulations discussed in the preceding paragraph exclusive of the Federal Financial Management Improvement Act disclosed one instance of noncompliance that is required to be reported under the "Government Auditing Standards" or Bulletin 98-08.

Under the Federal Financial Management Improvement Act, we are required to report whether USGS's financial management systems were in substantial compliance with requirements for Federal financial management systems, Federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level. To meet these requirements, we performed tests of compliance using the implementation guidance for the Federal Financial Management Improvement Act included in Appendix D of Bulletin 98-08. The results of our tests disclosed one instance in which USGS's financial management system was not in substantial compliance with these three requirements, as discussed in the paragraphs that follow.

D. Noncompliance With Managerial Cost Accounting Standards

Based on our tests of compliance with laws and regulations, we found that USGS was not in full compliance with managerial cost accounting standards because it did not identify the cost of outputs and the unit cost of outputs. Statement of Federal Financial Accounting Standards No. 4, "Managerial Cost Accounting Concepts and Standards," requires agencies to establish responsibility segments and to measure and report the full costs of resources consumed by the segment in producing each segment's outputs. According to Standard No. 4, "Outputs produced by responsibility segments should be accumulated and, if practicable, measured in units [and] the full costs . . . should be assigned to outputs." However, USGS has not identified the costs of all outputs and the costs per unit. For example, USGS reports as a performance measure the number of "decision-support systems or predictive models developed or improved and delivered to customers" but does not provide information on the costs of the decision-support systems.

Recommendation

We recommend that the Director, USGS, devise and implement a system that would measure and report the full cost of resources consumed by the segment in producing each segment's outputs.

USGS Response: In its August 11, 2000 response (Appendix 1) to the draft report, USGS did not concur with the recommendation. USGS stated that it "aligns its cost and Government Performance and Results Act (GPRA) information to comply with the managerial cost accounting standard." USGS further stated that its fiscal year 1999 responsibility segments "were identical to their Performance Act program performance goals" and that USGS "reported the full cost of these responsibility segments as required by the standard." USGS further said, "This reporting is supported by the Department of the Interior and fully meets [the Department's] cost accounting guidance."

Office of Inspector General Reply: We agree that USGS took actions to align cost information with Government Performance and Results Act information and used this strategy as a means to comply with Standard No. 4. We do not agree, however, that USGS has fully complied with the standard. According to the standard, "The purpose of cost accounting by a responsibility segment is to measure the costs of its outputs." Although USGS has assigned full costs to responsibility segments and aligned the responsibility segments with Government Performance and Results Act program activities, it has not identified all the outputs of the responsibility segments or the costs of those outputs.

The Department of the Interior has developed guidance for implementing managerial cost accounting, which we believe is a positive step in the direction of compliance with Statement of Federal Financial Accounting Standards No. 4. We believe that if USGS complies with the actions proposed by the Department, those actions will be sufficient for USGS to be in compliance with the managerial cost accounting requirements for fiscal year 2000.

CONSISTENCY OF OTHER INFORMATION

We reviewed the financial information presented in USGS's Strategic Plan and Budgetary Integrity section (pages 1-6) and supplemental information (pages 27-63) to determine whether the information was consistent with the principal financial statements. Based on our review, we determined that the information was consistent with the principal financial statements.

PRIOR AUDIT COVERAGE

Other than the unimplemented recommendations discussed in the Report on Internal Controls section of this report, our review of prior Office of Inspector General and General Accounting Office audit reports disclosed that there were no significant unresolved or unimplemented recommendations which affected USGS's principal financial statements.

OBJECTIVE, SCOPE, AND METHODOLOGY

USGS management is responsible for the following:

- Preparing the principal financial statements and the required supplemental information referred to in the Consistency of Other Information section of this report in conformity with generally accepted accounting principles and for preparing the other information contained in USGS's financial statements for fiscal year 1999.

- Establishing and maintaining an internal control structure over financial reporting. In fulfilling this responsibility, estimates and judgments are required to assess the expected benefits and related costs of internal control structure policies and procedures.

- Complying with applicable laws and regulations.

We are responsible for the following:

- Expressing an opinion on USGS's principal financial statements.

- Obtaining an understanding regarding the effectiveness of the internal controls based upon the internal control objectives contained in Bulletin 98-08, which require that transactions be properly recorded, processed, and summarized to permit the preparation of the principal financial statements and the required supplemental information in accordance with Federal accounting standards; that assets be safeguarded against loss from unauthorized acquisition, use, or disposal; and that transactions and other data that support reported performance measures be properly recorded, processed, and summarized to permit the preparation of performance information in accordance with criteria stated by management.

- Testing USGS's compliance with selected provisions of laws and regulations that could materially affect the principal financial statements or the required supplementary information.

To fulfill these responsibilities, we took the following actions:

- Examined, on a test basis, evidence supporting the amounts disclosed in the principal financial statements.

- Assessed the accounting principles used and the significant estimates made by management.

- Evaluated the overall presentation of the financial statements.

- Obtained an understanding of the internal control structure related to safeguarding assets; compliance with laws and regulations, including the execution of transactions in accordance with budget authority; financial reporting; and certain performance measure information reported in the Program Highlights.

- Tested relevant internal controls over the safeguarding of assets; compliance with laws and regulations, including the execution of transactions in accordance with budget authority; and financial reporting.

- Reviewed the internal controls relevant to the existence and completeness assertions for systems producing the performance measures reported in the Program Highlights.

- Tested compliance with selected provisions of laws and regulations.

We did not evaluate all of the internal controls relevant to the operating objectives as broadly defined by the Federal Managers' Financial Integrity Act, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to those controls needed to achieve the objectives outlined in our report on internal controls.

We identified other issues that, in our judgment, were not required to be included in this audit report but that should be communicated to management. These issues will be communicated separately in a management letter.

Based on USGS's response, we consider Recommendations B.1 and D.1 resolved and implemented and Recommendations A.1 and C.1 resolved but not implemented. Accordingly, the unimplemented recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

Since the recommendations are considered resolved, no further response to the Office of Inspector General is required (see Appendix 2).

This report is intended for the information of management of Reclamation and the Office of Management and Budget and for the Congress. However, this report is a matter of public record, and its distribution is not limited.

Roger La Rouche

Roger La Rouche
Acting Assistant Inspector General
for Audits

[CONTACT THE U.S. GEOLOGICAL SURVEY FOR INFORMATION ON ITS FINANCIAL STATEMENTS FOR FISCAL YEAR 2000, WHICH ARE NOT INCLUDED.]

MEMORANDUM

August 11, 2000

To: Assistant Inspector General for Audits

From: Carol F. Aten /s/ Timothy E. Calkins, for
Acting Chief, Office of Program Support

Subject: Comments on the Draft Report on U.S. Geological Survey (USGS) Financial Statements for Fiscal Year (FY) 1999

Thank you for the opportunity to comment on your draft report. Our comments are keyed to the recommendations in the report.

A. Accounts Receivable

The first two conditions cited were likewise cited in your FY 1996 audit report. At that time, USGS and the Office of Inspector General audit staff agreed that it would be impractical to implement the recommendation to reprogram the Project Cost Accounting System (PCAS) and agreed to do the adjustment mentioned in the audit report. We have developed a "work around" for the system deficiency and devoted approximately one-half of a position to manually correct advances and unbilled accounts receivable. We will provide you with documentation of these "work around" procedures, and request reclassification of this finding based upon our previous agreement and subsequent efforts.

We agree with the effect of the third condition but not the cause. Collections are being posted correctly to the budget fiscal year (BFY) on the associated bill, but imbalances are created when either (1) the BFY included on the billing document differs from the BFY where expenses were incurred or (2) reimbursable receipts are recorded as 'collections' and not 'advances' in the Federal Financial System. We are addressing the first condition by increasing our monitoring of advances and accounts receivable reports to detect these situations. To address the second condition we added a review and correction of all collections to our monthly reconciliation procedure. We are also developing procedures that would allow field offices to move advances from one BFY to another BFY for multi-year agreements, subject to review and approval by the central finance office.

B. Accrued Liabilities

The USGS agrees with this recommendation. We have explained the necessity for reviewing unliquidated obligations and establishing an accrual for goods or services received with various finance and administrative groups throughout the bureau. We have also formalized the year-end accrual policy and procedures in our closeout instructions for FY 2000. We will continue to work with program staff to address this problem.

C. Unliquidated Obligations

The USGS agrees with this recommendation and has taken a number of steps in FY 2000 to address the topic of invalid unliquidated obligations. We have issued instructions for reviewing USGS reports of unliquidated obligations. We have also established an inter-bureau group to address unliquidated obligations; that group has concentrated on intergovernmental unliquidated obligations and has developed several solutions. We have also issued a formal policy statement and procedures for deobligating invalid unliquidated obligations. Finally, we will participate in the Departmental group addressing this topic. We will continue to work on this issue with program staff and address the status of unliquidated obligations through our budget execution review process.

D. Cost Accounting

We do not concur with this finding. The USGS aligns its cost and Government Performance and Results Act (GPRA) information to comply with the managerial cost accounting standard. Our FY 1999 responsibility segments were identical to our GPRA program performance goals, and we reported the full cost of these responsibility segments as required by the standard. This reporting is supported by the Department of the Interior and fully meets its cost accounting guidance.

Please feel free to contact Jack Blickley at (703) 648-7609 or jblickley@usgs.gov if you have any questions concerning this response.

STATUS OF AUDIT REPORT RECOMMENDATIONS

Findings/Recommendation Reference	Status	Action Required
A.1and C.1	Resolved; not implemented.	No further response to the Office of Inspector General is required. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.
B.1 and D.1	Implemented.	No further action is required.