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United States Department of the Interior

Office of Inspector General

Washington, D.C. 20240

September 30, 2002

Memorandum

To: Director, U.S. Geological Survey

From: Roger La Rouche
Assistant Inspector General for Audits

Subject: Independent Auditors' Report on the U.S. Geological Survey's Financial Statements for Fiscal Years 2001 and 2000 (No. 2002-I-0054)

We contracted with KPMG LLP, an independent certified public accounting firm, to audit the U.S. Geological Survey's (USGS) financial statements for fiscal year 2001. The contract required that KPMG conduct its audit in accordance with the *Government Auditing Standards,* issued by the Comptroller General of the United States of America; Office of Management and Budget Bulletin (OMB) No. 01-02, *Audit Requirements for Federal Financial Statements;* and the General Accounting Office/President's Council on Integrity and Efficiency's *Financial Audit Manual.* The Office of Inspector General (OIG) is responsible for the opinion on the balance sheet and related notes for fiscal year 2000.

In connection with the contract, we monitored the progress of the audit at key points and reviewed KPMG's report and related working papers and inquired of their representatives. Our review, as differentiated from an audit in accordance with the *Government Auditing Standards*, was not intended to enable us to express, and we do not express, opinions on USGS's financial statements or conclusions about the effectiveness of internal controls or on conclusions about compliance with laws and regulations. KPMG is responsible for the auditors' report on the fiscal year 2001 financial statements (Attachment 1) and for the conclusions expressed in the report. However, our review disclosed no instances where KPMG did not comply in all material respects with *Government Auditing Standards*.

Because of the matters discussed in the following paragraph, KPMG stated that the scope of its work was not sufficient to enable KPMG to express, and KPMG did not express, an opinion on the financial statements of USGS as of and for the year ended September 30, 2001.

In its audit report dated February 1, 2002 KPMG reported that USGS did not maintain its accounting records during fiscal year 2001, particularly with respect to fund balances with Treasury, suspense accounts, unexpended appropriations and cumulative results of operations, thus requiring extensive reconciliation and adjustment of these and other accounts at year end, which USGS was unable to complete prior to the end of our audit. Management did not have access to evidential matter or was not able to make knowledgeable representation of facts and circumstances, regarding certain transactions occurring in the current and previous years. It was impracticable for KPMS to extend the time period and procedures of their audit sufficiently to determine the extent to which the financial statements as of and for the year ended September 30, 2001, may have been affected by these conditions.

KPMG found nine reportable material weaknesses related to internal controls and financial operations and one significant deficiency in internal controls related to management discussion and analysis. With regard to compliance with laws and regulations, KPMG found USGS to be noncompliant with the *Debt Collection Improvement Act* and the *Prompt Pay Act.* In addition, KPMG's tests of compliance with the *Federal Financial Management Improvement Act* section 803(a) requirements disclosed instances where the USGS's financial management systems did not substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger at the transaction level.

In its July 26, 2002 response (Attachment 3) to KPMG's draft report USGS generally agreed with all 13 findings; however, USGS did not agree with all of the recommendations related to the 13 findings. In addition, USGS did not agree with the statement in finding 3 that USGS might be non-compliant with the *Anti-Deficiency Act*; however, USGS agreed to regularly perform the recommended analyses. Based on USGS's response and discussion with USGS management we consider the recommendations related to findings 1, 2, 3, 4, 5, 6, 10, 11, and 12 resolved but not implemented. USGS has proposed alternatives to the recommendations for findings 7, 8, and 9 which if adequately implemented should correct the conditions identified in the findings. All of the recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for either resolution or tracking of implementation.

OIG in its report (Attachment 2) issued an unqualified opinion on the USGS's fiscal year 2000 consolidated balance sheet.

Section 5(a) of the *Inspector General Act* (5 U.S.C App. 3) requires the OIG to list this report in its semiannual report to the United States Congress. The Independent Auditors' Report is intended for the information and use of USGS management, OIG, Office of Management and Budget and the United States Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Attachments (3)

2001 M Street, NW
Washington, DC 20036

INDEPENDENT AUDITORS' REPORT

Director, U.S. Geological Survey and Inspector General
U.S. Department of the Interior:

We were engaged to audit the accompanying consolidated balance sheet of the U.S. Geological Survey (USGS) as of September 30, 2001, and the related consolidated statements of net cost, changes in net position and financing, and combined statement of budgetary resources for the year then ended (hereinafter referred to as "financial statements"). We were also engaged to consider USGS's internal control over financial reporting and to test USGS's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on its financial statements.

Summary

As discussed in our report on the financial statements, the scope of our work was not sufficient to express an opinion on the financial statements as of and for the year ended September 30, 2001.

Our consideration of internal control over financial reporting resulted in identifying the following reportable conditions, all of which we consider to be material weaknesses and none of which have been reported in USGS's fiscal year 2001 Federal Managers Financial Integrity Act (FMFIA) report:

1. Information technology systems lack adequate general controls.
2. Organizational structure of financial management needs improvement.
3. Proprietary and budgetary accounts are not reconciled.
4. Account analysis and adjustments are not performed timely or documented.
5. Fund Balance with Treasury has not been reconciled.
6. Suspense account balances are not timely reconciled and correctly recorded.
7. Revenue cycle lacks adequate policies and procedures.
8. Inventory is not accounted for in compliance with Federal accounting standards.
9. Property, plant and equipment lack adequate policies and procedures.

Our consideration of internal control over required supplementary information and performance measures resulted in identifying the following significant deficiency:

10. Content of Management Discussion and Analysis

The results of our tests of compliance with certain provisions of laws and regulations, exclusive of those referred to in the *Federal Financial Management Improvement Act* (FFMIA) of 1996, disclosed instances of noncompliance with the following laws and regulations that are required to be reported under *Government Auditing Standards* issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements.*

11. Debt Collection Improvement Act
12. Prompt Pay Act

In addition our tests of compliance with FFMIA section 803(a) requirements disclosed instances where the USGS financial management systems did not substantially comply with Federal financial management systems requirements, applicable Federal accounting standards, and the U.S. Standard General Ledger (SGL) at the transaction level.

The following sections discuss our report on USGS's financial statements, the results of our consideration of internal control over financial reporting, the results of our tests of compliance with certain provisions of applicable laws and regulations, and management's and our responsibilities.

Report on the financial statements

We were engaged to audit the accompanying consolidated balance sheet of the USGS as of September 30, 2001 and the related consolidated statements of net cost, changes in net position and financing, and combined statement of budgetary resources for the year then ended.

USGS did not maintain its accounting records during fiscal year 2001, particularly with respect to fund balances with Treasury, suspense accounts, unexpended appropriations and cumulative results of operations, thus requiring extensive reconciliation and adjustment of these and other accounts at year end, which USGS was unable to complete prior to the end of our audit. Management did not have access to evidential matter or was not able to make knowledgeable representation of facts and circumstances, regarding certain transactions occurring in the current and previous years. It was impracticable to extend the time period and procedures of our audit sufficiently to determine the extent to which the financial statements as of and for the year ended September 30, 2001, may have been affected by these conditions.

Because of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying financial statements of USGS as of and for the year ended September 30, 2001.

We were engaged to audit the financial statements as a whole. The statement of net cost consolidating information is presented for purposes of additional analysis rather than to present the net cost of the individual responsibility segments. The working capital fund supplemental information is also presented for purposes of additional analysis and is not a required part of the financial statements. We do not express an opinion on the consolidating information or the supplemental information for the reasons stated in the preceding second paragraph.

The information in the Management's Discussion and Analysis, Required Supplementary Stewardship Information, and the Supplemental Information sections is not a required part of the financial statements but is supplementary information required by the Federal Accounting Standards Advisory Board or OMB Bulletin 97-01 *Form and Content of Agency Financial Statements*, as amended. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

Internal Control Over Financial Reporting

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. In addition, other matters involving internal control over financial reporting might have been identified had we been able to complete our audit of the financial statements. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect USGS's ability to record, process, summarize, and report financial data consistent with the assertions by management in the 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, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal control, misstatements, due to error or fraud may nevertheless occur and not be detected.

We noted certain matters involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that all of these reportable conditions are material weaknesses:

1. **Information Technology Systems Lack Adequate General Controls**

   Weaknesses in USGS's computer systems raise concerns about the integrity of information being reported in the financial statements. Although USGS has taken preliminary steps in establishing a formal security program, USGS has not implemented information systems security policies or procedures to effectively control and protect information systems, programs and data supporting USGS operations and assets and has failed to meet minimum information technology (IT) security requirements of OMB Circular A-127. Some of the identified weaknesses have been previously reported, and persist despite developed corrective action plans. Weaknesses were identified in the following IT control areas:

   a) Entity-wide Security Program - USGS does not have in place an effective security management structure that provides a framework and continuing cycle of activity for managing risk, developing security policies, assigning responsibilities, and monitoring the adequacy of the entity's computer-related controls. The security function at USGS is shared between three branches of the Office of Information Services.

   b) Segregation of Duties - USGS has not ensured proper segregation of duties through its policies, procedures, and organizational structure such that one individual cannot control key aspects of computer-related operations and thereby conduct unauthorized actions or gain unauthorized access to assets or records without detection.

   c) Access Controls - USGS has established, but not implemented, resource classifications and criteria. Various access control weaknesses consist of network configuration management weaknesses, password management and logical access weaknesses, and lack of physical controls over the USGS data center.

   d) Application Software Development and Change Controls – USGS has not established, documented, and implemented a system for application software development and change controls to prevent unauthorized access to programs, or modifications to an existing program, from being implemented.

e) System Software Controls – USGS has not established system software controls that limit and monitor access to the programs and sensitive files that control the computer hardware and secure applications supported by the system. Eighteen users were found to have more than one FFS user ID and other users had been granted Master user profiles within FFS.

f) Service Continuity – USGS has established controls to ensure regular data backup is completed but the procedures need strengthening. USGS needs to test its Continuity of Operations Plan to ensure that critical operations continue without interruption, or are promptly resumed, and critical and sensitive data are protected should unexpected events occur.

Recommendations
We recommend that USGS implement an entity-wide security program to fully comply with OMB Circular A-130. Employee roles and responsibilities should be reviewed and restructured to achieve a higher degree of segregation of duties in computer-related operations. The USGS should improve its security management structure by taking immediate steps to secure the network vulnerabilities and access control deficiencies. We also recommend that application software development and change controls and system software controls be improved to prevent unauthorized program modification or access to read, modify or delete critical or sensitive information and programs.

2. Organizational Structure of Financial Management Needs Improvement

The financial management and control environment at USGS is not operating as effectively and efficiently as necessary to support the USGS organization. We noted the following circumstances that affected the financial management and control environment at USGS:

a) Fragmented accounting infrastructure;

b) Inconsistent financial management oversight in field offices;

c) Lack of communication/enforcement of policies and procedures;

d) Lack of trained field personnel; and

e) Vacant accounting positions in the central office.

In 2001, USGS reorganized its administrative and accounting functions. Among other changes, administrative personnel, who perform accounting functions, now report through a regional management structure rather than through a scientific discipline. USGS implemented this and other changes to improve its financial management processes and systems. While improvements have been made, the organizational structure as it relates to accounting processes remains fragmented, hindering the administration of accounting policies, procedures and processes.

The Office of Administrative Policy and Services (APS) is responsible for the development of accounting policies and procedures. However, the APS lacks authority to implement, and enforce accounting policies and procedures in the field offices. Field accounting personnel often perform a variety of duties outside of accounting and report to Regional Directors creating priority conflicts. Also, USGS operates in a highly decentralized control environment resulting in certain critical accounting functions being performed outside the direct oversight of the APS.

These situations have resulted in inconsistent managerial oversight of basic accounting functions, and impeded the effective communication and enforcement of accounting policies.

The central accounting office has several vacant key accounting positions, resulting in reassignment of critical management functions to existing employees who already have full workloads. This creates an environment where policies, procedures, and controls could be circumvented and not timely discovered with ordinary review and supervision. In addition, we noted that central accounting personnel do not adequately understand the business practices used by the field offices.

Also, field training of administrative personnel was conducted in fiscal year 2001 with limited success. This could be due, in part, to conflicting priorities of field personnel. USGS personnel do not receive adequate training and support to perform all assigned duties, including performing account analyses and reconciliations between accounts, subsidiary records, and financial statements routinely throughout the year to identify and correct errors or inaccuracies.

These situations resulted in material misstatements of account balances at year-end, requiring the central office to undergo extensive, time-consuming account analysis to determine and record more than 80 adjusting journal entries totaling more than $2 billion in order to prepare the financial statements. Many of the adjusting journal entries were based on conversations with field staff without sufficient support to verify amounts due to sheer volume of work, lack of resources, and difficulties in contacting field personnel. More than 120 days after year-end, material adjustments were still being recorded in the general ledger to produce financial statements.

In addition, certain disclosures that, in our opinion, are required by accounting principles generally accepted in the United States of America and OMB Bulletin No. 97-01, *Form and Content of Agency Financial Statements*, as amended, have been excluded from the financial statements, as described below:

a) *Revenues:* USGS does not adequately disclose its pricing policy on the goods or services they provide to the public or other government entities, the nature of intragovernmental exchange transactions in which goods or services are provided at less than full cost and the reasons for disparities between billing and full cost, or the full amount of any expected loss when specific goods or services are provided or made to order under a contract and a loss is both probable and measurable. USGS also does not have a policy that requires losses to be recognized when is probable or measurable in compliance with *Statement of Federal Financial Accounting Standards* (SFFAS) No. 7.*Accounting for Revenue and Other Financing Sources.*

b) *Statement of Budgetary Resources:* USGS does not adequately present the information for each of its major budget accounts as required supplementary information, the existence, purpose, and availability of permanent indefinite appropriations, or the differences between the statement of budgetary resources and the Presidents Budget submitted via the *Federal Agencies' Centralized Trial Balance System* (FACTS) in January.

Recommendations

The USGS needs to improve controls to ensure that accounting information processed by regional and district/field offices is complete, accurate, timely and in accordance with policy.

We recommend that USGS Office of Administrative Policy and Services leadership be given the authority to administer, manage and enforce compliance with accounting policies and procedures in a consistent manner throughout the entity. This recommendation includes any procedures performed by USGS's contracted personnel.

We recommend the USGS perform a review of controls within the regions and throughout the key accounting processes to test system design and identify control weaknesses. Further, with a decentralized accounting infrastructure, we recommend that USGS examine its accounting policies and procedures: including review, supervision and record retention, with the intent of strengthening the control environment and thereby improving the accuracy and reliability of accounting information.

We recommend that USGS establish and provide training programs for all accounting and administrative personnel. Vacancies should be promptly filled or position requirements should be consolidated with other similar duties regionally.

3. Proprietary and Budgetary Accounts are not Reconciled

The Department of Treasury's financial management office designed the standard general ledger (SGL) for federal government entities to use when recording their proprietary and budgetary accounting transactions. Certain relationships exist between the proprietary and budgetary accounts and assist in proving the reliability of the financial statements and the underlying accounting transactions. When these 'known' relationships between the proprietary and budgetary accounts are out of balance or unreconciled, it highlights potential problems with the completeness and accuracy of the recording of accounting transactions and undermines the reliability of reported financial information.

USGS is unable to reconcile and support differences between proprietary and budgetary balances reported in the financial statements as described below:

a) USGS was unable to adequately reconcile unexpended appropriations to unobligated available and unavailable authority and undelivered orders. As a result, we were unable to determine whether USGS correctly calculated the unobligated and obligated balances related to unexpended appropriations, properly computed and accrued year-end payables or whether the budgetary or proprietary accounts were properly recorded and presented in the financial statements. This situation indicates that USGS could be noncompliant with the *Anti-deficiency Act* and other related budgetary acts.

b) USGS was unable to produce a schedule of accounts payable and other accrued liabilities that reconciled to the SGL at September 30, 2001.

c) In addition, USGS performed analytical calculations of cumulative results of operations and total net position as presented in the 2001 financial statements. The analytical calculations are, by design, estimates of expected results based on select financial statement balances. In each case the analytical calculations produced estimates significantly different than the balances presented in the financial statements. The variances were outside the acceptable range of accuracy given the expected precision of the estimate, indicating likely errors in net position, as reported, or other financial statement balances.

d) As a matter of procedure, USGS also performs SGL analytical computations to review expected relationships between accounts and test the reasonableness of financial statement balances. This analysis, produced by USGS, also showed material differences from expected results for various financial statement line items.

Recommendations

We recommend that USGS reconcile and investigate the source of the differences noted in the findings above. This procedure will enable USGS to determine, support and document its compliance with the *Anti-deficiency Act*, and provide information to make appropriate adjustments to correct the accounts and restate unexpended appropriations, if necessary.

We also recommend that USGS accounting personnel implement regular analysis of their proprietary and budgetary accounts and determine the causes of any unreconciled differences. Specifically, USGS should review and correct any differences due to posting models used by its accounting system or noncompliant accounting procedures being practiced by the regional and field offices. USGS should implement policies and procedures to ensure the relationships between the proprietary and budgetary accounts are always correct and that budgetary status is routinely monitored to ensure compliance with the *Anti-deficiency Act* and improve the reliability of the accounting records.

4. Account Analysis and Adjustments are not Performed Timely or Documented

A substantial number of account analyses and reconciliations of accounts, subsidiary records, and financial reports are not performed routinely throughout the year. Consequently, errors and discrepancies remained in the financial accounts throughout the year, thereby rendering some interim USGS financial information unreliable as a source of business information. It also placed an unreasonable burden on the accounting staff to perform the reconcilations and post correcting entries within a short period of time after year-end, causing staff to work excessive overtime. We noted a severe override of review and management controls during this period in an effort to close the financial records and prepare for the annual audit. Many entries were posted without review or approval, creating an environment where material errors may occur and not be detected in the ordinary course of business. We noted that several adjustments were posted incorrectly during the closing process and required further analysis and rework. We were unable to audit certain year-end adjustments because USGS did not maintain supporting documentation for all year-end adjustments.

As an indication of the extent of reconciliation and analysis performed after year-end, the table below shows the *net* dollar adjustment made to certain individual accounts in the year-end closing process:

Account Name	*Net* Year-End Adjustments
Non-SF 224 transactions	$ 33,548,944
Unexpended appropriations	98,892,441
Allowance for loss on accounts receivable	6,880,923
Accounts receivable - unbilled	22,554,837
Other accrued liabilities	18,365,133
Advances from others	5,755,192
Liability for deposit funds in suspense	8,102,322

These are proprietary balance sheet accounts and contain the type of transactions that would normally be reconciled on a monthly or quarterly basis. We would normally expect to see relatively few year-end adjustments to these accounts if analysis and reconciliation procedures were effectively performed during the year. As mentioned in our comment on *Organizational Structure of Financial Management* above, more than 80 adjusting journal entries were posted after year-end.

USGS also needs to improve its reconciliation procedures with trading partners. Significant differences exist in amounts due/from USGS and other Interior Bureaus during the year. This creates an added burden at year-end to reconcile and post eliminating entries with trading partners. We identified more than $9 million of trading partner balances that remained unreconciled in the September 30, 2001 financial statements.

Recommendation

We recommend that USGS develop and implement procedures to ensure that all accounting adjustments are reconciled, adequately supported, timely and independently reviewed throughout the year.

5. Fund Balance with Treasury has not been Reconciled

USGS had an out-of-balance position of approximately $4 million with its Fund Balance with Treasury at September 30, 2001. We noted that:

a) USGS could not fully support and had not identified the cause of the $4 million difference;

b) A complete itemized listing of the reconciling items does not exist;

c) Some of the reconciled items represented reclassifications between appropriations, which was not documented.

d) Some of the items on the reconciliation were not supported;

e) Some of the items on the reconciliation were not accurate;

f) The out-of-balance condition is the net of numerous unreconciled amounts that affect Fund Balance with Treasury both positively and negatively;

g) The out-of-balance condition existed last year and will likely require a multi-year reconciliation to correct the situation and properly state Fund Balance with Treasury;

h) The differences and corrections will likely affect a variety of general ledger accounts and financial statement line items, by an undetermined amount (given the condition described in (f) above);

i) Fund Balance reconcilations, all of which are performed by professional staff, have not been sufficiently reviewed by financial management in a timely manner; and

USGS is unable to adequately support the reimbursable activity of $208 million presented in note 3, “Fund Balance with Treasury”.

We also noted that USGS has been performing monthly reconciliations of collections and disbursements; however, differences are not investigated and cleared on a timely basis. In some cases, reconciling items were simply recorded to expense or revenue, as needed, to force the balancing of the account.

Recommendations

We recommend that USGS develop and implement procedures to ensure that all Fund Balance with Treasury reconcilations are accurately performed after month-end, that all differences are identified, investigated and cleared timely. The revised procedures should also include a review by knowledgeable supervisors.

We recommend the USGS investigate the current out of balance condition, determine the source of differences and post the correcting adjustments to the financial records.

6. Suspense Account Balances are not Timely Reconciled and Correctly Recorded

USGS routinely uses SGL account 2400, Liability for Suspense, to temporarily record transactions pending the receipt of information needed to clear and properly record the transactions – a common practice for many Federal entities. However, we noted that USGS has not reconciled the suspense account sufficiently to clear all pending items. At year-end, a *net adjustment* totaling more than $8 million was recorded to expense to clear the suspense account, without evidence to support the entry. USGS was unable to determine, in the time permitted to prepare year-end financial statements, what the correct adjustments should have been (both dollar value and SGL accounts). We noted the following related to the liability for suspense account:

a) A significant number of transactions reside in suspense that are more than a few months old, pending resolution at year-end, which will likely result in numerous adjustments to a variety of financial statement line-items including proprietary and budgetary accounts;

b) USGS is not able to readily identify the nature or source of the remaining balances yet to be cleared;

c) The central finance office does not have ready access to the information needed to clear the remaining pending balances; and

d) Some of the unreconciled balances, individually and in aggregate, are material to the financial statements.

USGS is able to broadly classify the balances and generally identify the eventual disposition. However, the detail accounts that will be affected by the reconciliation of the suspense balances, and the dollar value of the adjustments, could not be determined prior to the end of our fieldwork.

Recommendations

We recommend that USGS develop and implement procedures to ensure that the liability for suspense account is reconciled on a timely basis after month-end, and that all pending transactions are investigated, properly supported, and recorded to the correct account. The revised procedures should also include a review by knowledgeable supervisors to ensure the completeness of the reconciliation and resulting postings. We also recommend that individual transactions be better identified to allow for easier research and the adoption of a policy requiring the clearing of transactions in less than 6 months. This policy will also help ensure that USGS is in compliance with applicable Treasury regulations.

We recommend that USGS investigate the pending transactions in suspense at September 30, 2001 and post the correcting adjustments to the financial records to properly clear the account.

7. Revenue Cycle Lacks Adequate Policies and Procedures

During our audit of USGS's revenue cycle and reimbursable agreements we noted a number of internal control, process and procedural deficiencies. The deficiencies listed below affect some or all of the accounts within the USGS revenue cycle, including expenses, earned revenue, unbilled and billed accounts receivable, allowance for doubtful accounts, bad debt expense and deferred customer revenue.

a) Significant discrepancies existed between the detail subsidiary ledgers and the general ledger at year-end that required extensive research by USGS to reconcile for financial statement purposes.

b) The management controls over reimbursable agreements need improvement. Agreements are often not immediately entered into the Project Cost Accounting System (PCAS) system upon receipt of the signed agreement. In some cases the same data is manually entered twice, into multiple systems, such as the Funds Management System or the BRD Administrative Information System, which partially replicates the financial data in the FFS system. Additionally, the contract systems do not electronically interface or automatically roll forward agreement data to the next fiscal year – instead agreements must be manually reentered each year - increasing the likelihood of error.

c) USGS is not billing customers timely. In approximately 15% of agreements reviewed we noted that USGS did not bill customers for more than a year past the time when the agreement allowed for billings to occur. This was one explanation given for the increase in unbilled receivables during the year. Further, billings are prepared manually and then sent to USGS headquarters for entry into the system. This process is inefficient, prone to error and resulted in billings not recorded in the financial accounting systems timely or correctly.

d) USGS was not able to provide supporting evidence for some transactions, due to missing documentation or difficulty in retrieving the information. In several instances, records supporting current balances were maintained off-site. This situation prevented us from completing our procedures on certain transactions and significantly impedes management's access to relevant financial information when needed.

e) We also noted two situations where USGS may not be refunding excess advances made by customers as required at the end of projects when unused funding remains. Additionally, USGS does not have a clear policy covering the transfer or use of funding between projects. We noted one instance where losses of one project where covered by transfers of excess funding balances of another unrelated project.

f) The central accounting office is reliant upon division personnel to take appropriate action to ensure collection of billed amounts. Some division personnel have not diligently pursued collections of past due amounts, resulting in an increase in accounts receivable each year for several years.

g) USGS has not established a methodology for estimating and recording an allowance for doubtful unbilled accounts receivable. USGS recorded an adjustment of approximately $5.7 million to establish a reserve for uncollectable unbilled accounts receivable, however the adjustment was not based on a thorough review of the detail records.

Recommendation

We recommend that USGS perform a study of its entire revenue cycle and consider redesigning or reengineering the process. We believe that findings (a) through (e) above can be addressed through this project. The USGS accounting process, including posting models, combined with the use, or lack of use, of technology and software and limited management oversight and review, is contributing to inefficiency and incidences of error. The system and process is unnecessarily complex and perhaps used in inappropriate ways (e.g. accounting for General Services Administration credits). We recommend that areas of process redesign should focus on:

- A review of the controls and procedures at the data entry points for reimbursable agreements and the revenue cycle – including coding and input of expenses, reimbursable agreement information, billings, payments and credits. We also recommend that a process flow analysis be performed to highlight areas of control deficiency and process inefficiencies.

- The ability to upgrade systems to reduce the extent of manual intervention, and improve automatic systems interface between the various subsidiary systems, produce management and informational reports, flag discrepancies, and carryover data into future years. We also recommend exploring the possibility of reducing the number of independent systems currently used in the revenue cycle – which is now more than five.

- Reduce the complexity of accounting for individual agreements and programs by redesign of the project coding or customer numbering system and application of burden rates. This objective would also be intended to simplify and improve the accuracy of the reconciliation process for both budgetary and proprietary accounts of reimbursable and direct agreements.

- Implement procedures to bill customers more frequently and follow-up on past due billings. We recommend that USGS consider centralizing and/or automating the billing process.

- Improve organization of customer agreements to enable better access to source documents and agreement information. We also recommend that USGS consider standardizing, to the extent possible, the format of its agreements to ensure that data critical to the accounting process is captured at the time of agreement execution.

The result of the process review and redesign would be (i) improved policies and procedures, including policies to ensure compliance with Federal contracting requirements, (ii) enhanced internal controls, (iii) improved efficiency and timeliness of processing, and (iv) better management tools to ensure completeness, existence and accuracy of amounts recorded in the system and reported in the financial statements. Our findings stated in (f) and (g) above can be corrected with improved management procedures to regularly monitor billed receivables, using an aging analysis and properly recording an allowance for doubtful accounts receivable for both billed and unbilled balances as needed.

8. Inventory is Not Accounted for in Compliance with Federal Accounting Standards

USGS has not established policies and procedures to account for map and hydrological inventory that will ensure compliance with SFFAS No. 3, *Accounting for Inventory and Related Property*, as noted below:

a) USGS recorded a $1.7 million adjustment to write-down the value of inventory held for sale to "net realizable value" as required by SFFAS No. 3. However, the adjustment was based on very limited review, was not documented by USGS and therefore, could not be independently verified by us. USGS also lacks written policies and procedures describing the method for and timing of recording valuation adjustments to inventory.

b) USGS is not currently recording the sale of merchandise in compliance with SFFAS No. 3, which states that "upon sale … the related expense shall be recognized and the cost of those goods shall be removed from inventory." Costs that are normally included in the valuation of inventory (e.g. raw materials, production) are being expensed as purchased or paid, not recorded as an asset in the valuation of inventory. This situation resulted in an understatement of cost of goods sold reported at the end of the year in USGS's financial records and a likely overstatement of period costs that would have otherwise been included in the valuation of inventory and expensed as sold. While these errors have an offsetting effect in the financial statements, time did not permit USGS to perform the analysis needed to properly adjust the expense accounts and determine the proper valuation of inventory (as also described in (a) above).

c) USGS has not properly classified revenue recognized from the sale of merchandise in the SGL. Inventory sales are currently classified as revenue on "reimbursable agreements" instead of "Revenue from Products Sold" in the SGL. While some inventory sales are likely related to reimbursable agreements, USGS did not have time to analyze the sales transactions and properly classify revenue from sales of merchandise in the SGL. This situation resulted in a classification error in the SGL. However, the error did not affect the financial statements in 2001 because the accounts combined for financial statement presentation purposes.

We were also unable to determine that USGS has appropriately valued inventory. USGS uses a costing model that is not clearly documented or understood within the organization and results in a value that may not reflect the true production or purchase cost of inventory.

Recommendations

We recommend that USGS establish policies and procedures to ensure compliance with SFFAS No. 3. The procedures should require a periodic (not less than annually) review to determine the proper carrying value of inventory. An adjustment to reduce the value of inventory should be made to expense when it is determined that the "net realizable value" (eventual sales price) of inventory will likely be less than the carrying cost.

We recommend that USGS review its methodology to value inventory. This review may result in an adjustment to restate inventory. It will also help address the material weakness related to cost of goods sold. As inventory is sold or otherwise used, USGS should record, in the same period, cost of goods sold equal to the value of inventory sold.

We also recommend that USGS record sales of inventory in the proper SGL account. A review should also be performed to ensure that reimbursable agreements are properly charged expense for any inventory usage associated with that agreement, to ensure that USGS is properly reimbursed for all allowable costs.

9. Property, Plant, and Equipment Lack Adequate Policies and Procedures

We noted the following issues that affected real property, personal property, capitalized software and construction in process:

Real property – USGS has not fully reconciled its real property subsidiary ledger to the detail listing that supports the general ledger amounts. USGS has developed a summary listing, which provides the names of each property owned, including all land, structures, and facilities owned at each property site, the status of the property, and the estimated value. However, the summary listing does not reconcile to the general ledger or the amounts presented in the financial statements.

Additionally, we were unable to ascertain the propriety of accumulated depreciation and related depreciation expense for an individual real property asset. USGS was unable to provide detail documenting how its real property depreciation values are tied to the individual components at each property site. We noted that depreciation expense and the related accumulated depreciation are calculated by entire property site instead of by individual assets. Since a variety of assets exist at each site, this method of computing depreciation will most likely not result in an accurate depreciation expense figure each period, and accumulated depreciation could be materially misstated.

The Branch of Management Support recorded a revaluation of real property assets resulting in a net decrease of real property in fiscal year 2001 of approximately $4.3 million. USGS was unable to provide adequate supporting documentation to substantiate a decrease in real property. USGS has not established a policy to address real property impairments. A post-closing entry was recorded to reinstate the real property balance and remove the associated period expense, until further documentation can be obtained to support the reduction in value.

Personal property – We noted errors in recording purchases, subsidiary (detailed) ledgers that did not agree and were not reconciled to the general ledger, and that USGS was unable to explain the differences, without extensive effort. The property, plant and equipment subsidiary ledger does not adequately interface with the FFS accounting system. Also, the subsidiary ledger is maintained by personnel who are not under supervision or subject to the review of the central accounting department, responsible for maintenance of the general ledger. We also noted that:

a) Several assets had been recorded as additions that had not been received during the year;

b) Depreciation expense was not being calculated and/or recorded on all assets properly;

c) An asset transferred in from another federal agency was incorrectly recorded; and

d) Documentation supporting acquisitions was not always available, without extensive research.

Capitalized software – USGS recorded a post-closing adjustment for approximately $6 million to implement SFFAS No. 10, *Accounting for Internal Use Software*, in fiscal year 2001. The single adjustment was recorded after year-end since USGS policy and procedures were not followed by divisional personnel, or adequately communicated to properly track the cost of developing the software, record software as a capital asset in the FFS, and establish amortization policies. We noted that several internally developed software projects had been completed during the year but had not been capitalized or put in service. This situation resulted in an understatement of capital assets until USGS accounting staff performed analyses to accumulate the appropriate costs and adjust the financial records after year-end.

Construction in process – USGS does not maintain a "construction in process" SGL account to properly record assets under construction or received in components. SFFAS No. 6 *Accounting for Property, Plant, and Equipment*, states "in the case of constructed property, plant and equipment, the property, plant and equipment shall be recorded as construction work in process until it is placed in service, at which time the balance shall be transferred to general property, plant and equipment."

Recommendations

We recommend that USGS implement a process to include a periodic reconciliation between the general and subsidiary ledgers – both personal and real property. The process could be made more efficient and accurate by using fields of common data elements in both systems. In addition, we advise USGS to establish policies and procedures to ensure property balances are complete and accurate. A review of beginning balances and inventory of property, plant and equipment may be required to ensure the accuracy of total gross book value reported in the financial statements. We also recommend that USGS review current processes to more completely identify internal control and process deficiencies and redesign the process and/or electronic systems. USGS should also consider aligning the property, plant and equipment acquisition process under a central system of review and supervision and enhancing the training of property accountants to ensure consistency in record-keeping for asset additions.

USGS should also review its procedures for recording depreciation expense to ensure that depreciation expense is accurately and completely recorded for each asset and a record of accumulated depreciation, by asset, should be maintained.

We recommend that USGS establish and implement accounting policies and procedural guidance to be used when revaluing assets. These accounting policies and procedures should specifically focus on the proper accounting treatment for revaluing assets.

The USGS should develop a system or process to have cost associated with the development of software recorded in the general ledger and should clearly communicate this requirement to all USGS organizations.

USGS should determine whether or not it has sufficient construction activity to maintain a construction in process account. If so, we recommend USGS develop and implement accounting policies and procedures for recording construction in process expenses. This should include a construction in process SGL account and a related subsidiary system to track the related construction in process amounts. The CIP system and property, plant, and equipment developed should incorporate both personal property and real property items.

USGS should follow the guidance provided in SFFAS No. 6, when transferring assets from other Federal entities, which states "The cost of general property, plant, and equipment transferred from other Federal entities shall be the cost recorded by the transferring entity for the PP&E net of accumulated depreciation or amortization. If the receiving entity cannot reasonably ascertain those amounts, the cost of the property, plant and equipment shall be its fair value at the time transferred."

A summary of the status of prior year reportable conditions is included as Exhibit I.

Internal Controls Over Required Supplementary Information and Performance Measures

We noted certain significant deficiencies in internal control over Required Supplementary Information discussed in the following paragraph that, in our judgment, could adversely affect USGS's compliance with the Required Supplementary Information reporting requirements.

10. Management Discussion and Analysis

The Management Discussion and Analysis (MD&A) did not contain a section to help users understand the financial results. OMB Bulletin No. 97-01, as amended, requires that MD&A should help users understand the entity's financial results. It should give the users the benefit of management's understanding of the relevance of particular balances and amounts shown in the principal financial statements, particularly if relevant to important financial management issues.

Recommendation
We recommend that USGS expand its MD&A section to include further discussion and analysis of financial results.

Compliance with Laws and Regulations

The results of our tests of compliance with the laws and regulations described in the Responsibilities section of this report, exclusive of the *Federal Financial Management Improvement Act* (FFMIA), disclosed several instances of noncompliance with the following laws and regulations that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements.*

11. Debt Collection Improvement Act

USGS divisional personnel did not identify all accounts receivable, that were delinquent for more than 180 days, as eligible for transfer to the U.S. Department of Treasury for collection or offset, resulting in a significantly lower transfer than would have otherwise been made.

Recommendation
We recommend that USGS establish a process, in fiscal year 2002, to ensure eligible receivables are referred to the U.S. Department of Treasury in a timely manner.

12. Prompt Pay Act

USGS did not always pay interest to vendors for late payments as required by the Prompt Pay Act, due to a lack of controls over data entry of vendor invoice information.

Recommendation
We recommend that USGS establish a process, in fiscal year 2002, to ensure late payments to vendors and creditors include interest penalties.

The results of our tests of FFMIA disclosed instances, described below, where USGS financial management systems did not substantially comply with the Federal financial management systems requirements, applicable accounting standards, and SGL at the transaction level.

13. FFMIA

FFMIA requires that each Federal agency shall implement financial management systems that comply substantially with (1) Federal financial management systems; (2) applicable Federal accounting standards; and (3) the US Standard General Ledger at the transaction level. Our findings in each area are described below:

EDP General Controls – We noted matters which we believe indicate that ineffective general controls exist over USGS's automated information systems, and are significant departures from certain requirements of OMB Circulars A-127, *Financial Management Systems*, and A-130, *Management of Federal Information Resources*, and were therefore instances of substantial non-compliance with the Federal financial management systems requirements under the Federal Managers' Financial Integrity Act.

As discussed above in our material weakness "*Lack of General Controls Over Information Technology Systems*," USGS needs to improve its EDP security and general control environment. USGS has not finalized and communicated an entity-wide security plan; has not configured the operating systems to provide optimal security and protection and to limit access to sensitive datasets and libraries; has not fully established system software controls that limit and monitor access to the programs and sensitive files; has not fully developed or segregated procedures for controlling changes over application software; and needs to improve maintenance of its off-site storage records. As a result, USGS does not substantially comply with the security and general EDP control requirements of OMB Circulars A-127 and A-130.

Federal Accounting Standards – We noted matters that we believe constitute noncompliance with applicable federal accounting standards. These matters are considered material weaknesses and described in finding No. 2 in the section of our report titled "Internal Control Over Financial Reporting".

Standard General Ledger – USGS is not in substantial compliance with US Standard General Ledger financial recording requirements. Transactions recorded in the revenue cycle and property, plant and equipment are recorded in a variety of subsidiary ledgers that do not follow the SGL format and do not reconcile to the general ledger. These transactions are then periodically recorded at a summary level into USGS's general ledger. While some of these subsidiaries systems data are recorded at a summary level monthly, at least one is recorded at a summary level annually. In addition, certain transactions involving the sale of inventory are not properly recorded at the SGL level, specifically cost of goods sold. These matters are considered material weaknesses and described findings Nos. 7, 8 and 9 in the section of our report titled Internal Control Over Financial Reporting.

Recommendation

We recommend that in fiscal year 2002, the Central Accounting Department and CFO devote resources toward efforts to:

- Improve the automated information systems environment.

- Improve financial statement preparation, presentation and disclosures to comply with *The CFO Act of 1990* and OMB requirements for the form and content of agency financial statements. Improvement would be facilitated using the GAO/PCIE *Financial Audit Manual* and CFO Act checklist issued July 2001.

- Address the control weaknesses described in the section of our report titled “Internal Control Over Financial Reporting.”

- Investigate alternatives for recording revenue cycle, property, plant and equipment and equipment transactions that will enable USGS to process transactions at the SGL level in subsidiary ledgers and therefore maintain compliance with FFMIA.

Responsibilities

Management’s Responsibility

The Government Management Reform Act (GMRA) of 1994 requires a federal agency to report annually to Congress on its financial status and any other information needed to fairly present its financial position and results of operations. To meet the GMRA reporting requirements, USGS prepares annual financial statements.

Management is responsible for:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
- Establishing and maintaining internal controls over financial reporting; required supplementary stewardship information and performance measures; and
- Complying with laws and regulations, including FFMIA.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies.

Auditors’ Responsibility

Because of the matters discussed above in the Report on the financial statements section, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying financial statements of USGS as of and for the year ended September 30, 2001. We considered the limitations on the scope of our work in forming our conclusions.

In connection with our engagement, we considered USGS’s internal control over financial reporting by obtaining an understanding of USGS’s internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our procedures. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers’ Financial Integrity Act of 1982. The objective of our procedures were not to provide assurance on internal controls over financial reporting. Consequently, we do not provide an opinion on internal control over financial reporting.

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

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

In connection with our engagement, 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 statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to USGS. Providing an opinion on compliance with laws and regulations was not an objective of our procedures, and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 01-02 and FFMIA, we are required to report whether the USGS financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

Distribution

This report is intended for the information and use of Department of the Interior's management, Department of the Interior's Office of the Inspector General, OMB and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

February 1, 2002

Exhibit I

USGS
Summary of the Status of Prior Year Reportable Conditions
September 30, 2001

Prior Year Report Reference	Condition and Comment Excerpt	Status
A	***USGS Needs Improved Controls Over Undelivered Orders.*** USGS overstated its year-end undelivered orders account balance and understated its year-end accounts payable and expense account balances.	**Repeated** Finding # 3
B	***USGS Needs Improved Controls Over Accounting Adjustments.*** USGS did not independently review all adjustments made to accounting data in its Federal Financial Systems (FFS) and maintain evidence that adjustments made to its Hyperion system were independently reviewed.	**Repeated** Finding # 4
C	***USGS Needs Improved Controls Over Its Capitalized Equipment Records.*** USGS did not ensure that its capitalized equipment records were accurate or complete.	**Repeated** Finding # 9
D	***USGS Needs Improved Controls Over Advance Payments Recorded in its Project Cost Accounting System.*** USGS Project Cost Accounting System, which tracks the costs of USGS projects, did not accurately account for advance payments received by the USGS under certain contractual agreements.	**Repeated** Finding # 7
E	***USGS Needs Improved Controls Over Compliance With the Prompt Payment Act.*** USGS did not timely compensate vendors for purchases and did not pay late payment interest penalties.	**Repeated** Compliance with Laws and Regulations Finding # 12

United States Department of the Interior

Office of Inspector General
Washington, D.C. 20240

Independent Auditors' Report

To: Director, U.S. Geological Survey

Subject: U.S. Geological Survey's Financial Statements for Fiscal Year 2000

We have audited the U.S. Geological Survey's (USGS) consolidated balance sheet and related notes as of September 30, 2000. The objective of our audit was to express an opinion on the fair presentation of the consolidated balance sheet. This financial statement is the responsibility of the USGS, and our responsibility is to express an opinion, based on our audit, on this financial statement.

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

In our opinion, the consolidated balance sheet referred to above presents fairly, in all material respects, the financial position of the USGS as of September 30, 2000, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 13, USGS has restated its FY 2000 consolidated balance sheet. These revisions were made to (a) correct an understatement of revenues for reimbursable funds, (b) correct inventory that was not recorded at the net realizable value, (c) correct the expired authority amount, and (d) reclassify the unreconciled difference in fund balance with Treasury to other assets.

In our report dated September 6, 2001, we expressed an opinion that USGS's statement of net cost for the year ended September 30, 2000 presented fairly, in all material respects, its net cost of operations in conformity with accounting principles generally accepted in the United States of America. As discussed in Note 17, USGS has restated its statement of net cost for the year ended September 30, 2000 to conform to the presentation of net cost for the year ended September 30, 2001. We did not audit the restated statement of net cost for the year ended September 30, 2000, and accordingly, we do not express an opinion on this statement.

Roger La Rouche
Assistant Inspector General for Audits
September 6, 2001, except for Note 13
as to which the date is February 1, 2002

United States Department of the Interior

U.S. GEOLOGICAL SURVEY
Reston, Virginia 20192

In Reply Refer To:
Mail Stop 270

MEMORANDUM

JUL 26 2002

To: Assistant Inspector General for Audits

From: Carol F. Aten
Chief, Office of Administrative Policy and Services

Subject: Comments on the Draft Audit Report of Fiscal Year (FY) 2001 Financial Statements

This memorandum contains our response to the recommendations in the draft Independent Auditors' Report, dated July 8, 2002, of the U. S. Geological Survey's (USGS) annual financial report.

1. Information Technology Systems Lack General Controls

USGS agrees with most of the issues raised in this finding. We have developed an action plan that addresses the more detailed issues raised in the Notices of Finding and Recommendation and have assigned a management official responsibility for completing the tasks.

Responsible Individual: Chief Technology Officer.
Implementation Time Frame: 10/18/02.

2. Organizational Structure of Financial Management

There are multiple issues and recommendations presented in this recommendation that need to be addressed separately.

We agree that we need to strengthen controls to ensure that accounting information processed by regional and field offices is complete, accurate, and timely. However, we believe the Chief, APS has the authority to enforce compliance with accounting policies and procedures. We recognize that our operational model splits authority and responsibility for financial transactions between our multiple entry points and our central accounting office, but we believe we can address this satisfactorily with a different approach. We do not intend to have administrative functions report to the Chief, APS; rather, we will continue with the present reporting relationship but will also improve controls and disperse accountability to make that structure effective. We do recognize, however, that we must address management control standards (as defined by OMB Circular

A-123), and especially the overall internal control environment, and we will make this a priority in FY 2002. We are also considering formalizing a schedule of regional and field office assistance and review visits. These visits will include tests and reviews of subsidiary systems and processes.

We conducted a workshop with regional administrative leadership to review accounting policies and procedures associated with the revenue cycle. This workshop also addressed the organizational placement of some of these functions, responsibility and accountability, and training needs.

We are also putting together a training plan for other accounting functions performed at field offices. This plan will include training sessions for the general control environment, unliquidated obligations, accruals, and expenses, and capitalization of internal use software, as well as training for the revenue cycle items mentioned above. This training will occur before the end of FY 2002.

We disagree with the recommendation to consolidate functions regionally. We believe our current decentralized structure is effective for a variety of reasons, and internal controls can be strengthened within this structure to address the issues you raised. Accordingly, we do not accept the consolidation recommendation.

Responsible Individual: Finance Officer.
Implementation Time Frame: 9/30/03.

3. Proprietary and Budgetary Accounts are not Reconciled

USGS has performed several analyses to prove that we are compliant with the Anti-deficiency Act. These analyses include an all proprietary account analysis, an all budgetary account analysis, and a combination of both sets of accounts.

USGS agrees that we need to regularly perform the types of analyses mentioned in the report. We know that an undeterminable portion of the differences are caused by our prior year commingling of direct and reimbursable funds, and we have a long-term solution to address that. In addition, we have already begun an analysis of our general ledger posting models.

We do not have enough senior level Accountants necessary to perform this work proactively. Accordingly, the USGS central accounting office will review its grading and staffing structure to address this higher level accounting work. We have also contracted for outside professional analytical assistance. In addition, USGS will review its monthly reconciliation process on an account-by-account basis, and improve existing, or develop new, automated tools to assist in this process.

Responsible Individual: Finance Officer.
Implementation Time Frame: 9/30/03.

4. Account Analysis and Adjustments are not Performed Timely or Documented

The number of adjustments we make at fiscal year end is a result of the way we are organized, the way we do business, and the way our major program lines close out at fiscal year end. This will not necessarily change, but we will instill more discipline and control in the closing and adjustment process. Previously, we were essentially dependent on one individual to close, analyze, and adjust, so we are also developing a staffing plan to instill more reconciliation, control, and review in this process.

Responsible Individual: Finance Officer.
Implementation Time Frame: 9/30/03.

5. Fund Balance with Treasury has not been Reconciled

USGS is currently addressing both recommendations. We have put together a team of professional Accountants to identify the out of balance condition and the necessary corrections and have contracted for other professional assistance. In addition, we are assigning new professional staff to the task, assigning a new supervisor to review the reconciliation, and developing new procedures and automated products to assist in the reconciliation. We also received assistance from knowledgeable Accountants in a fellow DOI Bureau on the last item.

Responsible Individual: Finance Officer.
Implementation Time Frame: 9/30/02.

6. Suspense Account Balances are not Timely Reconciled and Correctly Recorded

The nature and broad eventual disposition of the transactions in the suspense account is known, but not the specific product line or cost account. Consequently, balances have grown in the account and, as they age, become more difficult to research and clear.

The primary source of transactions entering the suspense account are failed collection transactions from other systems and intergovernmental disbursements that cannot be immediately costed to the proper account. USGS has developed a corrective action plan that includes an internal control review of the systems passing the failed collection transactions (see response to item 13), review and correction of associated general ledger posting models, and a review of the automated interfaces. We have convened an interBureau team to investigate the cause of the failed disbursement transactions and develop an institutional fix. We are also putting together a team to review and clear the backlogged transactions.

A professional Accountant will be hired to supervise the suspense account cleanup effort and institute a monthly reconciliation process. In addition, we will develop subsidiary reports and desk procedures. Finally, we will provide training to our field offices to stem the tide of these failed transactions.

Responsible Individual: Finance Officer.
Implementation Time Frame: 9/30/03.

7. Revenue Cycle Lacks Policies and Procedures

This is a particularly complex and detailed recommendation that calls into question our fundamental methods of operation. We most certainly agree with the intent of the recommendation as expressed in the final paragraph, but disagree with specific suggestions.

We agree that the systems and processes associated with our revenue cycle are complex, but we disagree that this complexity is unnecessary. This operating model is largely dictated by Congress (e.g., joint funding agreements) and OMB (encouragement to use more partnerships). The systems module (PCAS) we use to account for costs by customer is likewise necessarily complex; in fact, it was created largely to meet USGS' needs.

We are in the process of consolidating the functionality of several of the systems mentioned in the finding into a single planning system, thereby eliminating these other systems. We will also perform internal control reviews of two revenue systems (see response to item 13).

We conducted a workshop with administrative leadership from throughout the Bureau to address the issues presented in items b through f. Several workgroups are clarifying our procedures related to the revenue cycle and will propose specific policies and procedures.

Item a exists because of the complexity of the accounting associated with PCAS. We have looked for ways to improve this, but cannot identify any further efficiencies. We agree that extensive time and resources are devoted to this reconciliation, but that is the price we are willing to pay to support our method of operations, which were designed to best support the Bureau mission.

We did have a methodology for estimating and recording an allowance for doubtful accounts (item g), but KPMG did not agree with it. Nevertheless, we will adopt KPMGs recommended approach for developing the allowance.

In summary, we agree with the last paragraph of this recommendation but not necessarily the means to that end. We believe our alternative approach presented above will achieve the desired result.

Responsible Individual: Finance Officer.
Implementation Time Frame: 9/30/03.

8. Inventory is not Accounted for in Compliance with Federal Accounting Standards

There were significant deletions to this finding in the latest version of the draft report. KPMGs followup review of inventory began too late in the audit process for it to be completed, and this was recognized in the earlier versions of the report. However, that recognition has been removed from the latest version, and we object to those deletions.

KPMG is correct in saying that the central accounting office did not fully understand USGS' inventory process, and there was insufficient time to address KPMGs concerns with inventory valuation, cost of goods sold, and classification of revenue. Subsequent analyses by USGS leads us to believe that our inventory procedures are substantially correct and defensible, but there were insufficient audit resources or time to consider these analyses. Therefore, in advance of next year's audit, USGS will review its accounting models and document it's accounting for inventory. This will result in a revised inventory cycle memo that we invite KPMG to assist in developing.

This recommendation in the latest version of the draft report made a subtle but critical change in the recommendation. Enacted legislation takes precedence over accounting standards, and that needs to be reflected in the recommendation. We realize our challenge is to reconcile the two, but if that is not possible, then the legislation takes priority.

Responsible Individual: Finance Officer.
Implementation Time Frame: 9/30/02.

9. Property, Plant, and Equipment Lack Policies and Procedures

We generally agree with this recommendation. Our response is keyed to the different property topical areas as presented in the finding.

Real Property
USGS will review its records on owned real property holdings, confirm the accuracy of valuations, report on its findings, and make adjustments, if required, to Bureau financial records. We will calculate depreciation based on our findings. We will also document procedures that are consistent with SFFAS No. 6.

Personal Property
Since the implementation of the Fixed Assets Subsystem of the FFS, at which time USGS received assurances from the vendor that adequate reconciliation tools were in place, USGS has expended significant effort to reconcile personal property recorded in the Fixed Asset Subsystem of FFS with our general ledger. Software modifications designed to facilitate reconciliation were proposed but could not be implemented due to insufficient funding. Additionally, our property Accountant transferred to another Bureau last year and we were not able to replace him until late in the year.

There are serious system issues that prevent us from being able to effectively reconcile our personal property. We currently have a systems Accountant and a personal property expert working on the interdepartmental team addressing this issue. Until the systemic issues are corrected we will be forced to seek manual "workarounds" to balance our personal property account.

Capitalized Software
We believe we have an adequate policy for capitalizing internal use software, and we have established the accounting models to handle it. However, the policies have not been communicated well, nor has accountability for non-compliance been enforced. USGS will use

the GIOs office to assist in gaining compliance with this accounting standard. In addition, this will be a topic for the end-of-year training sessions.

Work in Process
USGS will review our real and personal property records to determine if we have sufficient construction activity to warrant a work in process system. We will share the results of this review with KPMG if we determine our level of activity does not justify such a system. Otherwise, we will develop the work in process system, the accounting models, policy and procedures, and include this in our end-of-year training.

General
Our real and personal property functions currently report to the Chief, APS, the Bureau CFO. We believe there is an element of control, accountability, and level of attention given to property when it is separated like this from the central finance office. Accordingly, we will not consolidate the property functions, either in the central finance office or some other centralized function. Rather, we will update our procedures, provide new training, and enforce accountability in our regional and field offices.

Responsible Individual: Chief, Office of Management Services.
Implementation Time Frame: 9/30/02.

10. Management Discussion and Analysis

We were aware of this requirement and included it in our annual report preparation plan. However, multiple competing priorities prevented us from completing this task. Fulfillment of the previously mentioned staffing plan will permit us to satisfy this requirement in FY 2002.

Responsible Individual: Finance Officer.
Implementation Time Frame: 9/30/02.

11. Debt Collection Improvement Act

USGS will update its procedures for determining eligibility for exclusion of delinquent debt from transfer to Treasury for collection or offset. Also, this topic was addressed at the previously mentioned administrative workshop and will also be a topic at the end-of-year training.

Responsible Individual: Finance Officer.
Implementation Time Frame: 9/30/02.

12. Prompt Pay Act

USGS will emphasize the proper recording of data in the payment process to correct this deficiency during the end-of-year training.

Responsible Individual: Finance Officer.
Implementation Time Frame: 9/30/02.

13. FFMIA

The latest version of the draft report adds the cost of goods sold to the standard general ledger portion of this finding. We disagree with that statement and believe we are properly recording cost of goods sold. KPMG did not do enough audit work to come to this conclusion and recognized that in the earlier versions of the report (also see the first paragraph under #8 of this response).

Our response to the first finding, Lack of General Controls Over Information Technology Systems, outlines the approach we are taking to implement this first recommendation.

We will address the second recommendation jointly with DOI. We were unaware of the GAO audit manual checklist until brought to our attention.

We appreciate the final recommendation, but we do not believe it is a practical recommendation for USGS, especially in the short term. The systems referred to are our personal property (fixed asset) and our revenue systems (DORRAN and IBiS). These systems serve multiple functions beyond the financial data. We believe the more practical, cost effective, and quickest solution is to work with these systems. Alternatively, we plan to perform comprehensive FFMIA and internal control reviews of the two revenue systems to raise our confidence in the quality of the data being passed to FFS. Following that we will investigate practical ways to timely interface data to FFS at the transaction level to comply with the general ledger posting at the transaction level requirement. As stated earlier, we are already working with DOI and the other DOI Bureaus on fixes and enhancements to the fixed asset module; however, due to the complexities of operating shared vendor software, these fixes and enhancements will not be available until at least FY 2004. We are developing and implementing manual "workarounds" in the interim.

Please feel free to contact me at 703-648-7200 (carol_aten@usgs.gov) or Jack Blickley at 703-648-7609 (jblickley@usgs.gov) if you have any questions concerning this response.