United States Department of the Interior

Office of Inspector General
Washington, D.C. 20240

April 11, 2003

Memorandum

To: Director, U.S. Geological Survey

From: Roger La Rouche Roger La Rouche
Assistant Inspector General for Audits

Subject: Independent Auditors' Report Regarding Observations on U.S. Geological Survey's Internal Control and Compliance with Laws and Regulations for Fiscal Year 2002 (No. 2003-I-0040)

KPMG LLP (KPMG), an independent certified public accounting firm, was engaged to audit the U.S. Geological Survey's (USGS) balance sheet as of September 30, 2002. However, because of the significant internal control deficiencies at USGS, the Office of Inspector General, in consultation with the Department of the Interior and USGS, decided not to issue audited fiscal year 2002 financial statements for USGS. As a result, the scope of KPMG's engagement was changed to perform only those procedures necessary to support the audit of the Department of the Interior's consolidated financial statements (Report No. 2003-I-0014).

As part of performing these procedures, KPMG considered USGS's internal control over financial operations and compliance with laws and regulations. The attached report dated January 24, 2003, provides KPMG's observations on internal control and compliance with laws and regulation. KPMG identified eight reportable conditions related to internal controls and financial operations, all of which KPMG considered to be material weaknesses:

A. Information technology systems controls
B. Organizational structure and leadership of financial management
C. Financial reporting controls
D. Account analysis and adjustments
E. Revenue cycle controls
F. Property, plant, and equipment controls
G. Inventory controls
H. Working capital fund accounting

In addition, KPMG found that USGS was not in substantial compliance with the three requirements of the *Federal Financial Management Improvement Act* (FFMIA). Specifically, USGS financial management systems did not substantially comply with federal financial management systems requirements, federal accounting standards, and the U.S. Government Standard General Ledger at the transaction level.

Management's response and corrective action plan are attached as Exhibit II to KPMG's report. USGS generally agreed with all the findings and recommendations. Based on the response and corrective action plan, all the recommendations are considered resolved but not implemented. The recommendations will be referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

Section 5(a) of the *Inspector General Act* (5 U.S.C. App. 3) requires the Office of Inspector General to list this report in its semiannual report to the Congress.

Attachment

2001 M Street, NW
Washington, DC 20036

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

We were engaged to audit the U.S. Department of the Interior's (Interior) financial statements as of and for the year ended September 30, 2002. As part of this audit we performed certain procedures related to the financial statements at the U.S. Geological Survey (USGS), a component of Interior. We also considered internal control when planning and performing the procedures at USGS.

The objective of the procedures performed at USGS was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon. We have not considered internal control since the date of our report.

Had we been able to perform sufficient procedures to express an opinion on USGS's financial statements additional matters might have come to our attention. Management of USGS is responsible for establishing and maintaining internal controls over financial reporting and complying with laws and regulations, including FFMIA.

While performing procedures at USGS we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

<u>Repeat Reportable Conditions from 2001</u>

A. Information technology systems controls

B. Organizational structure and leadership of financial management

C. Financial reporting controls

D. Account analysis and adjustments

E. Revenue cycle controls

F. Property, plant, and equipment controls

G. Inventory

<u>New Reportable Conditions</u>

H. Working capital fund accounting

We consider all these reportable conditions to be material weaknesses.

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

Management's corrective action plan is attached in Exhibit II. KPMG has not reviewed the corrective action plan and therefore has not determined whether the plan, if implemented, will fully address the reportable conditions described herein.

The following sections discuss the results of our consideration of internal control over financial reporting and the results of our tests of compliance with certain provisions of applicable laws and regulations.

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. 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 on its 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. Because of inherent limitations in internal control, misstatements due to error or fraud may nevertheless occur and not be detected.

Our consideration of internal control over financial reporting resulted in the following conditions being identified as reportable conditions, all of which we consider to be material weaknesses:

A. Information Technology Systems Controls (repeat finding)

During fiscal years 2002 and 2001, we noted weaknesses in USGS's computer systems. Although USGS has taken steps in fiscal year 2002 to establish a formal security program, USGS has not fully implemented information systems security policies or procedures to effectively control and protect information systems, programs and data supporting USGS operations and assets and has not met the minimum information technology (IT) security requirements of OMB Circular A-130. Specifically we noted the following:

1. *IT Risk Assessments* – Comprehensive risk assessments were not performed for two support systems within the established federal regulation timeframes. For these two support systems, security plans did not include all components (i.e., rules of the system, incident response capability, contingency plans and technical security) required by the National Institute of Standards and Technology (NIST).

2. *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. For example, some application users have been assigned privileges that allow them to enter, modify, and approve timesheet data.

3. *Access Controls* – USGS has not established access control procedures to prevent users from bypassing the network login script and gaining access to all financial systems on the network. Encryption tools are not consistently used for all network related activities and transmissions. Access control weaknesses include weaknesses in network configuration management, password

management, and failure to consistently monitor and follow-up on application security violations and unusual events.

4. *Application Software Development (or systems development life cycle - SDLC) and Change Controls* – USGS has not established, documented, and implemented a system for application software development and change controls to prevent the implementation of unauthorized, untested or incompatible software additions. Although a substantial number of applications are developed within USGS, a formal SDLC has not been established, documented, and implemented.

5. *Continuity of Operations* – USGS needs to test its Continuity of Operations Plan (COOP) to ensure that critical operations continue without interruption, or are promptly resumed, and critical and sensitive data are protected should unexpected events occur. USGS's COOP is dated February 2000 and has not been updated to reflect recent changes in hardware, software, systems architecture, and personnel.

Recommendations

As recommended in fiscal year 2001, we continue to recommend that USGS:

1. *IT Risk Assessments* – Implement an entity-wide risk assessment program to fully comply with OMB Circular A-130;

2. *Segregation of Duties* – Ensure proper segregation of duties and identify and if necessary adopt mitigating controls where segregation of duties cannot be achieved. In those specific cases where the USGS administrative procedures allow for incomplete segregation of duties (e.g., usually due to a small number of personnel at certain small field offices), appropriate mitigating controls need to be identified to account for expected risks;

3. *Access Controls* – Improve its security management structure by taking immediate steps to correct the network vulnerabilities and access control deficiencies;

4. *Application Software Development (or systems development life cycle - SDLC) and Change Controls* – Document and implement application software development and change controls to prevent unauthorized or untested program modifications; and

5. *Continuity of Operations* – Periodically test its continuity of operations plan in order to ensure its computer operations are recoverable and data is available in event of emergency situations or disaster.

B. Organizational Structure and Leadership of Financial Management (repeat finding)

During fiscal years 2002 and 2001, we noted that the financial management environment at USGS is not operating as effectively and efficiently as necessary to fully support the USGS organization. Specifically, we noted the following:

1. *Leadership structure* – Financial management has not provided an effective level of oversight in planning, prioritizing and executing the financial management practices within USGS.

2. *Accounting infrastructure* – Certain critical accounting functions are being performed outside the direct oversight and direct knowledge of the Office of Financial Management (OFM) and the Office of Administrative Policy and Services (APS).

3. *Financial management oversight in field offices* – Field accounting personnel often perform a variety of additional non-accounting duties and report to Regional Directors creating priority conflicts.

4. *Documentation, Communication and Enforcement of policies and procedures* – The proper financial management practices, policies, and procedures are not fully integrated or enforced in day-to-day operations throughout USGS. In addition, some policies and procedures are not clearly documented. For example, USGS performs routine reconciliations of fund balance with Treasury and its reimbursable activity; however, the procedures for performing these reconciliations are not documented.

5. *Training* – USGS personnel do not receive adequate training and support to perform all assigned duties, including how to analyze accounts and how to reconcile between accounts, subsidiary records, and financial statements.

6. *Accounting positions in the central office* – The duties of accounting positions in the central office are not adequately defined and are not always filled with personnel possessing the appropriate skills and background. In addition, several key accounting positions are vacant in the central accounting office resulting in reassignment of critical management functions to existing employees who already have full workloads. Furthermore, central accounting personnel do not have a thorough understanding of the business practices used by the field offices.

Recommendations

Given the decentralized control environment that USGS has adopted to support its mission and objectives, USGS's executive management must ensure that all personnel, including scientists, who perform accounting functions fully comply with OMB Circular No. A-123, *Management Accountability and Control*. OMB Circular A-123 states that "management controls are the organization, policies, and procedures used by agencies to reasonably ensure that…reliable and timely information is obtained, maintained, reported and used for decision making." Furthermore, "Federal managers must take systematic and proactive measures to develop and implement appropriate, cost-effective management controls."

We recommend that USGS:

1. *Leadership structure* – Align all accounting functions and responsibilities temporarily under a CFO who can focus directly on the improvement of financial management operations until effective policies, procedures, processes and controls are sufficiently in place to ensure continuous, reliable financial reporting.

2. *Accounting infrastructure* – Investigate the critical process weaknesses and perform a reassessment of needs that addresses personnel resources, management responsibilities, process flow, policies and procedures, and internal controls.

3. *Financial management oversight in field offices* – Improve and enforce controls to ensure that accounting information processed by regional and district/field offices are complete, accurate, timely and in accordance with policy. Because of USGS's 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 process and control environment and thereby improving the accuracy and reliability of accounting information.

4. *Documentation, Communication and Enforcement of policies and procedures* – Clarify APS's 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 that USGS formally document procedures for all accounts that could have a material affect on the financial statements and ensure that procedures are regularly updated. In addition, USGS should ensure that these procedures are effectively communicated to staff and that the appropriate level of training is provided.

5. *Training* – Develop and provide the appropriate training programs necessary for all accounting and administrative personnel.

6. *Accounting positions in the central office* – Assess the structure of the central accounting and finance operation to ensure that all accounting positions and responsibilities are appropriately defined and filled by personnel with the right skill sets, and fill vacancies or consolidate position requirements with other similar duties regionally.

C. Financial Reporting Controls (repeat finding)

USGS did not provide timely, accurate and appropriately reviewed reports to internal and external users because (1) their year-end closing procedures are complicated and not fully established, and (2) the need to review and adjust data provided by the financial system. In addition, OFM personnel responsible for the preparation of various financial reports rely on data entered into the financial system by or provided by other departments (mapping, property, etc.) that may not perform sufficient analysis or understand financial reporting requirements. As a result, USGS was late in providing the 4th quarter FY 2002 FACTS II submission to Treasury and the financial information needed to prepare Interior's FY 2002 financial statements.

Recommendations

We recommend that USGS:

1. Ensure qualified personnel perform appropriate reviews of the financial statements;

2. Establish and implement effective year-end closing procedures to facilitate timely preparation of financial information;

3. Implement quarterly or semi-monthly closing procedures to limit the extent of reconciliation required at year-end;

4. Implement procedures to ensure that individual financial statement line items are reconciled on a regular basis and that any resulting on-top adjustments are timely prepared and are separately authorized by a supervisor before being recorded; (see finding D)

5. Review SF-133's for accuracy and to facilitate timely submission of FACTS II data; and

6. Establish and implement procedures to ensure all required financial statement notes are properly prepared and reported.

D. Account Analysis and Adjustments (repeat finding)

Account analyses and reconciliations of accounts and subsidiary records are not performed routinely throughout the year. Consequently, the interim USGS financial information is not always complete and accurate and USGS expends a significant amount of resources during the year-end closing process. More than 150 adjusting journal entries were posted after year-end.

During our testwork, we identified errors resulting in material misstatements that netted to approximately $3.5 million in accounts payable and $4 million in undelivered orders. We also noted the following:

1. *Adjustments and Abnormal Balances* –Several of the adjustments USGS posted during year and during the yearend closing process were incorrect. As a result, additional analysis and work was required to identify and correct these adjustments. In addition, several SGL accounts had abnormal balances as of September 30, 2002. These abnormal balances appear to be mostly due to incorrect year-end adjustments.

2. *Suspense Account* – USGS did not analyze suspense account balances timely or properly record the related transactions. A significant number of the transactions and over 90% of the balance in suspense are more than a few months old.

3. *Budgetary and Proprietary Accounts* –Budgetary and proprietary account relationships were not analyzed during the year contributing to the abnormal balances in several accounts at year-end. USGS does not routinely prepare and review aged accounts payable and adjust for expired budgetary authority. In a related area we note some inconsistencies in yearend accruals and the proper classification of payables as governmental or intragovernmental.

4. *Eliminating Entries* – USGS had not fully reconciled balances with trading partners. Significant differences in amounts due from/to USGS and other Interior Bureaus existed during the year and were not resolved timely.

Recommendations

We recommend that USGS:

1. *Adjustments and Abnormal Balances* – Develop and implement procedures to ensure that all accounting adjustments are adequately supported, and independently reviewed throughout the year.

2. *Suspense Account*– Perform timely analysis after month end of the suspense account and related accounts such as other accrued liabilities, advances from others, and prepayments. Transactions should be investigated and moved to the appropriate account in timely manner and be properly supported. The revised procedures should also include a review by knowledgeable supervisors to ensure the completeness and accuracy of the analysis and resulting postings. We also recommend that individual transactions be more clearly identified and documented to allow for easier research. This policy will also help ensure that USGS is in compliance with applicable Treasury regulations.

3. *Budgetary and Proprietary Accounts*– Implement regular analysis of their proprietary and budgetary accounts and determine the causes of any unreconciled differences. Develop and implement accounting policies and procedures for reviewing aged accounts payable on a regular basis. In addition, these procedures should provide instructions on how to adjust payables related to funds where the budgetary authority no longer exists. Develop and implement more effective procedures to ensure the accuracy and validity of accruals recorded at year-end as well as the proper classification of payables as governmental or intragovernmental.

4. *Eliminating Entries* - Establish and implement procedures to address the timely reconciliation of intra-Departmental transactions. This will assist in USGS year-end closing procedures and eliminate the extensive burden of reconciling these items at year-end.

E. Revenue Cycle Controls (repeat finding)

We noted a number of internal control, process, and procedural deficiencies with USGS's revenue cycle and reimbursable agreement activity. The deficiencies listed below affect some or all of the accounts within the USGS revenue cycle, including reimbursable expenses and revenue, unbilled and billed accounts receivable, allowance for doubtful accounts, bad debt expense, and deferred revenue.

1. *Billing Process* - USGS is not always billing customers timely. Billings are prepared manually and sent to customers by the field offices. A copy is then forwarded to USGS headquarters for entry into FFS. This process has been inefficient, and resulted in some billings not being recorded in the financial accounting system timely or properly.

2. *Reimbursable Activity* - USGS does not perform a timely review of reimbursable agreement activity. Specifically, we noted the following:

    a. In some cases, billings exceeded earned reimbursements, creating negative unbilled amounts that are not adjusted except through the audit process.

    b. Certain agreements have both receivable (debit) and deferred revenue (credit) balances.

    c. Deferred revenue (customer advances) are not returned to customers as required at the end of projects when unused funding remains.

    d. Negative earned revenue/expenditures exist as a result of moving expenses from one agreement to another at the cost center level.

    e. Reimbursable expenses and related revenue has been recognized for agreements that have not been signed by both parties.

3. *Supporting Documentation* - We noted instances where USGS was unable to provide adequate documentation to support the expenses incurred and revenue recognized. These exceptions are due to USGS policies that do not require retention of documentation related to internal transactions.

4. *Collection Process and Allowance for Doubtful Accounts* - 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 in recent years. USGS's policies and procedures for the estimation of the allowance for doubtful accounts do not include the "specific identification" method. Additionally, for the allowance for billed receivables, USGS does not prepare a trend analysis to support collectibility. SFFAS No. 1 states that the specific identification methodology should be used in addition to a contingent allowance based on historical trends.

5. *Contract Accounting* – USGS occasionally modifies the terms of its reimbursable contracts to accommodate the specific needs of the customer. Contract modifications are generally made by program manager with approval of their supervisor, who may not fully understand the accounting implications of the change to the contract terms. Some changes may affect the propriety of accounting treatment of an individual contract, if not reviewed by accounting personnel and correctly recorded during term of the contract.

Recommendations

We recommend that USGS perform a study of its revenue cycle and consider redesigning the process. We recommend that areas of process redesign focus on:

1. *Billing Process* - Upgrading systems to reduce the extent of manual intervention and improve automatic systems interface between the various subsidiary systems; reducing the number of independent systems currently used in the revenue cycle and implementing 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.

2. *Reimbursable Activity* - Reducing the complexity of accounting for individual agreements and programs by redesign of the project coding or customer numbering system and application of burden rates. The objective would also be to simplify and improve the accuracy of the reconciliation process for both budgetary and proprietary accounts related to reimbursable and direct agreements.

3. *Supporting Documentation* – Establish policies and procedures for retaining support for expenses related to internal transactions.

4. *Collection Process and Allowance for Doubtful Accounts* – Establish procedures to ensure timely reviews of PCAS information, including billed and unbilled aging of receivables make the appropriate adjustments (e.g. accounting for General Services Administration credits, recognizing gains and losses timely, etc.). Fully incorporate the requirements of SFFAS No. 1 in the methodology used to estimate the allowance for doubtful accounts receivable.

5. *Contract Accounting* – Establish procedures to ensure compliance with applicable accounting standards for accounting for long-term contracts – specifically with regards to recognition of precontract costs and recognition of gains and losses on fixed price contracts.

The result of the process review and redesign would be (i) improved policies and procedures, including policies to ensure technical compliance in accounting for long-term contracts (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.

F. Property, Plant, and Equipment Controls (repeat finding)

We noted the following matters that affected real property, personal property, construction-in-process, and leased equipment:

1. <u>Real Property</u>

   The Real Property division manages land, buildings, and structures owned by USGS. However, recognizing and recording accounting transactions is beyond the Real Property division's scope of responsibility and technical expertise. The Office of Financial Management (OFM) maintains the responsibility for providing guidance in recording accounting entries and oversight to ensure real property is recorded correctly in the general ledger. However, OFM does not have the appropriate resources to fulfill its responsibilities. We noted the following:

a. *Capitalization policy* - According to USGS's policies, buildings, structures, and land should be capitalized if the acquisition cost is $50,000 or more. However, USGS had capitalized *all* buildings and structures including acquisitions for less than the capitalization threshold.

b. *Accumulated depreciation* – USGS was unable to provide supporting documentation for accumulated depreciation as of September 30, 2002. We also noted errors in USGS's calculation of accumulated depreciation due to the lack of guidance and supervisory review by OFM. Additionally, USGS recorded improvements to buildings and structures by adding the value to the acquisition cost, instead of itemizing acquisition within the subsidiary records.

c. *Detailed listing* – USGS does not maintain an accurate detailed listing or appropriate supporting documentation for real property. Along with this, USGS does not consistently monitor the real property accounts to ensure that postings to the account are accurate. Furthermore, USGS does not have policies and procedures in place to ensure the timely and accurate recording of real property additions and deletions.

2. *Personal property*

We noted the following discrepancies in personal property:

a. Shipping costs were not always included in the total acquisition costs of personal property items;

b. Lease payments were incorrectly added to the value of assets, leading to an increase in the total acquisition costs of those assets;

c. Documentation for deleted items often contained erroneous value amounts because field offices did not have access to the actual value information;

d. Several assets had an In-Service Date (a key variable in the calculation of depreciation) that was prior to the actual physical receipt date;

e. The capitalization threshold for improvements is very low at $1,000;

f. 176 personal property items totaling $1.6 million were included in the detailed listing of capitalized personal property, but were below the established capitalization threshold;

g. The estimated useful life policy that USGS uses for asset depreciation is not consistently followed; and

h. The depreciation expense for the newly acquired satellite was understated by $6.5 million due to a system limitation in FFS.

i. We also noted that the personal property inventory observation procedures may not be effective in ensuring the completeness and existence of recorded personal property.

3. *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."

4. *Leases*

   The Department of Interior has recently issued guidance on determining the difference between a capital and operating lease for personal property. USGS has not fully implemented procedures to ensure compliance with these required procedures.

Recommendations

We recommend that USGS:

1. *Real and Personal Property*

   a. Perform periodic reconciliations between the general and subsidiary ledgers – both personal and real property. The process could be made more efficient and accurate by using common data elements in both systems. In addition, we advise USGS to establish policies and procedures to ensure real and personal property balances are complete and accurate. A review of beginning balances and inventory of real and personal property may be required to ensure the accuracy of total gross book value reported in the financial statements.

   b. Continue to review current processes to identify internal control and process deficiencies and if necessary, redesign the process and/or electronic systems. USGS should also consider aligning under real and personal property, a central system of review and supervising the process of establishing the initial property records for newly acquired PP&E to ensure consistency in record keeping for asset additions.

   c. Review the procedures for recording depreciation expense to ensure that depreciation expense is accurately and completely recorded for each real and personal property asset and maintain an accumulated depreciation record for each asset.

   d. We also recommend that USGS review its current useful life policy for personal property and update it to more reasonably reflect the useful life expectancy of assets. USGS should also ensure it develops policies and procedures for evaluating and updating estimated useful lives as needed. USGS should ensure new controls are built into the 2004 personal property system upgrade to prevent premature depreciation from occurring. In addition, policies and procedures should be established to mitigate this problem.

   e. For personal property, determine the necessity for establishing additional, more effective, procedures to ensure that shipping costs of assets are correctly capitalized if required to place the asset in service.

   f. Establish procedures to ensure lease costs are not capitalized as part of the personal property additions.

   g. Analyze the benefits of increasing the betterment capitalization threshold for personal property.

   h. Revise and enforce its policies and procedures and provide necessary training over the personal property inventory observation procedures to ensure a proper level of understanding and increased reliability of data. This should include methods by which assets are physically marked and identified once counted, providing definitive instructions and format to allow for accuracy in testing of completeness of identified assets, and procedures to provide oversight of procedures performed, which may include testing of reported assets.

2. *Construction in progress* - Develop and implement accounting policies and procedures for recording construction-in-progress (CIP) costs. This should include a CIP SGL account and a related subsidiary system to track the related CIP amounts. The CIP system and property, plant, and equipment developed should incorporate both personal property and real property items.

3. *Leases* - Establish and provide training on the newly implemented accounting policies and procedures related to the proper determination of a lease classification for all leases and rental agreements.

G. Inventory Controls (repeat condition)

We noted that USGS has not established policies and procedures to account for inventory that will ensure compliance with SFFAS No. 3, *Accounting for Inventory and Related Property*. Specifically, we noted that USGS does not have an established method of computing net realizable values of inventory, recognizing cost of good sold, charging reimbursable agreements for use of inventory, and subsidiary (or perpetual) records that support the general ledger at the time of physical counts and during the year.

Recommendations

We recommend that USGS:

1. Establish policies and procedures to ensure compliance with SFFAS No. 3. The procedures should require a periodic (not less than annual) review to determine the proper carrying value of inventory. In addition, USGS should reduce the value of inventory and recognize a loss when it is determined that the "net realizable value" (eventual sales price) of inventory will likely be less than the carrying cost.

2. Review its methodology to value inventory. This review may result in an adjustment to restate inventory. 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.

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

4. Implement procedures to ensure quantities recorded equal the quantities used in the pricing models. Additionally, USGS should ensure that all inventories are included in the pricing module and those inventories that are held in excess are included in the adjustment to reduce inventory;

5. Complete a roll forward of inventory and that reconciles to the general ledger. A well-established roll forward will assist USGS in preparing analytics, accruals, and ensure related activity is recorded timely and properly; and

6. Update the current inventory observation procedures at the Denver Mapping Center and determine if other mapping centers need to update their inventory observation procedures.

H. Working Capital Fund Accounting

During our testwork over the Working Capital Fund (WCF), we noted that USGS does not record the investment component of the working capital fund in the proper standard general ledger accounts. As a result, USGS's expenses are overstated and other accounts are misstated during the year. Additionally, USGS has many reconciling items dating back to 1992 within each of the 12 components of their working capital funds.

Recommendations

We recommend USGS develop and implement a posting model that will properly record investment components of the working capital fund. Posting models should simplify the process for USGS's staff and require fewer adjustments at year-end. Additionally, USGS should reconcile each component's outstanding balances.

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

I. FFMIA

The results of our tests of FFMIA disclosed instances, described below, where USGS's financial management systems did not substantially comply with FFMIA. FFMIA requires that each Federal agency 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:

1. Financial Management Systems - As discussed above in under material weakness "*Information technology systems lack adequate general controls,"* USGS needs to improve its EDP security and general control environment. As a result, USGS does not substantially comply with the security and general EDP control requirements of OMB Circulars A-127 and A-130.

2. Federal Accounting Standards - We believe that the material weaknesses discussed under *Internal Controls Over Financial Reporting* constitute substantial non-compliance with federal accounting standards.

3. Standard General Ledger - USGS is not in substantial compliance with US Standard General Ledger at the transaction level. 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. 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 above in material weaknesses, D, E and H.

In addition, USGS made numerous adjustments during the year and after year-end to correct incorrect posting models. Furthermore, USGS did not consistently update its posting models for changes made to the SGL.

Recommendations

As recommended in fiscal year 2001, we continue to recommend that the CFO and OFM devote resources toward efforts to:

1. *Financial Management Systems* - Improve the automated information systems environment.

2. *Federal Accounting Standards* - 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 by using the GAO/PCIE *Financial Audit Manual* CFO Act checklist issued July 2001. Address the control weaknesses described in the section of our report titled "Internal Control Over Financial Reporting."

3. *Standard General Ledger* - 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.

Distribution

This report is intended for the information and use of USGS'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

January 24, 2003

Exhibit I

USGS's

Summary of the Status of Prior Year Findings

September 30, 2002

Ref	Condition Area	Status
A	Information technology systems lack adequate general controls.	Condition repeated in fiscal year 2002.
B	Organizational structure of financial management needs improvement.	Condition repeated in fiscal year 2002.
C	Proprietary and budgetary accounts are not reconciled.	Condition repeated in fiscal year 2002.
D	Account analysis and adjustments are not performed timely or documented.	Condition repeated in fiscal year 2002.
E	Fund Balance with Treasury has not been reconciled.	Corrected
F	Suspense account balances are not timely reconciled and correctly recorded.	Condition repeated in fiscal year 2002.
G	Revenue cycle lacks adequate policies and procedures.	Condition repeated in fiscal year 2002.
H	Inventory is not accounted for in compliance with Federal accounting standards.	Condition repeated in fiscal year 2002.
I	Property, plant, and equipment lack adequate policies and procedures	Condition repeated in fiscal year 2002.
J	Management Discussion and Analysis	Condition not addressed in fiscal year 2002 due to change in scope of audit.
K	Debt Collection Improvement Act	Corrected
L	Prompt Pay Act	Corrected
M	Compliance with FFMIA -EDP Controls -Federal Accounting Standards -Standard General Ledger	Condition repeated in fiscal year 2002.

Exhibit II

United States Department of the Interior

U.S. GEOLOGICAL SURVEY
Office of the Director
Reston, Virginia 20192

MEMORANDUM

MAR 24 2003

To: Assistant Inspector General for Audits

Through: for Bennett W. Raley R. Thomas Weimer
Assistant Secretary - Water and Science

From: Amy Holley Amy Holley
Deputy Director, U.S. Geological Survey

Subject: Comments on Draft Independent Auditors' Report Regarding Observations on U.S. Geological Survey's Internal Control and Compliance with Laws and Regulations

This responds to your March 11, 2003, memorandum transmitting the KPMG draft audit report.

We generally agree with all the findings and recommendations. Comments on specific findings and recommendations are detailed on Attachment 1. Our corrective action plan for each set of recommendations is on Attachment 2. This plan is geared toward achieving an unqualified balance sheet audit opinion for fiscal year 2003 and does not necessarily track each and every recommendation. We are aggressively addressing staffing and training needs to provide the resources needed to resolve issues and carry out our plan.

Please feel free to contact Carol Aten at 703-648-7200 or carol_aten@usgs.gov or Jack Blickley at 703-648-6319 or jblickley@usgs.gov if you have any questions concerning this response.

Attachments

Attachment 1

Comments on Specific Findings and Recommendations

A. Information Technology Systems Controls

Page 2 Item A 2 Under Segregation of Duties, add the following sentence at the end: In those specific cases where the USGS administrative procedures allow for incomplete segregation of duties (e.g., due to a small number of personnel at certain small field offices), appropriate mitigating controls need to be identified to account for expected risks.

B. Revenue Cycle Controls

E-1: There were very few instances of erroneous bills, and we believe the last sentence is overstating the condition.

E-5: We would like to explore with KPMG the legal requirements and accounting standards associated with item 5, contract accounting. The USGS has specific legal authorities to enter into "cooperative work, cooperative agreements, and cooperative programs" with our customers. Certain of these agreements allow us to unilaterally terminate the agreement. We believe these legal distinctions are relevant to the application of accounting standards, particularly with regard to recording gains and losses.

C. Property, Plant, and Equipment Controls

F-2.c: It is important to be precise when talking about deletions. We suggest the sentence read "Documentation for deleted items often contained erroneous value amounts because field offices did not have access to the actual value information."

F-4: This generalized statement is confusing. Please separately address the application of this finding to real or personal property leases, or to both.

Recommendations (general comment): It is especially important for each recommendation to specify whether it applies to personal property, to real property, or to both. There are different organizations, different processes, different thresholds, and different rules for these distinct programs. Where a recommendation is overly general or lumps the two programs together without recognition their many differences, it is difficult to understand the recommendation's intent, and devise an effective corrective action response.

Recommendation F-1.b: We suggest the second sentence be changed to "USGS should also consider aligning under a central system of review and supervision the process of establishing the initial property records for newly-acquired property, plant, and equipment." We would also like clarification of the term "property accountants." We have no staff classified as property accountants in the property office.

Recommendation F-1.f: We suggest that 'betterment' be inserted before capitalization.

Recommendation F-3: We need clarification on the intent and scope of this recommendation, training on capital versus operating leases, and inclusion of "rental agreements."

Attachment 2

Corrective Action Plan

1. Finding: Information Technology Systems Controls

Corrective Action Plan:

- Identify mitigating controls to account for expected risks in regard to segregation of duties in computer-related operations – 5/01/03
- Document and implement action plans to address application software development and change controls to prevent unauthorized program modification and access – 6/01/03
- Periodically test continuity of operations plan to ensure computer operations are recoverable and data are available in emergency or disaster situations – 8/01/03
- Implement entitywide risk assessment program to fully comply with Office of Management and Budget (OMB) Circular A-130 – 9/30/03
- Improve security management structure by taking immediate steps to secure network vulnerabilities and access control deficiencies – 9/30/03

Responsible Individual: Wendy Budd, 703-648-4786

2. Finding: Organizational Structure and Leadership of Financial Management

Corrective Action Plan:

- Create Audit Corrective Action Team – 1/28/03
- Restructure work assignments in central finance office – 2/07/03
- Develop training plans for central finance office staff – 3/03/03
- Create and fill a Senior Executive Service Deputy for Financial Management and Administration – 5/01/03
- Create and fill audit liaison, senior accountant, and branch chief positions – 5/01/03
- Fill other existing vacancies – 5/01/03

Responsible Individual: Carol Aten, 703-648-7200

3. Finding: Financial Reporting Controls

Corrective Action Plan:

- Prepare quarterly reports and financial statements as scheduled
    - FACTS II – within the OMB reporting window
    - Provide quarterly financial statements to the Department's Office of Financial Management and KPMG – 4/30/03, 7/30/03
- Prepare annual reports and financial statements as scheduled
    - FACTS II – within the OMB reporting window
    - Load August 31 data into Hyperion – 9/13/03
    - Complete August 31 line item variance analysis – 9/13/03

- Provide management discussion and analysis draft – 9/30/03
- Provide performance data to DOI – 10/15/03
- Complete bureau adjustments – 10/30/03
- Provide draft report to KPMG – 11/01/03
- Provide final report to KPMG – 11/04/03

Responsible Individual: Jack Blickley, 703-648-6319

4. Finding: Account Analysis and Adjustments

Corrective Action Plan:

- Correct general ledge posting models
  - Implement fund category posting by accounting event – 4/30/03
  - Correct journals and tables to agree with posting model
    - Working capital fund – 9/30/03
    - Reimbursable funds – 6/30/04
    - Direct funds – 9/30/04
    - All other funds – 9/30/04
- Develop conversion plan for data in no-year funds – 9/30/04

- Develop central finance office reports, reviews, analyses, and procedures
  - Develop missing critical function procedures – 6/30/03
  - Develop and begin applying checklist of monthly and quarterly reviews, reconciliations, and analyses – 6/30/03
  - Write desk procedures for all accounting positions – 9/30/03
  - Develop and apply advance statistical sampling and program review and remediation plans – 9/30/03

- Address accounts payable and suspense account reports and reconciliations
  - Develop a detailed accounts payable aging report and a suspense account report that reconciles to the general ledger – 9/30/03
  - Develop management review and certification process – 9/30/03
  - Develop data integrity processes and procedures – 9/30/03
  - Clean up accounts payable and suspense account data – 9/30/04

Responsible Individual: Jack Blickley, 703-648-6319

5. Finding: Revenue Cycle Controls

Corrective Action Plan:

- Establish a field managers team to identify and correct issues related to reimbursable agreements – 3/10/03
- Develop policies and procedures governing reimbursable agreements, including a policy for performing reimbursable work in advance of a signed agreement – 6/30/03

- Implement an automated billing process – 3/17/03
- Reissue requirements for the monthly review and followup of the prime revenue cycle report including a management mechanism to ensure the above reviews occur – 4/30/03
- Review and update current policies and procedures related to the revenue cycle, especially accounts receivable, accounts payable, and advances – 4/30/03
- Complete the review and correction of fixed price agreements – 9/30/03
- Develop an acceptable accounting model for fixed price agreements – 9/30/03

Responsible Individual: Jack Blickley, 703-648-6319

6. Finding: Property, Plant, and Equipment Controls

Corrective Action Plan:

- Begin monthly reconciliation of personal property – 2/28/03
- Update and reconcile real property quarterly – 4/01/03
- Implement revised personal property inventory procedures – 4/30/03
- Establish work-in-process account for real and personal property – 6/30/03
- Update real and personal property policies and procedures – 6/30/03
- Identify and correct erroneously capitalized personal property – 7/31/03
- Incorporate real and personal property procedures into training plan – 7/31/03
- Convert real property inventory to Federal Financial System – 9/30/03
- Implement fixed asset subsystem enhancement for personal property – 1/31/05

Responsible Individual: Keith Anderson, 703-648-7338

7. Finding: Inventory Controls

Corrective Action Plan:

- Review inventory valuation policies and procedures and update policy – 3/31/03
- Review inventory accounting policies and procedures – 3/31/03
- Correct inventory accounting model to properly record – 6/30/03
    - Beginning inventory balance
    - Cost of goods sold
    - Ending inventory balance (rollforward)
    - Net realizable value
    - Revenue
- Based on above steps, revalue inventory – 6/30/03
- Conduct FY 2003 inventory of map products – 9/15/03

Responsible Individual: Jack Blickley, 703-648-6319

8. Finding: Working Capital Fund Accounting

Corrective Action Plan:
- Implement fund category posting by accounting event – 4/30/03
- Correct journals and tables to agree with the working capital fund posting model – 9/30/03

Responsible Individual: Jack Blickley, 703-648-6319

9. Finding: Noncompliance With Federal Financial Management Improvement Act

Corrective Action Plan:
- Address revenue systems
  - Complete Federal Financial Management Improvement Act (FFMIA) and Federal Manangers Financial Integrity Act reviews of both revenue systems (DORRAN and IBiS) – 3/31/03
  - Complete OMB compliance indicator review for both systems – 5/01/03
  - Develop remediation plans – 6/30/03

- Address real property
  - Update and reconcile real property quarterly – 4/01/03
  - Establish work-in-process account for real property – 6/30/03
  - Convert real property inventory to FFS – 9/30/03

- Address other financial management systems
  - Develop schedule for performing FFMIA reviews of other systems identified as financial management systems – 9/30/03

- Address inventory issues
  - See corrective action plan for inventory – 9/15/03

- Address information technology issues
  - See corrective action plan for information technology issues – 9/30/03

- Address allowance for uncollectible unbilled accounts receivable issues
  - Analyze data and develop allowance methodology – 3/07/03
  - Document procedures – 3/07/03

Responsible Individual: Jack Blickley, 703-648-6319