



United States Department of Agriculture
Office of Inspector General





UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



DATE: November 8, 2011

REPLY TO
ATTN OF: 10401-0001-11

TO: Dave White
Chief
Natural Resources Conservation Service

ATTN: Stephen M. Kunze
Chief Financial Officer

Leon Brooks
Director of Compliance

FROM: Gil H. Harden /s/
Assistant Inspector General
for Audit

SUBJECT: Natural Resources Conservation Service's Financial Statements for
Fiscal Year 2011

This report presents the results of the engagement to audit Natural Resources Conservation Service's (NRCS) financial statements for the fiscal year ended September 30, 2011. The report contains a disclaimer of opinion on the financial statements, as well as an assessment of NRCS's internal controls over financial reporting and compliance with laws and regulations.

KPMG LLP, an independent certified public accounting firm, was engaged to conduct the audit. In connection with the contract, we reviewed KPMG LLP's report and related documentation and inquired of its representatives. Our review, as differentiated from an audit, in accordance with *Government Auditing Standards* (issued by the Comptroller General of the United States), was not intended to enable us to express, and we do not express, an opinion on NRCS's financial statements; internal control; whether NRCS's financial management systems substantially complied with the Federal Financial Management Improvement Act of 1996 (FFMIA); or conclusions on compliance with laws and regulations. KPMG LLP is responsible for the attached auditor's report, dated November 4, 2011, and the conclusions expressed in the report. However, our review disclosed no instances where KPMG LLP did not comply, in all material respects, with *Government Auditing Standards* and the Office of Management and Budget Bulletin 07-04, *Audit Requirements for Federal Financial Statements*, as amended, except as disclosed below.

KPMG LLP reported that NRCS was unable to provide sufficient evidential matter in support of certain transactions and account balances, as presented in the NRCS financial statements as of and for the year ended September 30, 2011, particularly with respect to beginning net position balances and current year activity; obligations incurred, including accrued expenses and undelivered orders; leases; real and personal property; recoveries of prior year unpaid obligations; advances to others; and stewardship land. NRCS was unable to complete corrective actions and make adjustments, as necessary, to these and other financial statement amounts prior to the completion date of the engagement.

It was impracticable for KPMG LLP to extend their audit procedures sufficiently to determine the extent to which NRCS's consolidated financial statements as of and for the year ended September 30, 2011, may have been affected by the matters discussed in the preceding paragraph. Accordingly, the scope of KPMG LLP's work was not sufficient to enable the auditors to express an opinion on the financial statements of NRCS as of and for the year ended September 30, 2011.

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

- Accounting and controls over undelivered orders;
- accounting and controls over accrued expenses;
- controls over financial reporting;
- accounting and controls for property, plant, and equipment;
- general and application access controls;
- accounting and controls over the revenue and unfilled customer orders; and
- controls over purchase and fleet card transactions.

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

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken or planned, including the timeframes to address the report's recommendations. Please note the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from report issuance.

**United States Department of Agriculture
Natural Resources Conservation Service
Audit Report
For the Year Ended September 30, 2011**

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KPMG LLP
2001 M Street, NW
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Independent Auditors' Report

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

We were engaged to audit the accompanying balance sheet of the United States Department of Agriculture (USDA) Natural Resources Conservation Service (NRCS) as of September 30, 2011, and the related statement of net cost, changes in net position, and budgetary resources (hereinafter referred to as "financial statements") for the year then ended. The objective of our engagement was to express an opinion on the fair presentation of these financial statements. We were also engaged to consider the NRCS's internal control over financial reporting and tested the NRCS's compliance with certain provisions of applicable laws, regulations, and contracts that could have a direct and material effect on these financial statements.

Summary

As stated in our opinion on the financial statements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the financial statements as of and for the year ended September 30, 2011.

Our consideration of internal control over financial reporting resulted in identifying certain deficiencies that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies, as defined in the Internal Control Over Financial Reporting section of this report, as follows:

Material Weaknesses

- 1 Improved Accounting and Controls Are Needed Over Undelivered Orders
- 2 Improved Accounting and Controls Are Needed Over Accrued Expenses
- 3 Improved Controls Are Needed Over Financial Reporting
- 4 Improved Accounting and Controls Are Needed for Property, Plant and Equipment
- 5 Improved General and Application Access Controls Are Needed

Significant Deficiencies

- 6 Continued Improvement in Accounting and Controls Are Needed Over the Revenue and Unfilled Customer Orders
- 7 Continued Improvement in Controls Are Needed Over Purchase and Fleet Card Transactions



The results of our tests of compliance with certain provisions of laws, regulations, and contracts disclosed the following instances of noncompliance or other matters 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. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

Noncompliance

- 8 NRCS Did Not Substantially Comply with the Federal Financial Management Improvement Act of 1996 (FFMIA)

Other Matter

We identified a matter that may be reported as a violation of the Merit System principles of 5 U.S.C., Section 2301 that has been referred to NRCS and OIG. The outcome of this matter, and any resulting ramifications, is not presently known.

Had we been able to perform all of the procedures necessary to express an opinion on NRCS's fiscal year 2011 financial statements, other internal control matters and other instances of noncompliance may have been identified and reported.

The following sections discuss the reasons why we are unable to express an opinion on NRCS's financial statements; our consideration of the NRCS's internal control over financial reporting; our tests of NRCS's compliance with certain provisions of applicable laws, regulations, and contracts; and management's and our responsibilities.

Opinion on the Financial Statements

We were engaged to audit the accompanying balance sheet of NRCS as of September 30, 2011, and the related statement of net cost, changes in net position, and budgetary resources for the year then ended.

NRCS was unable to provide sufficient evidential matter in support of certain transactions and account balances, as presented in the NRCS financial statements as of and for the year ended September 30, 2011, particularly with respect to beginning net position balances and current year activity; obligations incurred, including accrued expenses and undelivered orders; leases; real and personal property; recoveries of prior year unpaid obligations; advances to others; and stewardship land. NRCS was unable to complete corrective actions and make adjustments, as necessary, to these and other financial statement amounts prior to the contractually required completion date of the engagement.

It was impracticable to extend our audit procedures sufficiently to determine the extent to which NRCS's financial statements as of and for the year ended September 30, 2011 may have been affected by the matters discussed in the preceding paragraph; accordingly, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying financial statements as of and for the year ended September 30, 2011.

The information in the Management's Discussion and Analysis, Required Supplementary Information, and Required Supplementary Stewardship Information sections is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles.



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 was for the limited purpose described in the Responsibilities section of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, in our fiscal year 2011 engagement to audit, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in Exhibit I to be material weaknesses.

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

We noted certain additional matters that will be reported to management of NRCS in a separate letter dated November 4, 2011.

Exhibit IV presents the status of prior year significant deficiencies and material weaknesses.

Compliance and Other Matters

The results of certain of our tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed one instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, as amended and is described below.

We identified a matter that may be reported as a violation of the Merit System principles of 5 U.S.C., Section 2301 that has been referred to NRCS and Office of Inspector General (OIG). The outcome of this matter, and any resulting ramifications, is not presently known.

The results of our other tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance or other matters that are



required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, as amended.

The results of our tests of FFMIA disclosed instances in which the NRCS's financial management systems did not substantially comply with the (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.

* * * * *

Responsibilities

Management's Responsibilities. Management is responsible for the financial statements; establishing and maintaining effective internal control; and complying with laws, regulations, and contracts applicable to NRCS.

Auditors' Responsibilities. As discussed 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 NRCS as of and for the year ended September 30, 2011. We conducted our engagement in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 07-04, as amended. Those standards and OMB Bulletin No. 07-04, as amended, require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of NRCS's internal control over financial reporting. Accordingly, we express no such opinion.

An audit is planned to include:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall financial statement presentation.

In connection with our fiscal year 2011 engagement, we considered the NRCS's internal control over financial reporting by obtaining an understanding of the NRCS's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures, but not for the purpose of expressing an opinion on the effectiveness of the NRCS's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the NRCS's internal control over financial reporting. Furthermore, had we been able to perform all of the procedures necessary to express an opinion on the financial statements of NRCS as of and for the year ended September 30, 2011, other matters involving internal control over



USDA Natural Resources Conservation Service
November 4, 2011
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financial reporting may have been identified and reported. We did not test all controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

In connection with our engagement, we performed tests of the NRCS's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, as amended, including the provisions referred to in Section 803(a) of FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to NRCS. Had we been able to perform all of the procedures necessary to express an opinion on the financial statements of NRCS as of and for the year ended September 30, 2011, other matters involving compliance with laws, regulations, and contracts may have been identified and reported. Providing an opinion on compliance with laws, regulations, and contracts was not an objective of our audit and, accordingly, we do not express such an opinion.

The NRCS's response to the findings identified in our audit is presented in Exhibit VI. We did not audit the NRCS's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the NRCS's management, the USDA's Office of Inspector General, OMB, the U.S. Government Accountability Office, 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

November 4, 2011

USDA Natural Resources Conservation Service
Material Weaknesses

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

During our internal control testing of undelivered orders (UDOs) in fiscal year (FY) 2011, we noted that:

- Field personnel did not consistently and/or accurately review UDO balances;
- Obligations were not approved by the budget officer before the obligation document was signed and obligated in the accounting system;
- Easement disbursements were made against expired obligations; and
- Advances were not recorded to the correct general ledger account.

In addition to our controls testwork, we identified the following substantive exceptions that are indicative of control deficiencies that have an impact on UDOs:

- From a population of 197 recoveries of prior year unpaid obligations during the period 10/1/10 to 9/30/11, we identified 46 that were invalid and 17 that should have been recorded in a prior fiscal year;
- From a population of 99 open obligations as of September 30, 2011, we identified 12 that were invalid including accruals made at year-end that impacted the open obligation balance; and
- From a population of 31 open advances to others as of August 31, 2011, we identified eight invalid open balances. Additionally, our disbursement testwork identified instances where advances were not complete during FY 2011.

We were unable to conclude on the results of our testwork over undelivered orders, advances to others or recoveries of prior year unpaid obligations due to the materiality of identified differences. The control errors noted in our testwork increase the risk of an Anti-Deficiency Act violation.

The Federal Financial Management Improvement Act (FFMIA) requires each agency to implement and maintain systems that comply substantially with Federal Financial Management systems requirements, applicable Federal accounting standards, and the standard general ledger (SGL) at the transaction level.

The Anti-Deficiency Act states that “an officer or employee of the United States Government or of the District of Columbia government may not make or authorize an expenditure or obligation exceeding an amount available in an appropriation or fund for the expenditure or obligation.”

Office of Management and Budget (OMB) Circular A-123, Management’s Responsibility for Control states that transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports.”

Recommendation 1:

In addition to recommendation 1 from our FY 2009 and FY 2010 audit report, we recommend that NRCS management:

- Provide additional training to field personnel related to the identification and recording of advances and disbursements; and
- Provide guidance and policy to field personnel relating to the monitoring and validation of the obligation’s period of performance prior to payment.

Number 2: Improved Accounting and Controls Are Needed Over Accrued Expenses (Repeat Condition)

During our walkthrough of internal controls for accrued expenses during FY 2011, we noted that:

- State offices lacked internal controls over the completeness of accrued expenses;
- Expense accruals were recorded incorrectly or were inappropriate;
- Valid support for expense accruals from third parties was not obtained or available.

In addition to our controls testwork, we identified the following substantive exceptions that are indicative of control deficiencies that have an impact on accrued expenses:

- From a population of 190 detail accrued expense balances as of September 30, 2011, we identified 61 that were unsupported; adjustments that should have been recorded as obligations; or the related goods or services were already disbursed;
- From a population of 169 easement disbursements during the period 10/1/10 to 9/30/11, we identified five that included disbursements made against expired Agreements to Purchase or an advance that was improperly recorded as a delivered order;
- From a population of 164 other procurement disbursements during the period 10/1/10 to 9/30/11, we identified ten exceptions that were not adequately supported or related to an invalid adjustment which misstated the general ledger account;
- From a population of 90 non-routine procurement disbursements during the period 10/1/10 to 9/30/11, we identified 12 that were not adequately supported; and
- Our testwork of expenses and disbursements during FY 2011 identified expenses recorded to the wrong FY due to incomplete accruals as of September 30, 2010.

Additional testwork determined that the accrued expense balance as of September 30, 2011 was incomplete.

From a population of 64 disbursements during the period 10/1/10 to 9/30/11, we identified 22 that did not include, or had entered, an incorrect acceptance date into the Foundation Financial Information System (FFIS), misstated interest for late payments, or lacked supporting documentation for an actual disbursement.

We were unable to conclude on the results of our testwork over accrued expenses due to the materiality of identified differences. The control errors noted in our testwork increase the risk of non-compliance with the Prompt Payment Act.

In accordance with Statement of Federal Financial Accounting Standards (SFFAS) Number (No.) 1 paragraphs 74 and 77, "Accounts payable are amounts owed by a federal entity for goods and services received from, progress in contract performance made by, and rents due to other entities... When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of the goods. If invoices for those goods are not available when financial statements are prepared, the amounts owed should be estimated."

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

transactions that, according to current law and applicable policy, are unpaid amounts due as of the reporting date.”

Code of Federal Regulations Title 5, Part 1315: Prompt Payment requires “Executive departments and agencies to pay commercial obligations within certain time periods and to pay interest penalties when payments are late. Interest is computed from the day after the due date through the payment date, at the rate in effect on the day payment becomes overdue. Interest remaining unpaid for any 30-day period will be added to the principal, and interest thereafter will accrue monthly on the total of principal and previously accrued interest. Section 1315.4(b) of the rule provides that an invoice is deemed to be received on the later of 1) the date a proper invoice is received by an agency if the agency annotates the invoice with the date of receipt, or 2) the seventh day after the date in which goods are delivered or services completed, unless acceptance occurs earlier or if a longer acceptance period is specified in the contract. If the agency fails to annotate an invoice with the date of receipt of the invoice, the date placed on the invoice by the contractor is used to determine the start date for the payment period.”

Recommendation 2:

In addition to recommendation 3 from our FY 2009 and FY 2010 audit report, we recommend that NRCS management:

- Reduce the number of standard voucher and year end accruals required by configuring systems to record accruals when goods/services are receipted in the application, where there is a cost benefit;
- Enhance monitoring internal controls over obligations and payment approvals to determine whether appropriate documentation is provided to support the obligation and disbursement;
- Utilize transaction codes in FFIS to record accruals that do not reverse for direct entry obligations; and
- Provide guidance on the Prompt Payment Act related to the entry of acceptance dates and determine if additional interest is due to vendors or whether the vendor was overpaid as a result of any errors.

Number 3: Improved Controls Are Needed Over Financial Reporting (Repeat Condition)

During our FY 2011 engagement, we identified the following financial reporting weaknesses:

- Stewardship land information, comprised of conservation easements, is incomplete and inaccurate;
- NRCS did not have consistent monitoring controls to determine the condition of stewardship land;
- NRCS was unable to determine deferred maintenance costs as of September 30, 2011;
- The annual performance measures reported in the Management Discussion and Analysis (MD&A) were not clearly aligned with the current strategic plan that includes long term performance measures as of June 30, 2011. This was subsequently corrected by management within the MD&A as of September 30, 2011;
- NRCS did not have adequate internal controls over the Fund Balance with Treasury reconciliation;
- An apportionment was not approved by the OMB before being apportioned in FFIS;
- NRCS recorded anticipated resources into FFIS without an OMB approved Standard Form (SF)-132;
- NRCS recognized disbursing authority for a particular Treasury Appropriation Fund Symbol (TAFS) which has an open obligation past five years as no-year funds, and manually reclassifies amounts that post to the unapportioned authority and apportioned authority accounts to expired authority; and
- From a population of 524 standard voucher manual journal entries during the period 10/1/11 to 10/14/11, we identified 41 that were either processed without adequate supporting documentation or improperly recorded into the accounting system.

SFFAS No. 29, *Heritage Assets and Stewardship Land*, paragraph 41 states that “entities should report the condition of stewardship land as required supplementary information” (RSI) to the financial statements. In addition, it states that entities should report “the number of physical units by major category of stewardship land use for which the entity is the steward at the end of the reporting period” as well as “the number of physical units by major category of stewardship land use that were acquired and the number of physical units by major category of stewardship land use that were withdrawn during the reporting period.”

SFFAS No. 6, *Accounting for Property, Plant and Equipment*, paragraph 83 lists the information that is required for disclosure relating to deferred maintenance.

Treasury Financial Manual (TFM), Part 2, Chapter 4200 directs agencies on how to report their year end closing data into the FACTS II system. Section 4225.35a, Receivables, states that agencies should “exclude any receivable from the public, except when a provision of law specifies that such orders may be used as budget authority. Unfilled customer orders do not exist for orders placed by the public, since agencies must receive advances with the orders for goods or services from the public.” The United States SGL (USSGL) provides additional posting model and general ledger guidance for all financial transactions.

Recommendation 3:

In addition to recommendation 4 from our FY 2009 and FY 2010 audit report, we recommend that NRCS management:

- Enforce NRCS’s Circular 21 to ensure condition assessment policies and procedures are compliant with SFFAS No. 29;
- Incorporate agency accountability measures at the state office level to track adherence to monitoring policy in determining the condition of stewardship land;
- Continue development of a methodology to collect data and properly report deferred maintenance information in future years in accordance with U.S. generally accepted accounting principles (US GAAP);
- Implement a second level review and approval for apportionments entered into FFIS prior to posting that includes the agreement of the entry to a OMB approved SF-132;
- Apportion anticipated resources with OMB that NRCS plans to record in FFIS;
- Continue to timely correct expired transactions that post to current authority general ledger accounts in FFIS;
- Implement procedures to eliminate the need to record a large amount of adjustments at the end of the year;
- Establish policies/guidelines that assist accounting personnel in properly determining what constitutes necessary and sufficient supporting documentation for recorded manual adjustments; and
- Enhance the design of management review of standard voucher entries to include obtaining and inspecting supporting documentation.

Number 4: Improved Accounting and Controls Are Needed for Property, Plant, and Equipment (Repeat Condition)

During our FY 2011 internal control and substantive testwork over general property, plant and equipment (PP&E), we noted the following:

Real and Personal Property

- Duties were not appropriately segregated allowing one individual to acquire, inventory, and certify to the completeness of personal property inventory;
- The property inventory process failed to identify real and personal property items that existed, but were not included in the inventory listing;
- The inventory process failed to recognize items on the Personal Property Report (PROP) that no longer existed;
- A lack of accounting guidelines surrounding leasehold improvements;
- Information Technology (IT) property does not have an adequate tracking system to ensure items are properly omitted from PROP;
- NRCS was unable to provide supporting documentation for real and personal property balances and/or the date placed in service;
- Capitalized assets included items below the agency's capitalization threshold as a result of an incorrect budget object code (BOC) causing inaccurate accumulated depreciation and net book value; and
- Amounts were included in acquisition costs that should have been expensed and not capitalized.

Capital Leases

In testing internal controls over leases, we determined that NRCS lacks consistent application of its reconciliation control between the lease database and the records at the state office level and the review of the lease reconciliation reports are not evidenced. Additionally, testwork during field site visits identified 21 exceptions in 85 sampled items where leases recorded in FFIS were not included, over-obligated, or under-obligated, and lease amounts and/or start/end dates were not accurate in the lease database.

Our testwork over capital and operating leases as of July 31, 2011 identified 22 exceptions in 61 sampled items where the lease was either improperly classified, not adequately supported, or the capital lease asset and liability balance was incorrect.

NRCS has not implemented a procedure that determines the budgetary impact of leases that may be classified differently under OMB Circular A-11, *Preparation, Submission and Execution of the Budget* and SFFAS No. 6, *Accounting for Property, Plant and Equipment* criteria.

We were unable to conclude on the results of our testwork over real and personal property and leases due to the combination of the range of errors in the populations and incomplete databases.

OMB Circular A-123, *Management's Responsibility for Internal Control* states that management has a fundamental responsibility to develop and maintain effective internal control.

SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, states that "general PP&E shall be recorded at cost. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use. PP&E shall be recognized when title passes to the acquiring entity or when the PP&E is delivered to the entity or to an agent of the entity. In the case of constructed PP&E, the PP&E

shall be recorded as construction in progress until it is placed in service, at which time the balance shall be transferred to general PP&E.”

SFFAS No. 6, paragraph 20, identifies the 4 criteria for classification of capital and operating leases. Additionally, SFFAS No. 6 it states that “the present value of rental and other minimum lease payments (should exclude) that portion of the payments representing executory cost.”

SFFAS No. 5, paragraphs 45 and 46 identifies the “discount rate to be used in determining the present value of the minimum lease payments ordinarily would be the lessee's incremental borrowing rate unless (1) it is practicable for the lessee to learn the implicit rate computed by the lessor and (2) the implicit rate computed by the lessor is less than the lessee's incremental borrowing rate. If both these conditions are met, the lessee shall use the implicit rate.”

OMB A-11 identifies six criteria that a lease must meet in order to be considered an operating lease rather than a capital lease.

Recommendation 4:

In addition to recommendation 5 from our FY 2009 and 2010 audit report, we recommend that NRCS management:

- Develop in coordination with the Department Chief Information Officer (CIO) a reconciliation process for State offices to utilize to reconcile between the International Technology Services (ITS) property report and State inventory reports;
- Develop a policy and procedure to identify and account for leasehold improvements;
- Continue to train budget, program, and field office personnel to properly establish obligations depending upon the lease type;
- Develop and implement a system or tracking tool to timely identify upcoming lease end dates to determine whether amendments/renewals are needed and update the Corporate Property Automated Information System (CPAIS)/FFIS accordingly in a timely manner;
- Provide training to personnel in the state offices responsible for the accounting of real and personal property including an in depth training on the functionality of the PROP system. This training should include, but not be limited to, application procedures to ensure personnel are entering the correct BOC into PROP, guidance on how to individually enter items into PROP that are bundled together under one invoice or purchase order, and how to recognize what costs should be capitalized or expensed;
- Develop a procedure to obtain reasonable estimates in data where the lessor has not provided adequate documentation; and
- Determine if any lease classifications will change for budgetary purposes based on capital lease criteria differences between OMB A-11 and SFFAS No. 6.

Number 5: Improved General and Application Access Controls Are Needed (Repeat Condition)

USDA International Technology Services IT General Controls

At the Department level, the USDA OIG identified IT general control deficiencies at ITS, a service organization within USDA as part of their FY 2010 review. ITS manages the network/server infrastructure that supports major applications at NRCS. KPMG performed testing in FY 2011 and identified similar control weaknesses identified by the USDA OIG in FY 2010, including weaknesses in logical access.

Actions to resolve the conditions in the ITS IT general controls environment are critical to ensuring the protection of critical NRCS applications, resources and data.

NRCS IT General Controls

In testing general and application access controls at NRCS during FY 2011, we noted the following deficiencies:

Remote Access

NRCS has not implemented multi-factor authentication when signing or logging in for remote access.

Application-Level Access

- NRCS does not have a formal process to request access to zRoles (a user account/role management application used for ProTracts and Fund Manager);
- NRCS does not have a formal process to periodically review access to zRoles accounts;
- From a population of NRCS Easement Staging Tool (NEST) accounts, five NRCS separated employees retained access to their NEST accounts after the date of their termination;
- From a population of Active Directory users, 17 either lacked a System Authorization Access Request (SAAR) ticket or supervisor approval on their Access Request forms;
- No formal periodic review of users with Manager/Human Resource (HR) roles in EmpowHR; and
- A formal procedure is not in place with regard to access management for the HR system.

Configuration Management Support System Access

- NRCS does not have a formal process to periodically review users with access to the Administrator within CoLab; and
- The Administrator account within CoLab is a shared account and the password is not changed on a periodic basis.

User Access Management

From a population of Active Directory accounts, ten NRCS separated employees retained access to their Active Directory accounts after the date of their termination.

In addition to our access control testwork, we identified the following control deficiencies that have an impact on general and application access controls:

- No anti-virus software installed on Linux servers (which host the WebTCAS front-end);
- Vulnerability scanning was not performed over the Web Farm for at least 2 months during FY 2011;
- No Linux patches were implemented for at least 3 months during FY 2011;
- Vulnerabilities classified as “High” were not addressed in a timely manner; and
- A Service Level Agreement (SLA), which includes a financial management system, does not include explicit oversight of audit access/audit reporting and separation of employee procedures.

NRCS continues to have weak manual and entity-level controls, which further elevates the severity of the IT application and general control weaknesses. Additionally, access control findings at NRCS and ITS from FY 2008, 2009, and 2010 have not substantially been addressed and corrected.

The following lists criteria associated with the above conditions:

OMB Circular A-130, Appendix III, *Security of Federal Automated Information Resources*;

OMB M-07-16, *Safeguarding Against and Responding to the Break of Personally Identifiable Information*;

National Institute of Standards and Technology (NIST) SP 800-63, *Electronic Authentication Guideline*;

NIST SP 800-30, *Risk Management Guide for Information Technology Systems*;

NIST SP 800-40 v.2, *Creating a Patch and Vulnerability Management Program*;

NIST SP 800-35, *Guide to Information Technology Security Services – Developing Service Agreements*; and

NIST SP 800-53, *Recommended Security Controls for Federal Information Systems*.

Recommendation 5:

We recommend that NRCS management:

- Establish controls to monitor the control environment at ITS and mitigate the identified weaknesses;
- Work with ITS to implement two-factor authentication for remote users of NRCS specific applications;
- Monitor and respond promptly to any detected vulnerabilities and determine the impact of these invasions on financially significant systems and information;
- Continue to follow its established process for granting access to ensure that accounts are only granted to appropriate personnel and evidence of such approval is retained;
- Establish formal procedures for requesting and granting access to zRoles;
- Establish formal procedures for reviewing users with zRoles and their roles, HR and manager roles in EmpowHR, and Administrator accounts within CoLab;
- Install anti-virus software or implement and document compensating controls on Linux servers;
- Develop and implement a process that will timely identify that sufficient amount of licenses are available to perform vulnerability scanning each month. Renew or revise any contracts, etc. as necessary;
- Remediate, appropriately assign, or appropriately document via Exemption Form in a timely manner and according to policy critical vulnerabilities;
- Update SLAs, where applicable, to include provisions around access auditing and separation of employee procedures; and
- Identify any information systems with financial significance which has no formal policies and procedures with regard to access management and establish such formal policies and procedures, including guidelines for account creation, modification, removal, review, monitoring, and any other NIST specified criteria.

**USDA Natural Resources Conservation Service
Significant Deficiencies**

Number 6: Continued Improvement in Accounting and Controls Are Needed Over the Revenue and Unfilled Customer Orders (Repeat Condition)

During our test of design over reimbursable agreement controls, we noted that NRCS lacked internal controls over unfilled customer orders, accounts receivable, and revenue during the first two quarters of FY 2011. Specifically,

- Reimbursable agreements were not recorded timely;
- Recorded amounts were inaccurate;
- The funding source was not validated by the budget officer prior to approval and entry to the FFIS; and
- NRCS did not accrue for revenue earned during the first quarter.

Additionally, we identified two instances where unfilled customer orders were not recorded to FFIS. During our substantive testing for the period October 1, 2010 to March 31, 2011, we identified 20 instances where the recognition of revenue was incorrect or inadequately supported.

NRCS consolidated the accounting for revenue and reimbursable agreements to three locations during the 3rd quarter of FY 2011. The consolidation to three locations provides an additional control to detect and correct material misstatements. Our testwork during FY 2011 supports the operating effectiveness of the controls performed at the consolidated locations. To further support the improvement in the control environment, our testwork of balances and transactions after consolidation did not identify material misstatements to the revenue, accounts receivable, or unfilled customer order balances.

SFFAS No.7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, states that agencies should “recognize exchange revenue at the time that a Government entity provides goods or services to the public or to another Government entity.”

OMB Circular No. A-123, *Management’s Responsibility for Internal Control*, states that “management has a fundamental responsibility to develop and maintain effective internal control”.

Recommendation 6:

We recommend that NRCS management:

- Reduce the amount of time needed for National Headquarter approval of delegation of authority for signing that has to be delegated for reimbursable agreements; and
- Implement formal, sustainable reimbursable agreements monitoring controls that operate for the entire FY.

Number 7: Continued Improvement in Controls Are Needed Over Purchase and Fleet Card Transactions (Repeat Condition)

During our test of design of internal controls over purchase and fleet cards, we noted that:

- Quarterly supervisory review of purchase card transactions was not conducted during the 1st quarter of FY 2011;
- Purchase cardholder transactions were not reconciled within 30 days of the transaction date;

- Purchase cardholder accounts were not deactivated when there were unreconciled transactions greater than 60 days;
- Unreconciled transactions cannot be reviewed and approved by the cardholder's supervisor;
- Two cardholders were issued purchase cards, but had not registered the cards or taken the necessary training;
- One cardholder was a valid cardholder, but did not appear on the purchase card hierarchy listing as of April 2011;
- One cardholder had registered the purchase card, but NRCS was unable to provide proof of training completion for this individual; and
- Fleet card internal controls had not been implemented at the time of our testwork.

Additionally, our testwork of credit card disbursement for the period April 1, 2011 to July 31, 2011 identified nine instances where NRCS could not provide support that the Approving Official had reviewed and approved the sampled purchase card transactions.

Through our walkthrough of controls, we noted that NRCS implemented properly designed controls which validated purchase card holders in the 3rd quarter of FY 2011. To further support the improvement of internal controls, our testwork over transactions of credit card transactions did not identify material misstatements of credit card disbursements.

OMB Circular No. A-123 states that "management is responsible for developing and maintaining effective internal control."

USDA Departmental Regulation 5013-6, *Office of Procurement and Property Management*, paragraph 13, states that "cardholder supervisors will monitor purchasing activity of cardholders in their units. Supervisors shall review cardholder transaction reports at least quarterly or more often if agency procedures require. On reviewing a cardholder report, the supervisor shall initial it and retain it on file."

Department Regulation (DR) 5400-006 states that "users of the fleet charge cards or alternative payment methods must submit receipts for purchases. The local fleet program coordinator, an accountable property official, or other management official responsible for the fleet and non-fleet vehicles and motorized equipment must keep all receipts for a minimum of one calendar year in order to maintain an adequate audit trail."

USDA General Manual Title 120, Part 406.21, *Use of Government Purchase Cards*, states that "cardholders shall approve their transactions no later than 30 days after a transaction appears. The account of any cardholder who fails to approve transactions within 60 days after each transaction appears in AXOL will be deactivated."

USDA's *Approving Official Purchase Card Program Guide*, section 4.9.B states that "AOs are to 'final approve' cardholder transactions within 30 days from when they appear in their 'Manager's Approval Queue'."

Recommendation 7:

We recommend that NRCS management:

- Establish a sustainable control environment for fleet card purchases;
- Ensure compliance with the policy requiring supervisors to perform quarterly reviews;
- Require all cardholders to register cards in the US Bank system; and

- Ensure compliance with the policy requiring Approving Officials to perform timely reviews of purchase card transactions.

**USDA Natural Resources Conservation Service
Compliance with Laws and Regulations**

Number 8: NRCS Did Not Substantially Comply with the Federal Financial Management Improvement Act of 1996 (Repeat Comment)

Compliance with Federal Financial Management System Requirements

During our engagement, we determined that NRCS's systems are unable to:

- Provide extracts of certain balances at a period of time which resulted in the sampling of transactions;
- Allow for authority beyond ten years of availability; and
- Prevent the recording of invalid upward and downward adjustment to prior year obligations.

These issues were addressed through our recommendations in Exhibit I.

Compliance with Applicable Federal Accounting Standards

During our engagement, we determined that beginning net position balances and current year activity; obligations incurred, including accrued expenses and undelivered orders; leases; real and personal property; recoveries of prior year unpaid obligations; and advances to others were not properly recorded in accordance with Federal accounting standards. Stewardship information was incomplete and inaccurate, and is not in accordance with SFFAS No. 29. Additionally, NRCS was unable to present deferred maintenance information for real, personal, or stewardship property.

These issues were addressed through our recommendations in Exhibit I.

Compliance with the United States Standard General Ledger (USSGL)

During our engagement, we noted that NRCS did not use USSGL appropriate posting models for recoveries of prior year obligations paid and unpaid.

These issues were addressed through our recommendations in Exhibit I.

USDA Natural Resources Conservation Service
Status of Prior Year's Material Weaknesses and Significant Deficiencies

As required by *Government Auditing Standards* and OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended, we have reviewed the status of prior year's significant deficiencies and material weaknesses. The following table summarizes these issues and provides our assessment of the progress NRCS has made in correcting these findings.

Reported Condition	Year Identified	Fiscal Year 2011 Status
Improved Accounting and Controls Are Needed Over Undelivered Orders	2008, 2009, 2010 Material Weakness	Open (FY 2011 MW No.1)
Continued Improvement in Accounting and Controls Are Needed for Unfilled Customer Orders	2008, 2009, 2010 Material Weakness	Open (FY 2011 SD No. 6)
Improved Accounting and Controls Are Needed for Accrued Expenses	2008, 2009, 2010 Material Weakness	Open (FY 2011 MW No. 2)
Improved Accounting and Controls Are Needed for Property, Plant, and Equipment	2008, 2009, 2010 Material Weakness	Open (FY 2011 MW No.4)
Improved Controls Are Needed Over Financial Reporting	2008, 2009, 2010 Material Weakness	Open (FY 2011 MW No.3)
Improved General and Application Access Controls Are Needed	2008 and 2009 Significant Deficiency; 2010 Material Weakness	Open (FY 2011 MW No. 5)
Continued Improvement in Controls Are Needed Over Purchase and Fleet Card Transactions	2008 and 2009 Significant Deficiency; 2010 Material Weakness	Open (FY 2011 SD No. 7)

**USDA Natural Resources Conservation Service
Status of Prior Year's Non-Compliance Findings**

As required by *Government Auditing Standards* and OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended, we have reviewed the status of prior year's non-compliance findings. The following table summarizes these issues and provides our assessment of the progress NRCS has made in correcting these findings.

Reported Condition	Years Reported	Fiscal Year 2011 Status
NRCS Does Not Substantially Comply with Federal Financial Management Improvement Act of 1996	2008, 2009 and 2010	Open/Comment Repeated in 2011

United States Department of Agriculture



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

November 4, 2011

Mr. Brian J. Grega
KPMG, LLP
2001 M Street, NW
Washington, D.C. 20036

Dear Mr. Grega:

We have reviewed KPMG's Independent Auditors' Report dated November 4, 2011 and generally agree with its contents.

In FY 2011, NRCS has made significant strides towards remediating material weaknesses as evidenced by KPMG downgrading two material weaknesses to significant deficiencies for purchase and fleet cards, and unfilled customer orders. The Natural Resources Conservation Service (NRCS) is highlighting improvements in financial management of obligations, easements, and information technology application and access controls. While work completed will not result in a downgrading of the related material weaknesses in FY 2011, it is a key step in that process. The work is a collaborative effort between financial management, acquisitions, information technology, human resources, and program staff at both the national and state levels. The following has been accomplished:

Obligations

In an effort to improve the financial management of obligations, NRCS issued proactive guidance to states/division for monitoring un-liquidated obligations, implemented a scorecard for de-obligations of inactive obligations, tested obligations to determine the accuracy of the Review of Open Obligations Tool, completed a review of expired obligations, and incorporated performance elements regarding obligations in State Conservationists' Performance Plans.

Easements

The completeness and accuracy of NRCS stewardship land data improved after the deployment of the National Easement Staging Tool (NEST) late in FY 2010. During FY 2011 NRCS conducted a successful multiphase quality assurance effort targeted at the completeness of easement data. As a result of the implementation of NEST, the dedication and hard work of State and National NRCS staff, and on-going quality assurance efforts, NRCS made vast improvements in easement processes and data accuracy. Of particular note is the progress made in the completeness of the count of closed stewardship land easements. NRCS is looking forward to the opportunity to deliver stewardship land completeness in FY 2012.

Helping People Help the Land

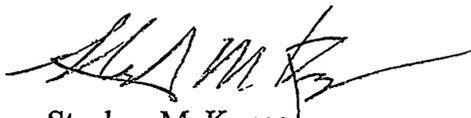
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Information Technology-General Application and Access Controls

Significant accomplishments in the IT area include: delivered training on new and existing access control management procedures, identified and tested a compensating control that mitigated the risk of Fund Manager Admin activities, verified the existence of a current and accurate user administration procedure for adding, modifying and removing user access to Active Directory, updated the Service Level Agreement between NRCS and International Technology Service, and installed the Juniper VPN Client on approximately 98% of NRCS laptops, PCs and tablets.

In FY 2012, NRCS will continue its audit remediation efforts. The remediation involves senior management commitment to corrective action plans and a continued strengthening of its financial management leadership, and financial management staff. NRCS will issue financial management procedures and conduct the related training. NRCS's A-123 internal control program will continue to evolve with additional cycles assessed, documented and tested. NRCS is committed to the audit remediation process and the actions needed to obtain a clean financial audit opinion. NRCS recognizes its obligation to be good steward of taxpayer dollars, along with its strategic goal of helping people help the land.

Sincerely,



Stephen M. Kunze
Chief Financial Officer

cc: Phyllis Fong
Office of the Inspector General



Natural Resources Conservation Service

Fiscal Year 2011
Financial Statements

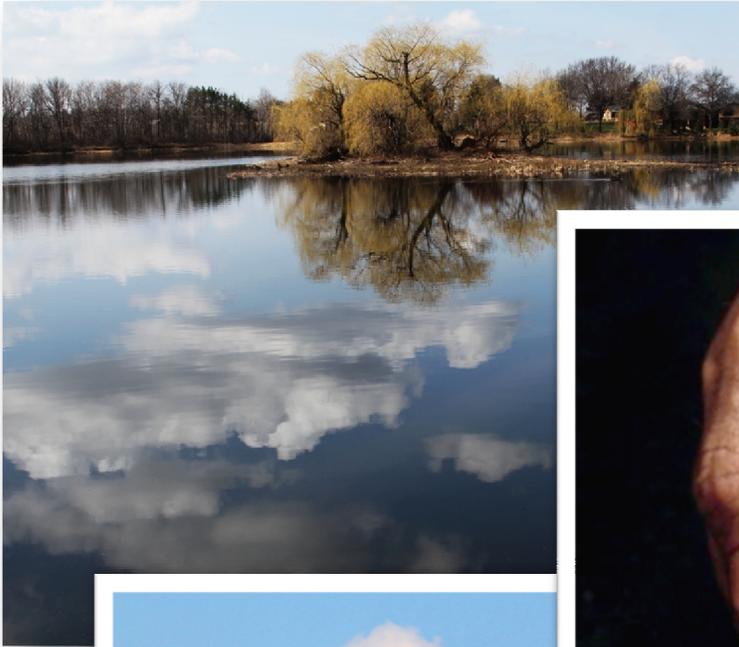


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Management's Discussion and Analysis (Unaudited)

Management's Discussion and Analysis

The Management's Discussion and Analysis (MD&A) serves as a high-level overview of the fiscal year (FY) 2011 financial and non-financial performance for the Natural Resources Conservation Service (NRCS), an agency of the United States Department of Agriculture (USDA).

The MD&A discusses the agency's compliance with legal and regulatory requirements, including the Federal Managers' Financial Integrity Act (FMFIA), the Federal Financial Management Improvement Act (FFMIA), the Inspector General Act and other key legal and regulatory requirements.

MISSION AND ORGANIZATIONAL STRUCTURE

Mission Statement

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

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

NRCS provides accurate and timely information on water supply and soil moisture conditions enabling resource managers to assess risks of damage from either drought or flooding and adjust operations as needed. Adoption of practices, such as water conserving irrigation systems, can reduce economic and environmental risk. In addition, practices applied to reduce erosion or to improve grazing land or forest health can mitigate the risk to resource productivity that severe weather or climate change might cause.

NRCS delivers technical assistance to communities experiencing development pressure by employing strategic approaches to land use planning and natural resource conservation. In addition, NRCS has programs that allow quick and decisive action to safeguard lives and property in any watershed whenever fire, flood or other natural disaster causes a sudden impairment to the watershed.

NRCS evaluates the latest research, technologies and techniques to continually improve the effectiveness of conservation systems, reduce implementation and maintenance costs, and maintain a high level of productivity for NRCS field personnel.

As a leader in providing critical research on soils, conservation practice effectiveness, and plant materials, we continue to increase our understanding of soil science, improve the technical skills of our field personnel and provide high quality products and services to the public. Four examples of NRCS technical products and services are:

Soil Survey: The Soil Survey Program provides current and consistent map interpretations and data sets of the soil resources within the United States. Understanding and managing soil as a strategic natural resource helps sustain the health, security and economy of the Nation. Scientists and policy makers use soil survey information to evaluate the sustainability, environmental impact and management of our natural resources. NRCS is the lead Federal agency for the National Cooperative Soil Survey (NCSS), a partnership of Federal land management agencies, State agricultural experimental stations, private consultants, and State and local governments. NRCS provides the scientific expertise to enable the NCSS to develop and maintain a uniform system for mapping and assessing soil resources.

Snow Survey: The Snow Survey and Water Supply Forecasting (SSWSF) Program collects high-elevation snow data in the Western United States, and provides managers and others with snowpack data and water supply forecasts. The data is used to estimate annual water availability, spring runoff, and summer stream flows. Individuals, Tribes, organizations and State and local governments rely on these water supply forecasts to make decisions relating to agricultural production, hydroelectric power generation, fish and wildlife management, municipal and industrial water supply, reservoir management, urban development, flood control, recreation, and water quality management.

Management's Discussion and Analysis (Unaudited)

Conservation practice effectiveness: The Conservation Effects Assessment Project (CEAP) is a multi-agency effort to quantify the environmental benefits of conservation practices and develop the science base for managing the agricultural landscape for environmental quality. Project findings help guide USDA conservation policy, program development and help farmers and ranchers make informed conservation choices. The three principal constituents of CEAP—national assessments, watershed assessment studies, and bibliographies and literature reviews—contribute to the evolving process of building the science base for conservation. This process also includes research, monitoring and data collection, modeling, assessment, and outreach.

NRCS Plant Material Centers (PMCs): PMCs collect and evaluate native plants for their potential use in a variety of environmental circumstances and develop vegetative technologies to address specific environmental situations. Examples include: suitable cover in short or long-term drought conditions; stream bank protection; erosion control, water quality, and carbon sequestration. Plant varieties that prove suitable for a particular use are cultivated for seed and made available to commercial growers. In addition, the Centers identify emerging needs, such as pollinator habitat, bio-feedstock and air quality. They also evaluate plant and vegetative technologies to address these needs and develop technical and training materials on those techniques, such as soil bioengineering, range plantings and pollinator habitat.

Organizational Structure

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

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

Strategic Planning and Accountability Framework

The Strategic Planning and Accountability framework is comprised of three major functional components: planning the work (strategically and annually), managing the work, and evaluating the work completed. The work is inclusive of two major components – the actual activities to be conducted and the funding used to do them (budget). It is an ongoing cyclical process. The Annual Performance Measures as outlined in the Annual Budget are tied directly to the Strategic Plan measures, and tracked through the Accountability Information Management System (AIMS). AIMS components include tools to collect performance data, program data, workload data, and time cost allocation. The Performance Results System (PRS), is the performance measurement component of AIMS, which mines on-the-ground data from the National Conservation Planning database, Customer Service Toolkit, ProTRACTs (Program Contracting System) and summarizes information based on business rules and queries reviewed, calculated, and locked on an annual basis. For more details on data quality assurance methodology, see Page 8). All functionality in the Strategic Planning and Accountability Framework is undergoing significant investment to provide continued improvement in accountability, performance, and efficiency.

Mission Goal: Get More Conservation on the Ground

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

**Management’s Discussion and Analysis
(Unaudited)**

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

Table 1: Key Performance Measures (KPM)

Management's Discussion and Analysis (Unaudited)

Performance Scorecard for FY 2011

The following scorecards display NRCS's accomplishments as related to the NRCS Strategic Plan, Mission Goal: Get More Conservation on the Ground.

Performance Scorecard for Fiscal Year 2011								
USDA Objectives	Milestones	Trend ¹				Fiscal Year 2011		
		FY 2007	FY 2008	FY 2009	FY 2010	Target	Actual	Result ²
2.1 Restore and Conserve the Nation's Forests, Farms, Ranches, and Grasslands	2.1.2 Cropland with conservation applied to improve soil quality (Conservation Technical Assistance (CTA) - millions of acres)	7.3	8.3	7.6	8.2	7.7	8.2	Met
	2.1.3 Cropland with conservation applied to improve soil quality (Environmental Quality Incentive Program (EQIP) - millions of acres)	5.3	5.6	4.8	4.8	4.8	4.6	Met
	2.1.4 Grazing land and forest land with conservation applied to protect and improve the resource base (CTA, millions of acres)	12.2	16.5	16.0	17.6	15.6	17.1	Met
	2.1.5 Grazing land and forest land with conservation practices applied to protect and improve the resource base (EQIP, millions of acres)	16.5	16.9	17.2	17.5	15.7	16.3	Met
	2.1.6 Prime, unique, or important farmland protected from conversion to nonagricultural uses by conservation easements (Farm and Ranchlands Protection Program (FRPP), thousands of acres)	38.5	27.4	38.3	53.9	45.0	51.5	Exceeded
	2.1.7 Non-Federal land with conservation applied to improve fish and wildlife habitat quality (WHIP, thousands of acres)	388.8	316.9	335.4	876.9	1,000.0	1,279.0	Exceeded
2.2 Protect and enhance America's water Resources	2.2.1 Comprehensive nutrient management plans applied ³ (CTA, number of plans)	1,911.0	1,745.0	1,485.0	1,349.0	1,350.0	1,264.0	Met
	2.2.2 Comprehensive nutrient management plans applied (EQIP, number of plans)	2,490.0	2,520.0	2,019.0	1,739.0	1,500.0	1,458.0	Met
	2.2.3 Priority landscapes with high-impact targeted conservation practices applied to improve water quality (CTA, millions of acres)	N/A ⁴	N/A ⁴	N/A ⁴	1.9	2.0	1.8	Met
	2.2.4 Wetlands created, restored or enhanced (Wetlands Reserve Program (WRP), thousands of acres)	149.3	128.9	106.4	129.1	125.0	131.8	Met

¹The sources of data for all performance measures are the National Conservation Planning Database (NCP), the Program Contracts Database (Pro Tracts) and the Performance Results System (PRS). The completeness, reliability, and quality of data are discussed on page 8.

²Rationale for Met Range is actual performance data, October 1, 2010 through September 30, 2011. Data assessment metrics to meet the target allow for an actual number in the range of 90% - 110% of the target.

³The published APP for EQIP has "developed" instead of "applied", which was in error. The correct measure with trend data is listed in this table.

⁴Priority Landscapes with high-impact targeted conservation practices applied to improve water quality was new in 2010.

Table 2: Performance Scorecard for FY 2011 - Trends, Targets and Results

Management's Discussion and Analysis (Unaudited)

Performance Goals, Objectives, and Results

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

- **Completeness of Data** – The reported performance measures are based on data reported through September 30, 2011. Numerous data quality mechanisms within PRS ensure the completeness of each performance record entry. Each performance record must adhere to a set of quality assurance requirements during the upload process. Business rules, definitions, and internal controls enforce accountability policies or business requirements and diagnose potential entry errors. Error reports are generated for managers at multiple levels to review for completeness or rejected entries, including the Strategic Planning and Accountability Deputy Area staff, and on an annual basis the State Conservationists certify that the data is complete.
- **Reliability of Data** – The data reported for performance measures was determined within PRS based on information validated and received from the National Conservation Planning (NCP) database and the Program Contracts System (ProTracts). ProTracts is a web-enabled application used to manage NRCS conservation program applications, cost share contracts, and program fund management. Conservation plans are developed in consultation with the customer, created with the Customer Service Toolkit (Toolkit), and warehoused in the NCP. Applied conservation practices are date-stamped, geo-referenced, and linked to employee ID, enabling detailed quality-assurance reviews. Periodic reviews are conducted by state office and headquarters personnel to assess the accuracy of reported data.
- **Quality of Data** – The data is reported by field staff located where the conservation is occurring. Field staff are trained and skilled in conservation planning and application suited to the local resource conditions. Error checking enhancements and reports within the PRS application maintain data quality by allowing users at local, state, and national levels to monitor data inputs. NRCS designates key personnel, at both the state and national levels, to conduct quality assurance reviews periodically throughout the year to ensure the data is reliable and accurate. At the end of the fiscal year, each State Conservationist signs and certifies that the PRS data is valid, complete, and reliable.
- **Linking Performance to Programs** – To ensure program accountability and evaluate program efficiency, data on performance measures for conservation applied must be linked to the program that funded the staff time needed to carry out each activity. Where more than one program is used to apply practices on the same land unit, each program is credited under the performance measure. The chief sources of data for these performance measures are NCP, ProTracts, and PRS.
- **Limitations Associated with Performance Management Reporting** – Problems with performance management reporting are typically caused by errors in data entry. NRCS developed a number of software controls within PRS to ensure such errors are minimized.

Management's Discussion and Analysis (Unaudited)

Business Lines and Resources

Business Lines

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

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

Conservation implementation includes environment improvement payments and monetary incentives through program contracts, easements, or other means to qualified program participants who participate in authorized USDA NRCS conservation programs. Financial assistance helps motivate producers to treat natural resource problems and to help sustain natural resources.

3. **Natural Resources Inventory** is the acquisition and development of natural resource data and information for natural resource planning, decision-making, and program and policy development at multiple scales. Natural Resource inventory includes strengthening cooperation with other Federal agencies, State agencies, and partners to collect natural resource data. Data collected is utilized at varying scales and compatible with data generated by other entities.
4. **Natural Resources Assessment** is the interpretation and delivery of natural resource data and information for natural resource planning, decision making, and program and policy development at multiple scales. This includes strengthening cooperation with other Federal agencies, State agencies, and partners to analyze natural resource data. Data collected is usable at varying scales and compatible with data generated by other entities.
5. **Natural Resources Technology Transfer** acquires, develops, evaluates, and transfers conservation tools, techniques, and standards based on research and new technologies. It includes the production and delivery of technical tools used in resource assessment, conservation planning and implementation, conservation standards and guidance documents, and the development and delivery.

NRCS focuses on ensuring that appropriate technology is usable and easily accessible to internal and external customers. For internal customers, the highest priority is the integration of field level tools into a user-friendly system that better supports the conservation planning process. For external customers, NRCS works to translate science and technology into tools that are easy to understand and easy to use.
6. **Conservation Operations** is the ongoing cyclical activities involved in the running of the Agency to fulfill the mission to get conservation on the ground. It includes information technology, human resources and services, financial management, and operational management. NRCS works to increase reliability and productivity of Agency resources and operations to deliver conservation.

Management's Discussion and Analysis
(Unaudited)

Analysis of Financial Statements and Stewardship Information

NRCS produces a series of financial statements on a quarterly basis to summarize the activity and associated financial position of the agency. The four principal statements are as follows:

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

NRCS is reporting total assets of \$6,318 million and total liabilities of \$903 million.

NRCS strives to provide relevant, reliable, and accurate financial information related to agency activities in producing the financial statements. The following tables reflect the comparative amounts for FY 2011 and FY 2010.

Assets

NRCS reported \$6,318 million in assets as of September 30, 2011, representing an increase of \$269 million over the FY 2010 amounts. The increase in accounts receivable is due to significant increases in two reimbursable agreements for which revenue was recognized and billed. The General Property, Plant and Equipment, net increase is caused by an increase in internal use software in development. Other assets include advance payments to others, with a \$218 million advance to the Commodity Credit Corporation (CCC) for the Grasslands Reserve Program.

Assets (in millions)	FY 2011	FY 2010	Difference	Difference (Percentage)
Fund balance with Treasury	\$5,970	\$5,786	\$184	3%
Accounts Receivable, Intragovernmental and Non-Intragovernmental, Net	40	20	20	100%
General Property, Plant and Equipment, Net	41	37	4	11%
Total Major Categories	6,051	5,843	208	4%
Other Asset Categories	267	206	61	30%
Total Assets	\$6,318	\$6,049	\$269	4%

Table 3: Assets as of September 30, 2011

Fund balance with Treasury (FBWT) is an asset account that represents the amount in the Agency's accounts with Treasury that is available only for the purposes for which the funds were appropriated, as discussed in Statements of Federal Financial Accounting Concepts (SFFAC) 2, Paragraph 84. According to the SFFAC, FBWT is the aggregate amount for which the Agency is authorized to make expenditures and pay liabilities. This account includes general funds, which are funds appropriated by Congress, trust funds, clearing accounts and funds transferred from CCC using borrowing authority.

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

Management's Discussion and Analysis (Unaudited)

Liabilities

NRCS reported \$903 million in liabilities as of September 30, 2011, representing an increase of \$382 million over FY 2010. The increase is primarily due to the increase in accrued expenses for the Conservation Stewardship Program and other contracts and agreements with producers and other landowners to provide technical and financial assistance for conservation programs.

The major liability amounts are provided below.

Liabilities (in millions)	FY 2011	FY 2010	Difference	Difference (Percentage)
Intragovernmental Other Liabilities	\$63	\$48	\$15	31%
Accounts Payable	22	11	11	100%
Unfunded Leave and FECA Benefits	122	131	(9)	(7%)
Capital Lease Liability	6	8	(2)	(25%)
Conservation Stewardship Liabilities	508	145	363	250%
Other Accrued Liabilities	182	178	4	2%
Total Liabilities	\$903	\$521	\$382	73%

Table 4: Liabilities as of September 30, 2011

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

Net Position

NRCS reported a net position of \$5,415 million for the year ended September 30, 2011, representing a decrease of (\$113) million over FY 2010. Net position represents unexpended appropriations consisting of undelivered orders, as well as unobligated funds, and the cumulative results of operations.

Unexpended appropriations reflect the spending authority made available by appropriation that is not currently obligated, or has been obligated but not disbursed or accrued, and therefore is unavailable for new obligations. The decrease in Unexpended Appropriations is due to increases in expenditures totaling \$922 million across all major NRCS programs including Conservation Operations, Farm Bill, and Watershed programs. Cumulative results of operations reflect the cumulative effect of financing in excess of expenditures and non-expenditure transfers from CCC.

Net Position (in millions)	FY 2011	FY 2010	Difference	Difference (Percentage)
Unexpended Appropriations	\$634	\$935	(\$301)	(32%)
Cumulative Results of Operations	4,781	4,593	188	4%
Total Net Position	\$5,415	\$5,528	(\$113)	(2%)

Table 5: Net Position for the year ended September 30, 2011

Management's Discussion and Analysis (Unaudited)

Net Cost of Operations

NRCS's net cost of operations was \$4,310 million for the year ended September 30, 2011, representing an increase of \$858 million over FY 2010.

Net Cost of Operations (in millions)	FY 2011	FY 2010	Difference	Difference (Percentage)
Gross Cost	\$4,487	\$3,565	\$922	26%
Less: Total Earned Revenue	177	113	64	57%
Total Net Cost of Operations	\$4,310	\$3,452	\$858	25%

Table 6: Net Cost of Operations for the year ended September 30, 2011

Costs

NRCS program costs were \$4,487 million for the year ended September 30, 2011, representing a \$922 million increase over FY 2010. This is due to increases in the delivery of conservation across programs, most notably Conservation Operations, Wetlands Reserve Program, and Conservation Stewardship Program.

Revenue

Earned revenue was \$177 million for the year ended September 30, 2011, including reimbursable agreements with other federal agencies as well as non federal partners for providing technical assistance under the Economy Act. The increase of \$64 million is due to significant increases in two reimbursable agreements for which revenue was recognized and billed.

Budgetary Resources

NRCS's total budgetary resources were \$6,264 million for the year ended September 30, 2011, representing a small increase of \$6 million over the FY 2010 funding.

Budgetary Resources (in millions)	FY 2011	FY 2010	Difference	Difference (Percentage)
Budgetary Resources	\$6,264	\$6,258	\$6	0%

Table 7: Budgetary Resources for the year ended September 30, 2011

Management's Discussion and Analysis (Unaudited)

Analysis of Systems, Controls and Legal Compliance

FY 2011 Financial Statement Audit Report Results

In FY 2011 KPMG LLP, an independent auditing firm, was engaged to audit the financial statements of NRCS. The auditors identified internal control deficiencies resulting in five material weaknesses, two significant deficiencies and one finding of non-compliance with laws and regulations.

Federal Managers' Financial Integrity Act (FMFIA) of 1982

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

In FY 2011, KPMG LLP reported the following Material Weaknesses in internal controls relating to:

- Undelivered orders;
- Accrued Expenses;
- Property, Plant and Equipment;
- Financial Reporting and;
- General and Application Access Control Environment.

Additionally, KPMG LLP reported the following significant deficiencies: Revenue and Unfilled Customer Orders, and Purchase and Fleet Card Transactions.

Management has conducted its annual evaluations of internal control and financial systems, pursuant to Section 2 and Section 4 of FMFIA, respectively, for the year ended September 30, 2011.

Given the material weaknesses noted above and based on the results of the evaluations, NRCS management provides qualified assurance that internal controls are operating effectively as of September 30, 2011. However, management asserts that improvements have been noted in the following areas:

- a. **Validity of Open Obligations** - Rigorous reviews of high-risk populations of open obligations were completed in FY 2011. The process identified obligations determined to be invalid due to periods of expiration, improper accounting for closed easements, and other processes. This resulted in significant reduction in the undelivered orders balance. Work in this area continues.
- b. **Inventory of Stewardship Land as Part of Financial Reporting** - Significant improvements have been made to ensure that the population of easements classified as stewardship land are properly identified and documented. Work in this area continues.
- c. **Information Technology – General Application and Access Controls** - Significant accomplishments in the IT area include: delivered training on new and existing access control management procedures, identified and tested a compensating control that mitigated the risk of Fund Manager Admin activities, verified the existence of a current and accurate user administration procedure for adding, modifying and removing user access to Active Directory, updated the Service Level Agreement between NRCS and International Technology Service, and installed the Juniper VPN Client on approximately 98% of NRCS laptops, PCs and tablets.

Management's Discussion and Analysis (Unaudited)

Federal Managers' Financial Integrity Act Action Plans

The following table provides information regarding the status of the corrective action plans for material weaknesses and significant deficiencies.

Identifier	Corrective Action Plan ID	Weakness Category	Year Identified	Original Estimated Completion Date	Actual Completion Date	Revised Completion Date
Section 2: Internal Controls						
Undelivered Orders						
OIG Audit: 10401-2-FM	NRCS_CAP 2011.10.07.001	MW	2008	9/15/2010		11/30/2013
OIG Audit: 10401-3-FM		MW	2009			
OIG Audit: 10401-4-FM		MW	2010			
OIG Audit: 10401-1-11	Under Development	MW	2011			
Reimbursable Agreements / Unfiled Customer Orders						
OIG Audit: 10401-2-FM	NRCS_CAP 2011.10.16.001	MW	2008	9/15/2010		11/30/2013
OIG Audit: 10401-3-FM		MW	2009			
OIG Audit: 10401-4-FM		MW	2010			
OIG Audit: 10401-1-11	Under Development	SD	2011			
Accrued Expenses						
OIG Audit: 10401-2-FM	NRCS_CAP 2011.10.07.001	MW	2008	9/15/2010		11/30/2013
OIG Audit: 10401-3-FM		MW	2009			
OIG Audit: 10401-4-FM		MW	2010			
OIG Audit: 10401-1-11	Under Development	MW	2011			
Financial Reporting						
OIG Audit: 10401-2-FM	NRCS_CAP 2011.10.09.001	MW	2008	2/28/2012		11/30/2013
OIG Audit: 10401-3-FM		MW	2009			
OIG Audit: 10401-4-FM		MW	2010			
OIG Audit: 10401-1-11	Under Development	MW	2011			
Property Management / PP & E						
OIG Audit: 10401-2-FM	NRCS_CAP 2008.10.04.001	MW	2008	8/15/2010		11/30/2013
OIG Audit: 10401-3-FM		MW	2009			
OIG Audit: 10401-4-FM		MW	2010			
OIG Audit: 10401-1-11	Under Development	MW	2011			
General & Application Access Controls						
OIG Audit: 10401-4-FM	Related POAMs 15111, 15112, 15113, 15114, 15115, 13975	MW	2010	9/30/2012		9/30/2012
OIG Audit: 10401-1-11	Under Development	MW	2011			
Purchase Card Management / Fleet Card Transactions						
OIG Audit: 10401-2-FM	NRCS_CAP 2008.10.13.001	SD	2008	9/30/2011		11/30/2011
OIG Audit: 10401-3-FM		SD	2009			
OIG Audit: 10401-4-FM		MW	2010			
OIG Audit: 10401-1-11	Under Development	SD	2011			

Weakness Categories: SD = Significant Deficiency MW=Material Weakness

Table 8: Federal Managers' Financial Integrity Act Action Plans

Compliance with Laws and Regulations

The FY 2011 audit noted that NRCS was not substantially complying with FFMIA. NRCS was unable to provide sufficient evidential matter in support of certain transactions and account balances, as presented in the NRCS financial statements as of, and for the year ended September 30, 2011, particularly with respect to beginning net position balances and current year activity; obligations incurred, including accrued expenses and undelivered orders; leases; real and personal property; recoveries of prior year unpaid obligations; advances to others; and stewardship land. NRCS was unable to complete corrective actions and make adjustments, as necessary, to these and other financial statement amounts prior to the contractually required completion date of the engagement.

Management's Discussion and Analysis (Unaudited)

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

In FY 2011, NRCS implemented an enhanced A-123 program and assessed the effectiveness of internal controls over financial reporting. The assessment included an evaluation of entity level controls, risk assessments, process descriptions and flowcharts, documentation of key controls, an assessment of the design of key controls, tests of operating effectiveness of properly designed controls, summary of deficiencies, and the development of corrective action plans for control deficiencies. Per Department guidance, key controls in the following cycles/processes were identified and reviewed: Grants Management, Human Resources, Reimbursable Agreements, Financial Reporting, Funds Control and Funds Control Management. The controls for Funds Control Management, Funds Control and Human Resources were tested. Additionally, a limited number of Information Technology access, personnel security, and account activity controls were reviewed and tested. The controls for Grants Management, Financial Reporting and Reimbursable Agreements were not tested due to the severity of the deficiencies noted by our independent auditor during the FY 2010 financial audit. Due to resource constraints, NRCS management decided to focus its limited resources on remediation efforts.

The following table outlines the deficiencies noted in FY 2011 and the status of the corrective action plans reported to the Department as part of the A-123 process.

Identifier	Short Title	Weakness Category	Year Identified	Original Estimated Completion Date	Actual Completion Date	Revised Completion Date
Section 2:						
Financial Reporting						
CAP Ref # 2011.10.09.001	Other Proprietary and Budgetary Reporting	MW	2008	02/28/2012		11/30/2013
CAP Ref # 2011.10.09.001	User Access and GL Maintenance	SD	2008	02/28/2012		11/30/2013
CAP Ref # 2011.10.09.001	Journal Entry Processing	SD	2008	02/28/2012		11/30/2013
CAP Ref # 2011.10.09.001	Monitoring	MW	2008	02/28/2012		11/30/2013
CAP Ref # 2011.10.09.001	Period End Reporting (Unliquidated Obligations)	MW	2008	02/28/2012		11/30/2013
CAP Ref # 2011.10.09.001	Significant Management Estimates	MW	2008	02/28/2012		11/30/2013
Human Resources						
CAP Ref # 2011.10.03.002	Reporting and Monitoring	SD	2011	09/30/2011		
Reimbursable Agreements						
CAP Ref # 2011.10.16.001	Reimbursable Agreements - Receivables	SD	2008	09/15/2010		11/30/2012
Grants Management						
CAP Ref # 2011.10.07.001	Awards	SD	2008	09/15/2010		11/30/2013
CAP Ref # 2011.10.07.001	Closeout	MW	2008	09/15/2010		11/30/2013
CAP Ref # 2011.10.07.001	Draws and Grant Expenditures	MW	2008	09/15/2010		11/30/2013
CAP Ref # 2011.10.07.001	Monitoring	MW	2008	09/15/2010		11/30/2013
CAP Ref # 2011.10.07.001	Period End Accruals	MW	2008	09/15/2010		11/30/2013
CAP Ref # 2011.10.07.001	Post - Closeout	MW	2008	09/15/2010		11/30/2013

Management's Discussion and Analysis (Unaudited)

Identifier	Short Title	Weakness Category	Year Identified	Original Estimated Completion Date	Actual Completion Date	Revised Completion Date
Section 4:						
Tracking Audit Findings						
POAM ID # 11529	General Computer Controls-Audit Monitoring, Analysis and Reporting (ProTracts)	CD	2009	11/30/2010		08/31/2011
POAM ID # 13538	General Computer Controls-Audit Monitoring, Analysis and Reporting (WebTCAS)	CD	2010	09/30/2011		09/30/2011
POAM ID # 15120	General Computer Controls – Lack of NFR Tracking	CD	2010	09/30/2011		09/30/2011
Access Control						
POAM ID # 11536	General Computer Controls-Lack of a Non-federal Employee System	CD	2009	12/31/2011		12/31/2011
POAM ID # 11539	General Computer Controls-Review of Protracts Roles/Access Privileges	CD	2009	11/01/2010	07/25/2011	
POAM ID # 11537	General Computer Controls-Lack of Controls over Expiring / Non-existent Passwords	CD	2009	07/30/2010	07/26/2011	
POAM ID # 11541	General Computer Controls-Disabling Privileges of Non-federal Employees	CD	2009	11/15/2011		11/15/2011
POAM ID # 11538	General Computer Controls-Lack of Documentation for Protracts Roles / Access Authorization	CD	2009	04/15/2011	07/25/2011	
POAM ID # 11555	General Computer Controls-SAAR IDs Missing on HR Terminations	CD	2009	10/31/2011		10/31/2011
POAM ID # 15115	General Computer Controls-Access Control Weaknesses	CD	2010	09/30/2011		09/30/2011
POAM ID # 13440	General Computer Controls-Remote Access Reviews	CD	2010	09/30/2011		09/30/2011
POAM ID # 13975	General Computer Control-Multi Factor Authentication	CD	2010	09/30/2011		09/30/2012
POAM ID # 15111	General Computer Controls – Supervision and Review of Access Controls	CD	2010	09/30/2011		09/30/2011
POAM ID # 15112	General Computer Controls – User ID and Authentication	CD	2010	09/30/2011		09/30/2011
POAM ID # 15113	General Computer Controls-Access Control Policies and Procedures	CD	2010	09/30/2011		09/30/2011
POAM ID # 15114	General Computer Controls-External Information System Services	CD	2010	09/30/2011		09/30/2011
POAM ID # 16012	General Computer Controls-Timeliness of Employee Separation Actions	CD	2010	09/30/2011		09/30/2011
POAM ID # 12506	General Computer Controls – Access Enforcements	CD	2009	02/28/2011	03/24/2011	

**Management's Discussion and Analysis
(Unaudited)**

Identifier	Short Title	Weakness Category	Year Identified	Original Estimated Completion Date	Actual Completion Date	Revised Completion Date
Personnel Security						
POAM ID # 15116	General Computer Controls - Personnel Security Policy and Procedures	CD	2010	09/30/2011		09/30/2011
POAM ID # 15117	General Computer Controls – Personnel Screening	CD	2010	09/30/2011		09/30/2011
Security Accreditation						
POAM ID # 15118	General Computer Controls – Unauthorized Use of Protracts / Fund Manager Application	CD	2010	09/30/2011		09/30/2011
POAM ID # 15119	General Computer Controls – Unauthorized Use of WebTCAS Application	CD	2010	09/30/2011		09/30/2011
Tracking Account Activity						
POAM ID # 11531	General Computer Controls- Lack of Procedures for Audit Record Generation	CD	2009	08/30/2011		08/30/2011
POAM ID # 13211	General Computer Controls- WebTCAS	CD	2010	09/30/2011		09/30/2011
POAM ID # 11535	General Computer Controls – Incident Handling	CD	2009	06/30/2010	08/10/2010	
Weakness Categories: SD = Significant Deficiency MW=Material Weakness CD = Control Deficiency						

Table 9: Deficiencies and Corrective Action Plan Status

Management's Discussion and Analysis
(Unaudited)

Federal Financial Management Improvement Act (FFMIA) of 1996

NRCS management evaluated its financial management systems under FFMIA for the year ended September 30, 2011. Based on the results of our evaluation, we have disclosed instances where NRCS' financial management systems did not substantially comply with Federal Financial Management System Requirements, the United States Standard General Ledger (USSGL), and applicable Federal Accounting Standards. NRCS' systems are unable to provide necessary audit extracts, allow for authority beyond ten years of availability, and prevent the recording of invalid upward and downward adjustments to prior year obligations. The FY 2011 audit noted that beginning balances, current year activity, leases, real and personal property, undelivered orders, downward adjustments for prior year obligations, stewardship land, and advances to others were not recorded in accordance with Federal accounting standards. Stewardship information is incomplete and inaccurate and not in accordance with Statements of Federal Financial Accounting Standards (SFFAS) No. 29. Additionally, NRCS is not able to present deferred maintenance information for real, personal, or stewardship property. Furthermore NRCS did not use USSGL appropriate posting models for recoveries of prior year obligations paid and unpaid.

Information Security, Policies, Procedures and Practices deficiencies have been noted for application control access, configuration management support system access, and user access management. Additionally, deficiencies were noted regarding anti-virus software, vulnerability scanning and classification and service level agreement issues. Significant improvements have taken place during FY 2011 in the areas of obligations, easements and general application and access controls.

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

Identifier	Year Identified	Original Estimated Completion Date	Actual Completion Date	Revised Completion Date
Section 1: Federal Financial Management Systems Requirements				
Non Compliance with Federal Financial Management Systems Requirements				
OIG-10401-2-FM	2008	02/28/2012		11/30/2013
OIG-10401-3-FM	2009			
OIG-10401-4-FM	2010			
OIG-10401-1-11	2011			
Section 2: Applicable Federal Accounting Standards				
Non Compliance with Federal Accounting Standards				
OIG-10401-2-FM	2008	02/28/2012		11/30/2013
OIG-10401-3-FM	2009			
OIG-10401-4-FM	2010			
OIG-10401-1-11	2011			
Statement of Net Cost				
OIG-10401-2-FM	2008	02/20/2012	04/30/2011	
OIG-10401-3-FM	2009			
OIG-10401-4-FM	2010			
Stewardship Reporting				
OIG-10401-2-FM	2008	02/28/2012		11/30/2012
OIG-10401-3-FM	2009			
OIG-10401-4-FM	2010			
OIG-10401-1-11	2011			
Section 3: Standard General Ledger at the Transaction Level				
Non Compliance with USSGL				
OIG-10401-2-FM	2008	02/28/2012		11/30/2013
OIG-10401-3-FM	2009			
OIG-10401-4-FM	2010			
OIG-10401-1-11	2011			
Section 4: Information Security, Policies, Procedures and Practices				
General and Application Access Controls				
OIG-10401-4-FM	2010	09/30/2012		09/30/2012
OIG-10401-1-11	2011			

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

Management's Discussion and Analysis (Unaudited)

Federal Information Security Management Act (FISMA) of 2002

FISMA provides the framework for securing the Federal Government information technology. Departments covered by the Paperwork Reduction Act must implement the requirements of FISMA, reporting annually to OMB and Congress on the effectiveness of the agency's security programs and independent Office of Inspector General evaluations. NRCS's security deficiencies are tracked in FISMA Plan of Actions and Milestones (POAM), which is updated monthly and reported to USDA quarterly for inclusion in its FISMA Report to OMB.

In FY 2011, Information Security, Policies, Procedures and Practices deficiencies have been noted for: application control access, configuration management support system access, and user access management. Additionally, deficiencies were noted regarding anti-virus software, vulnerability scanning and classification and service level agreement issues.

Improper Payments Elimination and Recovery Act (IPERA) of 2010

Improved financial performance through the reduction of improper payments continues to be a key financial management focus for the Federal government. IPERA requires each Federal agency to assess all programs and identify which, if any, may be subject to high risk with respect to improper payments. Agencies are also required to implement corrective measures. Per guidance provided by USDA, agency programs deemed high risk are required to be sampled on an annual basis. Programs deemed low risk are required to be sampled on a rotational basis.

OMB has deemed that although they do not meet the high risk threshold of being high risk programs, all of NRCS's Farm Security and Rural Investment Act of 2002 and the Food Conservation and Energy Act of 2008 (Farm Bill) financial assistance payments are considered to be high risk and require testing every year. NRCS's Farm Bill technical assistance payments and payments related to other non-Farm Bill programs (e.g. Soil Survey programs) are considered low risk.

Improper payments are also identified by Office of the Inspector General (OIG) program audits. In FY 2011, NRCS sent bills and demand letters to recoup improper payments identified by an OIG audit of the Conservation Security Program.

Additionally, NRCS identifies improper payments through self-reporting by states/centers. On a quarterly basis, states/centers are required to report all improper payments and recoveries of improper payments.

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

Per Department guidance, all Farm Bill financial assistance (high risk) and Farm Bill technical assistance (low risk) payments were statistically sampled and tested. As a result of this testing, three high risk overpayments totaling \$587,779 were identified. High risk improper payments were extrapolated to the entire high risk population. The extrapolated high risk improper payments totaled \$11,413,193. Additionally, low risk improper payments totaling \$25,519 were discovered. The Department did not require extrapolation of these overpayments.

The chart below is a summary of NRCS's improper payments and related recoveries as of September 30, 2011:

Improper Payments and Recoveries as of September 30, 2011		
Source	Improper Payment Amount Identified Current Year	Improper Payment Amount Recovered Current Year
Statistical Samples	\$613,298	\$0
Self reported by states/centers	\$1,008,989	\$338,558
OIG & GAO Audits	\$2,383,544	\$4,670
Total	\$4,005,831	\$343,228

Table 11: Improper Payments and Recoveries

**Management's Discussion and Analysis
(Unaudited)**

Anti-Deficiency Act

No violations of the Anti-Deficiency Act were identified or reported in FY 2011.

Inspector General Act Amendments of 1988

The Inspector General Act requires management to complete all final actions on audit recommendations within one year of the date of the Inspector General's final audit report.

GAO/OIG Active Audits

The GAO/OIG Active Audits Summary report below provides an overview of the current external audit activities in progress within the agency. After the final report has been provided to NRCS, NRCS may have several audit recommendations to complete before the audit is officially closed.

GAO/OIG Active Audits as of September 30, 2011			
Active Audit Number / Name	Start Date	Final Report Date	Audit Status
GAO-360644 - USDA Funding for EQIP	10/01/2005	09/01/2006	OPEN
OIG-10601-04-KC - Conservation Security Program	11/01/2006	06/01/2009	OPEN
OIG-10601-1-At - Flood Control Dam Rehabilitation	12/01/2006	07/15/2009	CLOSED
OIG-10099-6-SF - Farm and Ranch Lands Protective Program - Review of Non-Governmental Organizations	05/01/2007	07/06/2009	OPEN
OIG-10401-2-FM - NRCS Financial Statement Audit FY08	01/10/2008	11/13/2008	OPEN
OIG-50601-18-Te - Pasture, Rangeland, and Forage Pilot Program	03/24/2008	09/29/2010	OPEN
OIG-10601-6-KC - Disaster Assistance EWP	01/12/2009	04/05/2011	OPEN
OIG-10703-1-KC - ARRA Emergency Watershed Protection Program (phase 1)	04/02/2009	09/01/2010	OPEN
OIG-10401-3-FM - NRCS Financial Statement Audit FY09	10/01/2009	11/10/2009	OPEN
OIG-10703-2-KC-(2) American Recovery and Reinvestment Act - Watershed Protection and Flood Prevention Operations Program	10/05/2009	11/30/2010	CLOSED
GAO-130975 - Multiple Employment and Training Programs	11/09/2009	1/13/2011	CLOSED
OIG-10401-4-FM - NRCS Financial Statement Audit FY 2010	01/01/2010	11/18/2010	OPEN
OIG-10703-3-KC - ARRA Emergency Watershed Protection Program (phase 2)	01/22/2010		OPEN
OIG- 03601-51-TE - Conservation Reserve Program Soil Rental Rates	02/23/2010	No final report issued	CLOSED
GAO-450760 - OPM Leadership of Work/Life Programs	03/03/2010	12/01/2011	CLOSED
OIG- 10099-3-CH - Controls over the Farm and Ranch Lands Program	03/16/2010	09/14/2011	OPEN

**Management's Discussion and Analysis
(Unaudited)**

Active Audit Number / Name	Start Date	Final Report Date	Audit Status
GAO-361185 - Renewable Energy Initiatives	04/05/2010		OPEN
OIG-10703-4-KC - Watershed Protection and Flood Prevention Operations Program -Phase II (Field Communications)	07/15/2010		OPEN
OIG 10703-5-KC - NRCS American Recovery Reinvestment Act- Emergency Watershed Protection Program Floodplain Easements -Phase II (Field Communications)	07/15/2010		OPEN
OIG- 361216 - Chesapeake Bay Action Plan	08/27/2010	09/01/2011	CLOSED
OIG 10703-1-AT - ARRA - Rehabilitation of Flood Control Dams	09/01/2010		OPEN
GAO- 361251 -Nonpoint Source Water Pollution	11/29/2010		OPEN
OIG-10704-1-32 - Migratory Bird Habitat Initiative: NRCS' Response to Issues Caused by the Deepwater Horizon/BP (British Petroleum) Oil Spill	01/13/2011		OPEN
OIG-10401-1-11 - NRCS Financial Statement Audit FY11	02/28/2011		OPEN
GAO-440979- Equal Access to Justice Act (EAJA)	05/26/2011		OPEN
OIG 10024-1-11 Fiscal Year 2011 NRCS Improper Payment Review	06/16/2011		OPEN
OIG 50501-2-12 Federal Information Security Management Act	06/16/2011		OPEN
GAO-361318 Federal Farm Program Direct Payment	07/26/2011		OPEN
OIG-10601-0001-22 Oversight and Compliance Activities	08/01/2011		OPEN
GAO- 450909 Protection of Federal Workforce in a Pandemic Influenza	08/02/2011		OPEN
Audit Status - Closed indicates the audit report was officially closed during FY 2011			

Table 12: GAO/OIG Active Audits Summary Report - FY 2011

Management's Discussion and Analysis (Unaudited)

Other Management Information and Initiatives

Financial Management Initiative

NRCS management recognizes that in order to remediate FY 2011 audit deficiencies, substantial improvements must be made on the five material weaknesses and two significant deficiencies identified in the audit report. Key elements of the agency audit remediation plan include:

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

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

Streamlining Conservation Delivery

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

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

CDSI is organized and staffed in the Office of the NRCS Chief to ensure an integrated approach rather than a stove-piped Agency-wide approach. Five major initiatives are being implemented during 2010-2014 that will allow field staff to spend as much as 75% of their time in the field with clients, minimize duplicate or excessive data entry for staff and clients, reduce administrative workload burden from the field planners, provide clients web-enabled access to USDA conservation programs, ensure sound conservation plans support all financial assistance, significantly shorten the administrative time for program delivery, and strengthen financial management of Farm Bill programs.

Financial Management Modernization Initiative (FMMI)

NRCS is preparing for conversion from its current general ledger system, Foundation Financial Information System (FFIS) to the Financial Management Modernization Initiative (FMMI). NRCS's implementation of FMMI is scheduled for April 2012. Implementing FMMI will enable NRCS to more accurately and efficiently process and report financial transactions.

Limitations of Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the NRCS, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with GAAP for Federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.

These statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Financial Statements



BALANCE SHEET

As of September 30, 2011
(in millions)

Natural Resources Conservation Service		
Assets:		
Intragovernmental:		
Fund balance with Treasury	Note 2	\$5,970
Accounts receivable	Note 3	34
Other	Note 6	218
Total intragovernmental		6,222
Accounts receivable, net	Note 3	6
General property, plant and equipment, net	Note 4	41
Other	Note 6	49
Total assets		\$6,318
Stewardship PP&E		
	Notes 5 & 13	
Liabilities:		
Intragovernmental:		
Other	Notes 7 & 8	\$63
Total intragovernmental		63
Accounts payable		22
Federal employee and veterans benefits	Note 7	38
Unfunded leave	Note 7	84
Capital lease liability	Note 9	6
Conservation Stewardship Liabilities		508
Other	Note 8	182
Total liabilities		\$903
Commitments and contingencies		
	Note 10	
Net position:		
Unexpended appropriations		\$634
Cumulative results of operations		4,781
Total net position		\$5,415
Total liabilities and net position		\$6,318
The accompanying notes are an integral part of these statements.		

Unaudited – See accompanying independent auditors’ report

Financial Statements

	STATEMENT OF NET COST	
	for the year ended September 30, 2011	
	(in millions)	
Program costs:	Notes 11,12 & 14	
Get More Conservation on the Ground		
Gross costs		\$4,487
Less: earned revenue		177
Net Program Costs		4,310
Total Gross Costs:		4,487
Less: Total earned revenue		177
Net cost of operations		\$4,310
The accompanying notes are an integral part of these statements.		

Financial Statements



STATEMENT OF CHANGES IN NET POSITION

for the year ended September 30, 2011

(in millions)

Natural Resources Conservation Service

Cumulative Results of Operations:			
Beginning Balance			\$4,593
Budgetary Financing Sources:			
Appropriations used			1,184
Transfers in/out without reimbursement			3,128
Other Financing Sources (Non-Exchange):			
Imputed financing			186
Total Financing Sources			4,498
Net Cost of Operations			(4,310)
Net Change			188
Cumulative Results of Operations			\$4,781
Unexpended Appropriations:			
Beginning Balance			\$935
Budgetary Financing Sources:			
Appropriations received			915
Other adjustments			(31)
Appropriations used			(1,185)
Total Budgetary Financing Sources			(301)
Total Unexpended Appropriations			\$634
Net Position			\$5,415
The accompanying notes are an integral part of these statements.			

Unaudited – See accompanying independent auditors’ report

Financial Statements



Natural Resources Conservation Service

STATEMENT OF BUDGETARY RESOURCES

for the year ended September 30, 2011

(in millions)

Budgetary Resources:	
Unobligated balance, brought forward, October 1	\$1,688
Recoveries of prior year unpaid obligations	390
Budget Authority:	
Appropriations	915
Spending authority from offsetting collections	
Earned	
Collected	160
Change in receivables from Federal sources	18
Change in unfilled customer orders	
Advance received	(1)
Without advance from Federal sources	(3)
Budget Authority Subtotal	\$1,089
Nonexpenditure transfers, net	3,128
Permanently not Available	(31)
Total budgetary resources:	\$6,264
Status of Budgetary Resources:	
Obligations incurred (Note 16):	
Direct	\$4,189
Reimbursable	202
Subtotal	4,391
Unobligated balance:	
Apportioned	275
Unobligated balance not available	1,598
Total status of budgetary resources	\$6,264
Change in Obligated Balance:	
Obligated balance, net	
Unpaid obligations, brought forward, October 1	\$4,242
Uncollected customer payments from Federal sources, brought forward, October 1	(144)
Total unpaid obligated balance, net	4,098
Obligations incurred, net	
Gross outlays	(3,989)
Recoveries of prior year unpaid obligations, actual	(390)
Change in uncollected customer payments from Federal sources	(15)
Obligated balance, net, end of period	
Unpaid obligations	4,254
Uncollected customer payments from Federal sources	(159)
Total, unpaid obligated balance, net, end of period	\$4,095
Net Outlays:	
Gross outlays	
Offsetting collections	(159)
Net Outlays	\$3,830

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements

Notes to the Financial Statements for the year ended September 30, 2011

Note 1 – Significant Accounting Policies

A. Reporting Entity

The Natural Resources Conservation Service (NRCS) is a technical service agency within the United States Department of Agriculture (USDA). NRCS combines the authorities formerly assigned to the Soil Conservation Service (SCS) and additional programs that provide financial assistance for natural resource conservation. SCS was established in 1935 to carry out a continuing program of soil and water conservation in partnership with local conservation districts. In 1994, the Secretary of Agriculture reorganized SCS by establishing NRCS and broadened its responsibilities, using the authority provided in the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act of 1994.

Most of the nearly 12,000 NRCS employees work in approximately 2,700 field offices across the nation, providing services directly to our customers. Field office employees provide the technical expertise that helps enable land managers to balance their economic goals with the needs of the natural environment, while creating sustainable systems to produce abundant crops, livestock, and a quality environment. Field office staff work side by side with employees of the local conservation districts and state conservation agencies. Natural resource technology is developed and delivered through national centers (that focus on areas including cartography and geospatial; design, construction and soil mechanics; plant data; soil survey; water management; and water and climate) and National Technology Support Centers (NTSC). The NTSCs develop and maintain national technical standards and other technological procedures and references.

NRCS operates under the guidance of the USDA Under Secretary for Natural Resources and Environment. The NRCS mission is carried out across 3 regions covering all 50 States, Caribbean Area (Puerto Rico), and the Pacific Basin Area; 3 National Technology Support Centers, and 9 National Centers. The centers provide focus on national initiatives and provide coordination and assistance for conservation work on a functional basis in support of all 50 states.

Discretionary Programs

NRCS has discretionary funding appropriated by Congress to provide technical and financial assistance under five major programs: Conservation Operations, Resources Conservation and Development (RC&D), Watershed and Flood Prevention, Healthy Forest Reserve Program, and Watershed Rehabilitation Program. Program categories under the Conservation Operations program include Conservation Technical Assistance, Soil Surveys, Snow Surveys and Water Supply Forecasting, and Plant Materials Centers. Program categories under the Watershed and Flood Prevention program include Public Law (PL) 534 Flood Prevention Operations, PL-566 Small Watershed Operations, and Emergency Watershed Protection. The Emergency Watershed Protection program is only funded when natural disasters occur and Congress appropriates supplemental funding.

Funding for the RC&D program was eliminated effective April 15, 2011. This change was a result of the Department of Defense (DOD) and Full-Year Continuing Appropriations Act, 2011, to provide funding for the government for the rest of FY 2011.

Farm Bill Programs

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

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

Unaudited – See accompanying independent auditors' report

Notes to the Financial Statements

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

Authorized funding for the Farm Bill Programs approximated \$3.1 billion for FY 2011.

B. Basis of Presentation and Accounting

The Balance Sheet (BS), Statement of Net Cost (SNC), Statement of Changes in Net Position (SCNP), and the Statement of Budgetary Resources (SBR) (hereinafter referred to as the "financial statements") were prepared to report the assets, liabilities and financial position; net costs; changes in net position; and budgetary resources of NRCS. The financial statements have been prepared from the books and records of NRCS in accordance with U.S. generally accepted accounting principles and in accordance with OMB Circular A-136, *Financial Reporting Requirements*, revised September 29, 2010, with the exception that the statements are not presented comparatively.

The financial statements present both proprietary and budgetary information. The accounting structure of Federal agencies is designed to reflect both accrual and budgetary accounting transactions. Under the accrual method of accounting, revenues are recognized when earned, and expenses are recognized when incurred. Budgetary accounting principles are designed to recognize the obligation of funds when actions occur that require the Government to make a payment in the future. The recognition of budgetary accounting transactions is essential for compliance with legal constraints and controls over the use of Federal funds.

C. Fund Balance with the U.S. Treasury

The U.S. Treasury processes cash receipts and disbursements on behalf of NRCS. Funds on deposit with Treasury include general funds and discretionary appropriations, non-expenditure transfers, a clearing account and trust funds that are available to pay liabilities and finance authorized expenditures.

D. Accounts Receivable

Accounts receivable transactions are processed by National Finance Center (NFC) Administrative Billings and Collections (ABCO) staff. ABCO establishes receivables, generates billing statements, manages aging activities, accrues interest and penalty charges, assesses administrative fees, and processes collections. An allowance for doubtful accounts is recorded quarterly for receivables with the public for the amount of receivables determined to be uncollectible based on historical experience.

E. General Property, Plant, and Equipment, Net

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

F. Other Assets

Payments made in advance of the receipt of goods and services are recorded by NRCS as advances at the time of payment and recognized as expenditures/expenses when the related goods and services are received. The most significant advance by NRCS is for the Grasslands Reserve Program (GRP) as a part of the Farm Bill. The funding for GRP is transferred to NRCS from CCC as a non-expenditure transfer once the apportionment schedule is approved by OMB. NRCS immediately advances the funds for GRP back to CCC to make payments

Notes to the Financial Statements

to the landowners in the program on behalf of NRCS. CCC reports the actual GRP expenditures to NRCS on a monthly basis and NRCS makes appropriate adjustments to record the expense and decrease the advance because NRCS maintains administrative responsibility for the program.

G. Liabilities

Liabilities represent the probable and measurable future outflow of funds or other resources arising from past transactions or events. In general, funds cannot be withdrawn from the U.S. Treasury without an appropriation from Congress. Liabilities, for which there is no appropriation and for which there is no certainty that an appropriation will be enacted, are classified as unfunded liabilities.

H. Workers Compensation Liability

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Benefit claims incurred for NRCS's employees under FECA are administered by the U.S. Department of Labor (DOL). NRCS reimburses DOL for FECA claims. Consequently, NRCS recognizes a liability for this compensation comprised of: (1) an accrued liability that represents money owed for claims paid by the DOL through the current fiscal year, and (2) an actuarial liability that represents the expected liability for NRCS approved compensation cases to be paid beyond the current fiscal year.

I. Employee Annual, Sick, and Other Leave

Annual and other vested leave such as compensatory time earned, credit hours, and restored leave is accrued as it is earned and the accrual is reduced as leave is taken. Each quarter the balance in the accrued annual leave account is adjusted to reflect the latest pay rates and unused hours of leave. Funding will be obtained from future financing sources to the extent that current or prior year appropriations are not available to fund annual and other types of vested leave earned but not taken. Sick leave and other types of non-vested leave are expensed when incurred.

J. Pension and Other Retirement Benefits

NRCS employees participate in either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). FERS went into effect on January 1, 1987, pursuant to PL 99-335. FERS and Social Security automatically cover most employees hired after December 31, 1983. Employees hired prior to January 1, 1984 could elect to join FERS and Social Security or remain in CSRS. FERS offers a savings plan to which NRCS automatically contributes one percent of pay and matches an employee's contribution up to an additional four percent of pay. For FERS participants, NRCS also contributes the employer's matching share for Social Security.

NRCS recognizes the imputed cost of pension, other health and life insurance retirement benefits during the employees' active years of service. Office of Personnel Management (OPM) actuaries determine pension cost factors by calculating the value of pension benefits expected to be paid in the future and communicates these factors and information regarding the full cost of health and life insurance benefits to NRCS for the current period expense reporting.

K. Revenues and Other Financing Sources

NRCS has two major funding sources: Congressional appropriations for discretionary funds, and non-expenditure transfers of Farm Bill funds from CCC borrowing authority. NRCS receives annual, multi-year, and no-year appropriations that are used, within statutory limits, for operating expenditures and financial assistance payments to landowners. Other funding sources include reimbursable agreements with other Federal agencies, State and local governments, tribal agencies and the public.

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

In accordance with Federal government accounting guidance, NRCS classifies revenue as either "exchange revenue" or "non-exchange revenue". Exchange revenue arises from transactions where each party to the transaction gives value and receives value in return. An example of exchange revenue is the income from providing technical advice on controlling erosion on a stream bank. NRCS is authorized to use all or a portion of its exchange revenue for specific purposes. Non-exchange revenue is revenue the Federal government is able to demand or receive because of its sovereign powers. Penalties and cash donations received from private citizens and organizations are examples of non-exchange revenue.

Unaudited – See accompanying independent auditors' report

Notes to the Financial Statements

NRCS reports the full cost of products and services generated from the consumption of resources. Unless otherwise noted, full cost is the total amount of direct and indirect resources used to produce a product or provide a service. NRCS pricing policies are set to recover full costs.

L. Imputed Financing

NRCS recognizes the amount of accrued pension and post-retirement benefit expenses for current employees as imputed financing costs. The assets and liabilities associated with such benefits are the responsibility of the administering agency, Office of Personnel Management (OPM). Any amounts paid from the Treasury Judgment Fund in settlement of claims or court assessments against NRCS are also recognized as imputed financing. Additionally, NRCS recognizes imputed financing of \$186 million in FY 2011 for USDA headquarters allocations, Treasury Judgment Fund, and OPM.

M. Use of Estimates

Management has made certain estimates and assumptions in reporting assets, liabilities, revenue, and expenses. Actual results could differ from these estimates.

Note 2 - Fund Balance with Treasury

Funds with Treasury are primarily general (appropriated and transferred-in) and trust funds that are available to pay liabilities and finance authorized purchase commitments.

Fund Balance with Treasury (in millions)	2011
Fund Balances:	
Trust Funds	\$2
General Funds	5,965
Other Fund Types	3
Total	\$5,970

Table 13: Fund Balance with Treasury as of September 30, 2011

Status of Fund Balance with Treasury (in millions)	2011
Unobligated Balance:	
Available	\$275
Unavailable	1,598
Obligated balance not yet disbursed	4,095
Non-budgetary FBWT:	
Proceeds on the Sale of Personal Property	2
Total	\$5,970

Table 14: Status of Fund Balance with Treasury as of September 30, 2011

Notes to the Financial Statements

Note 3 – Accounts Receivable, Net

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

Accounts receivable with the public is comprised primarily of cost share agreements with state and local governments owed to NRCS for providing technical assistance on conservation projects. An allowance for receivables deemed uncollectible is based on historical experience.

Accounts Receivable (in millions)	2011
Accounts Receivable, Gross	
Intragovernmental	\$34
With the Public	7
Allowance	
Intragovernmental	0
With the Public	(1)
Accounts Receivable, Net	
Intragovernmental	34
With the Public	6
Total	\$40

Table 15: Accounts receivable as of September 30, 2011

Note 4 – General Property, Plant, and Equipment, Net

Depreciation of General PP&E is recorded using the straight-line method based on the estimated useful life in years as listed below. There are no restrictions on use or convertibility of general PP&E.

General Property, Plant, and Equipment, Net (in millions)	Estimated Useful Life (Years)	Cost	Accumulated Depreciation and Amortization	Net Book Value
Personal Property:				
Equipment	5 – 20	\$71	\$59	\$12
Internal Use Software	5	43	23	\$20
Total Personal Property		114	82	32
Real Property:				
Land and Land Rights		3	0	\$3
Buildings, Improvements and Renovations	15 – 30	9	6	\$3
Other Structures & Facilities	15 – 30	3	3	\$0
Assets under Capital Leases	Varies	8	5	\$3
Total Real Property		23	14	9
Total		\$137	\$96	\$41

Table 16: General PP&E as of September 30, 2011

Notes to the Financial Statements

Note 5 – Stewardship PP&E

The objective of Federal stewardship reporting is to report an entity’s stewardship PP&E, along with certain responsibilities that cannot be measured in traditional financial reports. Stewardship PP&E includes one historically significant heritage asset and stewardship land.

Stewardship Land

The Stewardship land for NRCS consists of conservation easements. NRCS’s mission objectives in administering the conservation easement programs are to provide landowners with financial and technical assistance in return for maintaining and improving high quality productive soils, clean and abundant water, healthy plant and animal communities, clean air, an adequate energy supply, and working farm and ranch land.

NRCS’s objectives in managing, monitoring and enforcing the terms and conditions of easement deeds are to ensure that: (1) taxpayer investments are properly used in accordance with the intent of the program; (2) the agency is a good steward of the land; and (3) the land is properly maintained. The specific uses for the land are identified under each program. Landowners are not allowed to withdraw from the program; however termination or expiration may occur.

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

NRCS, on behalf of USDA, administers and owns conservation easements on private lands through five different programs. For the purpose of stewardship asset reporting, all easements where NRCS is the grantee of the easement are included as stewardship land. Also included are easements that are administered by NRCS on behalf of other USDA agencies. During FY 2011 NRCS conducted a rigorous review to ensure all stewardship land was correctly included for reporting. This effort identified 1,330 conservation easements not included in the ending balance for FY 2010. As of September 30, 2011, NRCS had 13,977 conservation easements classified as stewardship land.

Heritage Assets

Heritage assets are unique for their historical or natural significance, for their cultural, educational, or artistic importance, or for their significant architectural characteristics. NRCS generally expects that heritage assets will be preserved indefinitely.

NRCS currently owns one heritage asset, the Tucson Plant Materials Center (TPMC) which is included in general PP&E as a multi-use asset. It was listed in the National Register of Historic Places (NRHP) on July 2, 1997. The TPMC develops and evaluates native plants and addresses an array of resource issues in the areas of rangeland, mined land, urban lands, cropland riparian areas, and desert lands. The TPMC provides technical assistance to NRCS field offices, Resource Conservation and Development (RC&D) groups, conservation districts, Federal, State, and Tribal agencies, and private landowners through the greater Southwest.

Stewardship PP&E (in numbers)	Ending Balance 2010	Adjustments to 2010 Balance	Beginning Balance 2011	Additions +	Expiration / Termination	2011 Balance
Heritage Assets						
Research Centers	1	0	1	0	0	1
Stewardship Land						
Conservation Easements	11,085	1,330	12,415	1,562	0	13,977

Table 17: Stewardship easements as of September 30, 2011

Notes to the Financial Statements

Note 6 - Other Assets

Other Assets – Intragovernmental is comprised of funds advanced to other Federal agencies. Most of this balance is represented by the funds advanced to CCC to make payments to landowners under the Grassland Reserve Program. Other Assets with the Public is comprised of funds advanced to state and local governments and non-Federal business entities, and the public through conservation plans and easements.

Other Assets (in millions)	2011
Intragovernmental	\$218
With the Public	49
Total	\$267

Table 18: Balance of Other Assets as of September 30, 2011

Note 7 – Liabilities Not Covered by Budgetary Resources

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

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

Liabilities Not Covered by Budgetary Resources (in millions)	2011
Intragovernmental:	
FECA	\$7
Custodial liabilities	2
Subtotal Intragovernmental	9
With the Public:	
Unfunded leave	84
Federal employee & veterans benefits	38
Subtotal with the public	122
Total liabilities not covered by budgetary resources	131
Total liabilities covered by budgetary resources	772
Total liabilities	\$903

Table 19: The balance of liabilities not covered by budgetary resources as of September 30, 2011

Notes to the Financial Statements

Note 8 - Other Liabilities

Other liabilities include but are not limited to payables for cooperative agreements, advances and prepayments from others, and accrued liabilities. NRCS's other liabilities include intragovernmental and those with the public as presented in table below.

Other Liabilities (in millions)	Fiscal Year 2011		
	Non-Current	Current	Total
Intragovernmental:			
Other Accrued Liabilities	\$0	\$41	\$41
Employee contributions & payroll taxes	0	12	12
Unfunded FECA Liability	7	0	7
Custodial Liability	0	2	2
Other Liabilities	0	1	1
Total Intragovernmental	\$7	\$56	\$63
With the Public:			
Payroll and Lease Liabilities	\$0	\$46	\$46
Watershed & Flood Protection Liabilities	0	40	40
Wetlands Reserve Program Liabilities	0	30	30
Environmental Quality Initial Program Liabilities	0	25	25
Conservation Operation Liabilities	0	24	24
Other Accrued Liabilities	0	17	17
Total Other Liabilities	\$0	\$182	\$182
Other accrued liabilities consist primarily of accruals for payroll and for receipt of goods and services not yet invoiced.			

Table 20: Other Liabilities as of September 30, 2011

Notes to the Financial Statements

Note 9 – Leases

NRCS has entered into leasing agreements with the General Services Administration (GSA) and other parties through leasing authority delegated by GSA for general facilities (buildings and office space), equipment and land for its Plant Materials Centers and other operations across the Nation. Leases may include renewal options for periods of one or more years. Most leases are subject to cancellation upon certain funding conditions and all are covered by budgetary resources. Capital lease assets and future payment information for capital and operating leases are shown in the tables below. NRCS enters into operating leases primarily for office space. The lease arrangements generally range from five to 10 years.

Entity as Lessee: Capital Leases	FY 2011 (in millions)
Summary of Assets Under Capital Leases	
Land and Buildings	\$8
Accumulated Amortization	5

Table 21: Capital Leases Summary as of September 30, 2011

Capital Leases Future Payments Due:	Land and Buildings (in millions)
Year 1 (2012)	\$2
Year 2 (2013)	2
Year 3 (2014)	2
Year 4 (2015)	1
Year 5 (2016)	1
After 5 Years	1
Total Future Lease Payments	\$9
Less: Imputed Interest	1
Less: Executory Costs	2
Net Capital Lease Liability	\$6
Lease liabilities covered by budgetary resources	6

Table 22: Total Capital Leases Future Payments

Operating Leases Future Payments Due:	Land and Buildings (in millions)
Year 1 (2012)	\$21
Year 2 (2013)	17
Year 3 (2014)	15
Year 4 (2015)	13
Year 5 (2016)	11
After 5 Years	22
Total Future Lease Payments	\$99
All leases covered by budgetary resources	

Table 23: Total Operating Leases Future Payments

Notes to the Financial Statements

Note 10 – Commitments and Contingencies

NRCS is subject to claims and contingencies related to lawsuits as well as commitments under contractual and other commercial obligations. No amount has been accrued in the September 30, 2011 financial statements where the amount is uncertain or where the probability of judgment against NRCS is remote. NRCS has no material probable or reasonably possible contingencies.

Note 11 – Intragovernmental Costs and Exchange Revenue

NRCS has one goal to accomplish its mission: Get More Conservation on the Ground. Costs and exchange revenue are disclosed as Intragovernmental or With the Public based on the related source or customer, respectively. The following table depicts the cost and exchange revenue for the year ended September 30, 2011.

Intragovernmental Costs and Exchange Revenue (in millions)	FY 2011
Costs	
Intragovernmental	\$676
Public	3,811
Total Program Costs	\$4,487
Earned Revenue	
Intragovernmental	\$174
Public	3
Total Program Earned Revenue	\$177

Table 24: Costs Incurred to Protect Natural Resources for the year ended September 30, 2011

Notes to the Financial Statements

Note 12 – Suborganization Program Costs/Program Costs by Segment

NRCS reflects costs under five program responsibility segments: Conservation Operations, Watershed Programs, Watershed Rehabilitation, Resource Conservation & Development and Farm Bill. The following tables illustrate actual costs by program for the year ended September 30, 2011.

Program Costs	Gross Costs	Earned Revenue	Net Cost
Conservation Operations:			
Conservation Technical Assistance	\$893	\$30	\$863
Soil Surveys	112	5	\$107
Snow Surveys & Water Supply Forecast	12	0	\$12
Plant Materials	12	2	\$10
Total Conservation Operations	1,029	37	992
Watershed Programs:			
Flood Prevention Operations (PL-534)	3	2	\$1
Emergency Watershed Protection	145	0	\$145
Flood Plain Easement Program - Recovery Act	37	0	\$37
Watershed Flood Prevention Operations - Recovery Act	49	0	\$49
Small Watershed Operations	51	36	\$15
Total Watershed Programs	285	38	247
Watershed Rehabilitation:			
Watershed Rehabilitation Program	26	1	\$25
Watershed Rehabilitation Program - Recovery Act	12	0	\$12
Total Watershed Rehabilitation	38	1	37
Resource Conservation & Development:			
Resource Conservation & Development	23	0	\$23
Total Resource Conservation & Development	23	0	23
Farm Bill:			
Environmental Quality Incentives Program	1,151	4	\$1,147
Wildlife Habitat Incentives Program	77	(2)	\$79
Agricultural Management Assistance	6	0	\$6
Agricultural Water Enhancement Program	57	0	\$57
Conservation Reserve Program	111	99	\$12
Conservation Security Program	201	0	\$201
Farm & Ranchlands Protection Program	117	0	\$117
Grasslands Reserve Program	47	0	\$47
Wetlands Reserve Program	543	0	\$543
Conservation Stewardship Program	758	0	\$758
Healthy Forest Reserve Program	5	0	\$5
Chesapeake Bay Watershed Initiative	39	0	\$39
Total Farm Bill	3,112	101	3,011
Totals	\$4,487	\$177	\$4,310

Table 25: Costs by Program for the year ended September 30, 2011

Notes to the Financial Statements

Note 13 - Cost of Stewardship PP&E

The FY 2011 costs of administering the program for stewardship land amounted to \$634 million, which consists primarily of easement, acquisition costs, and restoration.

Costs for stewardship land is a combination of all costs to acquire and prepare the land for its intended use for the purpose of assisting landowners in becoming better stewards of the Nation's soil, water, and related natural resources.

Note 14 – Exchange Revenues

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

Note 15 - Apportionment Categories of Obligations Incurred

OMB normally distributes budgetary resources in an account or fund by specific time periods, activities, projects, objects or a combination of these categories through the apportionment process. Trust fund apportionments are classified as category A and all others are category B. Category A apportionments distribute budgetary resources as needed. Category B apportionments typically distribute budgetary resources by activities, projects or objects. NRCS had no category A apportionments during FY 2011.

Note 16 - Legal Arrangements Affecting Use of Obligated Balances

NRCS has been granted extended authority for Treasury symbols 1221004, 1231004, 1241004, 1251004 and 1261004 under Section 766 of Public Law 108-447 (enacted on December 8, 2004), which states that "funds made available under Section 1240I and Section 1241(a) of the Food Security Act of 1985 in fiscal years 2002, 2003, 2004, and 2005 shall remain available until expended to cover obligations made in fiscal years 2002, 2003, 2004, and 2005, respectively, and are not available for new obligations". The majority of the unobligated balances in 1213322, 1221004, and 1231004 were returned to Treasury in FY 2009. Beginning in FY 2009, the unobligated balance for treasury symbols with extended disbursing authority were not canceled at the end of the fifth expired year; instead the unobligated balance remains in an expired status until the treasury symbol is closed or expended in accordance with OMB Circular A-11.

Note 17 - Explanation of Differences between the Statement of Budgetary Resources and the Budget of the United States Government

The President's Budget with actual numbers for FY 2011 has not yet been published and the release date is not known. This information can be found at <http://www.whitehouse.gov/omb>. A comparison of the FY 2010 Statement of Budgetary Resources to the President's Budget was not disclosed due to the disclaimer of opinion in FY 2010.

Note 18 – Undelivered Orders at the End of the Period

Budgetary resources obligated for undelivered orders as of September 30, 2011 is \$4.4 billion.

Note 19 – Reconciliation of Net Cost of Operations (Proprietary) to Budget

This note is intended to bridge NRCS's budgetary and financial (proprietary) accounting. It is a reconciliation that identifies total resources used by an entity during the period (budgetary and other) and makes adjustments to the resources based upon how they were used to finance net obligations or costs. The budgetary information used to calculate net obligations (the first four lines) is presented on a combined basis to enable a direct tie to the Statement of Budgetary Resources. The reconciliation explains the difference between budgetary net obligations and proprietary net cost of operations by setting forth the items that reconcile the two amounts. The budgetary net obligations and the proprietary net cost of operations are different in that (1) the net cost of operations may be financed by non-budgetary resources; (2) the budgetary and non-budgetary resources used by an agency may finance activities which are not components of the net cost of operations; and (3) the net cost of operations may contain components which do not use or generate resources in the period.

The Reconciliation of Net Cost of Operations (proprietary) to Budget for the year ended September 30, 2011 is provided in the following table.

Notes to the Financial Statements

 Natural Resources Conservation Service		Reconciliation of Net Cost of Operations (Proprietary) to Budget for the year ended September 30, 2011 (in millions)	
Reconciliation of Net Cost of Operations (Proprietary) to Budget for the year ended September 30, 2011 (in millions)		2011	
Resources Used to Finance Activities:			
Budgetary Resources Obligated			
Obligations Incurred			\$4,391
Less: Spending authority from offsetting collections and recoveries			564
Obligations net of offsetting collections and recoveries			3,827
Net Obligations			3,827
Imputed financing from costs absorbed by others			186
Total resources used to finance activities			\$4,013
Resources Used to Finance Items not Part of the Net Cost of Operations:			
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided			\$306
Resources that fund expenses recognized in prior periods			(2)
Budgetary offsetting collections and receipts that do not effect net cost of operations			
Change in Unfilled Customer Orders			(4)
Resources that finance the acquisition of assets			(10)
Total resources used to finance items not part of the net cost of operations			290
Total resources used to finance the net cost of operations			\$4,303
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:			
Components Requiring or Generating Resources in Future Periods:			
Total components of Net Cost of Operations that will require or generate resources in future periods			\$0
Components not Requiring or Generating Resources:			
Depreciation and amortization			6
Other components not requiring or generating resources			
Bad Debt Expense			1
Total components of Net Cost of Operations that will not require or generate resources:			7
Total components of Net Cost of Operations that will not require or generate resources in the current period			\$7
Net Cost of Operations			\$4,310

Table 26: Reconciliation of Net Cost of Operations (Proprietary to Budget) for the year ended September 30, 2011

Required Supplementary Stewardship Information

Required Supplementary Stewardship Information

Human Capital

NRCS's investment in human capital is primarily for education and training programs intended to: (1) increase or maintain national economic productive capacity and (2) produce outputs and outcomes that provide evidence of maintaining or increasing national productive capacity. Investment in human capital is expensed each year as incurred.

National Volunteer Program

As the Nation's conservation agenda continues to become more complex, the need for technical information and advice will increasingly exceed the capacity of the Federal workforce to respond in a timely manner. Volunteering began with the organization of conservation districts in 1937. In recognition of the interest and skills many Americans have in conservation, Congress passed legislation - Section 1526 of PL97-98, Food and Agriculture Act - in 1981 permitting NRCS to use volunteers. In 1985, the volunteer effort was organized as the Earth Team. The primary purpose of the Earth Team is to expand NRCS services by using volunteer time, talent and energy to help accomplish the NRCS mission. Total investment in the NRCS National Volunteer Program was \$163,548 for the five year period ending September 30, 2011.

Resource Conservation and Development

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

Resource Conservation and Development (in millions)	2007	2008	2009	2010	2011	Total Investment
Resource Conservation and Development	\$53	52	51	52	22	\$230

Table 27: NRCS Investments in Human Capital

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

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

Required Supplementary Stewardship Information

Research and Development

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

Plant Materials Centers

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

Applied research includes the plant selection and technology development activities of PMCs. PMC plant selection involves the assembly and evaluation of plants for specific attributes. These plant assemblies may undergo several cycles of crossing and evaluation. Replicated plantings and the use of statistical analysis may be involved in the evaluations. The product is a new conservation plant released to commercial growers for large-scale production and sale to customers (landowners) for natural resource conservation projects. PMCs develop the technology needed to grow these plant selections, which includes propagation, seed and plant production, and seed and plant processing. Commercial growers use this information in order to more efficiently produce the millions of pounds of seed and millions of plants needed for conservation projects each year. PMCs also develop technology for the application of plants used in conservation projects, including seeding technology, novel establishment methods, and management methods. NRCS field staff, conservation partners, and landowners use this information to improve the efficiency or long-term success of conservation plantings.

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

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

Research and Development Investment (in millions)	2007	2008	2009	2010	2011	Total Investment
Plant Materials Centers	\$13	\$13	\$12	\$13	\$8	\$59
Total Invested Each Year	\$13	\$13	\$12	\$13	\$8	\$59

Table 28: NRCS Investments in Research and Development

Required Supplementary Information

Required Supplementary Information

Deferred Maintenance

Deferred maintenance is maintenance not performed when it should have been or was scheduled to be and is put off or delayed for a future period. The NRCS is responsible for assessing the level and cost of deferred maintenance of its owned facilities. NRCS maintains an inventory of owned facilities and structures in the Corporate Property Automated Information System (CPAIS). NRCS has 27 Plant Materials Centers (PMCs) that date back as far as 1935. Of the 27 centers, 24 have NRCS owned facilities. These centers are located in 26 states and have service areas covering all 50 states and territories.

PMCs are research farms consisting of an office building, greenhouse, laboratories/work space, and warehouses. Other features of PMCs typically include electrical and domestic water distribution, irrigation water wells, pumps or distribution systems, paved or gravel surfaces, and fuel storage and pumps. These make up the major classes of assets.

In February 2011, NRCS entered into an inter-agency agreement with GSA to perform various tasks including but not limited to conducting condition assessments and providing deferred maintenance cost associated with owned property. At this time there is no deferred maintenance available to report.

Required Supplementary Information

Statement of Budgetary Resources by Major Budget Account:

Statement of Budgetary Resources by Major Budget Account as of September 30, 2011 (in millions)					
Budgetary Resources:	Conservation Operations	Watershed	Farm Bill	Other	Total
Unobligated balance, brought forward, October 1:	\$115	\$228	\$1,335	\$10	\$1,688
Recoveries of prior year unpaid obligations	25	46	319	0	390
Budget authority:					
Appropriations	896	18	0	1	915
Spending authority from offsetting collections:					
Earned:					
Collected	37	37	86	0	160
Change in receivables from Federal sources	0	2	16	0	18
Advance received	0	(1)	0	0	(1)
Without advance from Federal sources	(2)	(32)	31	0	(3)
Subtotal	931	24	133	1	1,089
Nonexpenditure transfers, net	0	0	3,127	1	3,128
Permanently not available	(16)	0	(13)	(2)	(31)
Total Budgetary Resources	\$1,055	\$298	\$4,901	\$10	\$6,264
Status of Budgetary Resources:					
Obligations Incurred:					
Direct	\$943	\$111	\$3,135	\$0	\$4,189
Reimbursable	44	17	141	0	202
Subtotal	987	128	3,276	0	4,391
Unobligated balance-apportioned	39	164	64	8	275
Unobligated balance not available	29	6	1,561	2	1,598
Total status of budgetary resources	\$1,055	\$298	\$4,901	\$10	\$6,264
Change in Obligated Balances:					
Obligated balance, net					
Unpaid obligations, brought forward, October 1	\$268	\$552	\$3,421	\$1	4,242
Uncollected customer payments from Federal sources, brought forward October 1	(36)	(79)	(29)	0	(144)
Total unpaid obligated balance, net	232	473	3,392	1	4,098
Obligations incurred net	987	128	3,276	0	4,391
Gross outlays	(939)	(335)	(2,715)	0	(3,989)
Recoveries of prior year unpaid obligations	(25)	(46)	(319)	0	(390)
Change in uncollected customer payments from Federal sources	1	30	(46)	0	(15)
Obligated balance, net, end of period					
Unpaid obligations	290	299	3,664	1	4,254
Uncollected customer payments from Federal sources	(35)	(49)	(75)	0	(159)
Total, unpaid obligated balance, net, end of period	\$255	\$250	\$3,589	\$1	\$4,095
Net Outlays:					
Gross outlays:	\$939	\$335	\$2,715	\$0	\$3,989
Offsetting collections	(35)	(49)	(75)	0	(159)
Distributed offsetting receipts	\$0	\$0	\$0	\$0	0
Net Outlays	\$904	\$286	\$2,640	\$0	\$3,830

Table 29: Statement of Budgetary Resources by Major Budget Account

Unaudited – See accompanying independent auditors’ report

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