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Good morning, Mr. Chairman and Members of the Subcommittee. Thank you for inviting me to appear before you today to address the Natural Resource Conservation Service's (NRCS) administration and management of its programs.

As the oversight agency of the U.S. Department of Agriculture (USDA), the Office of Inspector General (OIG) works to ensure that the Department's programs are delivered as efficiently and as effectively as possible and to prevent fraud, waste, and abuse in USDA's programs and operations. As part of overseeing NRCS, we have conducted a variety of recent audit work, including financial statement audits and audits of NRCS' program operations. We appreciate the agency's cooperation and assistance during these oversight reviews, and we note the good work being done by NRCS personnel across the country. I will begin my remarks by addressing NRCS' efforts to adequately account for the tax dollars it receives and spends.

Financial Statement Audits

The Chief Financial Officers Act of 1990 mandated that OIG perform financial statement audits of the Department's financial statements. In fiscal year 2007, OIG's financial audit responsibilities were expanded to include a separate audit of NRCS' financial statements. For fiscal year 2008, NRCS, in conjunction with OIG, contracted for an NRCS financial statement audit. The contractor, KPMG, conducted the audit with OIG serving as the Contracting Officer's Technical Representative to oversee and monitor the contract. For fiscal year 2008, KPMG was unable to provide an opinion on NRCS' financial statements because the agency could not document or support its transactions and account balances.

To understand how NRCS arrived at this point, some background is necessary. Prior to 2004, NRCS and the Farm Service Agency (FSA) shared responsibility for farm programs. As part of this arrangement between the two agencies, NRCS provided the technical assistance producers required, and FSA administered the programs, including providing the financial accounting. Since the Chief Financial Officers Act of 1990 did not require a separate financial statement audit of NRCS, OIG did not issue a separate opinion on the agency's financial statements. Instead, NRCS' transactions were included in the universe from which we selected transactions for the consolidated financial statement audit.

The Farm Security and Rural Investment Act of 2002 changed this arrangement by making NRCS fully responsible for administering its own farm programs, including the necessary financial accounting. Full responsibility switched to NRCS with the start of fiscal year 2004, which meant that NRCS employees were now preparing the transactions we sampled in our consolidated financial statements.

Beginning in fiscal year 2007, the Office of Management and Budget (OMB) required a separate financial statement audit of NRCS. In this requirement's first year, the agency contracted to perform a review of several accounts instead of a comprehensive audit. OIG monitored the contractor's work by attending meetings, reviewing audit evidence, and reviewing and approving deliverables. The contractor issued a report noting that NRCS' accounting departed from generally accepted accounting principles. These accounting problems were caused by NRCS overstating unpaid and undelivered orders, needing better accounting controls, and lacking complete supporting documentation. After the review, NRCS embarked on a project to improve its records in preparation for the fiscal year 2008 financial statement audit.

The 2008 financial statement audit was the first attempt to audit NRCS' transactions comprehensively. The independent certified public accounting firm contracted to perform this work—KPMG—was unable to provide an opinion because NRCS could not support its transactions and account balances. There were a wide range of documentation problems, including a lack of evidence supporting obligations such as accrued expenses, undelivered orders, and unfilled customer orders. For example, KPMG found a number of accrued expenses (which are expenses that are incurred during one fiscal year, but paid later) that either lacked support or lacked support that matched the expense. In addition, KPMG also found deficiencies in how NRCS accounted for leases and easements.

These problems occurred because NRCS lacked federal financial accounting expertise. Until 2004, NRCS had relied on FSA employees to help account for its transactions, and had not cultivated a staff of accounting professionals. Part of this problem also has to do with how NRCS understands its mission within USDA. Many NRCS officials perceive their primary role as providing technical and scientific assistance to producers. Training employees to correctly account for its activities was not the agency's first priority.

NRCS has taken steps to address the deficiencies disclosed in the 2008 financial audit. To reach a correct statement of the agency's balances as of September 30, 2008, NRCS has:

- Trained over 300 NRCS employees concerning financial accounting principles in the areas that were identified as deficiencies in the fiscal year 2008 audit.
- Developed an automated tool to assist these employees as they validate and correct balances for specific general ledger accounts.
- Performed quality assurance reviews of the clean-up efforts performed by the States to address issues identified in the audit.
- Required the Deputy Chiefs and State Conservationists to attest that their financial information is complete, accurate, and reliable.

Based on the results of this clean-up effort, NRCS will adjust its financial statements to what it believes are the correct balances for the fiscal year ending September 30, 2008. NRCS believes these ending balances will serve as the foundation for an improved fiscal year 2009 financial statement.

Beginning last month, NRCS engaged the services of KPMG to evaluate the effectiveness of its efforts to clean up its financial statements. While it would be premature to anticipate the results of KPMG's evaluation, NRCS believes that its clean-up efforts will enable the agency to achieve an unqualified opinion on future financial statement audits, which KPMG will also be performing.

Wetlands Reserve Program (WRP): Financial Accounting

As an illustration of how NRCS' financial accounting and its program operations are interrelated, I would like to discuss one of our recent audits of NRCS' Wetlands Reserve Program (WRP).[1] WRP is a voluntary program that offers landowners technical and financial support to restore, enhance, and protect qualified wetlands on their property. By the end of fiscal year 2008, over 2 million acres were enrolled in WRP under approximately 9,400 easements and 1,200 restoration agreements. As of October 15, 2008, NRCS had obligated approximately $150 million in WRP funds for fiscal year 2008.

Early in our review of WRP payments, we found that NRCS was obligating expired funds—the agency was using funds that had been authorized under the 1996 Farm Bill after that bill had been superseded by the 2002 Farm Bill. We found over 1,400 WRP contracts, totaling almost $74 million, that had been obligated using expired WRP funds.

NRCS' financial management officials allowed these expired funds to be used because they had mistakenly assumed that 1996 Farm Bill funds–like the 1990 Farm Bill funds–were "no-year funds" and, therefore, were available for obligation in subsequent fiscal years. We recommended that NRCS adjust its financial accounts to correct for these improper obligations, and the agency took corrective action to resolve this problem.

<u>NRCS Program Management</u>

Turning from NRCS' efforts to account for the funds it receives and spends, I would like to comment now on a number of audits concerning NRCS' program operations that OIG has already issued, or will soon issue.

WRP has been the subject of three different audit reports.[2] OIG's first audit dealt with how NRCS compensated owners for land that would be used for conservation. Under the WRP

[1] "WRP – Wetlands Restoration and Compliance," Audit Report 10099-4-SF, dated August 25, 2008.
[2] "WRP – Wetlands Restoration and Compliance," Audit Report 10099-4-SF, dated August 25, 2008; "Compensation for Easements," Audit Report 10099-3-SF, dated August 2005; and "Crop Bases on Lands with Conservation Easements—State of California," Audit Report 50099-11-SF, dated August 2007.

statute, NRCS was required to limit landowner compensation to the difference between the fair market value of the land before the WRP conservation easement and the fair market value of the land after the WRP easement (also known as the “residual value”).[3] NRCS assumed that lands subject to WRP easements had little or no remaining market value; therefore, the agency issued instructions to establish a residual value of zero. However, we found that the residual value can be substantial. As a result, we estimated that NRCS could have potentially saved the program more than $159 million from 1999 to 2003. In response to our recommendation, NRCS modified its WRP appraisal methodology to recognize the residual value of easement-encumbered lands.[4]

When producers participate in WRP, they must inform FSA that they have reduced the arable land they are farming by the number of acres now being dedicated to conservation. This step is important because it decreases the farm subsidy the producer receives from FSA. We found cases in which landowners had not notified FSA and continued receiving improper farm subsidy payments for land where conservation easements had been purchased by the Government.[5] This issue formed the basis of our second audit report on WRP, which found that ongoing problems of coordination between NRCS and FSA resulted in producers receiving farming subsidies for land they should have retired.[6, 7]

Our third report on WRP noted problems with how NRCS monitored landowners’ compliance with WRP conservation provisions.[8] During our audit of activities from 2003 to 2005, we found that 5 NRCS State offices did not annually monitor nearly 90 percent of our sample of 153 WRP easements. We found possible noncompliance issues on approximately 40 percent of the easement sites we inspected. With the number of easements increasing and field staff

[3] Residual value is the value of the land with the conservation easement restrictions, which may include the landowner’s continued control of access to the land; the right to allow hunting and fishing; and the pursuit of other undeveloped recreational uses, provided such uses do not impact other prohibitions listed in the warranty easement deed.
[4] “Compensation for Easements,” Audit Report 10099-3-SF, dated August 2005.
[5] We also found similar problems in NRCS’ Emergency Watershed Protection Program and FSA’s Grassland Reserve Program easements.
[6] “Crop Bases on Lands with Conservation Easements—State of California,” Audit Report 50099-11-SF, dated August 2007.
[7] In this report, we audited easements only in California, but NRCS took corrective action nationwide.
[8] “WRP – Wetlands Restoration and Compliance,” Audit Report 10099-4-SF, dated August 25, 2008.

decreasing, NRCS has fewer resources to monitor its easements for compliance with program requirements. To correct this problem, NRCS agreed to develop a risk-based monitoring system to optimize its monitoring resources.

OIG also has completed, or will soon complete, audits on other aspects of NRCS' program operations. For instance, we are currently performing an audit of the Conservation Security Program, intended to evaluate the adequacy of NRCS' controls over the program and to review participant and land eligibility.

We are also completing a review of NRCS' implementation of its dam rehabilitation program.[9] Recognizing the threat to public safety posed by the aging system of flood control structures, Congress appropriated approximately $160 million from fiscal years 2002 to 2007 for the purpose of assessing and rehabilitating these dams. We found, however, that NRCS has not always rehabilitated the dams that pose the greatest risk to public safety. Instead, seven years after the program was initiated, NRCS has not assessed 1,345 of 1,711 (79 percent) high hazard dams for rehabilitation and has spent $10.1 million (of the $160 million) to rehabilitate lower priority dams—dams where failures would be unlikely to result in the loss of human life. NRCS' efforts to implement the dam rehabilitation program have been hindered because the agency does not own the dams and lacks direct regulatory authority over dam owners. However, NRCS has not always established cooperative relationships with the State agencies responsible for overseeing dams. These State agencies can, if the need arises, compel owners to repair a dangerous structure. In our preliminary discussions with senior NRCS officials, they acknowledged the need to expeditiously complete assessment of high hazard dams. They also stated that the additional funding provided under the American Recovery and Reinvestment Act of 2009 will help accomplish this goal.

The American Recovery and Reinvestment Act of 2009 (Recovery Act)

Our review of the dam rehabilitation program is especially timely because the Recovery Act appropriated an additional $50 million for rehabilitating dams. In a recent meeting with senior

[9] "Rehabilitation of Flood Control Dams," Audit Report 10601-1-At. The report is not yet released.

NRCS officials, they agreed that our draft report will help them develop “best practices” as the agency prepares to expend the additional funding. We plan to do a followup review of this program later this fiscal year or early next fiscal year, which will provide NRCS an opportunity to demonstrate how it has responded to our recommendations as it spends this stimulus money.

The Recovery Act also appropriated to NRCS an additional $290 million, which NRCS distributed by allocating $145 million for floodplain easements and $145 million for watershed operations. The Department recently announced that it will release the full $145 million to restore floodplains and protect an estimated 60,000 acres through the floodplain easement component of its Emergency Watershed Protection Program (EWP). Since signups for the easements will end on March 27, we have already staffed an audit team to review this additional funding. In the first phase of this review, we will evaluate the adequacy of NRCS’ management controls over easements in EWP, given the control weaknesses we found in the processing of easements under WRP. In the second phase of our review, we intend to verify the eligibility of the participants and whether funds were expended properly.

We plan to apply a similar approach and methodology to our planned review of the $145 million allocated for watershed operations projects. In its announcement on March 9, 2009, the Department stated that it would be releasing $80 million of the amount that week. The funding will be provided to sponsoring local organizations, which will operate projects intended to protect watersheds, and promote flood mitigation and water quality improvements.

Mr. Chairman and Members of the Subcommittee, I would like to conclude by thanking the Subcommittee for the opportunity to present OIG’s recent work on these issues. I am happy to answer any questions you may have.