DEPARTMENT OF HOMELAND SECURITY
Office of Inspector General

Independent Auditor's Report on TSA's FY 2007 Balance Sheet

OIG-08-57 MAY 2008

Office of Inspector General

U.S. Department of Homeland Security
Washington, DC 20528

Homeland Security

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Preface

The Department of Homeland Security (DHS) Office of Inspector General (OIG) was established by the Homeland Security Act of 2002 *(Public Law 107-296)* by amendment to the Inspector General Act of 1978. This is one of a series of audit, inspection, and special reports prepared as part of our oversight responsibilities to promote economy, efficiency, and effectiveness within the department.

This report presents the results of the audit of the Transportation Security Administration's (TSA) consolidated balance sheet as of September 30, 2007. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the audit. The contract required that KPMG perform its audit according to generally accepted government auditing standards and guidance from the Office of Management and Budget and the Government Accountability Office. KPMG issued a qualified opinion on TSA's consolidated balance sheet for fiscal year 2007. KPMG's report identified five material weaknesses related to financial systems security, undelivered orders and accounts payable, property and equipment, financial reporting, and accrued leave and two significant deficiencies relating to accounts receivable and human resources documentation. It also identified instances of non-compliance with four laws and regulations. KPMG is responsible for the attached auditor's report dated February 8, 2008, and the conclusions expressed in the report. We do not express opinions on TSA's financial statements or internal controls, or conclusions on compliance with laws and regulations.

The recommendations herein have been developed to the best knowledge available to our office, and have been discussed in draft with those responsible for implementation. It is our hope that this report will result in more effective, efficient, and economical operations. We express our appreciation to all of those who contributed to the preparation of this report.

Richard L. Skinner
Inspector General

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Independent Auditors' Report

Assistant Secretary for the Department of Homeland Security
Transportation Security Administration, and Inspector General,
Department of Homeland Security

We have audited the accompanying consolidated balance sheet of the U.S. Department of Homeland Security (DHS) Transportation Security Administration (TSA) as of September 30, 2007. The objective of our audit was to express an opinion on the fair presentation of the consolidated balance sheet. In connection with our fiscal year 2007 audit, we also considered TSA's internal controls over financial reporting and performance measures and tested TSA's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on the consolidated balance sheet.

SUMMARY

As stated in our opinion on the consolidated balance sheet, we concluded that except for the effects on the consolidated balance sheet of such adjustments, if any, as might have been determined to be necessary had we been able to apply sufficient procedures to TSA's accrued unfunded leave, certain other intragovemmental liabilities, intragovemmental accounts payable, certain accounts payable, and the status of fund balance with Treasury section of Note 2, TSA's consolidated balance sheet as of September 30, 2007, is presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

Our consideration of internal control over financial reporting resulted in the following conditions being identified as significant deficiencies:

A. Financial Systems Security
B. Undelivered Orders and Accounts Payable
C. Property and Equipment
D. Financial Reporting
E. Accrued Leave
F. Accounts Receivable
G. Human Resources Documentation

We consider significant deficiencies A through E, above, to be material weaknesses.

We noted no deficiencies involving the design of the internal control over the existence and completeness assertions related to key performance measures.

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements 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.*

H. *Federal Financial Management Improvement Act of 1996*
I. *Federal Managers' Financial Integrity Act of 1982*
J. *Debt Collection Improvement Act of 1996*
K. Payroll-related Laws

The following sections discuss our opinion on TSA's consolidated balance sheet; our consideration of TSA's internal controls over financial reporting and performance measures; our tests of the TSA's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements; and management's and our responsibilities.

REPORT ON THE CONSOLIDATED BALANCE SHEET

We have audited the accompanying consolidated balance sheet of the Transportation Security Administration as of September 30, 2007.

TSA was unable to provide sufficient audit evidence to support the accuracy, completeness and existence of accrued unfunded leave, certain other intragovemrnental liabilities, intragovemrnental accounts payable, and certain accounts payable. It was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the accuracy, completeness and existence of $142 million of accrued unfunded leave; $52 million of the total reported other intragovemmental liabilities of $231 million; $40 million of intragovemmental accounts payable; and $351 million of the total reported accounts payable of $530 million in the consolidated balance sheet as of September 30, 2007. Such amounts enter into the determination of net position.

TSA was unable to provide sufficient audit evidence to support that undelivered orders remained valid obligations of TSA as of September 30, 2007. Although this result does not impact the consolidated balance sheet as amounts in error would be subject only to reclassification within unexpended appropriations, this result does impact the classifications within the status of fund balance with Treasury section of Note 2. It was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the proper presentation and disclosure of the status of fund balance with Treasury section of Note 2 as of September 30,2007.

In our opinion, except for the effects of such adjustments, if any, as might have been necessary had we been able to apply sufficient procedures to accrued unfunded leave, certain other intragovernmental liabilities, intragovemrnental accounts payable, certain accounts payable, and the status of fund balance with Treasury section of Note 2, as discussed in the preceding paragraphs, the consolidated balance sheet referred to above presents fairly, in all material respects, the financial posItIon of the Transportation Security Administration as of September 30, 2007, in conformity with U.S. generally accepted accounting principles.

The information in the Management's Discussion and Analysis and Required Supplementary Stewardship Information sections is not a required part of the consolidated balance sheet, but is supplementary information required by U.S. generally accepted accounting principles and OMB Circular No. A-136, *Financial Reporting Requirements.* 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 the internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects TSA's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of TSA's consolidated balance sheet that is more than inconsequential will not be prevented or detected by TSA's internal control over financial reporting. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the consolidated balance sheet will not be prevented or detected by TSA's internal control.

In our fiscal year 2007 audit, we consider the deficiencies, described in Exhibits I and II, to be significant deficiencies in internal control over financial reporting. However, of the significant deficiencies described in Exhibits I and II, we believe that the significant deficiencies presented in Exhibit I are material weaknesses. Exhibit IV presents the status of prior year reportable conditions.

INTERNAL CONTROLS OVER PERFORMANCE MEASURES

Our tests of internal control over performance measures, as described in the Responsibilities section of this report, disclosed no deficiencies involving the design of the internal control over the existence and completeness assertions related to key performance measures.

KPMG

COMPLIANCE AND OTHER MATTERS

Our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of* 1996 (FFMIA), disclosed three instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, and are described in Exhibit III.

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

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

* * * * *

RESPONSIBILITIES

Management's Responsibilities. Management is responsible for the consolidated balance sheet, including:

- Preparing the consolidated balance sheet in conformity with U.S. generally accepted accounting principles;
- Preparing the Management's Discussion and Analysis (including the performance measures) and Required Supplementary Stewardship Information;
- Establishing and maintaining effective internal control; and
- Complying with laws, regulations, contracts, and grant agreements applicable to TSA, including FFMIA.

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

Auditors' Responsibilities. Our responsibility is to express an opinion on the consolidated balance sheet of TSA as of September 30, 2007, based on our audit. Except as discussed in the second and third paragraphs in the Report on the Consolidated Balance Sheet section above, we conducted our audit 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. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated balance sheet is 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 TSA's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

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

We believe that our audit provides a reasonable basis for our opinion.

In planning and performing our fiscal year 2007 audit, we considered TSA's internal control over financial reporting by obtaining an understanding of TSA'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 for the purpose of expressing our opinion on the consolidated balance sheet. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 07-04. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of* 1982. The objective of our audit was not to express an opinion on the effectiveness of TSA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of TSA's internal control over financial reporting.

As required by OMB Bulletin No. 07-04 in our fiscal year 2007 audit, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis section, we obtained an understanding of the design of internal controls relating to the existence and completeness assertions and determined whether these internal controls had been placed in operation. We limited our testing to those controls necessary to report deficiencies in the design of internal control over key performance measures in accordance with OMB Bulletin No. 07-04. However, our procedures were not designed to provide an opinion on internal control over reported performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether TSA's fiscal year 2007 consolidated balance sheet is free of material misstatement, we performed tests of TSA's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the consolidated balance sheet amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to TSA. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 07-04 and FFMIA, we are required to report whether TSA's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

TSA's response to the findings identified in our audit are presented in Exhibit V. We did not audit TSA's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of TSA's management, management of DHS, DHS' 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

February 8, 2008

Discussed below are significant deficiencies that we believe are material weaknesses.

A. Financial Systems Security

Background: Controls over information technology (IT) and related financial systems are essential elements of financial reporting integrity. Effective general controls in IT and financial systems environment are typically defined in six key control areas: entity-wide security program planning and management, access control, application software development and change control, system software, segregation of duties, and service continuity. In addition to general controls, financial systems contain application controls which are the structure, policies, and procedures that apply to separate, individual application systems, such as accounts payable, property, payroll, or grants.

The United States Coast Guard's Finance Center (FINCEN) hosts the financial processing of key Transportation Security Administration (TSA) financial applications. As such, our audit procedures over IT controls for TSA included testing of FINCEN procedures, policies, and practices. We noted several actions taken by FINCEN to improve its IT general controls environment and to address many prior year IT general control issues. During the year, TSA and FINCEN were able to c,loseout ten previously issued IT findings in the area of access controls and entity-wide security. Despite these improvements, several significant IT general control weaknesses were identified this year, and many findings were re-issued again this fiscal year. These issues collectively limit TSA's ability to ensure that critical financial and operational data is maintained in a manner to ensure confidentiality, integrity, and availability.

Condition: The following IT and financial system control weaknesses identified at FINCEN in FY 2007 impact TSA:

1. Regarding entity-wide security program planning and management, we noted:
   - The contract that Coast Guard Headquarters has with its software vendor does not include security configuration requirements that must be adhered to during the configuration management process. ConsequentlY, system builds and maintenance packs may not be configured and implemented with comprehensive security configuration requirements.
   - Background investigations of FINCEN civilians and contractors employed to operate, manage and provide security over IT systems are not being consistently conducted.
   - TSA allows individuals to complete security awareness training within 60 days of beginning work and gaining access to its local area network (LAN) and application accounts. However, U.S. Department of Homeland Security (DHS) guidance requires that all individuals complete security awareness training prior to gaining access to the information systems. Furthennore, of our sample of nine individuals

for testing, one contractor had not completed initial security awareness training this fiscal year, alld a second employee had not completed his refresher training for this fiscal year.

- Eleven of a sample of 30TSA 1402 forms, *Separating Non-Screener Employee and ContractorlT Certificates,* were received. Additionally, of the 11· forms received, seven of the forms did not have the appropriate TSA application(s) identified in order to' deactivate the separating employee's accounts. Furthermore, we selected 30 TSA 1163 forms, the *Employee Exit Clearance Form,* for both contractors and TSA personnel alld only received nine completed forms.
- Coast Guard IT security role-based training policies and procedures lack appropriate criteria for defining personnel with significant IT responsibilities. Additionally, the personnel that are defined in the policy are very limited and do not fully cover the scope ofsecurity responsibilities addressed in DHSrequirements.
- The Certification and Accreditation (C&A) package of a key system was not complete and in accordance with DHS requirements.

2. Regarding access controls, we noted:

- Missing or weak user passwords were identified on key servers and databases.
- Excessive administrative privileges were identified on key systems.
- Certain workstations, servers, and network devices were not configured with the necessary security patches, or were not configured in the most secure manner.
- Accounts of terminated employees and contractors were not removed from the system in a timely manner.
- Procedures for the authorization, regular review, and removal of certain system access were not formalized and were inconsistent.
- Key systems have been configured to automatically end date accounts that have not been used in six months; however, DHS guidance requires accounts that have been inactive for 30 days be disabled.
- Policy and procedures for a formalized sanctioning process for individuals who do not follow computer access policies and procedures have not been fully developed and implemented. Specifically, the policies and procedures do not include consequences for individuals who do not sign the computer access agreements or complete initial or refresher security awareness training. Furthermore, of the nine individuals selected for testing, only one had completed a Computer Access Agreement.
- Procedures requiring the review of the activities of system administrators are not formally documented.
- AudiUogging was notenabled within certain applications. Additionally, audittrails of appropriate user actions, including changes to securityprofiles, are not generated and maintained for certain applications.

3. Regarding application software development and change control, we noted:
   - Several weaknesses existed in change control processes for certain applications. Specifically, change control procedures were not properly developed, formal change request forms were not in use, and test plans and results were not documented.
   - A separate and secondary change control process outside of and conflicting with the established change control process is in operation at the FINCEN. Specifically, this second change control process was used to create additional functionality in the system or correct data in the financial applications to compensate for gaps in the customized software. During our testing of this separate process, we identified it to be informal, undocumented, and not effective.
4. Regarding service continuity, we noted:
   - One of the business continuity plans is in draft form and has not been tested.
   - A memorandum of understanding (MOU) for business continuity services IS currently in draft form.
   - Nineteen out of 79 individuals had not yet completed the emergency response training.
   - Four employees, each with 24 hour access to the data center, had not yet completed the emergency response training as of July 2007. Upon notifying FINCEN of this exception, the four individuals completed the training and FINCEN provided the necessary supporting evidence.

Cause/Effect: While Coast Guard/FINCEN has developed and begun to implement planned corrective actions to address weaknesses in its financial processing environment, some of the actions are multi-phased and will take multiple years to complete. This is particularly applicable to weaknesses in the change control process of key financial applications and business continuity/disaster recovery planning efforts. Additionally, several weaknesses, such as those related to account management, configuration management, and monitoring of system software, require the implementation and enforcement of consistent policies and procedures.

Coast Guard/FINCEN reported the correction of weaknesses identified by periodic scans of its network for security weaknesses. However, system configurations and the application of required patches are not consistently monitored as application changes are implemented to ensure that they remain in compliance with DRS and Federal guidance. In addition, financial system functionality weaknesses in various processes can be attributed to non-integrated legacy financial systems that do not have the embedded functionality caned for by Office of Management and Budget (OMB) Circular No. A-127, *Financial Management Systems*. Further, TSA, Coast Guard, and the DRS Chief Information Officer do not consistently test and monitor IT controls to identify and mitigate weaknesses.

Criteria: DRS' Sensitive Systems Policy Directive 4300A, Information Technology Security Program, was utilized during the audit engagement. The *Federal Information Security Management Act* (FISMA) passed as part of the *E-Government Act of 2002* mandates that Federal entities maintain IT security programs in accordance with OMB and National Institute of Standards and Technology (NIST) guidance. OMB Circular No. A-*130, Management ofFederal Information Resources,* and various NIST guidelines describe specific essential criteria for maintaining effective general IT controls. In addition, OMB Circular No. A-127 prescribes policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems.

Recommendations: Unless specifically noted where TSA needs to take specific corrective action, we recommend that TSA monitor that the Coast Guard/FINCEN cOlnplete the following corrective actions:

1. For entity-wide security program planning and management:

   - Reevaluate and revise the·contract between Coast Guard and its software vendor or otherwise ensure that the security configurations associated with the builds, service packs, and software patches are in compliance with DRS and NIST standards.
   - Enforce DRS policy to ensure that all contractors and employees go through the appropriate background/suitabilitycheck.
   - Enforce the DRS policy by having all new and existing users (employees and contractors) complete the security awareness training *(TSA needs to take this action).*
   - Ensure that TSA employees consistently complete the required paperwork for terminated personnel *(TSA needs to take this action).*
   - Enhance current policies and procedures for IT role-based training to require those with critical security responsibilities, such as network administrators, system administrators, senior managers and system owners, to complete the role-based training on an annual basis and deploy the IT role-based training of civilian personnel with critical IT positions down to the Coast Guard component levels for implementation.
   - Update the C&A package to ensure that each subsystem component is fully described in the system security plan, an appropriate security categorization is assigned, and an appropriate set of security controls are identified in accordance with NIST guidance.

2. For access control:

   - Enforce password controls that meet DRS password requirements on all key servers and databases.
   - Remove all generic shared system accounts or establish individual accountability for these accounts. If these accounts cannot be removed, enable audit logging to capture the user's operating system logon ID so that individual accountability can be established for each instance of when these accounts are used *(TSA needs to take part ofthis action).*
   - Develop and implement a process for performing scans of the network environment, including the financial processing environment, for the identification and·correction of vulnerabilities in accordance with DRS and Federal guidance. These scans should occur on a regular basis, especially. after the implementation of a software release.
   - Notify and coordinate with Coast Guard to implement corrective actions that result in removing separated users from the system in a timely manner and in accordance with DRS guidance *(TSA needs to take part ofthis action).*
   - Develop and implement formal entity-wide procedures for controlling the processes associated with the granting, monitoring, and terminating user.accounts that require the periodic revalidation of user profiles by local security administrators that comply with existing policies *(TSA needs to take this action).*

- Track and end-date/disable key system accounts to be in compliance with DHS requirements.
- Complete the development and implementation of a sanctioning process for both TSA employees and contractors if requirements surrounding the completion of security awareness training and computer access agreements are not met.
- Ensure that computer access agreements are completed for all TSA employees and contractors with access to financial applications *(TSA needs to take this action).*

3. Establish detailed procedures for audit trail generation, review and management. The procedures should discuss the conditions under which the audit trails should be generated and reviewed, the frequency of the reviews, and the basis for determining when suspicious activity should be investigated. In addition, sufficient resources should be allocated to ensure the proper implementation and monitoring of these procedures.For application software development and change control:

   - Develop and enforce a standard set of configuration management procedures for developing and documenting test plans, documenting test results, delivering and implementing software, and management approving system changes for normal and emergency upgrade situations.

   - Implement a single, integrated change control process over the Coast Guards' financial systems with appropriate internal controls to include clear lines of authority to the components' financial management personnel and to enforce responsibilities of all participants in the process and documentation requirements.

4. For service continuity:

   - Finalize and implement the Continuity of Operations Plan (COOP) and ensure that it addresses disaster recovery procedures.
   - Periodically test the business continuity plan and evaluate the results so that the plan can be adjusted to correct any deficiencies identified during testing.
   - Finalize the MOU for business continuity services and document associated restoration procedures so that a specific Coast Guard component can serve as an alternate processing site in the eventthat the FINCEN is unavailable.
   - Ensure that all personnel with access to the data center have completed the data center emergency response training.

B. Undelivered Orders and Accounts Payable

Background: In accordance with Federal appropriations law, entities in the Federal govemmentare required to reserve funds for goods and services ordered but not yet delivered; this reserved amount is commonly referred to as an undelivered order (UDO). The UDO balance is the difference between the total order placed and the goods or services received to date. Larger UDO balances. are typically associated with larger purchases, where the period of performance / terms of delivery span multiple accounting periods.

TSA's Office of Acquisition and Office of Financial Management (OFM) are required to provide sufficient evidence in order to support expense and procurement transactions in the general ledger. These offices are also responsible for supporting the validity of outstanding UDOs and received but unbilled goods and services.

As part of the financial reporting process, TSA uses the UDO balance at the end of each quarter to calculate an accrual estimate for certain goods and services received for which an invoice has not been received. This estimate is based on a percentage of the related outstanding UDO. balance.

Additionally, TSA's Core Accounting System (CAS) calculates a liability for unpaid invoices at period end. This liability is referred to as the CAS-generated accounts payable. In FY 2007, TSA made a $127 million correction to this accounts payable balance. We attempted to test a sample of vendor invoices from the remaining balance at September 30, 2007, to determine if the remaining liability was fairly stated.

Condition:
June 30, 2007

During our interim UDO compliance, control, and substantive testwork, we selected a statistical sample of 72 contracts with outstanding UDO balances in order to verify that these items were valid. We identified 7 outstanding balance errors totaling a known misstatement of $1.3 million, with a most likely (e.g., projected) overstatement of $199 million. The results of our projection also indicated that items from budget fiscal year (BFY) 2005 and prior contained 86% ($171 million) of the projected errors. The remaining $28 million in projected errors was identified as post BFY 2005.

September 30,2007

During our year-end UDO compliance, control, and substantive testwork, we selected a statistical sample of 195 contracts with outstanding uno balances in order to verify that these items were valid. We identified 26 outstanding balance errors totaling a known misstatement of $16 million, with a most likely overstatement of $138 million. The results agajn indicated an overstatement of outstanding obligated balances.

During our year-end accounts payable testwork, TSA. provided a population of CAS-generated accounts payable as of September 30, 2007 that included all debit and credit activity recorded in CAS in that account since TSA migrated to CAS, instead of a population of invoices that totaled the balance reported in CAS. We selected a sample from the population provided to test the balance at September 30, 2007. As a result of the population including activity since the CAS migration (and not a detail of the account balance at September 30, 2007), our sample included some items that did not contribute to the accounts payable balance at September 30, 2007 and were aged; as a consequence, TSA was unable to provide sufficient documentation for 14 of 24 sample items in a timely manner to support the outstanding balance of CAS-generated accounts payable.

CauselEfJect:While otherUDO balances exist (e.g., travel), the significant balances relate to contract purchase orders. We determined that contracting officers are not performing a periodic review of outstanding UDOs in order to identify balances for de-obligation and determined that inadequate or incomplete accounting information recorded in the general ledger (e.g., period of performance) delays contracting officers from making appropriate decisions regarding de-obligation of funds.

Without the timely deobligation of funds that are no longer needed, TSA cannot accurately report onthe status of its budgetary resources and properly manage its funds. Additionally, since TSA calculates a significant portion of its accounts payable using UDOs as a basis, it cannot determine an appropriate amount to accrue for received but unbilled goods and services. The accounts payable balance that uses the UDOs· as a basis to estimate unbilled goods and services received as of September 30th approximated $336 million.

Without further work on TSA's part, we were unable to conclude that the UDO and related accounts payable balances are fairly stated as of September 30, 2007.

Additionally, the method used by TSA to generate the population provided for audit did not allow for the selection of invoices comprising the year-end accounts payable balance. Further, TSA has not completed its efforts to validate outstanding CAS-generated accounts payable balances by Treasury fund symbol to determine if the items exist and are recorded in the proper amount. As a result, we are unable to conclude that the CAS-generated accounts payable balances totaling $56 million are fairly stated as of September 30, 2007.

Criteria: U.S.C. Title 31 Chapter 15, Section 1554, Audit, Control, and Reporting states, "The head of each agency shall establish internal controls to assure that an adequate review of obligated balances is performed to support the certification required by section 1108(c) of this title."

The U.S. Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* (the Standards) state that, "Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear· in management directives, administrative policies, or operating manuals and may be in paperor electronic form. All d()cumentationand records should be properly managed and maintained." Additionally, with regard to accountabilityforrecords and resources, "Periodic comparison of resources with the recorded accountability should be made to help reduce the risk of errors, fraud, misuse, or unauthorized alteration."

OMB Circular No. A-II, Part I, Section 20 General Information, states that, "the obligation you incur must conform to other applicable provisions of law, and you must be able to support the amounts reported by the documentary evidence required by 31 U.S.C. 1501. Moreover, you are required to maintain certifications and records showing that the amounts have been obligated (31 USC l108}."

Recommendations: We recommend that TSA:

1. Require contracting officers to review and certify whether obligations are valid or deobligate obligations on a periodic basis (e.g., quarterly).
2. Refine or develop anew general ledger reporting tool that provides the contracting officers accurate information regarding outstanding obligated balances to include information related to the last activity date to assist in evaluating the balance.
3. Refine existing processes by which the Business Management Office periodically examines outstanding obligations and makes recommendations (e.g., deobligation) on outstanding balances.
4. Develop formal policies and procedures to assist in expediting deobligations of funds associated with invalid obligations in advance of a formal contract closeout.
5. Complete and document its validation of CAS-generated accounts payable balance by Treasury fund symbol, and record adjusting entries to CAS as necessary.
6. Develop and implement policies and procedures, including supervisory review, to periodically validate CAS-generated accounts payable balances by Treasury fund symbol.
7. To aid in the validation process, develop a system-generated report to extract a population of invoices that totals the CAS-generated accounts payable balance.

C. Property and Equipment

1. Reconciliation of Property, Plant and Equipment

Background: TSA acquires and maintains equipment to be used in the screening of passengers and baggage. In an effort to ensure proper financial reporting of the estimated value of this property, TSA reconciles its gross property, plant and equipment (PP&E) balances per its subsidiary ledgers (Sunflower and the Oracle Fixed Asset (FA) Module) to its general ledger (CAS) and to Department of Homeland Security's Treasury Information Executive Repository (TIER). TSA performs the reconciliation to identify any differences between the subsidiary ledgers and the general ledger and/or TIER in a timely manner and determine the need for any adjusting entries to be recorded to the general ledger and/or TIER to ensure the balances are properly stated at the close of each reporting period.

Condition: The PP&E reconciliation was not prepared in a timely manner during the March 31, 2007 close. Total PP&E approxirnated $2.1 billion in gross book value and net book value approximated 28% of total assets on the balance sheet at March 31, 2007.

However, during the third and fourth quarters, TSA completed and provided the necessary reconciliations in a timely manner as management dedicated additional resources to research the numerous property adjustments and reconcile the balance.

Cause/Effect: Differences identified through the PP&E reconciliation process may not be identified and recorded to the general ledger timely to ensure balances are properly stated at the close of each reporting period. Sufficient resources had not been applied to research the numerous adjustments needed to properly reconcile the PP&E balance.

Criteria: OMB Circular No. A-123, *Management's Responsibility for Internal Control,* states "Management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations....[The] documentation for internal control, all transactions, and other significant events is readily available for examination,"

Recommendation: Based on the improvements noted by the end of the fiscal year, we make no recommendation at this time.

2. Depreciation of Property, Plant and Equipment

Background: In an effort to ensure proper financial reporting of the estimated value of equipment, TSA depreciates the acquisition cost of its equipment over the estimated useful life of the equipment. Per section 5D, *Depreciation,* of the TSA Financial Management Manual for Property, Plant & Equipment dated May 21, 2007, TSA's policy on commencement of depreciation is as follows:

> *Depreciation begins when an asset meets the TSA capitalization threshold and is purchased or completed and placed into service. TSA capitalized property shall be depreciated over its useful life using the straight-line method (cost minus salvage value divided by asset useful life) with no salvage value as defined in Letter No. PMO-4000-1. The depreciation is calculated on the acquisition cost plus any ancillary costs. Depreciation is recognized on all capitalized PP&E except land and land rights of unlimited duration. Capitalized assets are integrated from the property management system (SAMS) to the accounting system's (CAS) fixed assets module where they are depreciated and posted to the general ledger.*

Through discussion with management, however, the date at which depreciation commences in practice has been calculated as the beginning of the month following the factory acceptance test (FAT) date. The FAT date is the date on which TSA has received and tested property and found it to be suitable for use in the field, regardless of whether or not it has yet been transferred to a field site and placed into service.

Condition: In performing our procedures over accumulated depreciation of PP&E, we noted that TSA'spolicy is to commence depreciation on the date that equipment is purchased or completed and placed into service. Through discussion with management, however, we noted that, in practice, depreciation commences in the beginning of the month following the FAT date (as defined above).

Based on further discussion with management, we noted that property is generally not placed into service until several months after it has gone through the factory acceptance test process and the FAT date has been identified.

Cause/Effect: The use of the beginning of the month following the FAT date as the depreciation commencement date has caused accumulated depreciation to be overstated, which has consequently caused net PP&E to be understated. We could not quantify the extent of the understatement of net PP&E due to the lack of accurate historical information in the subsidiary system and the source property records to support the actual date at which equipment has been placed into service. In addition, we could not reach a conclusion on the balance recorded for net PP&E as of March 31, 2007 because assets had been depreciated in a manner inconsistent with U.S. generally accepted accounting principles (GAAP).

As a result, TSA management developed and executed a plan to estimate the adjustment necessary to fairly present net PP&E as of September 30, 2007. Upon completion, TSA recorded an $80 million adjustment to reduce accumulated depreciation.

Criteria: OMB Circular No. A-123, *Management's Responsibility for Internal Control,* states "Management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations."

Per paragraph 35 of Statement of Federal Financial Accounting Standards (SFFAS) No.6, *Accounting for Property, Plant, and Equipment,* "Depreciation expense is calculated through the systematic and rational allocation of the cost of general PP&E, less its estimated salvage/residual value, over the estimated useful life of the general PP&E. Depreciation expense shall be recognized on an general PP&E, except land and land rights of unlimited duration....Various methods can be used to compute periodic depreciation expense so long as the method is systematic, rational, and best reflects the use of the PP&E."

CON 6, *Elements of Financial Statements,* paragraph 149 states, "However, many assets yield their benefits to an entity over several periods, for example,prepaid insurance, buildings, and various kinds of equipment. Expenses resulting from their use are normally allocated to the periods of their estimated useful lives (the periods over which they are expected to provide benefits) by a 'systematic and rational' allocation procedure, for example, by recognizing depreciation or other amortization. Although the purpose of expense allocation is the same as that of other expense recognition-to reflect the using up of assets as a result of transactions or other events or circumstances affecting an entity-. allocation is applied if causal relations are generally, but not specifically, identified. For example, wear and tear from use is known to be a major cause of the expense called depreciation, but the amount of depreciation caused by wear and tear in a period normally cannot be measured. Those expenses are not related directly to either specific revenues or particular periods. Usually no traceable relationship exists, and they are recognized by allocating costs to periods in which assets are expected to be used and are related only indirectly to the revenues that are recognized in the same period."

Recommendations: We recommend that TSA:

1. Make any system changes needed to propedycapture and maintain the date placed in service going forward.
2. Begin using the date placed in service, instead of the FAT date, in the monthly depreciation calculation.

3. Construction in Progress

Background: To acquire security equipment, TSA enters into contractual agreements with vendors that produce and sell such equipment. In some instances, TSA has entered into contracts that have required TSA to advance to the vendors a contractually agreed upon amount. This amount is intended to facilitate vendor acquisition of raw materials and production of the equipment TSA has sought to acquire.

In an effort to ensure proper financial reporting of security equipment acquired from these vendors, TSA has developed the TSA Financial Management Manual (FMM) for Property, Plant & Equipment dated May 21, 2007. Section 5B3 of the TSA FMM for Property, Plant & Equipment defines construction in progress (CIP) (or Construction Work in Progress, as named in section 5B3) as follows:

> Construction Work in Progress - includes the costs of real property and equipment being constructed and acquired, and not yet in use. The cost of equipment that is installed is an integral part of real property. The costs of items shall be accumulated (to include direct labor, materials and overhead costs) until the asset is completed and is available for use. When the asset is completed, the costs should be transferred to an appropriate asset account and (real or personal) property record. The cost of repairs and maintenance are expensed and not considered in Construction Work in Progress.

Condition: In performing our procedures over CIP at September 30, 2007, we obtained a detail of the CIP balance at that date, for which we noted a balance of approximately $50.6 million. Based on our review of the detail, we determined that approximately $48.6 million related to personal property being constructed by vendors. We determined that these items in the Clp· detail. relate to equipment being constructed by vendors for which TSA has advanced a contractually agreed upon amount.

In accordance with SFEAS No.6, we determined these amounts should not be capitalized as eIP because the underlying title to the assethas not yet passed. The underlying contracts for all amounts recorded as CIP as of September 30, 2007 incorporated by reference TSA Acquisition Management System (AMS) clauses 3.10.6-1a and 3.10.6-3a, which states: "The Government may terminate performance of work under this contract in whole or, from time to time, in part if the Contracting Officer determines·that a termination is in the Government's interest. The Contracting Officer shall terminate by delivering to the Contractor a Notice of Termination specifying the extent of termination and the effective date." Per TSA AMS Clause 3.10.6-3a, "The Government may terminate performance of work under thiscontractin whole or, from time to time, in part, if (1) The Contracting Officer determines that a termination is in the Government's interest; or (2) The·Contractor defaults in performing this contract. 'Default' includes failure to make progress in the work so as to endanger performance."

As such, we concluded that since TSA has the right to terminate for convenience and/or default, it is not satisfactory conveyance of title, and the amounts advanced under these contracts are not capitalizable asCIP as of September 30,2007.

Cause/Effect: Recording as CIP amounts advanced to vendors for which the underlying contracts are revocable has caused CIP to be overstated and advances and prepayments to be understated by approximately $48.6 million. This difference was included in the Summary of Unadjusted Audit Differences attached to management's FY 2007 representation letter.

Criteria: Office of Management and Budget Circular No. A-123 indicates: "Management is responsible for developing and maintaining effective internal control. Effective internal control provides assurance that significant weaknesses in the design or operation of internal control, that could adversely affect the agency's ability to meet its objectives, would be prevented or detected in a timely manner." In addition, "Internal control is an integral component of an organization's management thatprovides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations."

Paragraph 34 of SFFAS No.6 indicates: "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, thePP&E shall be recorded as construction work in progress until it is placed in service, at which time the balance shall be transferred to general PP&E."

Paragraph 57 of SFFAS No.1 indicates: "Advances are cash outlays made by a federal entity to its employees, contractors, grantees, or others to cover a part or all of the recipients' anticipated expenses or·as advance payments for the cost of goods and services the entity acquires. Examples include travel advances disbursed to employees prior to business trips, and cash or other assets disbursed under a contract, grant, or cooperative agreement before services or goods are provided by the contractor or grantee."

Recommendation: We recommend that TSA:

1. Develop and implement management review controls over equipment purchase contracts to ensure that amounts advanced to vendors are properly accounted for given the terms of the underlying contract.

<u>4. Other Property, Plant and Equipment</u>

Background: When TSA acquires new personal property to be used in the screening of passengers and baggage, this property may be either capitalized or expensed, depending on whether or not the amount of the property purchased exceeds the TSA capitalization threshold, which is set at $50,000 as of September30, 2007. Any personal property that is to be capitalized is recorded to account 1750 (Equipment). Any property that is to be expensed is recorded to account 6100 (Operating Expenses - Program Costs).

TSA and its accounting services provider may not always have the necessary information or documentation available to support the nature of the property purchased as either capitalized or expensed property. In an effort to ensure proper accounting for these transactions, TSA records any such purchases to account 1890 (Other General Property, Plant, and Equipment). Any amounts recorded to this account at quarter-end are reviewed to determine whether the amounts should be capitalized or expensed. Upon reaching these conclusions, journal entries are prepared to adjust amounts out of account 1890 and into either account 1750 or account 6100. Upon recording of all necessary adjustments, the balance in account 1890 should be immaterial at each quarter-end.

Condition: In performing our substantive procedures over the PP&E, we.noted a balance in account 1890, prior to adjustment, of approximately $41.5 million as of September 30, 2007. We inquired of management as to the appropriateness of the balance in the account and learned that the balance represented amounts that were to be transferred out of that account and recorded as either equipment (in account 1750) or as operating expenses – program costs (in account 6100).

Given that transactions are recorded to account 1890 that, upon availability of sufficient information ordocllmentation,may be recorded to account 6100, we noted that amounts are being recorded as capitalized assets that should instead be recorded as expenses. Although we noted that these amounts are·ultimately recorded to the appropriate account at·quarter-end, we noted that the recording of these amounts to account 1890 at points throughout the year, regardless of whether or not at a reporting date, is not in compliance with the USSGL at the transaction level.

Cause/Effect: Account 1890 is not used in a manner that complies with the USSGL at the transaction level. TSA and its accounting services provider do not assign sub-object class codes for property and equipment purchases in order to determine whether the asset purchased is either capitalized or expensed.

Criteria: Per Section 803(a) of the *Federal Financial Management Improvement Act of* 1996:

> *IN GENERAL – Each agency shall implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level.*

Recommendation: We recommend that TSA:

1. Develop and implement policies and procedures in coordination with its accounting services provider whereby transactions are recorded first to their appropriate sub-object class to assist in assigning the proper USSGL at the time the asset is acquired.

D. Financial Reporting

Background: Beginning in fiscal year 2005, TSA contracted with FINCEN to provide accounting services. As such, the FINCEN maintains TSA's general ledger and processes accounting transactions as directed by TSA. At the end of each accounting period, TSA submits adjusting journal entries to FINCEN as part of the closing process.

The transition to a new accounting system required the development and implementation of many new accounting processes and procedures, some of which were needed to mitigate material weaknesses in internal controls at the FINCEN. This process of setting up a financial accounting and reporting processes interfered with TSA's ability to prepare timely and accurate financial statements through fiscal year 2006, and contributed to a material weakness in internal controls over financial reporting. In fiscal year 2007, TSA developed and implemented a corrective action plan (CAP) to address its financial reporting and other accounting internal control weaknesses. The various steps within the CAP are expected to be completed in fiscal year 2008; however, significant progress has been made in this regard through fiscal year 2007.

During fiscal year 2007, TSA management implemented certain controls intended to either prevent or detect and correct significant misstatements to its consolidated financial statements. These controls include, but are not limited to, journal entry reviews, account balance reconciliations, and trial balance reviews. Management reports its results through its TIER submission to DRS ona monthly basis. As such, management has designed its account balance reconciliation and trial balance review controls to coincide with its monthly reporting requirements. In contrast, management records journal entries on a recurring basis, although some entries may be recorded only once monthly, quarterly, or annually. As such, management has designed journal entry control process to occur for every entry recorded.

Condition: During the course of our fiscal year 2007 audit procedures, we identified the following instances whereby financial reporting controls were determined either to not be properly designed or to not be operating effectively:

- TSA recorded a restatement to its prior year accounts payable balance which amounted to approximately $127 million.
- TSA was unable to breakout its intragovemmental balances and activities by each trading partner outside of DRS trading partners during the preparation of both the June and September balance sheets.
- We noted a number of PP&E journal entries that were recorded to correct, adjust or reverse errors in some manner throughout the year. We noted that the following entries indicate that financial reporting controls were either not properly designed or not operating effectively to prevent the initial errors from occurring:

  At February 28, 2007, a net $93.6 million debit was recorded to other general property, plant and equipment, with a related net credit to equipment in the amount of $93.6 million. The entry was selected during our journal voucher testwork and supporting documentation was not provided. We noted that the entry was· then reversed and re-recorded the subsequent month for a different amount which was supported.

  At June 30, 2007, a net $121.6 million debit was recorded to 1) operating expenses - program costs, and 2) losses on disposition of assets, with a related net credit to construction in progress in the amount of $121.6 million. This entry arose due to the FINCEN not reversing an entry that had been initially proposed and recorded as a reversing entry; we identified the error and TSA recorded this correcting entry.

  At September 30, 2007, a $79.7 million debit was recorded to accumulated depreciation, with related credits to 1) current year depreciation expense in the amount of $22.0 million, and 2) prior period adjustments due to changes in accounting principles for $57.7 million. This entry arose due to misapplication of GAAP relating to the date at which assets were placed into service, which was identified by us and communicated to TSA to be corrected (see Finding C for details). This entry required correction after it was posted, as the original entry was recorded to prior period adjustments due to changes in accounting principles and instead should have been recorded to prior period adjustments due to corrections of errors. The correction to the original entry was also identified by us and communicated to TSA to be corrected.

- We noted that the following accounts payable entry, which was recorded properly to correct an error, indicates that financial reporting controls were either not properly designed or not operating effectively to prevent the initial error from occurring. In this entry, a net $61.5 million in debits was recorded to 1) operating expenses - program costs, 2) undelivered orders – obligations unpaid, and 3) unexpended appropriations-cumulative, with related credits in the net amount of $61.5 million to 1) accounts payable, 2) delivered orders – obligations unpaid, and 3) expended appropriations. This entry was required because the equal and opposite entry, which was recorded to correct in the current year for overstatements to expenses and related liabilities in the prior year, was erroneously recorded twice.

- We identified a fund balance with Treasury journal entry that did not include adequate supporting documentation. An approximately $186.6 million debit was recorded to fund balance with Treasury with a related credit to revenue. This entry was recorded to reflect receipts of security fees. The related support provided amounted to approximately $184.0 million, which did not agree to the amount of the entry, indicating that a sufficient review was not performed over the entry recorded.

- We also noted that TSA's FY2007 Required Supplementary Stewardship Information (RSSI), specifically investments in human capital and research and development, did not report outcomes and outputs as required by OMB Circular No. A-136.

Cause/Effect: TSA identified errors in recording accounts payable during fiscal years 2005 and 2006 that resulted from fiscal years 2004 and 2005 estimated accruals not being reversed from the general ledger. This error caused the accounts payable balance to be overstated and the unexpended appropriations balance to be understated by $127 million.

TSA is unable to identify, summarize, reconcile and report non-DHS trading partner information in accordance with the Intragovemmental Business Rules.

Journal entries may be recorded in the consolidated balance sheet that are inappropriate and may significantly misstate balances and / or amounts in the consolidated balance sheet. Additionally, reversing journal entries may not be recorded to the consolidated balance sheet, which may significantly misstate balances and lor amounts in the consolidated balance sheet. Journal entries, reconciliations and trial balances were not always being sufficiently reviewed to ensure that all necessary journal entries are initially recorded appropriately. Additionally, reconciliations and trial balances are not always being sufficiently reviewed to ensure that all necessary reversing journal entries are recorded appropriately.

B.ecauseofthe movement of various grant programs within DHS, TSA has not been able to establish meaningful outcomes and outputs for its RSSI disclosures.

Criteria: The *Treasury Federal Intragovernmental Transactions Accounting Policies Guide,* dated August 18, 2006, and OMB Circular No. A-136, require FederalCFO Act and non-CFO Act entities identified in the Treasury Financial Manual (TFM) 2006, Vol. I, Part 2-Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government,* to perform quarterly reconciliations of intragovernmental activity/balances. TFM, Section 4706, *Intragovernmental Requirements,* requires reporting agencies to reconcile and confirm intragovernmental activity and balances quarterly for specific reciprocal groupings. TFM Bulletin 2007-03 *Intragovernmental Business Rules,* also provides guidance to Federal agencies for standardizing the processing and recording of intragovernmental activities.

OMB Circular No. A-123 indicates: "Management is responsible for developing and maintaining effective internal control. Effective internal control provides assurance that significant weaknesses in the design or operation of internal control, that could adversely affect the agency's ability to meet its objectives, would be prevented or detected in a timely manner." In addition, "Internal control is an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations." Finally, "documentation for internal control, all transactions, and other significant events [should be] readily available for examination."

Recommendations: We recommend that TSA:

1. Enforce procedures to ensure that all reversing journal entries are made timely.

2. Perform and document monthly reconciliations ofall asset and liability accounts. We recommend that these reconciliations be designed to both detect *and* correct errors and be reviewed and approved at an appropriate level ofmanagement.

3. Reinforce newly developed procedures to ensure that all journal entries are properly recorded, have appropriate support, and are sufficiently reviewed and approved prior to being recorded.

4. Perform monthlyreviewsofits trialbalance prior to its TIERsubmissionto DRS. We recommend that these reviews be designed to both detect *and* correct errors and be reviewed and approved at an appropriateleve1 ofmanagement.

5. Develop and implement procedures to identify and track relevant outcomes and outputs and report them as part of RSSI.

E. Accrued Leave

Background: As part of its compensation package, TSA provides annual leave to employees, which accrues to employees at varying rates based on years of service. Additionally, TSA provides compensatory leave to certain of its salaried employees for working overtime hours that are not compensated through salaries. Finally, TSA may also, in limited circumstances, restore annual leave to certain of its employees on a case-by-case basis. The unused portion of these three types of leave is accrued on TSA's balance sheet as of each period end. As of March 31, 2007, the accrued leave balance equaled $137.6 million.

In order to support the accrued leave balances that its employees have earned, TSA must retain adequate documentation supporting 1) the leave earned since the employee hire date, and 2) the leave used since the employee hire date. TSA relies on its Human Resources Division to retain such documentation.

- For leave earned, appropriate documentation should include the Standard Form 50 (SF-50), *Notification of Personnel Action,* which supports the employee hire date and years of service. The hire date and years of service are necessary to determine at what point and to what extent an employee earns accrued leave.
- For leave used, appropriate documentation should include employee timesheets, which evidence employee use of accrued leave, including supervisory approval thereof.
- For restored annual leave, TSA may restore forfeited balances because it was in excess of the maximum leave ceilings (i.e., 30, 45, or 90 days) if the leave was forfeited because of an administrative error, extraordinary work need of the public business, or sickness of the employee. Evidence of management's approval for these valid reasons should be documented in the employee's file.

Regardless of the manner through which an employee earns accrued leave, at the close of a reporting period, TSA must determine the accrued leave that employees have earned for purposes of calculating an amount to be accrued as a liability. Upon determining the accrued leave hours for each employee, these hours are multiplied by the current hourly pay rate for each employee to calculate the liability to be accrued for each employee. The sum of these calculations performed on an employee basis generates the amount that should be accrued at the close of a reporting period.

Beginning in August 2005, the U.S. Department of Agriculture's (USDA) Office of Chief Financial Officer (OCFO)/National Finance Center (NFC) has functioned as TSA's payroll processor.

Condition: In·perfonning our procedures over the balance·of accrued leave, we selected a statistical sample of 75 employees to detennine if the amount of the accrued leave liability was fairly stated as of March 31, 2007. In perfonning these procedures, we identified the following errors:

- For 62 of the 75 sample items selected, sufficient documentation, in the fonn of SF-50s and timesheets, was not provided because timesheets supporting leave taken were not available before August 21, 2005. For these 62 items, confinnations were sent to employees requesting verification of their accrued leave hours as of March 31, 2007 (pay period 5) as an alternative procedure.
- For 13 sample items for which sufficient documentation was provided, five errors were identified resulting from differences between the leave hours accrued on the TSA-prepared Leave Audit (which is a recalculation of employee leave balances) and the general ledger.
- For the 62 employees to whom confinnations were sent, five were not signed and returned by the employee verifying the accrued leave hours as of March 31, 2007.
- For the 62 employees to whom confinnations were sent, 20 were returned signed by the employee indicating accrued leave hours different from those accrued leave hours used in calculating the accrual as of March 31,2007.

Cause/Effect: As a result of the condition explained above we detennined:

- The annual leave balances.earned by employees per the NFC's output records are not being reconciled with input records submitted by TSA and with the TSA general.ledger on a periodic basis.
- Because of the age of some of the documentation requested, sufficient documentation to support certain accrued leave balances was not available.

Criteria: SFFAS No.5, *Accounting for Liabilities of the Federal Government*, requires Federal agencies to accrue a contingent liability for the existence of past events or transactions which require a probable future outflow of resources when the amount of the liability can be reasonably estimated.

Code of Federal Regulations Title 5, *Chapter* 1, *Part 293.304* states: "The head of each agency shall maintain in the Official Personnel Folder the reports of selection and other personnel actions named in section 2951 of Title 5, United States Code. The folder shall contain long-teim records affecting the employee's status and service as required by OPM's instructions and as designated in the *Guide to Personnel Recordkeeping."*

Chapter 1 of the Office of Personnel Management's (OPM) *Guide to Personnel Recordkeeping,* indicates: "Agencies should have management controls to ensure personnel records:

- Adequately document human resource management operations;

- Are accurate and timely;
- Are protected against loss or authorized alteration;
- Document the employment history of individuals employed by the Federal Government;
- Can be located when necessary; and
- Are retained and disposed of as required by General Records Schedule I."

General Records Schedule 2, Item 7, Time and Attendance Source Records, specifies the period for which timesheets should be retained is 6 years or after a GAO audit, whichever IS sooner.

Recommendations: We recommend that TSA:

1. Develop and implement policies and procedures to reconcile annual leave balances per the NFC's output records to input records submitted by TSA and to the TSA general ledger each pay period. These reconciliations should be documented, reviewed by an appropriate supervisor, and maintained.
2. Develop and perform procedures to enable management to assert to the appropriateness of the "beginning" accrued leave balance at a point in time (e.g., October 1, 2007). For example, these procedures may involve validating leave balances for all TSA employees at the selected point in time. These procedures should require that sufficient documentation be retained for purposes of the annual financial statement audit.

Discussed below are the significant deficiencies that we do not believe are material weaknesses.

F. Accounts Receivable

Background: Fees that fund part of TSA's operations are the result of monthly collections from airlines and passengers. Unremitted fees as of September 30th represent accounts receivable with the public. This receivable is offset by a contra-account for uncollectible amounts as a result of bankrupt air carriers.

Condition: Based on our comparison of the non-federal accounts receivable balances as of September 30, 2007 and 2006, we noted a decrease in the allowance for doubtful accounts balance of $121 million to $49 million and an increase in the gross accounts receivable balance of $261 million to $274 million.

The change in the allowance for doubtful accounts from the prior year primarily relates to current year collections from customers whose balances were initially fully reserved in prior years. TSA's current policy is to reserve 100% for all bankrupt non-paying customers. As several carriers emerged from bankruptcy during the current year, many of these receivables were collected, thus causing a decrease in the allowance for doubtful accounts and the related accounts receivable. Now that many of the major air carriers have emerged from bankruptcy and passenger fee collections have been received, the policy of reserving 100% for all bankrupt carriers should be reassessed. Further, as evidenced through the collections of passenger fees during the current year, the reserve policy for passenger fees should be altered as the passenger fees are only passed through the carriers (i.e., the service has been performed, earned, and paid by the customer; therefore, collections are reasonably assured).

In addition, TSA does not consistently follow up with airlines with delinquent payments and does not consider delinquent payments from individual airlines in determining the allowance for doubtful accounts.

Cause/Effect: TSA's allowance for doubtful accounts does not consider historical collection trends. Further, TSA's process used for identifying and aging receivables for airline and passenger fees is not monitored. As a result, TSA's allowance for doubtful accounts and related accounts receivable maybe misstated.

Criteria: Per paragraph 39 of SFFAS No.7: "When cash has not yet been received at the time revenueis recognized, a receivable should be recorded. An appropriate allowance for estimated bad debts should be established."

Recommendation: We recommend that TSA:

1. Enhance the process to monitor outstanding receivables by airline to include evidence of periodic follow up with the airlines.
2. Review and update the allowance for doubtful accounts methodology to consider the airline collection trends for all airlines.

G. **Human** Resources Documentation

Background: Employees of the U.S. Federal Government are subject to numerous employment-related laws and eligible for various benefits. The Federal Employees' Group Life Insurance Act of 1954 (P.L. 83-598 of August 17, 1954), P.L. 96-427, and P.L. 105-311 gave rise to the Federal Employees' Group Life Insurance (FEGLI) Program which is an employer-sponsored life insurance program under which benefit payments are made following the death or dismemberment of employees and retired employees. The Federal Employees' Health Benefits Act of 1959 (FEHB) was enacted to provide a health benefits program for Government employees. The Fair Labor Standards Act (FLSA) provides for the establishment of fair labor standards in employment. The Civil Service Retirement System Act (CSRS) and Federal Employees Retirement System Act (FERSA) provide retirement plan coverage for eligible employees.

Condition: We selected a sample of 39 employees to determine TSA's compliance with FEGLI, FEHB, FLSA, the pay and allowance system for TSA employees, CSRS, and FERSA in FY 2007. However, for certain employees, TSA was unable to provide us sufficient documentation to support compliance with the laws tested.

Cause/Effect; TSA did not have sufficient processes in place to readily provide documentation to support certain payroll-related transactions.

Criteria: The Government Accountability Office's *Standards for Internal Control in the Federal Government* states, "Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination."

Recommendation: We recommend that TSA:

1. Strengthen procedures to ensure that documentation is readily available to support payroll-related transactions and compliance with payroll-related laws.

H. *Federal Financial Management Improvement Act of 1996*

Passage of the *DHS Financial Accountability Act of 2004* made the DRS an agency covered by the Chief Financial Officers Act of 1990, and. as such, it was then subject to the *Federal Financial Management Improvement Act of 1996* (FFMIA). Prior to fiscal year 2005, DRS was not subject to FFMIA. Section 803(a) of FFMIA requires that agency Federal financial management systems comply with (1) Federal financial management system requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger (USSGL) at the transaction level. FFMIA emphasizes the need for agencies to have systems that can generate timely, reliable, and useful information with which to make informed decisions to ensure ongoing accountability. We noted TSA was not in full compliance with the requirements of FFMIA. Specifically:

- TSA's financial management systems do not comply substantially with Federal financial management system requirements because of certain weaknesses in general computer access controls discussed in Finding A of Exhibit I.

- TSA's financial management systems do not comply substantially with applicable Federal accounting standards because of the material weaknesses related to TSA ability to prepare financial statements and related disclosures consistent with Federal accounting standards related to property and equipment and financial reporting discussed in Findings C and D, respectively, of Exhibit I.

- TSA's financial management systems do not permit use of the USSGL at the transaction level for certain activities discussed in Finding C of Exhibit I.

Recommendation: We recommend that TSA implement the recommendations identified in Findings A, C and D of Exhibit I to address its FFMIA noncompliance.

I. *Federal Managers' Financial Integrity Act of 1982*

The *Federal Managers' Financial Integrity Act* (FMFIA) of 1982 and OMB guidance require the head of each executive agency to annually report whether there is reasonable assurance that the agency's controls are achieving their intended objectives and whether the agency's financial management systems conform to government-wide requirements. Agency heads are required to identify material weaknesses related to agency programs and operations (pursuant to Section 2 of FMFIA (31 U.S.C. 3512 (d)(2))) and nonconformances with government-wide financial systems requirements (pursuant to Section 4 of FMFIA (31 U.S.C. 3512(d)(2)(B))).

OMB Circular No. A-123, *Management's Responsibility for Internal Control,* is OMB's implementation guidance for FMFIA. During fiscal year 2007, the DRS Office of the Chief Financial Officer (OCFO) and the DRS components continued with their implementation of OMB Circular No. A-123, by performing tests of design and operating effectiveness on

entity level controls and other financial accounting and reporting processes as planned. However, TSA's testing process did not identify two material weaknesses that we identified during the course of the fiscal year 2007 audit.
Recommendation: We recommend that TSA fully implement the FMFIA process, as prescribed by the DHS OCFO, to ensure full compliance with FMFIA and its OMB approved plan for Circular No. A-123 implementation.

J. *Debt Collection Improvement Act 0/1996*

As a Federal entity, TSA is required to service and collect debts in accordance with the requirements established by the *Debt Collection Improvement Act of* 1996 (DCIA). In addition, the DCIA requires Federal agencies to refer eligible delinquent non-tax debts to Treasury for debt collection action, if they have not been successful in collecting those debts.

We noted TSA was not in full compliance with the requirements of DCIA during fiscal year 2007. Specifically, TSA's financial management system does not provide sufficient information regarding its fee collections and amounts due from airlines in order to properly identify delinquent debts for referral as further discussed in Finding F of Exhibit II.

Recommendation: We recommend that TSA implement the recommendations identified in Finding F of Exhibit II to address its DCIA noncompliance.

K. Payroll-related Laws

As a Federal entity, TSA is required to be in compliance with the *Federal Employees' Group Life Insurance Act,* the *Federal Employees' Health Benefits Act,* the *Fair Labor Standards Act,* and Pay and Allowance System for Civilian Employees including the *Civil Service Retirement Act* and the *Federal Employees' Retirement System Act.*

During fiscal year 2007, TSA's management did not provide sufficient information regarding certain payroll transactions in order for us to determine TSA's compliance with the payroll-related laws identified above as further discussed in Finding G of Exhibit II.

Recommendation: We recommend that TSA.implement the recommendations identified in Finding G of Exhibit II to address its potential noncompliance with payroll-related laws.

	Summary of Conditions As Reported in 2006 TSA Audit Report	Fiscal Year 2007 Status/ Disposition
A.	Financial Reporting - TSA experienced difficulties completing a timely analysis of security fees previously recorded and associated financial statement effects, meeting the requirements of the DRS June 30 hard close and the September year-end close, and timely and adequately supporting financial transactions.	Partially Repeated (Exhibit I-D)
B.	Financial Systems Security - TSA has information technology and financial system security control weaknesses in entity-wide security program planning and management, access controls, application software development and change controls, system software, and service continuity.	Partially Repeated (Exhibit I-A)
C.	Undelivered Orders and Contract File Maintenance - During the course of the interim compliance, control and substantive testwork, we were unable to obtain in a timely manner sufficient audit evidence to substantiate amounts recorded in TSA's general ledger related to the undelivered order balance.	Partially Repeated (Exhibit I-B)
D.	Property and Equipment - The interim subsidiary data provided by TSA did not reconcile to the trial balance. Based on our sample selection, management was unable to provide adequate supporting documentation for approximately 30% of the selected sample items. TSA's investigation also found the Fixed Assets Module of the general ledger had not been updated since FY 2004 for activity related to a unique organizational segment of the fixed asset balance, including depreciation, additions, and disposals. We also determined that TSA maintains idle property. in a warehouse. These idle property items were in the Fixed Assets Module and continued to be depreciated.	Partially Repeated (Exhibit I-C)

Summary of Conditions As Reported in 2006 TSA Audit Report		Fiscal Year 2007 Status/ Disposition
E.	Journal Voucher Preparation and Approval - A sample of journal vouchers (JVs) from October 2005 to July 2006 was unsupported or only partially supported by sufficient audit evidence.	Partially Repeated and Combined with Condition A above (Exhibit I-D)
F.	Grants Accrual Methodology and Grant Monitoring - The underlying expenditure data used in the accrual percentage and the actual expenditure data subsequently used for comparison/validation purposes may not be complete. Further, TSA had not developed policies and procedures to properly monitor grantees' compliance with OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations.*	Partially Repeated and Reported as a Control Deficiency (in the FY 2007 DHS management letter)
G.	Annual Leave - TSA was unable to provide the requested file with recorded annual leave balances which agreed to the general ledger.	Partially Repeated (Exhibit I-E)
H.	Noncompliance with the *Federal Financial Management Improvement Act 0/1996* - We noted TSA was not in full compliance with the requirements of FFMIA.	Partially Repeated (Exhibit III-H)
I.	Federal Information Security Management Act (Electronic Government Act of 2002) - We noted instances of noncompliance with FISMA.	Combined with FFMIA
J.	Noncompliance with the *Improper Payments Information Act of 2002* - we noted that TSA did not assess one unique organizational segment's programs and activities for susceptibility to erroneous payments.	Corrected

Summary of Conditions As Reported in 2006 TSA Audit Report		Fiscal Year 2007 Status/ Disposition
K.	**Noncompliance with the *Debt Collection Improvement Act of* 1996** - Our procedures identified that policies and procedures were not in place throughout the entire year to ensure Dunning Notices were promptly sent to debtors in accordance with Treasury guidelines. Dunning Notices are the first step before debt can be referred to Treasury's FMS.	Partially Repeated (Exhibit II-J)
L.	**Anti-deficiency Act -** TSA management notified us of an *Anti-deficiency Act* violation that occurred in the TSA, Expenses Account, Treasury Symbol - 70X0508 in an amount up to $195,000,000.	Corrected

U.S. Department of Homeland Security

Office of Financial Management
601 South 12th Street
Arlington, VA 22202-4204

Transportation
Security
Administration

MAR 2 8 2008

Mr. Richard L. Skinner
Inspector General
Department of Homeland Security
245 Murray Drive SW, Building 410
Washington, DC 20528

Dear Mr. Skinner:

This letter responds to KPMG's audit of the Transportation Security Administration (TSA) balance sheet as of September 30, 2007. The audit report notes the considerable financial management progress made by TSA during Fiscal Year (FY) 2007 while pointing out the challenges that remain. We fully concur with KPMG's findings and are taking aggressive action to implement the recommendations provided in the report.

The auditor's report has cited several significant internal control deficiencies, some of which rise to the level of material weaknesses. Following the guidance of the Department of Homeland Security Chief Financial Officer, TSA developed comprehensive Mission Action Plans (MAPs) to correct the material weaknesses in the years ahead. These plans were developed based on FY 2006 audit results, and have been updated to incorporate the findings and recommendations of your FY 2007 report. We report our MAP progress to the department on a monthly basis. We also provide our Management Control Council, a panel of agency leaders formed to oversee TSA's internal management control processes, with quarterly MAP progress reports. We will be glad to discuss our progress with your auditors upon request.

On behalf of Assistant Secretary Hawley, I would like to express my appreciation for the efforts of your staff and the KPMG team in completing this audit. The qualified opinion on the FY 2007 balance sheet represents a significant improvement from the disclaimer of opinion issued in FY 2006. The recommendations in your report help us to focus our corrective actions on the most critical issues as we strive toward our mutual goal of an unqualified audit opinion.

Sincerely,

David R. Nicholson
Assistant Administrator and Chief Financial Officer
Office of Finance and Administration

UNITED STATES DEPARTMENT OF HOMELAND SECURITY
TRANSPORTATION SECURITY ADMINISTRATION

Management's Discussion and Analysis

(Unaudited)

September 30, 2007

INTRODUCTION

The United States Department of Homeland Security (DHS or Department) Transportation Security Administration (TSA or Administration) presents to the American public, Congress, the Office of Management and Budget (OMB), and the transportation industry the current performance of TSA's major programs and a brief description of how the public benefits from them.

The major developments in our program and financial activities and the progress and commitment we have made to meet our strategic goals are described in the following sections of this report.

Management's Discussion and Analysis consists of four sections:

- *Mission and Organization Structure* provides an overview of the Administration's mission, organization, and major program activities.

- *Performance Goals, Objectives, and Results* are designed to ensure that America's transportation security excels in efficiency in protecting the American people.

- *Financial Analysis* highlights TSA's FY 2007 budgetary funding sources, discusses TSA's efforts to improve its financial management systems and procedures, and provides an analysis of TSA's Balance Sheet and stewardship information.

- *Analysis of Systems, Controls, and Compliance* summarizes TSA's FY 2007 *Federal Managers' Financial Integrity Act* Statement of Assurance. TSA's efforts to comply with the *Federal Financial Management Improvement Act* and the *Improper Payments Information Act* are also discussed.

The *Balance Sheet and Related Footnotes* are an important tool in promoting and improving accountability and stewardship over the public resources entrusted to the Administration. This information provides accurate and reliable information used in assessing performance and allocating resources.

Required Supplementary Stewardship Information relates to areas of Federal Government accountability over certain resources entrusted to TSA, and to certain responsibilities assumed by TSA, which are not measured in traditional financial reports. This information focuses on assets and investments made by the government for the benefit of the Nation.

Readers who would like to know more about TSA's programs and organization may access the TSA Internet website at http://www.tsa.gov.

UNITED STATES DEPARTMENT **OF HOMELAND SECURITY**
TRANSPORTATION SECURITY ADMINISTRATION

Management's Discussion and Analysis

(Unaudited)

September 30, 2007

MISSION AND ORGANIZATION STRUCTURE

On November 19, 2001, Congress enacted the *Aviation and Transportation Security Act (ATSA)* which established the Transportation Security Administration. The mission ofTSA is to prevent terrorist attacks and to protect the U.S. transportation network. **In** carrying out this mission, TSA strives always to bevigi1ant,effective and efficient. The organization is led by the Assistant Secretary of Homeland Security for TSA. Field operations, which consist primarily of aviation security activities, report to the headquarters program offices.

Transportation systems move billions of people and trillions of dollars worth of goods each year and are vital to the Nation's economic prosperity, global competitiveness, and national security. TSA recognizes that terrorism risks are asymmetric, and traditional linear thinking can not address the uncertainty and complexity of risks of terrorist attacks on a large, interconnected, and adaptive network like the U.S. transportation system. As a result, TSA'ssecurity strategy focuses on implementing unpredictable, flexible and layered security measures. Within the U.S. aviation system, TSA has strengthened aviation security by deploying thousands of explosive detection systems (EDS), checkpoint x-ray. devices, enhanced metal detectors, and explosive trace detection systems devices. However, the checkpoints constitute only one security layer among many others in place to protect the U.S. aviation system. Other layers include intelligence gathering and analysis, checking passenger manifests against watch lists, canine teams at airports, federal air marshals, federal flight deck officers, flight crew se1f-defense training and more security measures both visible and invisible to the public.

MAJOR PROGRAM ACTIVITIES

The following gives a general overview ofhow TSA endeavors to strengthen the security of, and reduce the risk associated with, the nation's transportation systems.

<u>The Aviation Security</u> program allows TSA to develop and deploy systems and programs to ensure air passengers and air cargo traveling through and entering in the United States are protected through a multi-layered security system. Deployment of technology, increased regulatory inspections and effective use of 10ca11aw enforcement within the airport environment are ongoing efforts, continuing to receive aggressive attention. Improving our ability to detect and deter the use of Improvised Explosive Devices·through technology, training and operational testing is a key goal of this program. Increased and innovative use of canine units, Behavior Detection Officers and Bomb Appraisal Officers will also greatly enhance security and deterrence efforts.

<u>The Law Enforcement! Federal Air Marshal Service (LE/FAMSJ</u> program promotes public confidence in our Nation's aviation and civil transportation systems through the effective risk-based strategic deployment of highly trained Federal Air Marshals and other LE/FAMS law enforcement resources in both air and land-based mission related assignments. TSA continues to engage in an integrated global strategy to help deter terrorism worldwide, encourage the emergence of Air Marshal programs in other countries, and develop operational and training relationships with our international partners. TSA continued its participation in the Crew Member Self Defense Training and the Federal Flight Deck Officer programs. **In** addition, TSA continues to enhance cargo security operations in the aviation sector and train canine teams for use in the commercial passenger aviation, air cargo and mass transit modes, and is implementing the Force Multiplier Program (FMP) to leverage other Federal law enforcement officers flying armed on commerica1 air carriers.

Surface Transportation Security efforts include resources for TSA's security operations in all non-aviation modes of transportation. To enhance security in all modes of transportation, TSA initiated Visual futermodal Protection and Response (VIPR) teams. VIPRs are used to enhance information management among Federal, state and local partners and the private sector. The current surge capability of the VIPR program is to deploy 250 FAMs, 500 Transportation Security Officers (TSO) and 30 canines within a 24 hour period. The mission of the VIPR is to protect the traveling public, deter criminal and terrorist activity, provide surveillance, and report and/or respond to suspicious activity. Different configurations of a VIPR are used to deter criminal and terrorist activity, provide surveillance, and build regional surge capability to the response of threats. TSA will further enhance and expand its VIPR capability to. support TSA's four concentric rings of security - securing infrastructure perimeter; enforcing security and surveillance detection; screening passengers, baggage and cargo; and securing assets.

Transportation. Threat Assessment and· Credentialing serves as the lead for all name based terrorist threat assessments, background check andcredentialing issues surrounding transportation industry workers and domestic passengers. Key initiatives include Secure Flight, Registered Traveler (RT), and the Transportation Worker Identification Card (TWIC).

Transportation Security Support supports the operational needs of TSA's extensive airportlfield and headquarters personnel and infrastructure.

PERFORMANCE GOALS, OBJECTIVES, AND RESULTS

The performance information contained within this report is reliable and complete in accordance with OMB standards.

DRS Strategic Goal = Protect our Nationfrom Dangerous People

Transportation Threat Assessment and Credentialing Performance Goal:	Continue to protect the transportation system from people that threaten its security					
Performance Measure:	Percent of individuals undergoing a Transportation Threat Assessment and Credentialing (TTAC) Security Threat Assessment (STA).					
Fiscal Year:	**FY 2004 Actual**	**FY 2005 Actual**	**FY 2006 Actual**	**FY 2007 Tar et**	**FY 2007 Actual**	**FY 2007 Results**
Actual:	None	None	100%	100%	100%	Met
Description:	This measure indicates the percentage of TTAC's total defined population thatisreceiving an STA. Thorough vetting will decrease vulnerabilities of sensitive transportation systems by limiting access of potentially dangerous individuals who are identified by TTAC vetting and credentialing programs. These populations currently include international flight crews, aviation workers,hazardous material drivers, and non-US citizens receiving flight instruction at the Federal Aviation Administration (FAA) certified flight schools in the U.S. and abroad. In the future,TTAC programs will·also cover domestic airline passengers·and surface transportation and maritime transportation workers.					

Explanation of Results:	Data collected reports the number of individuals vetted by each program, and is closely monitored by TTAC and is reported monthly in TSA's Management Review metrics report. 100% of all those submitted for vetting were vetted. Based on information from sources, no credible attack or threat was reported based on individuals vetted.

DHS Strategic Goal = Protect Critical Infrastructure						
Transportation Security Support Performance Goal:	Manage security risks to critical transportation infrastructure					
Performance Measure:	Percentage of systems certified based on *Federal Information System Management Act (FISMA),* as accepted by DHS and accredited as designated by ChiefInformation Officer (CIa).					
Fiscal Year:	FY 2004 Actual	FY 2005 Actual	FY 2006 Actual	FY 2007 Target	FY 2007 Actual	FY 2007 Results
Actual:	42%	11%	100%	100%	100%	Met
Description:	This is a meaSure of certified IT systems. A certified IT system is a mechanism for providing IT support. A certified IT system undergoes a security accreditation, which is the official management decision given by a senior agency official to authorize operation of an information system and to explicitly accept the risk to agency operations, agency assets, or individuals based on the implementation of an agreed-upon set of security controls. (Note: In FY2004, TSA had only seven operational IT systems. The certification effort became significantly more challenging in FY 2005, when the number of systems spiked up to 107. This resulted in TSAmissing its target. The process has stabilized and the current and future year targets are valid.)					
Explanation of Results:	Data is based upon the successful fulfillment of Federal Information Processing Standard (FIPS) 199,contingency plan and testing, privacy impact assessment, e - authentication, risk assessment, system security plan, security testing and evaluation plan, security assessment report, authorization to operate letter and annual assessments.					

DHS Strategic Goal = Protect Critical Infrastructure						
Aviation Security Performance Goal:	Manage security risks to critical transportation infrastructure					
Performance Measure:	Percent of screeners scoring above the national standard level of Threat Image Projection (TIP) performance.					
Fiscal Year:	FY2004 Actual	FY2005 Actual	FY2006 Actual	FY2007 Ta.r et	FY2007 Actual	FY2007 Results
Actual:	None	SSI*	SSI*	SSI*	S8I*	SSI*
Description:	TransportationSecurity Officers(TSOs) must be proficient in using scanning equipment in order to safeguardthe public against tertoristand criminal aftackson the air transportation system. TSAestablished a standard level of TIP performance, and the measure reflects the percentage ofscreeners performing above the standard. TSOs receiveongoing.training and performance assessments to ensure that their skills are being developed t6 address the variety of threats that may be presented. As threats change and evolve, the TIP program develops					

	new images and training to address the expanded needs of the TSO workforce, allowing TSA to maintain a high level of screener performance that ensures aviation security.
Explanation of Results:	*Sensitive Security Information (SSI): As defined in 49 C.F.R. Section 1520.5, information obtained or developed in the conduct of security activities, including research and development, the disclosure of which DHS/TSA has determined would (1) constitute an unwarranted invasion of privacy (including, but not limited to information contained in any personnel, medical, or similar filed); (2) reveal trade secrets or privileged or confidential information obtained from any person; or (3) be detrimental to the security of transportation.

DRS Strategic Goal = Protect Critical Infrastructure						
Surface Transportation Security Performance Goal:	Manage security risks to critical transportation infrastructure					
Performance Measure:	Percentage of high risk corporate systems on which Corporate Security Reviews have been conducted.					
Fiscal Year:	FY 2004 Actual	FY 2005 Actual	FY 2006 Actual	FY 2007 Target	FY 2007 Actual	FY 2007 Results
Actual:	None	None	31%	100%	87%	Not Met
Description:	This measure indicates the number of Corporate Security Reviews (CSRs) conducted in the pipeline and highway modes. The target universe consists of the largest owner/operators of critical transportation systems. Upon completion of the entire set of systems in the target universe, TSA intends to revisit systems. For the Pipeline Program, the intent of these corporate onsite security reviews is to develop first hand knowledge of security planning and execution at critical pipeline systems, establish communication with key pipeline security personnel, and identify and share smart practices. The Highway and Motor Carrier Corporate Security Review Program (CSR) is an "instructive" review that provides TSA with a general understanding of each state Department of Transportation's ability to protect its key physical and critical assets. In carrying out CSRs, teams of TSA modal experts evaluate and collect physical and operational preparedness information, critical assets, key point-of-contact lists; review emergency procedures and domain awareness training; and provide an opportunity to share smart practices. The on-site voluntary reviews serve to establish baseline data against which to evaluate minimum-security standards and identify coverage gaps within each state to reduce risk.					
Explanation of Results:	Information about conducted assessments (although not always the assessment itself) is shared throughout the federal government as well as with owner-operators of the assets and/or systems that are assessed. The annual target for this measure was to complete 16 Corporate Security Reviews (CSR) for high risk corporate transportation systems allocated between the Pipeline Division (target of 12) and the Highway Motor Carrier (HMC) Division (target of 4 state level). For the year, a total 14 were completed - 13 by Pipeline Division and 1 by HMC. HMC also completed a CSR for the District of Columbia but that CSR is not included in the reported results because of the data source definition for this measure calls for CSRs at the state level.					

	Due to management priorities, HMC focused its efforts on conducting 2,000 other CSRs with owners/operators of different aspects of the highway and motor carrier transportation. These were not done at the State level but instead were conducted with other transport system operators that had high-risk infrastructure or systems.

DRS Strategic Goal = Protect Critical Infrastructure						
Federal Air Marshal Service Performance Goal:	Manage security risks to critical transportation infrastructure					
Performance Measure:	Percentage level in meeting Federal Air Marshal Service (FAMS) mission and flight coverage targets for each individual category of identified risk.					
Fiscal Year:	FY 2004 Actual	FY 2005 Actual	FY 2006 Actual	FY 2007 Target	FY 2007 Actual	FY 2007 Results
Actual:	None	100%	100%	100%	96%	Not Met
Description:	This measure reflects the performance levels of Office of Law Enforcement, Federal Air Marshal Service (OLE/FAMS) coverage of high risk flights based upon impact (geographical location), vulnerability (aircraft destructive potential), threats, and intelligence relative to the availability of resources. Coverage is provided by specially trained armed law enforcement officers referred to as Federal Air Marshals (FAMs). These FAMs are deployed to fly missions on commercial U.S. aircraft for both domestic and international flights that have been identified as High Risk Flights under 10 individual risk categories that are found in the OLE/FAMS Concept of Operations. Coverage is provided using a risk-based management approach for mission planning. *For FY 2003-FY 2005, FAMS was within DHS Immigration and Customs Enforcement.					
Explanation of Results:	Data in support of this measure is closely monitored by FAMS management and the OLE/FAMS Office of Flight Operations. FAMS senior managers/leadership reviews the previous month's performance by the 5th of each month and validates the coverage levels and/or provides guidance on any actions that should be taken to increase any performance measure if deemed appropriate. In addition, FAMS procedures require ongoing quality control steps that include monthly validation checks of between 400 and 500 randomly selected individual flights by Headquarters personnel auditors to validate a reported FAM coverage on a high risk flight. The FAMS flight operations metrics reported monthly to TSA are based on performance targets expressed as a percentage of a number of goals. These goals were set several months prior to the Aug-06 UK threat. The FAMS' continuing response to that threat has resulted in a wide variation in the FAMS' ability to meet several of these goals, which might now be justifiably viewed as outdated. When the FAMS first developed these metrics, however, it was always the intention that the goals would be periodically revisited and adjusted if necessary. With the new fiscal year having begun, it is the intention of the FAMS to readjust the goals, which should in tum reduce the variability that has been reported over the past year.					

PERFORMANCE RESULTS

TSA's ability to achieve its mission, fulfill its performance goals, devise effective strategies, and allocate resources appropriately is enhanced by its understanding of historical trends and performance results. The following are some of the Administration's accomplishments during FY 2007 as they relate to the above-mentioned performance goals:

DHS Goal: Protect our Nation from Dangerous People

Transportation Worker Identification Credential (TWIC)program: The TWIC program, with joint participation by·the United States Coast Guard (USCG), provides security threat assessment and tamper-resistant biometric credentialing to maritime workers who need unescorted access to secure areas of port facilities and vessels.

Electronic Baggage ScreeningProgram (EBSP): The EBSP was initiated by the White House Commission on Aviation Safety and Security at the Federal Aviation Administration (FAA) in 1997. EBSP seeks to strengthen TSA's threat management capabilities through the prevention ofcatastrophic loss and air-piracy by deploying electronic baggage screening technology to as many airports as practical. As EBSP is required to substantially improve the effectiveness and efficiency of the deployed screening equipment, continuous improvements are required to increase equipment reliability and eliminate TSO safety hazards. One EBSP initiative to accomplish these objectives is to eliminate stand alone systems and create an in-line system approach. As of 2007, the EBSP has completed 23 in-line systems of the 24 targeted. To date, TSA has deployed more than 5300 Electronic Trace Detectors and 1500 Explosives Detection Systems.

Transportation Security Officer Career Progression: TSA has evolved its TSO workforce to be highly responsive and effective in addressing the variety of potential threats, such as those presented by liquids, aerosols and gels. TSA's initiative to assume document checking responsibility in high-risk airports in FY 2008 will also add an important layer of defense for aviation security. TSA is committed to retaining and leveraging its workforce to enhance its ability to secure the aviation sector. Continued execution of the TSO Career Progression Program will improve TSA's ability to retain more experienced and better trained TSOs. TSA implemented specialized technical career tracks including Behavior Detection Officers (BDO) and Bomb Appraisal Officers (BAO). BDOs .screen passengers by observation techniques (SPOT) and identify potentially high-risk individuals based on involuntary physical and physiological reactions. BAOs provide consistently higher levels ofimprovised explosive device (IED) training to the workforce while reducing the time needed to investigate suspicious items at airport checkpoints, resulting in fewer operational disruptions. As emerging threats are identified and new technical measures are implemented, this robust and scalable career path is essential to TSA's success.

DHS Goal: Protect Critical Infrastructure

Corporate Security Review (CSR) program: TSA surface modes have performed numerous assessments, including pipelines and highways, by means of .CSRs. A ·CSR ·evaluates security. policies, practices, and procedures; evaluates and collects physical and operational preparedness information, critical asset and key point-of-contact lists, emergency procedures,and domain awareness training; and provides an opportunity to share industry best·practices. The intent of these onsite CSRs is to develop first hand knowledge of security planning and execution at critical infrastructure systems and to establish. communication with industry stakeholders. To date, domestic CSRs, which include physical assessments, continue to be performed. TSA conducts domestic CSRsto learn about critical pipeline and highway infrastructure and the actions companies are taking to mitigate vulnerabilities. For instance, approximately 80 percent of U.S. pipeline commerce is conducted by only 5 percent, or about 100, of the industry's largest transmission·and distribution companies. Reviews have been completed for about 66 of the top pipeline companies. Due to management priorities, Highway Motor Carrier Division(HMC) focused its efforts on conducting 2,000 other CSRs with owners/operators of different aspects of the highway and motor carrier transportation system. For example, TSA has completed 96 CSRs in the highway modality and has entered into agreements with state transportation departments and bridge administrations to conduct additional CSRs of facilities and critical infrastructure. The assessments offer the strategic benefit of face-to-face contact between TSA and company executives, building mutual trust and shared ownership of solutions to security challenges.

FINANCIAL ANALYSIS

PROGRAM BUDGET OVERVIEW

TSA's budget authority is composed of appropriated and fee resources. The fee resources include two broad categories - aviation security fees from airline passengers and air carrier fees. These fees offset TSA's appropriations and direct fee-based programs, such as credentialing fees. More than half of TSA's FY 2007 funding was realized from appropriations. TSA's budget for 2007 (net of rescissions) is listed below:

(Amounts in millions)

		2007
Beginning of Fiscal Year	$	377
Appropriation Received		4,094
Spending Authority from Offsetting Collections		2,556
Other Sources of Budgetary Resources		414
Total	$	7,441

Most of TSA's funding is devoted to achieving overall security in the nation's airports. Other funding is devoted to transportation security for other transportation modes. TSA continues to implement a comprehensive aviation security program by continuing efforts to improve security at airport screening locations and speed the flow of passengers at these checkpoints.

FINANCIAL MANAGEMENT

During 2007, TSA continued to strengthen its financial management operations and controls. Significant progress was made in 2007 in the areas of:

- Management / Internal Control - The TSA Internal Management Control Program, implemented in 2005, continues to be expanded across the agency. TSA has concentrated on strengthening internal control over financial reporting, in accordance with DHS direction. During 2007, TSA cOlnpleted tests of operating effectiveness over entity level controls and fund balance with Treasury controls, as well as tests of design over property accounting, payment management,. and budgetary resources management controls.

- Financial System Controls - TSA continues to strengthen the controls in its core accounting system, most notably in the area of funds checking and certification. During FY 2007, new system-level funds checking controls were implemented to minimize the possibility of overspending account balances. As a result, funds certification functions, which were formerly performed centrally, were delegated to certain TSA program offices. These process improvements provide improved stewardship of resources and increase accountability at the program level.

- Accounting Improvements and Oversight - TSA continues to improve the quality of its accounting· data. During 2007, TSA resolved long-standing errors in its net position and accounts payable balances and restated prior year results accordingly. TSA also instituted new account reconciliation procedures and controls to ensure that the integrity of accounting relationships is maintained and material errors are identified and corrected quickly.

ANALYSIS OF THE BALANCE SHEET

As of September 30, 2007, TSA's total assets increased by about $300 million as compared to the total assets as of September 30, 2006. TSA's assets mostly consist of its fund balances with Treasury (cash), capitalized property and equipment and accounts receivable from public. The increase in total assets results from multiple factors, the most significant of which was the $395 million appropriation received in Public Law 110-28; *Wartime Supplemental Appropriation* that was enacted in May of 2007.

ANALYSIS OF SYSTEMS, CONTROLS AND COMPLIANCE

FEDERAL MANAGERS' FINANICIAL INTEGRITY ACT (FMFIA)

TSA identified the following weaknesses and system non-conformances in its FY 2007 *Federal Managers' Financial Integrity Act* Assurance Statement.

FMFIA Section 2 Material Weaknesses

- ***Anti-Deficiency Act* Violation.** In FY 2006 TSA identified an *Anti-Deficiency Act* violation stemming from erroneous prior-year transactions. Improvements in internal control processes to ensure TSA budget authority is not exceeded are ongoing. This weakness was first reported in FY 2006 asa prior year financial data integrity weakness. Immediately, we·hired experts to discover the root cause and related circumstances that led to the deficiency. Since that time, a detailed Corrective Action Plan (CAP) has been developed that, when fully implemented, will resolve issues that led to the *Anti-Deficiency Act* violation. A working group. on budget·execution was established to implement the CAP and has made improvements in financial and budgetary processes. We are currently preparing the final report which includes identification of the responsible parties and the status of on-going corrective actions; that report will be completed in the first halfofFY2008.

- **Personnel Data Security.** Improvements in internal control processes are required. to ensure safeguarding of sensitive employee data within the Office of Human Capital. This issue was identified in May 2007 when a portable storage device containing sensitive personnel data on TSAemployees was reported missing. As required, an investigation was conducted·and a review of TSA wide processes involving sensitive personnel data was completed. Immediate action was taken to remedy the known deficiency and a CAP has been implemented, that when completed in FY 2008 will resolve this weakness.

FMFIA Section 4 Systems Non-Conformances

- **United States Coast Guard (USCG) Finance Center (FINCEN) system weaknesses identified during prior audit impact TSA.** TSA receives core accounting and financial system support from the USCG FINCEN. Open audit issues identified for USCG FINCEN directly impact TSA conformance with Government-wide financial system requirements. USCG reported a Statement of No Assurance in FY 2007, FY 2006 and FY 2005.
  - Repeat finding from FY 2006 and FY 2005. This weakness is impacted by the multi-year USCG Financial Management Transformation Project initiated this year. TSA will monitor USCG remediation activities and implement compensating controls where possible.

- **Core Accounting System compliance with the U.S. Standard** General Ledger. Certain accounting processes in the USCG-owned Core Accounting System, used by TSA, do not comply with the U.S. Standard General Ledger at the transaction level. Areas of specific non-compliance include recording the purchase of property, plant, and equipment.
  - Repeat finding from FY 2006 and FY 2005. Originally projected for completion in FY 2007 as part of an existing CAP, the USCG was unable to support TSA's request for system upgrade.

The aforementi0ned financial systems non-conformances also prevent TSA from achieving full compliance with the *Federal Financial Management ImprovementAct of* 1996 at this time.

IMPROPER PAYMENTS INFORMATION ACT (IPIA)

During FY 2007, TSA sampled travel and contractual payments made by the Federal Air Marshal Service (FAMS) in making a determination as to the percentage of improper payments. Our review of travel disbursements included verifications for travel authorization, compliance with regulations, proper payment amount, and appropriate approval of each travel voucher. No evidence of improper payments was identified in the 272 travel vouchers that we reviewed. We also reviewed over $26 million in FAMS contracts for improper payments. Results documented an error rate of .03% which is attributable to issues associated with discounts and interest underpayments. A total of 14 underpayments and 1 overpayment were identified.

TSA also·completed a risk assessment of TSA. disbursements made during FY 2006 in order to identify TSA payment areas most susceptible to improper payment. This assessment was completed using specific guidance provided by the Department. Ourassessment reviewed the likelihood of improperpayment for payroll and non-payroll disbursements within TSA's five major program areas: Aviation Security, the FAMS, Surface Transportation Security, Transportation·Threat Assessment and Credentialing, and Transportation Security Support. Specific results reported Aviation Security Payroll as high risk and Aviation Security Non-payroU as medium risk. All other areas were deemed low risk. In accordance with DHS guidance, disbursements for Aviation Security Payroll (high risk) must be tested during FY 2008.

LIMITATIONS OF THE BALANCE SHEET

The balance sheet should be read with the realization that it is for a component of the United States Government, a sovereign entity. It has been prepared to report the financial position for TSA pursuant to the requirements of 31.U.S.C. 35l5(b). While the balance sheet has been prepared from the books and records ofTSA in accordance with U.S. generally accepted accounting principles (GAAP) for Federal entities and in thefonnat prescribed by OMB, the balance sheet is in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

UNITED STATES DEPARTMENT OF HOMELAND SECURITY
TRANSPORTATION SECURITY ADMINISTRATION

Consolidated Balance Sheet

As of September 30, 2007

(Dollars in thousands)

		2007 (Note 10)
ASSETS		
Intragovernmenta1:		
Fund Balance with Treasury (Note 2)	$	3,354,163
Accounts Receivable (Note 4)		691
Advances and Prepayments		1,338
Total Intragovernmenta1		3,356,192
Accounts Receivable, Net (Note 4)		227,974
General Property and Equipment, Net (Note 3)		842,758
Advances and·Prepayments		642
Total Assets	$	4,427,566
LIABILITIES		
Intragovernmenta1:		
Accounts Payable	$	40,407
Other (Note 6)		231,173
Total Intragovernmenta1		271,580
Accounts Payable		530,219
Actuarial FECA Liabilities (Note 5)		693,993
Accrued Payroll and Leave		114,018
Accrued Unfunded Leave (Note 5)		141,632
Other (Note 6)		11,697
Total Liabilities (Note 5)		1,763,139
Commitments and Contingencies (Notes 7)		
NET POSITION		
Unexpended Appropriations-Other Funds		2,241,679
Cumulative Results of Operations-Earmarked Funds (Note 8)		384,356
Cumulative Results of Operations-Other Funds		38,392
Total Net Position		2,664,427
Total Liabilities and Net Position	$	4,427,566

See accompanying notes to Consolidated Balance Sheet.

UNITED STATES DEPARTMENT OF HOMELAND SECURITY
TRANSPORTATION SECURITY ADMINISTRATION

Notes to the Consolidated Balance Sheet

September 30, 2007

(1) Summary of Significant Accounting Policies

(a) Reporting Entity

TSA was created by the *Aviation and Transportation Security Act*, Public Law (PL) 107-71, (the *Act)*, enacted on November 19, 2001, as an agency within the Department of Transportation (DOT). The *Act* transferred the Civil Aviation Security functions and responsibilities of the Federal Aviation Administration (FAA) to TSA not later than 3 months after the date of enactment. TSA assumed responsibility for the Civil Aviation Security functions from the FAA on February 13,2002. TSA's mission is ·to .develop transportation security policies and programs that contribute to providing secure transportation for the American public. Effective March 1, 2003, TSA transferred to the newly created Department of Romeland Security (DRS), as mandated by the *Homeland SecurityAct 0/2002,* PL 107-296.

(b) Basis ofPresentation

The consolidated balance sheet has been prepared from the accounting records of TSA in accordance with U.S. generally accepted accounting principles and the DRS accounting policies, which are summarized in this note.

Intragovernmental accounts result from activity with other Federal agencies. All other accounts result from activity with parties outside the Federal government. Intra-entity transactions and balances have been eliminated from the consolidated balance sheet.

(c) Budgets and Budgetary Accounting

TSA incurs obligations for specified purposes. TSA recognizes budgetary resources as assets when cash (funds held by the Department of the Treasury (Treasury» is made available through Treasury's General Fund warrants or as authorized by Congress through Continuing Resolution.

(d) Basis ofAccounting

Transactions are recorded on both the accrual basis of accounting and on a budgetary basis. Under the accrual method, revenues are recognized when earned, and expenses are recognized when incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds.

(e) Revenues and Other Financing Sources

Congress enacted one-year, multi-year, and no-year appropriations to be used, within statutory limits, for operating and capital expenditures. Additional amounts· are obtained from security fees assessed on the publicand aircartiers pursuant toPL 107-71 and from other federal agencies for services performed by TSA and on their behalf.

(f) Fund Balance with Treasury

TSA· does not maintain cash. in commercial bank accounts or foreign currency balances. Treasury processes cash receipts and disbursements. Fund Balance with Treasury represents amounts remaining as of September 30, 2007. Except for the portion that is due to other parties, this amount is available to pay current liabilities and finance authorized purchases.

(g) Accounts Receivable

Accounts receivable with the public consists of amounts owed to TSA that arise from security fees assessed on the public and air carners pursuant to PL 107-71. An allowance for doubtful accounts is based on specific identification and analysis of outstanding balances for reporting purposes. The allowance is adjusted accordingly at the time of collection or write off during the fiscal year. Accounts receivable is reported net of allowance amounts.

Intragovernmental accounts receivable represent amounts due from other Federal agencies for reimbursable work such as investigative services. All intragovernmental receivables are considered fully collectible.

(h) General Property and Equipment, Net

TSA has two capitalization thresholds, based on instructions from DHS. The first is $25,000 for personal property acquired prior to March 1, 2003, the date that TSA was transferred to DHS from DOT. The second threshold is $50,000 and applies to personal property acquired after March 1, 2003.

Personal property is depreciated using the straight-line method over its useful life, as determined for each general asset category. Depreciation and amortization commences the first month after the asset is placed in service.

Progress payments made pursuant to firm contracts for the purchase of capital assets are recorded in a capital asset account. However, the asset is not subject to depreciation until TSA takes delivery of the asset and the asset is placed in service.

(i) Advances and Prepayments

Payments made in advance of the receipt of goods and services are recorded as advances or prepayments at the time of prepayment and recognized as expenses or capitalized when the related goods and services are received.

(j) Liabilities

Liabilities represent amounts to be paid by TSA as a result of a transaction or event that has already occurred. However, no liability can be liquidated by TSA absent an appropriation or offsetting collection. Liabilities for which an appropriation has not yet been enacted are, therefore, classified as not covered by budgetary resources.

(k) Commitments and Contingencies

TSA recognizes losses for contingent liabilities when such losses are probable and estimable.

(l) *Annual, Sick, and Other Leave*

Annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. At each bi-weekly pay period, the balance in the accrued annual leave account reflects the latest pay rates and unused hours of leave. To the extent that appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of nonvested leave are expensed as used.

(m) *Benefit Plans*

Employees who participate in· the Civil Service Retirement System (CSRS) are beneficiaries of TSA's matching contribution equal to 8.51% of pay for non law enforcement employees and 7.5% for law enforcement employees to their annuity account in the Civil Service Retirement and Disability Fund.

On January 1, 1987, the Federal Employees' Retirement System (FERS) went into effect pursuant to PL 99-335. Most Federal employees hired after December 31, 1983 are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984 could elect either to join FERS and Social Security or to remain in CSRS. For those employees covered by FERS, TSA contributes 11.2% of non law enforcement employees' gross pay and 23.8% for law enforcement officers' retirement. A primary feature of FERS is that it offers a savings plan to which TSA automatically contributes 1% of pay and matches any employee contribution up to an additional 4%. For FERS participants, TSA also contributes the employer's matching share for Social Security.

TSA does not report CSRS or FERS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its. employees. Reporting such amounts is the responsibility of Office of Personnel Management (OPM).

The majority of TSA employees are authorized to participate in the Federal Employees Health Benefits (FEHB) program and the Federal Employees' Group Life Insurance (FEGL!) program, which are administered byOPM.

(n) *Imputed Financing Sources and Costs*

TSA recognizes as imputed financing sources and costs, the amount of accrued pension and post retirement benefit expense for current employees, insurance payments, and judgment fund payments. The assets and liabilities associated with such payments are the responsibility of OPM, Department of Labor (DOL), and Department of Justice (DOJ).

(0) *Net Position*

Net position is the difference between assets and liabilities and comprises unexpended appropriations and cumulative results of operations.

Unexpended appropriations represent the amount of unobligated and unexpended budget authority. Unexpended· appropriations are reduced for appropriations used and adjusted for other changes in budgetary resources, such as transfers and rescissions.

Cumulative results of operations represent the net results of operations since inception plus the cumulative amount of prior period adjustments. This includes the cumulative amount of donations and transfers of assets in and out without reimbursement.

(P) Use of Estimates

TSA has made certain estimates and assumptions relating to the reporting of assets and liabilities and the note disclosures of the consolidated balance sheet. Actual results could differ from these estimated amounts. Significant estimates include the allowance for uncollectible accounts receivable and accounts payable.

(q) Tax Exempt Status

As an agency of the Federal Government, TSA is exempt from all income taxes imposed by any governing body whether it is a Federal, state, commonwealth, local, or foreign government.

(r) Federal Employee Compensation Benefits

The *Federal Employees Compensation Act (FECA)* authorizes income and medical cost protection to covered federal civilian employees who are injured on the job or who have incurred a work-related occupational disease, and to beneficiaries of deceased employees whose death is attributable to a job-related injury or occupational disease. FECA benefit claims for TSA employees are initially paid by DOL and subsequently reimbursed by TSA.

TSA's FECA liability consists of two components: (1) accrued FECA liabilities and (2) actuarial FECA liabilities. Accrued FECA liabilities are claims paid by the DOL but not yet billed to or paid by TSA. Estimated future costs are determined by applying actuarial procedures. The DOL is responsible for calculating the actuarial FECA liability of future compensation benefits for all federal agencies. These benefits include the liability for death, disability, medical, and miscellaneous costs for approved compensation cases. This liability is determined using a paid-losses extrapolation method calculated over a 37-year period. This method utilizes historical benefit payment patterns that relate to a specific period. Projected annual benefit payments are discounted to present value. The resulting liability is then distributed by DOL to each benefiting agency. The DRS calculates and distributes each component's respective portion of the total DRS actuarial liability. It is reported as an extended future estimate of costs which will not be obligated against budgetary resources until the year in which the cost is actually billed to and paid by the TSA.

(s) Non-Entity Assets

Non-entity assets consist of the funds assessed and collected from interest, fines, and penalties. TSA has no authority to use these funds. The funds are deposited and maintained in the General Fund Receipt Accounts. Sections 31-Code of Federal Regulations (CFR)-900 and 49-CFR-89 provide TSA the authority to impose interest, fines, and penalties. The custodial amounts collected are incidental to TSA's operations.

(t) Earmarked Funds

TSA reports the net position for earmarked funds separately from other funds on the consolidated balance sheet and disclosed certain balances of these funds in the notes. This is in accordance with the provisions of the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards (SFFAS} No. 27, *Identifying and Reporting Earmarked Funds,* which became effective October 1, 2005. This standard amended SFFAS No.7, *Revenue and Other Financing Sources,* by:

- elaborating the special accountability needs associated with dedicated collections;
- separating dedicated collections into two categories - earmarked funds and fiduciary activity; and
- defining and providing accounting and reporting guidance for earmarked funds.

See Note 8 for specific required disclosures related to TSA's earmarked funds.

(u) Other Liabilities

The consolidated balance sheet has been prepared using the guidance provided in the Office of Management and Budget (OMB) Circular A-136, "Financial Reporting Requirements". Other Liabilities consist of items such as Accrued FECA Liabilities, Custodial Liabilities, Accrued Payroll and Benefits, Contingent Liabilities, and Accrued Annual and Compensatory Leave Liabilities. To enhance reporting consistency and properly reflect the materiality of certain items, TSA disaggregated Other Assets and Other Liabilities on the balance sheet. Note 6 shows the detail of items that have been reported as Other Liabilities on the balance sheet, and Note 10 provides a Balance Sheet Crosswalk to OMB Circular A-136 classifications.

(2) Fund Balance with Treasury

Fund Balance with Treasury as of September 30, 2007 consists of the following (dollars in thousands):

	2007
Fund Balances:	
Appropriated Funds	$ 2,884,515
Other Fund Types	469,648
Total	$ 3,354,163
Status of Fund Balance with Treasury:	
Unobligated Balance Available	$ 244,473
Unobligated Balance Not Available	445,554
Obligated Balance Not Yet Disbursed	2,656,467
Non-Budgetary	7,669
Total	$ 3,354,163

The Fund Balance. with Treasury is comprised of the aggregate amounts of the entity's accounts with Treasury for which TSA is authorized to make expenditures and pay liabilities. Other fund types include Suspense Accounts, which temporarily hold collections pending clearance to the applicable account, and Deposit Funds, which are established to record amounts held until ownership is determined. It also includes $6.1 million in General Fund Receipt accounts which are non-entity assets.

(3) General Property and Equipment, Net

General Property and equipment balances as of September 30, 2007 consists of the following (dollars in thousands):

Major classes	Useful lives	Acquisition value	Accumulated depreciation	Net book value
Equipment	5-7	$ 2,007,617	$ (1,219,496)	$ 788,121
Construction in progress	N/A	50,569		50,569
Leasehold improvements	5-10	6,071	(2,572)	3,499
Other	N/A	569		569
Total		$ 2,064,826	$ (1,222,068)	$ 842,758

(4) Accounts Receivable, Net

Accountsreceivable balances as of September 30, 2007 consists of the following (dollars in thousands):

	2007
Intragovernmental:	
Accounts receivable	$ 691
Total intragovernmental accounts receivable	691
With the public:	
Accounts receivable	273,992
Allowance for uncollectible accounts	(49,116)
Interest and penalties	3,098
Total accounts receivable with the public	227,974
Total accounts receivable	$ 228,665

The intragovernmental accounts receivable balance consists of reimbursable agreement activity with other DRS components, Department Operations (MGT), Customs and Border Protection (CBP), Science and Technology (S&T), and Information Analysis and Infrastructure Protection (IAlP), owed to TSA.

Interest and penalties of approximately $3.1 million represents non-entity assets.

(5) Liabilities not Covered by Budgetary Resources

TSA's liabilities not covered by budgetary resources as of September 30, 2007 consist of the following (dollars in thousands):

	2007
Intragovernmental:	
Accrued FECA liabilities	$ 145,908
Other employment related liabilities	51,625
Total intragovemmentalliabilities	197,533
Accrued unfunded leave	141,632
Actuarial FECA liabilities	693,993
Total public liabilities	835,625
Total liabilities not covered by budgetary resources	1,033,158
Totalliabilities covered by budgetary resources	729,981
Total liabilities	$ 1,763,139

(6) Other Liabilities

TSA's other liabilities as of September 30, 2007 consist of the following (dollars in thousands):

	Noncurrent liabilities	Current liabilities	Total
Intragovernmental:			
Advances from others	$	$ 4,641	$ 4,641
Accmed FECA liabilities	80,066	65,842	145,908
Employer contributions and payroll taxes payable		28,999	28,999
Other employment related liabilities		51,625	51,625
Total other intragovernmental liabilities	80,066	151,107	231,173
With the public:			
Advances from others		840	840
Custodial liability		9,656	9,656
Liability for deposit and dearing funds		1,201	1,201
Total other liabilities with public		11,697	11,697
Total other liabilities	$ 80,066	$ 162,804	$ 242,870

Other employment related liabilities consist of Unfunded Employment Related Liabilities such as benefits.

(7) Commitments and Contingencies

1) There are several claims which may be asserted against TSA regarding contractual agreements. Of these claims, there are currently four cases where unfavorable outcomes are reasonably possible and the potential losses for these four cases are estimated at $108 million. However, the government anticipates favorable outcomes in all cases. In addition, there are four additional cases asking for $13.5 million, where TSA has been unable to determine the outcome.

2) As of September 30, 2007 TSA has the following types of agreements that have potential liabilities:

a). TSA entered into a number of *Letters of Intent for Modifications* with eight major airports in which TSA may reimburse the airports for 75 percent (estimated total of $957 million) of the cost to modify the facilities for security purposes. These Letters of Intent would not obligate TSA until the funds have been appropriated and obligated. TSA has received appropriations of $188 million in fiscal year 2007 under this program. Since inception of the program through September 30, 2007, TSA has paid $539 million for the costs incurred related to these agreements and has accrued additional costs of $91 million related to invoices or documentation received but not paid as of September 30, 2007.

b) *Contract options with vendors* - In FY 2004, TSA entered into a contract with options that provide TSA with the unilateral right to purchase additional services and or equipment or to extend the contract terms. Exercising these rights would require the obligation of funds in future years.

(8) Earmarked Funds

TSA has the following two special fund receipt accounts that are earmarked funds.

Aviation Security Capital Fund

Fund Description. In FY 2005, P.L. 108-176 established the Aviation Security Capital Fund to finance projects to integrate explosive detection equipment into airport baggage handling systems. In accordance with P.L. 108-176, the first $250 million in aviation security fees collected by TSA is transferred into this fund. These collections, and the associated expenditures made against them, are tracked through a Special Fund account.

Sources of Revenue. Amounts in this fund are collected as fees from the traveling public and the airline industry. They represent an inflow of resources to the government. In FY 2007, a total of $250 million was collected in this fund.

Changes. There has been no change in legislation related to this fund during or subsequent to the reporting period and before the issuance of the balance sheet.

Unclaimed Money Fund

Fund Description. Unclaimed money is money that passengers inadvertently leave behind at airport security checkpoints during screening. In most cases, the monies are coins that passengers empty from their pockets so the metal detectors do not sound. Prior to FY 2005, receipts of unclaimed money were deposited into Treasury's miscellaneous receipt account. In the FY *2005 DHS Appropriation Act* (P.L. 108-334), TSA received statutory budget authority to expend the funding for purposes of providing Civil Aviation Security. Accordingly, beginning in FY 2005, the receipts of unclaimed money were deposited into a Special Fund account so that the resources could be easily tracked and subsequently expended.

Sources of Revenue. Amounts in this fund are collected as involuntary donations from the traveling public. They represent an inflow of resources to the government. In FY 2007, a total of $380 thousand was collected in this fund.

Changes. There has been no change in legislation related to this fund during or subsequent to the reporting period and before the issuance of the balance sheet.

(8) Earmarked Funds (Continued)

Condensed Information for Earmarked Funds

TSA's Earmarked Funds as of September 30, 2007 consist of the following (dollars in thousands):

Balance Sheet	Aviation Security Capital Fund	Unclaimed Money Fund	Combined
Assets			
Fund Balance with Treasury	$ 461,598	$ 380	$461,978
Total Assets	461,598	380	461,978
Liabilities and Net Position			
Liabilities			
Accounts Payable	$ 77,622		$ 77,622
Total Liabilities	77,622		77,622
Net Position			
Cumulative Results of Operations	383,976	380	384,356
Total Net Position	383,976	380	384,356
Total Liabilities and Net Position	$ 461,598	$ 380	$ 461,978

(9) Leases

TSA has a total of 578 occupancy agreements with the General Services Administration for space in airports or surrounding areas. In addition, TSA has 13 lease agreements with the public; they are TSA Headquarters, Transportation Security Operations Center, Clark County Department of Aviation, Gerald R. Ford International Airport, Airport Corporate Center, Massport Administrative Office, Reno/Tahoe International Airport, Greater Rochester International Airport, Integrated Test Facility at Ronald Reagan National Airport, Alexandria International Airport, John Wayne Airport, and two lease agreements with John F. Kennedy International Airport, as well as 20 FAMS lease agreements with the public consisting of the FAMS Headquarters lease in Reston, VA and 18 field offices. Lease expenses were $118 million in FY2007.

Operating Leases:

Future payments consist of the following (dollars in thousands):

Fiscal year:		
2008	$	100,081
2009		78,839
2010		66,238
2011		57,204
2012		51,477
After 2012		68,862
Total	$	422,701

UNITED STATES DEPARTMENT OF HOMELAND SECURITY
TRANSPORTATION SECURITY ADMINISTRATION

Notes to the Consolidated Balance Sheet

September 30, 2007

(10) Balance Sheet Crosswalk to OMB Circular A-136 Classifications

TSA's balance sheet is presented in a format which varies from the format prescribed by OMB Circular A-136. The following table shows reclassification adjustments needed to present the Balance Sheet in the OMB Circular A-136 format (dollars in thousands):

	As Presented	Reclassification Debit	Reclassification Credit	OMB A-136
ASSETS				
Intragovernmental				
Fund Balance with Treasury	$3,354,163	$ -	$ -	$3,354,163
Accounts Receivable	691	-	-	691
Advances and Prepayments	1,338	-	1,338	-
Other	-	1,338	-	1,338
Total Intragovernmental	3,356,192	1,338	1,338	3,356,192
Accounts Receivable, Net	227,974	-	-	227,974
General Property and Equipment, Net	842,758	-	-	842,758
Advances and Prepayments	642	-	642	-
Other	-	642	-	642
Total Assets	4,427,566	1,980	1,980	4,427,566
LIABILITIES				
Intragovernmental:				
Accounts Payable	40,407	-	-	40,407
Other	231,173	-	-	231,173
Total Intragovernmental	271,580	-	-	271,580
Accounts Payable	530,219	-	-	530,219
Actuarial FECA Liabilities	693,993	-	-	693,993
Accrued Payroll and Leave	114,018	114,018	-	-
Accrued Unfunded Leave	141,632	141,632	-	-
Other	11,697	-	255,650	267,347
Total Liabilities	1,763,139	255,650	255,650	1,763,139
Commitments and Contingencies	-	-	-	-
NET POSITION				
Unexpended Appropriations - Earmarked Funds	-	-	-	-
Unexpended Appropriations - Other Funds	2,241,679	-	-	2,241,679
Cumulative Results of Operations-Earmarked Funds	384,356	-	-	384,356
Cumulative Results of Operations-Other Funds	38,392	-	-	38,392
Total Net Position	2,664,427	-	-	2,664,427
Total Liabilities and Net Position	4,427,566	255,650	255,650	4,427,566

(11) Adjustment for Error in Depreciation

The General Property and Equipment balance was adjusted for a correction of an error relating to the calculation of depreciation for the Explosive Detection Systems (EDS). Since FY 2004, TSA used the factory acceptance test date (date at which TSA took title to the equipment) for the start of the useful life of this equipment for depreciation purposes. As a result of an intensive review of the records during fiscal year 2007 and analysis of accounting standards, it was apparent that the proper application of U.S. generally accepted accounting principles (GAAP) requires the useful life, for depreciation purposes, to begin when the equipment is installed, tested, and accepted for operation. The adoption of the site acceptance testing date to begin depreciation on the EDS is considered a correction of an error and should be applied retroactively under GAAP. This correction reduced the reported accumulated depreciation and depreciation expense from FY 2006 and prior and increased the FY 2007 beginning General Property and Equipment, Net balance by $58 million.

UNITED STATES DEPARTMENT OF HOMELAND SECURITY
TRANSPORTATION SECURITY ADMINISTRATION

Required Supplementary Stewardship Information

(Unaudited)

September 30, 2007

	2003 (unaudited)	2004 (unaudited)	2005 (unaudited)	2006 (unaudited)	2007 (unaudited)
Nonfederal property:					
Airport improvement program	$ -	$ 259,437	$ 211,447	$ (107,132)	$ 266,479
Airport renovation program	-	-	95,910	(13,998)	56,574
Port Security program	2,278	215,467	77,906	5,904	68,009
Intericty bus program	-	18,340	8,324	(3,609)	2,943
Total	$ 2,278	$ 493,244	$ 393,587	$ (118,835)	$ 394,005
Human capital:					
Highway watch cooperative agreement	$ -	$ 7,532	$ 21,020	$ 12,211	$ 317
Total	$ -	$ 7,532	$ 21,020	$ 12,211	$ 317
Research and Development:					
Applied research projects	$ -	$ 30,138	$ 22,979	$ 18,452	$ 13,324
Operation safe commerce	-	50,236	8,276	3,484	10,703
Total	$ -	$ 80,374	$ 31,255	$ 21,936	$ 24,027

Stewardship Investments

Stewardship investments are the costs incurred by the Federal Government for the benefit of the United States. These investments represent federally financed (but not federally owned) purchases, construction, or major renovations of physical property owned by state and local governments, including major additions, alterations, replacements, and the purchase of major equipment; and the purchase or improvement of other physical assets. Though the cost is treated as expenses to determine TSA's net cost of operations, these items merit special treatment so that users of Federal financial reports know the extent of investments that are made for the long-term benefit of the United States.

Originally, TSA did not report FY2003 expenditure data because the grant program was new and TSA determined it to be immaterial. Since this data was not captured in FY2003 and TSA has since migrated financial systems, the FY2003 expenditure amount is based on currently available information.

During FY 2004, the grant award functions of the TSA Maritime and Land Security programs were transferred to another DHS component. The transfer was accomplished in two phases. Program development and program management functions associated with the programs transitioning from TSA were integrated with the other component's existing program development and program management operations. The staffers associated with those functions were detailed to the other component, with permanent transfer at the end of FY 2004. Financial management functions for all grants issued prior to FY 2005 remain with TSA.

In FY 2006, it was determined that the accrual methodology related to stewardship investments used in FY 2005 resulted in an over-accrual. Therefore, TSA changed its method for calculating an accrual related to stewardship investments in FY 2006. This new methodology resulted in a much smaller calculated accrual. Since the FY 2006 actual expenses and calculated accrual were smaller than the reversal of the over-accrual in FY 2005, negative numbers are presented for certain nonfederal property investments. Since the negative amounts were due to a change in accrual methodology rather than an error or change in application of an accounting principle, TSA decided not to restate prior years' data.

Investments in Nonfederal Property

Airport Improvement Program – TSA purchases and installs in-line explosive detection systems (EDS) equipment through a variety of funding mechanisms, including Congressionally authorized Letters of Intent (LOIs). LOIs provide partial reimbursement to airports for facility modifications required to install in-line EDS solutions. TSA has issued eight LOIs for eight agreements to provide for the facility modifications necessary to accommodate in-line EDS screening solutions for these agreements.

In-line systems also allow TSA to achieve maximum baggage throughput capacity. For example, a stand-alone EDS can screen 180 bags per hour, while an in-line unit can screen 450 bags per hour. An added benefit is that installation of an in-line EDS system removes checked baggage screening operations from the airport lobby. However, in-line EDS systems are considerably more costly than stand-alone EDS, and many airports are not configured to accommodate installation of EDS technology in-line without extensive facility modifications. These funds are available only for physical modification of commercial service airports for the purpose of installing checked baggage EDS.

Airport Renovation Program - TSA entered into Other Transaction Agreements with 17 airports. These other transaction agreements are to establish the respective cost-sharing obligations and other responsibilities of the TSA and the specific entity (Board, Port, or Authority) relating not only to the installation of integrated and non-integrated EDS and Explosives Trace Detection (ETD) equipment, but also to the improvements to be made to the existing systems, in the baggage. handling area. All work will be completed in order to. achieve compliance with the *Aviation and Transportation Security Act (ATSA)* Public Law 107-71, November 19, 2001.

Port Security Grant Program - This program provided grants to critical national seaports to support the security efforts at the port through enhanced facility and operational security. These grants contribute to important security upgrades such as surveillance equipment, access controls to restricted areas, communications equipment, and the construction of new command and control facilities.

Intercity Bus Security Program - This program piovides funds to improve security for intercity bus operators and passengers. TSA awards grants based on the following program categories:

- Vehicle specific security enhancements to protect or isolate the driver, such as alarms and security mirrors.
- Monitoring, tracking, and communication technologies for over-the-road buses.
- Implementation and operation of passenger and baggage screening programs at terminals and over-the-road buses.
- Development of an effective security assessment/security plan that identifies critical security needs and vulnerabilities.

- Training for drivers, dispatchers, ticket agents, and other personnel in recognizing and responding to criminal attacks and terrorist threats, evacuation procedures, passenger screening procedures, and baggage inspection.
- Facility security enhancements (alteration/renovation) to terminals, garages and facilities, including but not limited to: fencing, lighting, secured access, locking down of vehicles, and securing of bus yards/depots.

Investments in Human Capital

Highway Watch Cooperative Agreement - This cooperative agreement between TSA and the American Trucking Association (ATA) expands ATA's Highway Watch program, which educates·highway professionals to identify and report safety and security situations on our Nation's roads. The program provides training and communications infrastructure to prepare 400,000 transportation professionals to respond in the event they or their cargo are the target of a terrorist attack and to share valuable intelligence with TSA if they witness potential threats. The intelligence allows Federal agencies and industry stakeholders to quickly move to prevent an attack or to immediately respond if an attack occurs.

Investments in Research and Development

Applied Research Projects - TSA funds applied research projects and grants to develop advance security technology equipment and systems. Projects include partnerships with George Mason University, the Regional Maritime Security Coalition, and the Federal Aviation Administration. These applied research projects include human factors research intended to enhance screener capabilities, improve person-machine performance, and increase human system effectiveness; ongoing certification testing of EDS and ETD technology; and infrastructure protection research related to using biometrics for passenger access controls and tracking.

Operation Safe Commerce - Operation Safe Commerce is a pilot program that brings together private business, ports, local, state, and federal representatives to analyze current security procedures for cargo entering the country. The ports of Seattle and Tacoma, Los Angeles and Long Beach, and the Port Authority of New YorklNew Jersey are participating in the pilot program. The program functions like a venture capital fund to utilize existing technology to monitor the movement and integrity of containers through the supply chain. Selected ports test new technologies and initiatives in selected supply chains. The new technologies look at improving security during the process of stuffing and deconsolidating. containers, physically securing and monitoring containers as they are transported through the supply chain, and exchanging timely and reliable communication.

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- Email us at DHSOIGHOTLINE@dhs.gov; or
- Write to us at:
  DHS Office of Inspector General/MAIL STOP 2600, Attention:
  Office of Investigations - Hotline, 245 Murray Drive, SW, Building 410,
  Washington, DC 20528.

The OIG seeks to protect the identity of each writer and caller.