Department of Homeland Security Annual Financial Report

Fiscal Year 2008

Homeland
Security

About this Report

The Department of Homeland Security *Annual Financial Report* for Fiscal Year 2008 presents the Department's detailed financial information relative to our mission and the stewardship of those resources entrusted to us. It also provides readers with a sense of the Department's priorities, and our strengths and challenges in implementing programs that enhance the safety of our Nation.

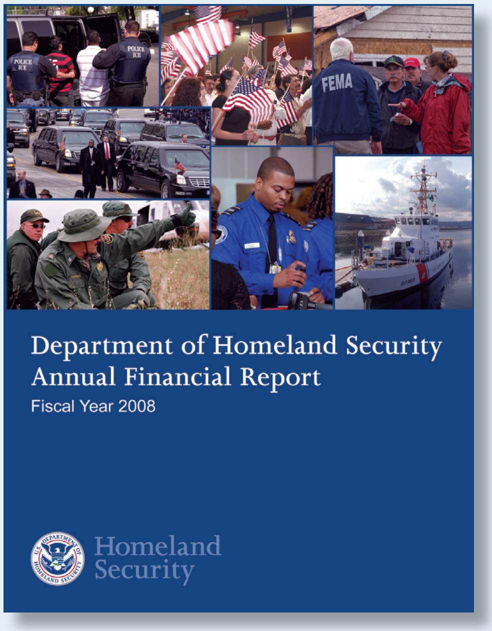
The Department is in its second year of an OMB pilot program to produce its Performance and Accountability Reports using an alternative approach. The pilot for FY 2008 consists of the following three reports:

- **DHS Annual Financial Report** –
  Published November 17, 2008

- **DHS Annual Performance Report** –
  Published by January 15, 2009

- **DHS Citizens' Report** –
  Published by January 15, 2009

All three reports are located at our public website at the address to the left of this box.



The Department of Homeland Security's FY 2008 Annual Financial Report is available at the following website:
http://www.dhs.gov/xabout/budget/editorial_0430.shtm

For more information or to obtain additional copies, contact:

Department of Homeland Security
Office of the Chief Financial Officer
Program Analysis and Evaluation (PA&E)
245 Murray Lane, SW
Mailstop 200
Washington, D.C. 20528

par@dhs.gov
(202) 447-0333

Table of Contents

Message from the Secretary

November 17, 2008

I am pleased to submit the Department of Homeland Security's (DHS) Annual Financial Report for Fiscal Year (FY) 2008. It is no accident that we have not suffered a major terrorist attack on U.S. soil since September 11, 2001. It is the result of the President's leadership and the hard work and constant vigilance of hundreds of thousands of men and women who work tirelessly both at home and overseas to protect our country. It also demonstrates the value of effective financial management which gets funding and resources to the men and women on the front lines of homeland security.

In our five years since stand up, we have strengthened our financial management operations and internal controls to protect against waste, fraud, and abuse and become better, more transparent stewards of taxpayer dollars. This report demonstrates the effects of our hard work to ensure taxpayer dollars are accurately accounted for and efficiently used. For the second consecutive year, we made significant progress improving Department-wide internal controls for financial reporting. As a result, I am able to provide assurances that internal controls over financial reporting are designed effectively, with the exception of the material weaknesses noted later in this report. Additionally, the performance measures for the Department are complete and reliable, and will be discussed in more detail in the forthcoming Annual Performance Report. The Annual Financial Report is an alternative approach to the consolidated performance and accountability report published in previous years. DHS's performance and accountability reports for this and previous years are available at our public website: http://www.dhs.gov/xabout/budget/editorial_0430.shtm.

DHS has made tremendous progress in protecting our Nation from dangerous people and goods, protecting the Nation's critical infrastructure on which our lives and economic prosperity depend, strengthening the Nation's preparedness and emergency response capability, and unifying departmental operations and management. Significant accomplishments include the following:

We are ***protecting our Nation from dangerous people*** through effectively controlling our borders, protecting our interior, and strengthening the screening of travelers and workers. DHS is bringing a multi-layered approach to keeping dangerous people out of our country while welcoming those who seek to legally come to the United States. U.S. Customs and Border Protection continued to train and equip new Border Patrol agents and has constructed 358 miles of fencing, with 204 miles of primary pedestrian fence and 154 miles of vehicle fence in place as of the end of FY 2008. We are well on our way to the goal of constructing 661 miles of fencing along our borders in areas identified as priorities by the Border Patrol. Additionally, U.S. Immigration and Customs Enforcement removed or returned more than 295,000 illegal aliens and dramatically increased the penalties against employers whose hiring process violates the law. We continue to ensure aviation security and strengthened airport screening operations through the efforts of the Transportation Security Administration.

We are ***protecting our Nation from dangerous goods*** that could be used to attack our Nation by preventing and detecting radiological, nuclear, biological, chemical, and other explosive materials from entering our country. We are also preventing illicit contraband from crossing our borders while facilitating trade. DHS has deployed more than 1,000 radiation detection devices to the Nation's land and sea ports of entry. We are scanning 97 percent of inbound cargo at border crossing points and sea ports through fixed radiation detection monitors. DHS has deployed biological monitoring units in over 30 jurisdictions across the Nation to provide critical early detection of dangerous biological pathogens. In the event of a widespread biological agent release, early detection will be critical to saving lives. We have invested in new technology to develop innovative ways to identify and defeat improvised explosive devices, a weapon of choice of our enemies. And DHS continued to thwart those wishing to smuggle drugs, guns, and other illicit contraband into our country.

We are ***protecting critical infrastructure*** while ensuring continuity of government communications and operations, improving cyber security and protecting transportation sectors. Under the direction of the National Protection and Programs Directorate, we have assessed and put in place protective measures in 100 percent of the Nation's high-risk key infrastructure. Our cyber intrusion detection system, EINSTEIN, is now deployed at 15 Federal agencies. Having to await necessary infrastructure improvements, we fell short of our EINSTEIN deployment target this year, but we plan to continue deployment in the coming year. Additionally, we deployed a new Travel Document Checking process that adds a layer of defense for aviation security by ensuring only passengers with authentic boarding passes can access the sterile area of airports and board aircraft.

We are ***strengthening our Nation's preparedness and emergency response capabilities*** by empowering Americans and governments at all levels to be prepared, capable and ready to respond to adverse incidents. The recent coordinated response by the Federal, State, and local communities during this year's hurricane season is a testament to the level of preparedness our Nation has achieved. It is also a demonstration of the soul of this country -- as countless individuals put themselves in harm's way to lend a helping hand to those in need. The Federal Emergency Management Agency took steps to ensure we were prepared for Hurricane Ike, without leaving those recovering from Gustav, Hanna, Fay, Edouard, and Dolly behind. We had a plan that allowed us to respond to multiple events. We supported Texas and Louisiana with millions of meals, bottles of water and pounds of ice, hundreds of generators, and hundreds of thousands of blankets and cots.

We are ***strengthening and unifying DHS operations and management*** by improving Department governance and performance, advancing intelligence and information sharing, and integrating policy, planning and operations coordination. A central part of our efforts to improve operations and unify the Department is reducing the number of worksite locations in the National Capital Region. Plans are in place to establish a single location for headquarters operations at St Elizabeth's in Washington, D.C. DHS has also demonstrated significant progress implementing a comprehensive set of security controls for all information technology systems and security controls design is now embedded in the department's System Engineering and Life Cycle process. Additionally, a significantly enhanced security operations program now ensures security controls remain effective throughout a system's lifecycle and security incidents are identified in real-time and are fully investigated, and addressed as quickly as possible. To advance the use of intelligence and information sharing, we are working more effectively within DHS and with external intelligence agencies and our State and local partners. And, we are instituting more rigorous analytical processes to ensure we fund programs that effectively reduce the risk to the American public.

This is just the beginning. As identified in our financial statements, DHS has $43 billion in undelivered orders. This means we've taken actions which will continue to provide additional equipment, infrastructure, and capabilities for years to follow. For example, we have contracts in place to deliver items such as two new National Security Cutters, three new Maritime Patrol Aircraft, hundreds of miles of border fencing, additional explosive detection systems for more than thirty airports, and twenty-six new border patrol stations. In addition, we have made available billions of dollars in grants to State and local communities that they will use to strengthen their preparedness and response capability. These and other investments are in place to deliver enhanced capabilities and outcomes well into the future.

Together we will continue to improve our operations and strengthen the Department to make our Nation safer everyday.

Sincerely,

Michael Chertoff

Management's Discussion and Analysis

The ***Management's Discussion and Analysis*** **(MD&A)** section explains the Department's mission, goals, and organization, and summarizes program and financial performance.

See *inside front cover* for a description of the DHS pilot approach to performance and accountability reporting.

Mission and Organization

Our Mission

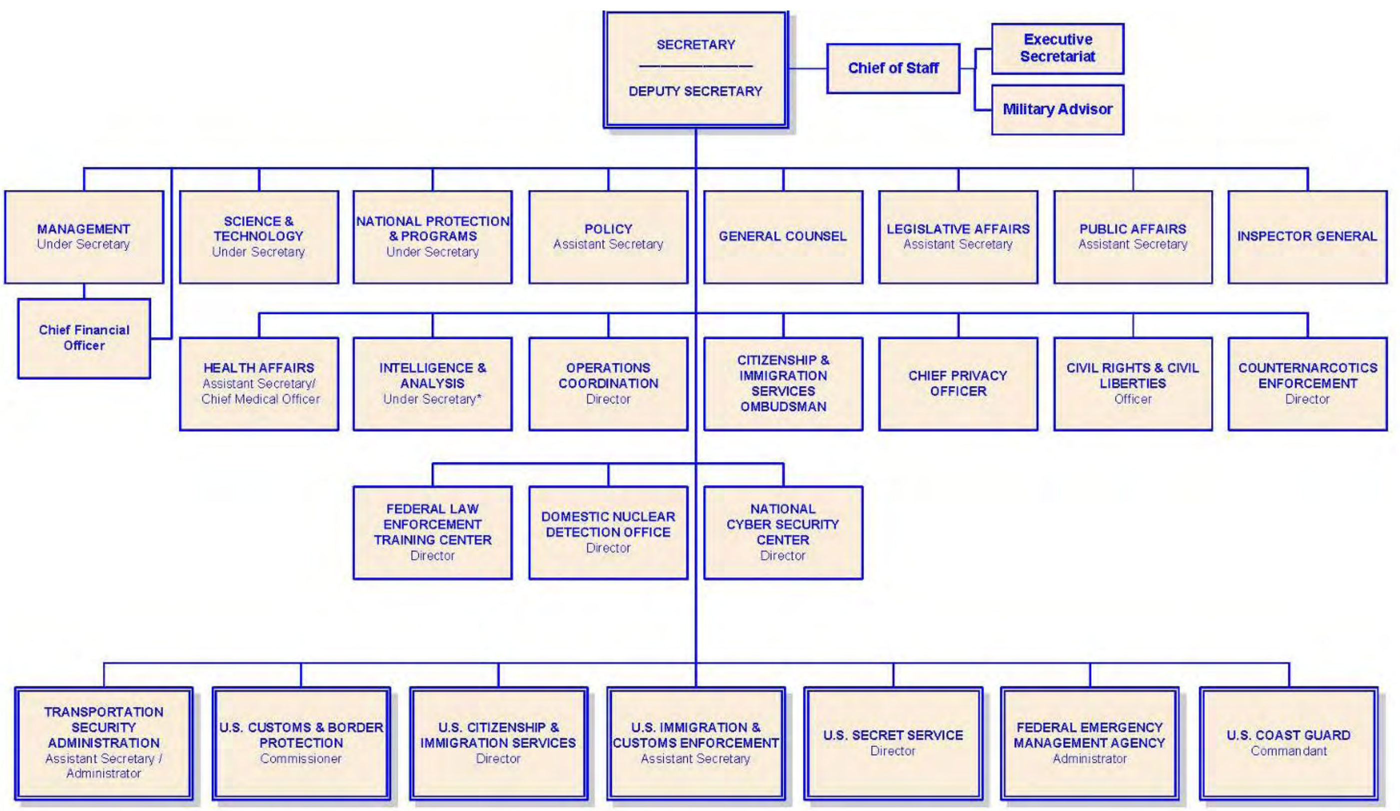
We will lead the unified national effort to secure America. We will prevent and deter terrorist attacks and protect against and respond to threats and hazards to the Nation. We will secure our national borders while welcoming lawful immigrants, visitors, and trade.

See our Strategic Plan at http://www.dhs.gov/xabout/strategicplan.

Our Organization

Homeland Security leverages resources within Federal, State, local, and tribal governments, coordinating the transition of multiple agencies and programs into a single, integrated agency focused on protecting the American people and their homeland. The seven front-line Components, listed along the bottom of the chart below, provide the bulk of the operational efforts the Department puts forth on a daily basis to protect the Nation. The remainder of the organization provides key resources, analysis, equipment, research, policies, and support to ensure the front-line organizations have the means to accomplish the DHS mission. For more information visit our website at http://www.dhs.gov/xabout/structure.

Figure 1. DHS Organizational Chart



* Under Secretary for Intelligence & Analysis title created by Public Law 110-53, Aug. 3rd, 2007

Goals and Objectives

Goal 1. Protect our Nation from Dangerous People

Objective 1.1: Achieve Effective Control of Our Borders
Achieves outcome of: Reducing the risk of potential terrorists, instruments of terrorism, or other unlawful activities from entering the United States through our borders.
Objective 1.2: Protect Our Interior and Enforce Immigration Laws
Achieves outcome of: Improving the protection of our Nation by enforcing immigration laws.
Objective 1.3: Strengthen Screening of Travelers and Workers
Achieves outcome of: Reducing the risk that potential terrorists will exploit travel and employment opportunities to harm our Nation.
Objective 1.4: Improve Security through Enhanced Immigration Services
Achieves outcome of: Preventing terrorists from exploiting our immigration process while enhancing immigration services.

Public Benefit

Protecting our Nation from dangerous people is one of the key priorities of the Department. To accomplish this, control of our borders is essential to ensure dangerous people are not entering the country. We continue to increase the number of border patrol agents and miles of fencing and barriers in areas of highest risk for illegal crossings. We also work to enforce our maritime security to prevent illegal encroachment of the United States exclusive economic zone. By continued enforcement of our immigration laws, we find illegal aliens already in our country and work to ensure the proper enforcement consequence occurs. Efforts continue to ensure that those entering the country at land ports of entry are compliant with laws, rules, and regulations. While we strive to keep out dangerous people, we also diligently work to enhance our immigration services in a timely manner for those who qualify. These combined efforts focus resources in those areas of highest risk to bring a multi-layered approach to keeping dangerous people out of our country, while welcoming those who seek to come through legal channels.

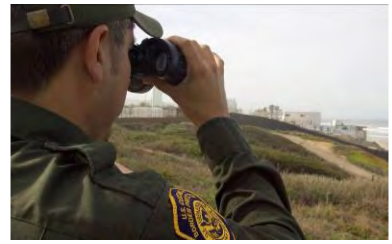
Below are a small set of highlighted performance measures to communicate our accomplishments related to Goal 1. A complete list of all the performance measures, with full descriptions and explanations, will be published in the DHS Annual Performance Report on January 15, 2009.

Table 1. Highlighted Performance Measures for Goal 1

Performance Measure	Objective Supported	FY 2006 Results		FY 2007 Results		FY 2008 Results	
		Target	Result	Target	Result	Target	Result
Border miles under effective control	1.1	388	449	524	599	674	757
Percent of at-risk miles under strategic air surveillance	1.1	50%	55%	60%	60%	70%	84%
Number of incursion into the U.S. exclusive economic zone (EEZ)	1.1	< 199	164	< 199	119	< 195	81
Percent of closed investigations which have an enforcement consequence (arrest, indictment, conviction, seizure, fine, or penalty)	1.2	38.5%	36.4%	36.5%	35.8%	36.6%	46.3%
Land border passengers compliant with laws, rules, and regulations	1.3	99.9%	99.9%	99.9%	99.97%	99.9%	99.9%
Average cycle time to process form N-400 (Application for Naturalization)	1.4	≤ 6 months	5.58 months	≤ 7[1] months	6.2 months	≤ 5 months	8.7[2] months

1. *Target increased due to change in measurement to include time for the actual citizenship ceremony.*
2. *Target not met predominantly due to a record number of applications in advance of fee increases enacted late FY 2007.*

Controlling the Border



DHS has made steady progress toward protecting our country from the threats of global terrorism, illegal migration, and trafficking of narcotics and other contraband; protecting our economy by enforcing trade laws, intellectual property rights, and collection of revenue on goods imported into the United States; protecting our food supply and agricultural industry from pests and disease; and increasing the security of our airspace. Significant investments in personnel, tactical infrastructure, technology, and air assets have led to a decrease in attempted illegal border crossings, as seen by the reduction in overall apprehensions. U.S. Customs and Border Protection's (CBP) border patrol expanded to over 17,000 agents by the end of FY 2008. CBP's Air and Marine is the largest civilian law enforcement air and marine force in the world, operating 272 aircraft to include unmanned aerial systems, and 181 marine vessels from 45 locations throughout the United States. In addition, through the Secure Border Initiative (SBI) Program Office, CBP has constructed a total of 204 miles of pedestrian fence and 154 miles of vehicle fence through the end of FY 2008.

Secure Communities Initiative Unveiled

U.S. Immigration and Customs Enforcement (ICE) unveiled the Secure Communities initiative in March 2008 which is a comprehensive plan to enforce our immigration laws. Secure Communities is a multi-year initiative to more effectively identify, detain and return removable criminal aliens incarcerated in Federal, State and local prisons and jails. ICE's plan will apply risk-based methodologies, use expanded integration technology, and build upon the relationships with State and local law enforcement agencies to ensure that incarcerated criminal aliens are removed from the country instead of being released into our communities after their time in custody.

Looking Forward

Below are some highlights of our plans for the near future.

- ***Border Patrol Agents*:** CBP plans to double the number of Border Patrol Agents from 10,717 in 2003 to 21,519 in 2012 continue increased enforcement along the border.
- ***Western Hemisphere Travel Initiative (WHTI):*** CBP's implementation of infrastructure and technology in support of WHTI will complete investments for implementation of this secure document requirement at land and sea border ports of entry by June 2009.
- ***E-Verify:*** This U.S. Citizenship and Immigration Services program will deploy additional staff covering information status verifiers, compliance, and monitoring. The program allows employers to use an automated system to verify employment eligibility of both citizen and noncitizen new hires.
- ***Secure Flight:*** The Secure Flight Program will be accelerated and will replace the current airline-managed passenger vetting program with a government-operated program.
- ***Automation Modernization of Information Technology Systems:*** ICE will acquire secure and interoperable tactical communications equipment, a biometric detainee location tracking module, and develop and integrate an enhanced Investigative Case Management system.
- ***Identity Management and Screening Services:*** The National Protection and Programs Directorate's US-VISIT Identity Management and Screening Services program will complete biometric interoperability between multiple Federal law enforcement database systems.

Goal 2. Protect our Nation from Dangerous Goods

Objective 2.1: Prevent and Detect Radiological/Nuclear Attacks
Achieves outcome of: Reducing the risk of a nuclear or radiological attack in the United States.
Objective 2.2: Prevent, Detect, and Protect Against Biological Attacks
Achieves outcome of: Reducing the risk of a biological attack in the United States.
Objective 2.3: Prevent and Detect Chemical and Explosive Attacks
Achieves outcome of: Reducing the risk of a chemical or explosive attack in the United States.
Objective 2.4: Prevent the Introduction of Illicit Contraband while Facilitating Trade
Achieves outcome of: Reducing the amount of illicit contraband that enters the United States while facilitating trade.

Public Benefit

Protecting our Nation from dangerous goods is another crucial element to our national security. One of the most devastating attacks could come in the form of a nuclear or radiological weapon. To counter this threat, the Department is scanning over 97 percent of all inbound cargo, using radiation portal monitors at our land and sea ports of entry, for nuclear and radiological materials that could be used to harm our Nation. We are also continuing our collaboration with other countries to scan cargo overseas prior to departure for the United States and to improve the security of the international cargo supply chain. To prevent, detect, and protect against biological attacks, the Department is using risk-based threat assessments to prioritize efforts to detect, characterize, and respond to biological attack. The Department is also focused on improving our ability to reduce the risk of chemical and explosive attacks, and to guard against unlawful goods entering the United States with minimal impact to legitimate trade. Below are a small set of highlighted performance measures to communicate our accomplishments related to Goal 2.

Table 2. Highlighted Performance Measures for Goal 2

Performance Measure	Objective Supported	FY 2006 Results		FY 2007 Results		FY 2008 Results	
		Target	Result	Target	Result	Target	Result
Percent of cargo, by volume, that passes through fixed radiation portal monitors at land and sea ports of entry	2.1	---	85%	90%	94%	95%	97%
Percent of worldwide U.S.-destined containers processed through Container Security Initiative (CSI) ports	2.1	81%	82%	86%	86%	86%	86.1%
Compliance rate of Customs-Trade Partnership Against Terrorism (C-TPAT) members with established C-TPAT security guidelines	2.1	90%	98%	95%	98%	95.5%	99.9%
Percent of the population in BioWatch jurisdictions covered by outdoor biological monitoring units	2.2	---	---	---	---	*	*
Percent completion of an effective restoration technology to restore key infrastructure to normal operation after a chemical attack	2.2	25%	25%	35%	30%	40%	58%
Baggage security screening assessment results	2.3	---	---	---	*	*	*
Percent of truck and rail containers screened for contraband and concealed people	2.4	10.25%	32.8%	33%	40%	42%	35.8%[1]
Percent of border vehicle passengers in compliance with agricultural quarantine regulations	2.4	94.6%	92.9%	94.6%	95.7%	94.6%	97.7%

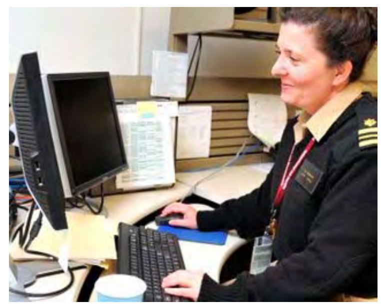
Note: Some performance measures have historical results but not historical targets.
* This information is classified or controlled unclassified information.
1. Targeting rules underwent refinement in FY 2008 resulting in an overall reduction in the number of mandatory examinations required.

Integrated Strategy for Radiation Detection

The Department, in cooperation with Federal, State, local, territorial, and international partners, has developed and is implementing a comprehensive Global Nuclear Detection Architecture to prevent the entry of radiological and nuclear weapons or materials into the United States. This architecture is risk-based, intelligence-driven, and built around a multi-layered strategy that starts overseas, continues at our borders, and is maintained within the U.S. interior to thwart the use of one of the most serious threats to our Nation, the terrorist use of nuclear and radiological materials.

Just a few years ago, we did not scan any of this cargo for radiation. We are currently scanning cargo at home ports of entry and closing gaps along the land, air, and sea borders. In total, through the efforts of the CBP field offices and the Domestic Nuclear Detection Office (DNDO), we now scan over 97 percent of the millions of containers entering our ports of entry each year. In an effort to extend our radiological detection efforts overseas, DHS is piloting the Secure Freight Initiative where our officers are working with their foreign counterparts overseas to scan U.S.-bound containers for radiation at international ports.

National Biosurveillance Integration Center



The Department opened the first-of-its-kind biosurveillance center in September 2008 that gives the Nation the ability to detect fast-moving, potential health threats in a new way – before it is too late. Whether it is food contaminated with salmonella, the first waves of illness from a pandemic flu, or an anthrax attack by terrorists, spotting biological threats sooner means that thousands of lives might be saved.

The center will combine multiple sources of information – from classified material shared in a secure environment, to transportation and border data, to local media reports – so that events around the country and the world can be connected and analyzed more closely and quickly, and emerging threats can be detected earlier than ever before.

Being able to identify emerging threats earlier was one of the key recommendations from the 9/11 Commission. As the Japanese learned in 1995 when the Aum Shinrikyo religious sect released sarin nerve gas on subway lines killing 12 and injuring 5,500 people, biological attacks are a modern global reality.

Looking Forward

Below are some highlights of our plans for the near future.

- ***Nuclear Detection Research, Development, and Operations:*** DNDO will continue their research, development, and operations, to provide resources for the development and evolution of the global nuclear detection architecture. DNDO will procure and begin deploying the first full-rate production allotment of the fixed Advance Spectroscopy radiation portal monitors in FY 2009 pending Secretarial certification.
- ***BioWatch*:** The Office of Health Affairs will procure automated biodetectors and initiate deployment activities of the autonomous detection system to existing BioWatch jurisdictions. BioWatch autonomous detection capability will be critical to the Nation to rapidly and reliably detect the presence of dangerous biological agents, so that available countermeasures can be deployed at the earliest possible time.

Goal 3. Protect Critical Infrastructure

Objective 3.1: Protect and Strengthen the Resilience of the Nation's Critical Infrastructure and Key Resources
Achieves outcome of: Ensuring the protection and resiliency of the Nation's fixed critical infrastructure and key resources.
Objective 3.2: Ensure Continuity of Government Communications and Operations
Achieves outcome of: Ensuring the Federal Government can perform essential functions if an emergency occurs.
Objective 3.3: Improve Cyber Security
Achieves outcome of: Reducing the risk of successful cyber attacks on Federal networks and the Nation's critical infrastructure.
Objective 3.4: Protect Transportation Sectors
Achieves outcome of: Ensuring the protection and safety of transportation sectors.

Public Benefit

Protecting and ensuring the continuity of the critical infrastructure and key resources (CIKR) of the United States is essential to the Nation's security, public health and safety, economic vitality, and our way of life. Strides have been made in prioritizing the protection of critical infrastructure and key assets using a risk-based approach. Critical infrastructure includes things such as buildings, bridges, chemical facilities, energy plants, and financial systems so vital to the United States that the incapacity or destruction of such assets would have a debilitating impact. Protecting key resources such as our national leaders, key government personnel, and our communications systems are vital to maintaining government operations during unforeseen incidents. Protecting our computer networks through the use of tools such as network sensors is another component of protecting our critical infrastructure. Ensuring the protection and safety of our airports and waterways is also an emphasis of our activities in this area. Below are a small set of highlighted performance measures to communicate our accomplishments related to Goal 3.

Table 3. Highlighted Performance Measures for Goal 3

Performance Measure	Objective Supported	FY 2006 Results		FY 2007 Results		FY 2008 Results	
		Target	Result	Target	Result	Target	Result
Percent of high priority Critical Infrastructure and Key Resources (CIKR) where a vulnerability assessment has been conducted and enhancement(s) have been implemented	3.1	---	---	---	---	95%	100%
Percentage of instances protectees arrive and depart safely	3.2	100%	100%	100%	100%	100%	100%
Priority services call completion rate during emergency communications periods	3.2	---	---	---	---	90%	97%
Percent of Federal Departments and Agencies with fully operational Continuity of Operations (COOP) capabilities	3.2	90%	95%	100%	100%	100%	100%
Percent of planned Einstein sensors deployed on-time annually throughout the Federal government (cyber security)	3.3	---	---	---	---	100%	26%[1]
Percent of airports in compliance with leading security indicators	3.4	---	95.68%	---	95.55%	95%	95%
Five-year average number of Collisions, Allisions, and Groundings (CAG) on waterways	3.4	< 1,748	1,816[2]	< 1,664	1,823[2]	< 1,756	1,857[2]

Note: Some performance measures have historical results but not historical targets.

1. *Deployment of sensors delayed at many locations because they did not have the required Trusted Internet Connections to complete installations.*
2. *While the FY 2004 and FY 2005 results met their targets, ambitious targets with the expectation to reduce CAGs were not met in FY 2006, FY 2007 or FY 2008.*

Financial Crimes Investigation

The U.S. Secret Service (USSS) initiated an investigation that led to the identification and indictment of eleven perpetrators involved in the hacking of eight major U.S. retailers, and the theft and sale of over 40 million credit and debit card numbers. This transnational group of criminals used these cards to withdraw tens of thousands of dollars from ATMs, and concealed and laundered their fraud proceeds by using anonymous internet-based currencies, and by channeling funds through bank accounts in Eastern Europe.

As a result of a three-year undercover USSS investigation, and through ongoing cooperation with domestic and international law enforcement partners, the defendants were charged with computer fraud, wire fraud, access device fraud, aggravated identity theft, and conspiracy on August 5, 2008. This case is the largest and most complex case of its type in U.S. history.

Aviation Security Inspections

The Transportation Security Administration (TSA) deploys nearly 1,000 Aviation Security Inspectors to evaluate security at over 450 U.S. airports, 550 foreign airports, and over 1,500 domestic and international air carriers operating in the United States. Inspectors participate in covert tests, airport employee credential checks, compliance inspections with TSA regulations and security directives at airports and indirect air carriers, and investigate violations. In FY 2008, Transportation Security Inspectors (TSI) conducted 6,000 Aviation Screening Assessment Program tests, over 1,100 airport inspections, and as part of Operation Airport Strike, participated in a week-long, full-scale airport and aircraft operator inspections in Boston, Philadelphia, Denver, Seattle, Chicago O'Hare, Cincinnati, and Phoenix. Results from TSI activities help identify vulnerabilities that can be improved by revising processes, procedures, staffing, and technology to evolve and improve the security of our air transportation systems.

Looking Forward

Below are some highlights of our plans for the near future.

- ***Protective Countermeasures***: The U.S. Secret Service's program will expand to provide the latest state-of-the-art equipment that will be used in the event of an explosive, chemical, biological, or radiological attack at a secured site or asset.
- ***Chemical Security Compliance Project***: The Chemical Security Compliance Project in the National Protection and Programs Directorate will implement the Chemical Facility Anti-Terrorism Standards which grant DHS the authority to regulate security of the Nation's high-risk chemical facilities.
- ***Travel Document Checking (TDC)***: The deployment of the Transportation Security Administration's TDC program will expand to the few remaining airports. The program adds a layer of defense for aviation security by ensuring only passengers with authentic boarding passes access the sterile area of airports and aboard aircraft.
- ***Vehicle-Borne Improvised Explosive Device/Person-Borne Improvised Explosive Device Detection Programs:*** The Science and Technology Directorate will continue its research and development of technical capabilities to detect, interdict, and lessen the impacts of nonnuclear explosives used in terrorist attacks against mass transit, civil aviation, special events, and critical infrastructure.

Goal 4. Strengthen Our Nation's Preparedness and Emergency Response Capabilities

Objective 4.1: Ensure Preparedness
Achieves outcome of: Ensuring the Federal Government, State and local governments, and all Americans are prepared, capable, and ready to respond to adverse incidents.
Objective 4.2: Strengthen Response and Recovery
Achieves outcome of: Ensuring Americans and their governments at all levels effectively respond to and recover from catastrophic incidents.

Public Benefit

One of the core missions of DHS is to enhance the ability to protect against, respond to, and recover from terrorist attacks and other disasters. The National Incident Management System works to integrate and coordinate incident management efforts among Federal, State, local, and tribal governments. Other preparedness efforts have focused on deploying biological monitoring units that indicate if harmful substances have been released in high-risk areas. Training our law enforcement community is another key tenet of preparing our Nation to respond to adverse incidents. When disasters do occur, many Components of DHS respond to those in need, providing the appropriate response assistance. For instance, having teams ready to respond at a moment's notice in the event of a catastrophic incident helps mitigate negative consequences. Also, providing resources and other assistance for those who have fallen in harm's way through individual recovery assistance demonstrates our response capability. Below are a small set of highlighted performance measures to communicate our accomplishments related to Goal 4.

Table 4. Highlighted Performance Measures for Goal 4

Performance Measure	Objective Supported	FY 2006 Results		FY 2007 Results		FY 2008 Results	
		Target	Result	Target	Result	Target	Result
Percent of Federal, State, local, and tribal governments compliant with the National Incident Management System (NIMS)	4.1	100%	100%	100%	100%	100%	100%
Time between an outdoor monitoring unit exposure to a biological agent and the declaration of a confirmed positive result	4.1	---	---	---	---	< 36 hrs	36 hrs
Percent of Partner Organizations that respond "agree" or "strongly agree" that FLETC training programs address the right skills needed for their officers/agents to perform their law enforcement duties	4.1	73%	71%	74%	79.75%	75%	79.75%
Percent of response teams reported at operational status	4.2	85%	85%	88%	88%	91%	93%
Percent of customers satisfied with Individual Recovery Assistance	4.2	90%	91%	91%	92.2%	92%	92.67%

Note: Some performance measures have historical results but not historical targets.

Commitment to Preparedness, Response, and Recovery Saves Lives

On August 31, 2008 the Federal Emergency Management Agency's (FEMA) commitment to ensuring preparedness and response was tested. Hurricane Gustav formed on August 25, 2008 about 260 miles southeast of Port-au-Prince, Haiti with a predicted 3-5 days before reaching the U.S. Gulf Coast. With limited time, FEMA set in motion several proactive initiatives in coordination with its State and local partners. Throughout the Gulf Coast, FEMA pre-stocked distribution centers with over 2.4 million liters of water, 4 million meals ready to eat, 141 truckloads of tarps, 267 truckloads of blankets and cots, and 478 emergency generators. FEMA also deployed its emergency teams and resources and strategically positioned them for a coordinated response. The largest evacuation in U.S. history was initiated during Hurricane Gustav, with over 90 percent of New Orleans residents leaving the city. As a result of FEMA's efforts, in coordination with State and local communities, evacuation of all areas in Gustav's path was successful.

U.S. Coast Guard Alaska Warrior Saves Crew of Alaska Ranger

The U.S. Coast Guard and fishing vessel Alaska Warrior recovered 46 of 47 crewmembers from the sinking fishing vessel Alaska Ranger 120 miles west of Dutch Harbor. Four crewmembers died and one is missing. "Saving 42 people in the Bering Sea in the winter is an incredible accomplishment," said Commander Todd Trimpert, 17th U.S. Coast Guard District Incident Management Chief and experienced Alaska rescue pilot. Crews from an H-60 Jayhawk helicopter from St. Paul, an H-65 Dolphin helicopter deployed aboard the U.S. Coast Guard Cutter (CGC) Munro, a C-130 Hercules airplane from Air Station Kodiak and CGC Munro from Kodiak rescued 20 crewmembers in 10-foot seas and 25-knot winds while the fishing vessel Alaska Warrior rescued 22 crewmembers. "When we got on scene there was a spread, at least a mile long, of 13 survivors in gumby suits with strobe lights," said Aviation Survival Technician 2nd Class O'Brien Hollow, U.S. Coast Guard Air Station Kodiak, "I went down without disconnecting from the helicopter and picked them up one at a time."

Looking Forward

Below are some highlights of our plans for the near future.

- ***Vision - Shape the Workforce:*** FEMA's Vision - Shape the Workforce program will strengthen FEMA's ability to marshal an effective national response; deliver service of value to the public; reduce vulnerability to life and property; and instill public confidence. This will be accomplished by transitioning "on-call" temporary responders to permanent full-time personnel to achieve the readiness and response capability required in the event of major disasters and emergencies.
- ***Homeland Security Grant Programs*****:** Congress enacted $3 billion for FY 2009 to support FEMA's State and local assistance programs which prepare State and local governments to prevent or respond to threats or incidents of terrorism and other catastrophic events. In FY 2009, DHS will continue to support existing Homeland Security Grant Programs, Port and Rail Security, Emergency Management Performance, and Assistance to Firefighters Grants programs. There will also be a new discretionary grant program targeted toward high priority security initiatives including REAL ID implementation.
- ***Recapitalizing Aging Vessels, Aircraft, and Shore Infrastructure*****:** The U.S. Coast Guard will invest over $1.3 billion to continue its recapitalization of many of its assets including marine vessels, aircraft, inland river assets, shore facilities, aids to navigation equipment, and operations and maintenance.

Goal 5. Strengthen and Unify DHS Operations and Management

Objective 5.1: Improve Department Governance and Performance
Achieves outcome of: Improving and integrating Department structure, processes, leadership, and culture.
Objective 5.2: Advance Intelligence and Information Sharing
Achieves outcome of: Reducing the risk of emerging terrorist threats through intelligence and information sharing.
Objective 5.3: Integrate DHS Policy, Planning, and Operations Coordination
Achieves outcome of: Improving coordination of Department-wide policy and non-routine, cross-cutting operations requiring multiple Component activities.

Public Benefit

An agile and effective Department is essential to the rapid implementation of homeland security priorities, policies, and objectives to support our front-line Components as they protect our Nation every day. It has been a challenge to take 22 separate agencies, each with their own culture and way of operating, and merge them together into a unified Department with a common mission of securing the homeland from terrorist and other threats. However, progress has been and continues to be made. For instance, we have moved forward in the area of financial management by decreasing the number of material weakness conditions across the Department identified by the independent financial audit of DHS. Follow-on efforts to the DHS employee survey results included holding a series of focus groups to better identify issues and design interventions to improve employee morale. Scores on the President's Management Agenda demonstrate progress is being made in other important support areas such as acquisition, information technology, human capital, and performance improvement. Efforts continue to share intelligence, security, and operations information with our key partners and stakeholders.

Many of our Components who functioned autonomously in the past are now working collaboratively within and outside the Department to provide the synergy our Nation needs to address the many threats we face in today's unsettling environment. Below are a small set of highlighted performance measures to communicate our accomplishments related to Goal 5.

Table 5. Highlighted Performance Measures for Goal 5

Performance Measure	Objective Supported	FY 2006 Results		FY 2007 Results		FY 2008 Results	
		Target	Result	Target	Result	Target	Result
Total instances of material weakness conditions identified by the independent auditor in their report on the DHS financial statements	5.1	<25	25	<25	16	< 16	13
Percent of favorable responses by DHS employees on the Federal Human Capital Survey	5.1	---	---	---	49%	50%	50%
Percent of President's Management Agenda initiatives that receive a green progress score from the Office of Management and Budget	5.1	---	53.6%	---	35.5%	50%	46.9%[1]
Number of Homeland Intelligence Reports disseminated	5.2	1,200	1,734	1,500	2,722	2,776	3,563
Percent of active Homeland Security Information Network (HSIN) users	5.3	---	---	90%	38%	50%	24%[2]

Note: Some performance measures have historical results but not historical targets.

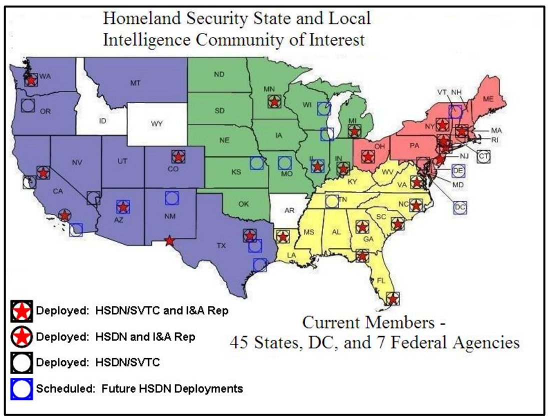
1. *Target not achieved primarily due to the delayed completion of the DHS Strategic Plan.*
2. *The program did not achieve the number of active users due to limited Homeland Security Information Network (HSIN) outreach resources to conduct needed training.*

Integrated Strategy for High-Risk Management

In FY 2008, DHS continued to make concerted efforts to ensure the preparedness of the American people. With the issuing of the Integrated Strategy for High-Risk Management, DHS brings together all of the Components of DHS in order to more effectively monitor ongoing corrective action plans. This was accomplished by improving organizational integration and cohesiveness.

The Integrated Strategy for High-Risk has several intended outcomes: clear accountability and responsibility; improved execution of strategic objectives; prompt and proper resolution of identified material weaknesses; and established guidelines and processes for the department to integrate risk analysis into other management systems, such as budget and program reviews. For more information, see ExpectMore.gov or http://www.dhs.gov/xabout/budget/gc_1214229806734.shtm. The Government Accountability Office's (GAO) High-Risk reports are located at http://www.gao.gov/docsearch/featured/highrisk.html.

Expanding Sensitive and Classified Information Sharing to Thwart our Enemies



The Office of Intelligence and Analysis (I&A) expanded the Homeland Security State and Local Intelligence Community of Interest (HS SLIC) in FY 2008. HS SLIC supports the National Strategy for Information Sharing, a first of its kind to create and foster a culture of sharing critical intelligence information with our Federal, State, local, tribal, and territorial stakeholders. HS SLIC, a comprehensive community of more than 1,700 intelligence analysts in 45 States and seven Federal agencies, communicates and collaborates by exchanging sensitive but unclassified information on the Homeland Security Information Network (HSIN) Intelligence Portal.

I&A is also aggressively deploying the Homeland Secure Data Network (HSDN) to extend secret-level communications to strategically important State and local Fusion Centers. HSDN is live at 23 centers as of August 2008, with another 22 centers planned for deployment over the next year. HSDN also is available to agencies that are not part of the statutory Intelligence Community and has gateways to other secret-level networks to allow information sharing across multiple partners.

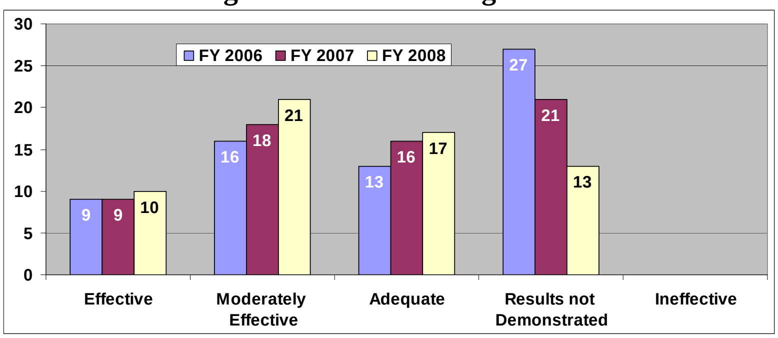
Looking Forward

- ***Quadrennial Homeland Security Review (QHSR):*** Beginning in FY 2009 and culminating in FY 2010, DHS will conduct its first ever QHSR. This effort will document and recommend long-term strategy and priorities of the Nation for homeland security and comprehensively examine programs, assets, budget, policies, and authorities required to provide the United States with strong, sound, and effective homeland security capabilities in the decades ahead.
- ***Office of Inspector General (OIG) Auditors:*** The OIG will expand staff oversight of DHS preparedness programs, through audits of preparedness grant programs, science and technology programs, and Department-wide programs that establish the Department's baseline preparedness efforts.
- ***Analysis & Operations (A&O) State and Local Fusion Center (SLFC) Program*:** The A&O State and Local Fusion Center program will continue to enhance its web of interconnected information nodes across the country ensuring information is gathered from all relevant operations and fused with information from the Homeland Security Stakeholder Community.

PART Ratings Overview

Integral to DHS performance management are the program evaluations that occur in collaboration with the Office of Management and Budget (OMB) using the Program Assessment Rating Tool (PART). The PART process evaluates programs across a set of performance-related criteria, including program design, strategic planning, program management, and delivery of results. Since FY 2006, DHS has reduced the number of "Results not Demonstrated" ratings from 27 to 13, a 52 percent improvement. For more detailed information on PART, please visit www.expectmore.gov.

Figure 2. PART Rating Trend



Scorecard on the President's Management Agenda

DHS is also striving to improve critical management functions in the Department. Criteria for success and milestones to achieve progress are established in conjunction with OMB as part of the President's Management Agenda (PMA). The PMA was launched in August 2001 as a strategy for improving the management and performance of the Federal Government. For more information on the PMA, please visit www.results.gov. In addition, the Management Challenges section of the report discusses efforts under-way to improve the overall management of DHS.

Table 6. DHS PMA Scorecard as of the End of FY 2008

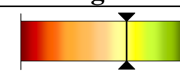
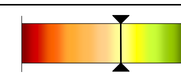
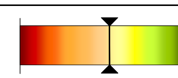
	Status					Progress
	FY '04	FY '05	FY '06	FY '07	FY'08	FY '08
Human Capital	R	Y	Y	Y	Y	G
Commercial Services Management	Y	Y	Y	Y	Y	R
Financial Performance	R	R	R	R	R	Y
E-Government	R	R	R	Y	Y	R
Performance Improvement	Y	Y	Y	Y	Y	G
Eliminating Improper Payments	R	R	Y	R	R	G
Real Property	R	R	Y	Y	Y	G
Faith Based and Community Initiative				R	R	G

DHS integrates performance measurement results and PART evaluations into the development of a performance budget, using the Planning, Programming, Budgeting, and Execution (PPBE) process. As an element of the programming phase of the PPBE cycle, performance measurement information and program evaluations are considered in the resource allocation plans and decisions for each Component. The process culminates in the annual development of the Department's Future Years Homeland Security Program (FYHSP). The FYHSP expresses the Secretary's five-year strategic resource allocation intentions, and connects the multi-year spending priorities of each program in the Department with the achievement of the goals and objectives of the DHS Strategic Plan.

Summary of Major Management Challenges

This summary presents high priority management challenge areas facing the Department of Homeland Security. For a more detailed analysis of these areas, please see the full report on management challenges identified each year by the DHS Office of the Inspector General (OIG), located on page 234. The indicators below display progress in meeting the listed challenge areas, all of which will take several years to address.

Table 7. DHS's Highest Priority Management Challenges

Management Challenge	Progress
Border Security (Full response on page 300)	
Accomplishments: The Secure Border Initiative (SBI) has completed construction of 358 miles of fencing to further secure the border by the end of FY 2008. Border Patrol met hiring targets and over 17,000 agents were on board as of the end of FY 2008. The pace of SBI*net* development and deployment was reduced to address issues related to equipment capabilities and operational requirements, but progress was made on defining the deployment configuration. *Plans*: The Department has committed resources to extend both pedestrian and vehicle fencing to complete a total of 661 miles of border fencing by the first half of 2009. U.S. Customs and Border Protection (CBP) will recruit Mission Support Specialists to perform non-law enforcement functions to allow agents to focus their efforts on safeguarding the borders and is on track to meet its patrol agent hiring, training, and deployment goals for both 2009 and 2010. CBP will continue to upgrade and enhance its Special Operations Group and Special Response Teams to significantly improve CBP's ability to respond to specific terrorist threats and support Border Patrol missions.	
Catastrophic Disaster Response and Recovery (Full response on page 288)	
Accomplishments: The Federal Emergency Management Agency (FEMA) continues to work closely with the public to develop quick response capabilities. FEMA awarded approximately 27 pre-disaster response contracts to pre-position materials and approximately 70 recovery contracts to assist communities recovering from disasters. To provide disaster assistance, FEMA now has 236 pre-scripted mission assignments with 33 Federal agencies up from FY 2006 when there were 44 pre-scripted mission assignments with only two Federal Agencies. FEMA also established the Disaster Reserve Workforce Division within the Management Directorate in March 2008 to manage the reserve workforce. As of October 1, 2008, 4,072 FEMA reservists were deployed in support of disaster response and recovery throughout the United States, including 2,365 reservists serving on the Gulf Coast and in other hurricane-affected areas. Plans: FEMA will continue to build on those logistics management capabilities similar to the Department of Defense's well-recognized logistics system and organization. We will continue to work with the Department of Housing and Urban Development and other Federal and State partners to improve both short-term disaster housing response and long-term housing recovery.	
Acquisition Management (Full response on page 274)	
Accomplishments: The Office of Chief Procurement Officer (OCPO) strengthened acquisition management across the Department through enhancements to its policies, procedures and workforce. New Directives and policies aligned acquisition functions, established clear lines of authority, and created the framework for investment reviews. A new periodic reporting system provides Components and the Department with a structured approach to producing standardized, improved program cost, schedule and performance metrics. OCPO established and initiated a centralized contracting intern program, resulting in the on-boarding of 48 contract specialists. Additionally, it continued to expand its certification and training efforts to cover other career fields, including program management, and contracting officer technical representatives. *Plans*: The OCPO will continue its work to improve reporting capabilities to the Congress and taxpayers by ensuring that procurements are properly reported and that the Heads of Contracting Activity are held accountable for accurately reporting their acquisitions to the Federal Procurement Data System-Next Generation.	

Financial Overview

Overview and Analysis of Financial Statements

DHS primarily uses the cash basis for its budgetary accounting. DHS appropriated budgetary resources were approximately $58 billion for FY 2008. The budget represents our plan for achieving the strategic objectives set forth by the Secretary to carry out our mission and to ensure that DHS manages its operations within the appropriated budgets using budgetary controls. DHS prepares its annual financial statements on an accrual basis, in accordance with generally accepted accounting principles, meaning that economic events are recorded as they occur, regardless of when cash is received or disbursed. These financial statements provide the results of our operations and financial position, including long-term commitments and obligations. The independent accounting firm, KPMG LLP, was engaged to audit the Balance Sheet and Statement of Custodial Activities.

DHS's FY 2008 budgetary resources increased by $11 billion from FY 2007, excluding borrowing authority, reflecting additional funding for Border Security, the Federal Emergency Management Agency, and the Transportation Security Administration. In addition, DHS restated FY 2007 balances primarily as a result of actions completed to correct financial management weaknesses reported in prior financial statement audit reports.

Balance Sheet: "What We Own and What We Owe"

The Balance Sheet presents the resources owned or managed by DHS that have future economic benefits (assets) and amounts owed by DHS that will require future payments (liabilities). The difference between DHS's assets and liabilities is the residual amounts retained by DHS (net position) that are available for future programs and capital investments.

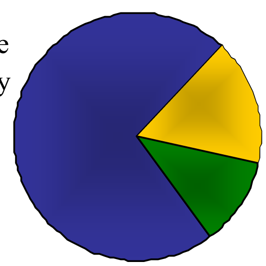
Condensed Consolidated Balance Sheet
As of September 20, 2008 and 2007
(In Millions)

	FY 2008	FY 2007 (Restated)	Change
Assets			
Fund Balance with Treasury	$63,157	$56,185	$6,972
General Property, Plant and Equipment, Net	14,501	12,602	1,899
Other	10,237	10,337	(100)
Total Assets	$87,895	$79,124	$8,771
Liabilities			
Federal Employee and Veterans Benefits	$36,230	$34,910	$1,320
Debt	17,719	18,153	(434)
Employee related and other	15,563	10,890	4,673
Accounts Payable	4,903	5,244	(341)
Total Liabilities (Note 17)	$74,415	$69,197	$5,218
Net Position			
Unexpended Appropriations	$55,228	$48,810	$6,418
Cumulative Results of Operations	(41,748)	(38,883)	(2,865)
Total Net Position	$13,480	$9,927	$3,553
Total Liabilities and Net Position	$87,895	$79,124	$8,771

Composition of Assets – What We Own
Assets represent amounts owned by DHS that can be used to accomplish its mission. At September 30, 2008, DHS had $87.8 billion in assets, representing an $8.8 billion increase from FY 2007 restated assets of $79 billion. The increase is primarily attributable to supplemental appropriations for FEMA's disaster recovery efforts. Additionally, CBP's assets increased due to the Secure Border Initiative (SBI) and significant investments in technology equipment. The U.S. Coast Guard also contributed to the asset increase with the completion of the first National Security Cutter and additional investments in the U.S. Coast Guard's Deepwater Program.

Fund Balance with Treasury (FBwT), the Department's largest asset, comprises 72 percent ($63.2 billion) of the total assets. Included in FBwT is the remaining balance of DHS unspent prior year budgets plus miscellaneous receipts. FBwT increased approximately $7 billion from FY 2007 in part due to supplemental appropriations for disaster recovery efforts during Hurricanes Gustav and Ike and an increase in funds received to support the Secure Border Initiative.

DHS Assets as of September 30, 2008



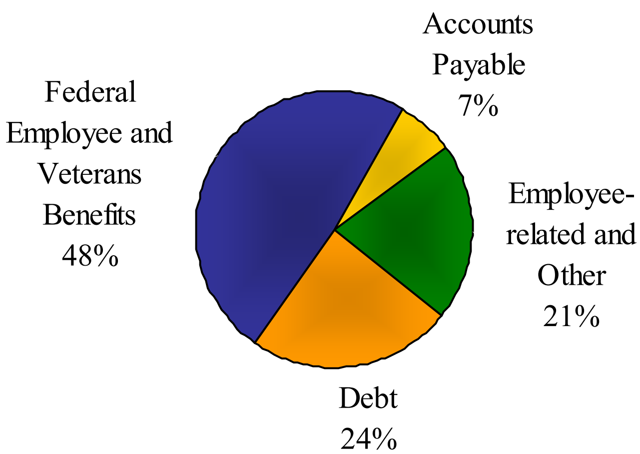
The U.S. Coast Guard operates an inventory of 12 high-endurance cutters, 31 medium-endurance cutters and numerous patrol boats and aircraft. The completed construction of the first U.S. Coast Guard National Security Cutter, the WMSL-750 Bertholf, in FY 2008 was a crowning achievement for Coast Guard Deepwater Program.

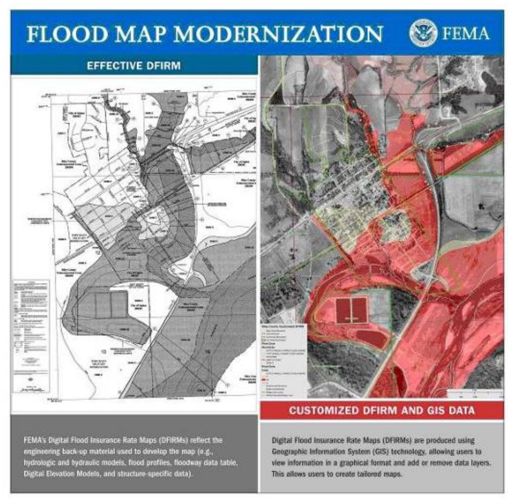
Property, Plant, and Equipment (PP&E) is the second largest asset, comprising 16 percent of total assets. The major items in this category include construction in progress, buildings and facilities, vessels, aircraft, and other equipment. In acquiring these assets, DHS either spent cash or incurred a liability to make payment at a future date; however, because we expect these assets to provide future benefits to DHS to help us accomplish our mission, we report these items as assets rather than expenses. PP&E is recorded net of accumulated depreciation. Recording the net value of the PP&E items is intended to approximate its remaining useful life. During FY 2008, PP&E increased by $1.9 billion. Contributing to this increase was CBP's initiative to protect America's borders by constructing additional fencing for the SBI and purchasing technology equipment and software related to the Automated Commercial Environment. In June FY 2008, the U.S. Coast Guard completed construction on their first National Security Cutter and capitalized the asset cost of $781 million. This steady progress in the U.S. Coast Guard Deepwater Program initiatives contributed to a 6 percent increase in FY 2008 Construction in Progress over prior fiscal year, which represents 44 percent of General Property Plant and Equipment for the Coast Guard.

Composition of Liabilities – What We Owe
At September 30, 2008, DHS reported approximately $74.4 billion in total liabilities. Liabilities represent amounts owed to the public or other federal agencies for goods and services provided but not yet paid for; to DHS employees for wages and future benefits; and for other liabilities. Eighty two percent of these liabilities are unfunded, meaning they will need to be paid from funds received in future appropriations. DHS's largest unfunded liability is for Federal Employee and Veterans Benefits, arising primarily from U.S. Coast Guard personnel benefits. The National Flood Insurance Program (NFIP) administered by FEMA is the second largest unfunded liability. Both are discussed in more detail below.

Liabilities increased approximately $5.2 billion from FY 2007 restated liabilities totaling $69.2 billion. The increase represents higher insurance liabilities existing at September 30, 2008 related to unpaid Hurricane Gustav and Ike flood insurance claims (described further in Footnote 20) and U.S Coast Guard personnel benefits which increased 4 percent from FY 2007.

DHS Liabilities as of September 30, 2008





FEMA Flood Insurance Liability (included under Debt) increased in FY 2008 through response and rescue efforts associated with Hurricanes Gustav and Ike.

DHS's largest liability is for Federal Employee and Veterans Benefits, representing 48 percent of total liabilities. This liability increased approximately 4 percent from FY 2007 due to an increase in personnel benefits for U.S. Coast Guard and actuarial adjustments reported by United States Secret Service for the District of Columbia Pension Plan (described further in Footnote 17). DHS owes these amounts to current and past civilian and military personnel for pension and other post employment benefits. The liability also includes medical costs for approved workers compensation cases and an estimate for incurred but not yet reported worker's compensation costs. Ninety-five percent of this liability is not covered by current budgetary resources, and DHS will need to seek future appropriations to cover these liabilities.

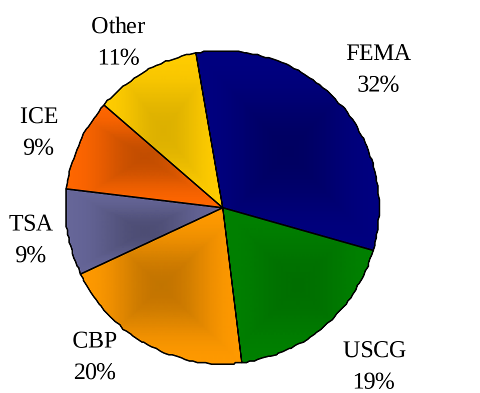
Debt is the second largest liability, representing 24 percent of total liabilities. This debt results from Treasury loans and related interest payable to fund the NFIP and Disaster Assistance Direct Loan Program operations of FEMA. Total debt decreased by 2 percent from FY 2007 as a result of the NFIP debt. Most of this debt is not covered by current budgetary resources. The premiums collected by FEMA for disaster assistance do not cover the cash outlays. This is discussed further in Footnote 15.

Employee-related and other liabilities, comprising 21 percent of the Department's liabilities, grew approximately 4 percent from FY 2007 primarily due to an increase in insurance claims related to floods in the Midwest caused by hurricanes Gustav and Ike. Also included in these liabilities are unpaid wages and benefits for current DHS employees. Seven percent of total liabilities results from accounts payable, which are actual or estimated amounts DHS owes to vendors for goods and services provided for which we have not yet paid. These liabilities are covered by current budgetary resources.

Statement of Net Cost

The Statement of Net Cost presents the annual net cost DHS expends to fulfill its mission. The statement shows all costs less certain revenue, such as fees collected at USCIS that offset our costs. For FY 2008, DHS used the strategic goals as a basis to integrate its net costs.

Composition of Net Costs at September 30, 2008



FEMA took steps to ensure that we were prepared for Hurricane Ike, without leaving those recovering from Gustav and previous hurricanes behind. DHS supported Texas and Louisiana with significant quantities of food, bottles of water, ice, generators, blankets and cots and plastic sheeting.

FEMA represents 32 percent of the Department's net cost, a 35 percent increase from FY 2007 resulted from FEMA funding much of the recovery costs associated with hurricanes Gustav and Ike. The U.S. Coast Guard incurred 19 percent of total net costs in ensuring maritime safety, security, and stewardship and represents an 11 percent decrease from FY 2007. CBP's net costs increased by approximately 20 percent from FY 2007, reflecting costs associated with employing new technologies to protect the border. Net costs for TSA and ICE, each representing 9 percent of total net costs, increased slightly from FY 2007. TSA's net costs increased 4 percent and net costs for ICE, which includes the Federal Protective Service, increased 14 percent.

During FY 2008, the Department earned approximately $9.2 billion in revenues; this is an increase of about $816 million from the restated amount of $8.4 billion on September 30, 2007. The Department classifies revenues as either exchange ("earned") or non-exchange revenue. Exchange revenues arise from transactions in which DHS and the other party receive value, and that are directly related to departmental operations. DHS also collects non-exchange duties, taxes and fee revenues on behalf of the Federal Government. These non-exchange revenues are presented in the Statement of Custodial Activity rather than the Statement of Net Cost. Examples of non-exchange revenues are user fees that CBP collects on behalf of the Federal Government as a result of its sovereign powers rather than as a result of providing goods or services for a fee. Donations to the Department are also reported as non-exchange revenues. Non-exchange revenues are either retained by the Department to further its mission or returned to the General Fund of the Treasury.

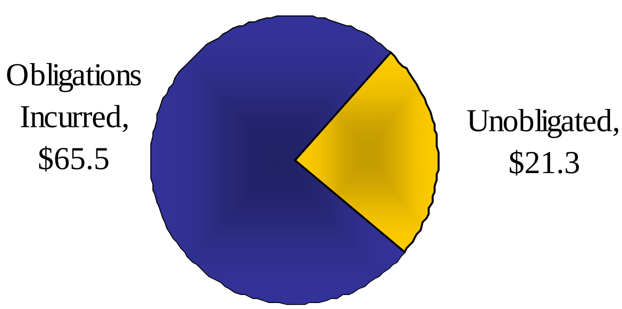
Statement of Changes in Net Position: "What Came In and What Went Out"

The Statement of Changes in Net Position shows the "accrual-based" results of DHS's operations and its affect on our overall net financial position. It is much like a corporation's stockholder's equity in that it shows the Department's "bottom line." Financing sources increase net position and include, but are not limited to, appropriations, user fees, and excise taxes. The net costs discussed above and transfers to other agencies decrease net position. In FY 2008, FEMA had higher disaster-related costs, thus contributing to the change in DHS's overall net position.

Statement of Budgetary Resources

This statement provides information on the status of the approximately $87 billion in budgetary resources available to DHS during FY 2008. This authority was derived from appropriations of $58 billion, $17 billion in authority carried forward from FY 2007, $10 billion in collections, and $2 billion of miscellaneous authority. The total amount of resources available increased by approximately $7 billion, primarily as a result of an increase of $11 billion in appropriated funds.

Status of Budgetary Resources at September 30, 2008 (in billions)



U.S. Customs and Border Protection (CBP) has completed a total of 358 miles of fencing along the Southwest Border, comprised of 204 miles of primary pedestrian fence and 154 miles of vehicle fence as of September 30, 2008. Resources are committed to extend both pedestrian and vehicle fencing to achieve a total of 661 miles in the near future. Budgetary resources are obligated to train and equip 2,200 new Border Patrol agents in 2009 which will more than double the size of the Border Patrol from 2001 levels, to 20,019 agents.

Of the total budget authority available, DHS incurred a total of $65.5 billion in obligations from purchase orders placed, contracts awarded, salaries and benefits, or similar transactions. These obligations will require payments during the same or future period. As of September 30, 2008, $21.3 billion, of the $87 billion available, was not obligated.

Statement of Custodial Activities

This statement presents the disposition of revenues collected and disbursed by DHS on behalf of other recipient entities. CBP and USCIS collect revenue from a variety of duties, excise taxes and various other fees that are subsequently remitted to the Treasury's General Fund or to other entities. Footnote 32 in the financial section provides additional information on these activities. Total cash collections increased by more than $721 million in FY 2008. The increase is primarily attributable to an increase in duties, but also to an increase in user fees and excise taxes.

Stewardship Assets and Investments

DHS's Stewardship PP&E primarily consists of U.S. Coast Guard Heritage Assets, which include ships' equipment, lighthouse and other aids to navigation/communication items, personal use items, ordnance, artwork, and display models. A heritage asset is any personal property that is retained by DHS because of its historic, cultural, educational, or artistic value as opposed to its current usefulness to carrying out the mission of the agency. Of the U.S. Coast Guard buildings and structures designated as Heritage Assets, including memorials, recreational areas and other historical areas, over two-thirds are multi-use Heritage assets. The remainder is comprised of historical lighthouses, which are no longer in use and awaiting transfer or disposal; their related assets; and a gravesite. CBP also has four multi-use heritage assets located in Puerto Rico and FEMA has one multi-use heritage asset that is used by the United States Fire Administration for training in Emmitsburg, Maryland.

Stewardship investments are substantial investments made by the Federal Government for the benefit of the Nation. When incurred, stewardship investments are treated as expenses in calculating net cost, but they are separately reported as Required Supplementary Stewardship Information (RSSI) to highlight the extent of investments that are made for long-term benefits. These include investments in Human Capital and Research and Development.

Other Key Regulatory Requirements

See the Other Accompanying Information section for Prompt Payment Act, Debt Collection Improvement Act, and Biennial User Charges Review information.

Management Assurances

The Federal Managers' Financial Integrity Act, Federal Financial Management Improvement Act, and Department of Homeland Security Financial Accountability Act

DHS is responsible for establishing, maintaining, and assessing internal control to provide reasonable assurance that the internal control objectives of the *Federal Managers' Financial Integrity Act*, 31 U.S.C. 3512 Sections 2 and 4, and the *Federal Financial Management Improvement Act*, P.L. 104-208, are met. To identify material weaknesses and non-conformance conditions, management used the following criteria:

- Merits the attention of the Executive Office of the President and the relevant Congressional oversight committees;
- Impairs fulfillment of essential operations or mission;
- Deprives the public of needed services;
- Significantly weakens established safeguards against waste, loss, unauthorized use or misappropriation of funds, property, other assets, or conflicts of interest;
- Substantial non compliance with laws and regulations; and
- Financial management systems conformance to government-wide systems requirements.

In addition, the *Department of Homeland Security Financial Accountability Act*, P.L. 108-330, requires a separate assertion of internal control over financial reporting and an audit opinion of the Department's internal controls over its financial reporting. A material weakness within internal control over financial reporting is defined as a reportable condition or combination of reportable conditions, that results in more than a remote likelihood that a material misstatement of the financial statements or other significant financial reports, will not be prevented or detected.

The DHS Accountability Structure includes a Senior Management Council (SMC), an Internal Control Coordination Board (ICCB), and a Senior Assessment Team (SAT). The SMC approves the level of assurances for the Secretary's consideration and is comprised of the Department's Under Secretary for Management, Chief Financial Officer, Chief Administrative Services Officer, Chief Human Capital Officer, Chief Information Officer, Chief Information Security Officer, Chief Security Officer, and Chief Procurement Officer. The ICCB seeks to integrate and coordinate internal control assessments with other internal control related activities and includes representatives from all DHS lines of business to address crosscutting internal control issues. Finally, the SAT led by the Chief Financial Officer, is comprised of senior level financial managers assigned to carry out and direct Component-level internal control over financial reporting assessments.

Individual Component assurance statements serve as the primary basis for the Secretary's assurance statements. The assurance statements are also based on information gathered from various sources including management initiated internal control assessments, program reviews, and evaluations. In addition, the DHS Office of Inspector General (OIG) and the Government Accountability Office (GAO) conduct reviews, audits, inspections, and investigations.

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

Homeland Security

November 13, 2008

Secretary's Assurance Statements

The Department of Homeland Security is dedicated to ensuring that internal control systems are comprehensively designed to achieve the mission and execute the strategy of the Department. The Department's management is responsible for establishing and maintaining effective internal control over the three internal control objectives of effectiveness and efficiency of operations; reliability of financial reporting; and compliance with applicable laws and regulations. In addition, the safeguarding of assets is a subset of these objectives. In accordance with the *Federal Managers' Financial Integrity Act* (FMFIA) and the *Department of Homeland Security Financial Accountability Act* (DHS FAA), I have directed an evaluation of internal control at the Department of Homeland Security in effect during the fiscal year ended September 30, 2008. This evaluation was conducted in accordance with OMB Circular No. A-123, *Management's Responsibility for Internal Control*, revised December 21, 2004. Based on the results of this evaluation, the Department provides the following assurance statements.

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2 and DHS FAA)

In accordance with the Department's OMB approved plan for Appendix A of OMB Circular A-123, our efforts focused on designing and implementing Department-wide internal controls. Based on information provided, for the processes assessed within Exhibit I, the Department provides reasonable assurance that internal control over financial reporting is designed effectively as of September 30, 2008, with the exception of the following known material weaknesses:

- Financial Reporting at U.S. Coast Guard, Federal Emergency Management Agency (FEMA), and Transportation Security Administration (TSA);
- Fund Balances with Treasury Management at U.S. Coast Guard;
- Financial System Security at U.S. Coast Guard, FEMA, and TSA;
- Budgetary Resource Management at U.S. Coast Guard and FEMA;
- Property Management at U.S. Coast Guard, TSA, and FEMA; and
- Human Resource Management at U.S. Coast Guard.

Although the Department has begun tests of operating effectiveness, we have not yet completed enough testing to provide reasonable assurance that internal control over financial reporting was operating effectively.

Effectiveness of Internal Control over Operations (FMFIA § 2)

Based on information provided, the Department provides reasonable assurance as to the effectiveness of internal control over operations, with the exception of the following known material weaknesses:

- Entity Level Internal Controls at FEMA and National Protection and Programs Directorate (NPPD);
- Improper Payments Information Act Noncompliance at FEMA;
- Grants Management, including;
  - Single Audit Act Noncompliance;
- Anti-Deficiency Act Controls at U.S. Coast Guard and NPPD;
- Controls over Collection and Depositing of Fees and Quality Assurance Over Data Entry at U.S. Citizenship and Immigration Services (USCIS);
- Federal Protective Service Operations at U.S. Immigration and Customs Enforcement (ICE);
- Administrative Management, including;
  - Lack of Consolidated DHS Headquarters;
  - Asset and Other Materials Oversight; and
  - Laptop Security (Accountability, Encryption, and Access Controls);
- Acquisition Management, including;
  - Secure Border Initiative Acquisition at U.S. Customs and Border Protection (CBP);
- Human Capital Management, including;
  - Candidate Shortages for Critical Mission Career Fields;
  - Headquarter Staffing Action Backlog; and
  - Management Controls within the USCIS Office of Human Capital and Training;
- US-VISIT System Security at CBP.

Conformance with Financial Management System Requirements (FMFIA § 4)

The Department's financial management systems do not substantially conform to government-wide requirements mandated by the *Federal Financial Management Improvement Act*. The following are known non-conformances:

- Federal Financial Management Systems Requirements, including:
  - Financial Systems Security at DHS Management Directorate, CBP, U.S. Coast Guard, FEMA, FLETC, USCIS, and TSA;
  - Integrated Financial Management Systems, including:
    - Integration of CBP Revenue System with CBP Core Financial System;
    - Integration of ICE Financial, Acquisition, and Asset Management Systems; and
    - Integration of U.S. Coast Guard Financial and Mixed Systems;
- Noncompliance with U.S. Standard General Ledger at U.S. Coast Guard; and
- Federal Accounting Standards at U.S. Coast Guard.

Michael Chertoff
Secretary
Department of Homeland Security

Summary of Internal Control Accomplishments

Since the passage of the DHS FAA, DHS has worked collaboratively with the Congress, GAO, OMB, DHS OIG, and our Independent Public Auditor to ensure we achieve the law's intended outcome of the design and implementation of Department-wide internal controls to support the DHS mission. On March 21, 2008, the Under Secretary for Management and Chief Financial Officer issued the second edition of the Internal Control Playbook. The Internal Control Playbook outlines the Department's strategy and process to design and implement internal controls through corrective actions and build management assertions for the operating effectiveness of internal controls. The results of the FY 2008 Internal Control Playbook are displayed below. Most significantly, we have developed the Secretary's internal control over financial reporting assurance statement from a statement of no assurance in FY 2005 to a design effectiveness assertion in FY 2008, and as a result DHS is poised to provide a qualified operational effectiveness assertion in the near term.

Exhibit I. Internal Controls Over Financial Reporting Assessment Results FY 2008

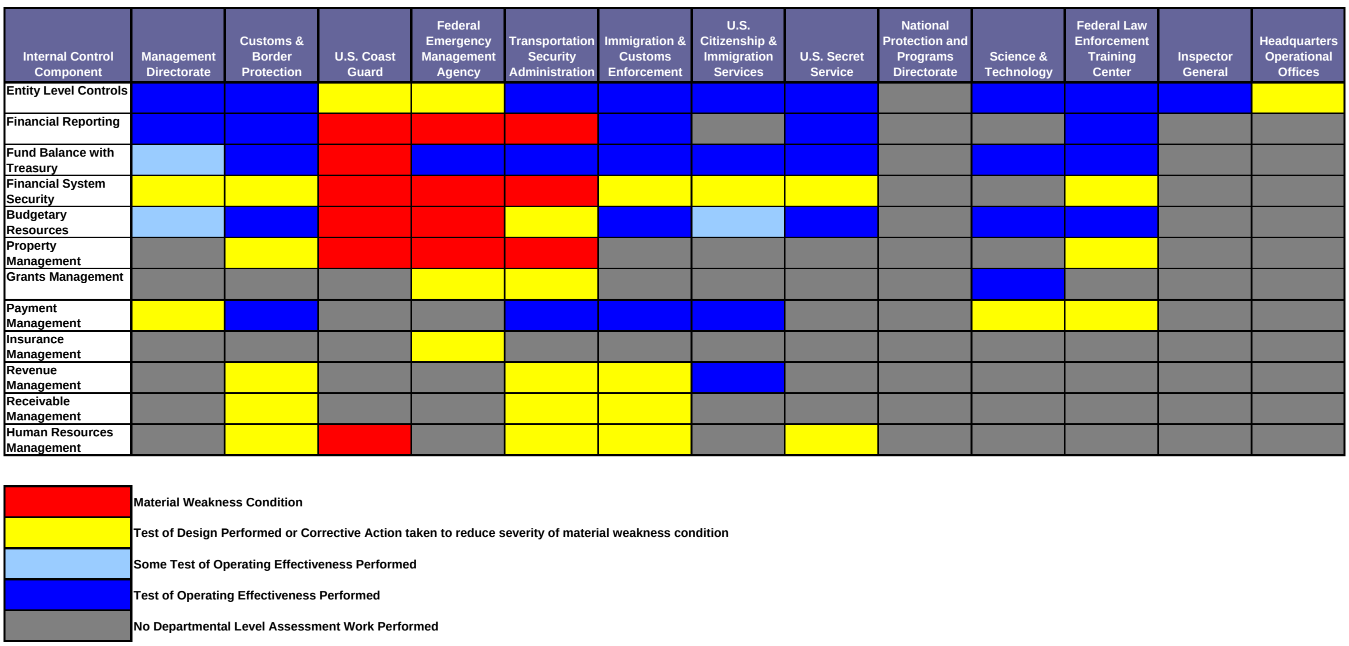
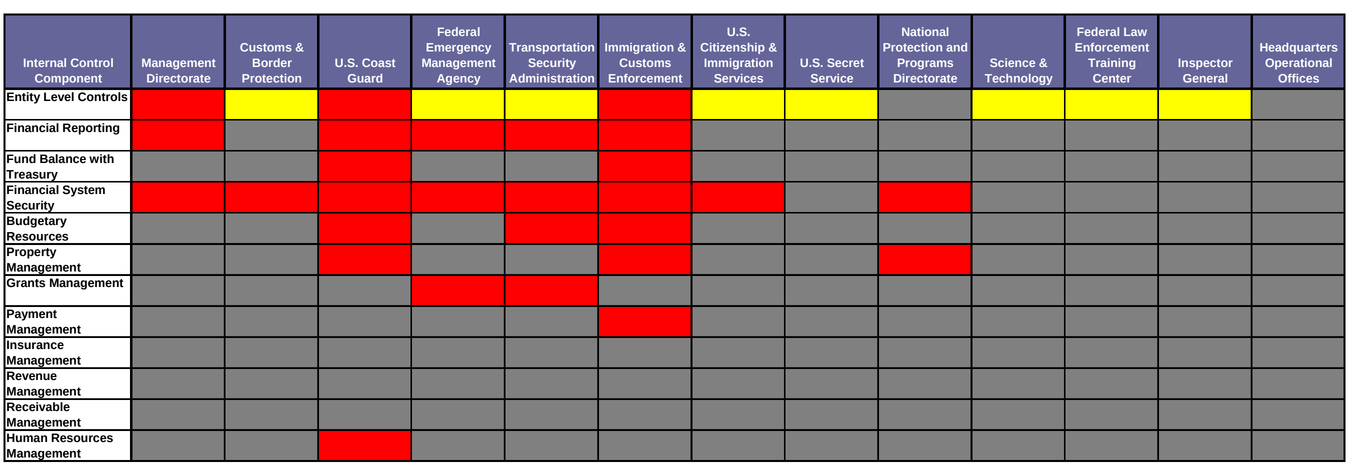


Exhibit II. Internal Controls Over Financial Reporting Assessment Results FY 2005



Office of Inspector General

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

Homeland Security

NOV 1 4 2008

MEMORANDUM FOR: The Honorable David Norquist
Chief Financial Officer

FROM: Richard L. Skinner
Inspector General

SUBJECT: FY 2008 Audit of DHS' Internal Control Over Financial Reporting

The attached report presents our independent auditors' opinion on the Department of Homeland Security's (DHS) internal controls over financial reporting as of September 30, 2008. The *Department of Homeland Security Financial Accountability Act* (P.L. 108-330), Section 4, requires that the Secretary of Homeland Security include an audit opinion of DHS' internal controls over its financial reporting in each performance and accountability report beginning after fiscal year 2005. DHS management is responsible for establishing and maintaining effective internal control over financial reporting in accordance with criteria established under the *Federal Managers' Financial Integrity Act* (FMFIA). Our responsibility is to express an opinion on the effectiveness of DHS' internal control based on our examination.

In our report on internal control as of September 30, 2007, we reported that DHS' internal controls over financial reporting were ineffective because of material weaknesses reported in the Secretary's Assurance Statement and the Independent Auditor's Report. Although DHS did not maintain effective internal control in the same areas in FY 2008, we recognize DHS' efforts towards meeting its goals for the correction of material weaknesses and compliance with FMFIA.

We appreciate the cooperation extended to the auditors by DHS' financial offices. Should you have any questions, please call me, or your staff may contact Anne L. Richards, Assistant Inspector General for Audits, at 202-254-4100.

Attachment

Office of Inspector General

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

Homeland
Security

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 addresses the effectiveness of DHS' internal control over financial reporting. It is based on an examination of applicable documents. We performed our examination during the course of DHS' FY 2008 financial statements audit in conjunction with the independent public accountant, KPMG LLP. KPMG was engaged to audit the department's balance sheets as of September 30, 2008 and 2007, and the related statement of custodial activity for the year ended September 30, 2008 (referred to herein as "financial statements"). KPMG was unable to provide an opinion on DHS' financial statements as of September 30, 2008 and 2007.

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

Richard L. Skinner
Inspector General

Office of Inspector General

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

Homeland Security

NOV 1 4 2008

We have examined the effectiveness of DHS' internal control over financial reporting as of September 30, 2008, based on the criteria established under the *Federal Managers' Financial Integrity Act* (FMFIA). DHS management is responsible for establishing and maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of DHS' internal control based on our examination.

We conducted our examination in accordance with Government Auditing Standards issued by the Comptroller General of the United States and attestation standards established by the American Institute of Certified Public Accountants. Our examination included obtaining an understanding of the internal control over financial reporting and performing such other procedures as we considered necessary in the circumstances. We believe that our examination and the report of the independent auditor provide a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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 financial statements will not be prevented or detected. A significant deficiency is a control deficiency or combination of control deficiencies that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected.

During fiscal year 2008, the following material weaknesses were identified by an independent auditor. Due to the issues noted below, additional material weaknesses may exist that have not been reported.

- Financial Reporting;
- Financial Systems General and Application Controls;
- Fund Balance with Treasury;
- Capital Assets and Supplies;

- Actuarial and Other Liabilities; and
- Budgetary Accounting.

Because of the effects of the material weaknesses mentioned above, in our opinion, DHS did not maintain effective internal control as of September 30, 2008, to meet the following objectives: (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements and stewardship information in conformity with Generally Accepted Accounting Principals (GAAP), and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with laws governing the use of budget authority and with other significant laws and regulations that could have a direct and material effect on the financial statements and stewardship information. Consequently, DHS' internal control did not provide reasonable assurance that misstatements, losses, or noncompliance with laws and regulations that are material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis.

Richard L. Skinner

Richard L. Skinner
Inspector General

Office of the Chief Financial Officer
U.S. Department of Homeland Security
Washington, DC 20528

Homeland Security

November 12, 2008

MEMORANDUM FOR: Richard L. Skinner
Inspector General

FROM: David L. Norquist
Chief Financial Officer

SUBJECT: Fiscal Year (FY) 2008 Internal Controls over Financial Reporting Audit Opinion

Thank you for the opportunity to review your draft audit opinion of the Department's internal control over financial reporting. I agree with your conclusions. Four years ago the *DHS Financial Accountability Act* posed profound challenges to our new Department. Over the years, I am pleased with how we have worked together to implement the Act. As we conclude the fourth year of implementing the Act, the progress the Department has made is significant. That success began with the strong working relationship between our offices, and in particular, Management's *Internal Control Playbook* and your independent performance audits that together identified the root causes and the necessary corrective actions. While challenges remain, for the second consecutive year the Department has made progress by implementing effective corrective actions. The Department has reduced from 16 to 13, the number of Component conditions that contributed to our material weakness conditions as well as fixing the root cause of other weaknesses. For example:

- The Federal Emergency Management Agency (FEMA) reduced the severity on one half of prior year material weaknesses, including:
  - Corrective actions resulted in $1.8 billion of Mission Assignment deobligations, funding was returned to Disaster Relief Fund for other mission priorities;
  - Conducted inventory counts to be better prepared for the Hurricane Season; and
  - Developed a grant accrual methodology for estimating grant expenses at year end.
- FEMA and U.S. Coast Guard reduced the severity of Departmental Financial Management and Oversight to a reportable condition, a first ever material weakness remediation at U.S. Coast Guard.
- The Transportation Security Administration corrected prior year material weakness conditions related to Other Liabilities and Budgetary Accounting.
- In coordination with the Chief Information Officer, we developed an integrated assessment methodology for information technology general computer controls.
- DHS Office of the Chief Financial Officer sustained FY 2007 progress and for the first time ever does not contribute to a material weakness condition.

The Department has established a Senior Management Council to help ensure progress continues. Thank you for your office's support throughout this audit. I look forward to continued cooperation and progress in the future.

Financial Information

The ***Financial Information*** demonstrates our commitment to effective stewardship over the funds DHS receives to carry out the mission of the Department, including compliance with relevant financial management legislation. It includes the ***Independent Auditors' Report***, an independent auditors' report on the Balance Sheet and Statement of Custodial Activities provided by the Department's Office of Inspector General (OIG), and provides the Department's ***Annual Financial Statements*** and accompanying ***Notes to the Financial Statements***.

Message from the Chief Financial Officer

November 14, 2008

The Annual Financial Report is our principal financial statement of accountability to the President, Congress and the American public, documenting the Department's progress in financial management and stewardship of taxpayer dollars.

More than five years ago, DHS financial management began with limited infrastructure, non-existent business processes, scarce office supplies and a handful of dedicated staff detailed to build the organization from the ground up. We inherited 18 material weaknesses and were put on the Government Accountability Office's high-risk list from day one. What did exist was the desire to make it work. Through strong leadership and the hard work of our teams, we put in place strong internal controls, critical workforce training, and sound policies – the fundamental building blocks for effective financial management.

Since the passage of the DHS Financial Accountability Act in 2004, the Department has worked collaboratively with Congress, the Government Accountability Office, OMB, DHS Office of the Inspector General, and our independent auditor to ensure we achieve the Act's intended outcome of strengthening financial management to support the Department's mission.

The Fiscal Year (FY) 2008 audit shows we continue to make measurable progress and that our corrective actions and internal controls are working. Earlier this year, we released the second edition of the Internal Control Playbook outlining our plan to resolve material weaknesses and build management assurances. I am particularly encouraged with how the corrective actions process has been sustained. Although we know DHS still faces financial management challenges, the auditor acknowledges the significant progress we've made this year and over the past four years. Consider these highlights:

- We reduced the number of material weaknesses from ten in FY 2006, to seven in FY 2007, to six in FY 2008;
- We reduced the number of component conditions contributing to material weaknesses from twenty-five in FY 2006, to sixteen in FY 2007, to thirteen in FY 2008;
- We reduced Department-wide audit qualifications from ten in FY 2006, to six in FY 2007 to three in FY 2008; and
- Fifty percent of our budget is now managed by Components with no material weaknesses compared to seven percent in FY 2005.

Audit challenges remain, albeit in much more focused areas. We will continue to partner with the U.S. Coast Guard, Transportation Security Administration and the Federal Emergency

Management Agency (FEMA) to help resolve material weakness conditions and build upon their demonstrated success. In FY 2008:

- FEMA reduced the severity on half of their prior year material weaknesses;
- The Transportation Security Administration corrected prior year material weakness conditions related to Other Liabilities and Budgetary Accounting; and
- U.S. Coast Guard and FEMA reduced the severity of Departmental Financial Management and Oversight to a reportable condition, a first ever material weakness remediation at U.S. Coast Guard.

We also recognize that strong, stable financial management operations do not rest on one element alone. Over the past several years we have made a concerted effort for comprehensive improvements:

- We improved the efficiency of transaction processing by paying 96 percent of vendors electronically to save taxpayer dollars, reduce paperwork, and strengthen cash management.
- The Department strengthened compliance with the *Improper Payments Information Act*, performed risk assessments to identify programs susceptible to improper payments, tested payments to estimate errors, implemented corrective action plans, and reported results.
- We established a Workforce Development Program to provide training and tools to support job execution, career path development, and talent management to recruit the next generation of financial management leaders. To date, more than 300 employees have been trained in our New Hire Orientation Program.
- We launched the Financial Management Policy Manual online repository which provides DHS guidance for program and budget formulation, budget execution, financial management, accounting, and reporting. In addition, the Manual provides a foundation for a system of effective internal controls to help the Department accomplish its financial management goals and prevent and detect potential waste, fraud, and abuse.
- In 2008, our Performance and Accountability Report was ranked fifth across the federal government for providing effective information on the public benefit and positive outcomes DHS delivers and accounting for our use of tax-payers dollars – achieving a double-digit climb in the rankings from 21st the previous year.

Financial management has come a long way at DHS since its inception. I continue to be inspired by the extraordinary efforts of our dedicated staff at Headquarters and in the Components. We have established a culture of integrity and accountability in all we do. It has been my honor to serve as the Department's Chief Financial Officer. I am pleased we have established a solid foundation in financial management to help ensure the continued success of the Department of Homeland Security.

Sincerely,

David L. Norquist

David L. Norquist
Chief Financial Officer

Introduction

The principal financial statements included in this report are prepared pursuant to the requirements of the *Chief Financial Officers Act of 1990 (P.L. 101-576),* as amended by the *Government Management Reform Act of 1994 (P.L. 103-356)*. Other requirements include the Office of Management and Budget (OMB) Circular Number A-136, *Financial Reporting Requirements*. The responsibility for the integrity of the financial information included in these statements rests with the management of DHS. An independent certified public accounting firm, selected by the Department's Inspector General, was engaged to audit the Balance Sheet and the Statement of Custodial Activity. The independent auditors' report accompanies the principal financial statements. These financial statements include the following:

- The **Balance Sheets** present as of September 30, 2008 and 2007, those resources owned or managed by DHS which represent future economic benefits (assets); amounts owed by DHS that will require payments from those resources or future resources (liabilities); and residual amounts retained by DHS comprising the difference (net position).

- The **Statements of Net Cost** present the net cost of DHS operations for the fiscal years ended September 30, 2008 and 2007. DHS net cost of operations is the gross cost incurred by DHS less any exchange revenue earned from DHS activities.

- The **Statements of Changes in Net Position** present the change in DHS's net position resulting from the net cost of DHS operations, budgetary financing sources, and other financing sources for the fiscal years ended September 30, 2008 and 2007.

- The **Statements of Budgetary Resources** present how and in what amounts budgetary resources were made available to DHS during FY 2008 and FY 2007, the status of these resources at September 30, 2008 and 2007, the changes in the obligated balance, and outlays of budgetary resources for the fiscal years ended September 30, 2008 and 2007.

- The **Statements of Custodial Activity** present the disposition of custodial revenue collected and disbursed by DHS on behalf of other recipient entities for the fiscal years ended September 30, 2008 and 2007.

- The **Notes to the Financial Statements** provide detail and clarification for amounts on the face of the Financial Statements for the fiscal years ended September 30, 2008 and 2007.

Limitations of Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Department, pursuant to the requirements of Title 31, United States Code, Section 3515 (b) relating to financial statements of Federal agencies. While the statements have been prepared from the books and records of the agency in accordance with U.S. Generally Accepted Accounting Principles (GAAP) for Federal agencies and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Independent Auditors' Report

Department of Homeland Security
Office of Inspector General

Independent Auditors' Report on DHS' FY 2008 Financial Statements

OIG-09-09 **November 2008**

Office of Inspector General

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

Homeland Security

November 15, 2008

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.

The attached report presents financial information excerpted from DHS' *Annual Financial Report* (AFR) and the results of the DHS financial statement audits for fiscal year (FY) 2008 and FY 2007. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the audits. The contract required that KPMG perform its audits according to generally accepted government auditing standards and guidance from the Office of Management and Budget and the Government Accountability Office. KPMG was unable to provide an opinion on DHS' balance sheet as of September 30, 2008 and 2007. The FY 2008 auditor's report discusses nine significant deficiencies, six of which are considered material weaknesses in internal control, and eight instances of noncompliance with laws and regulations. KPMG is responsible for the attached auditor's report dated November 14, 2008, and the conclusions expressed in the report. We do not express opinions on DHS' financial statements or internal control or conclusions on compliance with laws and regulations.

The recommendations herein 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

Richard L. Skinner
Inspector General

U.S. DEPARTMENT OF HOMELAND SECURITY

Excerpts from the DHS Annual Financial Report

Table of Contents

Office of Inspector General

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

November 15, 2008

MEMORANDUM FOR:	The Honorable Michael Chertoff Secretary
	Richard L. Skinner
FROM:	Richard L. Skinner Inspector General
SUBJECT:	Independent Auditors' Report on DHS' FY 2008 Balance Sheet and Statement of Custodial Activity

The attached report presents the results of the Department of Homeland Security's (DHS or department) financial statement audits for fiscal year (FY) 2008 and FY 2007. These are mandatory audits required by the *Chief Financial Officers Act of 1990* as amended by *Department of Homeland Security Financial Accountability Act of 2004*. This report is incorporated into the department's FY 2008 *Annual Financial Report*. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the audits.

Generally the mission action plans for DHS' components showed results of continued improvement in financial reporting during FY 2008, although overall the department still has much work remaining. For the fifth year, KPMG was unable to provide an opinion on the department's balance sheet; although elements and conditions of prior year weaknesses have been corrected, except for the improvement in Entity-Level Controls, the material weakness conditions at the department exist in many of the same processes as in prior years.

Summary

KPMG was unable to express an opinion on the department's balance sheets as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended, because DHS was unable to represent that certain financial statement balances were correct, and was unable to provide sufficient evidence to support its financial statements. In connection with the audits, KPMG also considered DHS' internal controls over financial reporting and compliance with certain provisions of laws and regulations. As a result, the FY 2008 Independent Auditors' Report discusses six significant deficiencies considered to be material weaknesses, three other significant deficiencies in internal control, and eight instances of non-compliance with laws and regulations, as follows:

Significant Deficiencies That Are Considered To Be Material Weaknesses

A. Financial Reporting
B. Financial Systems General and Application Controls
C. Fund Balance with Treasury
D. Capital Assets and Supplies
E. Actuarial and Other Liabilities
F. Budgetary Accounting

Other Significant Deficiencies

G. Entity-Level Controls
H. Custodial Revenue and Drawback
I. Deferred Revenue

Non-compliance with Laws and Regulations

J. *Federal Managers' Financial Integrity Act of 1982* (FMFIA)
K. *Federal Financial Management Improvement Act of 1996* (FFMIA)
L. *Single Audit Act Amendments of 1996,* and laws and regulations supporting OMB Circular No. A-50, *Audit Follow-up*, as revised
M. *Improper Payments Information Act of* 2002 (IPIA)
N. Chief Financial Officers Act of 1990
O. *Government Performance and Results Act of 199*3 (GPRA)
P. *Debt Collection Improvement Act of 1996* (DCIA)
Q. Anti-deficiency Act

Moving DHS' Financial Management Forward

While the auditors noted improvement toward correction of internal control weaknesses, the department was unable to represent that its financial statements as of, and for the year ended, September 30, 2008, were presented in conformity with U.S. generally accepted accounting principles. The U.S. Coast Guard (USCG), Transportation Security Administration (TSA), and the Federal Emergency Management Agency (FEMA), were unable to provide sufficient evidence to support account balances presented in the financial statements and collectively contributed to the auditors' inability to render an opinion.

Since last year, the department was able to reduce the number of conditions leading to the independent auditors disclaimer of opinion on DHS' financial statements from six to three. As a result, OFM and the Office of Health Affairs (OHA) no longer contribute to the disclaimer conditions and FEMA remediated all its prior year disclaimer conditions. However, during the FY 2008 audit new disclaimer conditions were identified at TSA and FEMA. TSA was unable to assert that its capital asset balances are fairly stated and FEMA was unable to assert that its capital asset balances, related to internal use software, are fairly stated respectively, at September 30, 2008.

The Coast Guard began FY 2008 with a focus on Entity-Level Controls, and the military portion of the fund balance with Treasury. During FY 2008, Coast Guard made initial steps toward improvements to procedural, control, and personnel by chartering the Senior Management Council (SMC) and revising its Financial Strategy for Transformation and Audit Readiness (FSTAR). To update FSTAR, Coast Guard performed an in-depth root cause analysis that identified seventeen areas for improvement. However, the Coast Guard was unable to fully remediate prior year control weaknesses, and the auditors again reported that the Coast Guard contributed to all six material weaknesses and the Entity-Level Controls significant deficiency.

Many of the DHS' challenges in financial management and reporting can be attributed to the original stand-up of a large, new, and complex executive branch agency without adequate organizational expertise in financial management and accounting. The department made modest progress in remediating weaknesses during FY 2008 and remains committed to focusing on remediation efforts at USCG, FEMA, and TSA, while sustaining progress made throughout FY 2008. During the past year, the department and its components continued the extensive effort to develop meaningful mission action plans to address specific material internal control weaknesses. We are evaluating the effectiveness of those mission action plans in a separate series of audits.

*****

KPMG is responsible for the attached independent auditor's report dated November 14, 2008, and the conclusions expressed in the report. We do not express opinions on financial statements or internal control or conclusions on compliance with laws and regulations.

Consistent with our responsibility under the *Inspector General Act*, we are providing copies of this report to appropriate congressional committees with oversight and appropriation responsibilities over the department. In addition, we will post a copy of the report on our public website.

We request that each of the department's chief financial officers provide us with a corrective action plan that demonstrates progress in addressing the report's recommendations.

We appreciate the cooperation extended to the auditors by the department's financial offices. Should you have any questions, please call me, or your staff may contact Anne Richards, Assistant Inspector General for Audits, at 202-254-4100.

Attachment

KPMG LLP
2001 M Street, NW
Washington, DC 20036

INDEPENDENT AUDITORS' REPORT

Secretary and Inspector General
U.S. Department of Homeland Security:

We were engaged to audit the accompanying balance sheets of the U.S. Department of Homeland Security (DHS or Department) as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended (referred to herein as "financial statements"). In connection with our fiscal year (FY) 2008 audit, we also considered DHS' internal controls over financial reporting, and DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these financial statements. We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources, for the years ended September 30, 2008 and 2007 (referred to herein as "other FY 2008 and 2007 financial statements").

Summary

As discussed in our report on the financial statements, the scope of our work was not sufficient to express an opinion on the DHS balance sheets as of September 30, 2008 and 2007, or the related statements of custodial activity for the years then ended.

As discussed in Note 1.X to the financial statements, in FY 2008, DHS changed its method of accounting for a budgetary allocation transfer made by the Office of Health Affairs (OHA), a DHS component, to another Federal agency.

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

A. Financial Reporting
B. Information Technology General and Application Controls
C. Fund Balance with Treasury
D. Capital Assets and Supplies
E. Actuarial and Other Liabilities
F. Budgetary Accounting
G. Entity Level Controls
H. Custodial Revenue and Drawback
I. Deferred Revenue

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

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*:

J. *Federal Managers' Financial Integrity Act of 1982* (FMFIA)
K. *Federal Financial Management Improvement Act of 1996* (FFMIA)
L. *Single Audit Act Amendments of 1996*, and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-up,* as revised
M. *Improper Payments Information Act of 2002*
N. *Chief Financial Officers Act of 1990*
O. *Government Performance and Results Act of 1993*
P. *Debt Collection Improvement Act of 1996*
Q. *Anti-deficiency Act*

KPMG

We also reported other matters related to compliance with the *Anti-deficiency Act* at the National Protection and Programs Directorate (NPPD), Federal Emergency Management Agency (FEMA), U.S. Coast Guard (USCG) and Federal Law Enforcement Training Center (FLETC).

Other internal control matters and other instances of non-compliance may have been identified and reported had we been able to perform all procedures necessary to express an opinion on the DHS balance sheets as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended, and had we been engaged to audit the other fiscal year 2008 and 2007 financial statements.

The following sections discuss the reasons why we are unable to express an opinion on the accompanying DHS balance sheets as of September 30, 2008 and 2007, and on the statements of custodial activity for the years then ended; our consideration of DHS' internal control over financial reporting; our tests of DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements and other matters; and management's and our responsibilities.

Report on the Financial Statements

We were engaged to audit the accompanying balance sheets of the U.S. Department of Homeland Security as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended. We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the years ended September 30, 2008 and 2007.

The United States Coast Guard (Coast Guard) was unable to provide sufficient evidential matter or make knowledgeable representations of facts and circumstances, that support transactions and account balances of the Coast Guard, as presented in the DHS balance sheets at September 30, 2008 and 2007; particularly with respect to fund balance with Treasury, accounts receivable, inventory and related property, certain categories of property, plant and equipment, actuarially-derived liabilities, environmental and other liabilities, undelivered orders and changes in net position, and adjustments, both manual and automated, made as part of Coast Guard's financial reporting process. The Coast Guard was unable to complete corrective actions and make adjustments, as necessary, to these and other balance sheet amounts, prior to the completion of the DHS FY 2008 *Annual Financial Report* (AFR). Because of the significance of these account balances and/or transactions and conditions noted above, DHS and Coast Guard management were unable to represent that the Coast Guard's balance sheets as of September 30, 2008 and 2007, were fairly stated in conformity with U.S. generally accepted accounting principles. The total assets of Coast Guard, as reported in the accompanying DHS balance sheet, were $17.4 billion and $15.9 billion, or 20 percent of total DHS consolidated assets in both years, as of September 30, 2008 and 2007, respectively.

The Transportation Security Administration (TSA) was unable to fully support the accuracy and completeness of certain capital asset balances and related effects on net position, if any, prior to the completion of the DHS FY 2008 AFR. The TSA capital assets as reported in the accompanying DHS balance sheet as of September 30, 2008, were $932 million or six percent of DHS' consolidated property, plant and equipment.

FEMA was unable to fully support the accuracy and completeness of certain capital assets balances related to internal use software, and related effects on net position, if any, prior to the completion of the DHS FY 2008 AFR. The FEMA capital assets related to internal use software, net as reported in the accompanying DHS balance sheet as of September 30, 2008 were $22 million or 0.2 percent of DHS' consolidated property, plant and equipment, net. In FY 2007, FEMA was unable to fully support the accuracy and completeness of certain stockpiled supplies, unpaid obligations related to mission assignments, and certain grants payable/advances, and the related effects on net position, if any, prior to the completion of the DHS FY 2007 AFR. The stockpiled supplies, as reported in the accompanying DHS balance sheet as of September 30, 2007, were $243 million or 38 percent of DHS' consolidated inventory and related property. FEMA's unpaid obligations related to mission assignments, as reported in the accompanying DHS balance sheet as of September 30, 2007, were $2.6 billion or five percent of DHS' consolidated unexpended appropriations. FEMA's net grants payable/advances, as reported in the DHS balance sheet as of September 30, 2007, were $149 million or three percent of DHS' consolidated accounts payable. The total net position of FEMA as reported in the accompanying DHS balance sheet as of September 30, 2007, was $10.1 billion or 13 percent of DHS' consolidated liabilities and net position.

In FY 2007, DHS Office of Financial Management (OFM) and certain DHS components were unable to reconcile intragovernmental transactions and balances with other Federal trading partners totaling approximately $1.5 billion as of September 30, 2007, prior to the completion of the DHS FY 2007 AFR.

In FY 2007, the DHS Office of Health Affairs (OHA) was unable to provide sufficient evidential matter to support its recording of $1.5 billion in both fund balance with Treasury and undelivered orders at September 30, 2007, resulting from a budgetary allocation transfer made by OHA to another Federal agency in FY 2007. Because of the significance of this allocation transfer, DHS management was unable to represent that the balance sheet of OHA was fairly stated in conformity with U.S. generally accepted accounting principles at September 30, 2007. The total assets of OHA, as reported in the accompanying DHS balance sheet as of September 30, 2007, were $3.3 billion or four percent of total DHS consolidated assets.

In addition, we were unable to obtain certain representations from DHS management regarding the matters described above, including representations as to compliance with U.S. generally accepted accounting principles, with respect to the accompanying DHS balance sheets and related statements of custodial activity as of and for the years ended September 30, 2008 and 2007, and were unable to determine the effect of the lack of such representations on the FY 2008 and 2007 DHS financial statements.

It was impractical to extend our procedures sufficiently to determine the extent, if any, to which the DHS balance sheets as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended, may have been affected by the matters discussed in the six preceding paragraphs. Accordingly, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements and the related notes thereto.

We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the years ended September 30, 2008 and 2007, and accordingly, we do not express an opinion on these financial statements.

As discussed in Note 33, DHS restated its FY 2007 financial statements to correct multiple errors identified by TSA, Coast Guard, OHA, and FLETC, that required adjustment of balances previously reported in DHS' FY 2007 financial statements. Because of the matters discussed in the second paragraph above regarding our FY 2008 audit at Coast Guard, and the control deficiencies described in our report on internal control over financial reporting, we were unable to audit the restatements identified by Coast Guard, and accordingly, we have not concluded on the appropriateness of this accounting treatment or the restatement of the DHS balance sheet as of September 30, 2007.

As discussed in Note 1.X to the financial statements, in FY 2008, DHS changed its method of accounting for a budgetary allocation transfer made by the OHA to another Federal agency that required adjustment of balances previously reported in DHS' FY 2007 financial statements.

The information in the Management's Discussion and Analysis (MD&A), RSSI, and Required Supplementary Information (RSI) sections of the DHS AFR is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We were unable to complete limited procedures over MD&A, RSSI, and RSI as prescribed by professional standards because of the limitations on the scope of our audit described in the previous paragraphs of this section of our report. Certain information presented in the MD&A, RSSI, and RSI is based on FY 2008 and 2007 financial statements on which we have not expressed an opinion. We did not audit the MD&A, RSSI, and RSI, and accordingly, we express no opinion on it.

The information in Other Accompanying Information of DHS' FY 2008 AFR is presented for purposes of additional analysis, and is not a required part of the financial statements. This information has not been subjected to auditing procedures, 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 DHS' 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 DHS' financial statements that is more than inconsequential will not be prevented or detected by DHS' 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 financial statements will not be prevented or detected by DHS' internal control.

Significant deficiencies in internal control over financial reporting and its operation are described in Exhibits I, II, and III. Deficiencies that are considered to be material weaknesses at the Coast Guard, when aggregated with deficiencies existing at other components at the consolidated level, are presented in Exhibit I. Deficiencies that are considered to be material weaknesses at other DHS components, when aggregated with deficiencies existing at the Coast Guard at the consolidated level, are presented in Exhibit II. Exhibit III presents significant deficiencies that are not considered to be material weaknesses when aggregated with deficiencies at all components at the consolidated level. As discussed in the Report on the Financial Statements section, the scope of our work was not sufficient to express an opinion on the balance sheets as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended, and accordingly, other internal control matters may have been identified and reported had we been able to perform all procedures necessary to express an opinion on those financial statements, and had we been engaged to audit the other FY 2008 and 2007 financial statements. A summary of the status of FY 2007 significant deficiencies is included as Exhibit V.

We also noted certain additional deficiencies involving internal control over financial reporting and its operation that we will report to the management of DHS in a separate letter.

Compliance and Other Matters

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

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

The results of our tests of FFMIA, disclosed instances described in Exhibits I, II and III where DHS' 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.

As discussed in our report on the financial statements, the scope of our work was not sufficient to express an opinion on the balance sheets as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended, and accordingly, other instances of noncompliance with laws, regulations, contracts, and grant agreements may have been identified and reported, had we been able to perform all procedures necessary to express an opinion on those financial statements, and had we been engaged to audit the other FY 2008 and 2007 financial statements. In addition, because of the matters discussed in our report on the financial statements, we were unable to perform certain tests of compliance over the Prompt Payment Act and Titles 10, 14, 31 (as related to the Anti-deficiency Act), and 37 of the United States Code at the Coast Guard.

Other Matters. NPPD management has continued a review of the classification and use of certain funds that may identify a violation of the *Anti-deficiency Act*, or other violations of appropriations law in FY 2008 or in previous years. In addition, NPPD management has initiated a review of certain fees collected for attendance at a DHS sponsored annual conference that may identify a violation of the *Anti-deficiency Act*. FLETC management has identified a matter that has been reported as a violation of the *Anti-deficiency Act* related to the classification of a building lease. The Office of Inspector General (OIG) intends to review the classification of two other building leases at FLETC that may identify a violation of the *Anti-deficiency Act* that occurred during previous years. The OIG has initiated a review, at FEMA management's request, of certain expenditures occurring in previous years that may have violated the *Anti-deficiency Act*. Coast Guard management has initiated a review of the use of certain funds to construct assets in previous years that may identify a violation of the *Anti-deficiency Act*.

KPMG

Management's Response to Internal Control and Compliance Findings

DHS management has indicated in a separate letter immediately following this report that it concurs with the findings presented in Exhibits I, II, III, and IV of our report. We did not audit DHS' response, and accordingly, we express no opinion on it.

Responsibilities

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

Auditors' Responsibilities. As discussed in the report on the financial statements section, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the DHS balance sheets as of September 30, 2008 and 2007, or on the related statements of custodial activity for the years then ended; and we were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the years ended September 30, 2008 and 2007.

In connection with our FY 2008 engagement, we considered DHS' internal control over financial reporting by obtaining an understanding of DHS' 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 audit procedures. We did not test all internal controls relevant to operating objectives as broadly defined by the FMFIA. The objective of our engagement was not to express an opinion on the effectiveness of DHS' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of DHS' internal control over financial reporting. Further, other matters involving internal control over financial reporting may have been identified and reported had we been able to perform all procedures necessary to express an opinion on the DHS balance sheet as of September 30, 2008, and the related statement of custodial activity for the year then ended, and had we been engaged to audit the other FY 2008 financial statements.

In connection with our FY 2008 engagement, we performed tests of DHS' 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 balance sheet amounts as of September 30, 2008, and the related statement of custodial activity for the year then ended, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to DHS. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our engagement, and accordingly, we do not express such an opinion. In addition, other matters involving compliance with laws, regulations, contracts, and grant agreements may have been identified and reported had we been able to perform all procedures necessary to express an opinion on the DHS balance sheet as of September 30, 2008, and the related statement of custodial activity for the year then ended, and had we been engaged to audit the other FY 2008 financial statements.

Restricted Use

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

KPMG LLP

November 14, 2008

Independent Auditors' Report
Introduction to Exhibits on Internal Control and Compliance and Other Matters

Our report on internal control over financial reporting and compliance and other matters is presented in accordance with *Government Auditing Standards,* issued by the Comptroller General of the United States. The internal control weaknesses, and findings related to compliance with certain laws, regulations, contracts, and grant agreements presented herein were identified during our engagement to audit the Department of Homeland Security (DHS or Department) balance sheet and related statement of custodial activity as of and for the year ended September 30, 2008. We were not engaged to audit the Department's FY 2008 statements of net cost, changes in net position, and budgetary resources (referred to as other FY 2008 financial statements). Our findings and the status of prior year findings are presented in five exhibits:

Exhibit I Significant deficiencies in internal control identified at the Coast Guard. All of the significant deficiencies reported in Exhibit I are considered material weaknesses that individually, or when combined with other significant deficiencies reported in Exhibit II, are considered material weaknesses at the DHS consolidated financial statement level.

Exhibit II Significant deficiencies in internal control identified at other DHS components (collectively referred to as DHS Civilian Components). All of the significant deficiencies reported in Exhibit II are considered material weaknesses that individually, or when combined with other significant deficiencies reported in Exhibit I, are considered material weaknesses at the DHS consolidated financial statement level.

Exhibit III Significant deficiencies that are not considered a material weakness at the DHS consolidated financial statement level.

Exhibit IV Instances of noncompliance with certain laws, regulations, contracts, and grant agreements that are required to be reported under *Government Auditing Standards* or Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements.*

Exhibit V The status of our findings reported in FY 2007.

As stated in our Independent Auditors' Report, our consideration of internal control over financial reporting would not necessarily disclose all matters that might be significant deficiencies or instances of noncompliance. We were not engaged to audit the other FY 2008 financial statements. In addition, the scope of our work was not sufficient to express an opinion on the financial statements that we were engaged to audit; consequently, other internal control matters and instances of noncompliance may have been identified and reported had we been engaged to audit all of the FY 2008 financial statements, and had we been able to perform all procedures necessary to express an opinion on those financial statements.

The determination of which findings rise to the level of a material weakness is based on an evaluation of how all component conditions, considered in aggregate, may affect the DHS balance sheet as of September 30, 2008, or the related statement of custodial activity for the year then ended.

We have also performed follow-up procedures on findings identified in previous engagements to audit the DHS financial statements. All of the material weaknesses identified and reported in Exhibit I for the Coast Guard are repeated from our FY 2006 and FY 2007 report, and include updates for new findings resulting from our 2008 audit procedures. To provide trend information for the DHS Civilian Components, Exhibit II contains a Trend Table next to the heading of each finding, except Exhibit II-B, *IT General and Application Controls*. The Trend Tables in Exhibit II depict the severity and current status of findings by component that has contributed to that finding from 2006 through 2008. A summary of our findings in FY 2008 and FY 2007 are presented in the Tables below:

Table 1 Presents a summary of our internal control findings, by component, for FY 2008.

Table 2 Presents a summary of our internal control findings, by component, for FY 2007.

We have reported six material weaknesses at the Department level in FY 2008, which is reduced from seven reported in FY 2007. As reported in Exhibit III-G, *Entity Level Controls,* financial management and entity level control deficiencies reported as a material weakness in FY 2007 (Table 2, Comments I-A and II-A below), are reported as a significant deficiency in FY 2008 (Table 1, Comment III-G).

Independent Auditors' Report
Introduction to Exhibits on Internal Control and Compliance and Other Matters

TABLE 1 - SUMMARIZED DHS FY 2008 INTERNAL CONTROL FINDINGS

Comment / Control Deficiency	DHS Consol.	CG	DHS HQ	CBP	CIS	FEMA	FLETC	ICE	S&T	TSA	US Visit
		Military	Civilian Components								
Material Weaknesses:		Exhibit I	Exhibit II								
A Financial Reporting	MW	MW	C			MW				MW	
B IT General and App. Controls	MW	MW	C	SD	SD	MW	SD	C		MW	
C Fund Balance with Treasury	MW	MW									
D Capital Assets and Supplies	MW	MW		SD		MW				MW	C
E Actuarial and Other Liabilities	MW	MW				SD	SD	SD	SD	C	
F Budgetary Accounting	MW	MW		SD		MW				C	
Significant Deficiencies: Exhibit III											
G Entity-Level Controls	SD										
H Custodial Revenue and Drawback	SD										
I Deferred Revenue	SD										

TABLE 2 - SUMMARIZED DHS FY 2007 INTERNAL CONTROL FINDINGS

Comment / Control Deficiency	DHS Consol.	CG	DHS HQ	CBP	CIS	FEMA	FLETC	ICE	S&T	TSA	US Visit
		Military	Civilian Components								
Material Weaknesses:		Exhibit I	Exhibit II								
A Financial Management and ELC	MW	MW				MW					
B Financial Reporting	MW	MW	MW			MW				SD	
C Financial Systems Security	MW	MW	SD	SD		MW	SD	SD		MW	
D Fund Balance with Treasury	MW	MW									
E Capital Assets and Supplies	MW	MW				MW				SD	SD
F Actuarial and Other Liabilities	MW	MW				MW				SD	
G Budgetary Accounting	MW	MW				MW				MW	
Significant Deficiencies: Exhibit III											
H Custodial Revenue and Drawback	SD										

C	Corrected in FY 2008
MW	Material Weakness (individually, or when combined with other components, result in Department level finding)
SD	Significant Deficiency (SD's in Exhibit II contribute to Department level material weakness)
	Contributing to a significant deficiency

All components of DHS, as defined in Note 1A – *Reporting Entity,* to the financial statements, were included in the scope of our engagement to audit the consolidated balance sheet of DHS as of September 30, 2008, and the related statement of custodial activity for the year then ended. Accordingly, our audit considered significant account balances and transactions of other DHS components not listed above. Control deficiencies identified in other DHS components that are not identified in the table above, did not individually, or when combined with other component findings, contribute to a significant deficiency at the DHS consolidated financial statement level.

i.2

Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

I-A Financial Reporting

Background: In FY 2007, we reported that the Coast Guard had several internal control weaknesses that led to a material weakness in financial reporting. In FY 2008, the Coast Guard revised its *Financial Strategy for Transformation and Audit Readiness* (FSTAR). The FSTAR is a comprehensive plan to identify and correct the root causes of control deficiencies. However, most of the actions outlined in FSTAR are scheduled to occur after FY 2008, and consequently, the Coast Guard was not able to make substantial progress in correcting the deficiencies we reported in previous years, and repeated below.

Conditions: The Coast Guard:

- Has not developed and implemented an effective general ledger system. The Core Accounting System (CAS), Aircraft Logistics Management Information System (ALMIS), and Naval Engineering Supply Support System (NESSS) general ledgers do not comply with the requirements of the *Federal Financial Management Improvement Act* (FFMIA), We noted that:
  - The general ledgers do not allow for compliance with the United States Standard General Ledger (USSGL) at the transaction level. For example, the general ledgers include non-compliant account definitions, invalid accounts, improper posting logic codes and inconsistent crosswalks to the Coast Guard *Treasury Information Executive Repository* (TIER) database;
  - The CAS general ledger includes static balances related to a legacy general ledger conversion;
  - Financial data in the general ledger may be compromised by automated and manual changes that are unsubstantiated, through the use of information technology (IT) scripts;
  - Financial information submitted to the Department for consolidation is from a database that does not maintain detail at the transaction level and is not reconciled or supported by the transaction level detail in the Coast Guard's three general ledgers; and
  - Topside adjustments necessary to close and report financial activity are not recorded at the transaction level in the respective general ledgers. Period-end and opening balances are not supported by transactional detail in the three general ledgers.
- Does not have properly designed, implemented and effective policies, procedures, and controls surrounding its financial reporting process, in order to support beginning balances, year-end close-out, and the cumulative results of operation analysis. For example, the Coast Guard does not have effective policies, procedures and / or internal controls:
  - To identify the cause and resolve system-level abnormal balances and account relationship discrepancies, e.g., budgetary to proprietary reconciliations, and identified potential errors in its financial data;
  - Over the process of preparing and reviewing adjustments to account balances and financial statement disclosures, and uses high-level analytical comparisons to identify adjusting entries;
  - To assess potential financial system problems, such as posting logic errors and automated changes to financial data through scripts (system modifications);
  - To record, review, and monitor accounts receivable activity;
  - To compile, support, review, and report financial statement disclosures submitted for incorporation in the DHS financial statements, to include the effective completion of the U.S. Government Accountability Office (GAO) Disclosure Checklist and valid support for the preparation of statement of net cost disclosures; and
  - To track and reconcile intragovernmental transactions with its Federal trading partners, especially those outside DHS, and to determine that Coast Guard intragovernmental balances, as reported in the DHS financial statements, are complete, accurate, appropriately valued, belong to the Coast Guard, and presented properly in the financial statements.

Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

Cause/Effect: Some of the conditions described above are related to the conditions described in Exhibit III-G *Entity-Level Controls.* The Coast Guard has general ledger structural and IT system functionality deficiencies that make the financial reporting process more complex and difficult. The financial reporting process is overly complex, labor intensive, and requires a significant number of topside adjustments (adjustments made outside the core accounting system for presentation of financial information given to the Department for consolidation). The accuracy of financial information is highly dependent on the knowledge and experience of a limited number of key financial personnel rather than on clearly documented procedural manuals and process-flow documentation. Consequently, the Coast Guard can not be reasonably certain that its financial statements are complete or accurate at any time. In its annual Assurance Statement provided to the DHS Secretary in September 2008, the Coast Guard was unable to provide reasonable assurance that internal controls over financial reporting are operating effectively, and was unable to represent to its auditors that any significant balance sheet line items, except for investments and contingent liabilities, are fairly stated at September 30, 2008.

Criteria: FFMIA Section 803(a) requires that Federal financial management systems comply with (1) Federal accounting standards, (2) Federal system requirements, and (3) the 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.

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) requires that agencies establish internal controls according to standards prescribed by the Comptroller General and specified in the GAO *Standards for Internal Control in the Federal Government (Standards).* These standards define internal control as 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.

The GAO *Standards* require that internal controls be documented in management directives, administrative policies or operating manuals; transactions and other significant events be clearly documented; and information be recorded and communicated timely with those who need it within a timeframe that enables them to carry out their internal control procedures and other responsibilities.

The *Treasury Federal Intragovernmental Transactions Accounting Policies Guide,* dated August 15, 2008, and OMB Circular No. A-136, *Financial Reporting Requirements,* as revised, require Federal CFO Act and non-CFO Act entities identified in the Treasury Financial Manual (TFM) 2008, 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.

Recommendations: We recommend that the Coast Guard:

1. Implement an integrated general ledger system that is FFMIA compliant. Until an integrated general ledger system is implemented, ensure that all financial transactions and adjustments, including top-side entries, are recorded in the proper general ledger at the detail USSGL transaction level as they occur, and all financial statement line items should be reconciled and supported by transactional detail contained in the general and subsidiary ledgers;
2. Conduct an assessment to identify and remove all non-compliant chart of account definitions, invalid and static accounts, identify any improper posting logic transaction codes, and identify inconsistencies in crosswalks to the TIER database provided to DHS OFM for consolidation;
3. Identify and evaluate each manual and automated IT script to determine the effect on the current year and prior year financial statement balances, and make adjustments in the appropriate general ledger system, as necessary;
4. Establish new or improve existing policies, procedures, and related internal controls to ensure that:

Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

a) The year-end close-out process, reconciliations, and financial data and account analysis procedures are supported by documentation, including evidence of effective management review and approval, and beginning balances in the following year are determined to be reliable and auditable;

b) Topside adjustments to account balances and abnormal balances and account relationship discrepancies, e.g., budgetary to proprietary reconciliations, are identified, reviewed, and documented;

c) Account reconciliations, for each of the three general ledgers and the monthly TIER submission, are performed timely each month, and differences are researched and resolved before the next month's reporting cycle. Reconciliations should include all funds maintained by the Coast Guard, including revolving, special, and trust funds;

d) All accounts receivables are identified and comprehensive Coast Guard-wide policies and procedures are implemented, including internal controls at a sufficient level of detail to determine that the accounts receivable process is effective to support management assertions, in compliance with generally accepted accounting principles, for the accounts receivable balance reported on the Coast Guard balance sheet; and

e) Financial statement disclosures submitted for incorporation in the DHS financial statements are compiled, supported, reviewed, and reported, to include the effective completion the GAO Disclosure Checklists and valid support for the preparation of the statement of net cost disclosure; and

5. Establish a formal documented review and approval process over reconciliation activities performed by Coast Guard to ensure that all intragovernmental activity and balances are identified and differences are being resolved in a timely manner in coordination with the Department's OFM. Intragovernmental balances should be reconciled to supporting detail files prior to submission to OFM.

I-B Information Technology (IT) General and Application Controls

Background: The Coast Guard maintains three general ledger systems that support its financial statements and other financial data provided to DHS OFM for consolidation, which are CAS, ALMIS, and NESSS – described in Exhibit I-A, *Financial Reporting*. Our audit included a review of the Coast Guard's IT general controls (ITGC), and specifically 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. During FY 2008, the Coast Guard took actions to improve aspects of its ITGC to address our prior year findings; however, the Coast Guard did not make all of the necessary improvements that they had planned to make during the year.

Conditions: During our FY 2008 ITGC testing, we identified 22 findings, of which 21 were repeat findings from prior years and one is a new finding. The ITGC and other financial system control weaknesses were identified at Coast Guard Headquarters and its components. We noted control deficiencies in three general control areas that when combined, present more than a remote possibility of materially impacting financial data integrity. The control deficiencies identified included:

- Weak security configurations and excessive access to key Coast Guard financial applications, as well as lack of review of privileged user actions;
- Application change control processes that are not adequately designed nor operating effectively; and
- Entity-wide security program deficiencies involving personnel background checks, IT security awareness training, policies and procedures for prompt employee termination, and lack of finalized certification and accreditation documentation.

The application change control process (second bullet), above is considered to be a material weakness impacting the DHS consolidated financial statements. In addition, the control deficiencies in application

Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

change control processes are among the principle causes of the Coast Guard's inability to support its financial statement balances. See Exhibit I-A, *Financial Reporting,* for a discussion of the related conditions causing significant noncompliance with the requirements of FFMIA. Our ITGC findings are described in greater detail in a separate *Limited Official Use* (LOU) letter provided to the Coast Guard and DHS management.

Cause/Effect: The Coast Guard has made progress correcting certain ITGC weaknesses identified in previous years. Specifically, the Coast Guard was able to close out 20 prior-year findings in the area of access controls, entity-wide security program, and service continuity. In addition, the Coast Guard has enhanced the assessment of the root cause of the ITGC weaknesses in order to effectively remediate issues; however, the Coast Guard was not able to fully implement all of its plans of action and milestones to remediate all ITGC control deficiencies in FY 2008.

Many of these weaknesses were inherited from system development activities that did not incorporate strong security controls during the initial implementation of the system more than five years ago, and will take several years to fully address. These weaknesses exist both in the documentation of processes and the implementation of adequate security controls over processes and within financial systems. Specifically, policies and procedures supporting the operation of various processes within control areas such as change control were developed without taking into account required security practices. Consequently, as policies and procedures are updated, many Coast Guard components are challenged to move away from previous methodologies and fully implement and enforce these new controls.

The effect of these ITGC weaknesses limits the Coast Guard's ability to ensure that critical financial data is reliable and is maintained in a manner to ensure confidentiality, integrity, and availability. In addition, as a result of the presence of IT weaknesses, there is added dependency on the other mitigating manual controls to be operating effectively at all times. Because mitigating controls often require more human involvement, there is an increased risk that human error could materially affect the financial statements.

Criteria: The *Federal Information Security Management Act* (FISMA), passed as part of the *Electronic Government Act of 2002,* mandates that Federal entities maintain IT security programs in accordance with National Institute of Standards and Technology (NIST) guidance.

OMB Circular No. A-130, *Management of Federal Information Resources,* describes specific essential criteria for maintaining effective general IT controls.

FFMIA sets forth legislation prescribing policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems. The purpose of FFMIA is (1) to provide for consistency of accounting by an agency from one fiscal year to the next, and uniform accounting standards throughout the Federal Government, (2) require Federal financial management systems to support full disclosure of Federal financial data, including the full costs of Federal programs and activities, (3) increase the accountability and credibility of federal financial management, (4) improve performance, productivity and efficiency of Federal Government financial management, and (5) establish financial management systems to support controlling the cost of Federal Government.

OMB Circular No. A-123, *Management's Responsibility for Internal Control,* states, "Agency managers should continuously monitor and improve the effectiveness of internal control associated with their programs. This continuous monitoring, and other periodic evaluations, should provide the basis for the agency head's annual assessment of and report on internal control, as required by FMFIA." This Circular indicates that "control weaknesses at a service organization could have a material impact on the controls of the customer organization. Therefore, management of cross-servicing agencies will need to provide an annual assurance statement to its customer agencies in advance to allow its customer agencies to rely upon that assurance statement. Management of cross-servicing agencies shall test the controls over the activities for which it performs for others on a yearly basis. These controls shall be highlighted in management's annual assurance statement that is provided to its customers [e.g., TSA]. Cross-servicing and customer agencies will need to coordinate the timing of the assurance statements."

DHS' *Sensitive Systems Policy Directive, 4300A*, as well as the DHS' *Sensitive Systems Handbook* documents policies and procedures adopted by DHS intended to improve the security and operation of all DHS IT systems including the Coast Guard IT systems.

Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

The GAO's *Federal Information System Controls Audit Manual* (FISCAM) provides a framework and recommended audit procedures that are used to conduct the IT general control test work.

Recommendations: We recommend that the DHS Office of Chief Information Officer in coordination with the Office of the Chief Financial Officer (OCFO) make the following improvements to the Coast Guard's financial management systems:

1. Implement the recommendations in our LOU letter provided to the Coast Guard and DHS management, to effectively address the deficiencies identified including: (1) weak security configurations and excessive access to key Coast Guard financial applications, including review of as of privileged user actions, (2) application change control processes, and (3) entity-wide security program issues;
2. Design and implement plan of action and milestones that address the root cause of the weakness; and
3. Develop and implement policies and procedures that appropriately consider required security practices when supporting the operation of various processes within the change control area.

I-C Fund Balance with Treasury

Background: In FY 2007, we reported a material weakness in Fund Balance with Treasury (FBwT) at the Coast Guard. In FY 2008, the Coast Guard revised its remediation plan (FSTAR); however, the majority of corrective actions are scheduled to occur after FY 2008, and accordingly, many of the conditions stated below are repeated from our FY 2007 report. FBwT at the Coast Guard totaled approximately $5.2 billion, or approximately 8.3 percent of total DHS FBwT, at September 30, 2008. The majority of these funds represented appropriated amounts that were obligated, but not yet disbursed, as of September 30, 2008.

Conditions: The Coast Guard has not developed and validated a comprehensive process, to include effective internal controls, to ensure that FBwT transactions exists and are complete and accurate. For example, the Coast Guard:

- Did not maintain adequate supporting documentation that validated the accuracy for five of the six Coast Guard Agency Location Codes FBwT reconciliations;
- Recorded adjustments to the general ledger FBwT accounts including adjustments to agree Coast Guard balances to Treasury amounts, that were unsupported and subsequently submitted to the Treasury;
- Does not have an effective process for clearing of suspense account transactions related to FBwT. The Coast Guard lacks documented and effective policies and procedures and internal controls necessary to support the completeness, existence, and accuracy of suspense account transactions. In addition, the Coast Guard was unable to produce complete and accurate detail listings of suspense transactions recorded in the general ledger; and
- Was unable to provide military and civilian payroll data to support the summary payroll transactions processed through the Coast Guard's FBwT. In addition, the Coast Guard lacked formal policies and procedures for processing and documenting all military and civilian payroll transactions.

Cause/Effect: The Coast Guard had not designed and implemented accounting processes, including a financial system that complies with federal financial system requirements, as defined in OMB Circular No. A-127, *Financial Management Systems*, and the requirements of the *Joint Financial Management Improvement Program* (JFMIP), now administered by the *Financial Systems Integration Office* (FSIO), to fully support the FY 2008 FBwT activity and balance as of September 30, 2008. Failure to implement timely and effective reconciliation processes could increase the risk of undetected errors and/or violations of appropriation laws, including instances of undiscovered *Anti-deficiency Act* violations or fraud, abuse and mismanagement of funds, which could lead to inaccurate financial reporting and affects DHS' ability to effectively monitor its budget status.

Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

Criteria: Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities,* paragraph 39 states, "Federal entities should explain any discrepancies between fund balance with Treasury in their general ledger accounts and the balance in the Treasury's accounts and explain the causes of the discrepancies in footnotes to the financial statements. (Discrepancies due to time lag should be reconciled and discrepancies due to error should be corrected when financial reports are prepared). Agencies also should provide information on unused funds in expired appropriations that are returned to Treasury at the end of a fiscal year."

Per *Fund Balance with Treasury Reconciliation Procedures, a Supplement to the I TFM 2-5100*, Section V, "Federal agencies must reconcile their SGL 1010 account and any related subaccounts [...] on a monthly basis (at minimum). [...] Federal agencies must [...] resolve all differences between the balances reported on their G/L FBwT accounts and balances reported on the [*Government-wide Accounting* system (GWA)]." In addition, "An agency may not arbitrarily adjust its FBWT account. Only after clearly establishing the causes of errors and properly documenting those errors, should an agency adjust its FBWT account balance. If an agency must make material adjustments, the agency must maintain supporting documentation. This will allow correct interpretation of the error and its corresponding adjustment."

Section 803(a) of FFMIA requires that Federal financial management systems comply with (1) Federal accounting standards, (2) Federal financial management system requirements, and (3) the 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.

The GAO *Standards* hold that transactions should be properly authorized, documented, and recorded accurately and timely.

Recommendations: We recommend that the Coast Guard:

1. Establish policies, procedures, and internal controls to ensure that FBwT transactions are recorded accurately and completely and in a timely manner, and that all supporting documentation is maintained for all recorded transactions. These policies and procedures should allow the Coast Guard to:
   a) Perform complete and timely FBwT reconciliations using the Treasury Government-wide Accounting tools;
   b) Better manage its suspense accounts to include researching and clearing items carried in suspense clearing accounts in a timely manner during the year, and maintaining proper supporting documentation in clearing suspense activity; and
   c) Maintain payroll data supporting payroll transactions processed through FBwT and have access to complete documentation, if needed.

I-D Capital Assets and Supplies

Background: The Coast Guard maintains approximately 59 percent of all DHS property, plant, and equipment (PP&E), including a large fleet of boats and vessels. Many of the Coast Guard's assets are constructed over a multi-year period, have long useful lives, and undergo extensive routine servicing that may increase their value or extend their useful lives. In FY 2008, the Coast Guard revised corrective action plans (FSTAR) to address the PP&E process and control deficiencies, and began remediation efforts. However, the FSTAR is scheduled to occur over a multi-year time-frame. Consequently, most of the conditions cited below have been repeated from our FY 2007 report.

Operating Materials and Supplies (OM&S) are maintained by the Coast Guard in significant quantities and consist of tangible personal property to be consumed in normal operations to service marine equipment, aircraft, and other operating equipment. The majority of the Coast Guard's OM&S is physically located at either two Inventory Control Points (ICPs) or in the field. The Coast Guard's policy requires regularly scheduled physical counts of OM&S, which are important to the proper valuation of OM&S and its safekeeping. The conditions cited below for OM&S have been repeated from our FY 2007 report.

Conditions: The Coast Guard has not:

Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

Regarding PP&E:

- Consistently applied policies and procedures to ensure appropriate documentation supporting PP&E acquisitions, and their existence, is maintained to support capitalized PP&E. In cases where original acquisition documentation has not been maintained, the Coast Guard has not developed and documented methodologies and assumptions to support the value of PP&E;
- Implemented appropriate controls and related processes to accurately, consistently, and timely record additions to PP&E and construction in process (CIP), transfers from other agencies, disposals in its fixed asset system, and valuation and classification of repairable PP&E;
- Implemented accurate and complete asset identification, system mapping, and tagging processes that include sufficient detail, e.g., serial number, to clearly differentiate and accurately track physical assets to those recorded in the fixed asset system; and
- Properly accounted for some improvements and impairments to buildings and structures, capital leases, and selected useful lives for depreciation purposes, consistent with generally accepted accounting principles (GAAP).

Regarding OM&S:

- Implemented policies, procedures, and internal controls to support the completeness, accuracy, existence, valuation, ownership, and presentation assertions related to the FY 2008 OM&S and related account balances;
- Fully designed and implemented policies, procedures, and internal controls over physical counts of OM&S to remediate conditions identified in previous years;
- Properly identified (bar-coded or tagged) recorded OM&S; and
- Established processes and controls to fully support the calculated value of certain types of OM&S to approximate historical cost.

Cause/Effect: PP&E policies and procedures are not appropriately designed, consistently followed, or do not include sufficient controls to ensure compliance with policy or to ensure complete supporting documentation is maintained and readily-available. The fixed asset module of the Coast Guard's CAS is not updated for effective tracking and reporting of PP&E. As a result, the Coast Guard is unable to accurately account for its PP&E, and provide necessary information to DHS OFM for consolidated financial statement purposes.

Coast Guard management deferred correction of most OM&S weaknesses reported in previous years, and acknowledged that the conditions we reported in prior years remained throughout FY 2008. Lack of comprehensive and effective policies and controls over the performance of physical counts, and appropriate support for valuation, may result in errors in the physical inventory process or inventory discrepancies that could result in financial statement misstatements.

Criteria: SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, provides the general requirements for recording and depreciating property, plant and equipment.

The Federal Accounting Standards Advisory Board (FASAB)'s Federal Financial Account Standards Interpretation No. 7, dated March 16, 2007, defines "items held for remanufacture" as items "in the process of (or awaiting) inspection, disassembly, evaluation, cleaning, rebuilding, refurbishing and/or restoration to serviceable or technologically updated/upgraded condition. Items held for remanufacture may consist of: Direct materials, (including repairable parts or subassemblies […]) and Work-in-process (including labor costs) related to the process of major overhaul, where products are restored to 'good-as-new' condition and/or improved/upgraded condition. 'Items held for remanufacture' share characteristics with 'items held for repair' and items in the process of production and may be aggregated with either class. Management should use judgment to determine a reasonable, consistent, and cost-effective manner to classify processes as 'repair' or 'remanufacture'."

Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

FFMIA Section 803(a) requires each agency to implement and maintain a system that complies substantially with Federal financial management system requirements. OMB Circular No. A-127 prescribes the standards for federal agencies' financial management systems. That Circular requires an agency's system design to have certain characteristics that include consistent "internal controls over data entry, transaction processing, and reporting throughout the system to ensure the validity of the information and protection of Federal Government resources."

According to GAO *Standards for Internal Control in the Federal Government*, assets at risk of loss or unauthorized use should be periodically counted and compared to control records. Policies and procedures should be in place for this process. The FSIO publication, *Inventory, Supplies, and Material System Requirements,* states that "the general requirements for control of inventory, supplies and materials consist of the processes of receipt and inspection, storing, and item in transit." Specifically, the "placement into inventory process" requires that an agency's inventory, supplies and materials system must identify the intended location of the item and track its movement from the point of initial receipt to its final destination." SFFAS No. 3, *Accounting for Inventory and Related Property*, states OM&S shall be valued on the basis of historical cost.

Recommendations: We recommend that the Coast Guard:

Regarding PP&E:

1. Improve controls and related processes and procedures to ensure that documentation supporting existing PP&E acquisitions, additions, transfers, and disposals, to include the CIP process, is maintained to support capitalized PP&E;
2. Implement processes and controls to record PP&E transactions accurately, consistently, and timely in the fixed asset system; record an identifying number in the fixed asset system at the time of asset purchase to facilitate identification and tracking; and ensure that the status of assets is accurately maintained in the system;
3. Revise procedures for performing physical inventories of repairable items, to include procedures for resolving differences and reporting results, to ensure that repairable PP&E is accurately and completely classified and recorded. Support the pricing methodology used to value repairable PP&E to ensure that balances, as presented in the financial statements, approximate amortized historical cost; and
4. Review policies and procedures to account for improvements and impairments to buildings and structures, capital leases, and identify proper useful lives for depreciation purposes in accordance with GAAP.

Regarding OM&S:

5. Update OM&S physical count policies, procedures, and controls, and provide training to personnel responsible for conducting physical inventories, and include key elements of an effective physical inventory in the policies;
6. Consider adopting an inventory control system for OM&S as a method of tracking usage and maintaining a perpetual inventory of OM&S on hand; and
7. Establish processes and controls to support the calculated value of OM&S to ensure accounting is consistent with GAAP.

I-E Actuarial and Other Liabilities

Background: The Coast Guard maintains pension, medical, and post employment travel benefit programs that require actuarial computations to record related liabilities for financial reporting purposes. The Military Retirement System (MRS) is a defined benefit plan that covers both retirement pay and health care benefits for all active duty and reserve military members of the Coast Guard. The medical plan covers active duty, reservists, retirees/survivors and their dependents that are provided care at Department of Defense (DoD) medical facilities. The post employment travel benefit program pays the cost of

Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

transportation for uniformed service members upon separation from the Coast Guard. Annually, participant and cost data is extracted by the Coast Guard from its records and provided to an actuarial firm as input for the liability calculations. The accuracy of the actuarial liability as reported in the financial statements is dependent on the accuracy and completeness of the underlying participant and cost data provided to the actuary as well as the reasonableness of the assumptions used. A combined unfunded accrued liability of approximately $30.1 billion for the plans is reported in the DHS consolidated balance sheet as of September 30, 2008.

The Coast Guard estimates accounts payable as a percentage of undelivered orders (UDOs) based on historical trends. As described in Exhibit I-F, *Budgetary Accounting*, reliable accounting processes surrounding the recording of obligations and disbursements, and tracking of UDOs, are key to the accurate reporting of accounts payable in the Coast Guard's financial statements.

The Coast Guard's environmental liabilities consist of two main types: shore facilities and vessels. Shore facilities include any facilities or property other than ships, e.g., buildings, fuel tanks, lighthouses, small arms firing ranges (SAFRs), etc.

The Coast Guard estimates its legal liabilities to include Oil Spill Liability Trust Fund claims that are incorporated, and recorded, as part of the DHS legal liability on DHS financial statements.

Conditions: We noted the following internal control weaknesses related to actuarial and other liabilities. The Coast Guard does not:

- Have effective policies, procedures, and controls to ensure the completeness and accuracy of participant data, medical cost data, and trend and experience data provided to, and used by, the actuary for the calculation of the MRS pension, medical, and post employment benefit liabilities. Reconciliations between subsidiary and general ledger amounts for medical expenditures are not effective;

- Have effective policies, procedures and internal controls over the Coast Guard's process for reconciling military payroll recorded in the CAS general ledger to detail payroll records. Military personnel data changes, including changes in leave balances and payroll corrections, are not processed in the appropriate payroll and/or reporting periods, and consequently impact the completeness and accuracy of leave and payroll accruals as well as data used for actuarial projections;

- Use a reliable methodology to estimate accounts payable. The method used was not supported as to the validity of data, assumptions, and criteria used to develop and subsequently validate the reliability of the estimate for financial reporting; and

- Support the completeness, existence, and accuracy assertions of the data utilized in developing the estimate for the FY 2008 environmental liability account balance. The Coast Guard has not fully developed, documented, and implemented the policies and procedures in developing, preparing, and recording the environmental liability estimates related to shore facilities, and has not approved policies and procedures for the review of the environmental liability estimate related to vessels.

Cause/Effect: Much of the data required by the actuary comes from personnel and payroll systems that are outside of the Coast Guard's accounting organization and are instead managed by the Coast Guard's Personnel Service Center (PSC). The Coast Guard has not updated its experience study since 2006, which contained several errors, and therefore, management is unable to provide assurance on the completeness and accuracy of the experience study which affects the completeness and accuracy of actuarially determined liabilities as stated in the DHS consolidated balance sheet at September 30, 2008. In addition, the Coast Guard does not have sufficient controls to prevent overpayments for medical services. Thus, inaccurate medical costs submitted to the Coast Guard actuary could result in a misstatement of the actuarial medical liability and related expenses.

The Coast Guard has not yet developed comprehensive policies and procedures or corrective action plans to address the conditions above, and consequently, management is unable to assert to the accuracy and completeness of the accounts payable and payroll accruals recorded as of September 30, 2008.

Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

Criteria: According to SFFAS No. 5, *Accounting for Liabilities of the Federal Government,* paragraph 95, the employer should recognize an expense and a liability for other post employment benefits (OPEB) when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the reporting date. Further, the long-term OPEB liability should be measured at the present value of future payments, which requires the employer to estimate the amount and timing of future payments, and to discount the future outflow over the period for which the payments are to be made.

The GAO *Standards* hold that transactions should be properly authorized, documented, and recorded accurately and timely. SFFAS No. 1 states, "When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of the goods. If invoices for those goods are not available when financial statements are prepared, the amounts owed should be estimated."

Statement on Auditing Standards (SAS) No. 57, *Auditing Accounting Estimates,* states "An entity's internal control may reduce the likelihood of material misstatements of accounting estimates." The standard specifically identifies, "accumulation of relevant, sufficient, and reliable data on which to base an accounting estimate," and "comparison of prior accounting estimates with subsequent results to assess the reliability of the process used to develop estimates" as two relevant aspects of internal control.

Federal Accounting Standards Advisory Board (FASAB) Technical Release No. 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government,* states that an agency is required to recognize a liability for environmental cleanup costs as a result of past transactions or events when a future outflow or other sacrifice of resources is probable and reasonably estimable. Probable is related to whether a future outflow will be required. Reasonably estimable relates to the ability to reliably quantify in monetary terms the outflow of resources that will be required.

Recommendations: We recommend that the Coast Guard:

Regarding actuarial liabilities:

1. Establish and document policies, procedures, and effective controls to ensure the completeness and accuracy of the actuarial pension, medical, and post employment travel benefit liabilities;
2. Establish and document policies, procedures, and effective controls to ensure the completeness and accuracy of participant data, medical cost data, and trend and experience data provided to, and used by, the actuary for the calculation of the MRS pension, medical, and post employment travel benefit liabilities; and
3. Perform a periodic reconciliation between the medical expenditures recorded in the subsidiary ledger and those recorded in the CAS, and address differences before data is provided to the actuary. This reconciliation should be performed for all significant sources of medical actuarial data, including TriCare, and DoD Military Treatment Facilities (MTFs). In addition, this reconciliation should be reviewed by someone other than the preparer to ensure accuracy.

Regarding accounts payable and payroll:

4. Analyze and make appropriate improvements to the methodology used to estimate accounts payable and support all assumptions and criteria with appropriate documentation to develop and subsequently validate the estimate for financial reporting; and
5. Implement corrective action, including appropriately designed and implemented internal controls, to support the completeness, existence, and accuracy of changes in member personnel data records and military payroll transactions, and to include recorded accrued military leave and payroll liabilities.

Regarding environmental liabilities:

6. Develop consistent written agency-wide policies, procedures, processes, and controls to ensure identification of and recording of all environmental liabilities, define the technical approach, cost estimation methodology, and overall financial management oversight of its environmental remediation projects. The policies should include:

Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

a) Procedures to ensure the proper calculation and review of cost estimates for consistency and accuracy in financial reporting, including the use of tested modeling techniques, use of verified cost parameters, and assumptions;

b) Periodically validate estimates against historical costs; and

c) Ensure that detailed cost data is maintained and reconciled to the general ledger.

I-F Budgetary Accounting

Background: Budgetary accounts are a category of general ledger accounts where transactions related to the receipt, obligation, and disbursement of appropriations and other authorities to obligate and spend agency resources are recorded. Each Treasury Account Fund Symbol (TAFS) with separate budgetary accounts must be maintained in accordance with OMB and Treasury guidance. The Coast Guard has over 90 TAFS covering a broad spectrum of budget authority, including annual, multi-year, and no-year appropriations; and several revolving, special, and trust funds. In addition, the Coast Guard estimates accounts payable at year end as a percentage of UDOs based on historical trends. Reliable accounting processes surrounding obligations, UDOs and disbursements are key to the accurate reporting of accounts payable in the DHS consolidated financial statements.

Conditions: We noted the following internal control weaknesses related to budgetary accounting, many of which were repeated from our FY 2007 report.

- The policies, procedures and internal controls over the Coast Guard's process for validation and verification of UDO balances are not effective to ensure that recorded obligations and UDO balances were complete, valid, accurate, and that proper approvals and supporting documentation is maintained.
- Procedures used to record commitment/obligations and internal controls within the process have weaknesses that could result in obligations of funds in excess of the apportioned and/or allotted amounts. In addition, the Coast Guard has not fully implemented current policies and procedures to monitor un-obligated commitment activity in CAS throughout the fiscal year as only a de-commitment process is executed at year end.
- The Coast Guard's procedures, processes, and internal controls in place to verify the completeness and accuracy of the year-end obligation pipeline adjustment to record all executed obligations were not properly designed and implemented. These deficiencies affected the completeness, existence, and accuracy of the year-end "pipeline" adjustment that was made to record obligations executed before year end.
- Automated system controls are not effectively used to prevent the processing of procurement transactions by an individual who does not have warrant authority, or by contracting officer's with expired warrant authority.

Cause/Effect: Several of the Coast Guard's budgetary control weaknesses can be corrected by modifications or improvements to the financial accounting system, process improvements, and strengthened policies and internal controls. Weak controls in budgetary accounting, and associated contracting practices increase the risk that the Coast Guard could violate the *Anti-deficiency Act* and overspend its budget authority. The financial statements are also at greater risk of misstatement. The untimely release of commitments may prevent funds from being used timely for other purposes.

Criteria: According to the Office of Federal Financial Management's *Core Financial System Requirements*, dated January 2006, an agency's core financial management system must ensure that an agency does not obligate or disburse funds in excess of those appropriated or authorized, and "the Budgetary Resource Management Function must support agency policies on internal funds allocation methods and controls." The *Federal Acquisition Regulation* (FAR) Section 1.602 addresses the authorities and responsibilities granted to contracting officers. Treasury's USSGL guidance at TFM S2 08-03 (dated August 2008) specifies the accounting entries related to budgetary transactions.

Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

FFMIA Section 803(a) requires that each Agency implement and maintain a system that complies substantially with Federal financial management system requirements. OMB Circular No. A-127 sets forth the standards for federal financial management systems.

Recommendations: We recommend that the Coast Guard:

1. Improve policies, procedures, and the design and effectiveness of controls related to processing obligation transactions, including periodic review and validation of UDOs. Emphasize to all fund managers the need to perform effective reviews of open obligations, obtain proper approvals, and retain supporting documentation;
2. Revise controls and related policies and procedures to periodically review commitments;
3. Improve procedures, processes, and internal controls to verify the completeness and accuracy of the year-end obligation pipeline adjustment to record all executed obligations for financial reporting; and
4. Establish automated system controls to prevent incurring a commitment/obligation in excess of established targets so that funds are not obligated in excess of the apportioned and allotted amounts and preclude the processing of procurement transactions if the contracting officer's warrant authority had expired.

Independent Auditors' Report
Exhibit II – Material Weaknesses – DHS Civilian Components

II-A Financial Reporting (TSA and FEMA)

	2008	2007	2006
DHS-HQ	C	MW	MW
FEMA	MW	MW	
TSA	MW	SD	MW

Key – Trend Table	
C	Corrected
SD	Significant Deficiency*
MW	Material Weakness*
* See Introduction	

Background: Since 2006, the Transportation Security Administration (TSA) has had difficulty establishing baseline accounting policies, procedures, and processes, with well-designed and effective internal controls. The transition to the Coast Guard's *Core Accounting System* (CAS) for its primary general ledger required the development and implementation of many new accounting processes and procedures, some of which were needed to mitigate information technology (IT) general control weaknesses that currently exist in CAS. In FY 2007, TSA adopted a two-year corrective action plan to address its financial reporting and other accounting internal control weaknesses, and progress has been made in correcting some material weaknesses identified in FY 2007. In addition, since FY 2006, TSA has made progress in building its financial reporting infrastructure and ability to support account balances. However, audit procedures performed by us identified additional and more serious financial reporting control weaknesses, some of which have existed since the agency's inception. As a result, TSA management was unable to assert that the entire balance sheet is fairly stated in compliance with generally accepted accounting principles (GAAP). In addition, we are now reporting weaknesses in entity-level controls at TSA (See Comment III-G, *Entity Level Controls*).

The Federal Emergency Management Agency (FEMA)'s accounting and financial reporting processes must support multi-faceted operations such as temporary assistance funds, disaster relief loans, national flood insurance programs, stockpiles of essential supplies, mission assignments to other federal agencies for restoration and reconstruction, and grants to state and local governments. These programs are sometimes subject to complicated accounting rules, as defined by the Federal Accounting Standards Advisory Board (FASAB), and require specialized technical knowledge to interpret and apply. In addition, FEMA's accounting personnel and IT systems need to be ready to mobilize and support disaster operations with little advance notice, while also maintaining effective internal controls over financial reporting. In FY 2008, FEMA made substantial progress toward correcting three material weaknesses we reported in FY 2007 and was able to assert to the completeness and accuracy of all financial statement balances except capital assets. While FEMA has taken positive steps in FY 2008, financial reporting control deficiencies existed throughout the year that, in aggregate, are considered a material weakness.

In FY 2008, the Department of Homeland Security (DHS or the Department) Headquarters (HQ) corrected its material weakness over financial reporting.

Conditions: We noted the following internal control weaknesses related to financial reporting at TSA and FEMA:

1. TSA:

   - Has not always followed policies and procedures that require supervisory reviews of financial statements and supporting documentation, and supervisory reviews performed have not been effective in identifying some material errors in the financial statements. For example TSA:

     - Routinely prepares the Government Accountability Office (GAO) accounting and disclosure checklists (FAM 2010 and 2020), as required by the Department; however, the completion of the checklists was not effective in identifying material errors in accounting for and presentation of property, plant and equipment. Consequently, TSA and the Department recorded restatements totaling more than $400 million to it FY 2007 financial statements in FY 2008 (see below and Comment II-D, *Capital Assets and Supplies*); and

     - Did not properly review and support 4 out of 27 journal vouchers sampled. Three out of the four exceptions resulted in incorrect postings to the general ledger.

Independent Auditors' Report
Exhibit II – Material Weaknesses – DHS Civilian Components

- Places inappropriate reliance on the audit as a control over financial reporting. Audit tests performed by the financial statement auditor routinely identify incomplete analysis and documentation of account balance reconciliations, which have lead to the discovery of errors in financial reporting by the auditor;
- Does not have effective procedures over the review and approval of accounting data provided to and/or received from contractors or outside specialists retained by TSA to support the financial statement audit. For example:
  - Data used in computation of the year-end accounts payable accrual was inaccurate, resulting in an erroneous reported balance; and
  - Information prepared by subcontractors supporting material adjustments made to the financial statements was not adequately reviewed by management before it was provided to the auditor.
- Has not developed and implemented procedures to fully analyze the effects of its current and newly adopted accounting policies to ensure full compliance with GAAP. For example, TSA:
  - Modified its capitalization threshold twice in FY 2008 in response to auditor inquiries regarding the appropriateness of the dollar threshold;
  - Restated its FY 2007 financial statements to correct an understatement of property, plant and equipment totaling approximately $87 million, caused by adopting a capitalization threshold that was determined to be too high; and
  - Did not perform an analysis of contingent liabilities that could aggregate to a material liability prior to the auditor's inquiry.
- Did not fully reconcile its intragovernmental balances with trading partners. For example, TSA:
  - Did not confirm its reporting, or identify the cause of the difference, with the Department of Transportation in the Material Differences Report for the third quarter; and
  - Reported in its CFO Certification form sent to DHS Office of Financial Management (OFM) that TSA was unable to fully identify and present its intragovernmental balances and transactions by trading partner as of June 30, 2008, and therefore was unable to provide supporting documentation to OFM as requested.

2. FEMA:

- Does not have a sufficient number of experienced financial managers and staff to address non-routine accounting issues timely. A lack of skilled accounting resources has contributed to FEMA's inability to perform important accounting functions timely throughout FY 2008. For example, we noted that FEMA:
  - Did not prepare and record adjustments for its National Flood Insurance Program (NFIP) accurately. Several errors were identified after submission of FEMA's interim financial information to OFM. In addition, certain of these journal entries were recorded in the general ledger prior to final review and approval of the supporting documentation; and
  - Did not establish an accounts payable accrual for certain outstanding obligations, and did not validate a supportable estimate of accounts payable throughout the year for certain other outstanding obligations, requiring a change in methodology in early October to ensure proper year-end reporting.
- Lacks segregation of duties in financial reporting roles, and consequently does not have sufficient supervisory review processes over all material accounts. For example, we identified an error in accounting for undelivered orders totaling approximately $1.5 billion, where the balance was not adequately reviewed and approved by a second supervisory level person.
- Did not fully reconcile its intragovernmental balances with trading partners. Differences related to FEMA's transactions and balances were identified in the Department of the Treasury's Material

II. 2

Independent Auditors' Report
Exhibit II – Material Weaknesses – DHS Civilian Components

Differences Report for the first three quarters of the fiscal year. In some cases, FEMA could not confirm or support reported balances or identify the reason for the differences.

Cause/Effect: TSA's corrective action plans, initiated in FY 2007, did not project full remediation of control deficiencies until FY 2009. Further, it was necessary for TSA to defer certain corrective actions to devote more resources to its review and correction of errors discovered in capital asset balances during FY 2008. Material errors discovered by the outside auditor are an indicator of continued material weaknesses in internal control over financial reporting. TSA's service provider could not provide the breakout of intragovernmental activity by trading partner.

FEMA maintains a relatively small headquarters financial and accounting staff compared to its diverse programmatic and mission focused objectives, and has experienced high turn-over in financial management and accounting personnel in FY 2008. FEMA also committed substantial human and financial resources to reconcile and correct potential errors in account balances that contributed to qualifications of our FY 2007 Independent Auditors' Report. As a result, sufficient resources were not available to fully address control deficiencies in other areas.

Criteria: Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control,* defines management's responsibility for internal control and provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal control. Within the organizational structure, management must clearly: define areas of authority and responsibility; appropriately delegate the authority and responsibility throughout the agency; establish a suitable hierarchy for reporting; support appropriate human capital policies for hiring, training, evaluating, counseling, advancing, compensating, and disciplining personnel; and uphold the need for personnel to possess and maintain the proper knowledge and skills to perform their assigned duties as well as understand the importance of maintaining effective internal control within the organization.

OMB Circular No. A-50, *Audit Follow-Up,* states that corrective action taken by management on resolved findings and recommendations is essential to improving the effectiveness and efficiency of Government operations. Each agency shall establish systems to assure the prompt and proper resolution and implementation of audit recommendations. These systems shall provide for a complete record of action taken on both monetary and nonmonetary findings and recommendations.

The *Treasury Federal Intragovernmental Transactions Accounting Policies Guide,* dated August 15, 2008, and OMB Circular No. A-136, *Financial Reporting Requirements,* as revised, require Federal CFO Act and non-CFO Act entities identified in the Treasury Financial Manual (TFM) 2008, 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.

Recommendations: We recommend that:

1. TSA:
   a) Adhere to established policies and procedures requiring supervisory review of financial information, supporting documentation, and account balance reconciliations, to ensure that all material errors in the financial statements are identified and corrected timely.
   b) Develop and implement policies and procedures to:
      i) Require supervisory reviews of accounting transactions (particularly non-routine transactions), and accounting data provided to and received from contractors and outside specialists, and adequately supervise and review work performed by accounting staff and contractors;

II. 3

ii) Analyze changes in accounting policy prior to their implementation, including steps to determine whether the implementation would result in a non-compliance with GAAP;

iii) Assign documented accountability for supervisory reviews; and

iv) Eliminate reliance on the outside auditor as a control over the accuracy and completeness of financial statements, and the sufficiency of account level reconciliations.

c) Work with its accounting service provider to ensure that the proper trading partner code is recorded for each intragovernmental transaction. Until such time, TSA should consistently perform its manual process for the timely identification and reporting of trading partners for intragovernmental activities and balances.

2. FEMA:

a) Evaluate the effect of its FY 2008 reorganization in the Office of the Chief Financial Officer (OCFO) to ensure that current positions are filled with personnel with the requisite skills, and abilities necessary to ensure that important accounting functions, including non-routine and complex transactions, are addressed and accurately accounted for in the general ledger timely;

b) Establish clear management oversight responsibilities and processes to effectively review NFIP journal vouchers;

c) Assign accounting functions and responsibilities of accounting staff to ensure proper segregation of duties and supervisory reviews of material transactions and account balance reconciliations; and

d) Develop and implement procedures to properly research and reconcile its intragovernmental balances to supporting schedules and to trading partners.

II-B Information Technology General and Application Controls

Background: IT general and application controls are essential to achieving effective, reliable reporting of financial and performance data. Effective IT general controls are typically defined by the GAO's *Federal Information System Controls Audit Manual* (FISCAM) 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 IT general controls, financial systems contain application controls, which are the structure, policies, and procedures that apply to use, operability, interface, edit and monitoring controls of an application.

During FY 2008, DHS civilian components made progress in strengthening its IT general controls, which resulted in the closure of more than 40% of our prior year IT control findings. Additionally, some DHS components reduced the severity of the weaknesses when compared to findings reporting in the prior year.

Conditions: The FISCAM IT general and application control areas that continue to present a risk to financial systems data integrity include:

- Excessive access to key DHS financial applications, including weaknesses in access documentation and approval, disabling account access upon termination, instances of inadequate or weak passwords, configuration of workstations, servers, or network devices without necessary computer software patches, inactivity time-outs, and up-to-date anti-virus software.

- Application change control processes that are inappropriate, not fully defined, followed, or effective, including instances where changes made to the system were not always properly approved, tested, documented, or performed through System Change Requests (SCRs); instances where policies and procedures regarding change controls were not in place to prevent users from having concurrent access to the development, test, and production environments of the system, or for restricting access to application system software and system support files; and policies and procedures surrounding the system development life cycle (SDLC) process that have not been documented or finalized.

Independent Auditors' Report
Exhibit II – Material Weaknesses – DHS Civilian Components

- Service continuity issues impacting DHS' ability to ensure that DHS financial data is available when needed, including instances where the Continuity of Operations Plan (COOP) did not include an accurate listing of critical information technology systems, did not have critical data files, and an alternate processing facility was not adequately tested and documented, and various weaknesses identified in alternate processing sites.

Our findings, including significant deficiencies that do not rise to the level of being a material weakness, are described in greater detail in a separate *Limited Official Use* letter provided to DHS' Office of Inspector General (OIG) and management.

Cause/Effect: Many of these weaknesses were inherited from the legacy agencies that came into DHS, or system development activities that did not incorporate strong general computer controls from the outset and will take several years to fully address. A contributing cause to repeated findings is that DHS lacks an effective component-wide prioritization of IT systems issues, including the development of a stable centralized IT platform for the Department. When weaknesses in controls or processes are identified, the corrective actions address the symptom of the problem and do not always correct the root cause – amounting to a temporary fix. The time and resources needed to implement corrective actions necessary to mitigate the weaknesses often take multiple years.

The conditions supporting our findings collectively limit DHS' ability to ensure that critical financial and operational data is kept secure and is maintained in a manner to protect confidentiality, integrity, and availability. Many of these weaknesses, especially those in the area of change controls, may result in material errors in DHS' financial data that are not detected in a timely manner in the normal course of business. In addition, as a result of the presence of IT weaknesses, there is added pressure on the other mitigating manual controls to be operating effectively at all times. Because mitigating controls often require more human involvement, there is an increased risk of human error that could materially affect the financial statements.

Criteria: 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 National Institute of Standards and Technology (NIST) guidance.

OMB Circular No. A-130, *Management of Federal Information Resources,* describes specific essential criteria for maintaining effective general IT controls.

The Federal Financial Management Improvement Act (FFMIA) set forth legislation prescribing policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems. The purpose of FFMIA is: (1) to provide for consistency of accounting by an agency from one fiscal year to the next, and uniform accounting standards throughout the Federal Government; (2) require Federal financial management systems to support full disclosure of Federal financial data, including the full costs of Federal programs and activities; (3) increase the accountability and credibility of federal financial management; (4) improve performance, productivity and efficiency of Federal Government financial management; and (5) establish financial management systems to support controlling the cost of Federal Government.

DHS' *Sensitive Systems Policy, 4300A*, documents policies and procedures adopted by DHS intended to improve the security and operation of all DHS IT systems.

The FISCAM provides a framework and recommended audit procedures that are used to conduct the IT general and application control test work on financial information systems.

Recommendations: We recommend that the DHS Office of the Chief Information Officer, in coordination with the Office of the Chief Financial Officer (OCFO), make the recommended improvements to the Department's financial management systems in FY 2009. Specific recommendations are provided in a separate *Limited Official Use* letter provided to DHS management.

II-C Not Used

II. 5

Independent Auditors' Report
Exhibit II – Material Weaknesses – DHS Civilian Components

II-D Capital Assets and Supplies (FEMA, TSA, and CBP)

	2008	2007	2006
CBP	SD		
FEMA	MW	MW	
TSA	MW	SD	MW
US-Visit	C	SD	MW

Background: FEMA has several internal use software programs that were either in development or in operation during FY 2008. In FY 2008, in response to auditor inquiries, FEMA initiated a review of its internal use software costs, but did not complete the analysis before DHS completed its FY 2008 Annual Financial Report (AFR). Consequently, FEMA was unable to assert that its capital asset balances, related to internal use software, are fairly stated at September 30, 2008.

In FY 2008, FEMA substantially corrected its control deficiencies over stockpile inventory.

TSA manages baggage X-ray, explosive, screening, and other equipment as part of its business. This equipment, in every major U.S. airport, is owned and maintained by TSA. The processes required to procure, ship, temporarily store, install, operate, and maintain this equipment are substantial, and consume a large portion of TSA's annual operating budget. Unique accounting processes and systems are necessary to track the status and accumulate costs, and to accurately value, account for, and depreciate the equipment. In FY 2008, in response to auditor inquires, TSA initiated various reviews of its capital assets and identified errors in its accounting for equipment used in airports that required a number of restatements to the FY 2007 financial statement balances, and current year corrections. These conditions also prevented TSA from asserting that its capital asset balances at September 30, 2008 are fairly stated prior to the completion of the DHS FY 2008 AFR.

The Customs and Border Protection (CBP)'s Secure Border Initiative (SBI) is a comprehensive multi-year plan to secure America's borders and reduce illegal immigration. The primary step in fulfilling this plan is to construct a fence along the border of the U.S. and Mexico. This fence will take many forms (i.e., physical, virtual, etc.) depending on the terrain of the land. Much of the physical fence will be constructed of steel, which has been purchased in bulk by CBP. Once a construction project is completed, the costs in construction-in-progress (CIP) are moved to Property, Plant, and Equipment (PP&E). As the SBI initiative is not part of CBP's normal course of business, CBP did not timely implement processes to record these transactions properly.

In FY 2008, US-Visit corrected its control deficiency over internal use software.

Conditions: We noted the following internal control weaknesses related to capital assets and supplies at FEMA, TSA, and CBP:

1. FEMA:

    - Does not have sufficient policies and procedures to routinely account for costs incurred to develop internal use software consistent with GAAP. For example, FEMA:
        - Did not record estimated or actual amounts for several internal use software programs under development in FY 2008, and alternatively, did not assess that the related capitalizable amounts were immaterial;
        - Has historically recorded an estimate of the capitalizable costs of internal use software on an annual basis, instead of the actual costs incurred;
        - Does not have policies and procedures to periodically assess the reliability of the internal use software estimates recorded, such as a comparison of estimates to actual costs;
        - Did not record internal use software in a separate account from internal use software in development as required by the United States Standard General Ledger (USSGL); and
        - Did not consistently begin amortization of software costs when the asset was placed in service.
    - Does not have adequate policies and procedures to accurately identify and account for the various stages of software development costs that would enable FEMA to identify the costs that should be capitalized and those that should be expensed as incurred.

II. 6

Independent Auditors' Report
Exhibit II – Material Weaknesses – DHS Civilian Components

2. TSA:

- Does not have policies and procedures in place to properly account for and report equipment and internal use software balances. For example, TSA did not:
  - Perform a periodic analysis of idle assets stored in a warehouse and adjust the carrying value of those assets to net realizable value (NRV), if necessary, as required by GAAP. TSA recorded an adjustment totaling $95.9 million to properly present idle assets at NRV in the FY 2008 financial statements, of which $1.6 million was to restate its FY 2007 financial statements;
  - Identify and properly account for other direct costs incurred to transport, store, and install screening equipment at airports. TSA recorded an adjustment totaling $108.5 million to restate its FY 2007 financial statements to correct this error;
  - Identify and account for software developed for internal use in compliance with the requirements of GAAP, since the inception of the Agency in 2002. TSA recorded an adjustment totaling $260.6 million in FY 2008, of which $212.9 million was a restatement of its FY 2007 financial statements to correct this error; and
  - Depreciate some of its screening equipment using appropriate useful lives. TSA recorded an adjustment totaling $ 28.6 million in FY 2008, of which $17.3 million was a restatement of its FY 2007 financial statements to correct for this error.
- Did not adopt an appropriate asset capitalization dollar threshold, (where asset purchases above a certain dollar value are capitalized, and below which are expensed). The dollar threshold used during FY 2008 and prior years was set too high, resulting in a material understatement of capitalized asset balances in prior years, and as of September 30, 2008 (See Comment II-A, *Financial Reporting*).

3. CBP:

- Did not adopt adequate policies and procedures in place to properly account for steel purchases and construction of the U.S. border fence accurately and timely. CPB initially recorded some capital asset purchases, related to the U.S. border fence construction as an expense, and several months later, properly reversed and capitalized the assets. For example, as of the end of August 2008, $224 million of steel was purchased; however, none was recorded as a capital asset until September 2008.
- Does not have adequate accounting processes and controls to ensure that transfers of assets from CIP to completed PP&E are recorded in the general ledger timely. As a result, CBP performed a review of asset additions to quantify the impact of the untimely transfers. As of September 30, 2008, CBP recorded an additional $48 million in accumulated depreciation and depreciation expense to correct for the identified errors.

Cause/Effect: FEMA has not devoted attention to accounting for software development in the past assuming the costs incurred to develop software for internal use were immaterial for DHS consolidated financial reporting purposes. However, in recent years, FEMA has increased its expenditures on internal use software to update its IT systems and improve their capabilities to support its mission. Although FEMA's Office of the Chief Financial Officer (OCFO) attempted to gather certain costs to capitalize in the second half of FY 2008, the data needed to account for the software costs could not be easily obtained from other offices. FEMA and DHS financial statements could be materially misstated without better processes for tracking and accounting for internal use software costs.

TSA management was not fully aware of the accounting requirements of SFFAS No. 6, *Accounting for Property, Plant, and Equipment,* until auditor inquiries led TSA to investigate its accounting policies for equipment, particularly related to internal use software and treatment of other direct costs. This control deficiency is also related to the conditions described in Comment II-A, *Financial Reporting*, and Comment III-G, *Entity Level Controls*. Extensive resources, including contractor assistance, were committed in FY 2008 in an attempt to identify the full extent of the error, and properly account for capital assets; however,

II. 7

Independent Auditors' Report
Exhibit II – Material Weaknesses – DHS Civilian Components

considering the scale of the project, management was not able to fully complete the work prior to the completion of the DHS 2008 AFR.

As the SBI initiative is not part of CBP's normal course of business, CBP did not timely implement processes to record these transactions properly. Accordingly, for several months throughout the year, CBP's financial statements did not accurately reflect the construction activity.

Criteria: SFFAS No. 10, *Accounting for Internal Use Software,* provides requirements for the capitalization and reporting of internal use software development costs. Per paragraph 16, the capitalizable cost should include "….the full cost (direct and indirect) incurred during the software development stage. Per SFFAS No. 10, paragraphs 18-20, "For COTS [Commercial off-the-shelf] software, capitalized cost should include the amount paid to the vendor for the software. For contractor-developed software, capitalized cost should include the amount paid to a contractor to design, program, install, and implement the software. Material internal cost incurred by the federal entity to implement the COTS or contractor-developed software and otherwise make it ready for use should be capitalized…Costs incurred after final acceptance testing has been successfully completed should be expensed."

Per the USSGL TFM S2 08-03, Part I Fiscal Year 2008 Reporting, Accounts and Definitions, account 1832, Internal Use Software in Development, "includes the full cost, as defined in FASAB SFFAS No. 10, *Accounting for Internal Use Software,* incurred during the software development stage of (1) contractor-developed software, and (2) internally developed software. Upon completion, these costs will be transferred to USSGL account 1830, Internal Use Software."

SFFAS No. 6, paragraph 38, states that general PP&E along with associated accumulated depreciation/amortization should be removed from the asset accounts in the period of disposal, retirement, or removal from service. Any difference between the book value of the PP&E and amounts realized should be recognized as a gain or loss in that period. SFFAS No. 6 requires all costs incurred to place an asset in service, including transportation, storage, and installation costs, to be capitalized and depreciated over the asset's useful life. Also, SFFAS No. 6 requires that upon completion of a construction project, costs should be capitalized into fixed assets.

GAO *Standards for Internal Control in the Federal Government (Standards)* require that internal control and all transactions and other significant events be clearly documented and readily available for examination. The Joint Financial Management Improvement Program (JFMIP), *Property Management Systems Requirements,* state that the agency's property management system must create a skeletal property record or have another mechanism for capturing information on property in transit from the providing entity (e.g., vendor, donator, lender, grantor, etc.).

Recommendations: We recommend that:

1. FEMA:
   a) Perform a review of all internal use software implemented and currently in development, to include the following:
      i) Compile the supporting documentation for all significant software projects less than three years old, including NextGen, PRISM, NDgrants, EMMIE, TAV, and Sunflower software, and account for the costs in accordance with SFFAS No.10;
      ii) Develop and implement a formal tracking system for the costs related to the development and implementation of internal use software, and use the information from the tracking system to either record actual costs of internal use software in the general ledger or validate estimated costs on a periodic basis (at least annually);
      iii) Ensure that costs of software in development are recorded in USSGL account 1832, and the full cost of the software is transferred to USSGL account 1830 after final acceptance testing is completed; and
      iv) Reclassify costs of software in development that are currently recorded in USSGL account 1830 to USSGL account 1832, and reverse the amortization expense recorded to date for the costs of software in development.

II. 8

Independent Auditors' Report
Exhibit II – Material Weaknesses – DHS Civilian Components

2. TSA:

   a) Complete the review currently in process over idle assets, other direct costs, and internal use software, and record the proper correcting adjustments in the general ledger;

   b) Develop and implement policies and procedures, including appropriate supervision and management oversight, to include accountability, to account for idle assets, other direct costs, and internal use software in accordance with SFFAS No. 6 and SFFAS No. 10 on an on-going basis; and

   c) Examine asset purchases and establish an appropriate dollar threshold for capitalization of purchases to ensure that asset purchases are presented as capital assets, and depreciated in compliance with GAAP (See Comment II-A, *Financial Reporting*).

3. CBP:

   a) Establish policies and procedures to capitalize costs of construction-in-progress accurately and timely; and

   b) Improve its policies and procedures to ensure that assets are transferred from CIP to in-use property timely, when the assets are placed in service.

II-E Actuarial and Other Liabilities (FEMA, FLETC, ICE, and S&T)

Background: In FY 2007, Grants and Training (G&T) operations were transferred to FEMA as a result of the *Post-Katrina Emergency Management Reform Act of 2006*. FEMA is now responsible for accounting and financial reporting for all legacy G&T grants, including the grant accrual methodology. FEMA manages the NFIP and relies on insurance underwriters to provide an estimate for NFIP loss reserves for financial statement purposes.

The Federal Law Enforcement Training Center (FLETC) maintains a number of firing ranges in at least four locations. FLETC also maintains facilities that contain lead-based paint and asbestos, where environmental liabilities may exist. The Immigration and Customs Enforcement (ICE) and Science and Technology (S&T) own land, buildings, and other structures and facilities, including firing ranges, that may be contaminated, or have underground storage tanks. S&T also owns the Plum Island Animal Disease Center and Orient Point, and has leased laboratory space in Manhattan.

	2008	2007	2006
FEMA	SD	MW	MW
G&T*		MW	MW
FLETC	SD		
ICE	SD		
S&T	SD		
TSA	C	SD	SD

* G&T merged with FEMA in 2007

In FY 2008, TSA corrected its material weakness in the unfunded employee leave process.

Conditions: We noted the following internal control weaknesses related to other liabilities at FEMA, FLETC, ICE, and S&T:

1. FEMA:

   - Had not fully implemented planned internal controls over its grant accrual as FEMA management made revisions to the accrual methodology through September 2008;
   - Did not work with its contractor actuary before the late October 2008 issuance of the final actuarial report for the flood insurance liability to ensure that the materiality standard used in the report was acceptable to management for financial statement reporting purposes;
   - Did not timely communicate to its auditors the details of significant changes to the methodology used in development of the flood insurance liability, particularly for hurricanes that occurred in August and September; and

II. 9

Independent Auditors' Report
Exhibit II – Material Weaknesses – DHS Civilian Components

- Does not have sufficient policies and procedures in place to fully comply with the *Single Audit Act Amendments of 1996* and related OMB Circular No. A-133, *Audits of States, Local Governments, and Nonprofit Organizations* (see Exhibit IV-L, *Single Audit Act Amendments of 1996*).

2. FLETC, ICE, and S&T:

- Have not fully implemented policies and standard operating procedures that will allow management to fully assert that environmental liabilities have been recorded, and disclosed in the financial statements, in accordance with applicable accounting standards. We noted that:
  - FLETC does not have a process in place whereby the Environmental and Safety Division identifies the existence of all environmental liabilities, and periodically reports an estimated clean up cost to the Finance Division. A detailed review and report was provided to the Finance Division in response to an auditor inquiry. In addition, FLETC did not consider all potential liabilities in its estimate, e.g., those that may relate to a time period before FLETC took possession of the Glynco facility from the Department of Defense;
  - ICE has not fully implemented a process and internal controls to identify, estimate, and report the potential environmental and disposal liability, and management stated that it had not performed or updated its assessment during FY 2008; and
  - Some of the remediation projects at S&T do not meet the criteria of an environmental liability while others do not include all costs to remediate the liability. We also noted that S&T has not performed a comprehensive survey to ensure the completeness of their environmental liability estimate.
- Each of the components do not have sufficient policies, procedures, and processes in place to fully comply with FASAB Technical Release No. 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government,* which requires the exercise of due care during the environmental liability estimation process. This can include examining facilities transferred to DHS for possible environmental issues.

Cause/Effect: FEMA accounting staff developed a new grant accrual methodology during FY 2008; however, they continued to make revisions throughout the year. FEMA does not have adequate procedures in place to monitor the decisions of its contractor actuary in the development of the flood insurance liability. As a result, the materiality standard used in the insurance loss reserve may be too high for management to accept for financial statement reporting purposes.

FLETC, ICE, and S&T have historically not considered environmental liabilities to be a matter that could have a material effect on the financial statements, and exercising due care involves either the use of an outside specialist or in-house engineering capabilities. Coordination with persons outside of the accounting departments has hampered the process. In cases where the appropriate expertise has been identified, the nature and extent of instructions provided by the accounting division has not been adequate to clearly describe the purpose and outcome of the inquiry.

Criteria: GAO *Standards* hold that transactions should be properly authorized, documented, and recorded accurately and timely. In addition, the *Standards* state that "Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."

OMB Circular No. A-133, Subpart D, provides for the responsibilities of federal agencies and pass-through entities for audits of states, local governments, and non-profit organizations.

SFFAS No. 6, paragraph 85, defines environmental cleanup costs as those costs for removing, containing, and/or disposing of (1) hazardous waste from property, or (2) material and/or property that consists of hazardous waste at permanent or temporary closure or shutdown of associated PP&E. Paragraph 88 states that these cleanup costs meet the definition of liability provided in SFFAS No. 5. In addition, SFFAS No. 6, paragraph 96, states that cleanup cost estimates shall be revised periodically to account for material changes due to inflation or deflation and changes in regulations, plans and/or technology. New remediation

Independent Auditors' Report
Exhibit II – Material Weaknesses – DHS Civilian Components

cost estimates should be provided if there is evidence that material changes have occurred; otherwise estimates may be revised through indexing.

FASAB Technical Release No. 2 states that an agency is required to recognize a liability for environmental cleanup costs as a result of past transactions or events when a future outflow or other sacrifice of resources is probable and reasonably estimable. The Agency must exercise "due care" in developing its estimated environmental liability. Examples of due care are provided in FASAB Technical Release No. 2.

Recommendations: We recommend that:

1. FEMA:
   a) Fully implement the designed internal controls over the quarterly grant accrual;
   b) Develop and implement policies and procedures for the Mitigation Division and the OCFO to consult with the actuary developing the flood insurance liability before year-end to review and agree with the materiality standard for insurance loss reserves to be used in the final year-end report. This agreement and related rationale should be documented;
   c) Develop and implement policies and procedures for the Mitigation Division to consult with the actuary developing the flood insurance liability before year-end to determine if any significant methodology changes will be made in the final year-end report. The details of any changes should be communicated timely to the auditor; and
   d) Implement policies and procedures to ensure full compliance with OMB Circular No. A-133.
2. FLETC, ICE, and S&T:
   a) Finalize and implement standard operating procedures requiring an annual review / update of environmental liabilities recorded in the general ledger, in accordance with applicable accounting standards, including procedures for:
      i) Identification and reporting of all material environmental liability estimates;
      ii) Communication, including written instructions, to serve as a memorandum of understanding between the financial / accounting offices and engineers or specialists who have expertise to identify possible pollutants and estimate the clean-up costs; and
      iii) Observance of due care in the process of maintaining the environmental liability estimate for financial statement purposes;
   b) Design and implement sufficient management level controls to ensure the completeness, accuracy, and proper disclosure of environmental liabilities; and
   c) Ensure that all estimates of environmental liabilities are supported by adequate documentation and reviewed by financial management for reasonableness. The supporting documentation should include assumptions made, the elements of the estimate calculation, and support for each element (e.g. specific type of contamination, square footage of the contaminated area or other applicable unit of measurement), the rate or cost per unit to remediate the specific type of contamination, and support for the determination of the rate or cost per unit for remediation.

II-F Budgetary Accounting (FEMA and CBP)

	2008	2007	2006
CBP	SD		
FEMA	MW	MW	MW
TSA	C	MW	MW

Background: Budgetary accounts are a category of general ledger accounts where transactions related to the receipt, obligation, and disbursement of appropriations and other authorities to obligate and spend agency resources are recorded. Combined, DHS has over 350 separate Treasury account fund symbols (TAFS), each with separate budgetary accounts that must be maintained in accordance with OMB and Treasury guidance. The TAFS cover a broad spectrum of budget authority, including annual, multi-year, and no-year appropriations; and

II. 11

several revolving, special, and trust funds. Accounting for budgetary transactions in a timely and accurate manner is essential to manage the funds of the Department and prevent overspending of allotted budgets.

In FY 2008, FEMA implemented a mission action plan (MAP) to perform an extensive review of its open obligations related to mission assignments with other Federal agencies. As a result, FEMA was able to deobligate over $1 billion in funds prior to year-end, and make those funds available for disaster relief. FEMA improved its processes and internal controls over the mission assignment obligation and monitoring process in FY 2008; however, some control deficiencies remain.

In FY 2008, TSA corrected the material weakness in its process of accounting for undelivered orders.

Conditions: We noted the following internal control weaknesses related to budgetary accounting at FEMA and CBP:

1. FEMA:

   - Did not consistently and adequately monitor the status of its obligations as part of its normal operations and ensure the timely deobligation of mission assignments. We noted the following:

     - Although a review over UDOs was performed and documented by FEMA during the third and fourth quarters of FY 2008, appropriate follow-up action was either not performed or not documented for 3 of 57 applicable cases following the third quarter review, and for 6 of 54 cases following the fourth quarter review; and

     - In samples of 85 and 151 mission assignment obligations tested as of June 30 and September 30, 2008, respectively, approximately 27 percent and 5 percent, respectively, were past their projected end dates by more than 90 days and were considered testwork exceptions.

   - Could not provide all supporting documentation for our sample of UDOs other than mission assignments and grant UDOs. We noted that responsible parties could not be readily identified, and the files were not accessible, or maintained in a form that clearly supported the balances reported in the financial statements.

2. CBP is not enforcing its policies and procedures (Directive 1220-011B) to monitor and deobligate or close-out its obligations in a timely manner. We noted that CBP did not properly deobligate inactive undelivered orders for approximately 58% of a sample as of March 31, 2008. In response to an audit inquiry, CBP initiated a review of open obligations and subsequently deobligated approximately $84 million in open obligations in FY 2008.

Cause/Effect: Other Federal Agencies (OFAs) did not always provide FEMA with timely progress reports that included sufficient cost and billing data, or with a timely response to validation requests of open mission assignments. Sufficient documentary evidence was not obtained and/or documented timely for Mission Assignment Manager follow-up procedures with the OFAs. The errors in each sample resulted in known overstatements, and most likely overstatements in undelivered orders.

CBP did not properly monitor all open obligations, and consequently government funds may be committed and not made available for CBP, or other Federal expenditures, for longer periods of time than necessary.

Criteria: FEMA's SOP for *Processing Mission Assignment and Interagency Payments for Fund Code 06*, updated April 2007, establishes the process for mission assignment closeouts. If no activity has been recorded within the last 90 days, the Disaster Finance Branch initiates the closeout process with the region or headquarters.

The FEMA Form 90-129, *Mission Assignment Agreement,* states that the OFA is responsible for submitting a Mission Assignment Monthly Progress Report to FEMA to include cost data when mission assignments take more than 60 days to complete, including billing.

According to GAO *Standards,* "transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records." Further, "control activities help to ensure that all transactions are completely and accurately recorded."

CBP Directive 1220-011B states that financial plan holders will review Systems, Applications, and Products (SAP) reports each quarter to reconcile their obligations to supporting records.

Recommendations: We recommend that:

1. FEMA:
    a) Consistently monitor the status of its obligations as part of the normal business process. Ensure that all mission assignments are reviewed and deobligated timely. In addition:
        i) Finalize the development and implementation of updated mission assignment policies and procedures;
        ii) Enforce the requirement that all OFAs submit not only a progress report when the mission assignment takes more than 60 days to complete, but a progress report every additional 30 days that the project remains either programmatically or financially incomplete; and
        iii) Ensure that appropriate personnel consistently perform and follow-up on the results of the quarterly obligation reviews to determine whether the remaining balance on a UDO is valid or should be deobligated.
    b) Update and improve procedures for documentation of supporting UDO information, including points of contact for information, so that supporting information is readily available for management review and audit purposes.
2. CBP:
    a) Continue to enforce CBP Directive 1220-011B to ensure that obligations are reviewed and deobligated timely.

III-G Entity Level Controls (USCG, FEMA, and TSA)

Background: In FY 2003 – FY 2007, we reported conditions that led to a Departmental level material weakness in entity level controls. The Department has undertaken and completed several steps designed to strengthen its entity and process level internal controls, and thereby improve the reliability of financial reporting. These steps are documented in the *Internal Control over Financial Reporting Playbook* released in March 2008, and in component level Mission Action Plans (MAPs) finalized early in FY 2008. The Department continued its OMB Circular No. A-123 program with the help of an external contractor.

Although weaknesses in entity level controls remain at FEMA and USCG and new entity level findings are reported at TSA, we now believe that steps taken by the Department and the Office of the Chief Financial Officer in FY 2007 and 2008 have strengthened the internal control framework and substantially mitigated component weaknesses, supporting a downgrade of our entity level control findings to a significant deficiency. The comments below should be read in conjunction with Comments I-B and II-B, *Information Technology General and Application Controls*, which describe entity level control weaknesses in Department and Component IT systems.

The Coast Guard updated its MAPs and *Financial Strategy for Transformation and Audit Remediation* (FSTAR) in FY 2008. The FSTAR is a comprehensive plan to identify and correct the root causes of control deficiencies. However, most of the actions outlined in FSTAR are scheduled for after FY 2008, and consequently, we repeat most of our entity level control findings identified at Coast Guard in previous years.

FEMA committed to, and substantially achieved, their MAPs to eliminate account balance qualifications identified in the Independent Auditors' Report (IAR) in FY 2007. FEMA also made modest progress toward correction of its entity level control deficiencies in FY 2008. While progress has been made, some entity level control deficiencies identified at FEMA in previous years continued during FY 2008, and are repeated below.

In FY 2008, TSA successfully addressed some control deficiencies that contributed to IAR qualifications in previous years. However, during our audit, we noted new deficiencies that are indicative of continued and more significant weaknesses in entity level controls at TSA.

Conditions: We noted the following internal control weaknesses related to entity level controls at USCG, FEMA and TSA:

1. USCG:

   - Has not fully implemented a financial management structure where:
     - GAAP is applied and financial statement balances are appropriately supported, interfering with the Coast Guard's ability to assert to the completeness, existence (validity), accuracy, valuation, or presentation of their financial data, with the exception of investments and legal liabilities;
     - Financial management oversight functions complete with an organizational chart, job descriptions, roles and responsibilities, and skill sets required, are well defined. Appropriate and clear internal reporting relationships have been established resulting in effective financial guidance and oversight over internal and external distribution of financial information, particularly related to the *Federal Managers' Financial Integrity Act of 1982* (FMFIA); and
     - The financial management infrastructure is appropriately staffed with experienced financial managers and staff to expeditiously identify and address control weaknesses, develop and implement effective policies, procedures, and internal controls to ensure that data supporting financial statement assertions are complete and accurate.
   - Has not fully implemented an on-going entity-wide risk assessment.
   - Does not have a process to monitor and control timely completion of the MAP or FSTAR milestones, and update the status of completion of such milestones.

Independent Auditors' Report
Exhibit III – Significant Deficiencies – All DHS Components

2. FEMA:

- Has not provided the CFO with clearly defined and complete authority for all financial accounting policy, processes, and control functions throughout the agency.
- Has not effectively communicated the importance of strong financial management and internal controls throughout the agency, resulting in several offices not fully cooperating with the OCFO related to accounting and auditing matters.
- Has not developed sufficiently effective methods of communication to ensure that significant financial-related events outside of the OCFO (e.g., changes in third party financial services providers and development of new software projects) are timely communicated to the OCFO to ensure proper and timely accounting and reporting consideration.
- Has not completed the placement of sufficient financial and accounting resources in its regional offices, which contributes to certain issues in mission assignment accounting. Mission assignment obligations are not closed out timely, and in a sample of 168 mission assignment payments selected for testwork as of March 31, 2008, we noted that approximately 16% of the payments were not properly reviewed and approved in accordance with FEMA policy.
- Has not documented and/or updated formal policies and procedures (including desk manuals) for many of the roles, responsibilities, processes, and functions performed within FEMA. For example, in FY 2008, we noted that improvements are needed in the formal documentation of policies and procedures related to *Anti-deficiency Act* compliance, policies for monitoring and responding to OMB Circular No. A-133 reports, Office of Inspector General (OIG) reports, and GAO report findings and recommendations; and the quarterly process for estimating accruals (including accrual validation).
- Has identified the Internal Controls Branch's sole function as the implementation of policies and procedures to close findings issued as a result of multiple external audits. Its mission does not include internal control monitoring to assess the overall quality and performance of operations on a continual basis.
- Has not committed sufficient resources to ensure that personnel attend required ethics training.

3. TSA:

- Lacks a sufficient number of skilled accounting staff in the proper positions in the Financial Statements and Report Branch to ensure that accounting policies, procedures, and internal controls over financial reporting are appropriate, and continuously effective; and to ensure that accounting principles are correctly applied in a timely manner.
- The organizational structure in finance and accounting, including an understanding and assignment of roles and responsibilities for financial oversight, supervision, and review may not be optimally aligned with its resources.
- Did not provide contractors retained to prepare materials for the financial statement audit with adequate management direction, supervision, and review, resulting in substantial rework, and delays in completion of the audit.
- Has weaknesses in communication, instruction, training, supervision and/or coordination with personnel outside of the office of financial management, that contribute to control weaknesses in processes dependent on operations. For example, idle assets maintained in an off-site warehouse by operational personnel may not be accounted for properly, due to a lack of understanding of, or willingness to follow, financial policies.
- Lacks sufficient oversight of financial reporting functions and consequently errors or misapplication of GAAP may go undetected, in some cases for several years, or until questioned by an auditor.

Independent Auditors' Report
Exhibit III – Significant Deficiencies – All DHS Components

These conditions lead directly to a number of audit findings in FY 2007 and in FY 2008 that when considered in aggregate, point to weaknesses in entity level controls. FY 2008 new findings reported elsewhere in our report include:

- Two new material weaknesses in internal control, Comment II-A, *Financial Reporting*, and Comment II-D, *Capital Assets and Supplies*;
- Significant restatements to prior year financial statements to correct multiple errors in capital assets balances described in Comment II-D, *Capital Assets and Supplies*, and to correct a misapplication of GAAP, described in Comment II-A, *Financial Reporting*; and
- Inability to complete its investigation of the errors in capital assets, referred to in Comment II-D, *Capital Assets and Supplies*, and record correcting adjustments prior to the completion of the DHS FY 2008 AFR, resulting in a qualification in the Independent Auditors' Report.

Cause/Effect: The Coast Guard's management has acknowledged that longstanding procedural, control personnel, IT, and cultural issues have impeded progress toward installing an effective financial management structure. The conditions described above continue to prevent the Coast Guard and DHS from timely preparation of accurate financial information and reports, and have also contributed to the conditions reported in Exhibit I-A, *Financial Reporting*, as well as other control deficiencies described in Exhibit I.

FEMA devoted substantial resources to correcting financial statement balances that could not be audited in FY 2007. Consequently, FEMA devoted comparatively less attention to improving the underlying accounting processes and correcting control deficiencies in FY 2008.

TSA, similar to FEMA, devoted resources to correcting financial statement balances that could not be audited in FY 2007. Management attempted to supplement its staff with contractors; however, the nature and extent of issues in capital asset balances, including the need to restate prior year reported balances, overwhelmed TSA's capacity to properly staff and supervise the project, and to fully correct control deficiencies in FY 2008. Also, TSA has not updated its entity level control self assessment (necessary for OMB Circular No. A-123 purposes) since 2006, which may have identified some or all of these conditions before our audit.

In their FY 2008 representations made to the Secretary pursuant to the *DHS Financial Accountability Act*, USCG and FEMA, each stated that they had not yet completed enough testing to provide reasonable assurance that internal controls were achieving their intended objectives.

Criteria: OMB Circular No. A-123, *Management's Responsibility for Internal Control*, as revised, states that internal controls are the organization, policies, and procedures that agencies use to help program and financial managers achieve results and safeguard the integrity of their programs.

FMFIA requires that agencies establish internal controls according to standards prescribed by the Comptroller General. These standards are established in the GAO *Standards for Internal Control in the Federal Government (Standards).* The GAO defines internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

The GAO *Standards* identify the control environment as one of the five key elements of control, which emphasizes the importance of conscientiousness in management's operating philosophy and commitment to internal control. These standards cover controls such as human capital practices, supervisory reviews, policies, procedures, monitoring, and segregation of duties.

Recommendations: We recommend that:

1. USCG:
   a) Review and enhance the entity level controls MAP to include steps to fully assess entity level controls, develop effective corrective actions, and implement improved financial processes and systems;

Independent Auditors' Report
Exhibit III – Significant Deficiencies – All DHS Components

b) Evaluate how recommendations from recent internal organizational and process assessments impact the conditions cited above, as well as the other conditions identified in Exhibit I-A, *Financial Reporting,* such as the number and type of personnel and resources needed, along with the requisite skills and abilities necessary, to provide effective guidance and oversight to program offices that are significant to financial management and reporting, and make the recommendations to senior management, as appropriate; and

c) Ensure that its FSTAR/MAP actions as designed and performed are:

   i) Effective in addressing all of the material weaknesses described in Exhibit I; and

   ii) Coordinated and prioritized with input from the Department's CFO to address matters that are preventing the Department from preparing reliable financial statements, and executing its fiscal management responsibilities.

2. FEMA:

   a) Provide the CFO with clear authority to develop and implement accounting and financial reporting policies, procedures, and internal controls throughout the Agency. Program offices should be required to adhere to policies;

   b) Consistently emphasize the importance of strong financial management and internal controls throughout the agency;

   c) Develop communication protocols agency-wide to ensure that significant financial-related events outside of the OCFO are timely communicated to the OCFO for proper and timely accounting and reporting consideration;

   d) Fully implement plans to place comptrollers in each regional office, to address weaknesses related to mission assignment accounting and implementation of financial directives described above;

   e) Ensure that formal policies and procedures (including desk manuals) are documented and current for all significant roles, responsibilities, processes, and functions performed within FEMA;

   f) Expand the mission and staffing of the Internal Controls Branch to perform internal control monitoring to assess the overall quality and performance of operations on a continual basis; and

   g) Develop procedures and dedicate resources to provide, track compliance with, and monitor the annual and new hire ethics training requirements.

3. TSA:

   a) Update the OMB Circular A-123 review of entity level controls and complete the GAO self assessment tool for entity level controls. Evaluate the deficiencies identified by the process and take appropriate corrective actions, including the development of a MAP for OCFO approval in FY 2009;

   b) Conduct a human resource needs assessment and financial organizational assessment to identify gaps in skill-sets, hire or re-align personnel to fill the gaps, and assign personnel with responsibilities that best match their expertise;

   c) Consider updating the financial organizational structure based on the human resources needs assessment;

   d) Strengthen the monitoring and supervision process over financial reporting, and use of contractors;

   e) Consistently emphasize the importance of strong financial management and internal controls throughout the agency;

   f) Improve communications, training, instruction and oversight of non-accounting personnel that are essential to the accounting process, and fair and timely presentation of financial statement balances; and

Independent Auditors' Report
Exhibit III – Significant Deficiencies – All DHS Components

g) Consider additional training to ensure that all general ledger and financial management personnel are kept current of GAAP requirements.

III-H Custodial Revenue and Drawback

Background: CBP collects approximately $31.4 billion in annual import duties, taxes, and fees on merchandise arriving in the United States from foreign countries (identified below as the Entry Process). Receipts of import duties and related refunds are presented in the statement of custodial activity in the DHS financial statements.

Drawback is a remittance, in whole or in part, of duties, taxes, or fees previously paid by an importer. Drawback typically occurs when the imported goods on which duties, taxes, or fees have been previously paid, are subsequently exported from the United States or destroyed prior to entering the commerce of the United States.

Our findings on the Entry Process include In-bond, Bonded Warehouse, Foreign Trade Zones, and the Compliance Measurement Program (CM). In-bond entries occur when merchandise is transported through one port; however, the merchandise does not officially enter U.S. commerce until it reaches the intended port of destination. Bonded Warehouses (BWH) are facilities, under the joint supervision of CBP and the Bonded Warehouse Proprietor, used to store merchandise that has not made entry into the United States commerce. Foreign Trade Zones (FTZ) are secured areas under CBP supervision that are used to manufacture goods that are considered outside of the United States commerce for duty collection.

CM is the primary method by which CBP measures risk in the areas of cargo security, trade compliance, and revenue collection. CBP utilizes the CM program to measure the effectiveness of its control mechanisms deployed, and its execution in collecting revenues rightfully due to the U.S. Department of the Treasury.

Conditions: We noted the following internal control weaknesses related to custodial activities at CBP:

Related to drawback:

- The Automated Commercial System (ACS) lacks automated controls to detect and prevent excessive drawback claims and overpayments, necessitating inefficient manual processes that do not effectively compensate for these automated controls.
- ACS lacks controls to prevent the overpayment of drawback claims at the summary line level.
- Drawback review policies do not require drawback specialists to review all, or a statistically valid sample, of prior drawback claims against the underlying consumption entries (UCE) to determine whether, in the aggregate, an excessive amount was claimed.
- Drawback review policy and procedures allow drawback specialists, with supervisory approval, to judgmentally decrease the number of ACS selected UCEs randomly selected for review, thus decreasing the review's effectiveness. Further, CBP implemented a new sampling methodology for selecting UCEs; however, this methodology is not considered to be statistically valid.
- The period for document retention related to a drawback claim is only three years from the date of payment. However, there are several situations that could extend the life of the drawback claim well beyond three years.

Related to the Entry Process:

- CBP is unable to determine the status of the in-bond shipments and lacks policies and procedures that require monitoring the results of in-bond audits and require the review of overdue immediate transportation in-bonds or air in-bonds.
- CBP does not perform an analysis to determine the potential loss of revenue through the in-bond process as a result of goods entering the commerce of the U.S. without formal entry.

Independent Auditors' Report
Exhibit III – Significant Deficiencies – All DHS Components

- CM oversight guidelines do not provide complete coverage over the CM program. The ports are not following a consistent set of procedures when performing CM reviews, and there are weaknesses in the oversight and monitoring of the CM program.
- Current BWH and FTZ Compliance Review Manuals lack specific guidance for ports to determine the appropriate risk assessment of a BWH or FTZ. In addition, HQ review of the BWHs and FTZs assessment results can take up to six months to compile and analyze. Furthermore, CBP does not maintain a centrally managed list of all BWHs and FTZs.

Cause/Effect: IT system functionality and outdated IT systems contribute to the weaknesses identified above. For example, CBP is unable to determine the status of the in-bond shipments with the information available within ACS, and CBP does not have the ability to run an oversight report to determine if ports have completed all required audits. For drawback, much of the process is manual until planned IT system functionality improvements are made, placing an added burden on limited resources. CBP's IT systems do not maintain one centrally managed list of all BWHs and FTZs.

The inability to effectively monitor the in-bond process and verify the arrival of in-bond merchandise at the port level can lead to a potential loss in revenue. This potential loss in revenue is due to uncollected duties and fees on in-bond merchandise that has physically entered U.S. commerce without formal entry.

The weaknesses in the CM program could result in CBP incorrectly evaluating the effectiveness of its control environment over the collections of duties, taxes, and fees.

It is possible that BWH/FTZ operators and users may be able to operate BWHs and FTZs that contain merchandise that CBP has no or limited knowledge about.

Criteria: Under FMFIA, management must implement cost-effective controls to safeguard assets and ensure reliable financial reporting. OMB's *Revised Implementation Guidance for FFMIA,* states that financial systems should "routinely provide reliable financial information consistently, accurately, and reported uniformly" to support management of current operations.

The Financial Systems Integration Office (FSIO) publications and OMB Circular No. A-127 outline the requirements for Federal financial systems. The Office of Federal Financial Management's *Core Financial System Requirements,* dated January 2006, states that the core financial system must maintain detailed information sufficient to provide audit trails and to support reconciliation and research activities. OMB Circular No. A-127, *Financial Management Systems,* requires that the design of financial systems should eliminate unnecessary duplication of a transaction entry. Wherever appropriate, data needed by the systems to support financial functions should be entered only once, and other parts of the system should be updated through electronic means consistent with the timing requirements of normal business/transaction cycles.

The *Improper Payments Information Act of 2002* requires agencies to annually review programs and activities and identify any that may be susceptible to significant improper payment. Whenever an agency estimates that improper payments may exceed $10 million, it must also provide a report on what actions are being taken to reduce such payments. In addition to the regulatory requirements stated above, CBP's *Drawback Handbook*, dated July 2004, states that management reviews are necessary to maintain a uniform national policy of supervisory review.

Recommendations: We recommend that CBP:

1. *Related to drawback*:
   a) Implement effective internal controls over drawback claims as part of any new system initiatives, including the ability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries and export documentation for which the drawback claim is based, and identify duplicate or excessive drawback claims;
   b) Implement automated controls within ACS and the Automated Commercial Environment (ACE) to prevent overpayment of a drawback claim;
   c) While ACE is in development, collaborate with ACE developers/engineers to ensure that the new system eliminates the need for statistical sampling of UCE and prior related drawback claims as

III.6

drawback claims. In addition, until ACE is implemented, we recommend that CBP explore other statistical approaches for selecting UCEs and prior related drawback claims under the current ACS environment; and

d) Continue to work with the U.S. Congress to lengthen the required document retention period for all supporting documentation so that it corresponds with the drawback claim life cycle.

2. *Related to the Entry Process:*

a) Implement a standard procedure to periodically compile the results of all in-bond audits during the year and develop an analysis function in order to evaluate the importers' compliance with regulations;

b) Develop policies and procedures to monitor the results of in-bond audits at the port level and to require reviews of overdue immediate transportation in-bonds and air in-bonds;

c) Analyze the in-bond program annually to determine the potential loss of revenue relating to in-bonds;

d) Provide additional detail in the CM guidelines, specifying the use of the monitoring report, data queries, and any other tools to provide complete coverage over the CM program. The guidance should also readdress the timing requirements for the monitoring reports or data queries and documentation retention;

e) Conduct periodic training to ensure that all port personnel have comprehensive knowledge of the CM program requirements; and

f) Develop standard operating procedures for conducting risk assessments for all BWHs and FTZs. In addition, develop standardized procedures for HQ or field office oversight to ensure compliance review schedules are being reviewed timely and provide effective training to ensure that all ports are aware of updates and changes to the program and can consistently execute all requirements presented in the compliance review manuals and handbooks.

III-I Deferred Revenue (USCIS)

Background: Throughout the year, the United States Citizenship and Immigration Service (USCIS) receives millions of applications and petitions for various immigration and naturalization benefits. Applications are received and processed at four service centers, the National Benefits Center (NBC), over 30 district offices, and numerous satellite offices. An application fee is associated with most applications received. USCIS recognizes these fees as revenue upon adjudication of the application. The fees associated with applications received but still pending adjudication at the end of a period are considered deferred revenue.

Conditions: We noted the following internal control weaknesses related to deferred revenue at USCIS:

- Deficiencies in policies and procedures over its deferred revenue quality assurance (QA) process. We noted that USCIS:
  - Did not initially use a statistician with experience in developing the type of methodology needed by USCIS for the selection of QA samples;
  - Does not perform deferred revenue 'floor-to-list' QA procedures over CLAIMS 4 naturalization applications located at Service Centers;
  - Does not have detailed QA instructions that ensure consistent practices (non-statistical selection, random selection, etc.) for selecting QA samples in the Service Centers and District Offices;
  - Does not have policies describing and requiring follow-up actions to be carried out when results of the QA fall outside the acceptable range specified in the USCIS sampling methodology; and

  - Personnel performing the deferred revenue QA procedures have a general lack of understanding and/or have differing perceptions as to what constitutes a 'pending' case, and what the QA procedures are meant to validate for financial reporting purposes.

- Does not have policies and procedures that require correction of the errors once discovered. Further, once the errors are identified, there is little formal follow-up to determine the root cause of the error.

Cause/Effect: The deferred revenue QA process and development of management's estimate of deferred revenue is a time consuming process and requires a large use of resources both at the field sites and at USCIS headquarters. Further, enhancements to the manual controls over the application processing process will generally not be made until new application tracking computer systems are implemented. However, error rates indicative of a control deficiency have been identified through the USCIS QA process and exist on USCIS' three largest application tracking systems: CLAIMS 3, CLAIMS 4, and RNACS. These weaknesses may result in a misstatement of deferred revenue, and systemic problems may not be identified and resolved. In addition, USCIS uses multiple, non-integrated systems for processing immigration and naturalization applications.

Criteria: OMB Circular No. A-123 states that internal controls are the organization, policies, and procedures that agencies use to help program and financial managers achieve results and safeguard the integrity of their programs.

According to the USCIS Quality Management Branch (QMB)'s Quality Assurance procedures guidance and client discussion, an analysis is required to be performed on all results that Headquarters receives from the District Offices and Service Centers. The analysis further verifies that the information that is being reported is complete and accurate. If any discrepancies are noted, Headquarters is to follow up with the issue and make sure the issue has been resolved.

Recommendations: We recommend that:

1. USCIS:

   a) Revise the design of the deferred revenue QA process so that Service Centers perform 'Floor-to-List' testing of CLAIMS 4 naturalization applications in addition to CLAIMS 3 immigration applications, to ensure the completeness of deferred revenue;

   b) Institute specific, detailed sampling instructions and QA training to ensure uniformity in the manner in which 'Floor-to-List' applications are selected and the validity of results are analyzed;

   c) Revise the design of the deferred revenue QA process at QMB so that a prescribed set of steps are carried out whenever quarterly QA results are outside the acceptable deviation rate;

   d) Enhance the design of the deferred revenue QA process to include a risk-based over-sampling of previous quarters' results, either by location or application type, to help identify and resolve the root cause of the errors;

   e) Train the individuals performing the various aspects of the deferred revenue QA process on the objectives of the QA as well as definitions of 'pending' applications for deferred revenue purposes;

   f) Correct the errors in application status when identified through the deferred revenue QA process to improve the integrity of system data relied on for financial reporting purposes, and analyze each error identified to determine whether there are any common causes of the errors that occur;

   g) Track all pending applications within one system or in a series of systems that are integrated; and

   h) Evaluate the overall data quality within the various systems to plan for pre-conversion validation of data.

Independent Auditors' Report
Exhibit IV – Compliance and Other Matters – All DHS Components

(Exhibits I and II include Comments A – F, and Exhibit III presents Comments G – I)

All of the compliance and other matters described below are repeat conditions from FY 2007.

IV-J *Federal Managers' Financial Integrity Act of 1982* (FMFIA)

Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, requires agencies and Federal managers to: (1) develop and implement internal controls; (2) assess the adequacy of internal controls; (3) separately assess and document internal control over financial reporting; (4) identify needed improvements; (5) take corresponding corrective action; and (6) report annually on internal controls. During FY 2008 and 2007, the Department of Homeland Security (DHS or the Department) developed an annual *Internal Controls over Financial Reporting Playbook* to implement corrective actions and support management assurances by performing tests of design and operating effectiveness on entity level controls and other financial accounting and reporting processes. DHS' implementation of OMB Circular No. A-123 facilitates compliance with FMFIA. The *DHS Financial Accountability Act of 2004* requires DHS to submit an annual audit opinion of internal control over financial reporting.

While we noted the Department overall has taken positive steps toward full compliance with FMFIA, OMB Circular No. A-123, and the *DHS Financial Accountability Act*, the Coast Guard has not fully established effective systems, processes, policies, and procedures to develop and implement internal accounting and administrative controls, and conformance of accounting systems. In addition, the Transportation Security Administration (TSA), National Preparedness Directorate (NPPD), and the Federal Emergency Management Agency (FEMA)'s control assessment processes require improvement to ensure full compliance with FMFIA.

Recommendation: We recommend that the Coast Guard, TSA, NPPD, and FEMA fully implement the FMFIA process, as prescribed by the OCFO, to ensure full compliance with FMFIA and its OMB-approved plan for Circular No. A-123 implementation in FY 2009.

IV-K *Federal Financial Management Improvement Act of 1996* (FFMIA)

FFMIA Section 803(a) requires that agency Federal financial management systems comply with (1) applicable Federal accounting standards; (2) Federal financial management system requirements; 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. OMB Circular No. A-123 requires agencies and Federal managers to: (1) develop and implement internal controls; (2) assess the adequacy of internal controls; (3) separately assess and document internal control over financial reporting; (4) identify needed improvements; (5) take corresponding corrective action; and (6) report annually on internal controls. During FY 2008, DHS OCFO continued with its 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. The *DHS Financial Accountability Act of 2004* requires DHS to submit an annual audit opinion of internal control over financial reporting.

While we noted the Department overall has taken positive steps toward full compliance with FFMIA, the Coast Guard, CBP, FEMA, FLETC, and TSA did not fully comply with at least one of the requirements of FFMIA. The reasons for noncompliance are reported in Exhibits I, II, and III. The Secretary of DHS also has stated in the Secretary's Assurance Statements dated November 13, 2008, as listed in Management's Discussion and Analysis (MD&A) of the Department's 2008 *Annual Financial Report* (AFR), that the Department cannot provide assurance that its financial management systems are in substantial compliance with the requirements of FFMIA. The Department's remedial actions and related timeframes are also presented in that section of the AFR.

An element within FFMIA Federal system requirements is ensuring security over financial management information. This element is addressed further in the *Federal Information Security Management Act of 2002* (FISMA), which was enacted as part of the *E-Government Act of 2002*. FISMA requires the head of each agency to be responsible for (1) providing information security protections commensurate with the risk and magnitude of the harm resulting from unauthorized access, use, disclosure, disruption, modification, or destruction of (i) information collected or maintained and (ii) information systems used or

IV.1

Independent Auditors' Report
Exhibit IV – Compliance and Other Matters – All DHS Components

operated; (2) complying with the requirements of the Act and related policies, procedures, standards, and guidelines, including (i) information security standards under the United States Code, Title 40, Section 11331 and (ii) information security standards and guidelines for national security systems; and (3) ensuring that information security management processes are integrated with agency strategic and operational planning processes.

We noted weaknesses in financial systems security, reported by us in Exhibits I-B and II-B, *Information Technology General and Application Controls*, which impact the Department's ability to fully comply with FISMA.

Recommendation: We recommend that DHS improve its financial management systems to ensure compliance with the FFMIA, and implement the recommendations provided in Exhibits I, II, and III in FY 2009.

IV-L *Single Audit Act Amendments of 1996,* and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-up,* as revised

During 2007, DHS' Grants and Training (G&T) Directorate merged its grants making function with FEMA. FEMA is now the only DHS component that has a significant grant making operation. OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* requires agencies awarding grants to ensure they receive grantee reports timely and to follow-up on Single Audit findings to ensure that grantees take appropriate and timely action. Although FEMA has adopted procedures to monitor grantees and their audit findings, FEMA did not fully comply with provisions in OMB Circular No. A-133 in FY 2008. We noted that FEMA does not always obtain and review grantee Single Audit reports in a timely manner, or follow up on questioned costs and other matters identified in these reports. Because Single Audits typically are performed by other entities outside of DHS, procedures related to these reports are not always entirely within the control of DHS and its components.

OMB Circular No. A-50, as revised, provides guidance for use by executive agencies when considering reports issued by Inspectors General, other executive branch audit organizations, the GAO, and non-Federal auditors, where follow up is necessary. Corrective action taken by management on findings and recommendations is essential to improve the effectiveness and efficiency of government operations, and to support the objectives of sound fiscal management. The DHS OCFO has developed an extensive corrective action plan that requires each component to develop and execute corrective actions to address all material weaknesses in internal controls. This strategy is documented in the DHS *Internal Controls over Financial Reporting* (ICOFR) "Playbook." Progress is monitored by the CFO, and regularly reported to OMB and other outside stakeholders, such as Congressional Committees. We noted that each component has complied with the OCFO directive to develop corrective actions, and they have been reviewed and approved by the CFO. All DHS components have made progress toward remediation of material internal control weaknesses; however, as shown in Exhibits I, II and III, deficiencies identified in prior years have not been fully corrected in FY 2008.

Recommendations: We recommend that:

Regarding Single Audit Act Amendments of 1996:

1. FEMA develop procedures to ensure compliance with its policy to obtain and review grantee Single Audit reports in a timely manner, and follow-up on questioned costs and other matters identified in these reports. We also recommend that FEMA perform the following in FY 2009:

   a) Further develop and implement a tracking system to identify each grantee for which an OMB Circular No. A-133 Single Audit is required, and the date the audit report is due;

   b) Use the tracking system to ensure audit and performance reports are received timely, and follow-up when reports are overdue; and

   c) Perform reviews of grantee audit reports, issue-related management decisions, and ensure that the grantees take appropriate corrective action, on a timely basis.

IV.2

Independent Auditors' Report
Exhibit IV – Compliance and Other Matters – All DHS Components

Regarding OMB Circular No. A-50, Audit Follow-up, as revised

DHS continue to follow and complete the actions defined in its ICOFR "Playbook," to ensure that audit recommendations are resolved timely and corrective action plans addressing all DHS audit findings are developed and implemented together with appropriate supervisory review in FY 2009.

IV-M *Improper Payments Information Act of 2002*

DHS is required to comply with the *Improper Payments Information Act of 2002* (the Act or IPIA). The Act requires agencies to review all programs and activities they administer annually and identify those that may be susceptible to significant erroneous payments. For all programs and activities where the risk of erroneous payments is significant, agencies must estimate the annual amounts of erroneous payments, and when the estimate exceeds $10 million, report the estimates to the President and Congress with a progress report on actions to reduce them. The agency must report a statistically valid error projection for susceptible programs in its annual Performance and Accountability Report (PAR). To facilitate the implementation of the Act, OMB issued guidance in Memorandum M-03-13, *Implementation Guide for the Improper Payments Information Act of 2002*, and in Appendix C, *Requirements for Effective Measurement and Remediation of Improper Payments*, to OMB Circular No. A-123, which provides a recommended process to meet the disclosure requirements.

In FY 2008, we noted the Department has taken positive steps toward full compliance with IPIA and Appendix C of OMB Circular No. A-123, including strengthening guidance, training, and oversight; identifying programs subject to IPIA; conducting a comprehensive process to assess the risk of programs susceptible to improper payments; and performing sample testing of programs. However, FEMA did not fully comply with the Act in FY 2008. We noted that FEMA:

- Excluded some programs from the scope of the IPIA risk assessment and test work. Specifically, FEMA excluded Mission Assignments and Technology Transfer Program from the scope of the IPIA test work;
- Excluded five programs identified as high risk of significant improper payments during the assessment process from testing; and
- Did not develop Mission Action Plans (MAPs) for five programs identified as "high risk" during the risk assessment process if no statistical sampling was performed to validate those risks during FY2008. FEMA completed a test pilot for these programs.

Recommendation: We recommend that FEMA fully implement the IPIA process, including performing risk assessments for all the programs it administers. We also recommend that FEMA complete its efforts to ensure that all programs identified as susceptible to significant improper payments in its annual risk assessment are subject to sampling, testing and analysis to determine the required statistically valid error rate to be reported in the DHS *Annual Financial Report.*

IV-N *Chief Financial Officers Act of 1990*

The *DHS Financial Accountability Act of 2004* made DHS subject to the *Chief Financial Officers Act of 1990*, as amended, which requires DHS to submit to the Congress and OMB audited financial statements annually. DHS' Office of the Inspector General (OIG) has engaged an independent auditor to audit the September 30, 2008 balance sheet and related statement of custodial activity. Other financial statements, including the statements of net cost, net position, and budgetary resources, are not currently auditable. DHS must be able to represent that its balance sheet is fairly stated, and obtain at least a qualified opinion before it is practical to extend the audit to other financial statements.

Recommendation: We recommend that DHS and its components continue to implement the Mission Action Plans described in DHS' ICOFR "Playbook" (see Comment IV – J, *Federal Managers' Financial Integrity Act of 1982*, above) to remediate the FY 2008 material weaknesses and significant deficiencies, and improve its policies, procedures, and processes, as necessary, to allow management to assert that all financial statements are fairly stated in compliance with accounting principles generally accepted in the United States, and are ready for an independent audit.

Independent Auditors' Report
Exhibit IV – Compliance and Other Matters – All DHS Components

IV-O *Government Performance and Results Act of 1993* (GPRA)

The *Government Performance and Results Act* requires each agency to develop a strategic plan that includes a description of how goals and objectives are to be achieved, including a description of the operational processes, skills and technology, and the human capital and other resources required to meet those goals and objectives. The Department's annual performance plan and performance reports that measure progress toward achieving strategic goals and related performance metrics are also integral to compliance with GPRA. We noted that DHS' Strategic Plan expired on October 1, 2006 and the Department had not provided an updated Strategic Plan prior to September 2008. Consequently, the Department was not in compliance with the requirements of GPRA during FY 2008.

Recommendation: We recommend that DHS ensure full compliance with GPRA by aligning all performance goals to its strategic objectives in the new Strategic Plan in FY 2009.

IV-P *Debt Collection Improvement Act of 1996* (DCIA)

The *DCIA of 1996* (DCIA) is intended to significantly enhance the Federal Government's ability to service and collect debts. Under the DCIA, the Treasury assumes a significant role for improving government-wide receivables management. The DCIA requires Federal agencies to refer eligible delinquent nontax debts over 180 days to U.S. Treasury for the purpose of collection by cross-servicing or the offset program. Our tests of compliance disclosed instances where DHS was not in compliance with certain provisions of the DCIA. Specifically, we noted that due process is not performed in a timely manner to ensure that some eligible debts are forwarded to the Treasury for cross-servicing or the offset program within the timeframes established by DCIA.

Recommendation: We recommend that DHS develop policies and procedures to ensure full compliance with the DCIA in FY 2009.

IV-Q *Anti-Deficiency Act* (ADA)

DHS and Federal Law Enforcement Training Center (FLETC) management notified us of an *Anti-deficiency Act* violation that occurred at FLETC, where a capital lease dating back to FY 2001 was not fully funded. The DHS Secretary has reported the violation to the President of the United States, the President of the Senate, the Speaker of the House of Representatives, and the Comptroller General, as required by 31 U.S.C. Section 1351.

In addition, various other management reviews and OIG investigations are on-going within the Department and its components that may identify ADA violations. The FLETC ADA violation described above relates to one building lease. FLETC has two other similar building leases that have been reviewed by the Department and determined to be operating leases and therefore a violation of ADA has not occurred. The OIG plans to initiate an independent review of the Department's decision to classify the two other FLETC buildings as operating leases. The OIG's review may identify additional ADA violations. The OIG has initiated a review, at FEMA management's request, of certain expenditures occurring in previous years that may have violated the *Anti-deficiency Act.* The Coast Guard management is reviewing a possible ADA violation related to use of funds to purchase assets that may identify a violation of the ADA. NPPD management is continuing their review, initiated in FY 2007, over the classification and use of certain funds that may identify an ADA violation. In addition, NPPD management has initiated a review of certain fees collected for attendance at a DHS-sponsored annual conference that may identify a violation of the *Anti-deficiency Act.*

Recommendations: We recommend that FLETC continue to implement the remedial actions resulting from its internal investigation of this matter. We recommend that the Department, along with the OIG and the other components, complete the internal reviews currently planned or being performed, and properly report the results in compliance with the ADA if necessary.

Independent Auditors' Report
Exhibit V – Status of Prior Year Findings

	Summary of Conditions As Reported in 2007 DHS Performance and Accountability Report	Fiscal Year 2008 Status/ Disposition
	Material Weaknesses:	
A.	**Financial Management and Oversight**	
A.1	The Coast Guard had not fully implemented a financial management organizational structure that ensures accounting principles are correctly applied and financial statement balances are appropriately supported. The Coast Guard has not established appropriate and clear internal reporting relationships, financial guidance, and oversight over internal and external distribution of financial information. The Coast Guard does not have clear and complete authority and responsibility for all financial accounting policy, processes, and control functions that rests with the CFO, and financial management oversight functions are not clearly defined. The Coast Guard financial management infrastructure is not appropriately staffed with experienced financial managers and staff, and the objectives of sound fiscal management are not embraced by all officers and personnel.	**Partially Repeated** (Exhibit III-G)
A.2	FEMA had not established a financial management organizational structure with clear oversight and supervisory review functions that supports the development and implementation of effective policies, procedures, and internal controls over financial reporting, including a lack of segregation of duties in financial reporting roles and a lack of supervisory review in financial functions. FEMA does not have a sufficient number of experienced financial managers and staff to expeditiously address nonroutine accounting issues. FEMA had not completed and implemented a comprehensive corrective action plan to correct internal control weaknesses as required by OMB Circular A-50, *Audit Follow-up,* as revised. FEMA had not documented and/or updated formal policies and procedures for many of the roles, responsibilities, processes, and functions performed within FEMA. FEMA had not completed the placement of sufficient financial and accounting resources in its regional offices, which contributed to certain issues in Mission Assignment accounting. **(Note: Also includes financial reporting material weaknesses)**	**Partially Repeated** (Exhibits I-A and III-G)
B.	**Financial Reporting**	
B.1	The Coast Guard had not developed and implemented an effective general ledger system. The general ledgers are not compliant with the USSGL. The Coast Guard's financial reporting process was complex and labor-intensive, and required a significant number of "on-top" adjustments. The Coast Guard had deficiencies in its policies, procedures, and controls surrounding its financial reporting process, and did not record all financial transactions to the general ledger systems or have adequate beginning balance and year-end close out procedures. The Coast Guard did not have effective policies and procedures to identify the cause and resolve abnormal balances and account relationship discrepancies, e.g. budgetary to proprietary reconciliations. The Coast Guard did not have a process to track and reconcile intragovernmental transactions with its Federal trading partners, and to determine that Coast Guard intragovernmental balances are complete and accurate.	**Repeated** (Exhibit I-A)

V.1

Independent Auditors' Report
Exhibit V – Status of Prior Year Findings

	Summary of Conditions As Reported in 2007 DHS Performance and Accountability Report	Fiscal Year 2008 Status/ Disposition
B.2	DHS HQ did not fully implement a consolidated financial reporting process, including establishing the accounting, reporting, and data gathering responsibilities for the newly established Office of Health Affairs (OHA) in a timely manner, timely or completely reconciling intragovernmental balances with other Federal entities. DHS HQ had not fully implemented recently issued policies, and weaknesses were noted in the beginning of the year balance reconciliations, interim financial statement preparation and support, and computation of abnormal or unusual account balances, including proprietary to budgetary account relationship analysis performed at the consolidated level. DHS HQ did not always perform key supervisory and monitoring control procedures over work prepared by accounting staff during the year. DHS HQ had not established Strategic Goals and the financial information systems or sufficiently documented processes to accumulate cost data by strategic goal as required by SFFAS No. 4, and did not have a current strategic plan as required by GPRA.	**Corrected**
B.3	TSA made a number of restatements to its prior year financial statements, did not have certain policies and procedures in place all fiscal year, required numerous other on-top adjustments to properly close and report its monthly and annual financial results, did not consistently reverse all on-top adjustments that required reversal, and did not record all on-top adjustments properly. TSA required significant additional human resources to perform its year-end general ledger close, prepare financial statements, and respond to audit inquiries in a timely manner.	**Partially Repeated** (Exhibit II-A)
C.	**Financial Systems Security**	
	OCFO and DHS components have IT and financial system security control weaknesses in entity-wide security program planning and management, access controls, change controls, system software, segregation of duties, and service continuity.	**Partially Repeated** (Exhibits I-B and II-B)
D.	**Fund Balance with Treasury (FBwT)**	
	The Coast Guard did not effectively manage its suspense accounts to include supporting suspense account transactions and producing complete and accurate populations, and did not maintain adequate supporting documentation that validated the accuracy of the FBwT reconciliations and the clearing of suspense items. The Coast Guard was unable to provide validated military and civilian payroll data to support payroll transactions processed through the FBwT account.	**Repeated** (Exhibit I-C)

V.2

Independent Auditors' Report
Exhibit V – Status of Prior Year Findings

	Summary of Conditions As Reported in 2007 DHS Performance and Accountability Report	Fiscal Year 2008 Status/ Disposition
E.	**Capital Assets**	
E.1	The Coast Guard had not consistently applied policies and procedures to ensure appropriate documentation is maintained to support Property Plant & Equipment (PP&E) acquisitions and their existence, and the methodologies and assumptions, to support the value of PP&E where documentation has not been maintained, has not been developed. The Coast Guard has not implemented appropriate controls to accurately, consistently, and timely record additions to PP&E and construction in process, transfers, disposals, and valuation and classification of repairable PP&E. The Coast Guard has not implemented accurate and complete asset identification, system mapping, and tagging processes for fixed assets, and has not properly accounted for some improvements and impairments to buildings and structures, capital leases, and selected useful lives. For Operating Materials and Supplies (OM&S), the Coast Guard has not implemented policies, procedures, and internal controls to support the assertions related to the OM&S account balances, or fully designed and implemented procedures over physical counts of OM&S. The Coast Guard has not properly identified recorded OM&S, or established processes and controls to fully support the calculated value of certain types of OM&S to approximate historical cost.	**Repeated** (Exhibit I-D)
E.2	FEMA did not fully adhere to its policies when performing its annual physical count of supplies inventory. Inventory counts were not fully reconciled to the inventory system, inventory counts were not conducted in a well-controlled environment, and in some cases, inventory in the system could not be located.	**Corrected**
E.3	TSA did not reconcile its PP&E subsidiary ledger to its general ledger consistently and timely throughout the year. TSA had not recorded depreciation on certain equipment using a method consistent with GAAP. TSA did not record PP&E purchases in an account compliant with the USSGL requirements of FFMIA, and improperly capitalized certain advance payments to vendors as construction in progress.	**Partially Repeated** (Exhibit II-D)
E.4	US-Visit did not consistently apply procedures to identify and capitalize software development costs or to reclassify software placed into production. US-Visit does not have a reliable financial accounting and reporting process or system in place to routinely account for its software expenditures, capitalize appropriate amounts, and report those balances to DHS OFM.	**Corrected**

V.3

	Summary of Conditions As Reported in 2007 DHS Performance and Accountability Report	Fiscal Year 2008 Status/ Disposition
F.	**Actuarial and Other Liabilities**	
F.1	The Coast Guard did not have an effective process to ensure the completeness and accuracy of data provided to, and used by, the actuary for the calculation of the Military Retirement System pension, medical, and postemployment benefit liabilities, and reconciliations between subsidiary and general ledgers for medical expenditures were not effective. The Coast Guard did not have an effective process for reconciling military payroll recorded in CAS to detail payroll records. Military personnel data changes are not processed in the appropriate payroll and/or reporting periods, and consequently impact the completeness and accuracy of leave and payroll accruals as well as data used for actuarial projections. The Coast Guard did not have a reliable methodology to estimate accounts payable or legal liabilities. The Coast Guard did not support the completeness, existence, and accuracy assertions of the data utilized in developing the environmental liability estimate.	**Repeated** (Exhibit I-E)
F.2	FEMA did not establish a reliable method to estimate G&T grants payable (or advances). FEMA did not have sufficient policies and procedures in place to fully comply with the *Single Audit Act Amendments of 1996* and related OMB Circular No. A-133, *Audits of States, Local Governments, and Nonprofit Organizations.*	**Partially Repeated** (Exhibit II-E)
F.3	TSA had not maintained all necessary supporting documentation over accrued annual leave. TSA had not reconciled annual leave balances earned by employees per the payroll provider's output records to the data submitted by TSA and with the general ledger on a routine basis.	**Corrected**
G	**Budgetary Accounting**	
G.1	The Coast Guard did not have effective policies, procedures and internal controls over Coast Guard's process for validation and verification of UDO balances to ensure that recorded obligations were valid, accurate, recorded timely, and that proper approvals and supporting documentation is maintained. The Coast Guard had not implemented procedures and controls to prevent incurring a commitment/obligation in excess of established targets so that funds are not obligated in excess of the apportioned and allotted amounts, and did not effectively monitor unobligated commitment activity in its procurement system. The Coast Guard did not have properly designed and implemented procedures, processes, and internal controls to verify the completeness and accuracy of the year-end obligation pipeline adjustment to record all executed obligations. Automated system controls were not effectively used to prevent the processing of procurement transactions by contracting officers with expired warrant authority, and the listings of warranted contracting officers were not complete.	**Repeated** (Exhibit I-F)

Independent Auditors' Report
Exhibit V – Status of Prior Year Findings

	Summary of Conditions As Reported in 2007 DHS Performance and Accountability Report	Fiscal Year 2008 Status/ Disposition
G.2	FEMA did not adequately monitor the status of its obligations and ensure the timely deobligation of mission assignments. In addition, Other Federal Agencies (OFA) did not always provide FEMA with timely progress reports that included sufficient cost/billing data and sufficient documentation of mission assignment manager follow-up procedures with the OFAs was not obtained and/or documented timely.	**Repeated** (Exhibit II-F)
G.3	TSA did not have a funds control process in place to monitor outstanding obligation balances on a periodic basis. TSA did not have sufficient policies and procedures requiring contract officers to monitor and close-out contracts, and deficiencies were noted in the validation and verification process conducted over obligations. TSA completed an investigation over certain obligations recorded in previous years and determined that a violation of the *Anti-deficiency Act* occurred in previous years.	**Corrected**
Other Significant Deficiencies:		
H.	**Custodial Revenue and Drawback**	
H.1	The CBP Automated Commercial System (ACS) lacked automated controls to detect and prevent excessive drawback claims and overpayments, necessitating inefficient manual processes that do not effectively compensate for these automated controls. The CBP's drawback review policies did not require drawback specialists to review all or a statistically valid sample of related drawback claims against the underlying consumption entries to determine whether, in the aggregate, an excessive amount was claimed. The policies, procedures, and general guidance provided to field offices for the monthly review of the entry process needed improvement. There were inconsistencies in the performance of risk assessments and compliance reviews of Bonded Warehouses and Foreign Trade Zones, and in-bond entries in various ports. CBP was unable to determine the status of the in-bond shipments with the information available within ACS.	**Repeated** (Exhibit III-H)

V.5

Independent Auditors' Report
Exhibit V – Status of Prior Year Findings

Summary of Conditions As Reported in 2007 DHS Performance and Accountability Report	Fiscal Year 2008 Status/ Disposition
Compliance and Other Matters:	
I. ***Federal Managers' Financial Integrity Act of 1982***	
The Coast Guard had not fully established effective systems, processes, policies, and procedures to develop and implement internal accounting and administrative controls and conformance of accounting systems. In addition, TSA and FEMA's control assessment processes require improvement to ensure full compliance with FMFIA.	**Repeated** (Exhibit IV-J)
J. ***Federal Financial Management Improvement Act of 1996***	
We noted that DHS and each significant component did not fully comply with at least one of the requirements of FFMIA. In addition, we noted weaknesses in financial systems security, which impact the Department's ability to fully comply with FISMA.	**Repeated** (Exhibit IV-K)
K. ***Single Audit Act Amendments of 1996,*** **and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-up,* as revised**	
DHS and its components did not have procedures in place to fully comply with provisions in OMB Circular No. A-133 that require them to timely obtain and review grantee Single Audit reports and follow up on questioned costs and other matters identified in these reports. DHS and its components did not fully implement corrective action plans to address all material weaknesses and significant deficiencies identified by previous financial statement audits within the time-frames established in OMB Circular No. A-50.	**Repeated** (Exhibit IV-L)
L. ***Improper Payments Information Act of 2002***	
DHS did not properly include all federal disbursements, some programs identified as high risk were not tested while others identified as low risk were tested, testing time frames selected for some components were not approved by OMB in advance, and corrective action plans were not developed for all programs identified as high risk during the risk assessment process if no statistical sampling was performed to validate those risks.	**Partially Repeated** (Exhibit IV-M)

V.6

	Summary of Conditions As Reported in 2007 DHS Performance and Accountability Report	Fiscal Year 2008 Status/ Disposition
M.	***DHS Financial Accountability Act of 2004 (Chief Financial Officers Act of 1990)***	
	The *DHS Financial Accountability Act of 2004* made DHS subject to the *Chief Financial Officers Act of 1990*, as amended, which requires DHS to submit to the Congress and OMB audited financial statements annually. DHS engaged an independent auditor to audit the September 30, 2007, consolidated balance sheet and statement of custodial activity only.	**Repeated** (Exhibit IV-N)
N.	***Government Performance and Results Act of 1993***	
	DHS' Strategic Plan expired on October 1, 2006 and the Department had not yet provided an updated Strategic Plan. The existing (expired) strategic plan did not align all strategic objectives to performance objectives as required.	**Partially Repeated** (Exhibit IV-O)
O.	***The Debt Collection Improvement Act of 1996***	
	DHS did not perform due process in a timely manner to ensure that some eligible debts are forwarded to the Treasury for cross-servicing or the offset program within the timeframes established by DCIA.	**Repeated** (Exhibit IV-P)
P.	***Anti-deficiency Act***	
	DHS, specifically TSA, violated the *Anti-deficiency Act* in fund 70X0508 in an amount up to $155 million, where expenditures and obligations exceeded available funding in FY 2004. The DHS Secretary had reported the violation to the President of the United States, the Head of the Senate, the Speaker of the House of Representatives, and the Comptroller General, as required by 31 U.S.C. Section 1351. A separate notification of the final determination was still required under 31 U.S.C. Section 1351.	**Corrected** (Exhibit IV-Q)

Office of the Chief Financial Officer
U.S. Department of Homeland Security
Washington, DC 20528

Homeland Security

November 12, 2008

MEMORANDUM FOR: Richard L. Skinner
Inspector General

FROM: David L. Norquist
Chief Financial Officer

SUBJECT: Fiscal Year (FY) 2008 Financial Statement Audit

Thank you for the opportunity to comment on the Independent Public Accountant's audit of our balance sheets as of September 30, 2008 and 2007, and the related statement of custodial activities. We agree with the Independent Public Accountant's conclusions.

Although the report on internal controls and compliance indicates that DHS still faces serious financial management challenges, the auditor also acknowledges the significant progress made this year. Specifically, DHS reduced the number of audit qualifications from six to three, reduced material weaknesses from seven to six, and reduced the number of component conditions contributing to material weaknesses from 16 to 13. This progress was possible due to the efforts of many throughout the Department who worked to develop and implement meaningful corrective actions to strengthen financial management processes and internal controls.

The FY 2008 audit results show that our corrective actions are working, and we are already updating our plans to address issues identified by the auditors and our own A-123 assessment. Our plans will continue to focus both on sustaining progress, as well as supporting corrective actions in areas where weaknesses remain. This year, we have expanded our plans to include developing and implementing action plans to remediate areas identified as internal control significant deficiencies.

Financial management at DHS has come a long way and I continue to be inspired by the dedication and extraordinary efforts of the Department's financial management community. I would also like to thank you for your efforts and the dedication shown by your staff and the Independent Public Accountant in working with the Department to improve financial management. I appreciate the partnership we have forged and I am confident that this partnership will allow DHS to continue to improve financial management in support of our important mission.

Appendix A
Report Distribution

Department of Homeland Security

Secretary
Deputy Secretary
Chief of Staff
Deputy Chief of Staff
General Counsel
Executive Secretary
Director, GAO/OIG Liaison Office
Assistant Secretary for Policy
Assistant Secretary for Public Affairs
Assistant Secretary for Legislative Affairs
Under Secretary, Management
Chief Financial Officer
Deputy Chief Financial Officer
Acting Director Office of Financial Management
Chief Information Officer
Chief Security Officer
Chief Privacy Officer
FEMA Administrator

Office of Management and Budget

Chief, Homeland Security Branch
DHS OIG Program Examiner

Congress

Congressional Oversight and Appropriations Committees, as appropriate

ADDITIONAL INFORMATION AND COPIES

To obtain additional copies of this report, please call the Office of Inspector General (OIG) at (202) 254-4199, fax your request to (202) 254-4305, or visit the OIG web site at www.dhs.gov/oig.

OIG HOTLINE

To report alleged fraud, waste, abuse or mismanagement, or any other kind of criminal or noncriminal misconduct relative to department programs or operations:

• Call our Hotline at 1-800-323-8603;

• Fax the complaint directly to us at (202) 254-4292;

• 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.

Financial Statements

Department of Homeland Security
Balance Sheets
As of September 30, 2008 and 2007
(In Millions)

	2008 (Unaudited)	2007 (Unaudited) (Restated)
ASSETS		
Intragovernmental		
Fund Balance with Treasury (Notes 2 and 3)	$63,157	$56,185
Investments, Net (Note 5)	3,103	2,778
Accounts Receivable (Note 6)	310	279
Other (Note 13)		
Advances and Prepayments	2,852	2,887
Due from Treasury (Note 2)	151	176
Total Intragovernmental	**$69,573**	**$62,305**
Cash and Other Monetary Assets (Notes 2 and 4)	67	321
Accounts Receivable, Net (Notes 2 and 6)	488	760
Taxes, Duties, and Trade Receivables, Net (Notes 2 and 7)	2,078	1,937
Direct Loans, Net (Note 8)	21	-
Inventory and Related Property, Net (Note 9)	518	632
General Property, Plant, and Equipment, Net (Note 11)	14,501	12,602
Other (Note 13)		
Advances and Prepayments	649	567
TOTAL ASSETS	**$87,895**	**$79,124**
Stewardship Property, Plant, and Equipment (Note 12)		
LIABILITIES		
Intragovernmental		
Accounts Payable (Note 3)	$1,989	$2,262
Debt (Note 15)	17,719	18,153
Other (Note 18)		
Due to the General Fund	2,397	2,085
Accrued FECA Liability	361	355
Other	394	245
Total Intragovernmental	**$22,860**	**$23,100**
Accounts Payable	2,914	2,982
Federal Employee and Veterans' Benefits (Note 16)	36,230	34,910
Environmental and Disposal Liabilities (Note 17)	288	275
Other (Notes 18, 19, 20, and 21)		
Accrued Payroll and Benefits	1,787	1,553
Deferred Revenue and Advances from Others	3,080	2,727
Unliquidated Antidumping and Countervailing Duties	161	514
Insurance Liabilities	5,531	1,508

Department of Homeland Security
Balance Sheets
As of September 30, 2008 and 2007
(In Millions)

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Refunds and Drawbacks	130	131
Other	1,434	1,497
Total Liabilities	**$74,415**	**$69,197**
Commitments and contingencies (Notes 19, 20, and 21)		
NET POSITION (Note 35)		
Unexpended Appropriations		
Unexpended Appropriations-Other Funds	$55,228	$48,810
Cumulative Results of Operations		
Cumulative Results of Operations-Earmarked Funds (Note 22)	(19,337)	(16,236)
Cumulative Results of Operations-Other Funds	(22,411)	(22,647)
Total Net Position	**$13,480**	**$9,927**
TOTAL LIABILITIES AND NET POSITION	**$87,895**	**$79,124**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Net Cost
For the Years Ended September 30, 2008 and 2007
(In Millions)

Directorates and Other Components (Note 23 and 24)	2008 (Unaudited)	2007 (Unaudited) (Restated)
U.S. Customs and Border Protection		
Gross Cost	$9,783	$8,198
Less Earned Revenue	(160)	(157)
Net Cost	**9,623**	**8,041**
U.S. Coast Guard		
Gross Cost	9,508	10,653
Less Earned Revenue	(465)	(492)
Net Cost	**9,043**	**10,161**
U.S. Citizenship and Immigration Services		
Gross Cost	2,184	1,731
Less Earned Revenue	(2,215)	(1,659)
Net Cost	**(31)**	**72**
Federal Emergency Management Agency		
Gross Cost	18,500	14,272
Less Earned Revenue	(3,027)	(2,842)
Net Cost	**15,473**	**11,430**
Federal Law Enforcement Training Center		
Gross Cost	447	402
Less Earned Revenue	(40)	(41)
Net Cost	**407**	**361**
National Protection and Programs Directorate		
Gross Cost	872	855
Less Earned Revenue	(1)	-
Net Cost	**871**	**855**
U.S. Immigration and Customs Enforcement		
Gross Cost	5,485	4,891
Less Earned Revenue	(928)	(900)
Net Cost	**4,557**	**3,991**

Department of Homeland Security
Statements of Net Cost
For the Years Ended September 30, 2008 and 2007
(In Millions)

Directorates and Other Components (Note 23 and 24)	**2008 (Unaudited)**	**2007 (Unaudited) (Restated)**
Office of Health Affairs		
Gross Cost	157	113
Less Earned Revenue	-	-
Net Cost	**157**	**113**
Departmental Operations and Other		
Gross Cost	1,316	1,204
Less Earned Revenue	(1)	(3)
Net Cost	**1,315**	**1,201**
U.S. Secret Service		
Gross Cost	1,747	1,689
Less Earned Revenue	(11)	(16)
Net Cost	**1,736**	**1,673**
Science and Technology Directorate		
Gross Cost	776	987
Less Earned Revenue	(6)	(14)
Net Cost	**770**	**973**
Transportation Security Administration		
Gross Cost	6,622	6,356
Less Earned Revenue	(2,385)	(2,299)
Net Cost	**4,237**	**4,057**
NET COST OF OPERATIONS (Note 23 and 24)	**$48,158**	**$42,928**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Changes in Net Position
For the Year Ended September 30, 2008
(In Millions)

	2008 (Unaudited)			
	Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
Cumulative Results of Operations				
Beginning Balances	$(16,236)	$(22,647)	$ -	$(38,883)
Budgetary Financing Sources				
Appropriations used	-	41,062	-	41,062
Non-exchange Revenue	3,823	6	-	3,829
Donations and Forfeitures of Cash and Cash Equivalents	2	-	-	2
Transfers in/out Without Reimbursement	(2,123)	1,854	-	(269)
Other	-	(38)	-	(38)
Other Financing Sources (Non-Exchange)				
Donations and forfeitures of property	-	14	-	14
Transfers in/out reimbursement	(43)	61	-	18
Imputed financing	2	751	15	738
Other	-	(63)	-	(63)
Total Financing Sources	1,661	43,647	15	45,293
Net Cost of Operations	(4,762)	(43,411)	(15)	(48,158)
Net Change	(3,101)	236	-	(2,865)
Cumulative Results of Operations	**(19,337)**	**(22,411)**	**-**	**(41,748)**
Unexpended Appropriations				
Beginning Balance	-	48,810	-	48,810
Adjustments:				
Adjustments (Note 35)	-	(1,468)	-	(1,468)
Beginning Balance, as Adjusted	**-**	**47,342**	**-**	**47,342**
Budgetary Financing Sources				
Appropriations Received (Note 31)	-	50,253	-	50,253
Appropriations Transferred in/out	-	(683)	-	(683)
Other Adjustments	-	(622)	-	(622)
Appropriations Used	-	(41,062)	-	(41,062)
Total Budgetary Financing Sources	-	7,886	-	7,886
Total Unexpended Appropriations	**-**	**55,228**	**-**	**55,228**
NET POSITION	**$(19,337)**	**$32,817**	**$ -**	**$13,480**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Changes in Net Position
For the Year Ended September 30, 2007
(In Millions)

	2007 (Unaudited) (Restated)			
	Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
Cumulative Results of Operations				
Beginning Balances	$(18,644)	$(20,919)	$ -	$(39,563)
Adjustments:				
Correction of Errors (Note 33)	-	266	-	266
Beginning Balance, as Adjusted	**(18,644)**	**(20,653)**	-	**(39,297)**
Budgetary Financing Sources				
Appropriations used	-	39,178	-	39,178
Non-exchange Revenue	3,603	6	-	3,609
Donations and Forfeitures of Cash and Cash Equivalents	2	-	-	2
Transfers in/out Without Reimbursement	(1,980)	1,855	-	(125)
Other	-	(174)	-	(174)
Other Financing Sources (Non-Exchange)				
Donations and forfeitures of property	-	4	-	4
Transfers in/out reimbursement	-	9	-	9
Imputed financing	2	848	11	839
Total Financing Sources	1,627	41,726	11	43,342
Net Cost of Operations	781	(43,720)	(11)	(42,928)
Net Change	2,408	(1,994)	-	414
Cumulative Results of Operations	**(16,236)**	**(22,647)**	-	**(38,883)**
Unexpended Appropriations				
Beginning Balance	-	48,853	-	48,853
Adjustments:				
Corrections of Errors (Note 33)		(89)		(89)
Beginning Balance, as Adjusted	-	**48,764**	-	**48,764**
Budgetary Financing Sources				
Appropriations Received (Note 31)	-	39,520	-	39,520
Appropriations Transferred in/out	-	295	-	295
Other Adjustments	-	(591)	-	(591)
Appropriations Used	-	(39,178)	-	(39,178)
Total Budgetary Financing Sources	-	46	-	46
Total Unexpended Appropriations	-	**48,810**	-	**48,810**
NET POSITION	**$(16,236)**	**$26,163**	**$ -**	**$9,927**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Budgetary Resources
For the Years Ended September 30, 2008 and 2007
(In Millions)

	2008 (Unaudited)		2007 (Unaudited) (Restated)	
	Budgetary	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**
BUDGETARY RESOURCES				
Unobligated Balance, Brought Forward, October 1 (Note 35)	$17,214	$131	$17,309	$ -
Recoveries of Prior Year Unpaid Obligations	3,824	-	4,997	-
Budget Authority:				
Appropriations (Note 31)	57,653	-	46,491	-
Spending Authority from Offsetting Collections:				
Earned:				
Collected	9,450	172	9,963	336
Change in Receivables from Federal Sources	(19)	-	7	-
Change in Unfilled Customer Orders:				
Advances Received	84	-	78	-
Without Advance From Federal Sources	(350)	(37)	696	(122)
Expenditure Transfers from Trust Funds	48	-	47	-
Subtotal	66,866	135	57,282	214
Non-expenditure Transfers, net; Anticipated and Actual	(210)	-	787	-
Temporarily Not Available Pursuant to Public Law	(14)	-	-	-
Permanently Not Available	(883)	(251)	(671)	(70)
TOTAL BUDGETARY RESOURCES	**$86,797**	**$15**	**$79,704**	**$144**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred: (Note 25)				
Direct	$56,814	$11	$56,653	$13
Reimbursable	8,664	-	5,320	-
Subtotal	65,478	11	61,973	13
Unobligated Balance:				
Apportioned	7,224	4	9,157	12
Exempt from Apportionment	91	-	97	-
Subtotal	7,315	4	9,254	12
Unobligated Balance Not Available	14,004	-	8,477	119
TOTAL STATUS OF BUDGETARY RESOURCES	**$86,797**	**$15**	**$79,704**	**$144**

Department of Homeland Security
Statements of Budgetary Resources
For the Years Ended September 30, 2008 and 2007
(In Millions)

	2008 (Unaudited)		2007 (Unaudited) (Restated)	
	Budgetary	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**
CHANGE IN OBLIGATED BALANCE				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, October 1 (Note 35)	$42,753	$480	$43,040	$642
Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(2,770)	(361)	(2,069)	(482)
Total Unpaid Obligated Balance, net	39,983	119	40,971	160
Obligations Incurred, net	65,478	11	61,973	13
Gross Outlays	(57,191)	(168)	(56,293)	(175)
Obligated Balance Transferred, net				
Actual Transfers, Unpaid Obligations	(25)	-	(18)	-
Total Unpaid Obligated Balance Transferred, net	(25)	-	(18)	-
Recoveries of Prior Year Unpaid Obligations, Actual	(3,824)	-	(4,997)	-
Change in Uncollected Customer Payments from Federal Sources	367	38	(702)	121
Obligated Balance, net, End of Period				
Unpaid Obligations	47,191	323	43,704	480
Uncollected Customer Payments from Federal Sources	(2,403)	(323)	(2,770)	(361)
Total, Unpaid Obligated Balance, net, End of Period	**$44,788**	**$ -**	**$40,934**	**$119**
NET OUTLAYS				
Gross Outlays	$57,191	$168	$56,293	$175
Offsetting Collections	(9,582)	(172)	(10,090)	(336)
Distributed Offsetting Receipts	(6,048)	-	(4,952)	-
NET OUTLAYS	**$41,561**	**$(4)**	**$41,251**	**$(161)**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Custodial Activity
For the Years Ended September 30, 2008 and 2007
(In Millions)

	2008 (Unaudited)	2007 (Unaudited)
Revenue Activity		
Sources of Cash Collections:		
Duties	$27,320	$26,658
User Fees	1,796	1,732
Excise Taxes	2,457	2,626
Fines and Penalties	89	60
Interest	26	15
Miscellaneous	149	25
Total Cash Collections	31,837	31,116
Accrual Adjustments	133	5,723
Total Custodial Revenue	**31,970**	**36,839**
Disposition of Collections		
Transferred to Others:		
Federal Entities:		
U.S. Department of Agriculture	8,258	148
U.S. Department of Labor	87	193
U.S. Department of State	45	46
National Science Foundation	104	107
Treasury General Fund Accounts	20,973	23,591
Other Federal Agencies	23	21
Non-Federal Entities:		
Government of Puerto Rico	12	14
Government of the U.S. Virgin Islands	2	5
Other Non-Federal Entities	875	20
(Increase)/Decrease in Amounts Yet to be Transferred	237	5,712
Refunds and Drawbacks (Notes 18 and 32)	1,296	6,922
Retained by the Department	58	60
Total Disposition of Custodial Revenue	**31,970**	**36,839**
Net Custodial Activity	**$ -**	**$ -**

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements (Unaudited)

Table of Contents for Notes to the Financial Statements (unaudited)

Notes to the Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

A. Reporting Entity

The Department of Homeland Security (DHS or the Department) was established by the *Homeland Security Act of 2002 (HSA), P.L. 107-296*, dated March 25, 2002, as an executive department of the U.S. Federal Government. DHS's mission is to lead the national effort to secure America. This mission includes the prevention and deterrence of terrorist attacks and protection against, and response to, threats and hazards to the Nation and critical infrastructure from dangerous people and goods. Additionally, DHS's mission is to ensure the safety and security of borders, welcome lawful immigrants and visitors, and promote the free-flow of commerce. In support of DHS's mission, the Secretary has established additional goals to build a nimble, effective emergency response system and a culture of preparedness, and to strengthen and unify DHS operations and management. The Department is composed of the following financial reporting Components[1]:

- **U.S. Customs and Border Protection (CBP)**
- **U.S. Coast Guard (USCG)**
- **U.S. Citizenship and Immigration Services (USCIS)**
- **Federal Emergency Management Agency (FEMA)**
- **Federal Law Enforcement Training Center (FLETC)**
- **National Protection and Programs Directorate (NPPD)**
- **U.S. Immigration and Customs Enforcement (ICE),** including the Federal Protective Services (FPS)
- **Office of Health Affairs (OHA)**
- **Departmental Operations and Other**, including the Management Directorate (MGMT), the Office of the Secretary, the Office of the Inspector General (OIG), the Domestic Nuclear Detection Office (DNDO), Office of Intelligence and Analysis, and the Office of Operations Coordination and Planning
- **U.S. Secret Service (USSS)**
- **Science and Technology Directorate (S&T)**
- **Transportation Security Administration (TSA)**

B. Basis of Presentation

These financial statements are prepared to report the consolidated financial position, net cost of operation, changes in net position, custodial activity, and the combined budgetary resources of the Department pursuant to the *Government Management Reform Act of 1994 (P.L. 103-356)* and *Chief Financial Officers Act of 1990 (P.L 101-576)*, as amended by the *Reports Consolidation Act of 2000 (P.L. 106-531)*.

The Department's financial statements have been prepared from the accounting records of the Department in conformity with U.S. Generally Accepted Accounting Principles (GAAP) and Office

[1] Financial reporting Components are to be distinguished from direct report Components.

of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*. GAAP for Federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB), the official accounting standards-setting body of the Federal Government.

The Department's financial statements reflect the reporting of Departmental activities including appropriations received to conduct operations and revenue generated from operations. The financial statements also reflect the reporting of certain non-entity (custodial) functions performed by the Department on behalf of the Federal Government.

Intragovernmental assets and liabilities result from activity with other Federal entities. All other assets and liabilities result from activity with parties outside the Federal Government, such as domestic and foreign persons, organizations, or governments. Intragovernmental earned revenues are collections or accruals of revenue from other Federal entities and intragovernmental costs are payments or accruals to other Federal entities. Transactions and balances among the Department's Components have been eliminated in the consolidated presentation of the Balance Sheets, Statements of Net Cost, Statements of Changes in Net Position, and the Statements of Custodial Activity. The Statements of Budgetary Resources are reported on a combined basis; therefore, intradepartmental balances have not been eliminated.

While these financial statements have been prepared from the books and records of the Department in accordance with the formats prescribed by OMB, these financial statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.

These financial statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity, whose liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the U.S. Government acting in its capacity as a sovereign entity.

C. Basis of Accounting

Transactions are recorded on an accrual and a budgetary basis of accounting. Under the accrual basis, revenues are recorded when earned and expenses are recognized when a liability is incurred, regardless of when cash is exchanged. Budgetary accounting facilitates compliance with legal constraints and the controls over the use of Federal funds. The balances and activity of budgetary accounts are used to prepare the Statements of Budgetary Resources. The Statements of Custodial Activity are reported using the modified cash basis. With this method, revenue from cash collections is reported separately from receivable accruals and cash disbursements are reported separately from payable accruals.

D. Use of Estimates

Management has made certain estimates and assumptions in the reporting of the financial statement balances and associated disclosures. Actual results could differ from these estimates. Significant estimates include: the year-end accruals of accounts and grants payable; contingent legal and environmental liabilities; accrued workers' compensation; allowance for doubtful accounts receivable; allowances for obsolete inventory and operating materials and supplies (OM&S) balances; allocations of indirect common costs to construction-in-progress; depreciation; subsidy re-estimates; deferred revenues; National Flood Insurance Program (NFIP) insurance liability; actuarial workers compensation assumptions; military and other pension, retirement and post-retirement benefit assumptions; allowances for doubtful duties, fines, penalties, and certain non-entity receivables; and payables related to custodial activities and undeposited collections.

E. Entity and Non-Entity Assets

Entity assets are assets that the Department has the authority to use in its operations. The authority to use funds in an entity's operations means that Department management has the authority to decide how funds are used, or management is legally obligated to use funds to meet entity obligations, e.g. salaries and benefits.

Non-entity assets are assets held by the Department, but are not available for use by the Department. An example of a non-entity asset is the portion of Fund Balance with Treasury which consists of special and deposit funds, permanent appropriations, and miscellaneous receipts that are available to pay non-entity liabilities.

F. Fund Balance with Treasury

Fund Balance with Treasury represents the aggregate amount of the Department's accounts with the U.S. Department of the Treasury (Treasury) available to pay current liabilities and finance authorized purchases, except as restricted by law. The Department's Fund Balance with Treasury balances are primarily appropriated, revolving, trust, deposit, receipt, and special fund amounts remaining as of the fiscal year-end.

For additional information, see Note 3, Fund Balance with Treasury.

G. Cash and Other Monetary Assets

The Department's cash and other monetary assets primarily consist of undeposited collections, imprest funds, cash used in undercover operations, cash held as evidence, cash held by insurance companies, and seized cash and monetary instruments.

The Department does not maintain cash in commercial bank accounts. For FEMA, certain receipts are received and processed by insurance companies. The remainder of the receipts and disbursements are processed by Treasury.

For additional information, see Note 4, Cash and Other Monetary Assets.

H. Investments, Net

Investments consist of U.S. Government non-marketable par value and market based Treasury securities, and are reported at cost or amortized cost net of premiums or discounts. Premiums or discounts are amortized into interest income over the terms of the investment using the effective interest method or the straight line method, which approximates the interest method. No provision is made for unrealized gains or losses on these securities because it is the Department's intent to hold these investments to maturity.

For additional information, see Note 5, Investments, Net.

I. Accounts Receivable, Net

Accounts receivable represent amounts due to the Department from other Federal agencies and the public. Intragovernmental accounts receivable generally arise from the provision of goods and services to other Federal agencies and are expected to be fully collected.

Accounts receivable due from the public typically results from various immigration and user fees, premiums and restitution from insurance companies and policyholders, breached bonds, reimbursable services, and security fees. Public accounts receivable are presented net of an allowance for doubtful accounts, which is based on analyses of debtors' ability to pay, specific identification of probable losses, aging analysis of past due receivables, or historical collection experience. Interest due on past due receivables is fully reserved until collected.

For additional information, see Note 6, Accounts Receivable, Net.

J. Advances and Prepayments

Intragovernmental advances, presented as a component of other assets in the accompanying Balance Sheets, consist primarily of disaster recovery and assistance advances to other Federal agencies tasked with mission assignments.

Advances and prepayments to the public, presented as a component of other assets in the accompanying Balance Sheets, consist primarily of disaster recovery and assistance grants to States and other grant activity. Advances are expensed as they are used by the recipients.

For additional information, see Note 13, Other Assets.

K. Direct Loans, Net

Direct loans are loans issued by the Department to local governments. FEMA, the only DHS Component with loan activity, operates the Community Disaster Loan program to support any local government which has suffered a substantial loss of tax and other revenues as a result of a major disaster and which demonstrates a need for Federal financial assistance in order to perform its governmental functions. Under the program, FEMA transacts direct loans to local governments who meet statutorily set eligibility criteria. Loans are accounted for as receivables as funds are disbursed.

All of the Department's loans are post-1991 obligated direct loans, and the resulting receivables are governed by the *Federal Credit Reform Act of 1990 (FCRA) (P.L. 101-508).* Under FCRA, for direct loans disbursed during a fiscal year, the corresponding receivable is adjusted for subsidy costs. Subsidy costs are an estimated long-term cost to the U.S. Government for its loan programs. The subsidy cost is equal to the present value of the estimated cash outflows over the life of the loans minus the present value of the estimated cash inflows, discounted at the applicable Treasury interest rate. Administrative costs such as salaries and contractual fees are not included. Subsidy costs can arise from interest rate differentials, interest subsidies, delinquencies and defaults, and other cash flows. The Department calculates the subsidy costs based on a subsidy calculator model created by OMB.

Loans receivable are recorded at the present value of the estimated net cash flows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recorded in the allowance for subsidy, which is estimated and adjusted annually, as of year-end. Interest receivable is the total interest that has accrued on each of the outstanding loans, less any cancellations that may have been recorded due to the FEMA cancellation policy as described in 44 CFR Section 206.366.

For additional information see Note 8, Direct Loans, net.

L. Inventory and Related Property, Net

Operating Materials and Supplies (OM&S) are tangible personal property consumed during normal operations. Department OM&S consists primarily of goods consumed during the service of vessels and aircraft. OM&S are valued based on an average unit cost, weighted moving average method, or on actual prices paid. OM&S are expensed when consumed or issued for use. Excess, obsolete, and unserviceable OM&S are stated at net realizable value net of an allowance, which is based on the condition of various asset categories, as well as historical experience with using and disposing of such assets.

Inventory is tangible personal property that is held for sale or used in the process of production for sale. Department inventories consist primarily of the U.S. Coast Guard Supply Fund, providing uniform clothing, subsistence provisions, retail stores, technical material and fuel, and the U.S. Coast Guard Industrial Fund, providing inventory for the repair of U.S. Coast Guard and other government agency ships and vessels. Inventories on hand at year-end are stated at cost using standard price/specific identification, first-in/first-out, last acquisition price, or weighted average cost methods, which approximates historical cost. Revenue on inventory sales and associated cost of goods sold are recorded when merchandise is sold to the end user.

Stockpile materials are critical materials held due to statutory requirements for use in national emergencies. The Department's stockpile materials held by FEMA include goods that would be used to respond to national disasters, including water, meals, cots, blankets, tarps, and blue roof sheeting. Inventory at year-end is stated at historical cost using the weighted average method.

For additional information see Note 9, Inventory and Related Property, Net

M. Seized and Forfeited Property

The Department's prohibited seized property results primarily from criminal investigations and passenger/cargo processing. Seized property falls into two categories, prohibited and non-prohibited. Prohibited seized property includes illegal drugs, contraband, and counterfeit items that cannot legally enter into the commerce of the United States; non-prohibited seized property includes items that are not inherently illegal to possess or own such as monetary instruments, real property, and tangible personal property of others.

Seized property is not considered an asset of the Department and is not reported as such in the Department's financial statements. However, the Department has a stewardship responsibility until the disposition of the seized items are determined, i.e., judicially or administratively forfeited or returned to the entity from which it was seized.

Forfeited property is seized property for which the title has passed to the U.S. Government. Prohibited forfeited items such as counterfeit goods, narcotics, or firearms are held by the Department until disposed of or destroyed. Non-prohibited forfeited property is transferred to the Treasury Forfeiture Fund.

An analysis of changes in seized and forfeited property of prohibited items is presented in Note 10.

N. General Property, Plant, and Equipment, Net

The Department's Property, Plant, and Equipment (PP&E) consists of aircraft, vessels, vehicles, land, structures, facilities, capital leases, leasehold improvements, software, information technology, and other equipment. PP&E is recorded at cost. The U.S. Coast Guard uses a market-based valuation method to record PP&E assets when the historical cost is unknown. For those assets that are unique and uncommon, formal appraisals are conducted to determine acquisition cost. The Department capitalizes PP&E acquisitions when the cost equals or exceeds an established threshold and has a useful life of two years or more.

Costs for construction projects are recorded as construction-in-progress until completed, and are valued at actual (direct) costs, plus applied overhead and other indirect costs. In cases where historical cost information was not maintained, PP&E is capitalized using an estimated cost based on the cost of similar assets at the time of acquisition or the current cost of similar assets discounted for inflation since the time of acquisition. The Department owns some of the buildings in which Components operate. Other buildings are provided by the General Services Administration (GSA), which charges rent equivalent to the commercial rental rates for similar properties.

Internal use software includes purchased commercial off-the-shelf software (COTS), contractor developed software, and internally developed software. For COTS software, the capitalized costs include the amount paid to the vendor for the software. For contractor developed software the capitalized costs include the amount paid to a contractor to design, program, install, and implement the software. Capitalized costs for internally developed software include the full cost (direct and indirect) incurred during the software development phase. Costs incurred during the preliminary design and post-implementation/operational phases are expensed in the period incurred. In addition, CBP applies capital lease accounting concepts to software license fee agreements that give CBP the "right to use" the software.

The schedule of capitalization thresholds shown below is a summary of the range of capitalization rules in place from the legacy agencies that comprised the Department. In accordance with DHS policy, Components were allowed to continue using their legacy thresholds and capitalization rules until a more comprehensive approach is developed that takes into account the vast differences in Component size and asset usage.

The ranges of capitalization thresholds and service life used by Components, by primary asset category, are as follows:

Asset Description	Capitalization Threshold	Service Life
Land	Zero to $200,000	Not Applicable
Improvements to Land	Zero to $200,000	2 years to 50 years
Buildings and improvement	Zero to $200,000	2 years to 50 years

Equipment and capital leases	$5,000 to $200,000	2 years to 57 years
Software	$50,000 to $750,000	2 or more years

The Department begins to recognize depreciation expense once the asset has been placed in service. Depreciation is calculated on a straight-line method for all asset classes over their estimated useful lives. Land is not depreciated. Leasehold improvements are depreciated over the shorter of the term of the remaining portion of the lease or the useful life of the improvement. Buildings and equipment acquired under capital leases are amortized over the lease term. Amortization of capitalized software is calculated using the straight-line method and begins on the date of acquisition if purchased, or when the module or component has been placed in use (i.e., successfully installed and tested) if contractor or internally developed. There are no restrictions on the use or convertibility of general PP&E.

For additional information see Note 11, General Property, Plant and Equipment, Net.

O. Stewardship Property, Plant and Equipment

Stewardship PP&E includes heritage assets and stewardship land which generally are not included in general PP&E presented on the Balance Sheet. Heritage assets are unique due to their historical or natural significance, cultural, educational, or artistic importance, or significant architectural characteristics. The Department's heritage assets consist primarily of historical artifacts, art work, buildings, and structures owned by the U.S. Coast Guard. The cost of improving, reconstructing or renovating heritage assets is recognized as an expense in the period incurred. Similarly, the cost to acquire or construct a heritage asset is recognized as an expense of the period incurred. Due to their nature, heritage assets are not depreciated because matching costs with specific periods would not be meaningful.

Heritage assets can serve two purposes: a heritage function and general government operational function. If a heritage asset serves both purposes, but is predominantly used for general government operations, the heritage asset is considered a multi-use heritage asset, which is included in general PP&E on the Balance Sheet. DHS depreciates its multi-use heritage assets over their useful life. The Department's multi-use heritage assets consist primarily of buildings and structures owned by CBP and the U.S. Coast Guard.

For more information see Note 12, Stewardship Property, Plant and Equipment.

P. Liabilities

Liabilities represent the probable and measurable future outflow or other sacrifice of resources as a result of past transactions or events. Liabilities covered by budgetary resources are those liabilities for which Congress has appropriated funds or funding is otherwise available to pay amounts due. Liabilities not covered by budgetary or other resources represent amounts owed in excess of available Congressionally appropriated funds or other amounts, and there is no certainty that the appropriations will be enacted. The U.S. Government, acting in its sovereign capacity, can abrogate liabilities of the Department arising from other than contracts.

Q. Contingent Liabilities

Certain conditions exist as of the date of the financial statements, which may result in a loss to the government, but which will only be resolved when one or more future events occur or fail to occur. The Department recognizes a loss contingency when the future outflow or other sacrifice of resources is probable and reasonably estimable. Loss contingencies that are determined by management to have a reasonably possible chance of occurring or that cannot be estimated are included as a footnote to the financial statements. Contingent liabilities considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee is disclosed.

For more information see Note 21, Commitments and Contingent Liabilities.

Environmental Cleanup Costs. Environmental liabilities consist of environmental remediation, cleanup, and decommissioning. The liability for environmental remediation is an estimate of costs necessary to bring a known contaminated asset into compliance with applicable environmental standards. Accruals for environmental cleanup costs are the costs of removing, containing, and/or disposing of hazardous wastes or materials that, because of quantity, concentration, or physical or chemical characteristics, may pose a substantial present or potential hazard to human health or the environment.

For all PP&E in service as of October 1, 1997, DHS recognizes the estimated total cleanup costs associated with the PP&E at the time the cleanup requirement is identified. DHS does not prorate a cleanup cost over the life of these PP&E. However, the estimate may be subsequently adjusted for material changes due to inflation/deflation or changes in regulations, plans, or technology. The applicable costs of decommissioning DHS's existing and future vessels are considered cleanup costs.

For more information see Note 17, Environmental and Disposal Liabilities.

R. Grants Liabilities

The Department awards grants and cooperative agreements to Federal, State, and local governments, universities, non-profit organizations, and private sector companies for the purpose of building the capacity to respond to disasters and emergencies, conduct research into preparedness, enhance and ensure the security of passenger and cargo transportation by air, land, or sea, and other Department-related activities. The Department estimates the year-end grant accrual for unreported grantee expenditures using historical disbursement data. Grants liabilities are combined with accounts payable to the public in the accompanying Balance Sheets.

S. Insurance Liabilities

Insurance liabilities are the result of the Department's sale or continuation-in-force of flood insurance known as the NFIP, which is managed by FEMA. The insurance liability represents an estimate of NFIP losses that are unpaid at the Balance Sheet date. Although the insurance underwriting operations believes the liability for unpaid losses and loss adjustment expenses is reasonable and adequate in the circumstances, actual incurred losses and loss adjustment expenses may not conform to the assumptions inherent in the estimation of the liability. Accordingly, the ultimate settlement of losses and the related loss adjustment expenses may vary from the estimate reported in the financial statements.

For more information see Note 18, Other Liabilities, and Note 20, Insurance Liabilities.

T. Debt and Borrowing Authority

Debt is reported within Intragovernmental Liabilities and results from Treasury loans and related interest payable to fund NFIP and Disaster Assistance Direct Loan Program (DADLP) operations. The Department's obligations for NFIP and DADLP are financed by principal repayments, flood premiums, and map collection fees.

The Department has borrowing authority for NFIP and DADLP, and may obtain additional borrowing authority if approved.

For more information see Note 15, Debt and Note 26, Available Borrowing Authority.

U. Accrued Payroll and Benefits

Accrued Payroll. Accrued Payroll consists of salaries, wages, and other compensation earned by the employees, but not disbursed as of September 30. The liability is estimated for reporting purposes based on historical pay information.

Leave Program. Earned annual and other vested compensatory leave is accrued as it is earned and reported on the Balance Sheet as an accrued payroll and benefits liability. The liability is reduced as leave is taken. Each year, the balances in the accrued leave accounts are adjusted to reflect the liability at current pay rates and leave balances. Sick leave and other types of non-vested leave are not earned benefits. Accordingly, non-vested leave is expensed when used.

Federal Employees Compensation Act. The *Federal Employees Compensation Act (FECA) (P.L. 103-3)* provides income and medical cost protection to covered Federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA program is administered by the U.S. Department of Labor (DOL), which pays valid claims and subsequently seeks reimbursement from the Department for these paid claims.

The FECA liability consists of two components. The first component, accrued FECA liability, is based on actual claims paid by DOL but not yet reimbursed by the Department. The Department reimburses DOL for the amount of actual claims as funds are appropriated for this purpose. There is generally a two to three-year time period between payment by DOL and reimbursement to DOL by the Department. As a result, the Department recognizes an intragovernmental liability for the actual claims paid by DOL and to be reimbursed by the Department.

The second component, actuarial FECA liability, is the estimated liability for future benefit payments and is recorded as a component of Federal Employee and Veterans' Benefits. This liability includes death, disability, medical, and miscellaneous costs. DOL determines the actuarial FECA liability annually, as of September 30, using an actuarial method that considers historical benefit payment patterns, wage inflation factors, medical inflation factors, and other variables. The projected annual benefit payments are discounted to present value using the OMB economic assumptions for ten year Treasury notes and bonds. The actuarial FECA liability is not covered by budgetary resources and will require future funding.

For more information on the Actuarial FECA Liability see Note 16, Federal Employee and Veterans' Benefits. For more information on the Accrued FECA Liability, Accrued Payroll and Accrued Leave, see Note 18, Other Liabilities.

V. Federal Employee and Veterans' Benefits

Civilian Pension and Other Post Employment Benefits. The Department recognizes the full annual cost of its civilian employees' pension benefits; however, the assets of the plan and liability associated with pension costs are recognized by Office of Personnel Management (OPM) rather than the Department.

Most U.S. Government employees of DHS hired prior to January 1, 1984, participate in the Civil Service Retirement System (CSRS), to which the Department contributes 7 percent of base pay for regular CSRS employees, and 7.5 percent of base pay for law enforcement agents. The majority of employees hired after December 31, 1983, are covered by the Federal Employees Retirement System (FERS) and Social Security. For the FERS basic annuity benefit the Department contributes 11.2 percent of base pay for regular FERS employees and 24.9 percent for law enforcement agents. A primary feature of FERS is that it also offers a defined contribution plan (Federal Thrift Savings Plan) to which the Department automatically contributes 1 percent of base pay and matches employee contributions up to an additional 4 percent of base pay. The Department also contributes the employer's Social Security matching share for FERS participants.

Similar to CSRS and FERS, OPM rather than the Department reports the liability for future payments to retired employees who participate in the Federal Employees Health Benefits Program (FEHB) and Federal Employees Group Life Insurance Program (FEGLI). The Department is required to report the full annual cost of providing these other retirement benefits (ORB) for its retired employees as well as reporting contributions made for active employees. In addition, the Department recognizes an expense and liability for other post employment benefits (OPEB), which includes all types of benefits provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents.

The difference between the full annual cost of CSRS and FERS retirement, ORB, and OPEB and the amount paid by the Department is recorded as an imputed cost and offsetting imputed financing source in the accompanying financial statements.

Military Retirement System Liability. The U.S. Coast Guard Military Retirement System (MRS) is a defined benefit plan that covers both retirement pay and health care benefits for all retired active duty and reserve military members of the U.S. Coast Guard. The plan is a pay-as-you-go system funded through annual appropriations. The actuarial unfunded accrued liability reported on the accompanying Balance Sheet is determined by subtracting the sum of the present value of future employer normal costs, the present value of any expected future employee contributions and any plan assets, from the present value of the future benefits expected to be paid. The Normal Cost (current period expense) is computed using the individual entry age normal actuarial cost method.

A portion of the accrued MRS liability is for the health care of non-Medicare eligible and Medicare eligible retirees/survivors. The U.S. Department of Defense (DOD) is the administrative entity for the Medicare-Eligible Retiree Health Care Fund (MERHCF), and in accordance with Statement of

Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*, is required to recognize the liability on the MERHCF's financial statements. The U.S. Coast Guard makes annual payments to the MERHCF for current active duty and reserve military members. Benefits for U.S. Coast Guard members who retired prior to the establishment of the MERHCF are provided by payments from the Treasury to the MERHCF. The future cost and liability of the MERHCF is determined using claim factors and claims cost data developed by DOD, adjusted for U.S. Coast Guard retiree and actual claims experience. The U.S. Coast Guard uses the current year actual costs to project costs for all future years.

Post-employment Military Travel Benefit. U.S. Coast Guard uniformed service members are entitled to travel and transportation allowances for travel performed or to be performed under orders upon separation from the service, including the member's termination, retirement, permanent disability, or pre-retirement death in service. These allowances are provided whether or not the member is on active duty at the time of travel and without regard to the comparative costs of the various modes of transportation.

The U.S. Coast Guard recognizes an expense and a liability for this benefit when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the reporting date. The U.S. Coast Guard treats this entitlement as an Other Retirement Benefit (ORB). Therefore, the liability for this benefit is determined in the same manner as the liability for the MRS by subtracting the sum of the present value of future normal costs from the present value of the future entitlements expected to be paid. The normal cost is computed using the individual entry age normal actuarial cost method.

Uniformed Division and Special Agent Pension Liability**.** The District of Columbia Police and Fireman's Retirement System (the DC Pension Plan) is a defined benefit plan that covers USSS Uniformed Division and Special Agents. The DC Pension Plan makes benefit payments to retirees and/or their beneficiaries. USSS receives permanent, indefinite appropriations each year to pay the excess of benefit payments over salary deductions. The DC Pension Plan is a pay-as-you-go system funded through annual appropriations. The unfunded accrued liability reported on the accompanying Balance Sheet is actuarially determined by subtracting the present value of future employer/employee contributions, as well as any plan assets, from the present value of future cost of benefits. Current period expense is computed using the aggregate cost method.

For more information on Civilian Pension and OPEB, MRS Liability, Post-employment Military Travel Benefits, and Uniformed Division and Special Agent Pension Liability see Note 16, Federal Employee and Veterans' Benefits.

W. Earmarked Funds

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes, and must be accounted for separately from the Federal Government's general revenues.

Earmarked non-exchange revenue and other financing sources, including appropriations and net cost of operations, are shown separately on the Statements of Changes in Net Position. The portion of cumulative results of operations attributable to earmarked funds is shown separately on both the Statements of Changes in Net Position and the Balance Sheets.

For additional information see Note 22, Earmarked Funds, and Note 5, Investments, Net.

X. Revenue and Financing Sources

Appropriations. The Department receives the majority of funding to support its programs through Congressional appropriations. The Department receives annual, multi-year, and no-year appropriations that may be used, within statutory limits, for operating and capital expenditures. Additional funding is obtained through exchange revenues, non-exchange revenues, and transfers-in.

Appropriations are recognized as financing sources when related expenses are incurred or assets are purchased. Revenue from reimbursable agreements is recognized when the goods or services are provided by the Department. Prices for goods and services sold to the public are based on recovery of full cost or are set at a market price. Reimbursable work between Federal agencies is subject to the *Economy Act (31 United States Code (U.S.C.) 1535)* or other statutes authorizing reimbursement. Prices for goods and services sold to other Federal Government agencies are generally limited to the recovery of direct cost.

Allocation Transfers. The Department is a party to allocation transfers with other Federal agencies as both a transferring (parent) entity and/or a receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. Generally, all financial activity related to these allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations, and budget apportionments are derived. During FY 2007, the Department, as the parent, allocated funds related to activities for the Biodefense Countermeasures Fund to the U.S. Department of Health and Human Services (HHS). During FY 2008, OMB granted an exemption from reporting this fund as a parent for FY 2008 and future periods. Therefore, balances from these funds will no longer be reported in the DHS financial statements and related footnotes. Based on the exemption granted by OMB, this change does not result in a restatement or reclassification of prior year amounts. DHS receives allocation transfers, as the child, from GSA, the U.S. Department of Transportation, and the Environmental Protection Agency.

Exchange and Non-Exchange Revenue. Exchange revenues are recognized when earned and are derived from transactions where both the government and the other party receive value; i.e., goods have been delivered or services have been rendered. Non-exchange revenues from user fees are recognized as earned in accordance with the *Consolidated Omnibus Budget Reconciliation Act of 1985 (P.L. 99-272)*, as amended. Non-exchange revenues also arise from transfers-in with and without financing sources and donations from the public. Other financing sources, such as donations and transfers of assets without reimbursements, are recognized on the Statements of Changes in Net Position during the period in which the donations and transfers occurred.

Deferred revenue is recorded when the Department receives payment for goods or services which have not been fully rendered. Deferred revenue is reported as a liability on the Balance Sheets until earned. Information and specific examples of deferred revenue include:

- Fees for flood mitigation products and services, such as insurance provided through FEMA's NFIP, are established at rates with the intent of generating sufficient premiums to cover losses and loss adjustment expenses of a historical average loss year and to provide a surplus to compensate the Insurance Underwriting Operations for the loss potential of an unusually severe loss year due to catastrophic flooding. NFIP premium revenues are recognized ratably over the life of the policies. Deferred revenue relates to unearned premiums reserved to provide for the remaining period of insurance coverage.
- USCIS requires advance payments of the fees for adjudication of applications or petitions for immigration and naturalization benefits. A major portion of the revenue received for certain applicant types is deferred and not considered earned until the application is adjudicated.

Imputed Financing Sources. In certain instances, operating costs of DHS are paid out of funds appropriated to other Federal agencies. For example, OPM, by law, pays certain costs of retirement programs, and certain legal judgments against DHS are paid from a Judgment Fund maintained by the Treasury. When costs that are identifiable to DHS and directly attributable to DHS operations are paid by other agencies, DHS recognizes these amounts as operating expenses. DHS also recognizes an imputed financing source on the Statements of Changes in Net Position to indicate the funding of DHS operations by other Federal agencies.

Custodial Revenue. Non-entity revenue and refunds are reported on the Statements of Custodial Activity using a modified cash basis. Non-entity revenue reported on the Department's Statement of Custodial Activity include duties, excise taxes, and various non-exchange fees collected by CBP and USCIS that are subsequently remitted to the Treasury General Fund or to other Federal agencies. Duties, user fees, fines and penalties are assessed pursuant to the provisions of Title 19 United States Code (U.S.C.); nonimmigrant petition fees under Title 8 U.S.C., and excise taxes under Title 26 U.S.C. CBP also enforces over 400 laws and regulations some of which require the collection of fees or the imposition of fines and penalties pursuant to other Titles within the U.S.C. or Code of Federal Regulations (C.F.R.).

CBP assesses duties, taxes, and fees on goods and merchandise brought into the United States from foreign countries. The custodial revenue is recorded at the time of collection. These revenue collections primarily result from current fiscal year activities. Generally, CBP records an equal and offsetting liability due to the Treasury General Fund for amounts recognized as non-entity tax and trade receivable and custodial revenue. Non-entity tax and trade accounts receivables are recognized when CBP is entitled to collect duties, user fees, fines and penalties, refunds and drawback overpayments, and interest associated with import/export activity on behalf of the Federal Government that have been established as a specifically identifiable, legally enforceable claim and remain uncollected as of year-end. CBP accrues an estimate of duties, taxes, and fees related to commerce released prior to year-end where receipt of payment is anticipated subsequent to year-end. Fees collected by USCIS for nonimmigrant petitions must be submitted with the petition. The portions of the fees that are subsequently remitted to other Federal agencies are recorded as custodial revenue at the time of collection.

Non-entity receivables are presented net of amounts deemed uncollectible. CBP tracks and enforces payment of estimated duties, taxes, and fees receivable by establishing a liquidated damage case that generally results in fines and penalties receivable. A fine or penalty, including interest on past due balances, is established when a violation of import/export law is discovered. An allowance for doubtful collections is established for substantially all accrued fines and penalties and related interest. The amount is based on past experience in resolving disputed assessments, the debtor's payment record and willingness to pay, the probable recovery of amounts from secondary sources, such as sureties and an analysis of aged receivable activity. CBP regulations allow importers to dispute the assessment of duties, taxes, and fees. Receivables related to disputed assessments are not recorded until the protest period expires or a protest decision is rendered in CBP's favor.

Refunds and drawback of duties, taxes, and fees are recognized when payment is made. A permanent, indefinite appropriation is used to fund the disbursement of refunds and drawbacks. Disbursements are recorded as a decrease in the amount Transferred to Federal Entities as reported on the Statement of Custodial Activity. An accrual adjustment is recorded on the Statements of Custodial Activity to adjust cash collections and refund disbursements with the net increase or decrease of accrued non-entity accounts receivables, net of uncollectible amounts, and refunds payable at year-end.

For additional information see Note 7, Taxes, Duties, and Trade Receivables, Net, and Note 32, Custodial Revenues.

Y. Taxes

The Department, as a Federal agency, is not subject to Federal, State, or local income taxes and accordingly, no provision for income taxes has been recorded in the accompanying financial statements.

Z. Restatements

In FY 2008, the Department restated certain FY 2007 balances. For additional information see Note 33, Restatements.

2. Non-Entity Assets

Non-entity assets at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Intragovernmental:		
Fund Balance with Treasury	$966	$1,130
Due From Treasury	151	176
Total Intragovernmental	1,117	1,306
Cash and Other Monetary Assets	15	48
Accounts Receivable, Net	21	17
Taxes, Duties, and Trade Receivables, Net	2,078	1,937
Total Public	2,114	2,002
Total Non-Entity Assets	3,231	3,308
Total Entity Assets	84,664	75,816
Total Assets	**$87,895**	**$79,124**

Non-entity Fund Balance with Treasury consists of special and deposit funds, permanent and indefinite appropriations, and miscellaneous receipts that are available to pay non-entity liabilities. Non-entity assets (also discussed in Notes 3 and 7) are offset by non-entity accrued liabilities at September 30, 2008 and 2007 (see Note 18). Non-entity receivables due from Treasury represent an estimate of duty, tax, and/or fee refunds and drawbacks that will be reimbursed by a permanent and indefinite appropriation account and will be used to pay estimated refunds and drawbacks payable. Duties and taxes receivable from the public represent amounts due from importers for goods and merchandise imported to the United States.

3. Fund Balance with Treasury

A. Fund Balance with Treasury

Fund Balance with Treasury at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Appropriated Funds	$57,063	50,770
Trust Funds	54	60
Revolving, Public Enterprise, and Working Capital Funds	896	963
Special Funds	4,555	3,563
Deposit Funds	589	829
Total Fund Balance with Treasury	**$63,157**	**$56,185**

Appropriated funds consist of amounts appropriated annually by Congress to fund the operations of the Department. Appropriated funds include clearing funds totaling $(42) million and $105 million at September 30, 2008 and 2007, respectively, which represent reconciling differences with Treasury balances.

Trust funds include both receipt accounts and expenditure accounts that are designated by law as a trust fund. Trust fund receipts are used for specific purposes, generally to offset the cost of expanding border and port enforcement activities and oil spill related claims and activities.

Revolving funds are used for continuing cycles of business-like activity, in which the fund charges for the sale of products or services and uses the proceeds to finance its spending, usually without requirement for annual appropriations. A public enterprise revolving fund is an account that is authorized by law to be credited with offsetting collections from the public and those monies are used to finance operations. The Working Capital Fund is a fee-for-service fund established to support operations of Department Components. Also included are the financing funds for credit reform and the National Flood Insurance Fund.

Special funds include funds designated for specific purposes including the disbursement of non-entity monies received in connection with antidumping and countervailing duty orders due to qualifying Injured Domestic Industries (IDI). The Department also has special funds for immigration and naturalization user fees and CBP user fees, as well as inspection fees, flood map modernization subsidy, and off-set and refund transfers. For additional information, see Note 22, Earmarked Funds.

Deposit funds represent amounts received as an advance that are not accompanied by an order and include non-entity collections that do not belong to the Federal Government.

B. Status of Fund Balance with Treasury

The status of Fund Balance with Treasury at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Budgetary Status		
Unobligated Balances:		
Available	$7,319	$9,266
Unavailable	14,004	8,596
Obligated Balance Not Yet Disbursed	44,788	41,053
Total Budgetary Status	66,111	58,915
Reconciling Adjustments:		
Receipt, Clearing, and Deposit Funds	655	940
Borrowing Authority	(3,415)	(3,465)
Investments	(3,063)	(2,767)
Receivable Transfers and Imprest Fund	(260)	(130)
Receipts unavailable for obligation	1,744	1,566
Authority Temporarily Precluded from Obligation	39	25
SFRBTF	1,346	1,101
Total Fund Balance with Treasury	**$63,157**	**$56,185**

Portions of the Unobligated Balances Available, Unavailable and Obligated Balance Not Yet Disbursed contain CBP's user fees of $768 million and $730 million at September 30, 2008 and 2007, respectively, which is restricted by law in its use to offset costs incurred by CBP. Further, the Unobligated Balances Available include appropriations received in the Disaster Relief Fund. As of September 30, 2008 and 2007, this fund has an unobligated balance available of $937 million and $4.4 billion, respectively.

Portions of the Unobligated Balance Unavailable include amounts appropriated in prior fiscal years that are not available to fund new obligations. However, it can be used for upward and downward adjustments for existing obligations in future years. The Obligated Balance Not Yet Disbursed represents amounts designated for payment of goods and services ordered but not received or goods and services received but for which payment has not yet been made.

The fluctuations in the Budgetary Status, including Unobligated Balances and Obligated Balance Not Yet Disbursed, primarily relate to the receipt of supplemental funding received by FEMA for hurricane related flooding, the change in the reporting requirement for the Biodefense Countermeasure Fund as described in Note 35, and obligations not yet disbursed for Secure Border Initiative fencing.

Since the following line items do not post to budgetary status accounts, the following adjustments are required to reconcile the budgetary status to non-budgetary Fund Balance with Treasury as reported in the accompanying Balance Sheets:

- Receipt, clearing, and deposit funds represent amounts on deposit with Treasury that have no budget status at September 30, 2008 and 2007.
- Borrowing authority is in budgetary status for use by FEMA for disaster relief purposes and Community disaster loans.
- Budgetary resources have investments included; however, the money has been moved from the Fund Balance with Treasury asset account to Investments.
- Receivable transfers of currently invested balances increase the budget authority at the time the transfer is realized; however, obligations may be incurred before the actual transfer of funds.
- Imprest funds represent monies moved from Fund Balance with Treasury to Cash and Other Monetary Assets with no change in the budgetary status.
- For receipts unavailable for obligations, authorizing legislation may specify that obligations are not available until a specified time in the future or until specific legal requirements are met.
- Sport Fish Restoration Boating Trust Fund (SFRBTF) is a Treasury-managed fund. This fund receives revenues transferred from custodial activities of the Treasury which are deposited in a Treasury account (see Note 22).

4. Cash and Other Monetary Assets

Cash and Other Monetary Assets at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Cash	$63	$282
Seized Monetary Instruments	4	39
Total Cash and Other Monetary Assets	**$67**	**$321**

DHS cash includes cash held by others, including the net balance maintained by insurance companies for flood insurance premiums received from policyholders, less amounts paid for insured losses; imprest funds; and undeposited cash, which represent fees collected but not yet deposited. In FY 2007, an announced increase in immigration application fees and a demand for preference visa categories, which became available under the Department of State's July 2007 Visa Bulletin, combined to create a large increase in immigration applications, resulting in an increase in immigration application fees collected but not yet deposited. Seized Monetary Instruments are held until disposition. The decrease in seized monetary instruments relates to gold coins no longer reported by the USSS. As of September 30, 2008 and 2007, restricted non-entity cash and other monetary assets is $15 million and $48 million, respectively.

5. Investments, Net

Investments at September 30, 2008, consisted of the following (in millions) (unaudited):

Type of Investment:	Amortization Method	Cost	Amortized (Premium) Discount	Interest Receivable	Investments, Net (Unaudited)	Market Value Disclosure
Intragovernmental Securities:						
Oil Spill Liability Trust Fund	Effective interest method	$1,124	$31	$ -	$1,155	N/A
Sport Fish Restoration Boating Trust Fund	Effective interest method	1,948	(2)	-	1,946	N/A
Total Non-Marketable		3,072	29	-	3,101	N/A
Non-Marketable, Market-Based	Straight line method	2	-	2 -	2	
Total Investments, Net		**$3,074**	**$29**	**$ -**	**$3,103**	**N/A**

Investments at September 30, 2007, consisted of the following (in millions) (unaudited and restated):

Type of Investment:	Amortization Method	Cost	Amortized (Premium) Discount	Interest Receivable	Investments, Net (Unaudited)	Market Value Disclosure
Intragovernmental Securities:						
Oil Spill Liability Trust Fund	Effective interest method	$925	$(7)	$ -	$918	N/A
Sport Fish Restoration Boating Trust Fund	Effective interest method	1,841	5	-	1,846	N/A
Total Non-Marketable		2,766	(2)	-	2,764	N/A
Non-Marketable, Market-Based	Straight line method	14	-	-	14	14
Total Investments, Net		**$2,780**	**$(2)**	**$ -**	**$2,778**	**N/A**

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds (Oil Spill Liability Trust Fund, Sport Fish Restoration Boating Trust Fund, and General Gift Fund) for the U.S. Coast Guard. The cash receipts collected from the public for an earmarked fund are deposited in the Treasury, which uses the cash for general Federal Government purposes. Treasury securities are issued to the U.S. Coast Guard as evidence of its receipts. Treasury securities associated with earmarked funds are an asset to the U.S. Coast Guard and a liability to the Treasury. Because Treasury and DHS are both parts of the Federal

Government, these assets and liabilities offset each other from the standpoint of the Federal Government as a whole. For this reason, these funds do not represent an asset or a liability in the U.S. Government-wide financial statements.

Treasury securities provide the U.S. Coast Guard with authority to draw upon the Treasury to make future benefit payments or other expenditures

6. Accounts Receivable, Net

Accounts Receivable, net, at September 30, consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Intragovernmental	**$310**	**$279**
With the Public:		
Accounts Receivable	737	1,229
Allowance for Doubtful Accounts	(249)	(469)
	488	**760**
Accounts Receivable, Net	**$798**	**$1,039**

Intragovernmental accounts receivable results from reimbursable work performed by the Department. Accounts receivable with the public consist of amounts due for reimbursable services and user fees. The decreases in accounts receivable with the public and allowance for doubtful accounts are primarily caused by FEMA suspension of recoupment efforts for payments made to disaster applicants affected by Hurricanes Katrina and Rita.

7. Taxes, Duties, and Trade Receivables, Net

Taxes, Duties, and Trade Receivables consisted of the following (in millions):

As of September 30, 2008 (Unaudited):

Receivables Category	Gross Receivables	Allowance	Total Net Receivables
Duties	$1,842	$(128)	$1,714
Excise Taxes	99	(6)	93
User Fees	144	(4)	140
Fines/Penalties	942	(887)	55
Anti-Dumping and Countervailing Duties	364	(288)	76
Total Tax, Duties, and Trade Receivables, Net	**$3,391**	**$(1,313)**	**$2,078**

As of September 30, 2007 (Unaudited)(Restated):

Receivables Category	Gross Receivables	Allowance	Total Net Receivables
Duties	$1,649	$(116)	$1,533
Excise Taxes	127	(6)	121
User Fees	132	(5)	127
Fines/Penalties	1,260	(1,185)	75
Anti-Dumping and Countervailing Duties	357	(277)	80
Refunds and Drawbacks	2	(1)	1
Total Tax, Duties, and Trade Receivables, Net	**$3,527**	**$(1,590)**	**$1,937**

When a violation of import/export law is discovered, a fine or penalty is established. CBP assesses a liquidated damage or penalty for these cases to the maximum extent of the law. After receiving the notice of assessment, the importer or surety has a period of time to either file a petition requesting a review of the assessment or pay the assessed amount. Once a petition is received, CBP investigates the circumstances as required by its mitigation guidelines and directives. Until this process has been completed, CBP records an allowance on fines and penalties of approximately 94 percent (94 percent at September 30, 2007) of the total assessment based on historical experience of fines and penalties mitigation and collection. Duties and taxes receivables are non-entity assets for which there is an offsetting liability due to the Treasury General Fund.

8. Direct Loans, Net

DHS's loan program consists of two types of direct loans, both administered by FEMA: (1) State Share Loans: FEMA may lend or advance to a state or an eligible applicant the portion of assistance for which the applicant is responsible under cost-sharing provisions of the Stafford Act. For 1992 and beyond, the State Share Loans are obligated from the Disaster Assistance Direct Loan Financing Account; and (2) Community Disaster Loans (CDLs): Loans may be authorized to local governments that have suffered a substantial loss of tax and other revenues as a result of a major disaster, and have demonstrated a need for financial assistance in order to perform their municipal operating functions. The loans are made at the current Treasury rate for a term of five years and cannot exceed 25 percent of the annual operating budget of the local government for the fiscal year in which the major disaster occurred, with the exception of Hurricanes Katrina/Rita Special CDL. The rates for Katrina/Rita Special CDL are less than the Treasury rate and cannot exceed 50 percent of the annual operating budget of the local government for the fiscal year in which the major disaster occurred. In addition, in accordance with recent Stafford Act amendments (P.L. 109-88), CDLs may exceed $5 million and shall not be cancelled. However, P.L. 110-28 amended the *Community Disaster Loan Act of 2005* (P.L. 109-88) by striking "Provided further, that notwithstanding section 471(c)(1) of the *Stafford Act*, such loans may not be cancelled." This resulted in total modification costs of $327 million (unaudited) for the 2006 Cohort. Of this amount, $207 million (unaudited) was transferred to the financing account to repay funds borrowed from Treasury. The balance remains in the Programming account to cover costs of undisbursed loans for the 2006 Cohort.

Loans totaling $161 million and $162 million have been disbursed to eligible borrowers as of September 30, 2008 and 2007, respectively. Disbursements are tracked by cohort as determined by the date of obligation rather than disbursement.

A. Summary of Direct Loans to Non-Federal Borrowers at September 30 (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
	Loans Receivable, Net	Loans Receivable, Net
Community Disaster Loans	$21	**$ -**

An analysis of loans receivable and the nature and amounts of the subsidy and administrative costs associated with the direct loans is provided in the following sections.

B. Direct Loans Obligated After FY 1991 (in millions):

At September 30, 2008 (Unaudited):	Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
Community Disaster Loans	**$952**	**$56**	**$(987)**	**$21**

At September 30, 2007 (Unaudited)(Restated):	Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
Community Disaster Loans	**$792**	**$30**	**$(822)**	**$ -**

C. Total Amount of Direct Loans Disbursed, Post-1991 (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Community Disaster Loans	**$161**	**$162**

D. Subsidy Expense for Direct Loans by Program and Component (in millions):

Subsidy Expense for New Direct Loans Disbursed as of September 30 (in millions):

Community Disaster Loans	Interest Differential	Defaults and Other	Total
2008 (Unaudited)	$37	$124	$161
2007 (Unaudited) (Restated)	$28	$93	$121

Modifications and Reestimates as of September 30 (in millions):

Community Disaster Loans	Interest Rate Reestimates
2008 (Unaudited)	$ -
2007 (Unaudited) (Restated)	$207

For the Community Disaster Loan Program the technical re-estimates for FY 2008 and FY 2007 were less than $1 million.

Total Direct Loan Subsidy Expense

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Community Disaster Loans	**$161**	**$329**

E. Direct Loan Subsidy Rates at September 30 (in millions):

The direct loan subsidy rates, by program, are as follows:

	2008 (Unaudited)		2007 (Unaudited)	
	Community Disaster Loans	State Share Loans	Community Disaster Loans	State Share Loans
Interest Subsidy Cost	5.01%	1.38%	4.9%	0.82%
Default Costs	- %	- %	- %	- %
Other	88.28%	0.35%	88.5%	0.36%

F. Schedule for Reconciling Subsidy Cost Allowance Balances at September 30 (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Beginning Balance of the Subsidy cost allowance	$822	$479
Add subsidy expense for direct loans disbursed during the reporting years by component:		
(a) Interest rate differential costs	37	28
(b) Other subsidy costs	124	93
Adjustments:		
(a) Loans written off	-	(1)
(b) Subsidy allowance amortization	4	16

(c) Other	-	207
Ending balance of the subsidy cost allowance before reestimates	987	822
Add subsidy reestimate by component		
(a) Technical/default reestimate	-	-
Ending balance of the subsidy cost allowance	**$987**	**$822**

As of September 30, 2008, there were no loans written off. As of September 30, 2007, the amount of loans written off was $1 million.

G. Administrative Expenses at September 30 (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Community Disaster Loans	**$0.5**	**$0.5**

9. Inventory and Related Property, Net

Inventory and Related Property, net at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Operating Materials and Supplies (OM&S)		
Items Held for Use	$323	$302
Items Held for Future Use	32	30
Excess, Obsolete and Unserviceable Items	132	149
Less: Allowance for Losses	(123)	(149)
Total OM&S, Net	**364**	**332**
Inventory		
Inventory Purchased for Resale	89	61
Less: Allowance for Losses	(5)	(4)
Total Inventory, Net	**84**	**57**
Stockpile Materials Held in Reserve	**70**	**243**
Total Inventory and Related Property, Net	**$518**	**$632**

The significant decrease in stockpile materials held in reserve was related to FEMA's issuance of disaster related materials for Hurricanes Gustav and Ike in FY 2008.

10. Seized and Forfeited Property

Prohibited seized property item counts as of September 30 and activity for FY 2008 and 2007 are as follows:

Seizure Activity						
Fiscal Year Ended September 30, 2008 (Unaudited)						
Seized Property Category:	Beginning Balance	New Seizures	Remissions	New Forfeitures	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	3,254	691,151	-	(694,570)	1,202	1,037
Cocaine	186	19,924	-	(19,876)	(19)	215
Heroin	20	5,866	-	(5,878)	-	8
Ecstasy	33	1,114	-	(1,145)	31	33
Steroids	136	393	(10)	(378)	4	145
Firearms and Explosives (in number of items)	1,130	1,444	(870)	(742)	(89)	873
Counterfeit Currency (US/Foreign, in number of items)	3,998,370	1,375,522	-	-	(1,697,546)	3,676,346
Pornography (in number of items)	76	96	(5)	(87)	(37)	43

Forfeiture Activity						
Fiscal Year Ended September 30, 2008 (Unaudited)						
Forfeited Property Category:	Beginning Balance	New Forfeitures	Transfers	Destroyed	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	172,395	694,570	(1,943)	(508,918)	(239,504)	116,600
Cocaine	21,564	19,876	(281)	(20,803)	15,018	35,374
Heroin	6,592	5,878	(11)	(1,790)	(3,603)	7,066
Ecstasy	1,867	1,145	(100)	(1,231)	(106)	1,575
Steroids	13	378	-	(355)	6	42
Firearms and Explosives (in number of items)	348	742	(732)	(8)	58	408
Pornography (in number of items)	29	87	-	(112)	23	27

Seizure Activity						
Fiscal Year Ended September 30, 2007 (Unaudited) (Restated)						
Seized Property Category:	Beginning Balance	New Seizures	Remissions	New Forfeitures	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	737	774,841	-	(772,729)	405	3,254
Cocaine	353	22,985	-	(23,075)	(77)	186
Heroin	20	5,459	-	(5,463)	4	20
Ecstasy	-	1,426	-	(1,393)	-	33
Steroids	-	514	(65)	(305)	(8)	136
Firearms and Explosives (in number of items)	864	1,970	(886)	(675)	(143)	1,130
Counterfeit Currency (US/Foreign, in number of items)	4,227,431	1,325,661	-	-	(1,554,722)	3,998,370
Pornography (in number of items)	101	173	(3)	(140)	(55)	76

Forfeiture Activity						
Fiscal Year Ended September 30, 2007 (Unaudited) (Restated)						
Forfeited Property Category:	Beginning Balance	New Forfeitures	Transfers	Destroyed	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	97,304	772,729	(234,858)	(459,151)	(3,629)	172,395
Cocaine	19,584	23,075	(156)	(20,545)	(394)	21,564
Heroin	2,221	5,463	(4)	(1,045)	(43)	6,592
Ecstasy	-	1,393	(9)	(1,060)	1,543	1,867
Steroids	-	305	-	(314)	22	13
Firearms and Explosives (in number of items)	253	675	(607)	(2)	29	348
Pornography (in number of items)	32	140	(1)	(195)	53	29

This schedule is presented for material prohibited (non-valued) seized and forfeited property only. These items are retained and ultimately destroyed by CBP and USSS and are not transferred to the U.S. Departments of Treasury or Justice Asset Forfeiture Funds or other Federal agencies. The ending balance for firearms includes only those seized items that can actually be used as firearms. Illegal drugs are presented in kilograms and a portion of the weight includes packaging, which often cannot be reasonably separated from the weight of the drugs since the packaging must be maintained for evidentiary purposes. The adjustments columns relate to prohibited property adjustments made due to items incorrectly tagged or marked as to seized or forfeited. For seizure activity the adjustments also include destroyed items.

The U.S. Coast Guard also seizes and takes temporary possession of small boats, equipment, contraband, and other illegal drugs. The U.S. Coast Guard usually disposes of these properties within three days by transfer to CBP (who transfers non-prohibited seized property to the Treasury Forfeiture Fund), the Drug Enforcement Administration, foreign governments, or by destroying it. Seized property in U.S. Coast Guard possession at year-end is not considered material and therefore is not itemized and is not reported in the financial statements of the Department.

CBP will take into custody, without risk or expense, merchandise termed "general order property," which for various reasons cannot legally enter into the commerce of the United States. CBP's sole responsibility with general order property is to ensure the property does not enter the Nation's commerce. If general order property remains in CBP custody for a prescribed period of time, without payment of all estimated duties, storage, and other charges, the property is considered unclaimed and abandoned and may be sold by CBP at public auction, retained by CBP for its official use, or at CBP's discretion, transferred to any other Federal, State, or local agency, destroyed, or disposed of otherwise. Auction sales revenue in excess of charges associated with the sale or storage of the item is remitted to the Treasury General Fund. In some cases, CBP incurs charges prior to the sale and funds these costs from entity appropriations. Regulations permit CBP to offset these costs of sale before returning excess amounts to Treasury.

11. General Property, Plant, and Equipment, Net

General Property, Plant, and Equipment (PP&E) consisted of the following (in millions):

As of September 30, 2008 (Unaudited):	Service Life	Gross Cost	Accumulated Depreciation/ Amortization	Total Net Book Value
Land and Land Rights	N/A	$131	N/A	$131
Improvements to Land	2-50 yrs	415	86	329
Construction in Progress	N/A	5,010	N/A	5,010
Buildings, Other Structures and Facilities	2-50 yrs	4,613	2,202	2,411
Equipment:				
Automated Data Processing Equipment	5 yrs	373	243	130
Aircraft	12-35 yrs	2,836	1,678	1,158

Vessels	5-57 yrs	5,127	2,471	2,656
Vehicles	3-8 yrs	530	403	127
Other Equipment	2-30 yrs	4,432	2,940	1,492
Assets Under Capital Lease	2-40 yrs	78	28	50
Leasehold Improvements	2-50 yrs	465	156	309
Internal Use Software	2-5 yrs	1,099	899	200
Internal Use Software- in Development	N/A	498	N/A	498
Total General Property, Plant, and Equipment, Net		**$25,607**	**$11,106**	**$14,501**

As of September 30, 2007 (Unaudited)(Restated):	Service Life	Gross Cost	Accumulated Depreciation/ Amortization	Total Net Book Value
Land and Land Rights	N/A	$90	N/A	$90
Improvements to Land	3-50 yrs	114	49	65
Construction in Progress	N/A	4,468	N/A	4,468
Buildings, Other Structures and Facilities	2-50 yrs	4,148	1,993	2,155
Equipment:				
Automated Data Processing Equipment	3-5 yrs	317	191	126
Aircraft	10-35 yrs	2,722	1,558	1,164
Vessels	5-65 yrs	4,317	2,365	1,952
Vehicles	3-8 yrs	573	448	125
Other Equipment	2-30 yrs	4,031	2,456	1,575
Assets Under Capital Lease	2-20 yrs	79	26	53
Leasehold Improvements	3-50 yrs	364	104	260
Internal Use Software	2-10 yrs	963	751	212
Internal Use Software- in Development	N/A	357	N/A	357
Total General Property, Plant, and Equipment, Net		**$22,543**	**9,941**	**$12,602**

12. Stewardship Property, Plant, and Equipment

The following table summarizes physical unit information related to heritage assets for the fiscal years ended September 30 (in number of units).

	2008 (Unaudited)	2007 (Unaudited)
U.S. Coast Guard	20,463	20,549
CBP	4	4
FEMA	1	1
Total	**20,468**	**20,554**

DHS's Stewardship PP&E primarily consists of U.S. Coast Guard's heritage assets, which are unique due to historical, cultural, artistic, or architectural significance. These assets are used to preserve and to provide education on U.S. Coast Guard history and tradition. Heritage assets are generally expected to be preserved indefinitely. Multi-use heritage assets have more than one purpose, such as operational or historical and are included with General PP&E.

The U.S. Coast Guard possesses artifacts that can be divided into six general areas: ship's equipment, lighthouse and other aids-to-navigation/communication items, personal use items, ordnance, artwork, and display models. The U.S. Coast Guard also has non-collection type Heritage Assets, such as sunken vessels and aircraft, under the property clause of the U.S. Constitution, Articles 95 and 96 of the International Law of the Sea Convention, and the sovereign immunity provisions of Admiralty law. Despite the passage of time or the physical condition of these assets, they remain government-owned until the Congress of the United States formally declares them abandoned. The U.S. Coast Guard desires to retain custody of these assets to safeguard the remains of crew members lost at sea, to prevent the unauthorized handling of explosives or ordnance which may be aboard, and to preserve culturally valuable relics of the U.S. Coast Guard.

The U.S. Coast Guard does not acquire or retain heritage buildings and structures without an operational use. Most real property, even if designated as historical, is acquired for operational use and is transferred to other government agencies or public entities when no longer required for operations. Of the U.S. Coast Guard buildings and structures designated as heritage, including memorials, recreational areas, and other historical areas, over two-thirds are multi-use heritage. The remaining assets include historical lighthouses, which are no longer in use and awaiting disposal, and historical vessels and aircraft artifacts preserved and recorded for memorial purposes and historical significance.

CBP also has four multi-use heritage assets located in Puerto Rico, and FEMA has one multi-use heritage asset that is used by the U.S. Fire Administration for training in Emmitsburg, Maryland. All multi-use heritage assets are reflected on the Balance Sheet as general PP&E and depreciated over their useful life. Heritage asset addition and withdrawal information and deferred maintenance for heritage assets and general PP&E are presented in the required supplementary information.

13. Other Assets

Other Assets at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Intragovernmental:		
Advances and Prepayments	$2,852	$2,887
Due from Treasury	151	176
Total Intragovernmental	**3,003**	**3,063**
Public:		
Advances and Prepayments	649	567
Total Public	**649**	**567**
Total Other Assets	**$3,652**	**$3,630**

Intragovernmental Advances and Prepayments primarily consist of FEMA's Disaster Relief Fund disaster assistance advances to other Federal agencies (principally the U.S. Department of Transportation) tasked with restoration efforts of the New York City region transportation system.

The Department provides advance funds to public grant recipients to incur expenses related to the approved grant. Advances are made within the amount of the total grant obligation.

14. Liabilities Not Covered by Budgetary Resources

Liabilities Not Covered by Budgetary Resources at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Intragovernmental:		
Debt (Note 15)	$17,110	$17,786
Accrued FECA Liability (Note 18)	361	355
Other	57	51
Total Intragovernmental	17,528	18,192
Public:		
Federal Employee and Veterans' Benefits:		
Actuarial FECA Liability (Note 16)	1,796	1,683
Military Service and Other Retirement Benefits (Note 16)	34,434	33,227
Environmental and Disposal Liabilities (Note 17)	254	254
Other:		
Accrued Payroll and Benefits (Note 18)	972	874
Insurance Liabilities (Note 20)	5,531	1,508
Contingent Legal Liabilities (Note 21)	280	179
Capital Lease Liability (Note 19)	89	107
Total Public	43,356	37,832
Total Liabilities Not Covered by Budgetary Resources	60,884	56,024
Liabilities Covered by Budgetary Resources or Non-Entity Assets	13,531	13,173
Total Liabilities	**$74,415**	**$69,197**

The Department anticipates that the liabilities listed above will be funded from future budgetary resources when required.

15. Debt

Debt at September 30 consisted of the following (in millions):

Fiscal year ended September 30, 2008	Beginning Balance	Net Borrowing/ Repayment	Ending Balance (Unaudited)
Debt to the Treasury General Fund:			
Debt for the NFIP	$17,902	$(183)	$17,719
Debt for Credit Reform	251	(251)	-
Total Debt to the Treasury General Fund	$18,153	$(434)	$17,719
Total Debt	**$18,153**	**$(434)**	**$17,719**

Fiscal year ended September 30, 2007	Beginning Balance	Net Borrowing/ Repayment	Ending Balance (Unaudited)
Debt to the Treasury General Fund:			
Debt for the NFIP	$17,239	$663	$17,902
Debt for Credit Reform	207	44	251
Total Debt to the Treasury General Fund	$17,446	$707	$18,153
Total Debt	**$17,446**	**$707**	**$18,153**

DHS's intragovernmental debt is owed to Treasury's Bureau of Public Debt (BPD) and consists of borrowings to finance claims under NFIP and borrowings to finance FEMA's credit reform programs (Disaster Assistance Direct Loan Program).

NFIP loans are for a three-year term. Interest rates are obtained from the BPD and range by cohort year from 1.88 percent to 4.88 percent as of September 30, 2008 and from 3.38 percent to 4.88 percent as of September 30, 2007. Simple interest is calculated monthly – offset by an interest rebate, if applicable. The interest rebate is calculated at a rate equal to the weighted average of the interest rates of outstanding loans for the month multiplied by the "positive" daily account fund balance for the month. Interest is paid semi-annually on October 1 and April 1. Interest is accrued based on the loan balances reported by BPD. Principal repayments are required only at maturity, but are permitted any time during the term of the loan. Flood premiums from policy holders and map collection fees are intended to repay loan principal and interest payments due to Treasury; however, due to the size of the debt incurred for damages sustained for Hurricanes Katrina and Rita, premiums received are only sufficient to cover the interest payments. Congress will need to enact legislation to provide funding to repay the Treasury Department, or to forgive the debt.

Under Credit Reform, the unsubsidized portion of direct loans is borrowed from the Treasury. The repayment terms of FEMA's borrowing from Treasury are based on the life of each cohort of direct loans. Proceeds from collections of principal and interest from the borrowers are used to repay the Treasury. In addition, an annual reestimate is performed to determine any change from the original subsidy rate. If an upward reestimate is determined to be necessary, these funds are available through permanent indefinite authority which is to be approved by OMB. Once these funds are appropriated, the original borrowings are repaid to Treasury. The weighted average interest rates for FY 2008 and FY 2007 were 5.09 percent and 4.87 percent, respectively.

16. Federal Employee and Veterans' Benefits

Accrued liability for military service and other retirement and employment benefits at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
U.S. Coast Guard Military Retirement and Healthcare Benefits	$30,661	$29,494
U.S. Coast Guard Post-Employment Military Travel Benefits	82	133
USSS DC Pension Plan Benefits	3,686	3,595
Actuarial FECA Liability	1,796	1,683
Other	5	5
Total Federal Employee and Veterans' Benefits	**$36,230**	**$34,910**

A. U.S. Coast Guard Military Retirement and Healthcare Benefits

The components of the MRS expense for the years ended September 30 consisted of the following (in millions):

Defined Benefit Plan:	2008 (Unaudited)	2007 (Unaudited) (Restated)
Normal cost	$682	$653
Interest on the liability	1,510	1,417
Actuarial losses/(gains)	(501)	120
Actuarial Assumption Change	-	721
Plan Amendments	-	136
Total Defined Benefit Plan Expense	**$1,691**	**$3,047**
Post-retirement Healthcare:		
Normal cost	$173	$151
Interest on the liability	275	287
Other Actuarial (gains)/losses	185	(281)
Total Post-retirement Healthcare Expense	**633**	**157**
Total MRS Expense	**$2,324**	**$3,204**

The U.S. Coast Guard's military service members (both active duty and reservists) participate in the MRS. The U.S. Coast Guard receives an annual "Retired Pay" appropriation to fund MRS benefits. The retirement system allows voluntary retirement for active members upon credit of at least 20 years of active service at any age. Reserve members may retire after 20 years of creditable service with benefits beginning at age 60. The U.S. Coast Guard's MRS includes the U.S. Coast Guard Military Health Services System (Health Services Plan). The Health Services Plan is a post-retirement medical benefit plan, which covers all active duty and reserve members of the U.S. Coast Guard.

A portion of the accrued MRS liability is for the health care of non-Medicare eligible retirees and survivors. Effective October 1, 2002, the U.S. Coast Guard transferred its liability for the health care of Medicare eligible retirees/survivors to the DOD MERHCF, which was established in order to finance the health care benefits for the Medicare-eligible beneficiaries of all DOD and non-DOD uniformed services. DOD is the administrative entity for the MERHCF and in accordance with SFFAS No. 5, is required to recognize the liability on the MERHCF's financial statements. The U.S. Coast Guard makes annual payments to the MERHCF for current active duty members and current reservists. Benefits for U.S. Coast Guard members who retired prior to the establishment of the MERHCF are provided by payments from the Treasury to the MERHCF. The future cost and liability of the MERHCF is determined using claim factors and claims cost data developed by the DOD, adjusted for U.S. Coast Guard retiree and actual claims experience. The U.S. Coast Guard uses the current year actual costs to project costs for all future years.

The unfunded accrued liability, presented as a component of the liability for military service and other retirement benefits in the accompanying Balance Sheet, represents both retired pay and health care benefits for non-Medicare eligible retirees/survivors. Valuation of the plan's liability is based on the actuarial present value of accumulated plan benefits derived from the future payments that are attributable, under the retirement plan's provisions, to a participant's credited service as of the valuation date. Credited service is the years of service from active duty base date (or constructive date in the case of active duty reservists) to date of retirement measured in years and completed months. The present value of future benefits is then converted to an unfunded accrued liability by subtracting the present value of future employer/employee normal contributions. U.S. Coast Guard plan participants may retire after 20 years of active service at any age with annual benefits equal to 2.5 percent of retired base pay for each year of credited service. Personnel who became members after August 1, 1986, may elect to receive a $30,000 lump sum bonus after 15 years of service and reduced benefits prior to age 62. Annual disability is equal to the retired pay base multiplied by the larger of: 1) 2.5 percent times years of service; or 2) the percent of member disability. The benefit cannot be more than 75 percent of retired pay base. If a U.S. Coast Guard member is disabled, the member is entitled to disability benefits, assuming the disability is at least 30 percent (under a standard schedule of rating disabilities by Veterans Affairs) and either: 1) the member has one month and one day of service; 2) the disability results from active duty; or 3) the disability occurred in the line of duty during a time of war or national emergency or certain other time periods.

The significant actuarial assumptions used to compute the MRS accrued liability are:

- life expectancy and expected future service are based upon the DOD decrement (mortality, disability, withdrawal, and retirement) tables, as adjusted to reflect actual U.S. Coast Guard experience;
- cost of living increases are 3.75 percent annually; and
- annual rate of investment return is 6.0 percent.

B. District of Columbia Police and Fireman's Retirement System for U.S. Secret Service Employees

Special agents and other USSS personnel in certain job series hired as a civilian before January 1, 1984, are eligible to transfer to the District of Columbia Police and Fireman's Retirement System (DC Pension Plan) after completion of ten years of Secret Service employment and ten years of protection related experience. All uniformed USSS officers who were hired before January 1, 1984, are automatically covered under this retirement system. Participants in the DC Pension Plan make contributions of 7 percent of base pay with no matching contribution made by USSS. Annuitants of this plan receive benefit payments directly from the DC Pension Plan. USSS reimburses the District of Columbia for the difference between benefits provided to the annuitants, and payroll contributions received from current employees. This liability is presented as a component of the liability for military service and other retirement benefits in the accompanying Balance Sheet. SFFAS No. 5 requires the administrative entity (administrator) to report the actuarial liability. However, USSS adopted the provisions of SFFAS No. 5 because the administrator, the DC Pension Plan, is not a Federal entity and as such the liability for future funding would not otherwise be recorded in the Government-wide consolidated financial statements.

The primary actuarial assumptions used to determine the liability at September 30, 2008, are:

- life expectancy is based upon the RP 2000 Combined Healthy Mortality Table;
- cost of living increases are 3.5 percent annually;
- rates of salary increases are 3.5 percent annually;
- annual rate of investment return is 7.25 percent; and
- rates of withdrawal for active service by gender and age.

Total expenses related to the DC Pension Plan for the fiscal years ended September 30, 2008 and 2007, were $225 million and $215 million, respectively.

C. Actuarial FECA Liability

The actuarial Federal Employees' Compensation Act (FECA) liability represents the estimated liability for future workers' compensation and includes the expected liability for death, disability, medical, and miscellaneous costs for approved cases. Future workers' compensation estimates, generated from an application of actuarial procedures developed by DOL, for the future cost of approved compensation cases were approximately $1.8 billion and $1.7 billion at September 30, 2008 and 2007, respectively (unaudited).

17. Environmental and Disposal Liabilities

Environmental and disposal liabilities at September 30, 2008 and 2007 are $288 million and $275 million, respectively (unaudited). The Department is responsible to remediate its sites with environmental contamination, and is party to various administrative proceedings, legal actions, and tort claims which may result in settlements or decisions adverse to the Federal Government. The source of remediation requirements to determine the environmental liability is based on compliance with Federal, State, or local environmental laws and regulations. The major Federal laws covering environmental response, cleanup, and monitoring are the *Comprehensive Environmental Response,* *Compensation and Liability Act (P.L. 96-510)* and the *Resource Conservation and Recovery Act (P.L. 94-580)*.

The liabilities are primarily due to lighthouses, light stations, fuel storage tank program, buildings containing asbestos and/or lead based paint, firing ranges, fuels, solvents, industrial chemicals, and other environmental cleanup associated with normal operations of CBP, FLETC, and the U.S. Coast Guard. Potential environmental liabilities may exist in addition to the amounts accrued in the accompanying financial statements that are not presently estimable for the Plum Island Animal Disease Center, under S&T, due to the facility's age, old building materials used, and other materials associated with the facility's past use as a U.S. Army installation for coastline defense.

The Department has an unrecognized environmental liability of $89 million as of September 30, 2008 for U.S. Coast Guard vessels that have a reasonable possibility of being converted into marine artificial reefs; however, decisions on these have not occurred. This possibility exists for vessels over 90 feet in length after they are decommissioned. The preparation process includes the removal of all grease and buoyant material that might be harmful to the marine environment.

Cost estimates for environmental and disposal liabilities are subject to revision as a result of changes in inflation, technology, environmental laws and regulations, and plans for disposal.

18. Other Liabilities

Other Liabilities at September 30 consisted of the following (in millions):

Fiscal year ended September 30, 2008	Current	Non-Current	(Unaudited)
Intragovernmental:			
Due to the General Fund (Note 2)	$2,397	$ -	$2,397
Accrued FECA Liability	137	224	361
Advances from Others	138	-	138
Employer Benefits Contributions and Payroll Taxes	149	1	150
Other Intragovernmental Liabilities	106	-	106
Total Intragovernmental Other Liabilities	**$2,927**	**$225**	**$3,152**
Public:			
Accrued Payroll and Benefits (See B. below)	$1,736	$51	$1,787
Deferred Revenue and Advances from Others (See B. below)	1,931	1,149	3,080
Unliquidated Antidumping and Countervailing Duties (Notes 2, 3, and 7)	161	-	161
Insurance Liabilities (Note 20)	1,844	3,687	5,531
Refunds and Drawbacks (Note 2) (See B. below)	130	-	130
Contingent Legal Liabilities (Note 21)	232	142	374
Capital Lease Liability (Note 19)	19	70	89
Other	970	1	971
Total Other Liabilities with the Public	**$7,023**	**$5,100**	**$12,123**
Total Other Liabilities	**$9,950**	**$5,325**	**$15,275**

Fiscal year ended September 30, 2007	Current	Non-Current	(Unaudited) (Restated)
Intragovernmental:			
Due to the General Fund (Note 2)	$2,085	$ -	$2,085
Accrued FECA Liability	219	136	355
Advances from Others	70	-	70
Employer Benefits Contributions and Payroll Taxes	118	-	118
Other Intragovernmental Liabilities	57	-	57
Total Intragovernmental Other Liabilities	**$2,549**	**$136**	**$2,685**

Public:			
Accrued Payroll and Benefits (See B. below)	$1,534	$19	$1,553
Deferred Revenue and Advances from Others (See B. below)	1,682	1,045	2,727
Unliquidated Antidumping and Countervailing Duties (Notes 2 and 3)	514	-	514
Injured Domestic Industries (Notes 2 and 3)	388	-	388
Insurance Liabilities (Note 20)	513	995	1,508
Refunds and Drawbacks (Note 2) (See B. below)	131	-	131
Contingent Legal Liabilities (Note 21)	224	1	225
Capital Lease Liability (Note 19)	50	57	107
Other	777	-	777
Total Other Liabilities with the Public	**$5,813**	**$2,117**	**$7,930**
Total Other Liabilities	**$8,362**	**$2,253**	**$10,615**

A. Intragovernmental Other Liabilities

Workers' Compensation. Claims incurred for the benefit of Department employees under FECA are administered by DOL and are ultimately paid by the Department. The accrued FECA liability represents money owed for current claims. Reimbursement to DOL on payments made occurs approximately two years subsequent to the actual disbursement. Budgetary resources for this intragovernmental liability are made available to the Department as part of its annual appropriation from Congress in the year in which the reimbursement takes place. Workers' compensation expense was $159 million and $154 million, respectively (unaudited), for the fiscal years ended September 30, 2008 and 2007.

Due to the General Fund. Amounts due to the Treasury General Fund represent duty, tax, and fees collected by CBP to be remitted to various General Fund accounts maintained by Treasury.

B. Other Liabilities with the Public

Accrued Payroll and Benefits. Accrued Payroll and Benefits at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Accrued Funded Payroll and Benefits	$776	$656
Accrued Unfunded Leave	947	852
Unfunded Employment Related Liabilities	25	22
Other	39	23
Total Accrued Payroll and Benefits	**$1,787**	**$1,553**

Deferred Revenue and Advances from Others. Deferred Revenue and Advances From Others for the periods ended September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
USCIS Application Fees	$1,343	$1,132
FEMA Unexpired NFIP premium	1,723	1,582
Advances from Others	14	13
Total Deferred Revenue	**$3,080**	**$2,727**

USCIS requires payments of fees for applications or petitions for immigration and naturalization benefits at the time of filing. FEMA's deferred revenue relates to unearned NFIP premiums that are recognized over the term of the period of insurance coverage.

Unliquidated Antidumping and Countervailing Duties and Injured Domestic Industries. The *Continued Dumping and Subsidy Offset Act of 2000,(P.L. 106-387), Title X*, enacted in FY 2001 calls for CBP to collect and disburse monies received in connection with antidumping and countervailing duty orders and findings to qualifying IDI. Antidumping duties are collected when it is determined that a class or kind of foreign merchandise is being released into the U.S. economy at less than its fair value to the detriment of a U.S. industry. Countervailing duties are collected when it is determined that a foreign government is providing a subsidy to its local industries to manufacture, produce, or export a class or kind of merchandise for import into the U.S. commerce to the detriment of a U.S. industry. The duties will eventually be distributed to affected U.S. companies, pursuant to rulings by the U.S. Department of Commerce.

Refunds and Drawbacks. The liability for refunds and drawbacks for the fiscal years ended September 30, 2008 and 2007 were $130 million and $131 million, respectively.

Other Liabilities. Other public liabilities consist primarily of deposit and suspense fund liability.

19. Leases

A. Operating Leases

The Department leases various facilities and equipment under leases accounted for as operating leases. Leased items consist of offices, warehouses, vehicles, and other equipment. The majority of office space occupied by the Department is either owned by the Federal Government or is leased by GSA from commercial sources. The Department is not committed to continue paying rent to GSA beyond the period occupied, providing that proper advance notice to GSA is made and unless the space occupied is designated as unique to Department operations. However, it is expected the Department will continue to occupy and lease office space from GSA in future years and lease charges will be adjusted annually to reflect operating costs incurred by GSA.

As of September 30, 2008, estimated future minimum lease commitments under operating leases, some of which are cancelable, for equipment and GSA controlled leases were as follows (in millions) (unaudited):

	Land and Buildings	Vehicles and Equipment	Total
FY 2009	$1,087	$65	$1,152
FY 2010	1,158	69	1,227
FY 2011	1,184	74	1,258
FY 2012	1,217	79	1,296
FY 2013	1,243	74	1,317
After FY 2013	2,925	226	3,151
Total Future Minimum Lease Payments	**$8,814**	**$587**	**$9,401**

The estimated future lease payments for operating leases, some of which are cancelable, are based on payments made during the year ended September 30, 2008.

B. Capital Leases

The Department maintains capital leases for buildings and commercial software license agreements. The liabilities associated with capital leases and software license agreements are presented as other liabilities in the accompanying financial statements based upon the present value of the future minimum lease payments.

Certain license agreements are cancelable depending on future funding. Substantially all of the net present value of capital lease obligations and software license agreements will be funded from future sources. As of September 30, the summary of assets under capital lease were as follows (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Land and Buildings	$69	$69
Vehicles and Equipment	10	10
Software	152	152
Accumulated Amortization	(142)	(123)
Assets under Capital Lease, Net	**$89**	**$108**

As of September 30, 2008, estimated future minimum lease payments under capital leases, which were all non-GSA, were as follows (in millions) (unaudited):

	Land and Buildings	Software	Total
FY 2009	$6	$18	$24
FY 2010	6	18	24
FY 2011	6	-	6
FY 2012	6	-	6
FY 2013	6	-	6
After FY 2013	58	-	58
Total Future Minimum Lease Payments	88	36	124
Less: Imputed interest and Executory costs	32	3	35
Total Capital Lease Liability	**$56**	**$33**	**$89**

20. Insurance Liabilities

Insurance liabilities for the periods ended September 30, 2008 and 2007 were $5,531 million and $1,508 million, respectively (unaudited), and consist of primarily NFIP insurance liabilities.

The insurance liability for unpaid losses and related loss adjustment expenses and amounts paid for the year ended September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Beginning Balance	$1,508	$3,567
Change in incurred losses	4,942	(926)
Less: Amounts paid during current period	(919)	(1,133)
Total Insurance Liability at September 30	**$ 5,531**	**$1,508**

The NFIP insurance liability, the majority of the insurance liability reported, represents an estimate of NFIP based on the loss and loss adjustment expense factors inherent in the NFIP insurance underwriting operations experience and expectations. Estimation factors used by the insurance underwriting operations reflect current case basis estimates and give effect to estimates of trends in claim severity and frequency. These estimates are periodically reviewed, and adjustments, reflected in current operations, are made as deemed necessary.

In September 2008, Hurricane Ike made landfall in Texas. The severity of the hurricane, and time of occurrence relative to year-end, prevents FEMA from making a precise estimate of the related potential NFIP loss. Management estimates that the future payouts for flood insurance claims related to Hurricane Ike range between $3.3 billion and $8.2 billion. Management has accrued a most likely estimate of $5.5 billion in the accompanying financial statements.

NFIP premium rates are generally established for actuarially rated policies with the intent of generating sufficient premiums to cover losses and loss adjustment expenses of a historical average loss year and to provide a surplus to compensate the Insurance Underwriting Operations for the loss potential of an unusually severe loss year due to catastrophic flooding.

Notwithstanding the foregoing, subsidized rates have historically been charged on a countrywide basis for certain classifications of the insured. These subsidized rates produce a premium less than the loss and loss adjustment expenses expected to be incurred in a historical average loss year. The subsidized rates do not include a provision for losses from catastrophic flooding. Subsidized rates are used to provide affordable insurance on construction or substantial improvements started on or before December 31, 1974, or before the effective date of the initial Flood Insurance Rate Map (i.e., an official map of a community on which NFIP has delineated both the special hazard areas and the non-subsidized premium zones applicable to the community).

21. Commitments and Contingent Liabilities

A. Legal Contingent Liabilities

The estimated contingent liability recorded in the accompanying financial statements included with other liabilities for all probable and reasonably estimable litigation related claims at September 30, 2008, was $374 million, of which $94 million was funded. This increase of the probable and reasonably estimable litigation value is the result of a change in methodology used to evaluate Oil Spill Liability Trust Fund claims and a class action lawsuit challenging the legality of certain Department fees collected. The range of probable and estimable litigation is $374 million to $905 million. Asserted and pending legal claims for which loss is reasonably possible is estimated to range from $532 million to $1,001 million at September 30, 2008. The Department is subject to various other legal proceedings and claims. In management's opinion, the ultimate resolution of other actions will not materially affect the Department's financial position or net costs.

The estimated contingent liability recorded in the accompanying financial statements included with other liabilities for all probable and estimable litigation related claims at September 30, 2007, was $226 million, of which $46 million was funded. The range of probable and estimable litigation is $226 million to $587 million. Asserted and pending legal claims for which loss is reasonably possible is estimated to range from $35 million to $561 million at September 30, 2007.

The nature of probable and reasonably possible claims is litigation related to the *Federal Tort Claims Act (P.L. 79-601),* Oil Spill Liability Trust Fund, and various customs laws and regulations. In addition, the Department is subject to various other legal proceedings and claims. In management's opinion, the ultimate resolution of other actions will not materially affect the Department's financial position or net costs.

DHS management and general legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing contingencies related to legal proceedings that are pending against DHS, or unasserted claims that may result in such proceedings, general legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims, as well as the perceived merits of the amounts of relief sought or expected to be brought therein.

If the assessment of the loss contingency indicates that it is probable that a material liability has been incurred and the amount of the liability can be estimated, then the estimated liability is accrued in the financial statements regardless of the source of funding used to pay the liability. If the assessment indicates that a potentially material contingent liability is not probable but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss, if determinable and material, is disclosed.

B. Duty and Trade Refunds

There are various trade related matters that fall under the jurisdiction of other Federal agencies, such as the U.S. Department of Commerce, which may result in refunds of duties, taxes, and fees collected by CBP. Until a decision is reached by the other Federal agencies, CBP does not have sufficient information to estimate a contingent liability amount, if any, for trade related refunds under jurisdiction of other Federal agencies in addition to the amount accrued on the accompanying financial statements. All known duty and trade refunds as of September 30, 2008 and 2007, have been recorded.

C. Loaned Aircraft and Equipment

The Department is generally liable to DOD for damage or loss to aircraft on loan to CBP and vessels on loan to the U.S. Coast Guard. As of September 30, 2008 and September 30, 2007, CBP had 16 aircraft loaned from DOD with a replacement value of up to $25 million (unaudited) per aircraft. As of September 30, 2008, the U.S. Coast Guard had three vessels loaned from DOD with a replacement value of $36 million (unaudited). As of September 30, 2007, the U.S. Coast Guard had five vessels loaned from DOD with a replacement value of $60 million (unaudited).

D. Other Contractual Arrangements

In addition to future lease commitments disclosed in Note 19, the Department is committed under contractual agreements for goods and services that have been ordered but not yet received (undelivered orders) at fiscal year-end. Aggregate undelivered orders for all Department activities are disclosed in Note 30. In accordance with Public Law 101-510, the Department is required to automatically cancel obligated and unobligated balances of appropriated funds five years after a fund expires. Obligations that have not been paid at the time an appropriation is cancelled may be paid from an unexpired appropriation that is available for the same general purpose. As of September 30, 2008, DHS estimates total payments related to cancelled appropriations to be $44 million (unaudited) of which $41 million (unaudited) for contractual arrangements may require future funding. As of September 30, 2007, DHS estimates $47 million (unaudited) in obligations related to cancelled appropriations for which the Department has a contractual obligation for payment, as well as an estimated $14 million (unaudited) for contractual arrangements which may require future funding.

TSA entered into a number of *Letters of Intent for Modifications to Airport Facilities* with eight major airports in which TSA may reimburse the airports for 75 percent (estimated total of $1,157 million) of the cost to modify the facilities for security purposes. These Letters of Intent would not obligate TSA until funds have been appropriated and obligated. TSA has received $200 million (unaudited) in FY 2008 and $162 million (unaudited) in FY 2007 under this program, which is available for payment to the airports upon approval by TSA of an invoice for the modification costs incurred. As of September 30, 2008, TSA has received invoices or documentation for costs incurred totaling $716 million (unaudited) related to these agreements. TSA has accrued $49.9 million for the invoices or documentation received but not paid.

22. Earmarked Funds

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities or purposes. SSFAS No. 27, *Identifying and Reporting Earmarked Funds*, defines the following three critieria for determining an earmarked fund: 1) a statute committing the Federal Government to use specifically identifed revenues and other financing sources only for designated activities, benefits, or purposes; 2) explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and 3) a requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguished the earmarked fund from the Federal Government's general revenues.

There are no eliminations within the earmarked funds. Earmarked funds consisted of the following (in millions) (unaudited):

	Customs User Fees	**Sport Fish Restoration Boating Trust Fund**	**Immigration Examination Fees**	**National Flood Insurance Program**	**All Other Earmarked Funds**	**Total Earmarked Funds**
Balance Sheet as of September 30, 2008						
ASSETS						
Fund Balance with Treasury	$768	$9	$1,716	$829	$1,515	$4,837
Investments, Net	-	1,945	-	-	1,158	3,103
Taxes Receivable	75	-	-	-	-	75
Other	104	20	38	536	360	1,058
Total Assets	**$947**	**$1,974**	**$1,754**	**$1,365**	**$3,033**	**$9,073**
LIABILITIES						
Other Liabilities	$100	$1,206	$1,716	$25,013	$375	$28,410
Total Liabilities	**$100**	**$1,206**	**$1,716**	**$25,013**	**$375**	**$28,410**
NET POSITION						
Cumulative Results of Operations	847	768	38	(23,648)	2,658	(19,337)
Total Liabilities and Net Position	**$947**	**$1,974**	**$1,754**	**$1,365**	**$3,033**	**$9,073**

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	All Other Earmarked Funds	Total Earmarked Funds
Statement of Net Cost for the Year Ended September 30, 2008						
Gross Program Costs	$376	$ -	$2,138	$6,671	$1,381	$10,566
Less: Earned Revenues	-	-	(2,227)	(2,921)	(656)	(5,804)
Net Cost of Operations	**$376**	**$ -**	**$(89)**	**$3,750**	**$725**	**$4,762**
Statement of Changes in Net Position for the Year Ended September 30, 2008						
Net Position Beginning of Period	$788	$771	$(4)	$(19,899)	$2,108	$(16,236)
Net Cost of Operations	(376)	-	89	(3,750)	(725)	(4,762)
Non-exchange Revenue	1,925	710	-	-	1,188	3,823
Other	(1,490)	(713)	(47)	1	87	(2,162)
Change in Net Position	59	(3)	42	(3,749)	550	(3,101)
Net Position, End of Period	**$847**	**$768**	**$38**	**$(23,648)**	**$2,658**	**$(19,337)**

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	All Other Earmarked Funds	Total Earmarked Funds
Balance Sheet as of September 30, 2007						
ASSETS						
Fund Balance with Treasury	$730	$8	$1,245	$656	$1,061	$3,700
Investments, Net	-	1,845	-	-	933	2,778
Taxes Receivables	69	-	-	-	-	69
Other	76	19	267	497	247	1,106
Total Assets	**$875**	**$1,872**	**$1,512**	**1,153**	**$2,241**	**$7,653**
LIABILITIES						
Other Liabilities	$87	$1,101	$1,516	$21,054	$131	$23,889
Total Liabilities	**$87**	**$1,101**	**$1,516**	**$21,054**	**$131**	**$23,889**
NET POSITION						
Cumulative Results of Operations	$788	$771	$(4)	$(19,901)	$2,110	$(16,236)
Total Liabilities and Net Position	**$875**	**$1,872**	**$1,512**	**$1,153**	**$2,241**	**$7,653**

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	All Other Earmarked Funds	Total Earmarked Funds
Statement of Net Cost for the Year Ended September 30, 2007						
Gross Program Costs	$369	$ -	$1,681	$799	$1,163	$4,012
Less: Earned Revenues	-	(76)	(1,669)	(2,622)	(426)	(4,793)
Net Cost of Operations	**$369**	**$(76)**	**$12**	**$(1,823)**	**$737**	**$(781)**
Statement of Changes in Net Position for the Year Ended September 30, 2007						
Net Position Beginning of Period	$798	$693	$8	$(21,725)	$1,582	$(18,644)
Net Cost of Operations	(369)	76	(12)	1,823	(737)	781
Non-exchange Revenue	1,808	628	-	-	1,167	3,603
Other	(1,450)	(626)	-	1	99	(1,976)
Change in Net Position	(11)	78	(12)	1,824	529	2,408
Net Position, End of Period	**$787**	**$771**	**$(4)**	**$(19,901)**	**$2,111**	**$(16,236)**

Customs User Fees

In April 1986, the President signed the *Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA)*, which authorized CBP to collect user fees for certain services. The law initially established processing fees for air and sea passengers, commercial trucks, rail cars, private vessels and aircraft, commercial vessels, dutiable mail packages, and CBP broker permits. An additional fee category, contained in tax reform legislation, for processing barges and bulk carriers for Canada and Mexico, was added later that year. The collection of COBRA fees for CBP services began on July 7, 1986.

In addition to the collection of user fees, other changes in CBP procedures were enacted due to the COBRA statute. Most importantly, provisions were included for providing non-reimbursable inspectional overtime services and paying for excess pre-clearance costs from COBRA user fee collections.

The *Customs and Trade Act of 1990* amended the COBRA legislation to provide for the hiring of inspectional personnel, the purchasing of equipment, and the covering of related expenses with any surplus monies available, after overtime and excess pre-clearance costs are satisfied. Expenditures from the surplus can only be used to enhance the service provided to those functions for which fees are collected. This legislation took effect on October 1, 1990.

19 USC Section 58c contains the fees for certain customs services. The authority to use these funds is contained in the annual DHS Appropriations Act.

Access to COBRA surplus funds provides CBP with additional resources to assist in the accomplishment of CBP's mission. Increased staffing and equipment have enhanced the manager's flexibility in dealing with the ever-increasing demands of the trade and travel communities.

Sport Fish Restoration Boating Trust Fund (SFRBTF)

The SFRBTF, previously known as the Aquatic Resources Trust Fund (ARTF), was created by Section 1016 of the *Deficit Reduction Act of 1984 (P.L. 98-369)*. Two funds were created under this act, the Boat Safety Account and the Sport Fish Restoration Account. The SFRBTF has been the source of budget authority for the Boat Safety program for many years through the transfer of appropriated funds. The SFRBTF is a Treasury-managed fund and provides funding to states and other entities to promote boat safety and conservation of U.S. recreational waters.

This fund receives revenues transferred from custodial activities of the Treasury which are deposited in a Treasury account. The revenues are derived from a number of sources including motor boat fuel tax, excise taxes on sport fishing equipment, and import duties on fishing tackle and yachts. Three agencies share in the available portion of the revenue, Fish and Wildlife Service in the U.S. Department of Interior (DOI) (14X8151), the U.S. Army Corps of Engineers (COE) (96X8333), and U.S. Coast Guard (70X8149).

The most recent reauthorization of SFRBTF and expenditure of Boat Safety funds for the National RBS Program was enacted in 2005 in the *Safe*, *Accountable*, *Flexible*, *and Efficient Transportation Equity Act: A Legacy for Users or SAFETEA-LU (P.L. 109-59)* and the *Sportfishing and Recreational Boating Safety Amendments Act of 2005 (P.L. 109-74*).

Immigration Examination Fees

In 1988, Congress established the Immigration Examination Fee Account (IEFA) and the fees deposited into the IEFA have been the primary source of funding for providing immigration and naturalization benefits, and other benefits as directed by Congress. The *Immigration and Nationality Act* (INA) section 286(m) provides for the collection of fees at a level that will ensure recovery of the full costs of providing adjudication and naturalization services, including the costs of providing similar services without charge to asylum applicants and other immigrants. The INA also states that the fees may recover administrative costs. This revenue remains available to provide immigration and naturalization benefits and allows the collection, safeguarding, and accounting for fees.

The primary sources of revenue are the application and petition fees that are collected during the course of the fiscal year and deposited into the Immigration Examinations Fee Account (Treasury Account Fund Symbol (TAFS) 70X5088). In addition, USCIS provides specific services to other Federal agencies, such as production of Border Crossing Cards for the U.S. Department of State, that result in the collection of other revenues that are the result of intragovernmental activities.

During FY 2007, two events occurred that impacted fee revenue resources, including the fee increase and the visa open window for employment benefits. Both events caused a surge in applications received and fees collected during the fourth quarter of FY 2007. Increased collections from the fee increase have continued during FY 2008.

National Flood Insurance Program

The National Flood Insurance Program (NFIP) was established by the *National Flood Insurance Act of 1968*. The purpose of NFIP is to better indemnify individuals for flood losses through insurance, reduce future flood damages through State and community floodplain management regulations, and reduce Federal expenditures for disaster assistance and flood control.

The *Flood Disaster Protection Act of 1973* expanded the authority of FEMA and its use of the NFIP to grant premium subsidies as an additional incentive to encourage widespread state, community, and property owner acceptance of the program requirements.

The *National Flood Insurance Reform Act of 1994* reinforced the objective of using insurance as the preferred mechanism for disaster assistance by expanding mandatory flood insurance purchase requirements and by effecting a prohibition on further flood disaster assistance for any property where flood insurance, after having been mandated as a condition for receiving disaster assistance, is not mandated.

The *Bunning-Bereuter-Blumenauer Flood Insurance Reform Act (FIRA) of 2004* provides additional tools for addressing the impact of repetitive loss properties on the National Flood Insurance Fund. It introduced a pilot project though FY 2009 that defines severe repetitive loss properties, authorizes additional funds for mitigation projects, and mandates a 50 percent increase of premiums for property owners who decline a mitigation offer, along with an appeal process. It also modifies the Flood Mitigation Assistance (FMA) Program by doubling the annual authorized funding level and directing it to give priority to those properties that are in the best interest of the National Flood Insurance Fund.

NFIP requires all partners (Write Your Own (WYO) Companies) in the program to submit financial statements and statistical data to the Bureau & Statistical Agent (B&SA) on a monthly basis. This information is reconciled and the WYO companies are required to correct any variances.

This program is an insurance program for which the Department pays claims to policyholders whose houses have been flooded. The WYO companies that participate in the program have authority to use Departmental funds (revenue and other financing sources) to respond to the obligations of the policyholders. Congress has mandated that the NFIP funds are to only be used to pay claims caused by flooding.

The NFIP sources of revenue and other financing comes from premiums collected to insure policyholder's homes and the borrowing authority provided to our program from Congress. The resources are inflows to the Government and are not the result of intragovernmental flows.

All Other Earmarked Funds

The balances and activity reported for all other earmarked funds result from the funds listed below. Information related to these earmarked funds can be located in the Department's appropriations legislation or the statutes referenced.

- 70X0715 Radiological Emergency Preparedness Program, Emergency Preparedness and Response, Department of Homeland Security

- 70X5089 U.S. Customs and Border Protection, Land Border Inspection Fees, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70_5087 U.S. Customs and Border Protection, Immigration User Fees, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5126 Breach Bond/Detention Fund, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5378 Student and Exchange Visitor Program, Border and Transportation Security, Department of Homeland Security; 110 Stat. 3009-706, Sec. (e)(4)(B)
- 70X5382 Immigration User Fee Account, BICE, Department of Homeland Security; 116 Stat. 2135
- 70X5385 Aviation Security Capital Fund, Transportation Security Administration, Department of Homeland Security; 117 Stat. 2567(h)(1)
- 70_5389 H-1B and L Fraud Prevention and Detection Account, U.S. Citizenship and Immigration Service, Department of Homeland Security; 8 U.S.C. § 1356 (s)
- 70X5390 Unclaimed Checkpoint Money, Transportation Security Administration, Department of Homeland Security; 118 Stat. 1317-1318, Sec.515(a)
- 70X5451 Immigration Enforcement Account, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5545 Airport Checkpoint Screening Fund, Transportation Security Administration, Department of Homeland Security; P.L. 110-161
- 70_5694 User Fees, Small Airports, U.S. Customs Service, Department of Homeland Security; 116 Stat. 2135
- 70X8149 Boat Safety, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8244 Gifts and Donations, Department Management, Department of Homeland Security; 116 Stat. 2135 (FEMA REPORTED)
- 70X8312 Oil Spill Liability Trust Fund, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70_8314 Trust Fund Share of Expenses, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8349 Oil Spill Recovery, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8533 General Gift Fund, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8870 Harbor Maintenance Fee Collection, U.S. Customs Service, Department of Homeland Security; 116 Stat. 2135
- 20X8185 Oil Spill Liability Trust Fund; 103 Stat. 2363, 2364
- 70_5106 H-1 B Nonimmigrant Petitioner Account, Department of Homeland Security; 116 Stat. 2135
- 70X8360 Gifts and Bequests, Federal Law Enforcement Training Center, Department of Homeland Security; 116 Stat. 2135
- 70X8420 Surcharge Collections, Sales of Commissary Stores, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8428 Coast Guard Cadet Fund, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X5543 International Registered Traveler Program Fund, U.S. Customs and Border Protection, Department of Homeland Security; 121 Stat. 2091-2092

23. Intragovernmental Costs and Exchange Revenue

For the year ended September 30, 2008 (in millions) (Unaudited)

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
U.S. Customs and Border Protection			
Gross Cost	$2,463	$7,320	$9,783
Less Earned Revenue	(55)	(105)	(160)
Net Cost	**2,408**	**7,215**	**9,623**
U.S. Coast Guard			
Gross Cost	702	8,806	9,508
Less Earned Revenue	(203)	(262)	(465)
Net Cost	**499**	**8,544**	**9,043**
U.S. Citizenship and Immigration Services			
Gross Cost	660	1,524	2,184
Less Earned Revenue	(5)	(2,210)	(2,215)
Net Cost	**655**	**(686)**	**(31)**
Federal Emergency Management Agency			
Gross Cost	1,597	16,903	18,500
Less Earned Revenue	(80)	(2,947)	(3,027)
Net Cost	**1,517**	**13,956**	**15,473**
Federal Law Enforcement Training Center			
Gross Cost	32	415	447
Less Earned Revenue	(38)	(2)	(40)
Net Cost	**(6)**	**413**	**407**
National Protection and Programs Directorate			
Gross Cost	337	535	872
Less Earned Revenue	(1)	-	(1)
Net Cost	**336**	**535**	**871**
U.S. Immigration and Customs Enforcement			
Gross Cost	1,315	4,170	5,485
Less Earned Revenue	(822)	(106)	(928)
Net Cost	**493**	**4,064**	**4,557**
Office of Health Affairs			
Gross Cost	119	38	157
Less Earned Revenue	-	-	-
Net Cost	**119**	**38**	**157**

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
Departmental Operations and Other			
Gross Cost	$380	$936	$1,316
Less Earned Revenue	(1)	-	(1)
Net Cost	**379**	**936**	**1,315**
U.S. Secret Service			
Gross Cost	427	1,320	1,747
Less Earned Revenue	(11)	-	(11)
Net Cost	**416**	**1,320**	**1,736**
Science and Technology Directorate			
Gross Cost	444	332	776
Less Earned Revenue	(6)	-	(6)
Net Cost	**438**	**332**	**770**
Transportation Security Administration			
Gross Cost	1,230	5,392	6,622
Less Earned Revenue	(1)	(2,384)	(2,385)
Net Cost	**1,229**	**3,008**	**4,237**
Total Department of Homeland Security			
Gross Cost	9,706	47,691	57,397
Less Earned Revenue	(1,223)	(8,016)	(9,239)
Net Cost	**$8,483**	**$39,675**	**$48,158**

For the year ended September 30, 2007 (in millions) (Unaudited) (Restated)

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
U.S. Customs and Border Protection			
Gross Cost	$2,089	$6,109	$8,198
Less Earned Revenue	(46)	(111)	(157)
Net Cost	**2,043**	**5,998**	**8,041**
U.S. Coast Guard			
Gross Cost	1,188	9,465	10,653
Less Earned Revenue	(372)	(120)	(492)
Net Cost	**816**	**9,345**	**10,161**
U.S. Citizenship and Immigration Services			
Gross Cost	569	1,162	1,731
Less Earned Revenue	(13)	(1,646)	(1,659)
Net Cost	**556**	**(484)**	**72**
Federal Emergency Management Agency			
Gross Cost	2,579	11,693	14,272
Less Earned Revenue	(98)	(2,744)	(2,842)
Net Cost	**2,481**	**8,949**	**11,430**
Federal Law Enforcement Training Center			
Gross Cost	29	373	402
Less Earned Revenue	(38)	(3)	(41)
Net Cost	**(9)**	**370**	**361**
National Protection and Programs Directorate			
Gross Cost	438	417	855
Less Earned Revenue	-	-	-
Net Cost	**438**	**417**	**855**
U.S. Immigration and Customs Enforcement			
Gross Cost	1,168	3,723	4,891
Less Earned Revenue	(783)	(117)	(900)
Net Cost	**385**	**3,606**	**3,991**
Office of Health Affairs			
Gross Cost	109	4	113
Less Earned Revenue	-	-	-
Net Cost	**109**	**4**	**113**

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
Departmental Operations and Other			
Gross Cost	$442	$762	$1,204
Less Earned Revenue	(2)	(1)	(3)
Net Cost	**440**	**761**	**1,201**
U.S. Secret Service			
Gross Cost	487	1,202	1,689
Less Earned Revenue	(16)	-	(16)
Net Cost	**471**	**1,202**	**1,673**
Science and Technology Directorate			
Gross Cost	583	404	987
Less Earned Revenue	(14)	-	(14)
Net Cost	**569**	**404**	**973**
Transportation Security Administration			
Gross Cost	1,393	4,963	6,356
Less Earned Revenue	(2)	(2,297)	(2,299)
Net Cost	**1,391**	**2,666**	**4,057**
Total Department of Homeland Security			
Gross Cost	11,074	40,277	51,351
Less Earned Revenue	(1,384)	(7,039)	(8,423)
Net Cost	**$9,690**	**$33,238**	**$42,928**

Intragovernmental costs represent exchange transactions made between two reporting entities within the Federal Government and are presented separately from costs with the public (exchange transactions made between the reporting entity and a non-Federal entity). Intragovernmental exchange revenue is disclosed separately from exchange revenue with the public. The criteria used for this classification requires that the intragovernmental expenses relate to the source of goods and services purchased by the reporting entity and not to the classification of related revenue. For example, with "exchange revenue with the public," the buyer of the goods or services is a non-Federal entity. With "intragovernmental costs," the buyer and seller are both Federal entities. If a Federal entity purchases goods or services from another Federal entity and sells them to the public, the exchange revenue would be classified as "with the public," but the related costs would be classified as "intragovernmental." The purpose of this classification is to enable the Federal Government to provide consolidated financial statements, and not to match public and intragovernmental revenue with costs that are incurred to produce public and intragovernmental revenue.

24. Suborganization Costs by DHS Goals

Operating costs are summarized in the Statement of Net Cost by responsibility segment, as applicable to the reporting period. The net cost of operations is the gross (i.e., total) cost incurred by the Department, less any exchange (i.e., earned) revenue. A responsibility segment is the Component that carries out a mission or major line of activity, and whose managers report directly to Departmental Management.

To integrate performance and financial information, as required by the *President's Management Agenda* and the *Government Performance and Results Act*, a supplemental schedule of net cost is included in this note, in which costs by Component are allocated to Departmental strategic goals. In September 2008, the Department issued Fiscal Year 2008 – 2013 Strategic Plan, which is used as the basis for integrating FY 2008 net costs to performance information for all Components with the exception of CBP. Due to the late issuance of the new strategic goals and insufficient time to fully reprogram them into CBP's complex cost management system, CBP's FY 2008 net cost information is presented based on the Secretary's two year goals used in FY 2007. In addition, FY 2007 net cost information is also presented based on the Secretary's two year goals consistent with the FY 2007 Annual Financial Report and Annual Performance Report, and has not been reclassified to be consistent with the current year presentation based on the new strategic goals.

Net Costs of Department Sub-organizations by Strategic Goals (in millions)
For the year ended September 30, 2008 (Unaudited)

	Protect our Nation from Dangerous People	Protect our Nation from Dangerous Goods	Protect Critical Infrastructure	Strengthen Our Nation's Preparedness and Emergency Response Capabilities	Strengthen and Unify DHS Operations and Management	TOTAL
U.S. Customs and Border Protection	$9,623	$ -	$ -	$ -	$ -	**$9,623**
U.S. Coast Guard	1,587	1,159	4,914	1,383	-	**9,043**
U.S. Citizenship and Immigration Services	(31)	-	-	-	-	**(31)**
Federal Emergency Management Agency	-	-	6	15,467	-	**15,473**
Federal Law Enforcement Training Center	-	-	-	407	-	**407**
National Protection and Programs Directorate	290	-	554	27	-	**871**
U.S. Immigration and Customs Enforcement	4,252	-	305	-	-	**4,557**
Office of Health Affairs	-	126	-	31	-	**157**
Departmental Operations and Other	-	257	-	-	1,058	**1,315**
U.S. Secret Service	-	-	1,736	-	-	**1,736**
Science and Technology Directorate	40	432	85	213	-	**770**
Transportation Security Administration	3,184	862	191	-	-	**4,237**
TOTAL Department	**$18,945**	**$2,836**	**$7,791**	**$17,528**	**$1,058**	**$48,158**

Net Costs of Department Sub-organizations by Secretary's Goals (in millions)
For the year ended September 30, 2007 (Unaudited) (Restated)

	Protect our Nation from Dangerous People	Protect our Nation from Dangerous Goods	Protect Critical Infrastructure	Emergency Response System and Culture of Preparedness	Strengthen and Unify DHS Operations and Management	TOTAL
U.S. Customs and Border Protection	$8,041	$ -	$ -	$ -	$ -	**$8,041**
U.S. Coast Guard	2,798	-	5,999	1,364	-	**10,161**
U.S. Citizenship and Immigration Services	72	-	-	-	-	**72**
Federal Emergency Management Agency	-	-	-	11,430	-	**11,430**
Federal Law Enforcement Training Center	-	-	-	361	-	**361**
National Protection and Programs Directorate	285	-	539	31	-	**855**
U.S. Immigration and Customs Enforcement	4,219	-	(228)	-	-	**3,991**
Office of Health Affairs	-	56	-	57	-	**113**
Departmental Operations and Other	-	106	-	-	1,095	**1,201**
U.S. Secret Service	-	-	1,673	-	-	**1,673**
Science and Technology Directorate	30	475	157	311	-	**973**
Transportation Security Administration	587	-	3,470	-	-	**4,057**
TOTAL Department	**$16,032**	**$637**	**$11,610**	**$13,554**	**$1,095**	**$42,928**

25. Apportionment Categories of Obligations Incurred: Direct versus Reimbursable Obligations

Apportionment categories are determined in accordance with the guidance provided in OMB Circular A-11, *Preparation, Submission and Execution of the Budget*. Category A represents resources apportioned for calendar quarters. Category B represents resources apportioned for other time periods, for activities, projects, or objectives, or for any combination thereof (in millions).

Year Ended September 30, 2008 (Unaudited):	**Apportionment Category A**	**Apportionment Category B**	**Exempt from Apportionment**	**Total**
Obligations Incurred - Direct	$32,618	$23,206	$1,001	$56,825
Obligations Incurred - Reimbursable	3,631	5,023	10	8,664
Total Obligations Incurred	**$36,249**	**$28,229**	**$1,011**	**$65,489**

Year Ended September 30, 2007 (Unaudited):	**Apportionment Category A**	**Apportionment Category B**	**Exempt from Apportionment**	**Total**
Obligations Incurred - Direct	$30,738	$24,335	$1,593	$56,666
Obligations Incurred - Reimbursable	4,583	737	-	5,320
Total Obligations Incurred	**$35,321**	**$25,072**	**$1,593**	**$61,986**

The increase in obligations incurred was the result of obligation activity against increased funding as a result of hurricane flooding.

26. Available Borrowing Authority

The Department, through FEMA's NFIP, at the beginning of FY 2008 had available borrowing authority of $3,465 million (unaudited). During FY 2008, FEMA used $50 million in borrowing authority; which leaves a balance of $3,415 million. For FY 2007, FEMA had a beginning balance of used $4,230 million in borrowing authority; reductions of $70 million and used $695 million leaving a balance of $3,465 million. DADLP annually requests borrowing authority to cover the principal amount of direct loans not to exceed $25 million less the subsidy due from the program account.

27. Permanent Indefinite Appropriations

Permanent indefinite appropriations refer to the appropriations that result from permanent public laws, which authorize the Department to retain certain receipts. The amount appropriated depends upon the amount of the receipts rather than on a specific amount. The Department has two permanent indefinite appropriations as follows:

- CBP has a permanent and indefinite appropriation, which is used to disburse tax and duty refunds and duty drawbacks. Although funded through appropriations, refund and drawback activity is, in most instances, reported as custodial activity of the Department. Refunds are custodial revenue-related activity in that refunds are a direct result of overpayments of taxes, duties, and fees. Federal tax revenue received from taxpayers is not available for use in the operation of the Department and is not reported on the Statement of Net Cost. Likewise, the refunds of overpayments are not available for use by the Department in its operations.

- USSS has a permanent and indefinite appropriation, which is used to reimburse the DC Pension Plan for the difference between benefits to participants in the DC Pension Plan (see Note 16), and payroll contributions received from current employees.

These appropriations are not subject to budgetary ceilings established by Congress. CBP's refunds payable at year-end are not subject to funding restrictions.

28. Legal Arrangements Affecting the Use of Unobligated Balances

Unobligated balances whose period of availability has expired are not available to fund new obligations. Expired unobligated balances are available to pay for current period adjustments to obligations incurred prior to expiration. For a fixed appropriation account, the balance can be carried forward for five fiscal years after the period of availability ends. At the end of the fifth fiscal year, the account is closed and any remaining balance is canceled and returned to Treasury. For a no-year account, the unobligated balance is carried forward indefinitely until: 1) specifically rescinded by law; or 2) the head of the agency concerned or the President determines that the purposes for which the appropriation was made have been carried out and disbursements have not been made against the appropriation for two consecutive years.

Included in the cumulative results of operations for special funds is $1.1 billion (unaudited) at September 30, 2008 and 2007 that represents the Department's authority to assess and collect user fees relating to merchandise and passenger processing; to assess and collect fees associated with services performed at certain small airports or other facilities; retain amounts needed to offset costs associated with collecting duties; and taxes and fees for the Government of Puerto Rico. These special fund balances are restricted by law in their use to offset specific costs incurred by the Department. Part of the passenger fees in the User Fees Account, totaling approximately $735 million (unaudited) and $758 million (unaudited) at September 30, 2008 and 2007, respectively, is restricted by law in its use to offset specific costs incurred by the Department and are available to the extent provided in Department Appropriation Acts.

The entity trust fund balances result from the Department's authority to use the proceeds from general order items sold at auction to offset specific costs incurred by the Department relating to their sale, to use available funds in the Salaries and Expense Trust Fund to offset specific costs for expanding border and port enforcement activities, and to use available funds from the Harbor Maintenance Fee Trust Fund to offset administrative expenses related to the collection of the Harbor Maintenance Fee.

29. Explanation of Differences between the Statement of Budgetary Resources and the Budget of the U.S. Government

The table below documents the material differences between the FY 2007 Statement of Budgetary Resources (SBR) and the actual amounts reported for FY 2007 in the Budget of the U.S. Government. Since the FY 2008 financial statements will be reported prior to the release of the

Budget of the U.S. Government, DHS is reporting for FY 2007 only. Typically, the Budget of the U.S. Government with the FY 2008 actual data is published in February of the subsequent year. Once published the FY 2008 actual data will be available on the OMB website at: www.whitehouse.gov/omb.

(in millions)	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
FY 2007 Actual Balances per the FY 2009 President's Budget	**$75,305**	**$59,920**	**$5,112**	**$44,333**
Reconciling Items:				
Accounts that are expired that are not included in Budget of the United States.	1,437	151		
Distributed Offsetting Receipts not included in the Budget of the United States.				(4,952)
Refunds and drawbacks not included in the Budget of the United States.	1,538	1,538		1,538
Byrd Program (Continued Dumping and Subsidy Offset) not included in the Budget of the United States.	954	381		381
Various unexpired programs that are not included in the Budget of the United States	559			40
Immigration Examination fees that were captured as deferred revenue			(404)	
President's Budget outlays that were overstated due to misclassification as an offsetting receipt			250	(250)
Miscellaneous Differences	55	(4)	(6)	
Per the 2007 SBR (Unaudited) (Restated)	**$79,848**	**$61,986**	**$4,952**	**$41,090**

30. Undelivered Orders, End of Period

An undelivered order exists when a valid obligation has occurred and funds have been reserved, but the goods or services have not been delivered. Undelivered orders for the periods ended September 30, 2008 and 2007 were $41,855 million (unaudited) and $38,172 million (unaudited) (restated), respectively.

31. Explanation for the Difference between the Appropriations Received reported on the Statement of Budgetary Resources and on the Statement of Changes in Net Position

The SBR reported $57,653 million (unaudited) for appropriations received for FY 2008. This balance does not agree to the balance reported on the Statement of Changes in Net Position (SCNP) of $50,253 million (unaudited) for FY 2008. The difference is primarily related to: 1) $6,642 million in certain trust and special fund receipts not reflected in the unexpended appropriations section of the SCNP; 2) $(62) million for the decrease in amounts appropriated from certain Treasury-managed trust funds; 3) $1,000 million related to refunds and drawbacks; and 4) $(180) million for receipts unavailable for obligations upon collection from certain trust and special funds.

The SBR reported $46,491 million (unaudited) for appropriations received for FY 2007. This balance does not agree to the balance reported on the SCNP of $39,520 million (unaudited) for FY 2007. The difference is primarily related to: 1) $5,718 million in certain trust and special fund receipts not reflected in the unexpended appropriations section of the SCNP; 2) $(34) million for the decrease in amounts appropriated from certain Treasury-managed trust funds; 3) $1,611 million related to refunds and drawbacks; 4) $(324) million for receipts unavailable for obligations upon collection from certain trust and special funds; and 5) $1 million for a temporary reduction/cancellation returned by appropriation.

32. Custodial Revenues

The Department collects revenue from a variety of duties, excise taxes, and various other fees. Collection activity primarily relates to current year activity. Non-entity revenue reported on the Department's Statement of Custodial Activity include duties, excise taxes, and various non-exchange fees collected by CBP and USCIS that are subsequently remitted to the Treasury General Fund or to other Federal agencies. CBP assesses duties, taxes, and fees on goods and merchandise brought into the United States from foreign countries. At the time an importer's merchandise is brought into the United States, the importer is required to file entry documents. Generally, within ten working days after release of the merchandise into the United States commerce, the importer is to submit an entry document with payment of estimated duties, taxes, and fees.

The significant types of non-entity accounts receivable (custodial revenues as presented in the Statement of Custodial Activity) are described below.

- **Duties:** amounts collected on imported goods collected on behalf of the Federal Government.
- **Excise taxes:** amounts collected on imported distilled spirits, wines, and tobacco products.
- **User fees:** amounts designed to maintain U.S. harbors and to defray the cost of other miscellaneous service programs. User fees include application fees collected from employers sponsoring nonimmigrant petitions.

- **Fines and penalties:** amounts collected for violations of laws and regulations.

- **Refunds:** overpayments of duties, taxes, fees, and interest to an importer/exporter for which the importer/exporter needs to reimburse the payer. Refunds include drawback remittance paid when imported merchandise, for which duty was previously paid, is exported from the United States.

Tax disbursements from the refunds and drawbacks account, broken out by revenue type and by tax year, were as follows for the fiscal years ended September 30, 2008 and 2007 (in millions) (unaudited):

2008 Tax Disbursements

	Tax Year				
	2008	2007	2006	2005	Prior Years
Customs duties	$815	$162	$54	$27	$238
Total nonexchange revenue refunded	815	162	54	27	238
Exchange revenue refunded	-	-	- -	-	
Total tax refunds and drawbacks disbursed	**$815**	**$162**	**$54**	**$27**	**$238**

2007 Tax Disbursements

	Tax Year				
	2007	2006	2005	2004	Prior Years
Customs duties	$5,531	$222	$327	$363	$479
Total nonexchange revenue refunded	5,531	222	327	363	479
Exchange revenue refunded	-	-	- -	-	
Total tax refunds and drawbacks disbursed	**$5,531**	**$222**	**$327**	**$363**	**$479**

The disbursements include interest payments of $34 million and $655 million, for the fiscal years ended September 30, 2008 and 2007, respectively (unaudited).

The disbursement totals for refunds include antidumping and countervailing duties collected that are refunded pursuant to rulings by the U.S. Department of Commerce (DOC). These duties are refunded when the DOC issues a decision in favor of the foreign industry. See Footnote 18, Other Liabilities for more information.

The total amounts of antidumping and countervailing duties vary from year to year depending on decisions from DOC. Antidumping and countervailing duty refunds (included in total refunds presented above) and associated interest refunded for the fiscal years ended September 30, 2008 and 2007, consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Antidumping and Countervailing Duty Refunds	$16	$5,034
Interest	1	655
Total Antidumping and Countervailing Duty Refunds	**$17**	**$5,689**

33. Restatements

A. OHA Restatement (Unaudited)

The Department restated the FY 2007 financial statements to record accounts payable for goods delivered but not yet billed to OHA from FY 2004 through FY 2006. This error required correcting adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Custodial Activity, as follows:

A.1 – Increase intragovernmental accounts payable by $197 million;
A.2 – Decrease unexpended appropriations by $197 million;
A.3 – Increase expenses by $108 million;
A.4 – Increase appropriations used by $108 million; and
A.5 – Decrease beginning FY 2007 unexpended appropriations by $89 million.

B. FLETC Restatement (Unaudited)

The Department restated the FY 2007 financial statements to record revenues for reimbursable construction and supply expenses accrued at year-end in FY 2007 at FLETC. Additionally, because the adjustments affected intradepartmental transactions with S&T, the Department recorded an offsetting elimination entry of $10 million to the Balance Sheet, resulting in a net $1 million increase in accounts receivable and FLETC revenue, and related effects on the Statement of Budgetary Resources. The error required correcting adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Custodial Activity, as follows:

<u>FLETC:</u>
B.1 – Increase intragovernmental accounts receivable by $1 million;
B.2 – Increase revenue by $1 million;
B.3 – Decrease cumulative results of operations by $11 million;
B.4 – Increase to change in receivables from Federal sources by $11 million; and
B.5 – Decrease unfilled customer orders without advance from Federal sources by $11 million;

<u>S&T:</u>
B.6 – Decrease unexpended appropriations by $10 million; and
B.7 – Increase appropriations used by $10 million.

C. TSA Restatement (Unaudited)

Unliquidated Obligations. The Department restated the FY 2007 financial statements to deobligate unliquidated obligations at TSA. These obligations were for contracts with periods of performance that expired in FY 2007. The error required correcting adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Custodial Activity as follows:

C.1 – Decrease accounts payable with the public by $13 million;
C.2 – Decrease intragovernmental accounts payable by $1 million;
C.3 – Increase unexpended appropriations by $14 million;
C.4 – Decrease expenses by $14 million;
C.5 – Decrease appropriations used by $14 million;
C.6 – Increase recoveries of prior year obligations by $59 million;
C.7 – Decrease obligations incurred by $16 million;
C.8 – Increase unobligated balance, apportioned, by $16 million; and
C.9 – Increase unobligated balance not available by $59 million.

Capital Assets. The Department restated the FY 2007 financial statements to correct errors in capital asset balances and transactions at TSA, described below:

- The development of internal use software was being expensed in error instead of being capitalized;
- Costs related to the installation and networking of capitalized equipment were erroneously expensed in prior years;
- TSA had incorrectly been using five years instead of seven years for the useful life of certain equipment acquired in FY 2006 and FY 2007;
- TSA had not properly identified and accounted for asset impairments; and
- TSA did not use an appropriate capitalization threshold.

Correction of these errors required adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Custodial Activity as follows:

C.10 – Increase property, plant, and equipment by a net value of $327 million;
C.11 – Decrease cumulative results of operations by $327 million;
C.12 – Decrease expenses by $70 million; and
C.13 – Decrease beginning FY 2007 cumulative results of operations by $257 million.

D. U.S. Coast Guard Restatement (Unaudited)

The Department restated the FY 2007 financial statements to reclassify contingent legal liabilities from a loss contingency of reasonably possible to probable related to the Oil Spill Liability Trust Fund. The error required correcting adjustments to each of the principal financial statements and related footnotes, except for the Statement of Custodial Activity as follows:

D.1 – Increase other liabilities by $89 million;
D.2 – Increase cumulative results of operations by $89 million; and
D.3 – Increase expenses by $89 million.

Additionally, this change resulted in a decrease in the total range of loss contingencies disclosed per Note 21.

E. Other Restatements (Unaudited)

The Department recorded miscellaneous restatements to correct various errors as follows:

E.1 – Decrease accounts payable with the public by $9 million;
E.2 – Decrease beginning cumulative results of operations by $9 million;
E.3 – Decrease unobligated balance brought forward by $4 million;
E.4 – Increase unpaid obligations brought forward by $4 million;
E.5 – Increase unpaid obligations, end of period, by $4 million; and
E.6 – Decrease unobligated balance, not available by $4 million.

BALANCE SHEET, in millions	Original 2007	Effects of Restatements	Restated 2007	Description Reference
ASSETS				
Intragovernmental				
Fund Balance With Treasury	$56,185	$ -	$56,185	
Investments, Net	2,778	-	2,778	
Accounts Receivable	278	1	279	B.1
Other				
Advances and Prepayments	2,887	-	2,887	
Due from Treasury	176	-	176	
Total Intragovernmental	**$62,304**	**$ 1**	**$62,305**	
Cash and Other Monetary Assets	$321	$ -	$321	
Accounts Receivable, Net	760	-	760	
Taxes, Duties, and Trade Receivables, Net	1,937	-	1,937	
Direct Loans, Net	-	-	-	
Inventory and Related Property, Net	632	-	632	
General Property, Plant, and Equipment, Net	12,275	327	12,602	C.10
Other				
Advances and Prepayments	567	-	567	
TOTAL ASSETS	**$78,796**	**$ 328**	**$79,124**	**B, C**
LIABILITIES				
Intragovernmental				
Accounts Payable	$2,066	$196	$2,262	A.1, C.1
Debt	18,153	-	18,153	
Other				
Due to the General Fund	2,085	-	2,085	
Accrued FECA Liability	355	-	355	
Other	245	-	245	
Total Intragovernmental	**$22,904**	**$196**	**$23,100**	
Accounts Payable	$3,003	$ (21)	$2,982	C.1, E.1
Federal Employee and Veteran Benefits	34,910	-	34,910	
Environmental and Disposal Liabilities	275	-	275	
Other				
Accrued Payroll	1,553	-	1,553	
Deferred Revenue and Advances from Others	2,727	-	2,727	
Unliquidated Antidumping and Countervailing Duties	514	-	514	

BALANCE SHEET, in millions	**Original 2007**	**Effects of Restatements**	**Restated 2007**	**Description Reference**
Insurance Liabilities	1,508	-	1,508	
Refunds and Drawbacks	131	-	131	
Other	1,408	89	1,497	D.1
Total Liabilities	**$68,933**	**$264**	**$69,197**	**A, C, D, E**
Net Position				
Unexpended Appropriations- Earmarked Funds	$ -	$ -	$ -	
Unexpended Appropriations- Other Funds	49,003	(193)	48,810	A.1, B.6, C.3
Cumulative Results of Operations- Earmarked Funds	(16,236)	-	(16,236)	
Cumulative Results of Operations-Other Funds	(22,904)	257	(22,647)	B.3, C.11, D.2, E.2
Total Net Position	**$9,863**	**$64**	**$9,927**	**A, B, C, D, E**
TOTAL LIABILITIES AND NET POSITION	**$78,796**	**$ 328**	**$79,124**	

STATEMENT OF NET COST, in millions	**Original 2007**	**Effects of Restatements**	**Restated 2007**	**Description Reference**
Directorates and Other Components				
U.S. Customs and Border Protection				
Gross Cost	$8,198	$ -	$8,198	
Less Earned Revenue	(157)	-	(157)	
Net Cost	8,041	-	8,041	
U.S. Coast Guard				
Gross Cost	10,564	89	10,653	D.3
Less Earned Revenue	(492)	-	(492)	
Net Cost	10,072	89	10,161	
U.S. Citizenship and Immigration Services				
Gross Cost	1,731	-	1,731	
Less Earned Revenue	(1,659)	-	(1,659)	
Net Cost	72	-	72	
Federal Emergency Management Agency				
Gross Cost	14,272	-	14,272	
Less Earned Revenue	(2,842)	-	(2,842)	
Net Cost	11,430	-	11,430	
Federal Law Enforcement Training Center				
Gross Cost	402	-	402	
Less Earned Revenue	(40)	(1)	(41)	B.2
Net Cost	362	(1)	361	
National Protection and Preparedness Directorate				
Gross Cost	855	-	855	
Less Earned Revenue	-	-	-	
Net Cost	855	-	855	
U.S. Immigration and Customs Enforcement				
Gross Cost	4,891	-	4,891	
Less Earned Revenue	(900)	-	(900)	
Net Cost	3,991	-	3,991	

STATEMENT OF NET COST, in millions	Original 2007	Effects of Restatements	Restated 2007	Description Reference
Office of Health Affairs				
Gross Cost	5	108	113	A.3
Less Earned Revenue	-	-	-	
Net Cost	5	108	113	
Departmental Operations and Other				
Gross Cost	1,204	-	1,204	
Less Earned Revenue	(3)	-	(3)	
Net Cost	1,201	-	1,201	
U.S. Secret Service				
Gross Cost	1,689	-	1,689	
Less Earned Revenue	(16)	-	(16)	
Net Cost	1,673	-	1,673	
Science and Technology Directorate				
Gross Cost	987	-	987	
Less Earned Revenue	(14)	-	(14)	
Net Cost	973	-	973	
Transportation Security Administration				
Gross Cost	6,439	(83)	6,356	C.4, C.12
Less Earned Revenue	(2,299)	-	(2,299)	
Net Cost	4,140	(83)	4,057	
NET COST OF OPERATIONS	**$42,815**	**$113**	**$42,928**	**A, B, C, D**

STATEMENT OF CHANGES IN NET POSITION, in millions	**Original 2007**	**Effects of Restatements**	**Restated 2007**	**Description Reference**
Cumulative Results of Operations				
Beginning Balances	$(39,563)	$ -	$(39,563)	
Adjustments:				
Corrections of Errors	-	266	266	C.13, E.2
Beginning balance, as adjusted	**$(39,563)**	**$ 266**	**$(39,297)**	
Budgetary Financing Sources:				
Appropriations Used	$39,074	$104	$39,178	A.4, B.7, C.5
Non-Exchange Revenue	3,609	-	3,609	
Donations and Forfeitures of Cash and Cash Equivalents	2	-	2	
Transfers in/out without Reimbursement	(125)	-	(125)	
Other	(174)	-	(174)	
Other Financing Sources (Non-Exchange):				
Donations and Forfeitures of Property	4	-	4	
Transfers in/out reimbursement	9	-	9	
Imputed Financing	839	-	839	
Total Financing Sources	43,238	104	43,342	
Net Cost of Operations	(42,815)	(113)	(42,928)	
Net Change	**423**	**(9)**	**414**	**A, B, C, E**
Cumulative Results of Operations	**$(39,140)**	**$ 257**	**$(38,883)**	
Unexpended Appropriations:				
Beginning Balance	$48,853	$ -	$48,853	
Adjustments:				
Corrections of errors	-	(89)	(89)	A.5
Beginning Balance, as adjusted	**$48,853**	**$(89)**	**$48,764**	
Budgetary Financing Sources:				
Appropriations Received	$39,520	$ -	$39,520	
Appropriations transferred in/out	295	-	295	
Other Adjustments	(591)	-	(591)	
Appropriations Used	(39,074)	(104)	(39,178)	A.4, B.7, C.5
Total Budgetary Financing Sources	150	(104)	46	
Total Unexpended Appropriations	**49,003**	**(193)**	**48,810**	**A, B, C**
NET POSITION	**$9,863**	**$64**	**$9,927**	

STATEMENT OF BUDGETARY RESOURCES, in millions	Original 2007		Effects of Restatements		Restated 2007		
	Budgetary	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Description Reference**
BUDGETARY RESOURCES							
Unobligated Balance, brought forward October 1	$17,313	$-	$(4)	$ -	$17,309	$ -	E.3
Recoveries of Prior Year Unpaid Obligations	4,938	-	59	-	4,997	-	C.6
Budget Authority:							
Appropriations	46,491	-	-	-	46,491	-	
Borrowing Authority	-	-	-	-	-	-	
Spending Authority from Offsetting Collections:							
Earned:							
Collected	9,963	336	-	-	9,963	336	
Change in Receivable from Federal Sources	(5)	-	12	-	7	-	B.4
Change in Unfilled Customer Orders:							
Advance Received	78	-	-	-	78	-	
Without Advance From Federal Sources	707	(122)	(11)	-	696	(122)	B.5
Previously unavailable	-	-	-	-	-	-	
Expenditure transfers from trust funds	47	-	-	-	47	-	
Subtotal	57,281	214	1	-	57,282	214	
Non-expenditure transfers, net; anticipated and actual	787	-	-	-	787	-	
Temporarily Not Available Pursuant to Public Law	-	-		-	-	-	
Permanently Not Available	(671)	(70)	-	-	(671)	(70)	
TOTAL BUDGETARY RESOURCES	**$79,648**	**$144**	**$56**	**$ -**	**$79,704**	**$144**	**B, C, E**

STATEMENT OF BUDGETARY RESOURCES, in millions	Original 2007 Budgetary	Original 2007 Non-Budgetary Credit Reform Financing Accounts	Effects of Restatements Budgetary	Effects of Restatements Non-Budgetary Credit Reform Financing Accounts	Restated 2007 Budgetary	Restated 2007 Non-Budgetary Credit Reform Financing Accounts	Description Reference
STATUS OF BUDGETARY RESOURCES							
Obligations Incurred:							
Direct	$56,669	$13	$ (16)	$ -	$56,653	$13	C.7
Reimbursable	5,320	-	-	-	5,320	-	
Subtotal	**61,989**	**13**	**(16)**	**-**	**61,973**	**13**	
Unobligated Balance:							
Apportioned	9,141	12	16	-	9,157	12	C.8
Exempt from Apportionment	97	-	-	-	97	-	
Subtotal	**9,238**	**12**	**16**	**-**	9,254	12	
Unobligated Balance Not Available	8,421	119	56	-	8,477	119	C.9, E.6
TOTAL STATUS OF BUDGETARY RESOURCES	**$79,648**	**$144**	**$56**	**$ -**	**$79,704**	**$144**	**C, E**

STATEMENT OF BUDGETARY RESOURCES, in millions	Original 2007		Effects of Restatements		Restated 2007		Description Reference
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	
CHANGE IN OBLIGATED BALANCE							
Obligated Balance, Net							
Unpaid obligations brought forward, October 1	$43,036	$ 642	$4	$ -	$43,040	$642	E.4
Less: Uncollected customer payments from Federal Sources, brought forward, October 1	(2,069)	(482)	-	-	(2,069)	(482)	
Total unpaid obligated balance, net	40,967	160	4	-	40,971	160	
Obligations incurred, net	61,989	13	(16)	-	61,973	13	C.7
Less: Gross Outlays	(56,293)	(175)	-	-	(56,293)	(175)	
Obligated balance transferred, net							
Actual transfers, unpaid obligations	(18)	-	-	-	(18)	-	
Total unpaid obligated balance transferred, net	(18)	-	-	-	(18)	-	
Recoveries of Prior Year Unpaid Obligations, Actual	(4,938)	-	(59)	-	(4,997)	-	C.6
Change in uncollected customer payments from Federal Sources	(702)	121	-	-	(702)	121	
Obligated balance, net end of period							
Unpaid obligations	43,775	480	(71)	-	43,704	480	C.6, C.7, E.5
Less: Uncollected customer payments from Federal Sources	(2,770)	(361)	-	-	(2,770)	(361)	
Total, unpaid obligated balance, net end of period	41,005	119	(71)	-	40,934	119	C, E
Net Outlays							
Gross Outlays	56,293	175	-	-	56,293	175	
Less: Offsetting Collections	(10,090)	(336)	-	-	(10,090)	(336)	
Less: Distributed Offsetting Receipts	(4,952)	-	-	-	(4,952)	-	
NET OUTLAYS	**$41,251**	**$(161)**	**$ -**	**$ -**	**$41,251**	**$(161)**	

34. Reconciliation of Net Cost of Operations (Proprietary) to Budget

The Reconciliation of Net Cost of Operations to Budget reconciles the Department's *Resources Used to Finance Activities* (first section), which consists of the budgetary basis of accounting Net Obligations plus the proprietary basis of accounting Other Resources, to the proprietary basis of accounting Net Cost of Operations. The second section, *Resources Used to Finance Items Not Part of the Net Cost of Operations*, reverses out items included in the first section that are not included in Net Cost of Operations. The third section, *Components of Net Cost of Operations that Will Not Require or Generate Resources in the Current Period*, adds items included in the Net Cost of Operations that are not included in the first section.

The third section's subsection, *Components Requiring or Generating Resources in Future Periods*, includes costs reported in the current period that are included in the Liabilities Not Covered by Budgetary Resources reported in Note 14. This subsection does not include costs reported in prior fiscal years that are also included in Liabilities Not Covered by Budgetary Resources.

The reconciliations of net cost of operations to budget for FY 2008 and FY 2007 are as follows:

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred (Note 25)	$65,489	$61,986
Less: Spending Authority from Offsetting Collections and Recoveries	(13,172)	(16,002)
Obligations Net of Offsetting Collections and Recoveries	52,317	45,984
Less: Offsetting Receipts	(6,048)	(4,952)
Net Obligations	46,269	41,032
Other Resources		
Donations and Forfeiture of Property	14	4
Transfers in (out) Without Reimbursement	18	9
Imputed Financing from Costs Absorbed by Others	738	839
Other	(63)	-
Net Other Resources Used to Finance Activities	707	852
Total Resources Used to Finance Activities	**$46,976**	**$41,884**

Resources Used to Finance Items Not Part of the Net Cost of Operations		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but not yet Provided	$4,858	$344
Resources that Fund Expenses Recognized in Prior Periods	(347)	(1,500)
Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations:		
Credit program Collections that Increase Liabilities for Loan Guarantees or Allowances for Subsidy	172	336
Other	(2,862)	(2,355)
Resources that Finance the Acquisition of Assets	4,035	2,926
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations	1,008	1,733
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	6,864	1,484
TOTAL RESOURCES USED TO FINANCE THE NET COST OF OPERATIONS	**$40,112**	**$40,400**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increase in Annual Leave Liability	$105	$85
Increase in Environmental and Disposal Liability	20	34
Increase in Exchange Revenue Receivable from the Public	-	(1)
Other		
Increase in Insurance Liabilities	92	3
Increase in Actuarial Pension Liability	729	2,200
Increase in U.S. Coast Guard Military Post Employment PCS Benefits	-	6
Increase in Actuarial Health Insurance Liability	447	265
Other	4,449	(1,679)
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	5,842	913
Components not Requiring or Generating Resources		
Depreciation and Amortization	1,375	1,153
Revaluation of Assets or Liabilities	167	17
Other	662	445
Total Components of Net Cost of Operations that will not Require or Generate Resources	2,204	1,615
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	**8,046**	**2,528**
NET COST OF OPERATIONS	**$48,158**	**$42,928**

35. Explanation for the Adjustment to the FY 2008 Beginning Balances

During FY 2007, the Department was a party in allocation transfers with other Federal agencies as both a transferring (parent) entity and/or a receiving (child) entity. During FY 2007, the Department, as the parent, reported funds related to activities for the Biodefense Countermeasures Fund to the U.S. Department of Health and Human Services (HHS) in accordance with OMB Circular A-136 requirements. OMB granted DHS an exception over this fund as a parent for FY 2008 and future periods, whereby HHS will report all balances. Therefore, the balances from this fund will no longer be reported in the DHS financial statements and related footnotes beginning with FY 2008. The exemption granted by OMB does not result in a restatement or reclassification of prior year amounts.

Consequently, DHS Current Year Beginning Balances and Prior Year Ending Balances differ. The Statement of Budgetary Resources has differences for the current year and prior year balances for Unobligated Balances Brought Forward of $517 million and Unpaid Obligations of $951 million. Further, the Statement of Changes in Net Position shows adjustments to the current year beginning balance for Unexpended Appropriations of $1,468 million.

Required Supplementary Information (Unaudited)

1. Stewardship PP&E

Heritage Assets

The U.S. Coast Guard, CBP, and FEMA maintain heritage assets, located in the United States, including the Commonwealth of Puerto Rico. Heritage assets are PP&E that have historical or national significance; cultural, educational, or artistic importance; or significant architectural characteristics. Heritage assets are generally expected to be preserved indefinitely. Multi-use heritage assets have more than one purpose such as an operational purpose and historical purpose.

The following table summarizes activity related to heritage assets for the fiscal years ended September 30 (in number of units).

2008 (Unaudited)	USCG	CBP	FEMA	Total
Beginning Balance	20,549	4	1	20,554
Additions	203	-	-	203
Withdrawals	(289)	-	-	(289)
Ending Balance	**20,463**	**4**	**1**	**20,468**

2007 (Unaudited) (Restated)	USCG	CBP	FEMA	Total
Beginning Balance	20,425	4	1	20,430
Additions	278	-	-	278
Withdrawals	(154)	-	-	(154)
Ending Balance	**20,549**	**4**	**1**	**20,554**

The U.S. Coast Guard possesses artifacts that can be divided into six general areas: ship's equipment, lighthouse and other aids-to-navigation/communication items, personal use items, ordnance, artwork, and display models. Historical artifacts are also gifted to the U.S. Coast Guard. Withdrawals are made when items have deteriorated through inappropriate display, damage due to moving and transportation, or environmental degradation. Withdrawals are also made when the U.S. Coast Guard curatorial staff, in conjunction with the U.S. Coast Guard Historian, determines that an artifact does not meet the needs of the collection or is duplicated.

- Ship's equipment is generally acquired when the ship is decommissioned and includes small items such as sextants, ship's clocks, wall plaques, steering wheels, bells, binnacles, engine order telegraphs, ship's name boards, silver service items, china, and other equipment that is either unique or provides a means to education on U.S. Coast Guard history. Conditions will vary based upon use and age.

- Aids-to-navigation/communication items include fog and buoy bells, lanterns, lamp changing apparatus, lighthouse lenses, flags, trophies, and plaques. Buoy equipment is usually acquired when new technology renders the equipment obsolete. Classical lighthouse lenses can vary in condition. The condition is normally dependent on how long the item has been out of service. The lenses go to local museums or U.S. Coast Guard bases as display items.
- Personal use items are generally donated by retired U.S. Coast Guard members and include clothing as well as insignia and accessories. Most clothing is in fair to good condition, particularly full dress items.
- Ordnance includes cannons, rifles, pistols, lyle guns and associated accessories.
- Artwork consists of a mix of modern art depicting both historical and modern U.S. Coast Guard activities and the U.S. Coast Guard's collection of World War II combat art.
- Display models are mostly of U.S. Coast Guard vessels and aircraft. These are often builders' models. Display models are generally in very good condition. Builders' models are acquired by the U.S. Coast Guard as part of the contracts with the ship or aircraft builders. The withdrawal of display models normally results from excessive wear.

The U.S. Coast Guard also has non-collection type heritage assets, such as sunken vessels and aircraft, under the property clause of the U.S. Constitution, Articles 95 and 96 of the International Law of the Sea Convention, and the sovereign immunity provisions of Admiralty law. Despite the passage of time or the physical condition of these assets, they remain government-owned until the Congress of the United States formally declares them abandoned. The U.S. Coast Guard desires to retain custody of these assets to safeguard the remains of crew members lost at sea, to prevent the unauthorized handling of explosives or ordnance which may be aboard, and to preserve culturally valuable relics of the U.S. Coast Guard's long and rich tradition of service to our Nation in harm's way.

The U.S. Coast Guard does not acquire or retain heritage buildings and structures without an operational use. Most real property, even if designated as historical, is acquired for operational use and is transferred to other government agencies or public entities when no longer required for operations. Of the U.S. Coast Guard buildings and structures designated as heritage, including memorials, recreational areas, and other historical areas, over two-thirds are multi-use heritage. The remaining assets are historical lighthouses, which are no longer in use and awaiting disposal; their related assets; and a gravesite.

CBP also has four multi-use heritage assets located in Puerto Rico, and FEMA has one multi-use heritage asset that is used by the U.S. Fire Administration for training in Emmitsburg, Maryland. All multi-use heritage assets are reflected on the Balance Sheet and related footnotes. Deferred maintenance information for heritage assets and general PP&E is presented in the required supplementary information.

2. Deferred Maintenance

The Department Components use condition assessment as the method for determining the deferred maintenance for each class of asset. The procedure includes reviewing equipment, building, and other structure logistic reports. Component logistic personnel identify maintenance not performed as scheduled and establish future performance dates. Logistic personnel use a condition assessment survey to determine the status of referenced assets according to the range of conditions shown below:

Good. Facility/equipment condition meets established maintenance standards, operates efficiently, and has a normal life expectancy. Scheduled maintenance should be sufficient to maintain the current condition. There is no deferred maintenance on buildings or equipment in good condition.

Fair. Facility/equipment condition meets minimum standards but requires additional maintenance or repair to prevent further deterioration, increase operating efficiency, and to achieve normal life expectancy.

Poor. Facility/equipment does not meet most maintenance standards and requires frequent repairs to prevent accelerated deterioration and provide a minimal level of operating function. In some cases, this includes condemned or failed facilities. Based on periodic condition assessments, an indicator of condition is the percent of facilities and item of equipment in each of the good, fair, or poor categories.

Deferred maintenance as of September 30, 2008, was estimated to range from $1,062 million to $1,296 million on general property, plant, and equipment and Heritage Assets with a range of poor to good condition. In FY 2007, the Department reported estimated deferred maintenance ranging from $777 million to $1,064 million on general property, plant, and equipment and Heritage Assets with a range of poor to good condition. These amounts represent maintenance on vehicles, vessels, and buildings and structures owned by the Department that was not performed when it should have been, or was scheduled to be and was delayed for a future period.

A summary of deferred maintenance, by asset class, at September 30, 2008, is presented below (in millions):

	Low estimate	**High estimate**	**Asset Condition**
Building & Structures	$ 788	$ 948	Good to Poor
Equipment (vehicles and vessels)	270	341	Good to Fair
Heritage assets	4	7	Good to Fair
Total	**$ 1,062**	**$ 1,296**	

3. Statement of Budgetary Resources

Schedule of FY 2008 Budgetary Resources by Responsibility Segments (in millions) (page 1 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
BUDGETARY RESOURCES													
Unobligated balance, brought forward, Oct 1	$2,896	$1,666	$844	$8,482	$81	$498	$925	$433	$377	$82	$296	$765	**$17,345**
Recoveries of Prior Year Obligations	485	117	51	2,757	20	191	2	37	15	-	34	115	**3,824**
Budget Authority:													
Appropriations	11,973	9,032	2,555	18,720	289	4,993	116	1,456	1,177	1,612	829	4,901	**57,653**
Borrowing Authority	-	-	-	-	-	-	-	-	-	-	-	-	-
Spending Authority from Offsetting Collections:													
Earned:													
Collected	1,612	525	33	3,670	179	1,123	28	445	12	28	33	1,934	**9,622**
Change in Receivable from Federal Sources	(6)	-	(3)	(23)	(8)	7	4	19	-	(7)	(1)	(1)	**(19)**
Change in Unfilled Customer Orders:													
Advance Received	-	(2)	1	49	-	1	-	42	(1)	(4)	1	(3)	**84**
Without Advance From Federal Sources	(34)	(21)	6	(281)	(23)	(21)	1	-	2	1	19	(36)	**(387)**
Anticipated for Rest of Year, without advances	-	-	-	-	-	-	-	-	-	-	-	-	-
Previously Unavailable	-	-	-	-	-	-	-	-	-	-	-	-	-
Expenditure transfers from trust funds	3	45	-	-	-	-	-	-	-	-	-	-	**48**
Subtotal	13,548	9,579	2,592	22,135	437	6,103	149	1,962	1,190	1,630	881	6,795	**67,001**
Non-expenditure transfers, net; anticipated and actual	334	356	(8)	(24)	9	29	(915)	8	(6)	18	-	(11)	**(210)**
Temporarily Not Available Pursuant to Public Law	-	(14)	-	-	-	-	-	-	-	-	-	-	**(14)**
Permanently Not Available	(87)	(325)	(11)	(584)	(6)	(22)	-	(42)	(15)	(32)	-	(10)	**(1,134)**
TOTAL BUDGETARY RESOURCES	**$17,176**	**$11,379**	**$3,468**	**$32,766**	**$541**	**$6,799**	**$161**	**$2,398**	**$1,561**	**$1,698**	**$1,211**	**$7,654**	**$86,812**
STATUS OF BUDGETARY RESOURCES													
Obligations Incurred:													
Direct	12,939	9,052	2,470	14,757	285	4,909	118	1,573	1,258	1,616	989	6,859	**56,825**
Reimbursable	1,764	535	29	4,436	151	1,119	33	520	5	19	48	5	**8,664**
Subtotal	14,703	9,587	2,499	19,193	436	6,028	151	2,093	1,263	1,635	1,037	6,864	**65,489**
Unobligated Balance:													
Apportioned	8	835	536	4,193	83	357	10	255	128	15	166	642	**7,228**
Exempt from Apportionment	-	89	-	2	(1)	-	-	1	-	-	-	-	**91**
Subtotal	8	924	536	4,195	82	357	10	256	128	15	166	642	**7,319**
Unobligated Balance Not Available	2,465	868	433	9,378	23	414	-	49	170	48	8	148	**14,004**
TOTAL STATUS OF BUDGETARY RESOURCES	**$17,176**	**$11,379**	**$3,468**	**$32,766**	**$541**	**$6,799**	**$161**	**$2,398**	**$1,561**	**$1,698**	**$1,211**	**$7,654**	**$86,812**

Schedule of FY 2008 Budgetary Resources by Responsibility Segments (in millions) (page 2 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
CHANGE IN OBLIGATED BALANCES													
Obligated Balance, Net													
Unpaid obligations brought forward, Oct 1	$4,069	$3,812	$700	$25,285	$221	$2,176	$914	$1,297	$697	$333	$1,097	$2,632	**$43,233**
Uncollected customer payments from federal sources, brought forward, Oct 1	(321)	(214)	(13)	(1,661)	(134)	(431)	-	(253)	(2)	(19)	(34)	(49)	**(3,131)**
Total unpaid obligated balance, net	3,748	3,598	687	23,624	87	1,745	914	1,044	695	314	1,063	2,583	**40,102**
Obligations incurred, net	14,703	9,587	2,499	19,193	436	6,028	151	2,093	1,263	1,635	1,037	6,864	**65,489**
Gross Outlays	(12,833)	(9,394)	(2,096)	(14,900)	(468)	(5,607)	(306)	(1,741)	(965)	(1,622)	(993)	(6,434)	**(57,359)**
Obligated balance transferred, net	-	-	-	(25)	-	-	-	-	-	-	-	-	**(25)**
Recoveries of Prior Year Unpaid Obligations	(485)	(117)	(51)	(2,757)	(20)	(191)	(2)	(37)	(15)	-	(34)	(115)	**(3,824)**
Change in uncollected customer payments from Federal Sources	41	21	(2)	304	30	15	(4)	(19)	(2)	5	(18)	34	**405**
Obligated balance, net end of Period													
Unpaid Obligations	5,454	3,888	1,053	26,796	169	2,406	758	1,612	979	346	1,107	2,946	**47,514**
Uncollected customer payments from Federal Sources	(280)	(193)	(16)	(1,357)	(104)	(416)	(5)	(272)	(3)	(14)	(52)	(14)	**(2,726)**
Total, unpaid obligated balance, net, end of period	5,174	3,695	1,037	25,439	65	1,990	753	1,340	976	332	1,055	2,932	**44,788**
NET OUTLAYS													
Net Outlays													
Gross Outlays	12,833	9,394	2,096	14,900	468	5,607	306	1,741	965	1,622	993	6,434	**57,359**
Offsetting collections	(1,614)	(568)	(33)	(3,719)	(180)	(1,125)	(28)	(487)	(11)	(24)	(34)	(1,931)	**(9,754)**
Distributed offsetting receipts	(2,797)	(5)	(2,625)	37	-	(153)	-	(2)	-	(1)	-	(502)	**(6,048)**
Net Outlays	**$8,422**	**$8,821**	**$(562)**	**$11,218**	**$288**	**$4,329**	**$278**	**$1,252**	**$954**	**$1,597**	**$959**	**$4,001**	**$41,557**

Schedule of FY 2007 Budgetary Resources by Responsibility Segments (in millions) (page 1 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
BUDGETARY RESOURCES													
Unobligated balance, brought forward, Oct 1	$2,297	$1,881	$419	$9,166	$88	$654	$1,468	$218	$279	$56	$408	$375	**$17,309**
Recoveries of Prior Year Obligations	199	-	59	3,022	14	215	915	42	47	14	70	400	**4,997**
Budget Authority:													
Appropriations	11,191	8,551	2,323	10,700	275	4,209	8	1,636	965	1,494	978	4,161	**46,491**
Spending Authority from Offsetting Collections:													
Earned:													
Collected	1,514	575	35	3,803	137	1,141	-	400	-	23	35	2,636	**10,299**
Change in Receivable from Federal Sources	(34)	(11)	2	9	19	(8)	-	25	-	2	2	1	**7**
Change in Unfilled Customer Orders:													
Advance Received	(3)	38	-	42	-	(1)	-	-	2	(6)	1	5	**78**
Without Advance From Federal Sources	(20)	(8)	(14)	669	(39)	(45)	1	52	1	(4)	(2)	(17)	**574**
Previously Unavailable	-	-	-	(1)	-	-	-	-	-	-	-	1	**-**
Expenditure transfers from trust funds	3	45	-	-	-	-	-	-	-	-	-	(1)	**47**
Subtotal	12,651	9,190	2,346	15,222	392	5,296	9	2,113	968	1,509	1,014	6,786	**57,496**
Non-expenditure transfers, net; anticipated and actual	373	323	-	67	-	(8)	17	6	(4)	8	-	5	**787**
Temporarily Not Available Pursuant to Public Law	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Permanently Not Available	(102)	(222)	(12)	(135)	(3)	(28)	-	(18)	(5)	(21)	(128)	(67)	**(741)**
TOTAL BUDGETARY RESOURCES	**$15,418**	**$11,172**	**$2,812**	**$27,342**	**$491**	**$6,129**	**$2,409**	**$2,361**	**$1,285**	**$1,566**	**$1,364**	**$7,499**	**$79,848**
STATUS OF BUDGETARY RESOURCES													
Obligations Incurred:													
Direct	$11,036	$8,956	$1,939	$17,308	$288	$4,560	$966	$1,467	$908	$1,468	$1,045	$6,725	**$56,666**
Reimbursable	1,487	551	28	1,552	123	1,066	-	462	1	16	24	10	**5,320**
Subtotal	12,523	9,507	1,967	18,860	411	5,626	966	1,929	909	1,484	1,069	6,735	**61,986**
Unobligated Balance:													
Apportioned	17	923	233	5,999	64	300	528	336	170	47	291	261	**9,169**
Exempt from Apportionment	-	92	-	5	-	-	-	-	-	-	-	-	**97**
Subtotal	17	1,015	233	6,004	64	300	528	336	170	47	291	261	**9,266**
Unobligated Balance Not Available	2,878	650	612	2,478	16	203	915	96	206	35	4	503	**8,596**
TOTAL STATUS OF BUDGETARY RESOURCES	**$15,418**	**$11,172**	**$2,812**	**$27,342**	**$491**	**$6,129**	**$2,409**	**$2,361**	**$1,285**	**$1,566**	**$1,364**	**$7,499**	**$79,848**

Schedule of FY 2007 Budgetary Resources by Responsibility Segments (in millions) (page 2 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
CHANGE IN OBLIGATED BALANCES													
Obligated Balance, Net													
Unpaid obligations brought forward, Oct 1	$3,067	$3,144	$640	$27,673	$267	$1,649	$1,802	$758	$773	$307	$1,256	$2,346	**$43,682**
Uncollected customer payments from federal sources, brought forward, Oct 1	(375)	(233)	(25)	(981)	(153)	(484)	-	(175)	(1)	(21)	(34)	(69)	**(2,551)**
Total unpaid obligated balance, net	2,692	2,911	615	26,692	114	1,165	1,802	583	772	286	1,222	2,277	**41,131**
Obligations incurred, net	12,523	9,507	1,967	18,860	411	5,626	966	1,929	909	1,484	1,069	6,735	**61,986**
Gross Outlays	(11,356)	(8,839)	(1,814)	(18,208)	(443)	(4,889)	(3)	(1,348)	(926)	(1,444)	(1,153)	(6,045)	**(56,468)**
Obligated balance transferred, net	34	-	(34)	(18)	-	-	15	2	(12)	-	(5)	-	**(18)**
Recoveries of Prior Year Unpaid Obligations	(199)	-	(59)	(3,022)	(14)	(215)	(915)	(42)	(47)	(14)	(70)	(400)	**(4,997)**
Change in uncollected customer payments from Federal Sources	55	20	12	(679)	19	54	-	(81)	(1)	2	-	18	**(581)**
Obligated balance, net end of Period													
Unpaid Obligations	4,070	3,813	700	25,285	221	2,172	1,865	1,296	697	333	1,097	2,635	**44,184**
Uncollected customer payments from Federal Sources	(321)	(214)	(13)	(1,660)	(134)	(431)	-	(253)	(2)	(19)	(34)	(50)	**(3,131)**
Total, unpaid obligated balance, net, end of period	3,749	3,599	687	23,625	87	1,741	1,865	1,043	695	314	1,063	2,585	**41,053**
NET OUTLAYS													
Net Outlays													
Gross Outlays	11,356	8,839	1,814	18,208	443	4,889	3	1,348	926	1,444	1,153	6,045	**56,468**
Offsetting collections	(1,515)	(657)	(35)	(3,846)	(135)	(1,140)	-	(400)	(2)	(18)	(36)	(2,642)	**(10,426)**
Distributed offsetting receipts	(2,361)	(23)	(2,080)	(61)	(1)	(155)	(1)	2	-	-	1	(273)	**(4,952)**
Net Outlays	**$7,480**	**$8,159**	**$(301)**	**$14,301**	**$307**	**$3,594**	**$2**	**$950**	**$924**	**$1,426**	**$1,118**	**$3,130**	**$41,090**

4. Statement of Custodial Activity

Substantially all duty, tax, and fee revenues collected by CBP are remitted to various General Fund accounts maintained by Treasury and the U.S. Department of Agriculture. Treasury further distributes these revenues to other Federal agencies in accordance with various laws and regulations. CBP transfers the remaining revenue (generally less than two percent of revenues collected) directly to other Federal agencies, the Governments of Puerto Rico and the U.S. Virgin Islands, or retains funds as authorized by law or regulations. Refunds of revenues collected from import/export activities are recorded in separate accounts established for this purpose and are funded through permanent indefinite appropriations. These activities reflect the non-entity, or custodial, responsibilities that CBP, as an agency of the Federal Government, has been authorized by law to enforce.

CBP reviews selected documents to ensure all duties, taxes, and fees owed to the Federal Government are paid and all regulations are followed. If CBP believes duties, taxes, fees, fines, or penalties are due in addition to estimated amounts previously paid by the importer/violator, the importer/violator is notified of the additional amount due. CBP regulations allow the importer/violator to file a protest on the additional amount due for review by the Port Director. A protest allows the importer/violator the opportunity to submit additional documentation supporting their claim of a lower amount due or to cancel the additional amount due in its entirety. Work in progress will continue until all protest options have expired or an agreement is reached. During this protest period, CBP does not have a legal right to the importer/violator's assets, and consequently CBP recognizes accounts receivable only when the protest period has expired or an agreement is reached. For FY 2008 and FY 2007, CBP had legal right to collect $2.1 billion and $1.9 billion of receivables, respectively. There was an additional $2 billion and $2.7 billion representing records still in the protest phase for FY 2008 and FY 2007, respectively. CBP recognized as write-offs $310 million and $183 million respectively, of assessments that the Department has statutory authority to collect at September 30, 2008 and 2007, but has no future collection potential. Most of this amount represents fines, penalties, and interest.

5. Risk Assumed Information

The Department has performed an analysis of the contingencies associated with the unearned premium reserve for the NFIP. The underlying calculation estimates the amount of subsidy in the total rates, removes the expense load, and applies the results to the unearned premium reserve. The range is designed to straddle the resulting estimate. That analysis shows unearned premium reserve is less than the estimated present value of unpaid expected losses by $500 to $600 million.

Actual flood losses are highly variable from year to year. For the majority of years, this unearned premium reserve is adequate to pay the losses and expenses associated with this unearned premium. In those years with catastrophic flooding, the reserve will prove inadequate, and the average across all years will be inadequate because of the subsidies in premium levels.

Required Supplementary Stewardship Information (Unaudited)

Stewardship Investments

Stewardship investments are substantial investments made by the Federal Government for the benefit of the Nation. When incurred, stewardship investments are treated as expenses in calculating net cost, but they are separately reported as Required Supplementary Stewardship Information (RSSI) to highlight the extent of investments that are made for long-term benefit. The Department's expenditures (including carryover funds expended in FY 2008) in Human Capital and Research and Development are shown below:

Summary of Stewardship Investments (in millions)

	FY 2008	FY 2007	FY 2006	FY 2005	FY 2004
Research and Development	$880	$1,115	$1,144	$975	$364
Human Capital	78	89	29	21	8
Non-Federal Physical Property	204	394	(118)	394	496
Total	$1,162	$1,598	$1,055	$1,390	$868

1. Investments in Research and Development

Investments in Research and Development represent expenses incurred to support the search for new or refined knowledge and ideas for the application or use of such knowledge for the development of new or improved products and processes with the expectation of maintaining or increasing national productive capacity or yielding other future benefits. TSA, the U.S. Coast Guard, and S&T have made significant investments in Research and Development.

TSA

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 screening officers' capabilities, improve person-machine performance, and increase human system effectiveness, including ongoing certification testing of explosive detection systems (EDS) and explosives trace detection (ETD) technology; and infrastructure protection research related to using biometrics for passenger access controls and tracking.

Operation Safe Commerce is a pilot program that brings together private business, ports, and local, State, and Federal representatives to analyze current security procedures for cargo entering the country. 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.

<u>U.S. Coast Guard</u>

The U.S. Coast Guard Research & Development Program invests in the application of research and development projects. Following are some of the major developmental projects that are ongoing:

- Determine the most effective Unmanned Aerial System (UAS) to operate off the National Security Cutter (NSC). Provide U.S. Coast Guard leadership with the information, traceable to NSC mission needs, to support a UAS major acquisition program. Report on the capability that will provide the most value for the lowest risk to meet NSC mission needs;
- Develop a means to certify a shipboard system to insure aquatic nuisance species (ANS) have been eradicated before entering U.S. waters;
- Further develop the at-sea biometrics system that can leverage a unique, identifiable human characteristic to identify individuals encountered at sea. Partner with and leverage the databases of other government agencies; and
- Improve port security by clearly identifying/prioritizing gaps and providing support for Countermeasures Strategy (CS) development to the U.S. Coast Guard through identification of critical needs across both prevention and response phases of operations relative to threat vectors from explosives in the (surface) maritime environment.

Significant Accomplishments in Development:

- Testing small Unmanned Aerial Vehicles for greater surveillance capabilities: Developed a Modeling and Simulation (M&S) capability that can be used during a field exercise to produce a visualization tool for post test event analysis and future event planning;
- Developing and evaluating at-sea biometrics system prototype for migrant identification: Developed proof-of-concept portable biometric collections system that could be used in a maritime environment. Implemented and operated this stand-alone biometric system and delivered standard operating procedures, training package, and equipment to the U.S. Coast Guard operational entity;
- Developed specific tools that model the survivability of distressed mariners in a variety of conditions and that can be incorporated into search and rescue (SAR) planning software to provide clear and understandable operational SAR guidance and decision support tools for decision makers; and
- Developed a Sensor Visualization and Analysis Tool to visualize and assess a variety of surveillance/search concepts of operations and provide guidance on setting up sensors for the best coverage in key tactical situations.

The following major new applications developments are ongoing:

- Develop and evaluate the most promising capabilities and techniques for recovering heavy viscous oil on the ocean floor; integrate those capabilities and techniques with heavy oil detection systems;
- Conduct market research to identify and evaluate technologies that meet the broad range of current and future mission requirements on inland and intracoastal waterways while reducing the environmental impact through green technologies; and
- Compile a knowledge base of Arctic technology and activities, including those by government, industry, and foreign entities to support establishment of requirements for, and the acquisition of, appropriate U.S. Coast Guard capabilities to support our evolving Arctic missions.

Significant Accomplishments in Research:

- Conducted proof of concept evaluations of four heavy oil detection systems; selected two systems for further testing;
- Provided analysis of potential problem areas in Mass Rescue Operations and targeted opportunities for further research, as well as potential technological improvements. Documented issues that hamper efficient response, as well as the need for training and simulation capability; and
- Evaluated persistent lighter-than-air and fixed-wing aircraft concepts, including High Altitude Long Endurance UAVs that could support multi-sensor wide area surveillance payloads anchored by long-range radar.

S&T

S&T develops new standards, educates the next-generation workforce and conducts testing and evaluation activities to further increase the security of the Nation.

Major New Applications Developed During the Year:

In FY 2008, S&T made progress in the development of an automated biological threat detection system which will be piloted by the Department in FY 2009. This automated detection system will identify airborne biological agents and notify the authorities when a positive test occurs giving medical and public officials time to respond to incidents. S&T also demonstrated a prototype countermeasure to protect aircraft from shoulder fired missiles along with a remote launch detection system that would lessen the amount of technology that each plane would have to carry.

2. Investments in Human Capital

Investments in Human Capital include expenses incurred for programs to educate and train the public. These programs are intended to increase or maintain national productive capacity as evidenced by outputs and outcomes. Based on a review of the Department's programs, FEMA and TSA have made significant investments in Human Capital.

FEMA

The mission of the Center for Domestic Preparedness (CDP) is to operate a federal training center for the delivery of high-quality, comprehensive, and relevant training programs for the nation's emergency responders. The CDP training program contributes to the DHS vision of creating a safe, secure America by offering training programs that lead to an emergency response community prepared for and capable of responding to all-hazards events. Located in Anniston, Alabama, the CDP is the Nation's and the Department of Homeland Security's only federally chartered training center that provides toxic agent training to emergency responders.

TSA

The Highway Watch Cooperative Agreement between TSA and the American Trucking Association (ATA) supports 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.

3. Investments in Non-Federal Physical Property

Investments in Non-Federal Physical Property are expenses included in the calculation of net cost incurred by the reporting entity for the purchase, construction or major renovation of physical property owned by State and local governments. TSA has made significant investments in non-Federal physical property.

TSA

Airport Improvement Program. To help facilitate EDS installations, TSA purchases and installs in-line EDS equipment through a variety of funding mechanisms, including Congressionally authorized Letters of Intent (LOI). Since the modifications tend to be so expensive, the LOI is used to offset the physical modification costs incurred by commercial service airports for the modifications. TSA issued eight LOIs in FY2007 and another three agreements in FY 2008.

Airport Renovation Program. Another funding mechanism employed by TSA are Other Transaction Agreements (OTA) that exist for one year and establish the respective cost-sharing obligations and other responsibilities of the TSA and the specific entity (Board, Port, or Authority) related not only to the installation of integrated and non-integrated EDS and ETD equipment, but also to the improvements to be made to the existing systems in the baggage handling area. TSA entered into OTAs with 27 airports in FY2007 and another 15 in FY2008. 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. TSA has not had any programmatic or administrative responsibilities for this grant program since FY 2004.

Intercity Bus Security Program. This program provides funds to improve security for operators of fixed route intercity and charter bus services. TSA awards grants based on the users of funds outlined in section 1532(b) of Public Law 110-53, more commonly known as the "9/11 Act." Funding priorities reflect the Department's overall investment strategy, including risk-based funding and regional security cooperation. Funding priorities are collaboratively developed with transit security partners based on threat, vulnerabilities, and transit system assessment results. Priority is given to projects that can be implemented quickly, and have a high return on investment. By developing clear funding priorities and a scoring methodology that reflects those priorities and risk, TSA is able to ensure that grant dollars are spent appropriately.

Other Accompanying Information

The ***Other Accompanying Information*** section contains information on Tax Burden/Tax Gap, Summary of Financial Statement Audit and Management Assurances, Improper Payments Act, and Other Key Regulatory Requirements. Also included in this section is the OIG Report on the Major Management Challenges Facing the Department of Homeland Security followed by a Management Response.

Tax Burden/Tax Gap

Revenue Gap

The Compliance Measurement Program collects objective statistical data to determine the compliance level of commercial imports with U.S. trade laws, regulations and agreements, and is used to estimate the revenue gap.

The revenue gap is a calculated estimate that measures potential loss of revenue owing to noncompliance with trade laws, regulations, and agreements using a statistically valid sample of the revenue losses and overpayments detected during Compliance Measurement entry summary reviews conducted throughout the year.

For FY 2007 and 2006, the estimated revenue gap was $412 and $450 million, respectively. The preliminary estimated revenue gap for FY 2008 is $347 million. The preliminary estimated over-collection and under-collection amounts due to noncompliance for FY 2008 were $70 and $417 million, respectively. The preliminary estimated over-collection and under-collection amounts due to noncompliance for FY 2007 were $90 and $502 million, respectively. The preliminary overall trade compliance rate for FY 2008 and FY 2007 is 98 and 98.1 percent respectively. With overall compliance at a high level, CBP has been able to emphasize matters of significant trade risk.

The final overall trade compliance rate and estimated revenue gap for FY 2008 will be issued in February 2009.

Summary of Financial Statement Audit and Management Assurances

Table 8 and Table 9 below provide a summary of the financial statement audit and management assurances for FY 2008.

Table 8. FY 2008 Summary of the Financial Statement Audit

Audit Opinion	Disclaimer				
Restatement	Yes				
Material Weakness	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Ending Balance**
Financial Management and Entity-Level Controls	1		✓		0
Financial Reporting	1	✓	✓		1
Financial Systems Security	1				1
Fund Balance with Treasury	1				1
Capital Assets and Supplies	1	✓	✓		1
Actuarial and Other Liabilities	1	✓	✓		1
Budgetary Accounting	1	✓	✓		1
Total Material Weaknesses	**7**	**4**	**(5)**	**0**	**6**

The Department's Independent Public Auditor reported six material weakness conditions at the Department level in FY 2008, a reduction from the seven reported in FY 2007. This improvement reflects a decrease in the severity of Financial Management and Entity-Level Control conditions at U.S. Coast Guard and FEMA from a material weakness in FY 2007 to a significant deficiency in FY 2008. Portions of other material weakness conditions were resolved. However, new conditions were identified causing the other material weaknesses to repeat at the consolidated level. For example, the DHS OCFO resolved its Financial Reporting material weakness conditions but TSA's prior year significant deficiency in Financial Reporting was elevated to a material weakness condition. Similarly, FEMA resolved its prior year material weakness conditions for Capital Assets and Supplies related to stockpile inventory but a new material weakness condition associated with internal use software was identified at FEMA and TSA. FEMA also resolved its Other Liabilities material weakness conditions related to grant accruals but new significant deficiencies were identified related to environmental liabilities at ICE, FLETC, and S&T. As a result, the Actuarial and Other Liabilities material weakness repeated. Finally, FEMA and TSA resolved prior year conditions for Budgetary Accounting. However, new conditions were identified with undelivered orders at FEMA causing this material weakness to repeat.

Table 9. FY 2008 Summary of Management Assurances

Effectiveness of Internal Control Over Financial Reporting (FMFIA Section 2)						
Statement of Assurance	No Assurance					
Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
Entity Level Controls	1		✓			0
General Ledger Management: Including Financial Reporting and Intragovernmental Reconciliations	1	✓	✓			1
Fund Balances with Treasury	1					1
Financial Systems Security	1					1
Budgetary Resource Management	1	✓	✓			1
Property Management	1	✓	✓			1
Grants Management	1				✓	0
Insurance Management	1				✓	0
Human Resource and Management	1					1
Total Material Weaknesses	**9**	**3**	**(4)**	**0**	**(2)**	**6**
Effectiveness of Internal Controls over Operations (FMFIA Section 2)						
Statement of Assurance	Qualified					
Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
Entity Level Controls	1					1
Improper Payments Information Act	1					1
Anti-Deficiency Act Controls	1					1
Security Controls over Collection and Depositing of Fees	1					1
Federal Protective Service Transformation	1					1
DHS Headquarters Consolidation	1				✓	0
Acquisition Management	1					1
Human Capital Management	1					1
Information Technology Management	1				✓	0
Long Term Strategic Planning and Outcome Based Management	1				✓	0
Grants Management	0	✓				1
Administrative Management	0	✓				1
US-VISIT System Security	0	✓				1
Total Material Weaknesses	**10**	**3**	**0**	**0**	**(3)**	**10**
Conformance with financial management systems requirements (FMFIA Section 4)						
Statement of Assurance	Systems do not conform to financial management systems requirements					
Non-Conformances	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
Federal Financial Management Systems Requirements, including Financial Systems Security and Integrated Financial Management Systems	1					1
Noncompliance with the U.S. Standard General Ledger	1					1
Federal Accounting Standards	1					1
Total Non-conformances	**3**	**0**	**0**	**0**	**0**	**3**

Compliance with Federal Financial Management Improvement Act (FFMIA)	DHS	Auditor
Overall Susbstantial Compliance	No	No
1. System Requirements	No	
2. Accounting Standards	No	
3. USSGL at Transaction Level	No	

Effectiveness of Internal Control Over Financial Reporting

Pursuant to the DHS FAA, the Department focused its efforts on corrective actions to design and implement Department-wide internal controls. Although the Secretary made no assertion about the operating effectiveness of internal controls over financial reporting, a qualified assurance on the design effectiveness was provided to appropriately represent the status of DHS's corrective action efforts and to facilitate implementation of the Act's audit opinion requirement.

The Secretary reported six material weakness conditions at the Department level in FY 2008, which is reduced from nine reported in FY 2007. Most significantly, the U.S. Coast Guard and FEMA implemented corrective actions to reduce the severity of the prior year Entity-Level Control material weaknesses to reportable conditions. Management concurred with the material weakness conditions reported by independent audit. Additions and deletions to beginning balances are consistent with the summary of financial statement audit results described above. Grants Management was reassessed and reported as an internal control over operations material weakness condition. In addition, Insurance Management at FEMA was reassessed and was considered a supporting condition of Financial Reporting at FEMA as opposed to a stand alone material weakness condition. Differences between condition titles reported by DHS Management and the Independent Public Auditor (IPA) are due to the Department's grouping of material weakness conditions by financial management processes as defined by the General Services Administration's Financial Systems Integration Office (FSIO). The FSIO process definitions used by management aid corrective actions and facilitate development of standard controls and business processes.

Significant internal control challenges remain at U.S. Coast Guard, FEMA, and TSA. To support these Components, the Department's Chief Financial Officer will conduct monthly corrective action meetings with Senior Management and weekly working group meetings with Senior Staff. Table 10 below summarizes material weaknesses in internal controls as well as planned corrective actions with estimated target correction dates.

Table 10. FY 2008 Internal Controls Corrective Actions

Material Weaknesses in Internal Controls Over Financial Reporting	Year Identified	DHS Component	Corrective Actions	Target Correction Date
Financial Reporting: U.S. Coast Guard, TSA, and FEMA have not established an effective financial reporting process due to limited staffing resources, informal policies and procedures, and lack of integrated financial processes and systems.	FY 2003	U.S. Coast Guard, TSA, and FEMA	The DHS OCFO corrected prior year financial reporting conditions and will continue efforts to support U.S. Coast Guard, TSA, and FEMA in implementing corrective actions to address staffing shortfalls and develop policies and procedures to establish effective financial reporting control activities.	FY 2010
Financial Systems Information Technology (IT) Controls: The Department's Independent Public Auditor had identified Financial Systems Security as a material weakness in internal controls since FY 2003 due to a myriad of inherited control deficiencies surrounding general computer and application controls. The *Federal Information Security Management Act* mandates that Federal Agencies maintain IT security programs in accordance with OMB and National Institute of Standards and Technology guidance.	FY 2003	U.S. Coast Guard, TSA, and FEMA	Prior year Department-wide IT control findings were reduced by 40 percent. Additional financial audit support for U.S. Coast Guard, FEMA, and TSA will be provided from the Offices of the Chief Financial Officer and the Chief Information Security Officer in order to design and implement internal controls in accordance with *DHS 4300A Sensitive Systems Handbook, Attachment R: Compliance Framework for CFO Designated Financial Systems.*	FY 2010
Fund Balance with Treasury: U.S. Coast Guard did not implement effective internal controls to accurately clear suspense transactions in order to perform accurate and timely reconciliations of Fund Balance with Treasury accounts.	FY 2004	U.S. Coast Guard	U.S. Coast Guard will develop short term compensating controls to reconcile significant payroll classes of transactions, while longer term corrective actions are implemented to sustain Fund Balance with Treasury Reconciliations.	FY 2010
Capital Assets and Supplies: The controls and related processes surrounding U.S. Coast Guard Property Plant and Equipment (PPE) and Operating Materials and Supplies (OMS) to accurately and consistently record activity are either not in place or contain errors and omissions. FEMA and TSA have not implemented policies and procedures to identify and account for software capitalization in accordance with Statement of Federal Financial Accounting Standard (SFFAS) No. 10, *Accounting for Internal Use Software* .	FY 2003	U.S. Coast Guard, TSA, and FEMA	FEMA implemented corrective actions to address the prior year material weakness condition related to stockpile inventory. U.S. Coast Guard will implement policies and procedures to support completeness, existence, and valuation assertions for PPE and OMS. In addition, acquisition, construction, improvement, and construction in progress controls will be implemented to properly capitalize PPE. FEMA and TSA will develop policies and procedures to account for software capitalization in accordance with SFFAS No. 10.	FY 2010
Actuarial Liabilities and Other Liabilities: U.S. Coast Guard has not implemented policies and procedures to account for actuarial liabilities. In addition, internal control weaknesses exist in developing estimates for accounts payable and environmental liabilities at U.S. Coast Guard. New significant deficiencies were identified related to environmental liabilities at ICE, FLETC, and S&T, which contributed to repeating the Actuarial and Other Liabilities material weakness.	FY 2006	U.S. Coast Guard	TSA implemented corrective actions to address the prior year material weakness condition related to unfunded employee leave. In addition, FEMA reduced the severity of its prior year grant accrual material weakness condition. U.S. Coast Guard will implement corrective actions to support financial assertions for the Actuarial Pension Liability associated with unfunded military retirement pay by improving data quality and establishing controls at servicing personnel offices. The DHS OCFO will support U.S. Coast Guard, ICE, FLETC, and S&T in developing a cross cutting corrective action plan for environmental liabilities.	FY 2010
Budgetary Accounting: Policies and procedures over obligations, disbursements, and validation and verification of undelivered orders for accurate recording of accounts payable were not effective.	FY 2004	U.S. Coast Guard and FEMA	TSA corrected its portion of the prior year budgetary accounting material weakness. In addition, FEMA implemented corrective actions to improve the deobligation of mission assignments, however new corrective actions will need to be developed for other FEMA undelivered orders. U.S. Coast Guard developed corrective actions to improve budgetary accounting however corrective actions may extend beyond FY 2010 due to resource constraints and magnitude of other corrective actions.	FY 2010

Effectiveness of Internal Control Over Operations

The DHS Management Directorate is dedicated to ensuring that Departmental Offices and Components perform as an integrated and cohesive organization, focused on leading the national effort to secure America. Critical to this mission is a strong internal control structure. As we strengthen and unify DHS operations and management, we will continually assess and evaluate internal control to evaluate our progress in ensuring the effectiveness and efficiency of operations and compliance with laws and regulations. For the second consecutive year, we have made tremendous progress in strengthening Department wide internal controls, as evidenced by the following FY 2008 achievements:

- Reinvigorated the Department's Senior Management Council to establish mechanisms to provide corrective action governance and oversight.
- Finalized the Department's Strategic Plan and strengthened performance management.
- Established a Departmental acquisition oversight function and conducted reviews of five Level One Programs with an aggregate value of $26 billion.
- Successfully migrated fifty-one application systems to the first enterprise data center and took delivery of 10,000 square feet of raised floor at a second data center. There are thirty-nine migration projects for both centers now in progress.
- Implemented a standard E-mail system (Microsoft Exchange) across the enterprise and established a unified address list for the entire Department, improving departmental communications.
- Implemented web based shipping procedures to drive operational efficiencies and improvements.
- Updated the DHS Headquarters Continuity of Operations Plan with new operational concepts and operational procedures for the Department to better respond internally to continuity of operations events.
- Led a complete Mission Essential Function and Primary Mission Essential Function analysis for the Department in support of Homeland Security Presidential Directive (HSPD) 20 implementation.
- Implemented HSPD-12 to strengthen security employee identification and the State and Local Field Coordinator Program; conducted six security compliance reviews; continued the Defensive Counterintelligence Program in conjunction with the Office of Intelligence and Analysis; and trained more than 10,000 DHS employees in security awareness issues.
- Addressed strategic human capital priorities through the development of the FY 09-13 DHS Human Capital Strategic Plan and implemented the DHS University System as defined by the Learning and Development Strategic Plan; established the DHS Diversity Strategy and Council; and launched action plans to address concerns raised in the Annual Employee Surveys.

For the first time, Mission Action Plans were prepared for internal control over operations. During the year, responsible officials briefed the DHS Senior Management Council on the status of corrective actions for material weaknesses identified in their component heads annual assurance statement to the Secretary. Corrective actions were completed at TSA and USCIS as described below:

- TSA Personnel Data Security was identified in May 2007 when a portable storage device containing sensitive personnel data on TSA employees was reported missing. Immediate action was taken to remedy the known deficiency and all corrective actions have been completed to prevent future recurrences.
- USCIS IT Management: Internal control assessments in FY 2007 by USCIS' Office of Information Technology disclosed serious internal control weaknesses. Corrective actions to be completed, starting in FY 2006, were captured in the Mission Action Plan. Critical actions to remedy this issue were completed this fiscal year, including assessing the

qualifications of IT staff and updating training requirements, position descriptions and performance work plans.

For the following two Mission Action Plans, all corrective actions were completed. However, additional reviews and/or an expansion of the scope of the challenge will require DHS Components to develop re-baselined Mission Action Plans for FY 2009 with new milestones.

- CBP Laptop Security: All the milestones identified in the FY 2008 Mission Action Plan were completed, including reviewing documentation on disposing laptops to assure offices are complying with guidance for disposals, performing semi-annual inventories of laptops, and conducting two site visits per month to perform laptop reviews. New controls and training have been implemented; and while significant progress has been made, additional controls and monitoring are still required given the number of laptops at CBP. Therefore, CBP will have a FY 2009 Mission Action Plan on Laptop Security, with corrective actions and milestones.
- USCIS Security of Controls over Collection and Depositing Fees: All the actions identified in the Mission Action Plan to resolve the reported Material Weakness were completed. These included steps to correct deficiencies identified at USCIS' Texas Service Center. USCIS' ultimate solution is to transition the processing of applications and fees to a lockbox environment. Steps to complete the transition to a lockbox environment are still in process. During FY 2008, USCIS assessed the application and fee collection processes at the California and Nebraska Service Centers and identified weaknesses. This assessment completed USCIS' internal control testing of application and fee collection processes for all four of its Service Centers. Consequently, while the actions identified in the FY 2008 Mission Action Plan pertaining to the security over the front log of applications and fees and the deposit of fees within Department of Treasury guidelines were completed, USCIS is developing a new Mission Action Plan in the area of general security over applications and fees for all USCIS Service Centers for FY 2009, with new milestones identified, to address new findings.

Work continues for the following Mission Action Plans, which have, or will have, milestones extending beyond FY 2008:

- Human Capital Management: The Human Capital Management Mission Action Plan was based on the FY 2007-2008 Human Capital Operational Plan, which identified short-term initiatives that supported the long-term outcomes of integrating programs for hiring, retention, training and development, and performance. Half of the critical milestones targeted for completion by the end of this fiscal year were completed, including deploying e-Recruitment at Headquarters, providing standards and model for the nine mandatory training activities, and meeting FY 2008 hiring targets. During FY 2008, the Office of the Chief Human Capital Officer (OCHCO) experienced a significant backlog in staffing actions that impacted DHS Headquarter organizations. This backlog arose due to a significant increase (surge) in staffing actions for NPPD and human capital contractor services transitioning from one provider to another during the NPPD surge. Corrective actions were taken, resulting in a full elimination of the backlog. OCHCO has developed a new strategic plan, and the implementation of this new strategic plan will be the basis for an updated Human Capital Management Mission Action Plan beginning in FY 2009.

- Acquisition Management: One of the three critical milestones identified for completion this year was accomplished. The Office of the Chief Procurement Officer briefed the Acting Deputy Secretary on the results of Program Quick Looks to examine the current status and priority of major programs. The second milestone, which was not completed, involved modifying Management Directive 0003 to provide DHS-wide coverage and expanding contracting to acquisition. USSS has not agreed to the modification eliminating their exemption from Headquarters oversight. The third milestone to update Management Directive 1400, Investment Review Process, is near completion. The document has been drafted into a more comprehensive directive (102-01) and will be implemented by November 2008.
- CBP Secure Border Initiative Acquisition: Correcting weaknesses identified in the Secure Border Initiative's acquisition organization and processes is a long-term process, as reflected in the Mission Action Plan’s target completion date of September 30, 2009. Only three of ten critical milestones were targeted for completion by the end of this fiscal year. Two milestones were completed: 1) Creating a SBI Acquisition Office (completed in FY 2007); and 2) Establishing Executive Level SBI Governance Structure within CBP (completed in FY 2008). One critical milestone, to develop and implement a process for program and milestone review and approvals within Secure Border Initiative and CBP was targeted for completion in FY 2008 and is in progress, but not yet completed. Reviews have been conducted since early summer, but the policy and procedures that formally document the process have not yet been completed. For the remaining critical milestones, work is planned or in progress.
- U.S. Coast Guard Deepwater Acquisition: Substantial progress has been made to address internal control deficiencies in the Deepwater acquisition program and work continues to implement controls and monitor compliance in areas of acquisition, design, delivery, program management, contractor accountability, human capital, and cost control. Of 102 identified critical milestones, 67 percent have been completed. The target completion date for this Mission Action Plan is July 1, 2009.
- Federal Protective Service (FPS) Transformation: All of the 45 milestones identified in the FPS Transformation Mission Action Plan were targeted for completion by October 1, 2008. Of these, 17 milestones were completed. While significant progress has been made, FPS still does not have the optimal number of resources to fully execute its financial management and budget functions while implementing all of the necessary internal controls. During FY 2008, FPS made significant efforts to meet the goals and objectives included in their Mission Action Plan by undergoing key transformations while it worked to execute its DHS mission with the right resources as proposed in the President’s FY 2009 budget. Ongoing FPS efforts are focused on ensuring that FPS operations are effective and efficient, the organization is meeting its mandate and customer requirements, and that it has the right people in the right positions.
- FEMA Improper Payments Information Act: While FEMA continues to be non-compliant with IPIA, substantial progress was made in completing the critical milestones identified in FEMA’s Mission Action Plan. Most of the milestones related to two programs, the Individuals and Households Program and the Disaster Relief Program Vendor Payments. Of the 13 critical milestones that were not completed, one milestone was to conduct statistically valid testing to estimate improper payments for all FEMA high-risk programs, and another was to conduct a recovery audit of contract payments. Both tasks are key components of a successful IPIA program. To address the former, a test pilot was conducted this year,

enabling FEMA to develop methodologies to sample test four high-risk grant programs and the National Flood Insurance Program in the future.

Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires Federal agencies to implement and maintain financial management systems that comply substantially with:

- Federal financial management system requirements;
- Applicable Federal accounting standards; and
- The U.S. Standard General Ledger at the transaction level.

In assessing compliance with FFMIA, DHS utilizes OMB guidance and considers the results of the OIG, annual financial statement audits, and Federal Information Security Management Act (FISMA) compliance reviews. As reported in the Secretary's Management Assurance Statements, DHS financial management systems do not substantially conform to government-wide requirements. However, significant consolidation efforts are in progress to modernize, certify, and accredit all financial management systems.

Financial Management Systems Framework

The President's Management Agenda: The President's Management Agenda (PMA) specifies that a clean financial audit and timely, useful, and reliable financial information are critical to improving financial and budget management performance government-wide. In support of these PMA objectives, the DHS Office of the Chief Financial Officer (OCFO) has undertaken a Department-wide initiative to consolidate 13 disparate baselines. A top priority for the OCFO, this initiative is part of the strategic DHS financial management framework that addresses a full range of issues in the areas of people, policy, process, systems, and assurance to achieve the goals of the PMA and the Department.

Financial Management Systems Strategy and Vision: Transformation and Systems Consolidation (TASC) is an effort to consolidate financial management systems across DHS with a focus on standardizing and centralizing business processes, moving to a single OMB-compliant accounting line, facilitating clean audit opinions and yielding timely and accurate financial data. On March 17, 2008, the U.S. Court of Federal Claims issued a ruling adverse to the Department. The revised TASC acquisition strategy is moving forward under a full-and-open competition to include a broader range of technology solutions already existing in the federal space. A Request for Information (RFI) was released to industry in May 2008. Twenty industry responses were received and 10 meetings conducted between industry and DHS headquarters/component representatives. A draft RFP was released in October 2008. The award date is approximated for quarter two 2009.

The Under Secretary for Management, Chief Financial Officer, Chief Information Officer, Chief Procurement Officer, and the Chief Administrative Officer are unified in achieving efficiencies in business processes and in the systems used throughout DHS.

Benefits and Compliance: The TASC initiative facilitates compliance with applicable Federal laws and regulations and satisfies the requirements of the PMA for improving financial and budget management government-wide by:

- Supporting an OMB-compliant accounting line to provide DHS decision makers with more accurate, timely, and reliable reporting;
- Strengthening Department-wide financial accountability, moving DHS closer to a sustainable clean audit opinion;
- Providing the foundation for effective internal controls and segregation of duties supported by a compliant software baseline;
- Removing manual processes and strengthening internal controls;
- Utilizing real-time interoperability to streamline reporting across the financial management enterprise;
- Supporting an approved Chart of Accounts compliant with the United States Standard General Ledger (USSGL) and OMB Circular A-127;
- Ensuring compliance with the National Institute of Standards and Technology Special Publication 800-53 – Recommended Security Controls for Federal Information Systems and the GAO's Federal Information System Controls Audit Manual;
- Achieving Financial Management Line of Business compliance by standardizing data collection and transaction processes throughout the organization; and
- Providing optimal mission support through efficient finance, procurement, and asset management operations and business processes.

Federal Information Security Management Act (FISMA)

The E-Government Act of 2002 (Public Law 107-347) Title III FISMA provides a framework to ensure the effectiveness of security controls over information resources that support Federal operations and assets. FISMA provides a statutory definition for information security.

The U.S. Department of Homeland Security *2008 Federal Information Security Management Act (FISMA) Report and Privacy Management Report* consolidated reports from three DHS offices:

- Chief Information Officer (CIO) / Chief Information Security Officer (CISO);
- Inspector General (OIG); and
- Privacy Office.

In FY 2008, the Department continued to implement improvements to the DHS information system security program, and the CIO documented improvements in the following areas of FISMA:

- Information Systems Inventory;
- Certification and Accreditation;
- Plan of Action and Milestones;
- Configuration Management;
- Incident Detection, Handling and Analysis;
- Security Training; and
- Privacy.

FISMA Department Oversight - Policy and Procedures

A number of policy updates to the DHS Sensitive Systems Policy (DHS 4300A) were issued over the past year and are published on the DHS intranet Web site at the CISO home page.

The Department uses two enterprise tools for facilitating agency-wide security management and compliance tracking against DHS policies and procedures, and a number of procedural updates were provided during the course of the year. These tools serve as the basis for generating monthly FISMA scorecards to the Components that track six compliance metrics for both classified and unclassified systems. The six compliance metrics include:

- Annual testing (system tests and evaluations and annual self-assessments);
- Plans of action and milestones (POA&Ms);
- Certifications and accreditation (C&A);
- Configuration management;
- Incident reporting; and
- Information security training.

The latest DHS 4300A Version 6.1, dated September 23, 2008, includes security control tests and reporting requirements for CFO-designated financial systems that must be performed annually. These controls and requirements were based on OMB Circular A-123, and grouped into the following control domains:

- Entity-wide security program planning and management;
- Access controls;
- Application software development and change control;
- System software;
- Service continuity; and
- Segregation of duties.

Information System Inventory

In FY 2008, DHS maintained a single inventory of its sensitive but unclassified general support systems and major applications, including contractor owned and operated systems, as illustrated below. The DHS inventory remains under strict change control processes and all additions, deletions, or changes to the Component's inventory are tracked by the Department to ensure completeness. The Department identified 591 information systems in FY 2008, as shown in the table below.

Table 11. DHS FY 2006 - 2008 System Inventory Breakdown

Type of System	FY 2006	FY 2007	FY 2008
DHS-Owned Systems	486	396	376
Contractor Owned/Operated	206	207	215
Total	692	603	591

In addition, the Department conducts site visits at Components to identify systems that were not included in the annual inventory update process.

The FY 2009 DHS Information Security Performance Plan requires the DHS Inventory Team to participate in the certification and accreditation (C&A) approval process to ensure that system boundary definitions and subsystems are identified and documented.

Certification and Accreditation

As part of the Department's FY 2008 Information Security Performance Plan, the CIO raised the bar on accuracy and completeness of ten artifacts used to support the DHS system certification and accreditation process. The ten artifacts include:

- FIPS 199 Assessment;
- Authority to Operate Accreditation Letter;
- System Security Plan;
- Security Assessment Report;
- Risk Assessment;
- Security Test & Evaluation Plan;
- Contingency Plan;
- Contingency Plan Test Results;
- E-authentication Analysis; and
- Privacy Threshold Analysis.

DHS established monthly metrics to monitor Component C&A compliance against published criteria in order to ensure the ten C&A documents met departmental standards. The Department's Chief Information Officer has documented significant improvements in key system certification and accreditation areas, as shown in the table below.

Table 12. DHS Certification and Accreditation Improvements

C&A Improvement	FY 2006		FY 2007		FY 2008	
	Number	Percent	Number	Percent	Number	Percent
Systems C&A'd	589	85	506	84[a]	560	95
Control Testing	613	89	579	96	584	99
Contingency Plan Testing	413	60	507	84	552	93
Total Systems	692	--	603	--	591	--

[a]One Component failed to provide completed C&A packages for 26 percent of its systems. This significantly reduced the Department's total for accredited systems

The Department's FY 2009 Information Security Performance Plan incorporates additional metrics for reviewing and approving C&A related documents. All Component C&A packages must be approved by the Component CISO prior to Headquarters review and all C&A artifacts will have the same approval and expiration dates. The Department also plans to perform continuous monitoring of key security controls, including key financial system security controls and system configuration controls.

Plans of Action and Milestones (POA&M)

In FY 2008, the Department continued to improve Component POA&M oversight, adding a number of quality checks, as well as, new requirements for managing and closing POA&Ms within reasonable timeframes for the scorecard. A "reasonableness" matrix was developed to allow POA&M schedules and resources to be checked automatically to ensure that both were realistic. Additionally, the DHS POA&M Process Guide (Attachment H of DHS 4300A) was updated to address issues raised in OIG audit reports. In particular, root cause analysis was included as part of the PO&AM process and a new attachment detailing a root cause analysis process and worksheet were added. POA&M scorecards and detailed completeness reports were distributed to the Information System Security Managers (ISSMs) and Component POA&M point-of-contacts daily. The POA&M scorecard measured the following six key elements:

- POA&M quality;
- System POA&M closure within one year;
- All audit recommendations captured;
- POA&Ms less than 90 days overdue;
- POA&Ms are validated and approved by Component ISSMs; and
- POA&M remediation schedules and resources are reasonable.

As of July 31, 2008, 99 percent (586 out of 591) of the Department's systems had no deficiency in any POA&M element.

To help in these efforts, CISO staff provided POA&M related training to more than 500 ISSO and compliance staff personnel in FY 2008. Training included 39 site visits to 16 different Components as well as three sessions at the DHS FY 2008 Security Conference held in Baltimore, Maryland.

The Department's FY 2009 Information Security Performance Plan addresses all of the FY 2008 OIG recommendations for POA&M improvements and new policies and procedures have been developed to ensure that the root causes of each weakness is addressed in a POA&M. Additional Departmental oversight is now planned to ensure that:

- All system acquisition and security architecture related weaknesses are captured in a POA&M;
- New system POA&Ms are scheduled for completion within a 6 month period; and
- Existing system POA&Ms are closed within 1 year.

Configuration Management

During FY 2008, the Department strengthened its oversight at the Components and conducted 15 compliance reviews of Component level configuration management processes. In addition, the Department issued a baseline configuration guide for the Components to follow when configuring their Windows Vista workstations.

The Department's FY 2009 Information Security Performance Plan incorporates additional requirements to further the continuous monitoring process for configuration management at the system level.

Incident Detection, Handling, and Analysis

In FY 2008, the Department continued to provide employees specialized training on the Departments' security incidents handling policies and procedures through its annual security awareness program. The DHS Security Operations Center (SOC) also implemented a comprehensive vulnerability alert, assessment, remediation, and reporting process to more effectively identify computer security vulnerabilities as part of a department-wide vulnerability assessment program. The SOC performed comprehensive vulnerability assessment scans at three components during FY 2008.

During FY 2009, the Department plans to increase the percentage of Component systems visible to the DHS SOC's vulnerability assessment scans and perform more vulnerability assessment reviews.

Security Training

In FY 2008, the Office of Human Capital implemented a department-wide web-based learning management system "*DHScovery*" to provide standardized security awareness training across the Department and track employee completion of training. In addition, the Department continued to provide a high level of security awareness and specialized security training to its employees as the table below illustrates.

Table 13. DHS Security Training Improvements

Security Training	FY 2006		FY 2007		FY 2008	
	Number	Percent	Number	Percent	Number	Percent
Total Employees	207,776	--	220,149	--	231,425	--
Employees Receiving Awareness Training	155,212	74	209,309	95	222,694	96
Employees w/Specialized Security Responsibilities	1,277	--	1,372	--	2100	--
Employees Receiving Specialized Training	1,283[1]	99	1,352	99	1967	94

1. One Component reported training provided to non-Federal employees.

At the 2008 DHS Security Conference and Workshop, the Chief Information Security Officer and Chief Security Officer presented the following tracks that focused on specialized information security topics:

- ISSO Roles and Responsibilities: Introductory Level;
- ISSO Roles and Responsibilities: Experienced Level;
- C&A for Designated Accreditation Authorities and Program Managers;
- DHS Security Management Tools;
- IT Security for CFO-Designated Financial Systems;
- Security Essentials;
- Information Security Policy and Architecture;
- Security Assessments;
- Identity Management;
- Operations and Security; and
- Privacy Policy.

These topics form the basis for defining DHS specific specialized training requirements. The Department's FY 2009 Information Security Performance Plan will incorporate additional requirements to address the OIG recommendations to track individuals and establish appropriate training.

FISMA Summary

In FY 2008, the OIG reported that the Department continued to improve and strengthen its enterprise-wide security program and show improvement in four key performance areas: POA&M weakness remediation, quality of C&As, annual testing and validation, and security program oversight. The OIG report, "Evaluation of DHS's Information Security Program for Fiscal Year 2008," identified seven recommendations for information security improvements and two recommendations for privacy compliance. POA&Ms have been developed to resolve the information security weaknesses identified in the OIG report. The OCIO plans to utilize the FY 2009 Information Security Performance Plan's enhanced metrics to further improve compliance.

The Department's requirements to support privacy controls has increased. Currently, 288 systems in the DHS inventory contain personally identifiable information; 169 systems require a privacy impact assessment; and 265 systems require systems of records notice. The privacy office is working to improve compliance in these areas and has published policies to address privacy breach notifications, and rules of behavior and consequences for failures to comply. Additional plans have also been prepared to eliminate unnecessary use of social security numbers and reduce usage of personally identifiable information.

Improper Payments Information Act

The *Improper Payments Information Act* (IPIA) of 2002 (P.L. No. 107-300) requires agencies to review their programs and activities to identify those susceptible to significant improper payments. In addition, the *Defense Authorization Act* (P.L. No. 107-107) established the requirement for government agencies to carry out cost-effective programs for identifying and recovering overpayments made to contractors, also known as "Recovery Auditing." OMB has established specific reporting requirements for agencies with programs that possess a significant risk of improper payments and for reporting on the results of recovery auditing activities.

I. Risk Assessments

In FY 2008, risk assessments were conducted on 74 DHS programs, totaling $52 billion in FY 2007 disbursements. Assessments were not conducted on programs with disbursements less than $10 million ($50 million at FEMA). Two FEMA Disaster Relief Programs, Individuals and Households Program (IHP) and Vendor Payments, were not risk-assessed as they had well established high-risk error measurements and corrective actions established from prior year testing. FEMA also excluded Mission Assignments and the Technology Transfer Program from the scope of their IPIA work. In FY 2007, DHS risk assessments included all payments (contracts, payroll, grants, travel, etc) except intra-governmental payments. In FY 2008, DHS risk assessments were expanded to include all payments.

The susceptibility of programs to significant improper payments was determined by qualitative and quantitative factors. These factors included:

<u>Payment Processing Controls</u> – Management's implementation of internal controls over payment processes including existence of current documentation, the assessment of design and operating effectiveness of internal controls over payments, and the identification of deficiencies related to payment processes.

<u>Quality of Internal Monitoring Controls</u> – Periodic internal program reviews to determine if payments are made properly.

<u>Human Capital</u> – Level of turnover and average tenure of program staff.

<u>Complexity of Program</u> – Time program has been operating. Complexity and variability of interpreting and applying laws, regulations, and standards required of the program.

<u>Nature of Payments</u> – Type, volume, and size of payments. Length of payment period.

<u>Operating Environment</u> – Existence of factors which necessitate or allow for loosening of financial controls. Any known instances of fraud.

<u>Additional Grant programs factors</u> – Federal Audit Clearinghouse information on quality of controls within grant recipients. Identification of deficiencies or history of improper payments within recipients. Type and size of program recipients and sub-recipients. Maturity of recipients' financial infrastructure, experience with administering Federal payments, number of vendors being paid, and number of layers of sub-grantees.

A weighted average of these qualitative factors was calculated. This figure was then weighted with the size of the payment population to calculate an overall risk score. Scoring was done on a 1 (low) to 5 (high) scale. Programs with an overall score of 3 or above were considered to be high-risk for issuing improper payments.

Based on this year's assessment process, the following programs were deemed to be vulnerable to significant improper payments:

Table 14. Programs at High-Risk for Improper Payments Based on FY 2008 Risk Assessments and Prior Year Payment Sample Testing

Component	Program Name	FY 2007 Disbursements ($ Millions)
CBP	Custodial – Refund & Drawback	$6,709[1]
CBP	Custodial – Continued Dumping & Subsidy Offset Act (CDSOA) & Payments to Wool Manufacturers	$409[1]
FEMA	Disaster Relief Program – Individuals and Households Program	$636[2]
FEMA	Disaster Relief Program – Vendor Payments	$1,908[2]
FEMA	Insurance – National Flood Insurance Program (NFIP)	$55
FEMA	Grants – Public Assistance Programs	$3,481
FEMA	Grants – Homeland Security Grant Program (HSGP)	$2,041
FEMA	Grants – Assistance to Firefighters Grants (AFG)	$485
FEMA	Grants – Infrastructure Protection Program (IPP)	$112[3]
ICE	Detention and Removal Operations (DRO)	$1,232[4]
ICE	Investigations	$227[4]
ICE	Federal Protective Service (FPS)	$723[4]
TSA	Aviation Security – Payroll	$2,012
U.S. Coast Guard	Active Duty Military Payroll	$2,448
U.S. Coast Guard	Contract Payments – Operating Expenses	$966[5]
U.S. Coast Guard	Contract Payments – Acquisition, Construction & Improvements	$845[5]
Total FY 2007 Disbursements		**$24,289**

1. CBP's programs were reported as one program, Custodial, in the FY 2007 DHS AFR.
2. FEMA's two Disaster Relief Programs are high-risk based on prior year payment sample testing.
3. The only exception to the rating scale used to identify high-risk programs in FY 2007 was for FEMA's Infrastructure Protection Program (IPP). This grant program received an overall score of 3.1 for FY 2006 disbursements but dropped to 2.3 for FY 2007 disbursements. The scores for the risk conditions were exactly the same in both years, but relative to other programs, expenditures dropped to the lowest impact category. Since IPP was not tested for FY 2006 disbursements when it was rated a high-risk, the risk condition rating remained the same, and expenditures increased, it was determined that IPP would remain classified as a high-risk program until payments underwent sample testing.
4. Only the non-payroll portion of ICE programs was found to be high-risk. Disbursement figures are for non-payroll disbursements.
5. Contracts were reported as a single program for U.S. Coast Guard in the FY 2007 DHS AFR.

DHS has no programs previously identified in the former Section 57 of Circular A-11 (now covered under OMB Circular A-123, Appendix C).

II. Statistical Sampling Process

A stratified sampling design was used to test payments based on FY 2007 disbursement amounts and the assessed risk of the program. The design of the statistical sample plans and the extrapolation of sample errors across the payment populations was completed by a statistician under contract.

Sampling plans generally provided an overall estimate of the percentage of improper payment dollars within +/-2.5 percent precision at the 90 percent confidence level, as specified by OMB guidance. An expected error rate of 5 percent of total payment dollars was generally used in the sample size calculation.

Using stratified random sampling, payments were grouped into mutually exclusive “strata” or groups based on total dollars. A stratified random sample typically required a smaller sample size than a simple random sample to meet the specified precision goal at any confidence level. Once the overall sample size was determined, the individual sample size per stratum was determined using the Neyman Allocation method.

The following procedure describes the sample selection process:

- Identify large payment dollars as the certainty stratum;
- Assign each payment a randomly generated number using a seed;
- Sort payments within each stratum (by ordered random numbers); and
- Select payments following the sample size design. For the certainty strata, all payments are selected.

To estimate improper payment dollars for the population from the sample data, the stratum specific ratio of improper dollars (gross, underpayments, and overpayments, separately) to total payment dollars was calculated.

DHS sample test results are listed in Table 15.

Table 15. DHS Sample Test Results

Component	Program	FY 2007 Payment Population ($millions)	FY 2007 Sample Size ($millions)	Est. Error Amount ($millions)	Est. Error Percentage (%)
CBP	Refund & Drawback	6,709	48	2	0.03
	Custodial – Continued Dumping & Subsidy Offset Act (CDSOA) & Payments to Wool Manufacturers	409	315	0	0
FEMA	Disaster Relief Program - Individuals and Households Program	636	3	46[1]	7.22[1]
	Disaster Relief Program - Vendor Payments	1,908	597	144	7.57
ICE	Detention and Removal Operations	1,232	358	10	0.85
	Federal Protective Service	723	87	267[2]	36.92[2]
	Investigations	227	64	4	1.87
TSA	Aviation Security - Payroll	2,012	1	2	0.09
U.S. Coast Guard	Operating Expenses - Active Duty Military Payroll	2,448	4	21	0.84
	Operating Expenses - Contracts	966	203	0	0.02
	Acquisition, Construction, and Improvements - Contracts	845	452	0	0.001
DHS	**All Programs**	**18,115**	**2,132**	**496**	**2.74**
DHS	**High-Risk Programs (Est. Error Amount >$10 Million)**	**5,715**	**691**	**478**	**8.36**

1. The estimated error amount and rate for Hurricanes Katrina and Rita are $43 million and 10.22 percent. The estimated error amount and rate for all other disasters is $3 million and 1.21 percent. FEMA IHP payments for Hurricanes Katrina and Rita used a 15 percent expected error rate.
2. The precision rate for ICE's Federal Protective Service program was +/- 5.0 percent at the 90 percent confidence level because the actual error rate was higher than the sample design estimate.

The DHS Office of the Chief Financial Officer devoted significant staff and contractor resources to: strengthen sample testing guidance; work with Components in developing test plans; and independently review sample test results. Several programs considered at high-risk based on risk assessment grading were not confirmed as at high-risk based on sample test results. The main reason for the estimated error rates falling below $10 million for these programs was the presence of strong compensating controls such as additional levels of payment review for manually intensive processes. Compensating controls will be considered more prominently in future risk assessments.

Based on the results of sample testing, corrective action plans are required for the following five programs due to estimated error amounts above $10 million: FEMA's Disaster Relief Program - Individuals and Households Program, FEMA's Disaster Relief Program - Vendor Payments, ICE's Detention and Removal Operations, ICE's Federal Protective Service and U.S. Coast Guard's Operating Expenses – Active Duty Military Payroll.

IPIA Pilot Study

Due to the complexity of testing grant programs, developing robust test plans, defining the sampling unit, and obtaining the underlying source documentation for testing, FEMA and DHS determined that for FY 2007 payments, the most effective approach was to conduct a test pilot study of five FEMA programs in order to gain an understanding of the most effective way to test each program in FY 2009.

During FY 2008, FEMA conducted a test pilot review of five programs identified as high-risk during the FY 2007 risk assessments. The five programs are: the National Flood Insurance Program (NFIP), and four high-risk grant programs – Public Assistance (PA), Homeland Security Grant Program (HSGP), Assistance to Firefighters Grant (AFG) Program, and Infrastructure Protection Program (IPP). This pilot developed approaches for conducting an IPIA assessment and a methodology for testing payments.

During the pilot study, FEMA developed draft test plans for the five programs and determined sampling methodologies focusing on the areas of highest risk within each program. The pilot study included a review of program specific policies, grant documents, and data from the systems of record, site visits, and interviews of key staff at Headquarters and the Regions. During the pilot study, FEMA confirmed that the programs vary in complexity depending on the relationship between FEMA, the States (applicants), sub-applicants, and private insurance companies. FEMA identified recommended assessment options conducive to IPIA testing and is in a position to conduct testing in FY 2009. Improper payment targets will be developed upon completion of sample testing.

III. Corrective Action Plans

Corrective Action Plans for High-Risk Programs

Following are corrective actions plans for programs with estimated improper error amounts above $10 million.

FEMA IHP

Table 16. Completed IHP Corrective Actions

Category of Error	Risk Factors	Corrective Actions	Completed Date	Comments
1. Insufficient system edits.	1. Ownership / Occupancy feature in NEMIS was not fully operational.	1. Upgrade system edits.	June 2006	ChoicePoint contract made verification feature operational.
	2. Address capability in NEMIS needed improvements.	1. Update system edits.	April 2007	
	3. NEMIS system lacked data to verify all eligibility amounts.	1. Update system with Federal maximum assistance amounts.	December 2007	

Category of Error	**Risk Factors**	**Corrective Actions**	**Completed Date**	**Comments**
1. Insufficient system edits.	4. NEMIS system lacked sufficient data and edits to prevent and detect improper payments in a timely manner.	1. Sign contract for data verification and pre-population of verified data.	December 2007	
2. Inadequate monitoring, training, and quality assurance work.	1. Incomplete real-time quality control monitoring.	1. Improve procedures and capabilities supporting real-time quality control monitoring.	August 2006	
	2. Inability to judge and improve caseworker performance.	1. Develop metrics to measure caseworker performance.	October 2006	Caseworker scoring metrics focus on whether disaster policies were followed and whether case correspondence and processing were correct.
	3. Improved quality controls needed for manual reviews.	1. Implement controls to prevent duplicate or incorrect payments.	July 2007	
	4. Additional IPIA testing needed to confirm progress, update error estimate, and comply with IPIA.	1. Conduct additional rounds of IPIA sample testing, assess findings, and update reporting.	July 2007 and Ongoing	Four rounds of IHP sample testing completed to date.
3. Poor or outdated policy and guidance.	1. Applicant recertification guidelines needed improvement.	1. Develop processes to prevent and detect improper payments in a timely manner.	December 2007	
	2. Processes lacking for approving policy and guidance.	1. Improve policies and guidance for approving and making payments to affected individuals and households for certain functional areas identified by IPIA sample testing.	March 2008	

Category of Error	Risk Factors	Corrective Actions	Completed Date	Comments
3. Poor or outdated policy and guidance.	3. Inadequate Expedited Assistance policy.	1. Complete an Expedited Assistance policy memo.	September 2008	Expedited Assistance restrictions were addressed by Disaster Assistance Interim Policy 9462.1: Critical Needs Assistance for Displaced Individuals and Households which was signed into effect on September 2, 2008.
4. Inability to scale up operations to handle catastrophic disaster workload.	1. Additional, impartial housing inspectors needed.	1. Recompete housing inspection contract.	March 2007	
	2. Additional trained call center agents needed to process greatly increased number of claims.	1. Award a contract to make available 6,000 call center agents.	March 2008	

Table 17. In Process and Planned IHP Corrective Actions

Category of Error	Risk Factors	Corrective Actions	Target Completion Date	Comments
1. Insufficient system edits.	1. Separated Households policy needs to be reflected in system edits.	1. Clarify policy and develop consistent system edit checks.	March 2009	Developed draft policy on Separated Households to clarify in which circumstances FEMA will authorize separate applications and provide temporary housing assistance to more than one disaster application from a single household.

Category of Error	Risk Factors	Corrective Actions	Target Completion Date	Comments
2. Inadequate monitoring, training, and quality assurance work.	1. Personnel need training with the Lodging Expense Reimbursement System.	1. Provide training and require employees to pass a certification test.	March 2009	Enhanced training was not provided in FY 2008 for Lodging Expense Reimbursement. FEMA uses an established policy dated August 1998. Training on this policy was provided in previous years. Recent disasters hindered the scheduling of training.
3. Poor or outdated policy and guidance.	1. Inconsistent application of disaster-specific policy.	1. Develop and implement a process which ensures consistent application of disaster-specific policy.	October 2008	Quality Control will expand its function to include review on a near real-time basis of special projects, new processing procedures, and disaster specific processing procedures.
	2. Separated Households policy is incomplete.	1. Develop policies and guidance needed to approve and make payments to affected individuals and households.	March 2009	

FEMA Vendor Payments

Table 18. Completed Vendor Payments Corrective Actions

Category of Error	Risk Factors	Corrective Actions	Completed Date	Comments
1. Inadequate monitoring, training, and quality assurance work.	1. Training of COTR roles and responsibilities needed improvement.	1. Develop and require a standard COTR Appointment Letter identifying the COTR's authority.	November 2007	Implemented a standard COTR Appointment Letter and Nomination Form.
	2. Internal control gaps existed in the vendor payment process.	1. Initiate a quality assurance review process to reduce improper payments.	November 2007	
	3. Training of Accounting Technicians roles and responsibilities needed improvement.	1. Update training for Accounting Technicians to ensure it addresses improper payment problems.	January 2008	Multiple training presentations given on improper payments and internal controls.

Category of Error	Risk Factors	Corrective Actions	Completed Date	Comments
1. Inadequate monitoring, training, and quality assurance work.	4. Payments of invoices were sometimes authorized without proper signature authority, supporting documentation, and quality checks.	1. Strengthen the process and controls for designating authorized invoice reviewers and approvers so that designated signatories and alternates are properly documented and readily accessible.	July 2008	
2. Poor or outdated policy and guidance.	1. Policies for Accounting Technicians lacked precision and formal documentation.	1. Conduct a review of policies, procedures, and job descriptions for Accounting Technicians.	November 2007	Reviewed major duties, SOPs, policies, and process maps for Accounting Technicians. Reviewed job description for Financial Management Specialists.
		2. Document the Invoice Follow-up process responsibilities for Accounting Technicians to ensure invoices are paid in a timely manner.	January 2008	Process documented with emphasis on how to identify and return improper invoices and how to process corrected invoices.
3. Inability to scale up operations to handle catastrophic disaster workload.	1. Processes to expand operations in response to catastrophic disasters needed improvement.	1. Initiate a quality assurance review process to reduce improper vendor payments.	November 2007	Quality assurance review completed. Work from 50 percent of accounting technicians sampled.
		2. Analyze results of the policies, procedures, and job descriptions for Accounting Technicians and implement changes, as needed.	February 2008	Problems with signature authorities identified and resolved.

Table 19. In Process and Planned Vendor Payments Corrective Actions

Category of Error	Risk Factors	Corrective Actions	Target Completion Date	Comments
1. Inadequate monitoring, training, and quality assurance work.	1. FEMA contracts were not consistently written for similar items.	1. Review procurement contracting language, standardize contracts where practical, and monitor compliance.	March 2009	Lack of consistency created issues with review and approval of payments.

ICE Detention and Removal Operations

Table 20. Planned Detention and Removal Operations Corrective Actions

Category of Error	Risk Factors	Corrective Actions	Completed Date	Comments
1. Lack of Supporting Documentation.	1. Potential incidence of fraud, waste, and abuse of government funds.	1. Implement general oversight and monitoring to verify valid contract and obligation exists.	January 2009	All DRO offices will transition to a single point of receipt for invoices. This change will enable the ICE OCFO to perform an up-front verification that an invoice is associated with a valid contract and obligation.
2. Goods and services received prior to award of contract.	1. Unauthorized use of budgetary resources.	1. Build awareness of regulations and laws through focused training and improved dissemination of policies.	Ongoing	- In August 2008, ICE conducted comprehensive training for its Analysts on obligation recording, monitoring, and management. - Implementing further training to reiterate policies and procedures.
3. Proper invoice did not exist in that the invoice did not contain the vendor's name.	1. Illegitimate invoice that can lead to potential incidence of fraud, waste, and abuse of government funds.	1. Implement up-front verification to ensure invoices received are in compliance with the FAR regulations.	January 2009	All DRO offices will transition to a single point of receipt for invoices. This change will enable the ICE OCFO to verify that an invoice is compliant with FAR upon receipt.

Category of Error	Risk Factors	Corrective Actions	Completed Date	Comments
3. Proper invoice did not exist in that the invoice did not contain the vendor's name.	1. Illegitimate invoice that can lead to potential incidence of fraud, waste, and abuse of government funds.	2. Improved documentation of award contract that clearly states the elements of a FAR compliant invoice.	January 2009	All DRO specific Contracting Specialists will be trained to include instructions for submission of invoice on the contract/award document.
4. Adjustments were not duly authorized.	1. Potential over/under payment of invoice.	1. Implement improved controls for monitoring invoice adjustments.	January 2009	All DRO offices will transition to a single point of receipt for invoices. This change will enable ICE OCFO to monitor the payment of each invoice and assist DRO with invoice adjustment, as needed.
		2. Monitor compliance with the standard operating procedure for processing invoice adjustment.	Ongoing	
5. No receiving report documentation	1. No formal documentation of receipt of goods and services	1. Implement improved controls for receiving and approval process.	January 2009	All DRO offices will transition to an improved invoice process where invoices are not paid unless authorized receiving and approval documentation is received by ICE OCFO.
6. Under paid interest.	1. Potential violation of Prompt Payment Act.	1. Ensure invoice receipt date is clearly indicated on the invoices.	January 2009	All DRO offices will transition to a single point of receipt for invoices. This change will enable ICE OCFO to stamp each invoice with the 'invoice received date' prior to forwarding it for processing.
		2. Ensure compliance with standard operating procedures.	January 2009	
7. Over paid interest.	1. Potential waste of government funds that could have been utilized for mission support activities.	1. Ensure invoice receipt date is clearly indicated on the invoices.	January 2009	All DRO offices will transition to a single point of receipt for invoices. This change will enable ICE OCFO to stamp each invoice with the 'invoice received date' prior to forwarding it for processing.
		2. Ensure compliance with standard operating procedures.	January 2009	

ICE Federal Protective Service

Table 21. Completed Federal Protective Service Corrective Actions

Category of Error	Risk Factors	Corrective Actions	Completed Date	Comments
1. Lack of Supporting Documentation.	1. Potential incidence of fraud, waste, and abuse of government funds.	1. Implement general oversight and monitoring to verify valid contract and obligation exists.	August 2007	Throughout FY 2007 and 2008, ICE implemented a single point of receipt for invoices. This change has enabled ICE OCFO to perform an up-front verification that an invoice is associated with a valid contract and obligation.
2. Goods and services received prior to award of contract.	1. Unauthorized use of budgetary resources.	1. Build awareness of regulations and laws through focused training and improved dissemination of policies.	Ongoing	- In August 2008, ICE conducted comprehensive training for its Analysts on obligation recording, monitoring, and management. - Implementing further training to reiterate policies and procedures.
3. Proper invoice did not exist in that the invoice did not contain the vendor's name.	1. Illegitimate invoice that can lead to potential incidence of fraud, waste, and abuse of government funds.	1. Implement up-front verification to ensure invoices received are in compliance with the FAR regulations.	August 2007	Throughout FY 2007 and 2008 ICE implemented a single point of receipt for invoices. This has enabled ICE OCFO to verify that an invoice is compliant with FAR.
		2. Improved documentation of award contract that clearly states the elements of a FAR compliant invoice.	August 2007	Throughout FY 2007 and 2008, ICE trained its Contracting Specialists to ensure award documents included specific instructions for submission of invoice.
4. Adjustments were not duly authorized.	1. Potential over or under payment of invoice.	1. Implement improved controls for monitoring invoice adjustments.	August 2007	Throughout FY 2007 and 2008, ICE implemented a single point of receipt for invoices. This change has enabled ICE OCFO to monitor the payment of each invoice and assist Programs with Invoice Adjustment as need.

Category of Error	**Risk Factors**	**Corrective Actions**	**Completed Date**	**Comments**
4. Adjustments were not duly authorized.	1. Potential over or under payment of invoice.	2. Monitor compliance with the standard operating procedure for processing invoice adjustment.	Ongoing	
5. No receiving report documentation.	1. No formal documentation of receipt of goods and services.	1. Implement improved controls for receiving and approval process.	August 2007	Throughout FY 2007 and 2008, ICE implemented improved invoice processes where invoices are not paid unless authorized receiving and approval documentation is received.
6. Under paid interest.	1. Potential violation of Prompt Payment Act.	1. Ensure invoice receipt date is clearly indicated on the invoice.	August 2007	Throughout FY 2007 and 2008, ICE implemented a single point of receipt for invoices. The ICE OCFO now stamps each invoice with the 'invoice received date' prior to forwarding it for processing.
		2. Ensure compliance with standard operating procedures.	Ongoing	
7. Over paid interest.	1. Potential waste of government funds that could have been utilized for mission support activities.	1. Ensure invoice receipt date is clearly indicated on the invoice.	August 2007	Throughout FY 2007 and 2008, ICE implemented a single point of receipt for invoices. The ICE OCFO now stamps each invoice with the 'invoice received date' prior to forwarding it for processing.
		2. Ensure compliance with standard operating procedures.	Ongoing	

U.S. Coast Guard Active Duty Military Payroll

Table 22. In Process and Planned ADMP Corrective Actions

Category of Error	Risk Factors	Corrective Actions	Target Completion Date	Comments
1. Lack of supporting documentation.	1. Missing personnel record source documentation.	1. Issue contract to evaluate status of records and recommend corrective actions.	January 2009	90 day contract signed with report due mid-January.
		2. Update policy to include the retention of appropriate source documents within military personnel data records.	January 2009	Scanned oath is critical to proving person works at USCG. Interim policy by January 2009. Final policy to include monitoring procedures.
		3. Establish procedures to ensure appropriate source documentation is captured at the Accession points.	July 2009	Involvement of military recruiters and servicing personnel offices is key.
		4. Develop and implement monitoring procedures to ensure adequacy of personnel record source documentation.	December 2009	
2. Untimely updating of personnel system.	1. Incorrect housing allowance.	1. Through training, ensure payroll systems are updated timely with housing change information.	March 2009	When feeder system is not updated timely, payment systems do not know the housing allowance entitlement has changed. Pay stubs contain a message alerting payee that errors must be brought to the immediate attention of personnel officer.

Category of Error	Risk Factors	Corrective Actions	Target Completion Date	Comments
2. Untimely updating of personnel system.	1. Incorrect housing allowance.	2. Expand use of housing report which identifies records with a housing action and housing allotment set to yes.	FY 2005 and Ongoing	USCG has been using such a report since FY 2005 which has resulted in a decline in overpayments from 15-20 per month to 0-5 per month. Summer transfer season is when error rate is greatest.
3. IPIA testing issues.	1. Delays in producing a correct payment detail file.	1. Reconcile transaction file total to accounting system trial balance.	December 2008	FY 2008 was the first year that USCG and DHS conducted IPIA sample testing of large payroll payment populations.
		2. Increase test time period to allow ample time for retrieval of supporting documentation.	December 2008	USCG should begin compiling detailed FY 2008 transaction file in late November. Other corrective actions and lessons learned should speed up document retrieval.
4. USCG organizational issues.	1. Competition for resources with actuarial pension liability testing and other financial statement audit testing.	1. Review, and when possible, synchronize time frames to minimize conflict and maximize efficiency.	December 2008	
	2. Need to reduce and standardize critical personnel source documentation.	1. Reach agreement between all critical parties on required data elements and source documentation.	January 2009	U.S. Coast Guard transformation team will host joint meetings in November with human resources, CFO, and CIO.
	3. No single owner of personnel offices.	1. The U.S. Coast Guard Modernization will result in organizational enhancements which will align recruiting, payroll, and personnel under one command.	March 2009	This issue is critical and resolution has proved elusive.

Category of Error	Risk Factors	Corrective Actions	Target Completion Date	Comments
4. USCG organizational issues.	4. Improve training for field personnel and housing officers (payroll processing is a secondary duty for majority of transaction processors).	1. Require completion of online training to acquire certification before transactions can be entered into feeder systems.	July 2009	This step will address geographic dispersion and the large number of officers. Roll out targets need to be established.

IV. Program Improper Payment Reporting

Table 23 summarizes improper payment amounts for DHS high-risk programs and projects future year improvements based on completing corrective actions. Improper payment (IP) percent and dollar figures are based on statistical estimates for FY 2007. These estimates are then projected for FY 2008 and beyond based on improvements expected from completing corrective actions.

Table 23. Improper Payment Reduction Outlook

Improper Payment Reduction Outlook
($ in millions)

Program	FY 2007 Outlays	FY 2007 IP%	FY 2007 IP$	FY 2008 Outlays	FY 2008 IP%	FY 2008 IP$	FY 2009 Est. Outlays	FY 2009 IP%	FY 2009 IP$	FY 2010 Est. Outlays	FY 2010 IP%	FY 2010 IP$	FY 2011 Est. Outlays	FY 2011 IP%	FY 2011 IP$
IHP (FEMA)	$636	7.22	$46	$606	7.00	$42	$636	5.50	$35	$668	3.50	$23	$701	2.50	$18
Vendor Payments (FEMA)	$1,908	7.57	$144	$1,526	7.00	$107	$1,602	5.00	$80	$1,682	3.00	$50	$1,766	2.50	$44
DRO (ICE)	$1,232	0.85	$10	$1,738	0.75	$13	$2,332	0.48	$11	$2,205	0.30	$7	$2,198	0.18	$4
FPS (ICE)	$723	36.9	$267	$745	26.00	$194	$778	19.45	$151	$812	9.00	$73	$848	1.50	$13
Active Duty Military Payroll (USCG)	$2,448	0.84	$21	$2,551	0.84	$21	$2,628	0.74	$19	$2,707	0.59	$16	$2,788	0.44	$12

The following programs (with actual FY 2007 and FY 2008 Outlays and Projected FY 2009-2011 Outlays listed in $millions) will have measurements reported beginning in DHS's FY 2009 AFR:
FEMA – National Flood Insurance Program (NFIP), (Outlays – FY 2007 $55; FY 2008 $53; FY 2009 $76; FY 2010 $112; and FY 2011 $137)
FEMA – Public Assistance Grants, (Outlays – FY 2007 $3,481; FY 2008 $1,026; FY 2009 $2,324; FY 2010 $2,579; and FY 2011 $2,648)
FEMA – Homeland Security Grant Program, (Outlays – FY 2007 $2,041; FY 2008 $2,189; FY 2009 $2,284; FY 2010 $2,348; and FY 2011 $2,450)
FEMA – Assistance to Firefighters Grants, (Outlays – FY 2007 $485; FY 2008 $356; FY 2009 $378; FY 2010 $416; and FY 2011 $453)
FEMA – Infrastructure Protection Program, (Outlays – FY 2007 $112; FY 2008 $417; FY 2009 $138; FY 2010 $153; and FY 2011 $164)

Notes:
For FEMA's IHP and Disaster Relief Program vendor payments programs, two major assumptions are used. The first assumption involves estimating future year outlays. The difficulty is that these programs do not have stable outlays from year to year because emergency response to Presidential declared disasters and other emergencies varies through time. The estimated outlay figures above were based on an average of the five most recent fiscal years (in millions of dollars for vendor payments – FY 2003 $774; FY 2004 $1,322; FY 2005 $6,645; FY 2006 $6,747; and FY 2007 $1,782; in millions of dollars for IHP payments – FY 2003 $684; FY 2004 $982; FY 2005 $4,638; FY 2006 $3,902; and FY 2007 $932). Figures for FEMA's NFIP program are for payments made directly by FEMA and do not include payments made by insurance companies on FEMA's behalf. These excluded payments in millions of dollars were: FY 2007 $1,306; FY 2008 $2,522; FY 2009 $1,837; FY 2010 $1,568; and FY 2011 $1,628.

Outlay projections for Active Duty Military Payroll use a 3.0 percent cost-of-living adjustment applied to FY 2008 actuals.

Recovery of Improper Payments

As of September 30, 2008, FEMA has collected $20.6 million for Hurricanes Katrina, Rita, and Wilma IHP payments identified as improper as a result of payment sample testing. In January 2007, DHS published interim regulation 6 CFR Part 11, which took effect immediately and required FEMA to provide disaster applicants who were in recoupment with the opportunity for an oral hearing. This regulation applied to disasters declared on or after January 30, 2007. On June 13, 2007, the U.S. District Court in Ridgely applied the same criteria to disaster applicants from Hurricanes Katrina and Rita.

In response to the Ridgely lawsuit, FEMA published a notice in the *Federal Register* on September 5, 2008. This notice effectively withdrew previous recoupment notifications sent to disaster applicants affected by Hurricanes Katrina and Rita and announced FEMA's intention to implement a new recoupment process for those applicants in accordance with 6 CFR Part 11. The *de novo* process provides that FEMA will review the files of Katrina and Rita disaster applicants identified for recoupment. If FEMA's latest review indicates a debt may be owed, FEMA will send a new notice and commence new recoupment proceedings that include an opportunity for an oral or paper hearing.

V. Recovery Auditing Reporting

DHS completed recovery audit work for FY 2007 disbursements and continued collection activities for errors identified in prior year recovery audits. Work was completed at ICE, U.S. Coast Guard, and the Components they cross-service (DNDO, MGMT, NPPD, S&T, TSA, and USCIS). Work was also completed at CBP. In Table 24 which follows, CY equals FY 2007 disbursements and PY covers FY 2005 and FY 2006 for DNDO, TSA, and U.S. Coast Guard; FY 2004 to FY 2006 for ICE, MGMT, NPPD, S&T, and USCIS; and FY 2004 to FY 2005 for CBP.

Table 24. Recovery Audit Results

DHS Component	Amount Subject to Review for CY Reporting ($ Millions)	Actual Amount Reviewed and Reported CY ($ Millions)	Amounts Identified for Recovery CY ($000)	Amounts Recovered CY ($000)	Amounts Identified for Recovery PYs ($000)	Amounts Recovered PYs ($000)	Cumulative Amounts Identified for Recovery (CY + PYs) ($000)	Cumulative Amounts Recovered (CY + PYs) ($000)
CBP[1]	$1,765	$1,765	$90	$0	$180	$131	$270	$131
DNDO	$54	$54	$0	$0	$0	$0	$0	$0
ICE	$1,749	$1,749	$102	$50	$1,663	$1,479	$1,765	$1,529
MGMT	$292	$292	$11	$8	$146	$62	$157	$70
NPPD[2]	$297	$297	$0	$0	$190	$125	$190	$125
S&T	$362	$362	$1	$1	$53	$53	$54	$54
TSA[3]	$1,865	$1,865	$643	$625	$86	$67	$729	$692
USCG[4]	$2,505	$2,505	$74	$44	$90	$66	$164	$110
USCIS	$495	$495	$8	$0	$895	$850	$903	$850
Totals	**$9,384**	**$9,384**	**$929**	**$728**	**$3,303**	**$2,833**	**$4,232**	**$3,561**

1. Prior year amounts identified for recovery adjusted down from $184 to $180 based on additional FY 2008 research.
2. Includes the US-VISIT program and legacy Component Information Analysis and Infrastructure Protection.
3. Prior year amounts identified for recovery adjusted down from $91 to $86 based on additional FY 2008 research.
4. Prior year amounts identified for recovery adjusted down from $282 to $90 based on additional FY 2008 research.

VI. Ensuring Management Accountability

Managers are held accountable for reducing and recovering improper payments in a variety of ways. DHS receives quarterly grades from OMB on the President's Management Agenda (PMA) Eliminating Improper Payments scorecard. Managers are responsible for completing internal control work on payment processing as part of the Department's OMB Circular A-123 effort. Payment processing key controls were evaluated for test of design and documentation in FY 2007. In FY 2008, payment processing key controls were tested for their operating effectiveness.

The importance of reducing improper payments was discussed at meetings with all levels of staff. For example, the importance of improper payments was discussed regularly at DHS Senior Assessment Team meetings. Half-day workshops on improper payment topics were held. Presentations on improper payments were made at a New Hire Orientation for Financial Managers and at the annual DHS Financial Managers Conference.

VII. Agency Information Systems and Other Infrastructure

The Department is undertaking a Transformation and Systems Consolidation initiative which is discussed further in the Financial Management Systems Framework (see Page 206).

FEMA is improving its financial system interfaces to reduce improper payments in its Disaster Relief Program. CBP is upgrading its financial system to automate the handling of Custodial payments.

The Department applied additional contractor support resources in FY 2008 to strengthen its guidance, test plan development, and review of Component IPIA payment sample testing.

VIII. Statutory or Regulatory Barriers

None.

IX. Overall Agency Efforts

The Department focused its FY 2008 efforts on improving payment sample testing. Sample testing was based on risk assessment results. Additional guidance was provided on test attributes for different payment types. Sample test plan development and review were more rigorous. An independent review of Component reported sample test results was completed at three Components. The completion of a test pilot prepares the Department to begin reporting error measurements for the National Flood Insurance Program and four high-risk FEMA grant programs in FY 2009.

The Department completed several IPIA related initiatives in FY 2008 including: 1) expansion of IPIA related classes as part of DHS's Internal Control University and CFO New Hire Orientation training; 2) active participation in government-wide IPIA groups including the Improper Payments Transformation Team and a government-wide partnership examining how to better leverage IPIA and Single Audit Act grant payment work; and 3) completion of the testing of key controls over payments at several Components as required by OMB Circular A-123.

Other Key Regulatory Requirements

Prompt Payment Act

The *Prompt Payment Act* requires Federal agencies to make timely payments (within 30 days of receipt of invoice) to vendors for supplies and services, to pay interest penalties when payments are made after the due date, and to take cash discounts only when they are economically justified. The Department's Components submit Prompt Payment data as part of data gathered for the OMB CFO Council's Metric Tracking System (MTS). Periodic reviews are conducted by the DHS components to identify potential problems. Interest penalties as a percentage of the dollar amount of invoices subject to the *Prompt Payment Act* has been measured between 0.01 percent and 0.04 percent for the period of October 2007 through September 2008, with an annual average of 0.02 percent (Note: MTS statistics are reported with at least a six week lag).

Debt Collection Improvement Act (DCIA)

The DHS Office of the Chief Financial Officer (CFO) is developing and implementing comprehensive debt collection regulations that would supersede Components' legacy agency regulations. The DHS-wide debt collection regulations will provide instructions to the components on meeting the reporting requirements in support of the *Debt Collection Improvement Act* of 1996 (DCIA). This act established the following purposes:

- To maximize collections of delinquent debts owed to the Federal Government by ensuring quick action to enforce recovery of debts and the use of all appropriate collection tools;
- To minimize the costs of debt collection by consolidating related functions and activities and utilizing interagency teams;
- To reduce losses arising from debt management activities by requiring proper screening of potential borrowers, aggressive monitoring of all accounts, and sharing of information within and among Federal agencies;
- To ensure that the public is fully informed of the Federal Government's debt collection policies and that debtors are cognizant of their financial obligations to repay amounts owed to the Federal Government;
- To ensure that debtors have appropriate due process rights, including the ability to verify, challenge, and compromise claims, and have access to administrative appeals procedures which are both reasonable and protect the interests of the United States;
- To encourage agencies, when appropriate, to sell delinquent debt, particularly debts with underlying collateral; and
- To rely on the experience and expertise of private sector professionals to provide debt collection services to DHS components.

To achieve these purposes, the Department's goals are to: 1) overcome DCIA deficiencies by having fair, aggressive, and consistent internal programs to recover non-tax delinquent debt; 2) improve the Department's non-tax debt collection performance by promoting the resolution of delinquencies as quickly as possible; 3) refer all eligible non-tax delinquent debts to Treasury (for Treasury Offset and/or Cross Servicing) at the 180 day point as required by the DCIA; 4) reduce future write-offs of debt by implementing a debt collection strategy incorporating the authorities within OMB's Circular A-129, *Policies for Federal Credit Programs and Non-Tax Receivables (11/2000)*; 5) require that all DHS Components have finalized internal policies and procedures to ensure that potential debtors to the Federal Government have all appropriate due process rights; and, 6) ensure the accuracy and timeliness of reports on receivables by reporting, certifying, and verifying all required data on the Treasury Report on Receivables and Debt Collection Activities.

FY 2006 Biennial User Charges Review

The Chief Financial Officers Act of 1990 requires each agency CFO to review, on a biennial basis, the fees, royalties, rents and other charges imposed by the agency, for services and things of value provided to specific recipients, beyond those received by the general public. The purpose of these reviews is to identify those agencies assessing user fees, and to periodically adjust existing charges to 1) reflect unanticipated changes in costs or market values; and, 2) to review all other agency programs to determine whether fees should be assessed for Government services or the use of Government goods or services.

To ensure compliance with this biennial requirement, each DHS Component is required to compile and furnish individual summaries for each user fee by addressing the key points for each user fee, in sufficient detail, to facilitate a review by the OCFO. For FY 2007, five of the DHS Components were responsible for collecting forty-one different user fees covering various services provided to the traveling public and trade community. The following is a detailed analysis of the fee collections and costs of the related services:

- ***United States Customs and Border Protection (CBP)*** **–** The user fee programs for CBP consist of 23 different fees covering various services that are provided to passengers and conveyances at ports of entry to the United States. In FY 2007, the fees collection totaled $2.311 billion and the costs for services provided relative to these fees totaled $2.977 billion. The shortfall from fee revenue is over $666 million.

- ***United States Citizenship and Immigration Services (USCIS)*** **–** USCIS is responsible for collecting fees from persons requesting immigration benefits and depositing them into the Immigration Examination Fee Account (IEFA). These fees are used to fund the full cost of processing immigration and naturalization benefit applications and petitions, biometric services, and associated support services. In addition, these fees must recover the cost of providing similar services to asylum and refugee applicants and certain other immigrants at no charge. Additionally, USCIS collects fees for Fraud Reporting and Nonimmigrant worker benefit applications. These fees generated a total of $2.160 billion in revenues and $1.783 billion in expenditures resulting in a surplus of $377 million. USCIS is currently conducting a new comprehensive review of the resources and activities funded by the IEFA to determine whether the current fees reflect current processes or recover the full costs of services that should be provided.

- ***Transportation Security Administration (TSA)*** **–** TSA is responsible for collecting nine different security fees which include: the Air Cargo Security Fee; the Aviation Security Infrastructure Fee; Fees for Security Threat Assessments for HAZMAT Drivers; Flight Training for Aliens Fee; the Passenger Civil Aviation Security Service Fee; the Registered Traveler Fee; the Protection of Sensitive Security Information Fee; the Transportation

Worker Identification Credential Fee and the Ronald Reagan Washington National Airport Enhanced Security Procedures for Certain Operations Fees. During FY 2007, TSA collected $2.560 billion for these five fees. The obligations incurred by TSA for providing these services were $10.222 billion. This amount exceeded related fee collections by $7.662 billion.

- ***U.S. Coast Guard*** **–** The U.S. Coast Guard charges fees for the following maritime services: 1) Merchant Mariner Licensing and Documentation User Fees, 2) Commercial and Recreational Vessel Documentation User Fees, 3) Vessel Inspection User Fees for U.S and Foreign Vessels requiring a certificate of inspection, and 4) Overseas Inspection and Examination Fees. In FY 2007, the fee collections from these services amounted to $27.3 million.

- ***Federal Emergency Management Agency (FEMA)*** **–** FEMA collects fees for Radiological Emergency Preparedness Program. This program provides site-specific, plume pathway Emergency Planning Zone (EPZ) biennial exercise-related component services. In FY 2007, the fees collected for this program totaled $24.9 million.

A preliminary review of DHS user fees was conducted by the Office of the Chief Financial Office (OCFO) in FY 2008. This review was based on the component's FY 2007 data and user fee structures that had been established through the legacy agencies.

Major Management Challenges

Office of Inspector General

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

Homeland Security

November 12, 2008

MEMORANDUM FOR: The Honorable Michael Chertoff
Secretary

FROM: Richard L. Skinner
Inspector General

SUBJECT: *Major Management Challenges Facing the Department of Homeland Security*

Attached is our annual report, *Major Management Challenges Facing the Department of Homeland Security,* for inclusion in the DHS FY 2008 Annual Financial Report. This report, including the department's comments in their entirety, will also be posted on our public website.

Should you have any questions, please call me, or your staff may contact James Taylor, Deputy Inspector General, at (202) 254-4100.

Attachment

Department of Homeland Security
Office of Inspector General

**Major Management Challenges
Facing the Department of Homeland Security**

OIG-09-08 **November 2008**

Office of Inspector General

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

Homeland Security

November 12, 2008

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.

The attached report presents our FY 2008 assessment of the major management challenges facing the Department of Homeland Security. As required by the *Reports Consolidation Act of 2000* (Public Law 106-531), we update our assessment of management challenges annually.

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

Richard L. Skinner
Inspector General

Office of Inspector General

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

Major Management Challenges Facing the Department of Homeland Security

The creation of the Department of Homeland Security galvanized the Nation's fight against terrorism by consolidating and mobilizing the assets of the federal government under one roof with a single, focused mission: to ensure that the tragic events of Sept. 11, 2001, are never repeated again on American soil.

After just 5 short years, we are beginning to witness the positive effects of the department's efforts and initiatives: tighter security at the borders; increased immigration enforcement; greater cooperation with our international partners; expanded partnerships with the private sector; better and more efficient passenger screening at our airports; and regenerated disaster response and recovery management. Despite these considerable accomplishments, DHS still has much to do to establish a cohesive, efficient, and effective organization.

The major management challenges we have identified significantly affect the department's ability to protect our homeland and are decisive factors in setting priorities for audits, inspections, and evaluations of DHS programs and operations. As required by the *Reports Consolidation Act of 2000* (Public Law 106-531), we update our assessment of management challenges annually.

We have identified the following major management challenges:

- Acquisition Management
- Financial Management
- Information Technology Management
- Catastrophic Disaster Response and Recovery
- Grants Management
- Infrastructure Protection
- Border Security
- Transportation Security
- Trade Operations and Security

Since the major management challenges have tended to remain the same from year to year, we are developing scorecards to distinguish the department's progress in selected areas. Our first scorecard, published in the *Semiannual Report to Congress*, October 1, 2006 – March 31, 2007, included an assessment of DHS' acquisition function. This report features scorecards for acquisition management, financial management, information technology management, and catastrophic disaster response and recovery. These four scorecards are summarized in Figure 1 and incorporated in our discussion of the major management challenges.

Figure 1.

DHS' OVERALL PROGRESS IN SELECTED AREAS	
Ratings are based on a four-tiered scale: Limited, Modest, Moderate, and Substantial.	
Acquisition Management	**Modest Progress**
Financial Management	**Modest Progress**
Information Technology Management	**Moderate Progress**
Catastrophic Disaster Response and Recovery	**Moderate Progress**

ACQUISITION MANAGEMENT

Contracting for goods and services consumes nearly 40% of the department's annual budget and is absolutely critical to achieving its mission. Acquisition management is a complex process that goes beyond simply awarding a contract. It begins with the identification of a mission need; continues with the development of a strategy to fulfill that need while balancing cost, schedule, and performance; and concludes with contract closeout after the terms have been satisfactorily met. A successful acquisition process requires an effective acquisition management infrastructure.

The following are critical acquisition success factors:

- Organizational Alignment and Leadership—ensures appropriate placement of the acquisition function, defines and integrates roles and responsibilities, and maintains clear, strong executive leadership;
- Policies and Processes—partnering with internal organizations, effective use of project management approaches, and establishment of effective internal controls;
- Acquisition Workforce—commitment to human capital management, integration and alignment of human capital approaches with organizational goals, and investment in people; and
- Knowledge Management and Information Systems—tracking of key acquisition data, analysis of supplies and services spending, and data stewardship.

Acquisition Management Scorecard

The following scorecard demonstrates areas where DHS has strengthened its acquisition management practices. We based our assessment on pertinent reports, particularly recent audit work conducted at the Federal Emergency Management Agency (FEMA), reports published by the Government Accountability Office (GAO), and congressional testimony. Given the scope of our review, we did not perform an in-depth assessment of each cornerstone of the acquisition framework. We used the critical elements within each—organizational alignment and leadership, policies and processes, acquisition workforce, and knowledge management and information systems—as well as our broader knowledge of the acquisition function, to gauge overall progress in those cornerstones.

The ratings were based on a four-tiered scale ranging from limited to substantial progress:

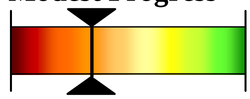
- **Limited:** While there may be plans to address critical success factors, few if any have been implemented;
- **Modest:** While some improvements have been made, many of the critical success factors have not yet been achieved;
- **Moderate:** Many of the critical success factors have been achieved; and
- **Substantial:** Most or all of the critical success factors have been achieved.

Based on the consolidated result of the four acquisition management capability areas, DHS has made "modest" progress overall in the area of Acquisition Management.

ACQUISITION MANAGEMENT SCORECARD

Organizational Alignment and Leadership

Modest Progress

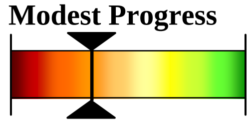


DHS' executive leadership has made "modest" progress in ensuring that the acquisition program achieves the organizational alignment needed to perform its functions. The department continues to face challenges associated with implementing an acquisition function that is not fully integrated. According to GAO,[1] the structure of DHS' acquisition function creates ambiguity about who is accountable for acquisition decisions. The Chief Procurement Officer (CPO) has used collaboration and cooperation with the components as the primary means of managing DHS-wide acquisition oversight. However, the CPO faces challenges in implementing the corrective actions, as they are only recommendations, and the component head determines what action will be taken.[2]

FEMA has made "modest" progress in aligning the acquisition function to serve as a partner, rather than a support function, for FEMA program offices. The Office of Acquisition Management (OAM) has created an Acquisition Program & Planning branch, which aligns acquisition personnel with program functions and will serve as the primary link between acquisitions and the program areas that generate requirements.[3] A major challenge is maintaining a sufficient acquisition workforce. In addition, OAM has experienced turnover of the senior leadership responsible for developing and communicating a strategic vision.

Policies and Processes

Modest Progress



DHS has made "modest" progress in developing policies and processes to ensure that components comply with regulations, policies, and processes to achieve department-wide goals. Previously, we reported that the department had begun implementation of its acquisition oversight plan, which incorporates DHS policy, internal controls, and elements of an effective acquisition function. However, the oversight program does not include an evaluation of outcomes from contracting methods such as performance-based acquisitions. According to GAO[4], the initial implementation of the plan has helped the components prioritize actions to address identified weaknesses, although it is too early to assess the plan's overall effectiveness.

---

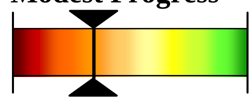
[1] GAO-07-948T, *Department of Homeland Security Ongoing Challenges in Creating an Effective Acquisition Organization,* June 2007.
[2] GAO-07-900, Department of Homeland Security, *Progress and Challenges in Implementing the Department's Acquisition Oversight Plan*, June 2007.
[3] DHS-OIG, *FEMA's Preparedness for the Next Catastrophic Disaster*, OIG-08-34, March 2008.
[4] GAO-08-646T, *Progress Made in Implementation of Management Functions, But More Work Remains*, April 2008.

ACQUISITION MANAGEMENT SCORECARD

FEMA has implemented the Virtual Acquisition Office ™ that provides an easily accessible, one-stop shop for useful acquisition guidance, and OAM has updated its *Emergency Acquisition Field Guide*. However, clear and transparent policies and processes for all acquisitions are still needed.

Acquisition Workforce

Modest Progress

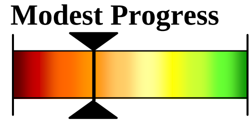


DHS has made "modest" progress in building and maintaining a skilled acquisition workforce. Previously, we reported that personnel budget increases had allowed the department to fill many acquisition staff positions. However, there are still workforce challenges across the department. GAO reported in April 2008 that approximately 61% of the minimum required staff and 38% of the optimal level of contract specialists were in place. Components within the department such as the U.S. Coast Guard (Coast Guard) have initiatives to develop and retain a workforce capable of managing complex acquisition programs, but they are still relying on contractors to fill key positions. DHS also needs to improve the tracking of its acquisition workforce training and qualifications to ensure workforce development and appropriate assignment to acquisition projects.

FEMA has significantly increased the number of its acquisition staff and has developed training initiatives for them. However, FEMA needs to focus on preparing the acquisition workforce to respond to a catastrophic disaster.

Knowledge Management and Information Systems

Modest Progress



DHS has made "modest" progress in developing and deploying information systems to track and analyze acquisition data and improve user efficiency. Some progress has been made in the integration of information systems. For example, according to the Coast Guard, it has completed the integration of three separate Coast Guard accounting systems into a single Acquisition, Construction, and Improvement data set that is usable by all Coast Guard acquisition personnel as part of its Blueprint for Acquisition Reform. However, the department and its components still need to improve database reliability and verification.

FEMA has made limited progress in providing staff with the tools they need to carry out their jobs. The outdated and nonintegrated information systems currently used by acquisition personnel were to be replaced by the PRISM contract-writing system in early 2008. The PRISM roll-out has now been pushed back to 2009. Until PRISM is instituted, acquisition personnel must use nonintegrated systems that require duplicate

ACQUISITION MANAGEMENT SCORECARD
input of data, thus increasing the possibility of errors. Logistics systems are not integrated with acquisition systems and do not provide complete asset visibility of disaster goods.[5]

FINANCIAL MANAGEMENT

DHS has continued to improve financial management in FY 2008, but challenges remain. As in previous years, our independent auditors were unable to provide an opinion on DHS' FY 2008 financial statements because the department could not provide sufficient evidence to support its financial statements or represent that financial statement balances were correct. The department has continued to remediate material weaknesses and has reduced the number of conditions that contribute to the disclaimer of opinion.

Although the Transportation Security Administration's (TSA) entity level controls deteriorated in FY 2008, the department made overall improvements in entity level controls at the departmental and component level. These improvements resulted in a reduction in the total number of material weaknesses from seven in FY 2007 to six in FY 2008. Even though new conditions were identified at FEMA and TSA, all components generally made progress in FY 2008.

As in FY 2007, the departmental material weaknesses in internal control were primarily attributable to the Coast Guard, FEMA, and TSA. The Coast Guard's material weaknesses, which have existed since 1994[6], contribute to all six of the department's material weaknesses, while FEMA contributes to four and TSA contributes to three. The Coast Guard also contributes to TSA's financial systems security material weakness due to TSA's reliance on the Coast Guard's financial systems. Although the other components did not have material weaknesses, some had significant deficiencies that, when combined, contributed to the departmental material weaknesses.

Financial Management Scorecard

The following scorecard presents the status of DHS' effort to address internal control weaknesses in financial reporting that were identified in FY 2007. The scorecard is divided into two categories: (1) Military – Coast Guard and (2) Civilian – all other DHS components. The scorecard lists the seven material weaknesses and one other significant deficiency identified during the independent audit of the FY 2007 DHS consolidated balance sheet and statement of custodial activity. For a complete description of the internal control weaknesses identified in the FY 2007 audit, see OIG-08-12.[7] To determine the status, we compared the

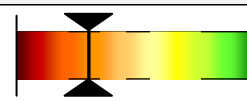
[5] Statement of James L. Taylor, Deputy Inspector General, U.S. Department of Homeland Security, Before the Subcommittee on Management, Investigations, and Oversight, Committee on Homeland Security, U.S. House of Representatives, September 17, 2008; DHS-OIG, *Logistics Information Systems Need to be Strengthened at the Federal Emergency Management Agency*, OIG-08-60, May 2008.
[6] DOT-OIG, *Significant Internal Control Weaknesses Identified in Audits of FY 1994 and 1995*, R3-CG-6-011, August 1996.
[7] DHS-OIG, *Independent Auditors' Report on DHS' FY 2007 Financial Statements*, OIG-08-12, November 2007.

material weaknesses reported by the independent auditor in FY 2007 with those reported in FY 2008. The scorecard does not include other financial reporting control deficiencies identified in FY 2008 that do not rise to the level of a significant deficiency, as defined by the American Institute of Certified Public Accountants. The ratings show that the department made some progress in FY 2008 toward remediation of the control weaknesses that were identified in FY 2007.

The ratings were based on a four-tiered scale ranging from limited to substantial progress as follows:

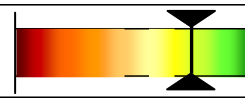
- **Limited:** While there may be plans to address internal control weaknesses, few if any have been remediated;
- **Modest:** While some improvements have been made, many of the internal control weaknesses have not yet been remediated;
- **Moderate:** Many of the internal control weaknesses have been remediated; and
- **Substantial:** Most or all of the internal control weaknesses have been remediated.

Based on the consolidated result of the seven financial management capability areas, DHS has made "modest" progress overall in the area of Financial Management.

FINANCIAL MANAGEMENT SCORECARD		
Financial Management and Entity Level Control: Entity level controls are the foundation that ensures internal control systems are comprehensively designed to achieve the mission and execute the department's strategy.		
Military	**Modest Progress**	
	The Coast Guard made "modest" progress in addressing its internal control weaknesses related to financial management and entity level controls. In FY 2007, the independent auditor's report (IAR) noted that several conditions related to entity level control weakness also existed in prior years. For example, the Coast Guard did not fully implement a financial management organizational structure that incorporates U.S. generally accepted accounting principles or appropriately supports its financial statement balances. As a result, the Coast Guard could not assert to the completeness, existence (validity), accuracy, valuation, or presentation of its financial data. Although entity level control weaknesses continued to exist at the Coast Guard in FY 2008, some progress has been made. The FY 2008 IAR noted that the Coast Guard updated its Mission Action Plans in FY 2008 and created the *Financial Strategy for Transformation and Audit Remediation* (FSTAR). The FSTAR is a comprehensive plan to identify and correct the root causes of control deficiencies. However, most of the	

FINANCIAL MANAGEMENT SCORECARD

corrective actions outlined in the FSTAR were not scheduled to begin in FY 2008. Consequently, most of the entity level control weaknesses identified during FY 2007 continued to exist during FY 2008. The conditions noted at the Coast Guard contributed to an overall significant deficiency in entity level control at the department for FY 2008.

Civilian	**Moderate Progress**	

Overall, DHS has demonstrated “moderate” progress in establishing a financial management organization structure to enforce accountability and institute internal controls into the department’s culture. As a result, DHS has remediated the severity of this condition from a material weakness to a significant deficiency with Coast Guard, FEMA, and TSA contributing to this condition. However, while FEMA was the only civilian component that contributed to the material weakness in FY 2007, there is now one additional component (TSA) contributing to a significant deficiency in FY 2008.

The department has undertaken and completed several steps designed to strengthen its entity and process level internal controls, thereby improving the reliability of financial reporting. These steps are documented in the DHS FY 2008 *Internal Control Playbook*, released in March 2008, and in component level Mission Action Plans finalized in FY 2008.

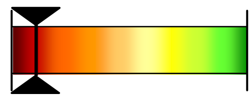
During FY 2007, a number of internal control weaknesses related to financial management and entity level controls at FEMA rose to a material weakness at the DHS consolidated financial statement level. Among other conditions, the independent auditors noted that FEMA had not established a financial management organization structure with clear oversight and supervisory review functions that support the development and implementation of effective policies, procedures, and internal controls over financial reporting. Such policies, procedures, and controls are needed to ensure that accounting principles are correctly applied and accurate financial data is submitted to the Office of Financial Management for consolidation in a timely manner.

FEMA has made “modest” progress toward correcting its entity level control deficiencies. During FY 2008, the independent auditors noted that FEMA developed Mission Action Plans to eliminate account balance qualifications identified in the IAR in FY 2007. However, some entity level control deficiencies identified in previous years continued to exist throughout FY 2008.

FINANCIAL MANAGEMENT SCORECARD

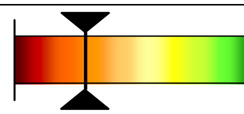
During FY 2008, TSA successfully addressed some account balance discrepancies and control deficiencies that contributed to the disclaimer of opinion on DHS' financial statements. However, during the FY 2008 audit, additional deficiencies that are indicative of weaknesses in entity level controls were identified at TSA.

Financial Reporting: Financial reporting is the process of presenting financial data about an agency's financial position, the agency's operating performance, and its flow of funds for an accounting period. The Federal Financial Management Improvement Act 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.

Military	**Limited Progress**	

The Coast Guard has demonstrated "limited" progress in remediating the numerous internal control weaknesses identified by the independent auditors during FY 2007. Significant control deficiencies contributing to a material weakness in financial reporting in FY 2007 included: 1) lack of an effective general ledger system; and 2) lack of effective policies, procedures, and controls surrounding the financial reporting process.

Although the Coast Guard developed its FSTAR during FY 2008, most of the corrective actions outlined in the document are scheduled to occur after FY 2008. Consequently, the Coast Guard was unable to make substantial progress in correcting the control weaknesses that were reported in prior years, and a material weakness still existed in FY 2008.

Civilian	**Modest Progress**	

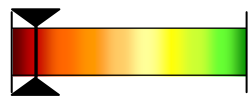
During FY 2008, DHS made "modest" progress in correcting the conditions that contributed to the material weakness in financial reporting in FY 2007**.** In FY 2007, conditions at the Office of Financial Management and FEMA rose to a level of material weakness, and conditions at TSA were considered a significant deficiency.

During FY 2008, the Office of Financial Management fully corrected its material weakness over financial reporting, and FEMA made substantial progress toward correcting four material weaknesses that were reported in FY 2007. However, while FEMA has taken positive steps in FY 2008, some control weaknesses related to financial reporting continued to exist throughout FY 2008. These conditions at FEMA in the aggregate are considered a material weakness. In FY 2007, TSA adopted a two-year corrective action plan to address its financial reporting and other

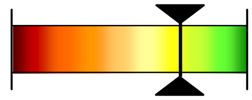
FINANCIAL MANAGEMENT SCORECARD

accounting internal control weaknesses. This resulted in TSA making some progress in the development of its core accounting processes throughout FY 2008. However, the independent auditors noted additional and more serious financial reporting control weaknesses, some of which have existed since the agency's inception. As a result, the severity of the condition worsened in FY 2008 and TSA now has a material weakness condition in financial reporting at the department level.

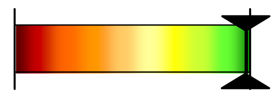
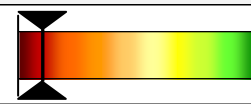
Financial Systems Security: Financial systems security is essential to achieving effective, reliable reporting of financial and performance data.

Military	**Limited Progress**	

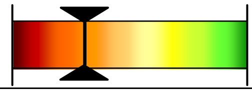
The Coast Guard has made "limited" progress in correcting certain information technology (IT) general control weaknesses identified in previous years. During FY 2007 significant control deficiencies included: 1) excessive access to key Coast Guard financial applications, 2) application change control processes that are not adequately designed nor operating effectively, 3) entity-wide security program issues involving personnel background checks, 4) system software weaknesses involving patch management, 5) segregation of duties involving lack of policies and procedures and excessive privilege access issues, and 6) service continuity issues involving the lack of disaster recovery testing . Significant deficiencies in application change control processes are among the principle causes of the Coast Guard's inability to support its financial statement balances. In addition, the Coast Guard was not able to effectively prioritize and implement Corrective Action Plans to remediate the root cause of the IT general control weaknesses in 2007. Many of these weaknesses were inherited from system development activities that did not incorporate strong security controls during the initial implementation of the system over five years ago, and will take several years to fully address. These weaknesses exist in the documentation of processes, the implementation of adequate security controls over processes, and within financial systems. In FY 2008, the Coast Guard remediated approximately 48% of its prior year IT general controls weaknesses. Specifically, the Coast Guard has made progress in remediation of issues in the areas of segregation of duties, systems software, and service continuity. Although there has been an improvement in the remediation effort, significant issues with the Coast Guard's change control process continue to exist for its financial applications.

FINANCIAL MANAGEMENT SCORECARD		
Civilian	**Moderate Progress**	
	The DHS Office of Chief Financial Officer and Office of Chief Information Officer (OCIO) have demonstrated moderate progress in improving their financial systems security. In FY 2007, two civilian components contributed to the financial systems security material weakness. Significant control deficiencies were noted in the areas of access controls, application change control and service continuity. In FY 2008, these two components continued to contribute to this material weakness although one component did make improvements in the area of service continuity. Overall improvements in the Federal Information System Controls Audit Manual domains for all civilian components resulted in the closing of approximately 43 % of the IT general control findings identified in FY 2007. One component however, continues to show significant weaknesses in the areas of access controls and application change controls for its financial systems. In addition, results of a performance audit conducted in FY 2008 noted that the OCIO's Plan of Action and Milestones process does not contain actionable steps to remediate the issues or address the root cause of the material weakness. In addition, Plans of Action and Milestones are not consistently updated, and there is no correlation between the OCIO's Plan of Action and Milestones and the Office of the Chief Financial Officer's OMB A-123 strategy.	
Fund Balance with Treasury (FBwT): FBwT represents accounts held at Treasury from which an agency can make disbursements to pay for its operations. Regular reconciliation of an agency's FBwT records with Treasury is essential to monitoring and safeguarding these funds, improving the integrity of various U.S Government financial reports, and providing a more accurate measurement of budget resources.		
Military	**Limited Progress**	
	The Coast Guard has demonstrated "limited" progress in addressing the material weaknesses noted in this area in FY 2007. Some of the conditions noted in FY 2007 included: 1) lack of adequate supporting documentation that validated the accuracy of all of the Coast Guard FBwT reconciliations; 2) lack of an effective process for accounting for suspense account transactions related to FBwT; 3) the Coast Guard's inability to provide validated military and civilian payroll data to support payroll transactions processed through the Coast Guard's FBwT account.	

FINANCIAL MANAGEMENT SCORECARD

	In FY 2008, the Coast Guard developed a remediation plan (FSTAR) to address the control deficiencies. However, most of the corrective actions noted in the plan are scheduled to occur after FY 2008, thus, many of the conditions identified in FY 2007 continued to exist throughout FY 2008. These control weaknesses at the Coast Guard resulted in an overall material weakness for the Department in FY 2008, as FBwT at the Coast Guard represented approximately 8.3 % of total DHS FBwT at the end of FY 2008.	
Civilian	**Substantial Progress**	
	No control deficiencies related to FBwT were noted at the civilian components in FY 2007. Corrective actions implemented in previous years continued to be effective throughout FY 2007 and FY 2008.	
Capital Assets and Supplies:	DHS capital assets and supplies consist of items such as property, plant and equipment, operating materials, and supplies, including boats and vessels at the Coast Guard, passenger and baggage screening equipment at TSA, and stockpiles of inventory to be used for disaster relief at FEMA.	
Military	**Limited Progress**	
	The Coast Guard has demonstrated "limited" progress in remediating the control deficiencies related to capital assets and supplies in FY 2008. The Coast Guard maintains approximately 60% of all DHS' property, plant, and equipment (PP&E), which includes a large fleet of boat and vessels. Since many of the Coast Guard's assets are constructed over a multi-year period, have long useful lives, and undergo extensive routine servicing that may increase their value or extend their useful lives, comprehensive policies and procedures are necessary to accurately and timely account for these assets. In FY 2007, as in prior years, the independent auditors noted that the Coast Guard has been unable to provide auditable documentation for certain categories of PP&E due to a number of policy, control, and process deficiencies that will require several years to correct. Many of these conditions still existed throughout FY 2008. In FY 2008, the Coast Guard developed corrective action plans (FSTAR) to address the PP&E process and control deficiencies, and began remediation efforts. However, the corrective actions included in the FSTAR are scheduled to occur over a number of years. Consequently, most of the material weakness conditions cited in FY 2007 remained throughout FY 2008.	

FINANCIAL MANAGEMENT SCORECARD

Civilian	**Modest Progress**	

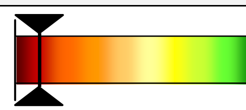
Overall, the civilian components demonstrated "modest" progress in addressing the conditions identified in this area in FY 2007. In FY 2007, three civilian components contributed to a material weakness in capital assets and supplies. In FY 2007, conditions reported at FEMA rose to a level of material weakness, and significant deficiency at TSA and US-VISIT.

During FY 2008, FEMA and US-VISIT were able to fully remediate the conditions leading to the material weaknesses identified in FY 2007. However, FEMA was unable to assert to the validity of internal use software and as a result, continues to contribute to the capital assets and supplies material weakness at the departmental level.

Additionally in response to auditor inquires, TSA initiated various reviews of its capital assets and identified errors in its accounting for equipment used in airports that required a number of restatements to the FY 2007 financial statement balances, and current year corrections. As a result, TSA was unable to assert to the validity of capital assets and supplies and contributes to the qualification of the financial statements and material weaknesses at the department level.

Also, new control weaknesses were identified at Customs and Border Protection (CBP) which were considered a significant deficiency. CBP's internal control deficiencies in this area are primarily related to construction of a fence along the border of the United States and Mexico. The FY 2008 IAR noted that CBP had expensed construction cost instead of capitalizing it as construction-in-progress.

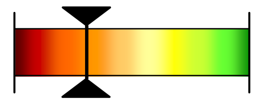
Actuarial and Other Liabilities: Liabilities represent the probable and measurable future outflow or other sacrifice of resources as a result of past transactions or events. The internal control weaknesses reported in this area are related to various types of liabilities, including accounts and grants payable, and legal and actuarial, and environmental liabilities.

Military	**Limited Progress**	

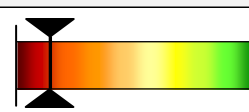
The Coast Guard maintains pension, medical, and postemployment travel benefit programs that require actuarial computations to record related liabilities for financial reporting purposes. Other liabilities include accounts payable, environmental, and legal liabilities.

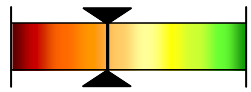
During FY 2008, the Coast Guard made "limited" progress in

FINANCIAL MANAGEMENT SCORECARD

	remediating the conditions that contributed to the material weakness in this area. Control deficiencies identified by the independent auditors in FY 2007 and prior years continued to exist in FY 2008. For example, the FY 2008 IAR on DHS financial statements noted that the Coast Guard did not have effective policies, procedures, and controls to ensure the completeness and accuracy of participant, medical cost and other data provided to the actuary for the calculation of related benefit liabilities.	
Civilian	**Modest Progress**	
	Overall, the department demonstrated "modest" progress in this area. During FY 2008, TSA fully corrected the control weaknesses that contributed to a significant deficiency in this area in the prior year. Additionally, conditions at FEMA were reduced to significant deficiency (from material weakness in FY 2007). However, new control weaknesses that rise to the level significant deficiency were identified at three additional civilian components. For FY 2008, the auditors noted that FEMA had not established a reliable method to estimate certain accounts payable for accrual in the financial statements until the end of the fiscal year. Additionally, for FY 2008 the Federal Law Enforcement Training Center, Immigration and Customs Enforcement (ICE), and Science and Technology components did not fully implement policies and standard operating procedures that will allow management to assert that environmental liabilities have been recorded and disclosed in the financial statements in accordance with applicable accounting standards. In the aggregate, the significant deficiencies at the four components and the material weakness at the Coast Guard amount to an overall material weakness for the department.	

Budgetary Accounting: Budgetary accounts are a category of general ledger accounts where transactions related to the receipt, obligation, and disbursement of appropriations and other authorities to obligate and spend agency resources are recorded. Since the department received a disclaimer of opinion in FY 07, the audit is limited to the balance sheet and statement of custodial activity. As a result, audit coverage over budgetary accounts is limited to undelivered orders.

Military	**Limited Progress**	

<table>
<tr><th colspan="3">FINANCIAL MANAGEMENT SCORECARD</th></tr>
<tr><td></td><td colspan="2">The Coast Guard has made “limited” progress in this area. Many of the internal control weaknesses that contributed to a material weakness in budgetary accounting at the Coast Guard in FY 2007 remained throughout FY 2008. For example, the FY 2007 IAR noted that the policies, procedures, and internal controls over the Coast Guard’s process for validation and verification of some account balances are not effective to ensure that recorded amounts are complete, valid, accurate, and that proper approvals and supporting documentation is maintained. This condition also existed during FY 2008. While some issues may take a number of years to be corrected, several of the budgetary control weaknesses can be corrected by process improvements and strengthened policies and internal controls.</td></tr>
<tr><td>Civilian</td><td>Modest Progress</td><td></td></tr>
<tr><td></td><td colspan="2">DHS has demonstrated “modest” progress in remediating internal control weaknesses that were noted in the FY 2007 IAR. During FY 2008, TSA corrected its material weakness in this area. However, DHS’ biggest challenge in this area remains at FEMA.

In FY 2008, FEMA implemented corrective actions and performed an extensive review of its open obligations, including disaster relief and response mission assignments with other federal agencies. As a result, FEMA was able to deobligate over $1 billion in funds prior to year-end, and make those funds available for FY 2008 disaster relief. FEMA also improved its processes and internal controls over the mission assignment obligation and monitoring process in FY 2008; however, significant control deficiencies remain. As a result, the departmental level material weakness condition remains at FEMA.

Additionally, CBP did not enforce its policies and procedures to monitor and deobligate or closeout its obligations in a timely manner. In response to an audit inquiry, CBP initiated a review of open obligations and subsequently deobligated approximately $84 million in open obligations in FY 2008. As a result, CBP has a significant deficiency condition related to budgetary accounting and contributes to the departmental level material weakness.</td></tr>
</table>

INFORMATION TECHNOLOGY MANAGEMENT

Creating a unified IT infrastructure for effective integration and agency-wide management of IT assets and programs remains a challenge for the DHS Chief Information Officer (CIO). In September 2008, we reported that DHS had taken steps to strengthen the CIO’s role for centralized management of IT by providing greater authority and responsibility for overseeing component CIOs' IT acquisitions.[8] As a result, the DHS CIO is better positioned to govern the department's IT investments and resources. However, continued CIO staffing shortages and inconsistent component-level IT budget practices hinder the DHS CIO's ability to fully integrate department-wide IT programs. We recommended that the DHS CIO update the CIO office's staffing plan, ensure that components submit comprehensive budgets, and develop and maintain IT strategic plans and enterprise architectures aligned with DHS' mission.

DHS also faces challenges in meeting OMB's requirement to transition to a new internet protocol, IPv6, which supports an unlimited number of IP addresses and other enhanced capabilities.[9] Although DHS is in the early stages of the transition, the department is unlikely to be positioned to take timely advantage of the enhanced capabilities of IPv6. DHS must also ensure that several key activities, such as establishing a comprehensive inventory of all IPv6 devices, finalizing its IPv6 transition strategy, and engaging its components in IPv6 transition planning and activities, are completed before it can fully transition to IPv6 functionality.

Security of IT Infrastructure

During our FY 2007 *Federal Information Security Management Act*[10] (FISMA) evaluation of the department's intelligence systems, we reported that much progress had been made in establishing an enterprise-wide IT security program that supports the department's intelligence operations and assets. However, procedural and operational issues remained regarding the implementation of the department's intelligence security program and system controls.[11]

We also reviewed Homeland Security Presidential Directive 12 (HSPD-12), *Policy for a Common Identification Standard for Federal Employees and Contractors*. The purpose of HSPD-12 is to enhance security, increase government efficiency, reduce identity fraud, and protect personal privacy by establishing a mandatory, government-wide standard for secure and reliable forms of identification issued by the federal government to its employees and contractors. The department is scheduled to complete its HSPD-12 implementation in 2010, two years after OMB's mandated deadline for all agencies.

In September 2008, we reported that components have not implemented appropriate security controls to enforce the department's policies on the acceptable use of portable storage devices.[12] The proliferation and uncontrolled use of portable storage devices (e.g., flash

[8] DHS-OIG, *Progress Made in Strengthening DHS Information Technology Management, But Challenges Remain*, OIG-08-91, September 2008.
[9] In August 2005 OMB issued Memorandum 05-22 (M-05-22), *Transition Planning for Internet Protocol Version 6* (IPv6), establishing the goal of transitioning federal agencies' wide area networks to IPv6.
[10] Title III of the 2002 E-Government Act, Public Law 107-347
[11] DHS-OIG, *Challenges Remain in Executing the Department of Homeland Security's Information Technology Program for Its Intelligence Systems*, OIG-08-48, April 2008.
[12] DHS-OIG, *Review of DHS Security Program for Portable Storage Devices*, OIG-08-95, September 2008.

drives, external hard drives, and portable music players) increases the risk of theft and mishandling of sensitive information.

DHS Component IT Management

Although improvements have been made, DHS continues to struggle with agency-wide IT management, planning, and investment, which has resulted in limited system integration and data sharing. For example, in October 2007, we reported that due to a lack of authority and standard policies to govern technology implementation, TSA's CIO faces significant challenges in conducting agency-wide IT planning and investment management. We concluded that TSA's IT management could be strengthened by empowering the CIO with IT budget authority, developing an agency-wide strategic planning approach, implementing an enterprise architecture, establishing guidelines to manage IT development, and increasing staff resources within the IT division.

Similarly, our April 2008 assessment of FEMA's efforts to upgrade its disaster logistics management systems[13] showed that, although the agency has made short-term progress in addressing disaster goods procurement and delivery during disasters, more remains to be done to address long-term planning and systems integration needs. FEMA has taken steps to improve its logistics capabilities by gathering independent evaluations to assess its existing systems, identify IT systems requirements, and select technologies to meet its logistics needs. However, existing systems do not provide complete asset visibility, comprehensive asset management, or integrated logistics information. We recommended that FEMA finalize its logistics strategy and operational plans, develop standard business processes and procedures for logistics activities, evaluate current technologies, and develop a strategy for acquiring IT systems to support the logistics mission.

Privacy

DHS still faces challenges in ensuring that privacy concerns are addressed throughout the lifecycle of each program and information system that contains sensitive personally identifiable information. According to the *E-Government Act of 2002*, federal agencies must conduct a Privacy Impact Assessment (PIA) for each new or substantially changed IT system that collects, uses, maintains, or disseminates personally identifiable information, demonstrating that they have incorporated privacy safeguards throughout the development lifecycle of their programs or systems. Although DHS requires PIAs at the very earliest stage of a project or before beginning a pilot test, DHS officials did not conduct risk assessments in a number of IT system implementations.[14]

In April 2008, we reported that the Intelligence and Analysis' National Applications Office (NAO) had made progress by involving the DHS Privacy Office early in its privacy program planning and development of key organizational documents. However, a revised PIA and a

[13] DHS-OIG, *Logistics Information Systems Need to be Strengthened at the Federal Emergency Management Agency,* OIG-08-60, May 2008.
[14] DHS Privacy Office, *Privacy Impact Assessment Guidance*, May 2007.

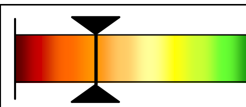
Civil Liberties Impact Assessment reflecting changes in NAO's Charter and proposed operations were also necessary before NAO become operational.[15]

IT Management Scorecard

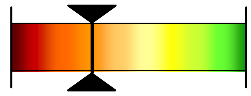
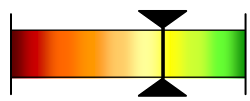
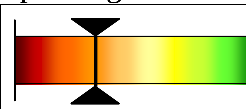
The following scorecard demonstrates where IT management functions of the DHS CIO and the seven largest DHS component-level CIO offices have been strengthened. This high-level assessment identifies progress in six IT management capability areas: IT budget oversight, IT strategic planning, enterprise architecture, portfolio management, capital planning and investment control, and IT security. These six elements were selected based on IT management capabilities required by federal and DHS guidelines for enabling CIOs to manage IT department-wide. The ratings were based on a four-tiered scale ranging from limited to substantial progress:

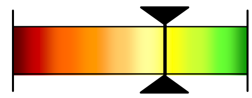
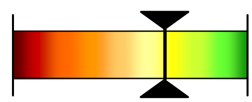
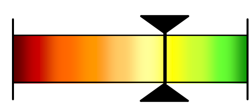
- **Limited:** Plans are in place for this capability, but the capability has not been fully implemented;
- **Modest:** The capability is partially implemented, with limited IT management benefits realized;
- **Moderate:** The capability is implemented with moderate IT management benefits realized; and
- **Substantial:** The capability is implemented with substantial IT management benefits realized.

Based on the consolidated result of the six IT management capability areas, the DHS OCIO has made "moderate" progress in the area of overall Information Technology Management.

IT MANAGEMENT SCORECARD		
IT Budget Oversight: ensures visibility into IT spending and alignment with the strategic IT direction.		
DHS CIO	**Modest Progress**	
	The DHS CIO has made improvements in managing department-wide IT budgets in accordance with the *Clinger-Cohen Act* and the department's mission and policy guidance. The DHS CIO plans to conduct reviews across the department of all investments that contain IT assets and services. The goals for IT budget reviews are to resolve IT budget issues prior to OMB submission, align IT investments with targets and priorities, and eliminate redundancies. Progress in this area was further evidenced by the FY 2010 IT budget planning guidance, issued in January 2008, on better integrating component IT resource reviews with DHS program and budget reviews. With support of DHS leadership, the	

[15] DHS-OIG, *National Applications Office Privacy Stewardship*, OIG-08-35, April 2008.

IT MANAGEMENT SCORECARD		
	DHS OCIO will continue to focus on improving IT budget capabilities.	
Component CIOs	**Modest Progress**	
	Overall, components demonstrated “modest” progress in conducting IT budget planning and programming functions. Although component-level IT budget responsibilities have increased through *DHS Management Directive* 0007.1, more than 70% of DHS component CIOs remain hindered by ineffective, decentralized IT budget practices. Most component CIOs plan to further centralize existing IT budget functions to meet requirements in the management directive to prepare a component IT budget. A number of DHS components are implementing initiatives to increase centralized management of IT investments by restructuring and consolidating IT spending accounts that are currently managed by separate offices throughout the agency.	
IT Strategic Planning: helps align the IT organization to support mission and business priorities.		
DHS CIO	**Moderate Progress**	
	Per OMB Circular A-130, an effective IT strategic plan establishes an approach to align resources and provides a basis for articulating how the IT organization will develop and deliver capabilities to support mission and business priorities. The DHS OCIO has made progress aligning IT with department goals. Although the current IT strategic planning approach does not fully link technology to mission requirements, the OCIO plans to achieve strategic outcomes and stronger IT alignment with the Secretary’s goals. The OCIO is currently updating DHS’ IT strategic plan and has communicated the plan’s goals to the CIO Council.	
Component CIOs	**Modest Progress**	
	As of January 2008, approximately 70% of the component-level CIOs had developed an IT strategic plan as required by *Management Directive* 0007.1. However, not all components can consistently link strategic goals and objectives with IT investments. Further, although some component CIOs said that they had developed an IT strategic plan, not all are up-to-date. Improvements are planned by some component CIOs who are updating their IT strategic plans. However, until the improvements are made, the agency may fall short of its potential to improve business processes and systems.	

IT MANAGEMENT SCORECARD		
Enterprise Architecture: functions as a blueprint to guide IT investments for the organization.		
DHS CIO	**Moderate Progress**	
	The *Clinger-Cohen Act*[16] requires that CIOs develop and implement an integrated IT architecture for the agency to avoid the risk that systems will be duplicative, not well integrated, and limited in optimizing mission performance. The DHS-level enterprise architecture has advanced greatly as an effective tool for reviews and IT management decision-making. Overall, the DHS OCIO has increased its ability to enforce architecture alignment through *Management Directive* 0007.1. Significant progress is due in part to the IT Acquisition Review process, which has helped promote and enforce such alignment. The OCIO plans to mature and optimize the department's architecture through performance-based outcomes and to develop the data architecture further in mission-critical areas.	
Component CIOs	**Moderate Progress**	
	Management Directive 0007.1 requires component CIOs to implement a detailed enterprise architecture specific to the component's mission and in support of DHS' mission. As of January 2008, more than 70% of the component-level CIOs could align IT investments with the department's architecture. Most components have component-level architectures used for some degree of IT investment decision-making. However, architecture products, such as reference models, definitions of current and future state architectures, and transition plans are in varying stages of development or use. A number of components said that their architecture products were out of date or needed to be better defined.	
Portfolio Management: improves leadership's ability to understand interrelationships between IT investments and department priorities and goals.		
DHS CIO	**Moderate Progress**	
	The DHS OCIO has made "moderate" progress in establishing the department's portfolio management capabilities as instructed by OMB Circular A-130.[17] The DHS portfolio management program aims to	

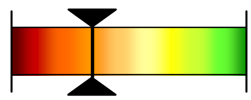
[16] *Clinger-Cohen Act of 1996*, Public Law 104-106, Division E, Section 5125, February 10, 1996.

[17] Revision of Office of Management and Budget Circular A-130, Transmittal 4, *Management of Federal Information Resources*, July 1994.

IT MANAGEMENT SCORECARD

group related IT investments into defined capability areas to support strategic goals and missions. Portfolio management improves leadership's visibility into relationships among IT assets and department mission and goals across organizational boundaries.

The DHS OCIO has a solid plan in place to implement portfolio management capabilities in FY 2008. The OCIO has recently finalized plans, along with the first round of documentation and guidance, for a department-level portfolio management approach. Currently, there are 22 defined portfolio areas, six of which are considered priority areas: infrastructure, geospatial, case management, human resources, screening and credentialing, and finance. In addition, OCIO has created a portfolio management integrated project team to develop transition plans, measure performance, and standardize the portfolio management process. Although progress is being made, the department is not yet realizing management benefits from the portfolio management program. As a result, the department may miss opportunities for system integration and cost savings.

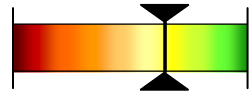
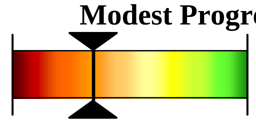
Component CIOs	**Modest Progress**	

Overall, DHS components have made "modest" progress in establishing portfolio management capabilities. Full implementation of this capability remains a work in progress, due in part to challenges in creating and aligning component-specific portfolios with DHS' 22 portfolios. Most DHS component-level CIOs have developed a mapping approach to align component IT systems with DHS-level portfolios.

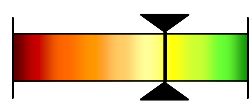
Many CIOs said that it is a complicated process to align their unique mission and business processes with multiple DHS-level IT portfolios. For example, Coast Guard officials said that they are working with DHS OCIO officials to determine which portfolios will be associated with each of the systems they identified in the IT budget review. Until this capability is fully implemented, DHS components may continue to invest in systems within organizational silos, limiting opportunities for consolidation and cost savings.

IT MANAGEMENT SCORECARD

Capital Planning and Investment Control: improves the allocation of resources to benefit the strategic needs of the department.

DHS CIO	**Moderate Progress**	
	The *Clinger-Cohen Act* requires that departments and agencies create a capital planning and investment control (CPIC) process to manage the risk and maximize the value of IT acquisitions. The CPIC process is intended to improve the allocation of resources to benefit the strategic needs of the department. As part of the CPIC process, agencies are required to submit business plans for IT investments to OMB demonstrating adequate planning. Through such efforts, in FY 2007, the 94 DHS programs on the management watch list were reduced to 18. In FY 2008, 53 programs are listed. Officials in the OCIO have sought to remove these programs from the list by working with the program managers through the CPIC Administrator's bimonthly meetings.	
Component CIOs	**Modest Progress**	**Modest Progress** 
	Most components have not yet achieved an integrated planning and investment management capability. More than 70% of the major DHS components had limited capital planning processes outside the existing OMB 300 process. However, some component CIOs said that they are creating a CPIC process to integrate with existing governance structures such as the Investment Review Board. For example, the ICE Investment Review Board resembles a CPIC group, incorporating major areas such as security, budget, and enterprise architecture. The ICE CIO said that this process has helped components leverage resources more effectively.	

IT Security: ensures protection that is commensurate with the harm that would result from unauthorized access to information.

DHS CIO	**Moderate Progress**	
	DHS IT security is rated at "moderate," for progress made during the last 2 years in compliance with FISMA. OMB Circular A-130 requires agencies to provide protection that is commensurate with the risk and magnitude of the harm that would result from unauthorized access to information and systems assets or their loss, misuse, or modification. The DHS CIO has taken an active role in ensuring that components comply with FISMA. In 2007, the CIO requested that components focus on improving areas such as certification and accreditation, annual self-	

IT MANAGEMENT SCORECARD	
	assessments, and plan of action and milestones management. According to the DHS OCIO, additional quality control measures have been implemented manage the certification and accreditation process better. The DHS OCIO also plans to focus on improving disaster recovery and continuity of operations over the coming year.
	(Components were not rated on IT Security)

CATASTROPHIC DISASTER RESPONSE AND RECOVERY

The primary mission of FEMA is to reduce the loss of life and property and protect the Nation from all hazards, including natural disasters, acts of terrorism, and other man-made disasters. FEMA does this by leading and supporting the Nation in a risk-based, comprehensive emergency management system of preparedness, protection, response, recovery, and mitigation.

In March 2008, we released a report on FEMA's progress in addressing nine key preparedness areas related to catastrophic disasters.[18] FEMA made moderate progress in five of the nine areas: overall planning, coordination and support, interoperable communications, logistics, and acquisition management. FEMA made modest progress in evacuation, housing, and disaster workforce, and limited progress in mission assignments. (Please see the catastrophic disaster response and recovery scorecard below for a discussion of selected areas.) Our broader recommendations addressed the improvements needed in overall planning, coordination, and communications. FEMA officials said that budget shortfalls, reorganizations, inadequate IT systems, and confusing or limited authorities impeded their progress.

In FY 2009, we will continue to conduct studies regarding FEMA's preparedness, response, and recovery efforts. These studies will allow us to further assess FEMA's progress in transforming itself to be better prepared to lead the federal effort in responding to a catastrophic disaster.

<u>Catastrophic Disaster Response and Recovery Scorecard</u>

The following scorecard highlights FEMA's progress in six key areas: logistics, evacuations, housing, disaster workforce, mission assignments, and acquisition management. The ratings were based on a four-tiered scale ranging from limited to substantial progress:

- **Limited**: There is an awareness of the critical issues needing to be addressed, but specific corrective actions have not been identified;
- **Modest**: corrective actions have been identified, but implementation is not yet underway;

[18] DHS-OIG, *FEMA's Preparedness for the Next Catastrophic Disaster*, OIG-08-34, March 2008.

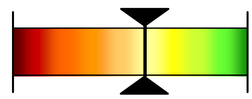
- **Moderate**: Implementation of corrective action is underway, but few if any have been completed; and
- **Substantial**: Most or all of the corrective actions have been implemented.

Based on the consolidated result of the six areas, FEMA has made "moderate" progress in the area of catastrophic disaster response and recovery.

FEMA CATASTROPHIC DISASTER RESPONSE AND RECOVERY SCORECARD

Logistics

Moderate Progress



The mission of FEMA's Logistics Management Directorate is to plan, manage, and sustain the national logistics response and recovery operations in support of domestic emergencies. FEMA has made "moderate" progress in meeting its logistics responsibilities such as acquiring, receiving, storing, shipping, tracking, sustaining, and recovering commodities, assets, and property in the event of a catastrophic disaster.

The *Post-Katrina Emergency Management Reform Act of 2006 (Post-Katrina Act)* [19] requires FEMA to develop a logistics system that provides visibility of disaster goods from procurement to delivery. FEMA has not yet met this requirement. FEMA's total asset visibility system is unable to track goods from warehouses to staging areas to distribution sites. Nor can it track goods received from federal and nonfederal partners. FEMA needs to finalize its logistics plans, implement standardized processes and procedures for logistics activities, and develop a strategy for acquiring IT systems to support the logistics mission.[20]

Determining the types and quantities of commodities that FEMA may need in the aftermath of a disaster is a continuing challenge. In 2005, FEMA was criticized for having too few commodities available in the aftermath of Hurricane Katrina. In 2006, FEMA acquired inventory that was not needed during the mild hurricane season, resulting in waste. In-depth analysis of this issue resulted in FEMA's determination that pre-positioning commodities is neither logistically prudent nor an effective use of taxpayer funds. Instead, FEMA plans to rely on public and private sector partners to provide needed items. FEMA appears to have made progress in developing these partnerships, as well as working more closely with states to determine where state shortfalls are likely to occur.

A Distribution Management Strategy Working Group is developing and documenting an integrated national policy and strategy for managing and controlling inventory,

[19] Public Law 109-295, Title VI – National Emergency Management, *Department of Homeland Security Appropriations Act of 2007*.

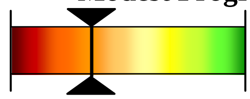
[20] DHS-OIG, *Logistics Information Systems Need to Be Strengthened at the Federal Emergency Management Agency*, OIG-08-60, May 2008.

FEMA CATASTROPHIC DISASTER RESPONSE AND RECOVERY SCORECARD

positioning commodities, and distributing critical resources. In the past, FEMA has been prone to drafting strategies, policies, and procedures that were never finalized. FEMA leadership should ensure that this Working Group proposes strategies and policies in a timely manner and that these proposals are promptly reviewed, finalized, and implemented.

Evacuations

Modest Progress

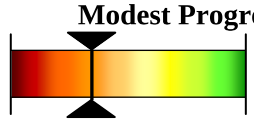


The conduct of evacuation operations is generally a state, tribal, and local responsibility. However, some circumstances exceed the capabilities of those jurisdictions to support mass evacuations. Where federal support is required, FEMA coordinates the support with the affected state, local and tribal governments. Federal support is scaled to the incident level and may be provided in the form of cost reimbursement or direct assistance, for example, providing buses, trains, and air ambulances for evacuation.

FEMA has a number of initiatives underway for improving evacuation management capabilities and published a *Mass Evacuation Incident Annex* describing evacuation functions and agency roles and responsibilities in mass evacuations. However, no single entity within FEMA is responsible for emergency evacuation planning or operations. FEMA has not yet developed a single national system to support multistate, state-managed, or local evacuation operations. Coordinating transportation for evacuees during emergencies, collaborating with states to receive and accommodate the needs of evacuees, and ensuring that dedicated resources are available to support evacuation plans, remain significant challenges.

Housing

Modest Progress



Although improvements have been made, disaster housing remains a major challenge, as demonstrated by the results of our recent audits of FEMA housing programs and initiatives. Issues with accountability, management, and disposal of emergency housing units persist. Plans for addressing catastrophic disaster housing needs must be developed and tested. As we have learned from past and recent disasters, not being prepared with a full range of housing options has significant implications for evacuees and the states and communities that host them.

In March 2008, we reported that FEMA had made modest progress in the key preparedness area of housing. While FEMA is striving to improve its disaster housing assistance strategy and coordination, it needs to develop and test innovative catastrophic disaster housing plans to deal with large-scale displacement of citizens for extended periods, where traditional housing programs have been shown to be inefficient, ineffective, and costly.

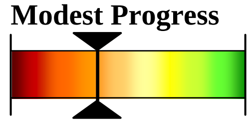
FEMA CATASTROPHIC DISASTER RESPONSE AND RECOVERY SCORECARD

In October 2008, we reported that FEMA's strategy for ending its direct housing assistance program is generally sound, and that FEMA has made considerable progress recovering temporary housing units in the Gulf Coast region.[21] However, FEMA's strategy is not complete since FEMA's strategy has not recertified resident eligibility or taken action to recover temporary housing units from ineligible residents. FEMA must implement the recertification of eligibility process to ensure recovery of all temporary housing units by March 1, 2009, which is the ending date of FEMA's direct housing assistance program for hurricanes Katrina and Rita.

The Post-Katrina Act requires FEMA to develop, coordinate, and maintain a National Disaster Housing Strategy (NDHS). FEMA released the draft NDHS for a 60-day public comment period in July 2008. We are currently conducting a review of FEMA's future housing strategies and are reviewing the NDHS as part of this effort. FEMA must move forward with a finalized strategy to guide future disaster housing efforts.

Disaster Workforce

Modest Progress



A trained, effective disaster workforce is one of the most effective tools FEMA has to meet its mission. FEMA's disaster workforce consists mainly of reservists who serve temporarily during a disaster, with no employee benefits. During the 2005 Gulf Coast hurricanes, FEMA struggled to provide qualified staff and did not have the automated support to deploy more than 5,000 disaster personnel on short notice. As FEMA evolves, its disaster workforce strategy, structure, and systems need to keep pace.

To date, FEMA has not completed or has not been able to verify the completion of five of nine workforce-related actions required by the *Post-Katrina Act*. The five incomplete or unconfirmed actions are:

- Developing a Strategic Human Capital Plan;
- Establishing career paths;
- Conferring with state, local, and tribal government officials when selecting regional administrators;
- Training regional strike teams as a unit and equipping and staffing these teams; and
- Implementing a surge force capacity plan.

The congressionally mandated due dates for these actions range from March 2007 through July 2007.

[21] DHS-OIG, *FEMA's Exit Strategy for Temporary Housing in the Gulf Coast Region,* OIG-09-02, October 2008.

FEMA CATASTROPHIC DISASTER RESPONSE AND RECOVERY SCORECARD

Mission Assignments

Limited Progress

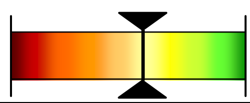
FEMA is responsible for coordinating the urgent, short-term emergency deployment of federal resources to address immediate threats and for stewardship of the associated expenditures from the Disaster Relief Fund. FEMA uses mission assignments to request disaster response support from other federal agencies. Past audits and reviews regarding mission assignments have concluded that FEMA's management controls were generally not adequate to ensure that:

- Deliverables (missions tasked) met requirements;
- Costs were reasonable;
- Invoices were accurate;
- Federal property and equipment were adequately accounted for or managed; and
- FEMA's interests were protected.

FEMA guidelines regarding the mission assignment process, from issuance of an assignment through execution and closeout, have never been fully developed, creating misunderstandings among federal agencies concerning mission assignment operational and fiduciary responsibilities. Implementing Section 693 of the *Post-Katrina Act*, which allows FEMA to designate up to 1% of the funds provided to federal agencies for disaster relief activities as oversight funds, will help ensure effective stewardship and oversight of monies the recipient agencies use for activities conducted under the FEMA reimbursable mission assignment process.

Acquisition Management (Catastrophic Disasters)

Moderate Progress



After a disaster, FEMA's tendency has been to acquire goods and services quickly, but with insufficient attention to costs, definition of requirements, and competition. To balance urgency of needs with good business practices, FEMA's OAM has awarded approximately 27 pre-disaster response contracts and 70 recovery contracts. Planning and negotiating these contracts in advance of a disaster provides more advantageous terms to the government and more opportunity for small and local businesses.

FEMA has found it difficult to recruit experienced acquisition staff. FEMA has increased its acquisition staff from just 35 when Hurricane Katrina struck to about 150 today. FEMA has also increased staffing and training of contracting officer's technical representatives (COTRs), who are responsible for technical contract oversight, inspecting goods, and approving invoices. However, staffing remains a challenge. The new acquisition personnel need training and experience in acquiring goods and services under emergency circumstances. Recent OIG reports recommended increased oversight of contractor actions and reviews of services and invoices by COTRs.

FEMA CATASTROPHIC DISASTER RESPONSE AND RECOVERY SCORECARD

FEMA needs to continue hiring and training acquisition personnel, allocating staff where the need is greatest among Headquarters and the 10 FEMA regional offices, and developing reliable, integrated financial and information systems.

GRANTS MANAGEMENT

Monitoring and documenting the effectiveness of DHS' multitude of grant programs poses an increasingly significant challenge for the department. DHS manages more than 80 disaster and non-disaster grant programs. This challenge is compounded by other federal agencies' grant programs that assist state and local governments in improving their abilities to prepare for, respond to, and recover from acts of terrorism or natural disasters. FEMA has yet to fully implement the April 2007 reorganization directed by the *Post Katrina Emergency Management Reform Act of 2006*. Most states are not sufficiently monitoring subgrantee compliance with grant terms and cannot clearly document critical improvements in preparedness as a result of grant awards.

During FY 2008, we issued audit reports on homeland security preparedness grant management by the states of New Jersey, Ohio, Michigan, Georgia, Florida, Utah, Arizona, and Washington. These states generally did an adequate job of administering the program requirements; however, the most prevalent areas needing improvement concerned the monitoring of subgrantees and controls over personal property and equipment.

We are concluding audits of the effectiveness of grant awards under the State Homeland Security Grant Program in California and Illinois. During the first quarter of FY 2009, we also anticipate issuing an audit mandated by the *Implementing Recommendations of the 9/11 Commission Act of 2007* (Public Law 110-53) on FEMA's grant management and oversight practices.

Given the billions of dollars appropriated annually for preparedness, disaster, and non-disaster grant programs, DHS needs to ensure that internal controls are in place and adhered to, and that grant recipients are sufficiently monitored to achieve successful outcomes. DHS should continue refining its risk-based approach to awarding preparedness grants to ensure that areas and assets that represent the greatest vulnerability to the public are as secure as possible. Sound risk management principles and methodologies will help DHS prepare for, respond to, recover from, and mitigate acts of terrorism and natural disasters.

INFRASTRUCTURE PROTECTION

DHS has direct responsibility for leading, integrating, and coordinating efforts to protect 10 critical infrastructure and key resources (CI/KR) sectors: the chemical industry; commercial facilities; dams; emergency services; commercial nuclear reactors, materials, and waste; information technology; telecommunications; postal and shipping; transportation systems; and government facilities. In addition, DHS has an oversight role in coordinating the protection of seven sectors for which other federal agencies have primary responsibility.[22] The requirement to rely on federal partners and the private sector to deter threats, mitigate vulnerabilities, or minimize incident consequences complicates protection efforts for all CI/KR. Combined with the uncertainty of the terrorist threat and other manmade or natural disasters, the implementation of protection efforts is a great challenge.

In FY 2007, we reported several opportunities for DHS to improve its engagement of public and private partners and to prioritize resources and activities based on risk.[23] For example, a comprehensive national database that inventories assets is essential to provide a comprehensive picture of the Nation's CI/KR and to enable management and resource allocation decision-making. We are reviewing how DHS uses an asset database to support its risk management framework. We also plan to evaluate how DHS coordinates infrastructure protection with other sectors by reviewing the protection of petroleum and natural gas infrastructure within the energy sector.

Protecting national as well as internal cyber infrastructure continues to be a challenge for DHS. We recently reviewed the department's progress in identifying and prioritizing its internal cyber critical infrastructure in accordance with Homeland Security Presidential Directive 7.[24] This directive established a national policy for the federal government to identify, prioritize, and protect U.S. critical infrastructure, including the internal critical assets used by each department. We found that the department needs to take additional steps to produce a prioritized inventory and to coordinate related efforts to secure these assets. We recommend that the department assign responsibility and provide the resources necessary to determine protection priorities for its internal critical infrastructure, including critical cyber infrastructure. In addition, the department should develop a process to coordinate internal efforts to protect these assets. In FY 2009, we plan to review the National Cyber Security Division's strategy for control systems security and its Computer Emergency Readiness Team.

BORDER SECURITY

A principal DHS challenge is reducing America's vulnerability to terrorism by controlling the borders of the United States. To this end, DHS is implementing the Secure Border Initiative (SBI), a comprehensive multi-year program to secure the borders and reduce illegal immigration. The Coast Guard, U.S. Citizenship and Immigration Services, CBP, and ICE

[22] The seven sectors for which DHS has an oversight role are agriculture and food; the defense industrial base; energy; public health and healthcare; national monuments and icons; banking and finance; and water and water treatment systems.
[23] DHS OIG, *A Review of Homeland Security Activities Along a Segment of the Michigan-Canadian Border*, OIG-07-68, August 2007; *Review of the Buffer Zone Protection Program*, OIG-07-59, July 2007; *The Department of Homeland Security's Role in Food Defense and Critical Infrastructure Protection*, OIG-07-33, February 2007.
[24] DHS OIG, *Letter Report: DHS Needs to Prioritize Its Cyber Assets*, OIG-08-31, March 2008.

all have key roles in the SBI program. To ensure SBI success, it is critical that the program be thoroughly planned. DHS also must institute an approach to coordinating the SBI functions and activities of the participating DHS components with the related efforts of other agencies. We are conducting a series of audits to evaluate whether the SBI program initiatives are being accomplished in an economical, efficient, and effective manner.

The technology component of SBI, known as SBInet, involves the acquisition, development, integration, and deployment of surveillance systems. It also involves communications and intelligence technologies. In FY 2006, we recommended that CBP improve the effectiveness of remote surveillance technology to correct the lack of integration between border surveillance cameras and ground sensors, which were plagued by false alarms.[25] CBP has made some progress in improving surveillance and detection technology along the Southwest border via Project 28, which includes enhanced radars, sensors, and cameras. However, delays associated with software integration problems have required CBP to extend the completion dates for implementation from December 2008 to sometime in 2009. Consequently, Border Patrol Agents continue to use technology that predates SBInet and, in the Tucson, Arizona sector, they are still using capabilities from SBInet's prototype system despite previously reported performance shortfalls.[26]

The definition and management of requirements is another significant challenge for the SBI*net* program. According to GAO,[27] the SBI*net* program office issued guidance on the development and acquisition of software and systems that is consistent with recognized leading practices. However, this guidance was not finalized until February 2008, and thus was not used in performing a number of important requirements-related activities. For example, there is a lack of traceability among the different levels of requirements. This limits the program office's ability to determine whether the scope of the contractor's design, development, and testing efforts will produce a system that meets operational needs and performs as intended.

Also, efforts are needed to ensure that ICE can support its detention and removal operations. In our recent reviews of ICE's oversight of immigration detention facilities, we recommended that ICE improve its standards, strengthen its oversight of facilities, and enhance operations.[28] We are completing an audit of ICE's acquisition and management of "bed space" needs to support detention and removal operations.

[25] DHS-OIG, *A Review of Remote Surveillance Technology along U.S. Land Borders*, OIG-06-15, December 2005.
[26] GAO-08-1141T, *SBI Observations on Deployment Challenges*, September 2008.
[27] GAO-08-1086, *Secure Border Initiative: DHS Needs to Address Significant Risks in Delivering Key Technology Investment*, September 2008.
[28] DHS-OIG, *ICE Policies Related to Detainee Deaths and the Oversight of Immigration Detention Facilities*, OIG-08-52, June 2008; DHS-OIG, *ICE's Compliance with Detention Limits for Aliens with Final Order for Removal from the U.S.*, OIG-07-28, February 2007; DHS-OIG, *U.S. Immigration and Customs Enforcement's Detainee Tracking Process*, OIG-07-08, November 2006; DHS-OIG, *Treatment of Immigration Detainees Housed at Immigration and Customs Enforcement Facilities*, OIG-07-01, December 2006; *Detention and Removal of Illegal Aliens*, OIG-06-33, April 2006.

TRANSPORTATION SECURITY

The Nation's transportation system, which moves millions of passengers and tons of freight every day, is an attractive terrorist target and creates an enormous security challenge due to its size and complexity. TSA was originally created as a part of the Department of Transportation after September 11, 2001, to strengthen the security of the Nation's transportation systems, including aircraft, ships, rail, motor vehicles, airports, seaports, transshipment facilities, roads, railways, bridges, and pipelines. However, since its inception, TSA has focused on aviation.

Checkpoint and Checked Baggage Performance

The *Aviation and Transportation Security Act*[29] requires TSA to screen or inspect all passengers, goods, and property before entry into the sterile areas of an airport. Our undercover audits of screener performance revealed that improvements are needed in the screening process to ensure that dangerous prohibited items are not carried into the sterile areas of heavily used airports and do not enter the checked baggage system. In past testing, we noted four areas that caused most of the test failures: training; equipment and technology; policies and procedures; and management and supervision. TSA agreed with our conclusion that significant improvements in screener performance will be possible only with the introduction of new technology. TSA plans to purchase 300 advanced technology x-rays and 80 passenger imagers. Currently TSA has 700 advanced x-rays and 40 passenger-imaging units deployed at 12 airports. We recently released a classified report on our penetration testing results, specifically at those airports with explosives trace portals and an airport that had a whole body imager, and found that improvements to effectively secure sterile airport areas are still needed.[30]

The OIG will continue to exercise oversight of TSA's performance and processes of checkpoint and checked baggage screening. We are currently in the process of conducting audits of TSA's controls over screener uniforms, badges, and identification cards, as well as the effectiveness of TSA's explosives detection systems on-screen alarm resolution protocol. These reports will be issued later this year.

Employee Workplace Issues

A stable, mature, and experienced TSA workforce is one of the most effective tools to meet the agency's mission. Despite the value of the TSA workforce, employees have expressed their concerns about how the agency operates by historically filing formal complaints at rates higher than other federal agencies of comparable size. Our audit of TSA's efforts to address employee concerns found that low employee morale continues to be an issue at some airports and has contributed to TSA's 17% voluntary attrition rate.[31]

[29] Public Law 107-71, November 19, 2001.
[30] DHS-OIG, *Airport Passenger and Checked Baggage Performance*, OIG-08-25, February 2008.
[31] DHS-OIG, *TSA's Efforts to Proactively Address Employee Concerns*, OIG-08-62, May 2008.

More than half the employees we interviewed described the agency's efforts to educate them on the various initiatives available to address their workplace concerns as "inadequate." We made six recommendations to the Assistant Secretary of TSA to provide employees with sufficient tools, including clear guidance and better communication, on the structures, authorities, and oversight responsibilities of the initiatives we reviewed. TSA fully or partly concurred with five of the recommendations and has taken action to resolve them.

Passenger Air Cargo Security

The vast and multifaceted U.S. air cargo system transports approximately 7,500 tons of cargo on passenger planes each day, making air cargo vulnerable to terrorist threats. Federal regulations (49 CFR) require that, with limited exceptions, passenger aircraft may *only* transport cargo originating from a shipper that is verifiably "known" either to the aircraft operator or to the indirect air carrier that has tendered the cargo to the aircraft operator. We are conducting an audit to assess how TSA ensures that cargo from unknown shippers is not being shipped on passenger planes. This report is expected to be issued later this year. During 2009, we also plan to audit TSA's cargo security measures during ground movement.

Rail and Mass Transit

Since the terrorist attacks of September 11, 2001, the London subway bombings, and the Madrid rail bombings, DHS has taken steps to manage risk and strengthen our Nation's rail and transit systems. While most mass transit systems in this country are owned and operated by state and local government or private industry, securing these systems is a shared responsibility among federal, state, and local partners.

DHS operates multiple programs, including several grants, to improve rail and mass transit security. In June 2008, we reported on TSA's efforts to secure mass transit through four major assistance programs: the Surface Transportation Security Inspection Program, Transit Security Grant Program, Visible Intermodal Prevention and Response program, and the deployment of canine explosive detection teams for rail.[32] TSA needs to clarify its transit rail mission, improve interoffice communication and coordination, develop memorandums of understanding with local transit authorities, and develop additional regulations. TSA also needs to understand and address system-specific security requirements better. We are completing mandates to review the effectiveness of the Trucking Industry Security Grant Program and to report further on the Surface Transportation Security Inspection Program.

During emergencies transit agencies must rely on well-designed and regularly practiced drills and exercises to respond and recover rapidly and effectively. Recent events on the rail systems in Washington DC, including a derailment and a fire, have raised questions regarding the mass transit agencies' contingency plans and the ability to handle these basic issues, as well as major emergencies. We will evaluate TSA's efforts to ensure that mass transit agencies are prepared to respond and recover from emergencies on passenger rail systems. We will review TSA's role in security program management and accountability,

[32] DHS-OIG, *TSA's Administration and Coordination of Mass Transit Security Programs,* OIG-08-66, June 2008.

security and emergency response training, drills and exercises, public awareness, and other protective measures for passenger rail systems.

TRADE OPERATIONS AND SECURITY

CBP is primarily responsible for trade operations and security, with the support of the Coast Guard and ICE. Each year, more than 16 million containers arrive in the United States by ship, truck, and rail. CBP typically processes more than 70,000 truck, rail, and sea containers per day, along with the personnel associated with moving this cargo across U.S. borders or to U.S. seaports. Modernizing trade systems, using resources efficiently, and managing and forging partnerships with foreign trade and customs organizations pose significant challenges for CBP and DHS.

CBP works with trade representatives to implement processes and systems to help secure the supply chain and uses targeting systems to identify the highest risk cargo on which to focus its limited resources. Recently, CBP increased its international efforts to secure the cargo supply chain by expanding its work with the Customs-Trade Partnership against Terrorism program and by improving its multi-layered security strategy.

The *Coast Guard and Maritime Transportation Act of 2004* (Public Law 108-293) requires us to evaluate and report annually on the effectiveness of the Automated Targeting System (ATS), which is an intranet-based enforcement and decision support tool used by CBP seaport inspectors to help determine which containers entering the country will undergo inspection. Our annual ATS review in 2008[33] focused on a subsystem of ATS, the Cargo Enforcement Reporting and Tracking System (CERTS), which is designed to gather data on cargo examination findings and report on how efficiently examination equipment is being used. We identified the need for improvements in planning, updating, developing, and implementing CERTS. Specifically, CBP needs to update the project plan to include the scope of work, and a detailed implementation schedule for system design, developing and testing, and cost estimates past phase one. In addition, CBP bypassed key life cycle reviews designed to ensure that end users have a properly working system and have received management's approval to continue the project.

The Coast Guard is responsible for developing and implementing a comprehensive National Maritime Transportation Security Plan to deter and respond to transportation security incidents. Our most recent annual review of mission performance[34] revealed that the Coast Guard must make several improvements to implement the *Maritime Transportation Security Act of 2002* (Public Law 107-295) in a timely and effective manner. For example, the Coast Guard needs to balance the resources devoted to the performance of homeland and non-homeland security missions; improve the performance of its homeland security missions; maintain and re-capitalize its Deepwater fleet of aircraft, cutters, and small boats; restore the

[33] DHS-OIG, *Targeting of Cargo Containers 2008: Review of CBP's Cargo Enforcement Reporting and Tracking System*, OIG-08-65, June 2008.
[34] DHS-OIG, *Annual Review of Mission Performance – FY2006*, OIG-08-30, February 2008.

readiness of small boat stations to perform their search and rescue missions; and increase the number and quality of resource hours devoted to non-homeland security missions.

We are reviewing CBP's Account Management Program and National Targeting and Analysis Groups, which aim to improve revenue collection compliance. We are also reviewing DHS' planning, management oversight, and implementation of security measures to protect against small vessel threats.

Appendix A
Report Distribution

Department of Homeland Security

Secretary
Deputy Secretary
Executive Secretariat
Chief of Staff
Deputy Chief of Staff
General Counsel
Under Secretary Management
Assistant Secretary for Public Affairs
Assistant Secretary for Policy
Assistant Secretary for Legislative Affairs
Chief Financial Officer
Chief Information Officer
Chief Security Officer
Chief Privacy Officer

Office of Management and Budget

Chief, Homeland Security Branch
DHS' OIG Program Examiner

Congress

Congressional Oversight and Appropriations Committees, as appropriate

ADDITIONAL INFORMATION AND COPIES

To obtain additional copies of this report, please call the Office of Inspector General (OIG) at (202) 254-4199, fax your request to (202) 254-4305, or visit the OIG web site at www.dhs.gov/oig.

OIG HOTLINE

To report alleged fraud, waste, abuse or mismanagement, or any other kind of criminal or noncriminal misconduct relative to department programs or operations:

• Call our Hotline at 1-800-323-8603;

• Fax the complaint directly to us at (202) 254-4292;

• 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.

Management's Response to Major Management Challenges Facing the Department of Homeland Security

The Reports Consolidation Act of 2000 requires that the Department include a statement by the Inspector General that summarizes the most serious management and performance challenges facing the Department and briefly assesses the progress in addressing those challenges. The Office of Inspector General (OIG) considers the most serious management and performance challenges to the Department to be in the following areas:

- Acquisition Management;
- Financial Management;
- Information Technology Management;
- Catastrophic Disaster Response and Recovery;
- Grants Management;
- Infrastructure Protection;
- Border Security;
- Transportation Security; and
- Trade Operations and Security.

In addition to the OIG report on management challenges, the Government Accountability Office (GAO) identifies Federal programs and operations that are high-risk due to their greater vulnerabilities to fraud, waste, abuse, and mismanagement. GAO periodically publishes updates to their High-Risk Series. In recent years, GAO has also identified high-risk areas to focus on the need for broad-based transformations to address major economy, efficiency, or effectiveness challenges. The areas that fall within the Department's purview and the year the issue was identified are listed below. The GAO maintains these issues in their High-Risk Series until satisfied that acceptable progress has been made to correct the issues.

- Implementing and Transforming the Department of Homeland Security (2003);
- National Flood Insurance Program (2006);
- Protecting the Federal Government's Information Systems and the Nation's Critical Infrastructures (1997); and
- Establishing Appropriate and Effective Information-Sharing Mechanisms to Improve Homeland Security (2005).

The Department of Homeland Security has steadfastly worked to resolve the challenges identified in the Inspector General's FY 2008 report and the GAO High-Risk Series. The Department will continue to address the unresolved challenges, many of which may require several years to completely address due to the complexity of the challenge.

The following highlights the accomplishments of the Department during FY 2008, and details the future plans to be completed to overcome these significant challenges identified by the OIG. DHS has published their plans to address the GAO High-Risk Series separately and this information can be found at http://www.dhs.gov/xabout/budget/gc_1214229806734.shtm.

FY 2008 Challenge 1: Acquisition Management

The Office of Chief Procurement Officer (OCPO) continues to take leadership responsibility for the Department's efforts to improve its functional capabilities, to utilize sound acquisition practices, and to achieve quality business results as it engages in acquiring the complex and diverse requirements to meet DHS's varied missions. The past year's successes have served to strengthen the acquisition infrastructure and produce:

- Better organizational alignment of acquisition functions;
- Improved acquisition policies and processes;
- Enhanced workforce capabilities; and
- Increased capability to retrieve and report data.

The Department will continue to build upon its successes to improve and strengthen acquisition management to ensure security of the Homeland.

Organizational Alignment and Leadership

In order to establish clear lines of authority and accountability within individual Component acquisition communities and to the Department's Chief Procurement Officer (CPO), the OCPO drafted Management Directive 252-01, Acquisition Line of Business Integration and Management, and Instruction 252-07-001. The directive authorizes the establishment of the position of Component Acquisition Executive to be responsible for all acquisition functions, except for contracting and procurement, within each Component. The Head of Contracting Activity would be responsible for all contracting and procurement functions. The Component Acquisition Executives and the Heads of Contracting Activity would report to their respective Component heads, but would be subject to the policies and oversight of the Acquisition Line of Business Chief.

To provide management oversight in key decision points throughout a program's lifecycle, two new Senior-Executive led divisions were established within the OCPO, the Cost Analysis Division and the Acquisition Program Management Division. The Cost Analysis Division provides cost estimating guidance, oversight of program-generated cost estimates, and addresses systemic issues associated with existing Life Cycle Cost Estimates. The Cost Analysis Division is currently engaged in providing a life cycle cost assessment of all DHS Level I investments prior to that investment being presented to a formal Acquisition Review Board for a development or production decision.

The Acquisition Program Management Division was established to strengthen acquisition program management within the Department by ensuring that program management teams are appropriately staffed and trained, and sound program management principles are applied. The Acquisition Program Management Division worked collaboratively with representatives Department-wide to develop a revised Acquisition Management framework. The framework provides governance to DHS's investment programs and reinstituted the Investment Review Board process with a more rigorous oversight function. The Chief Information Officer's Enterprise Architecture Board and the Chief Administrative Officer's DHS Asset Review Boards provide technical expertise and assistance to the Board where needed. During the period from September 2007 to September 2008, the Acquisition Program Management Division conducted 37 quick-look program reviews of

Level 1 investment programs, two Independent Review Team level program reviews, and eight Investment Review Boards.

To foster collaboration and integration among the Department's acquisition community, the Acquisition Policy and Legislation Branch chairs a monthly OCPO Acquisition Policy Board for the purpose of conveying acquisition related information and exchanging best practices.

Future Actions

- OCPO is working to release two major policy documents that will overhaul the current alignment of the acquisition community;
  - One policy document is the Line of Business Directive that will clarify the lines of authority and the roles and responsibilities of the acquisition community within DHS.
  - A second policy document is a companion to the Line of Business Directive and will furnish implementation instructions.
- OCPO will improve the compatibility for improving cost goals by leading the Department's efforts to standardize cost estimating practices and models, providing up-to-date estimating guidance, and expanding the range of cost estimating support to the Components;
- The Cost Analysis Division will provide Acquisition Review Board assessments and furnish consulting services to the Components to further institute department-wide standardization of good costing principles; and
- OCPO will jointly develop with the Government Accountability Office a Cost Assessment Guide and ensure that DHS's acquisition community is informed of changes.

<u>Policies and Processes</u>

During FY 2008, the OCPO strengthened its policies and processes to further integrate planning, requirements, budgeting, and acquisition decisions and actions. The Acquisition Policy and Legislation Branch revised the Homeland Security Acquisition Regulations and the Homeland Security Acquisition Manual, the primary source of acquisition guidance Department-wide, to incorporate significant policy revisions. Several of these regulatory changes were incorporated into the Federal Acquisition Regulation (FAR). DHS procurement personnel are engaged with various FAR Teams in analyzing complex acquisition related issues and recommending government-wide policy. DHS guidance regarding Interagency Agreements was developed and disseminated with stakeholder cooperation, input, and buy-in that resulted in reduced time and effort required to enter into Interagency Agreements.

To increase acquisition oversight, OCPO published the Acquisition Oversight Program Guidebook to promote sound business processes in financial accountability. Internal controls for our investments were instituted through our Acquisition Oversight Program which was favorably reviewed by the Comptroller General.

OCPO revised the Quarterly Operational Status Report that furnishes metrics that gauge the success of the DHS Components' acquisition programs. These metrics report internal management controls while providing a verification and validation mechanism. The enhanced reporting capability ensures that essential data is obtained for establishing benchmarks to monitor the acquisition processes at each of the Components.

OCPO also completed field work to establish a baseline for each of the Components' procurement practices and operations. These on-site reviews served as a foundation for future oversight reviews by providing: 1) a listing of best practices for distribution and consideration by the Components; 2) a mechanism for identifying systemic issues, recommendations, and action plans; and 3) a basis for conducting assessments and tailoring future review programs to focus on key issues identified in past reviews. These reviews also entailed reviewing Component Heads of Contracting Activity human resources capacity and assessed IT system functionality to facilitate acquisitions and integration with financial systems. Additionally, the Acquisition Oversight Branch has conducted three special reviews of high-risk acquisitions to assess all aspects of the acquisition, provide a risk analysis, and recommending improvements for these acquisitions. This branch has also developed a capability and capacity to monitor and review high-risk contracts for the purposes of managing and mitigating risk and overseeing the awarded contracts. It also recognized the importance of improving the process of evaluating cost and pricing of contracts by conducting training to improve the skills of acquisition professionals with regard to the pricing of contracts whenever cost or pricing principles are to be applied. The training has further assisted with ensuring compliance with Federal laws, policies, and regulations.

The Head of Contracting Activity Desk Officer Branch reviewed more than 100 acquisition-related documents, valued at over $50 million each, provided consulting services and furnished business recommendations to DHS's acquisition professionals including new acquisition initiatives and opportunities. The Desk Officer Branch provided procurement subject matter experts to support the Acquisition Oversight reviews, Acquisition Program Management Division reviews, the Office of Management and Budget (OMB) Exhibit 300 reviews, and participated on the source selection teams for several of DHS's high visibility acquisitions.

To further institutionalize Performance Based Acquisitions (PBA) the OCPO released a memorandum to the Heads of Contracting Activity emphasizing the Chief Procurement Officer's commitment to improving the quality and appropriate application of PBA, and requesting that each Component update its Performance Based Acquisition Management Plan. The Oversight Branch within the OCPO is also taking action to improve the Department's PBA reporting. OCPO conducted procurement management reviews of a sample of performance-based contracts within DHS Components to ascertain whether they include fundamental PBA elements such as performance-based statements of work and corresponding performance metrics, and to ensure that a quality assurance surveillance plan is in place and being used to validate the contract compliance with the contract mandated outcomes. PBA data is reviewed on a quarterly basis with the Department's PBA goals to outcomes; feedback capability is being added to this process this quarter. The GAO determined that the contracts that were reviewed had outcome-oriented requirements. The OCPO continues to work with Program Mangers to provide support and oversight to implement Performance Based Contracting for major, complex acquisitions.

The Acquisition Program Management Division initiated and continues to chair a Program Management Council that meets regularly to discuss policies, procedures, and current issues affecting government acquisition, and completed a rewrite of a management directive that established a new process to be followed by all significant acquisition programs. An Acquisition Program Baseline guide was created to foster meaningful content and strong programmatic documentation of a program's cost, schedule, performance thresholds and objectives with quantifiable metrics from which progress can be measured and assessed. Once a requirement is identified, validated and resourced, the program will be subject to reviews at critical decision points to ensure continued investment in the program is in the best interest of the government.

Future Actions

- OCPO will continue to align the Homeland Security Acquisition Manual and the Homeland Security Acquisition Regulations to meet the Component's acquisition needs and align with the Federal Acquisition Regulation requirements;
- OCPO will develop and disseminate guidance to improve the acquisition communities' knowledge of important aspects of acquisition, such as Intellectual Property, Government Furnished Property, Source Selection and Protests; and
- OCPO will continue to aggressively pursue the development of policies and procedures that are necessitated by legislation, such as the National Defense Authorization Bill of 2009, that has requirements impacting the Federal Acquisition system and its workforce, as well as the need to respond to agendas of the next President's Administration and the next session of Congress, which are both expected to push for acquisition reforms.

Acquisition Workforce

Significant strides have been taken to create an acquisition workforce program that reflects the need to recruit, train, and retain a cadre of acquisition professionals with multiple disciplines. The Acquisition Workforce Branch has focused on four acquisition workforce initiatives:

1) Establishment of the Acquisition Professional Career Program;
2) Certification and training requirements for acquisition functional areas;
3) Creation of a centralized acquisition training fund; and
4) Centralized recruitment and hiring of acquisition personnel.

The OCPO-led recruitment efforts resulted in a net increase of 147 contracting professionals and 49 highly qualified procurement interns hired under the Acquisition Professional Career Program being placed into acquisition offices Department-wide.

The same attention given to the recruitment of staff is being directed to the retention of our existing staff. In this respect, retired acquisition personnel were hired to serve as mentors to our acquisition interns in the training and oversight areas, and a tuition assistance program was instituted by the Head of Contracting Activity of the Office of Procurement Operations. Annual employee satisfaction surveys, an exit survey, and structured rotational and development work assignments were also implemented.

The Department made progress in certifying personnel in the acquisition career fields of Contract Specialists, Program Management, and Contracting Officer Technical Representatives. Four hundred ninety nine contracting professionals Department-wide achieved their Level I, II, or III Federal Acquisition Certification in Contracting; 561 program management professionals achieved certification at Levels I, II, or III; and 2,283 personnel achieved Contracting Officer Technical Representatives certification. The Chief Procurement Officer established revised training, standards, and certification processes for program managers pursuant to Management Directive 782, after analyzing multiple certification systems, including the Defense Department's Defense Acquisition Workforce Improvement Act-based system; the Federal Acquisition Institute's policy, and the Program Management Institute's guidelines.

Acquisition-related training was centralized across the Department to enable all DHS acquisition professionals to receive training promptly. As a result, 711 acquisition professionals were trained in various required courses. The culmination of these activities has yielded an acquisition professional better equipped to support the DHS mission and a DHS workforce with the requisite skills, knowledge, and abilities to accomplish its responsibilities.

Future Actions

- The Acquisition Professional Career Program will be adding an additional 150 contracting interns through FY 2010 and seeking to strengthen program management, including related functions such as cost analysis, logistics, systems engineering, and testing and evaluation;
- OCPO's certification program will continue to establish standards for additional acquisition career fields that will lead to minimizing skill and competency gaps and critical vacancies;
- To aid with succession planning, a mechanism to identify acquisition professionals will be developed to help ensure that acquisition positions are filled by an acquisition professional trained and certified at the appropriate level; and
- Additionally, recruitment efforts will be centralized to improve efficiency and increase the Department's ability to attract and retain quality acquisition professionals.

Knowledge Management and Information Systems

The Acquisition Systems Branch is managing the Enterprise Acquisition System Initiative to consolidate and standardize the Department's contract writing and management systems. The Federal Law Enforcement Training Center was migrated to the enterprise system, and the Federal Emergency Management Agency conducted acceptance testing for compatibility with their financial management system. The enterprise system was rehosted to the DHS-secure environment at Stennis, Mississippi. To address FY 2007 Appropriations Act language authorizing the establishment of a Disaster Response Registry, the Branch headed efforts to incorporate the functions of this registry into the Central Contractor Registry in order to utilize a single government-wide repository for collecting contractor business data.

The Acquisition Program Management Division, in collaboration with the DHS Chief Information Officer (CIO), developed a new internal periodic reporting system for acquisition programs. The system is centered on the parameters established in the Acquisition Program Baseline, and includes other commonly accepted best practice metrics, such as Earned Value Metrics, and a Probability of Program Success assessment technique modeled after similar systems at the Department of Defense, U.S. Coast Guard, and other agencies. The new periodic reporting system provides Components and the Department with a structured approach to produce standardized program cost, schedule, and performance metrics. This system will increase program oversight by senior managers and program managers.

To improve the Department's reporting capabilities and increase the reliability of information posted to the Federal Procurement Data System-Next Generation, a standard report format was developed that meets mandatory requirements. In addition, Heads of Contracting Activity are held accountable for accurately reporting their acquisitions. An improved formal agreement with General Services Administration to expedite posting of National Interest Actions in the Federal Procurement Data System was also implemented.

Future Actions

- Plans for information retrieval and reporting efforts in the short term are going to focus on increasing the integrity and enhancing the reporting of acquisition related data;
- To aid Program Mangers and their leadership with obtaining real time reporting of meaningful information regarding their program, the OCPO, in collaboration with the Chief Information Officer, is leading efforts to pilot a web-based reporting system that provides current metrics, conditions, and issues related to a given program. The principal means of reporting procurement data to interested parties outside the agency is the Federal Procurement Data System-Next Generation;
- OCPO is working closely with the systems program personnel to make improvements that will produce a higher quality system that produces more meaningful results;
- Additionally, OCPO is working to ensure the integrity of the data by certifying that the data input into the system is as current, complete, and accurate as possible; and
- The Department will continue migrating components to the Enterprise System for uniform contract writing.

U.S. Coast Guard Acquisition Processes

During the last year, the U.S. Coast Guard has instituted a more disciplined approach to many aspects of the business processes within acquisition. Having implemented reforms addressing contracting, program management (for cost, schedule and performance), personnel, policies and procedures -- the U.S. Coast Guard has taken a major step toward building capability and capacity, and instituting more effective contract and program management oversight. This response addresses the Inspector General's challenge regarding U.S. Coast Guard's Deepwater acquisition to recapitalize many of its assets.

Blueprint for Acquisition Reform

The *Blueprint for Acquisition Reform* is the U.S. Coast Guard's capstone strategic document for reshaping its acquisition and contracting capabilities. The Blueprint for Acquisition Reform was developed using the GAO's *Framework for Assessing the Acquisition Function at Federal Agencies* (September 2005), and later revised for alignment with Office of Federal Procurement Policy *Guidelines for Assessing the Acquisition Function* (May 2008). It provides the framework for establishing the capacity and capability of the U.S. Coast Guard to organically acquire assets and services in four areas: Organizational Alignment and Leadership, Policies and Processes, Human Capital, and Information Management and Stewardship. Each of these four focus areas are further divided into key elements, each aligned with critical success factors to measure attainment of the key element. The central goal is to enhance the U.S. Coast Guard's mission execution through effective and efficient acquisition and contracting activities.

In July 2008, the Blueprint for Acquisition Reform underwent an annual update to Version 3.0. The document was developed collaboratively between the major offices within the U.S. Coast Guard's Acquisition Directorate (CG-9) and reviewed by senior U.S. Coast Guard leadership. Along with overall strategic direction, it provides a summary of directorate objectives for the next year and a two-year rolling action plan. The revised action plan provides updates and adjustments to the existing action items and adds 62 new actions. Prior to the shift from Version 2.0, the U.S. Coast Guard was "on schedule" with 59 percent of action items completed during the first of two plan years. To date, the new Version 3.0 has more than 43 percent of the existing (Version 2.0) and new actions completed.

The establishment of a centralized Acquisition Directorate (CG-9) in July 2007 set the stage for fundamental progress in U.S. Coast Guard acquisition reform efforts that continued throughout 2008, including:

- Continued integration of organic technical authority review in acquisition projects, and strengthened partnerships with other directorates including Human Resources (CG-1); Engineering and Logistics (CG-4); Command, Control, Communications, Computers and Information Technology (CG-6); and alignment with the Sponsor, Operations Directorate (CG-7);
- Continued incorporation of independent, third party review of major acquisitions, along with more robust organic and governmental certification programs;
- Continued emphasis on acquisition discipline in documented, transparent and repeatable practices through the development of Standard Operating Procedures, and adherence to the U.S. Coast Guard's *Major Systems Acquisition Manual;*
- Enhancement of the Acquisition Performance Management System to include additional metrics and reporting, a system that integrates input from three U.S. Coast Guard accounting systems into a complete Acquisition, Construction, and Improvement data set;
- Completion of an Alternatives Analysis for the Integrated Deepwater System, a program-wide analysis that included an assessment of the major systems and platforms and validated the Deepwater asset mix;
- Reduction in the involvement of the commercial lead systems integrator (for example, in the recently awarded Fast Response Cutter contract), and initiation of efforts to discontinue the use of Integrated Coast Guard Systems (ICGS) as lead systems integrator beyond the current award term;
- Consolidation of personnel from the Systems Integration Program Office to the Assistant Commandant for Acquisition offices in U.S. Coast Guard Headquarters, Jemal Riverside Building, ending the Government collocation with Integrated U.S. Coast Guard Systems and relocating personnel in proximity to U.S. Coast Guard leadership and the technical authorities;
- Continued building a workforce of approximately 1,000 uniformed, civil service and contractor personnel, which included the hiring of 92 government personnel in FY 2008, and the development of a DHS-approved Human Capital Strategic Plan; and
- Continued efforts to implement an aggressive professional certification process, achieving compliance with DHS requirements for Level I investment program managers being DHS-Level III certified in program management, as well as innovative training approaches, and acquisition intern programs to help grow the workforce in the highly competitive job market.

Future Actions

<u>Acquisition Workforce</u>

- The U.S. Coast Guard has developed a specific human capital plan for its acquisition workforce, while simultaneously transforming its organization and its acquisition approach to develop and apply more government expertise in procurement decisions;

- The U.S. Coast Guard is using a Sustainment/Acquisition Composite Model to forecast required manpower for projects. To date, 12 projects have used this model as part of a DHS pilot program. Further analysis is being conducted to ensure the U.S. Coast Guard has the optimum acquisition workforce;
- Additional resources at all levels of the U.S. Coast Guard have been applied to hiring the most qualified people for the Acquisition Directorate, leading to 92 new government acquisition hires in FY 2008; and
- Following recruitment of new acquisition professionals, the U.S. Coast Guard continues to train its new and current acquisition personnel in the areas of technical management, cost estimating and contracting. Currently, the Level 1 Investment (equivalent to Acquisition Category 1) program managers are DHS-Level III certified in program management. This will position the U.S. Coast Guard in FY 2009 and beyond to become both an effective and efficient DHS acquisition component that delivers the operational assets the U.S. Coast Guard requires.

Major Systems Acquisition Manual Compliance

- The U.S. Coast Guard is in the process of updating the *Major Systems Acquisition Manual* to incorporate many acquisition reform initiatives documented in the *Blueprint for Acquisition Reform*, with release expected in October 2008; and
- Additionally, the U.S. Coast Guard is in the process of bringing all Acquisition Directorate and designated non-major acquisition projects into compliance with the *Major Systems Acquisition Manual*. This will enhance the U.S. Coast Guard's ability to provide oversight into the cost, schedule, and performance of all acquisition projects valued in excess of $20 million or otherwise designated for management.

Non-Major Acquisition Process

- In support of the *Blueprint for Acquisition Reform*, the U.S. Coast Guard has developed a process for the management and oversight of non-major acquisitions. This process has been documented in draft Commandant Instruction 5000.11 "Non-Major Acquisition Process" that is currently in concurrent clearance prior to final approval by the Component Acquisition Executive. The goal of this process is to efficiently acquire assets and systems to meet U.S. Coast Guard mission objectives with an appropriate level of project management and oversight tailored for the effort yet robust enough to address the risks associated with non-major acquisitions.

Lead System Integrator

- Aligning with ongoing efforts to fully assume the role of lead systems integrator, the U.S. Coast Guard's Assistant Commandant for Acquisition has prepared an official memorandum expressing the service's intent to not extend the current contract relationship with the lead systems integration contractor, ICGS, beyond the current award term, which ends on January 25, 2011. This official action is another step in the process toward the U.S. Coast Guard becoming the lead systems integrator for its acquisition projects. The U.S. Coast Guard recognizes it cannot fully accomplish that goal under the current contract structure, which limits the Service's oversight with individual manufacturers. By ending the current contract structure, the U.S. Coast Guard will be better able to manage and oversee first-tier contractors, ensure best value for the government, and ensure adequate competition for future procurements. Transition plans are in the initial stages of development.

Requirements Generation

- The U.S. Coast Guard expects ongoing acquisition reforms to positively impact requirements generation as they require the Acquisition Directorate to assist the sponsor with initial requirements generation, and to translate those requirements into a quality contract solicitation package. The Acquisition Directorate has significantly refocused the work of the U.S. Coast Guard Research and Development Center (which merged into the Acquisition Directorate during the reorganization) into requirements identification, generation and validation; modeling and simulation; and independent third party studies oversight (e.g. Alternatives Analysis) along with the center's more traditional missions.

- The U.S. Coast Guard plans to ensure this collaboration with its Research and Development Center is formalized and implemented through the following:
  - An update to the U.S. Coast Guard's *Major Systems Acquisition Manual* to better define the requirements development process; manage requirements across the life of the project; consider cost and affordability as a key factor in generating requirements; and validate and update the project requirements prior to each milestone decision point.
  - Early engagement by the Acquisition Directorate in training, supporting, and monitoring requirements development for all projects.
  - Certification that the generated project requirements meet the following criteria:
    - The specific performance parameters stated in the generated requirements are substantiated through analysis.
    - The requirements are clearly stated and are measurable.
  - Coordination by the Acquisition Directorate to independently validate the Life-Cycle Cost Estimate for meeting the generated requirements for each major acquisition project, and conduct Life-Cycle Cost Estimate revisions for changes to requirements.

Fleet Mix Analysis

- The Acquisition Directorate is partnering in a collaborative Fleet Mix Analysis to validate mission targets, design fleet alternatives, analyze fleet performance and costs, and calculate return on investment. The U.S. Coast Guard's Operations Directorate is the sponsor for this effort with collaboration from all directorates and technical authorities, and an upgraded version of the U.S. Coast Guard campaign-level model will be used for the analysis; and
- The U.S. Coast Guard augmented its organic capacity, experience, and expertise through a strategic relationship between the U.S. Coast Guard Research and Development Center and the Johns Hopkins University Applied Physics Laboratory, which is a Navy University Affiliated Research Center acting solely in the government interest. An interim product is expected in July 2009. The final product, a business case for the optimal fleet mix, is scheduled for late December 2009.

FY 2008 Challenge 2: Financial Management

Since the passage of the DHS Financial Accountability Act, the Department has worked collaboratively with Congress, the Government Accountability Office, OMB, DHS Office of the Inspector General, and our independent auditor to ensure that we achieve the Act's intended outcome of strengthening financial management to support the Department's mission. For the second consecutive year financial management at DHS has improved dramatically, as evidenced by the following achievements:

- Throughout the year, Civilian Components reconciled Fund Balance with Treasury with only infrequent reconciling differences, in over half of the year earning the highest OMB rating (Green) on financial management performance indicators;
- Improved the efficiency of transaction processing by paying 96 percent of vendors electronically to save taxpayer dollars, reduce paperwork, and strengthen cash management;
- Maintained current on over 99 percent of travel card balances, and 100 percent current on purchase cards, tied for top- ranked cabinet level agency;
- Established a Workforce Development Program to provide training and tools to support job execution, career path development, and talent management to recruit the next generation of financial management leaders;
- Launched the Financial Management Policy Manual online repository. The Financial Management Policy Manual serves as the single authoritative guide on financial management and the foundation for Department-wide knowledge sharing and standardization;
- Appointed a Performance Improvement Officer to improve Department program performance and finalized the Department's Strategic Plan;
- Strengthened Improper Payments Information Act (IPIA) guidance, training, and oversight; conducted a comprehensive process to assess the risk of programs susceptible to improper payments; and performed sample testing of programs;
- Reduced from 16 to 13, the number of Component conditions that contributed to our material weakness conditions in internal controls over financial reporting.
- FEMA reduced the severity on one half of prior year material weaknesses, including:
    - Corrective actions resulted in $1.8 billion of Mission Assignment deobligations, funding was returned to Disaster Relief Fund for other mission priorities;
    - Conducted inventory counts to be better prepared for the Hurricane Season; and
    - Developed a grant accrual methodology for estimating grant expenses at year-end.
- TSA corrected prior year material weakness conditions related to Other Liabilities and Budgetary Accounting;
- U.S. Coast Guard and FEMA reduced the severity of Departmental Financial Management and Oversight to a reportable condition, a first ever material weakness remediation at U.S. Coast Guard;
- The OCFO and OCIO developed an integrated assessment methodology for strengthening Information Technology General Computer Controls; and
- DHS OCFO sustained FY 2007 progress and for the first time ever, the DHS OCFO does not contribute to a material weakness condition.

Financial management has come a long way at DHS since its inception. We have established a culture of integrity, accountability, and excellence in all we do. This foundation will support the transition of the new administration and our success will continue to provide influential financial management leadership to support the Department's mission.

Future Actions

- Conduct a Department-wide Financial Reporting Risk Assessment;
- Provide training for cross cutting financial management challenges, e.g., Internal Use Software and Environmental Liabilities; and
- Update the FY 2009 Internal Control Playbook for FY 2008 Independent Audit and Management Assessment Results.

FY 2008 Challenge 3: Information Technology Management

DHS has completed many activities in FY 2008 to significantly reduce many of the major IT management challenges facing the Department of Homeland Security. There will be ongoing efforts to continually review and update these and other activities based on new technologies, revised management practices and guidance.

Information Security Controls

DHS has taken efforts to ensure effective information security controls and address IT risks and vulnerabilities. In Fiscal Year (FY) 2005, the Chief Information Security Officer (CISO) for the Department of Homeland Security (DHS) outlined a five-year strategic plan to improve its security posture and achieve compliance with the Federal Information Security Management Act (FISMA) of 2002. In FY 2008, the Department completed the next phase, "Achieving Excellence," by enhancing its information security compliance requirements and improving security operations through the development of a robust Network Operations Center/Security Operations Center to enhance network situational awareness and incident response.

The Department continued to show improvements in FISMA compliance for the 591 operational systems in use in the Department, particularly in the areas of security controls testing, Plans-of-Action and Milestones management, and focused security operations.

The Department partnered with Components to improve four key process areas: Certification and Accreditation, weakness remediation, annual testing and validation, and program management. In addition, the Department performed formalized data verification at the Component level and updated the DHS FY 2008 Information Security Performance Plan to further improve the quality of the Certification and Accreditation process. The DHS updated the Security Policy and Architecture Guidance to address new operational requirements and advancing technology. The update also revised methods to identify, report, and remediate known and new cyber threats, as well as adapting new information security best practices.

The implementation of the DHS Security Operations Center has significantly improved efforts to improve information security controls. By bringing the Components under a single Security Operations Center, DHS now has the ability to monitor network activity 24/7 and standardize information security controls. The DHS Security Operations Center centralized security related information to provide an enterprise view of risks and issues. In support of the DHS FY 2009 Information Security Performance Plan, the Security Operation Center has established measures to monitor vulnerabilities that facilitate an enterprise-wide Vulnerability Assessment. In addition, establishing a remote access infrastructure at one of DHS's data centers provides an enterprise-wide remote access solution for all Components.

The United States Computer Emergency Readiness Team (US-CERT) serves as a partnership between DHS and public and private sectors. This partnership allows State, local, tribal, and territorial governments access to the US-CERT Secure portal designed to provide incident response teams across the world a common access portal for information sharing, secure messaging and security alerts, as well as coordinating defense against and responses to cyber attacks across the nation. The Protected Critical Infrastructure Information Program is an information protection program that enhances information sharing between the private sector and the government. DHS and other Federal, State, local, tribal, and territorial analysts use Protected Critical Infrastructure Information to analyze and secure critical infrastructure and protected systems, identify vulnerabilities, develop risk assessments, and enhance recovery preparedness measures.

Future Actions

- During FY 2009, the Department intends to complete the fifth phase of its strategic plan, "Maintaining Excellence," by continually improving all information security processes as well as process measurement;
- The Department will continue its review of all systems to ensure FISMA compliance; and
- The Security Operations Center will implement its FY 2009 Information Security Performance Plan to monitor DHS systems.

<u>IT Infrastructure Integration</u>

In an effort to acquire and implement systems and other technologies to streamline operations within DHS Component organizations, DHS consolidated operations in two Enterprise Data Centers. These centers are secure, geographically diverse to enable disaster recovery, and engineered for redundancy and interoperability, permitting ample redundancy (backup) in the event of a disaster or other service disruption. As a core IT infrastructure service, enterprise data center services enable information sharing across Components while meeting critical mission requirements for the "One DHS Enterprise Architecture", minimizing infrastructure costs and enhancing the disaster recovery posture of the Department.

DHS established a Trusted Internet Connection at each Enterprise Data Center thereby reducing the number of internet access points. The Trusted Internet Connection effort simplifies management standardization of information security controls across the DHS infrastructure, reducing multiple points of vulnerability, improving response, enhancing forensics capabilities, and reducing cost. This is a major step in the DHS wide area network consolidation called OneNet and demonstrates significant progress towards OMB's Trusted Internet Connection goals. Six major area networks (U.S. Secret Service, Office of Inspector General, DHS Headquarters, U.S. Citizenship and Immigration Services, Immigration and Customs Enforcement, and the Federal Law Enforcement Training Center) have been moved to the Trusted Internet Connection and EINSTEIN was deployed.

DHS established a Federal Desktop Core Configuration (FDCC) working group to align the department to FDCC guidelines. To date, the working group has identified variances and established a baseline. The working group is now in the process of developing a strategy for aligning DHS with FDCC requirements and tracking progress. Desktop standardization will strengthen DHS IT security by reducing opportunities for hackers to access and exploit government computer systems.

The DHS OCIO updates the Enterprise Architecture on a continual basis to ensure standards, specifications, and technologies that collectively support the secure delivery, exchange, and construction of business and application components (service components) are current. The National Information Exchange Model will continue to develop as the standard for information exchange internal and external to the Department supporting law enforcement, intelligence and emergency management missions at all levels of government. This will enable agile enterprise-wide communications with capabilities for alerts, messaging, video conferencing, online learning, collaboration, and secure application of customer oriented information services. Additionally, in FY 2008, DHS assumed leadership as the Acting National Information Exchange Model Executive Director, reflecting DHS's significant growth in the utilization of standards and data sharing consistent with the President's National Strategy for Information Sharing.

Future Actions

- The remaining DHS components are expected to be migrated to OneNet Trusted Internet Connection in FY 2009;
- DHS intends to continue streamlining operations by completing the transition of five legacy wide-area networks to a single integrated network and designing and deploying an enterprise email solution that will replace the existing 12 Component email systems;
- Efforts to consolidate enterprise communications and common operational picture activities are also planned for FY 2009; and
- DHS will continue the development of the Geospatial Enterprise Segment Architecture to support situational awareness and interoperability of spatial data and analysis throughout the homeland security community.

Information Sharing with Partners

DHS strives to support effective information sharing with State, local, tribal, and territorial governments, the private sector, and the public. To this end, the Department invested more than $254 million over a period of several years to assist State and local governments with establishing 58 fusion centers to share information within their jurisdictions as well as with the Federal Government. The DHS Office of Intelligence and Analysis currently provides more than 30 DHS intelligence and analysis professionals to the fusion centers. The Department also established the Control Systems Security Program to reduce control system risks across all critical infrastructure sectors by coordinating efforts among Federal, State, local, and tribal governments, as well as control system owners, operators, and vendors.

DHS provides communications systems capable of delivering to States and major urban areas real-time interactive connectivity with the National Operations Center. The Homeland Secure Data Network enables the Federal Government to move information and intelligence to the States at the Secret level and is deployed at 23 fusion centers. Through the Homeland Secure Data Network, fusion center staff can access the National Counterterrorism Center's (NCTC) classified portal of the most current terrorism-related information, NCTC Online. The Homeland Security Information

Network enables all States and major urban areas to collect and disseminate information between Federal, State, and local agencies involved in combating terrorism.

Future Actions

- The Department plans to continue its commitment to information sharing with State and local governments by providing more than 10 additional intelligence and analysis professionals to the fusion centers in 2009.

Privacy Concerns

DHS's efforts to address privacy concerns while integrating its myriad systems and infrastructures demonstrate that privacy and information security are closely linked, and strong practices in one area typically supports the other. In fact, security is one of the Fair Information Practice Principles. To that end, the Chief Information Security Officer works closely with the Privacy Office to monitor the privacy requirements under the Federal Information Security Management Act (FISMA).

The DHS FY 2008 Information Security Performance Plan was updated to further improve the quality of the DHS Certification and Accreditation process and included the addition of Privacy as one of the key process areas. The FISMA scorecard was updated to include a status of systems requiring privacy related Privacy Impact Assessments and/or System of Records Notice (SORN) records. The privacy metrics are designed to provide the status of completed Privacy Impact Assessments or SORNs for those systems requiring such information. The metric is not applied to systems other than those identified by the Chief Privacy Officer as designated privacy systems.

On a quarterly and annual basis, DHS reports to OMB its progress in conducting PIAs and issuing SORNs for IT systems that are required to go through the FISMA Certification and Accreditation. At the end of the FY 2007 reporting period, October 1, 2007, DHS conducted Privacy Impact Assessments on 26 percent of the IT systems that required Privacy Impact Assessments and 66 percent of the IT systems were covered by a SORN. By July 1, 2008, DHS improved its FISMA privacy numbers to 40 percent for Privacy Impact Assessments and 84 percent for SORNs.

One of the requirements for protecting privacy sensitive systems is the process of authorizing, approving, and tracking personal identifiable information extracts from DHS systems. In response to this requirement and the need for standard operating procedures to supplement Attachment S, the DHS Privacy Office established a Data Extracts Working Group. The group, made up of privacy personnel from various components, is developing a set of Standard Operating Procedures to establish uniform practices throughout the Department for authorizing, approving, and tracking data extracts.

Future Actions

- In FY 2009, DHS plans to continue efforts to ensure electronic information and data are fully accessible to members of the public and employees with disabilities.

Budget Oversight/Capital Planning and Investment Control

Management Directive 0007.1 requires that the DHS CIO within the Office of the Chief Information Officer approve any Information Technology (IT) acquisition of $2.5 million and greater. The acquisition actions that require review include, but are not limited to contracts, task orders, and delivery orders, Interagency Agreements, reimbursable agreements, modifications, exercise of options, Military Interdepartmental Procurement Requests, commodity purchases and any other contractual activity that includes an obligation of $2.5 million and above. This includes any IT element(s) of $2.5 million or greater that may be contained within a "non-IT" acquisition. To facilitate the reviews, the OCIO implemented a process, which must be followed for IT acquisitions. The OCIO established an email address for handling communications on the review process to include acquisition request submittals.

The IT Acquisition Review process has resulted in a 50 percent increase in the number of programs reviewed by the Enterprise Review Board to validate alignment to the Homeland Security Enterprise Architecture improved security and accessibility requirements through introduction of specific, contractually binding language; the improved progress of the Wide Area Network consolidation into DHS OneNet, and accelerated transition to the DHS's consolidated Data Centers. Planned accomplishment for FY 2008 support the Secretary's priorities, are consistent with the direction expressed in OCIO Strategic Plan for FYs 2007 – 2011 and align with DHS mission priorities.

The OMB Watch List shows 16 DHS programs on the Management Watch List for President's FY 2009 Budget, down from 53.

Future Actions

- For FY 2009, the CIO plans to actively manage the IT portions of the Watch List programs through the IT Acquisition Review process.

FY 2008 Challenge 4: Catastrophic Disaster Response and Recovery

Since Hurricane Katrina in 2005, major improvements have been made within FEMA and in our ability to work effectively with our partners to improve preparedness and develop a comprehensive emergency management system across the Nation. The pace of improvement at FEMA has been steady and we have strived to use our resources wisely to address the many requirements that have been identified. We believe FEMA's response to Hurricanes Gustav and Ike this hurricane season has shown that while there is still work to be done, FEMA is an agency much improved since the 2005 hurricane season.

In March 2008, the Office of Inspector General identified major management challenges in nine key areas of concern. Following is an assessment of our progress in six of the key areas identified in the report: 1) Logistics; 2) Evacuation; 3) Housing; 4) Disaster Workforce; 5) Mission Assignments; and 6) Acquisitions. For each area we have described the issue and identified accomplishments, challenges, and further actions.

Under a Needs Analysis Initiative rolled out in the Spring of 2007, a Gap Analysis Tool was developed in coordination with the State of New York Emergency Management Office/New York City Office of Emergency Management and has been implemented to provide FEMA and its partners at both the State and local levels in the hurricane prone regions of the country a snapshot of asset gaps at the local, State and National levels. Seven critical areas are incorporated for review in the tool: debris removal, commodity distribution, evacuation, sheltering, interim housing, medical needs, and fuel capacity along evacuation routes. The FEMA regions and corresponding hurricane prone States, territories and local communities have been conducting meetings to discuss capabilities and gaps for responding to hurricane disasters:

- Region I: Connecticut, Rhode Island, Maine, Massachusetts, New Hampshire;
- Region II: New York, New Jersey, Puerto Rico, Virgin Islands;
- Region III: Maryland, Delaware, Virginia, District of Columbia;
- Region IV: Mississippi, Florida, North Carolina, South Carolina, Alabama, Georgia; and
- Region VI: Louisiana, Texas

Logistics

FEMA is responsible for coordinating the delivery of commodities, equipment, personnel, and other resources to support emergency or disaster response efforts, and therefore, FEMA's ability to track resources is key to fulfilling its mission. Logistics plans must move the agency beyond simply providing commodities (e.g., meals, water, and tarps) but toward a holistic management approach that is sufficiently flexible and efficient to meet requirements, and leverages the private sector and 21st Century advances in supply chain management.

FEMA established the Logistics Management Directorate to effectively plan, manage, and sustain the national logistics response and recovery operations, in support of domestic emergencies and special events. The Directorate is responsible for logistics policy, guidance, standards, execution, and governance of logistics support, services, and operations. The Directorate has issued several key operational documents reflecting new processes for testing and validation: 1) Logistics Operations Manual – describes how DHS/FEMA and its public and private sector partners provide logistics support during domestics emergencies and special events; 2) National Logistics Staging Area Concept of Operations – provides a framework for the establishment, operation, and demobilization of the National Logistics Staging Areas which are designated sites where personnel and material are temporarily received, pre-positioned, and shipped for further distribution and deployment; 3) Direct Housing Support Concept of Operations – outlines the logistics support provided to the Disaster Assistance, Individual Assistance Program through the stockage, maintenance, and deployment of temporary housing units; and, 4) FEMA Logistics Transportation Users Guide – prescribes the procedures for acquiring multi-modal transportation, covers mission previously executed by the Department of Transportation Emergency Transportation Center. These documents will be reviewed and updated to reflect lessons-learned from the past hurricane season. Recent responses to the Midwest Floods and Hurricanes Gustav and Ike have helped to validate these processes.

Several of the concepts tested in FY 2008 are as follows: the National Logistics Coordinator concept; Emergency Support Function 7 co-lead with Government Services Agency; Emergency transportation management, (formerly a Department of Transportation role in Emergency Support

Function 1); Distribution Management strategies; Evacuation support through Logistics-based contracts; and the National Logistics Staging Area concept.

FEMA also developed and implemented new internal management controls, and improved total asset visibility and pre-positioning of commodities. Based upon gap-analysis data, FEMA Logistics pre-positioned critical life-saving and life-sustaining disaster commodities throughout the hurricane-prone regions in Florida, Alabama, Mississippi, Louisiana, Texas, and New York, hence were able to significantly enhance the first 72 hour response capability. Total Asset Visibility in-transit extended to all ten regions, Total Asset Visibility specialist cadre developed and trained for rapid deployment. The Logistics Management Directorate established an Internal Management Control program beginning with formalized training of a Program Lead. Logistics played pivotal role in the rewrite of the Property Management Manual 6150-1, following through with the accurate accounting of disaster accountable property and conducting wall-to-wall inventories for 100 percent accountability.

Future Actions

- FEMA intends to engage the private sector and incorporate industry best practices to include incorporating a third party logistics structure into the Logistics Management Directorate where appropriate. During FY 2009, the Directorate will concentrate on four strategic cornerstones: People, Customers, Processes, and Systems, in that order. The focus is to institutionalize command and coordination of strategic logistics planning, operations and management while pushing operational control and execution down to the most effective level of execution. More specifically, to develop National Level collaboration while continuing to improve internal operations and capability such as further developing the Single-Integrator concept and National Supply chain strategy. The Logistics Management Transformation Initiative is the overarching program to help transform the Directorate into a more effective, responsive organization with improved readiness and response capability. A Transformation Management Office was established in FY 2008 to drive transformation. The Transformation Management Office will provide the governance structure to assist in galvanizing the transformation process. Third-party logistics opportunities are continuously explored and analyzed as future integrated supply chain options; and
- FEMA will implement Logistics Management capabilities similar to the Department of Defense's well-recognized logistics (J4) system and organization. The National Logistics Coordinator concept promotes FEMA Logistics Management as the Single-Integrator for strategic planning, operational, and tactical logistics support. The National Logistics Coordinator will coordinate domestic emergency logistics planning, management and sustainment capabilities, and promote the strategic and tactical logistics collaboration among public, private and non-governmental organization partners. The National Logistics Coordinator concept somewhat mirrors the role J4 plays in the Military Service.

Evacuation

FEMA made improvement in its plans and capabilities for managing mass evacuations and the resulting displaced populations, including additional State and local plans and development and expansion of evacuee tracking systems. FEMA is working closely with States to ensure that evacuation plans are in place, and completed five state hosting plans for large numbers of evacuees, including refined evacuee hosting guidance. While the Department of Transportation has retained responsibility for some transportation functions, FEMA has taken over the standby contracts for air/bus/rail support to ensure available evacuation transport when State and local governments cannot handle the evacuation process.

Enhancements were made to the National Shelter System and enhancements were made to the National Shelter System and the Aidmatrix Network which is a national disaster relief coordination system funded by FEMA, The UPS Foundation, Accenture, and the Aidmatrix Foundation, Inc. to better manage unsolicited donations and volunteers. This network connects State and local governments with donors, State Voluntary Organizations Active in Disaster, National Voluntary Organizations Active in Disaster, and FEMA through web-based tools to reduce paperwork and allow for easy information sharing. No software, hardware or additional IT staff is required with this hosted solution, and training is minimal. FEMA also produced an annual report to Congress, per Homeland Security Act of 2002, Section 882, and quarterly reports on the status of National Capital Region, West Virginia, and Pennsylvania evacuation planning.

Future Actions

- Refine evacuee hosting guidance and complete five State hosting plans for large numbers of evacuees in FY 2009 and FY 2010; and
- Complete enhancements to the National Shelter System and Aidmatrix system to improve system security and user interface, and continue to provide technical assistance and training to users nationwide.

<u>Housing</u>

Possibly the largest problem FEMA faced in the aftermath of Hurricane Katrina was providing financial assistance, sheltering, and housing to evacuees. Because FEMA lacked a catastrophic disaster housing strategy and had never before been faced with meeting the short- and long-term housing needs of hundreds of thousands of disaster victims, it relied on shelters, hotels, motels, cruise ships, and tents, as well as any other available housing resources to meet sheltering and housing needs.

To address short and long-term disaster housing, FEMA developed the draft National Disaster Housing Strategy that describes how the Nation provides housing to those affected by disasters and charts a new direction to better meet the needs of disaster victims and communities. This draft Strategy is available for public comment and is being reviewed by key partners. The Strategy provides the overarching vision, goals, and principles for a national disaster housing effort. A 2008 Disaster Housing Plan was also issued which compliments the draft Strategy and describes the specific actions that FEMA will take this year to support State and local officials in meeting the housing needs for disaster victims. Additionally, FEMA staff completed a compendium of potential alternative housing solutions with ratings and guidelines for best application of particular units given disaster conditions through the Joint Housing Solutions Group.

Future Actions

- FEMA will develop and implement priority elements of the National Disaster Housing Strategy;

- They will continue to make strides in interagency planning and coordination to assist communities with long-term recovery, to address contaminated debris, debris volume estimation, and streamlining the Public Assistance Program processing for very large events through planning, training, and technology improvements; and
- FEMA must continue to improve and test/exercise FEMA's capabilities for all of its Individual Assistance functions (mass care, emergency assistance, housing, and human services).

Disaster Workforce

Section 624 of the Post-Katrina Emergency Management Reform Act of 2006 requires that a plan for a Surge Capacity Force be submitted to Congress not later than 6 months after enactment. The Surge Capacity Force is an external resource which supplements FEMA when a disaster exceeds the Agency's internal capabilities to respond. The plan therefore must include procedures on how to designate sufficient numbers of trained, credentialed employees for disaster missions from DHS and other Federal agencies. Since Disaster Reservists account for 70 percent or more of all FEMA employees who deploy to each disaster, a viable plan for the Surge Capacity Force must first be premised on a stronger Disaster Reserve Workforce.

A comprehensive assessment of the Disaster Reserve Workforce was initiated in 2007, and completed in September 2007. Based in part on the results of this assessment, the Disaster Reserve Workforce Division (DRWD) was established within the Management Directorate in March 2008. The new Division grew out of a small staff located within the Disaster Operations Directorate, and is now led by a career Senior Executive and several experienced reserve managers. DRWD is the Agency's single accountable program manager for transforming the legacy Disaster Assistance Employee program into an all-hazard Disaster Reserve Workforce. This Division also coordinates the deployment, tracking and FEMA-specific credentialing of all FEMA employees for disaster response and recovery. Increased expectations for performance, balanced with improved benefits for qualifying Disaster Reservists, are essential to creating a professional, national, all-hazards workforce.

Working with FEMA's Emergency Management Institute, DRWD is co-sponsoring an 18-month initiative to produce a standardized, National Incident Management System (NIMS) compliant credentialing process applicable to all 23 disaster specialties ("cadres") and 230 disaster job titles found at Joint Field Offices. Completion of this project will be subject to the availability of funding. FEMA recently released interim policies to pay Disaster Reservists for administrative absences and designated Federal holidays when the Joint Field Office or assigned work site is closed and the Reservist does not work.

Future Actions

- FEMA will complete the standardized credentialing plan project for all 230 disaster job titles staffed by FEMA disaster workers. With the completion of the credentialing project, the Agency will have completed an important step towards a consistently credentialed, more professional disaster workforce standardized across all cadres;
- FEMA will improve deployment systems by finalizing and deploying a web-enabled upgrade to the Agency's Automated Deployment Database system. Future actions also include formalizing interim policies regarding administrative absence and designated

Federal holiday pay, as well as developing policies for sick leave, telework, and prospective legislation that address benefits or training for Disaster Reservists;

- DRWD will work with planners and cadre managers at the Headquarters and Regional levels to determine the number and composition of skilled Disaster Reservists required for response and recovery; and
- A more robust, more professional Disaster Reserve Workforce will minimize the size and composition of *Post-Katrina Emergency Management Reform Act* Surge Capacity Force required for catastrophic events and major disasters. However, to comply with Section 624 of the *Post-Katrina Emergency Management Reform Act*, FEMA worked with DHS component agencies in spring 2008 to identify criteria in selection of prospective selectees for the Surge Capacity Force. In September 2008, this initial effort was augmented by the establishment of an ad hoc working group of selected DHS agencies to develop a Concept of Operations (CONOPS) for this Surge Capacity Force. This CONOPS will describe the process for selection, training, deployment, and reimbursement of the Surge Capacity Force. A completed, approved CONOPS for the Surge Capacity Force is anticipated by summer 2009.

Mission Assignments

Mission Assignments (MAs) are a critical component of the Federal Government's response to an incident and require significant Federal funds and resources. Other Federal departments and agencies have considerable resources and expertise that can prove effective in life-saving circumstances and provide major support to the response and recovery process. FEMA uses MAs to coordinate the urgent, short-term emergency deployment of federal resources to address immediate threats, and is responsible for stewardship of the associated expenditures from the Disaster Relief Fund. The issuance and execution of MAs touch virtually every functional area in a response, and requires coordination with many, if not all of those areas, such as operations, recovery programs, planning, acquisitions, logistics, finance, administration, and information technology.

FEMA has expanded the use of pre-scripted mission assignments. In 2006, FEMA had only 44 pre-scripted mission assignments with two Federal agencies. In 2007, FEMA had 224 pre-scripted mission assignments in coordination with 31 Federal departments and agencies, and in 2008 FEMA had 236 pre-scripted mission assignments with 33 Federal departments and agencies.

Future Actions

- Continue to build on the number of pre-scripted mission assignments and enhance the requisite coordination with Federal departments and agencies. Increased capabilities and resources in this arena will ensure fewer errors and greater programmatic control and consistency.

Acquisitions

In the aftermath of Hurricane Katrina, FEMA was not prepared to provide the scope and nature of acquisition support needed for a catastrophic disaster. Challenges included acquisition planning and preparation for the large number of acquisitions needed immediately after a disaster; clearly communicated acquisition responsibilities; and sufficient numbers of acquisition personnel to manage and oversee contracts. Pursuant to the Post-Katrina Act, FEMA has undergone significant reorganization to improve this function.

FEMA has established a strategic roadmap for the Office of Acquisition Management (OAM) that outlines goals, objectives and strategies to build a world-class acquisition organization. They have also provided technical support and training for the ProTrac and ProDoc systems, which provides contract management, tracking, and document generation capability. In addition, Acquisition staff created a robust program to support and provide on-the-job guidance to Contracting Officer's Technical Representatives. Finally, they developed and coordinated the addition of an Acquisition Advisor to the Federal Coordinating Officer under the Incident Command System structure to include improving the quality of business advice and expertise during major disasters and emergencies.

Future Actions

- FEMA will continue to implement and refine the Office of Acquisition Management strategic roadmap and improve the office's ability to meet customer needs;
- They will also sustain and improve business processes by leveraging e-business technologies such as ProTrac, ProDoc, FedBid and other systems;
- Acquisition will build upon the Contracting Officer's Technical Representative program by establishing a tiered Contracting Officer's Technical Representative development program that provides greater levels of training based on the level of contract management required for a particular program or contract; and
- Finally, Acquisition Management must continue to provide a full range of acquisition services that support the procurement and contract management programs' policies, procedures, operations, contract planning, awards, administration, and closeouts.

FY 2008 Challenge 5: Grants Management

To meet its mission and to ensure fulfillment of Congressional requirements, the DHS Headquarters' Office of Grant Policy and Oversight (GPO) continues to develop policies that address grants management administrative requirements. This will ensure standardization of processes for grant-making components and offices, including FEMA. Grant management policies will be issued through the DHS Headquarters Office of the Chief Financial Officer's (OCFO) *Financial Management Policy Manual.*

Reorganization

The FY 2008 Challenge addresses FEMA's reorganization as well as other components' grants management processes. In FY 2009 the DHS Headquarters grants management policy and oversight function was transferred from the Office of the Chief Procurement Officer (OCPO) to the Office of the Chief Financial Officer (OCFO). Under this transfer, *Single Audit Act* process, currently administered by the DHS Office of General Inspector (OIG), will also be transferred to and implemented by the Headquarters OCFO, GPO. Monitoring associated with the receipt, review, and resolution of audits/findings will provide administrative management insight for the stewardship of DHS assistance awards. Timely review of audits will provide information related to the management and expenditure of awards from the sub-recipient to the DHS component levels. As a result of this monitoring DHS will provide guidance and technical assistance to the components regarding audit findings, which in turn should be provided to primary recipients of assistance awards.

An implementation plan for the transfer and expansion of the grant management function to the CFO/GPO will be completed in early 2009. The plan will include a timetable for the transfer of the *Single Audit Act* function from the OIG, and enhancement for the organization and staffing. This move will enhance statutory authority compliance and provide resources for a more vigorous oversight capability as it relates to accountability of funds, internal controls and audit processing/oversight of assistance awards.

The transfer and expansion will also address the concerns identified in the OIG Management Challenge regarding the transfer of Grants and Training and Preparedness Offices into FEMA. Not only will the expanded OCFO/GPO oversight ensure compliance, but it will identify redundant planning, effective management gaps, identification of duplicate program efforts/initiatives/funding and lack of monitoring within the components. The goal of this initiative is to support and complement objective by providing a comprehensive DHS oversight for grants management requirements that also meets the needs of individual assistance programs.

Future Actions

- CFO to develop implementation plan for the transfer and expansion of the grant management function to be completed in early 2009; and
- Transfer DHS Headquarters grants management policy and oversight function from OCPO to the OCFO in FY 2009.

<u>Oversight and Internal Controls</u>

The DHS Grants Management Challenge for 2008 states, in part, "DHS needs to ensure that internal controls are in place and adhered to, and grants are sufficiently monitored to achieve successful outcomes."

As part of internal controls oversight, the GPO will analyze all DHS assistance programs to identify programs that: 1) may duplicate other programs; 2) are similar to other programs; or 3) complement other programs. Once the analysis is completed, GPO will coordinate the results with other DHS oversight offices and components with applicable programs. The analysis and report will be completed by September 30, 2009 in order to capture all programs that have been announced for assistance funding opportunities. The report will be submitted to the DHS Policy Office for follow up to determine if the program needs to be redirected to address duplication of efforts. GPO will provide a similar report annually and provide recommendations for combining programs when appropriate.

GPO is also currently reviewing all the Terms and Conditions of assistance awards in conjunction with the other Headquarters oversight offices, (e.g., Office of General Counsel, Office of Chief Information Officer, Privacy Office, etc.) and program offices to determine validity, compliance, and consistency within DHS. The terms and conditions will be tied to the compliance requirements, risk assessment, and internal controls associated with the appropriate program(s). This task is to be completed in 2009, as copies of FY 2009 Award Terms and Conditions are submitted to GPO for review.

Internal control development for DHS grants management processes will continue to be developed through policy development and implementation, monitoring and oversight, through coordination with the OCFO internal controls management action plans. This will ensure effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. It is anticipated that the internal control infrastructure will be in place by the end of 2009.

Future Actions

- GPO will analyze all DHS assistance programs to identify programs that: 1) may duplicate other programs; 2) are similar to other programs; or 3) complement other programs in FY 2009;
- GPO to review contractual Terms and Conditions of assistance awards to determine validity, compliance, and consistency within DHS; and
- Internal controls Mission Action Plans to be developed to address monitoring and oversight functions.

Standardization/Streamlining

FY 2008 Grants Management Challenge discusses the development of two Grants Management Line of Business life-cycle grants management systems. To address that challenge, and to further standardize and streamline grants management processes, DHS through FEMA is developing two life-cycle electronic grants management systems; one for disaster and one for non-disaster grants. It is anticipated that by FY 2011, all DHS assistance awards should be executed and managed through one of the systems. Once activated, the systems will provide consistent internal controls over data entry, transaction processing and reporting for all DHS assistance programs. Because of the volume and urgency of the disaster award processing, it is not anticipated that the systems will be fully integrated. DHS will develop an interface between the two systems that will provide joint capability for payment processing, data generation, reporting, and other functional requirements.

Future Actions

• **Interim Action Items:**	**Target Date:**
- Under Secretary for Management delegation to CFO	11/30/2008
- Post Vacancies and Recruit Staff	11/30/2008
- OIG/CFO Memorandum of Understanding to transfer A-133 Audit Function	12/31/2008
- Develop A-133 Audit Strategy/Implementation Plan	12/31/2008
- Complete Policies	03/31/2009
- Transfer A-133 Audit Function	04/01/2009

- **Long-Term Action Items:**
  - Analyze DHS assistance programs to determine possible duplicate programs — 09/30/2009
  - In coordination with OGC, develop "Standard Terms and Conditions Template" for assistance awards — 09/30/2009
  - FEMA development of two life-cycle electronic grants management systems to be operational — FY 2011

FY 2008 Challenge 6: Infrastructure Protection

<u>Coordination of Critical Infrastructure and Key Resources (CIKR)</u>

In the management challenges report, the Inspector General notes that, "*the requirement to rely on federal partners and the private sector to deter threats, mitigate vulnerabilities, or minimize incident consequences complicates protection efforts for all CIKR. Combined with the uncertainty of the terrorist threat and other manmade or natural disasters, the effective implementation of protection efforts is a great challenge.*" The Office of Infrastructure Protection within the National Protection and Programs Directorate (NPPD) recognizes the challenge of ensuring protection in a voluntary environment, and continues to be proactive in leading the coordination of a national Critical Infrastructure and Key Resources (CIKR) risk management program. As part of this program, Infrastructure Protection is required to prepare and submit to Congress the National CIKR Protection Annual Report (NAR).

The CIKR Sector Partnership Framework, as outlined in Chapter 4 of the National Infrastructure Protection Plan (NIPP), is the core enabling component of the CIKR risk and performance management efforts. The Framework includes Government Coordinating Councils and the Sector Coordinating Councils for each of the 18 CIKR sectors. Infrastructure Protection ensures that the NIPP and the Sector Specific Plans are fully implemented, that they remain aligned with long-term strategies, and that the sectors achieve the milestones set out in these documents. The Sectors are responsible for submitting their Sector Annual Report each year to provide updates on how the sector is implementing the NIPP and their Sector Specific Plans. The Sector Annual Reports are then consolidated into the NAR.

Future Actions

- Revise metrics chapter of the National Annual Report to emphasize an outcome-focused view on CIKR performance management across all sectors; and
- Develop outcome-oriented scorecards across all sectors in order for DHS to effectively identify security gaps and progress, regardless of whether it is DHS, other Federal agencies, State, local, tribal, and territorial entities, or the private sector leading the CIKR security efforts.

<u>Incident Management</u>

During crises, Infrastructure Protection uses the NIPP and the National Response Framework to guide its response activities with federal partners and the private sector. Through the Infrastructure Protection Incident Management Cell, the Infrastructure Protection Assistant Secretary, CIKR owners and operators, the 18 SSAs, and other security partners work collaboratively to monitor an incident, develop impact assessments, and coordinate and facilitate prevention, response, and recovery activities. Infrastructure Protection's efforts during recent Hurricanes Ike and Gustav illustrate this coordination. Before the storm hit landfall the National Infrastructure Coordinating Center, National Infrastructure Simulation and Analysis Center, and the deployed Protective Security Advisors were working with stakeholders to provide up-to-date information based on hurricane models.

NPPD's Office of Cybersecurity and Communications (CS&C), also plays a significant role in addressing infrastructure protection issues associated with cybersecurity across the public and private sectors. Specifically, DHS's national response mechanism, the National Cyber Security Division's (NCSD) United States Computer Emergency Readiness Team (US-CERT), provides stakeholders with alerts and actionable information, such as Critical Infrastructure Information Notices and Federal Information Notices, needed to protect information systems.

Future Actions

- US-CERT is working with NCSD's Outreach and Awareness Program and other cross-sector working groups to increase awareness through communication channels such as the Homeland Security Information Network for Critical Sectors, the National Cyber Alert System, various information sharing and analysis centers, the US-CERT Portal, the Government Forum of Incident Response and Security Teams Portal and the US-CERT Public Website. These channels allow for ongoing information exchange with public and private sector stakeholders to distribute alerts and warnings in the event of a cyber incident.

Infrastructure Data Warehouse

The Inspector General states that, "*a comprehensive, national database that inventories assets is essential to provide a comprehensive picture of the nation's CIKR and to enable management and resource allocation decision-making. Their office is currently reviewing how DHS uses an asset database to support its risk management framework.*" Infrastructure Protection is currently developing the Infrastructure Data Warehouse to maintain a national database of CIKR systems and assets. The Infrastructure Data Warehouse is a federated data architecture that provides a single virtual view of one or more infrastructure data sources. In addition, Infrastructure Protection produces the annual prioritized lists of systems and assets critical to the Nation (The Tier 1/Tier 2 and Critical Foreign Dependencies Lists). The Tier 1/Tier 2 program, which develops the Tier 1/Tier 2 list each year, is a joint effort between the Sector Specific Agencies, the States, Infrastructure Protection, and other entities. This list informs grant programs such as the Buffer Zone Protection Program and the Homeland Security Grant Program. During the 2008 Fiscal Year, Infrastructure Protection conducted 395 vulnerability assessments and 743 Energy Conversation Investment Program (ECIP) Assessments, of which 40 assessments were part of the California Water System Comprehensive Review which utilized extensive National Infrastructure Simulation and Analysis Center modeling.

Future Actions

- The Infrastructure Data Warehouse plans to have initial operating capability by Spring 2009 of a national database of CIKR systems and assets;

- In FY 2009, Infrastructure Protection will increase functionality of the Tier 1/Tier 2 program to more efficiently and effectively conduct analysis of high priority critical infrastructure and key resource assets and facilitate information exchange, verification, and maintenance with State and sector partners; and
- In FY 2009 Fiscal Year, Infrastructure Protection plans to conduct over 300 vulnerability assessments and over 1,000 ECIP Assessments, which will include a multi-asset/system-based Comprehensive Review, on Tier 1 and Tier 2 Facilities and 12 New Nuclear Reactor Security Consultations.

<u>Securing Critical Infrastructure and Key Resources</u>

On September 17, 2008, DHS created the Office of the Chief Administrative Officer, Office of Business Continuity and Emergency Preparedness in response to the Inspector General's assertion that, "*protecting national as well as internal cyber infrastructure continues to be a challenge for DHS. We recently reviewed the department's progress in identifying and prioritizing its internal cyber critical infrastructure in accordance with Homeland Security Presidential Directive 7…we found the department needs to complete additional steps to produce a prioritized inventory and to coordinate related efforts to secure these assets, and the recommendation to designate a specific office to determine protection priorities for its internal cyber critical infrastructure*." Under Secretary for Management designated Business Continuity and Emergency Preparedness to manage the DHS-internal CIKR program, including the determination of protection priorities for its internal critical cyber infrastructure. Established in 2006, Business Continuity and Emergency Preparedness provides DHS with an office for central management and coordination of the Department's internal continuity of operations and emergency preparedness programs. The two programs are interrelated with CIKR as well as other internal Department protection and preparedness programs.

Future Actions

- Business Continuity and Emergency Preparedness will apply an integrated "mission assurance" approach by leveraging capabilities and analysis within interrelated programs to identify and protect CIKR resources.

<u>Mission Essential Functions and Primary Mission Essential Functions</u>

The Inspector General also suggested, "*the department should develop a process to coordinate internal efforts to protect these assets*". During FY 2008 a major focus of the COOP program was the identification and analysis of the Department's Mission Essential Functions (MEF) and Primary Mission Essential Functions (PMEF) and how those functions support the National Essential Functions. The MEF/PMEF process is detailed in the FEMA developed Federal Continuity Directive – 2, "Federal Executive Branch Mission Essential Function and Primary Mission Essential Function Identification Process," dated February 2008. Analysis of DHS MEF/PMEF includes identification through a detailed Business Process Analysis of key resources required to perform the MEF/PMEF. The Business Process Analysis results will serve as a new baseline for the CIKR program including determination of internal critical cyber infrastructure and the priority of asset protection and recovery based on the asset's impact on Department MEF/PMEF and business functions.

In addition, the National Cybersecurity Initiative, formalized by National Security Presidential Directive 54/Homeland Security Presidential Directive-23, enables NCSD—and the Department as a whole—to expand its current activities which contribute to its mission. The National Cybersecurity Initiative is a series of continuous efforts designed to further safeguard Federal Government systems and reduce potential vulnerabilities, protect against intrusion attempts, and better anticipate future threats.

Future Actions

- NCSD is working with other Departmental and Interagency components to develop the strategic analysis of the Nation's critical cyber infrastructure, integrating all relevant and appropriate sources of information to support predictive analysis;
- NCSD is seeking to engage stakeholders in other Federal and non-Federal agencies to provide them with actionable information based on this predictive analysis; and
- The National Communications System will provide the Director of the Office of Science and Technology Policy and DOD with an implementation plan for a comprehensive Continuity Communications Architecture. The implementation plan will include the minimum requirements necessary to finalize selection of a secure communications system by DOD.

FY 2008 Challenge 7: Border Security

Along with the successes enjoyed by U.S. Customs and Border Protection (CBP) in FY 2008, CBP acknowledges that there will be challenges in the coming fiscal year in order to secure the borders against all threats. The following are the top challenges for FY 2009 and plans to address and resolve them.

Secure Border Initiative (SBI)

As of September 30, 2008, U.S. Customs and Border Protection, through the Secure Border Initiative (SBI), has constructed 204 miles of pedestrian fence and 154 miles of vehicle fence to further secure the border. CBP has other miles that are currently under construction, 66.3 miles of pedestrian fence and 33.3 of vehicle fence, but CBP is not counting those miles as completed until all elements of construction have been undertaken. In addition, 74.9 miles of pedestrian fence and 116.2 miles of vehicle fence are currently under contract. All remaining mileage will be awarded prior to the end of the calendar year. CBP remains committed to achieving the goal of 661 miles of fencing in the areas that the border patrol has identified as operational priorities. By the end of the calendar year, CBP believes that it can get close to the goal in terms of miles that are actually finished, under construction, or in some cases under contract.

Successful execution of the SBI mission requires the establishment and sustainment of a well-trained and coordinated team of acquisition professionals. To accomplish this, an SBI Acquisition Workforce Development, Sustainment, and Training Working Group was established in January 2008, consisting of members from the SBI Acquisition Office and SBI Program Executive Office. SBI policies and procedures were and continue to be established to standardize the execution of acquisition functions, and an SBI Joint Policy Board, consisting of members from the SBI Program Executive Office, and the SBI Acquisition Office, was established. Continuing into FY 2009, a comprehensive set of acquisition and procurement policies and procedures are being implemented to establish expectations and govern the planning, execution and oversight of all SBI procurement and acquisition activities to assure that intended results are achieved. In FY 2009, CBP will finalize the policy that defines functional roles and responsibilities of all acquisition positions within the SBI Acquisition Office and SBI Program Executive Office. In addition, to ensure that sound acquisition practices are being developed and adhered to, an SBI Acquisition Management and Customer Support Division was established during FY 2008.

In the past, tactical infrastructure maintenance and repair was accomplished on an ad hoc basis by either Border Patrol employees (uniformed or civilian) or the military (Operation Jump Start or other military units on a rotational, short term basis). This has not been an efficient use of resources and a more permanent solution is under development. The SBI Tactical Infrastructure Program Management Office is taking steps to award a Comprehensive Tactical Infrastructure Maintenance and Repair contract in the July 2009 time frame. This contract will cover maintenance and repair of all types of tactical infrastructure, including fencing, and will provide coverage to all nine Southwest Border Patrol Sectors. In FY 2009, a set of metrics will be developed and utilized to eliminate redundancies, identify potential process improvements, identify strategic sourcing opportunities, provide for internal control monitoring, aid in workload management, and track status of SBI procurements.

Future Actions

- SBI Tactical Infrastructure will coordinate Real Estate acquisition support for SBI*net* in FY 2009 to obtain the numerous real estate tracts required to support the number of tower sites through a partnership with the U.S. Army Corps of Engineers. Prospective sites are identified at the outset, which requires engaging more landowners for Rights of Entry than will ultimately be needed for acquisition, with new sites identified as the project progresses. In FY 2009, these acquisitions will be negotiated toward purchase to the fullest extent possible, but they may require Department of Justice involvement to enter into the condemnation process;
- The SBI Tactical Infrastructure Program Management Office is taking steps to award a Comprehensive Tactical Infrastructure Maintenance and Repair contract in the July 2009 time frame. This contract will cover maintenance and repair of all types of Tactical Infrastructure, including fencing, and will provide coverage to all nine Southwest Border Patrol Sectors;
- In FY 2009, CBP will finalize the policy that defines functional roles and responsibilities of all acquisition positions within the SBI Acquisition Office and SBI Program Executive Office; and
- In FY 2009, a set of metrics will be developed and utilized to eliminate redundancies, identify potential process improvements, identify strategic sourcing opportunities, provide for internal control monitoring, aid in workload management, and track status of SBI procurements.

SBI*net*

SBI*net* is employing a "spiral" approach of iterative design-prototype-test-learn cycles. This spiral development approach provides for an initial definition of requirements (under formal configuration control), and then a period of development and testing to gain user feedback and engineering confidence with initial (sometimes draft) designs. Final requirements, as well as final designs, are worked together and often in parallel. The initial test spirals also help to complete detailed test plans and procedures needed for qualification and acceptance testing. Activity to accomplish this includes revising or developing the Mission Need Statement, the Operations Requirements Document, the Acquisition Program Baseline, and the Test and Evaluation Master Plan. Additionally, to track progress being made by SBI contractors, increased utilization of earned value management principles is being emphasized.

Future Actions

- In 2009, SBI*net* will continue to follow a disciplined set of activities for planning, executing, and reporting SBI*net* program testing; and
- SBI will include in the SBI*net* Block 1 Acquisition Program Baseline a revised SBI*net* life cycle management approach, including a Systems Engineering Plan, and Test and Evaluation Master Plan that highlights specific testing roles and responsibilities, and those parties accountable for the revised test.

Border Patrol Workforce

CBP is continually challenged to maintain and expand the gains we have achieved in securing operational control of our borders. As CBP improvises and adapts to the tactics of human and narcotics smugglers, the same criminal organizations move to adapt to the tactics of CBP. To counteract this in FY 2009, CBP will continue to rely on and implement intelligence driven operations, as well as maintain a well trained and flexible work force of agents. CBP will also continue to upgrade and enhance its Special Operations Groups of Border Patrol Tactical Units, Border Patrol Search, Trauma, and Rescue, and Special Response Team units. As a highly mobile, rapid-response tool, the Special Operations Group personnel will significantly improve CBP's ability to respond operationally to specific terrorist threats and incidents, as well as support the traditional Border Patrol mission. Additionally, a consequence of the very successful Border Patrol agent recruiting program was that there has not been a commensurate number of Mission Support Specialists brought on board to support the Agents. Mission Support Specialists perform non-law enforcement functions that allow agents to focus their efforts on safeguarding the borders. CBP relies on these very important positions to allow them to conduct the important business of safeguarding the borders of the United States.

Future Actions

- CBP will conduct a strong recruiting and hiring campaign in FY 2009 for these Mission Support positions, similar to the recruiting and hiring campaign for Border Patrol agents;
- CBP will conduct a series of training exercises and classes in FY 2009 to include advanced weapons training, explosive handler courses, primary marksman courses, high-risk operations and special response team training;
- A series of exercises in coordination with other Federal and State agencies addressing airlift and search and rescue operations will be conducted in FY 2009; and
- Additionally, the Office of Border Patrol intends to train 690 First Responders in FY 2009.

Integration of Border Activities

A number of actions taken in 2008 and current initiatives emphasize the vital role of integration and capitalizing on efforts of multiple organizations to successfully secure the border. CBP and the U.S. Coast Guard are operating a Joint Program Office for unmanned aircraft systems to link requirements and test maritime variants. A joint maritime advanced concept and technology demonstration occurred in March 2008. DHS is using a unified command structure in select locations such as the San Diego Sector where U.S. Coast Guard, U.S. Immigration and Customs Enforcement, U.S. Customs and Border Protection employ maritime response protocol integration in interagency efforts. Project Seahawk in Charleston, South Carolina, is a prime example of a successful multi-jurisdictional task force comprised of Federal, State, and local law enforcement agencies charged with preventing or disrupting illicit activity. Department leadership concluded an acquisition review of Border Security, Fencing, Infrastructure and Technology investment in September 2008 and underscored the importance of a common operational picture with a more open architecture to readily adapt to changes in sensor types, technologies, and an integrated concept of operations.

Also in FY 2008, CBP and ICE jointly hosted the Human Trafficking Symposium which raised awareness and discussed best practices in the fight against human trafficking. CBP also sponsored the 2008 Joint Agency Agriculture Stakeholders Conference that strengthened existing partnerships (CBP-Agriculture Plant Health Inspection Service, CBP-States and CBP-Industry), and provided a forum for State Governments and private industry to offer ideas for fulfilling our agricultural mission.

Future Actions

- CBP will form a focus group using the recently completed Massachusetts Institute of Technology Lincoln Laboratory Architecture Trade Study as a starting point to make recommendations to leadership by January, 2009; and
- The Department is also beginning a cross-Component analytical effort to assist in resource allocation across programs and Components and to measure effectiveness of inter-Component DHS efforts on the border.

Detention and Removal

U.S. Immigration and Customs Enforcement (ICE) introduced new Performance-Based Detention Standards to ensure that safe, secure and humane conditions of confinement exist for ICE's detained alien population. These new and improved standards are based upon the performance-based format now endorsed by the American Correctional Association and focus on the results and outcomes that daily performance expectations should accomplish. Also, the Performance-Based Detention Standards provide enhanced transparency at ICE facilities and to the public, to non-governmental organizations and to third-party oversight groups.

Further, oversight of the ICE detention assets was strengthened by the establishing of a Detention Facilities Inspection Group (DFIG) within the Office of Professional Responsibility. The DFIG provides ICE with an independent inspection arm dedicated to oversight of ICE’s Detention and Removal Operations (DRO) program. The DFIG conducts independent Quality Assurance Reviews, and Special Assessment Reviews requested by the Assistant Secretary. The DFIG conducts independent reviews of critical incidents involving ICE detainees in concert with ICE DRO headquarters personnel. The DFIG prepares executive summaries and final reports for the Assistant Secretary, ICE Executive Leadership and for DRO management. The group monitors the progress being made by DRO to correct any non-complying condition.

Additionally, ICE has contracted with private companies to provide on-site compliance verification of the Performance-Based National Detention Standards at all ICE detention facilities. These personnel are posted full time at ICE's 40 largest facilities to monitor both the detention standards and quality of life issues at all Service Processing Centers, Contract Detention Facilities, and the larger State, local and county jails that house ICE detainees via Intergovernmental Service Agreements. In addition, ICE now uses a contracted service that performs annual inspections of all detention facilities that house ICE detainees. These inspections are performed by detention subject-matter experts who specialize in Health Services, Security, Safety and Food Service. More than 200 facility reviews have already been completed.

Border Enforcement Security Task Force

In 2006, DHS Secretary Michael Chertoff adopted the Border Enforcement Security Task Force (BEST) initiative to leverage Federal, State, local and foreign law enforcement resources in an effort to identify, disrupt, and dismantle organizations that seek to exploit vulnerabilities in the border and threaten the overall safety and security of the American public. The task forces are designed to increase information sharing and collaboration among the agencies combating this threat on both sides of the border.

During 2005, the Laredo, Texas and Nuevo Laredo, Mexico areas experienced a significant increase in violent crimes, specifically murder and kidnappings. These crimes were often associated with the underlying criminal activities, primarily drug smuggling, human smuggling, arms trafficking, bulk cash smuggling, and money laundering. In response to the increased violence in this geographical area and other areas along the Southwest border with Mexico, the U.S. Immigration and Customs Enforcement (ICE) in partnership with various Federal, State, foreign, and local law enforcement officials expanded its ongoing Border Crimes Initiative by creating a multi-agency operation called the Border Enforcement and Security Task Force, or BEST.

BESTs utilize a comprehensive approach toward dismantling the cross-border criminal organizations that exploit vulnerabilities of the United States border, while also developing information useful toward eliminating the top leadership and the supporting infrastructure that sustains these often-violent organizations. BESTs includes personnel from ICE, CBP, the Drug Enforcement Administration, the Bureau of Alcohol, Tobacco, Firearms and Explosives, the Federal Bureau of Investigation, the U.S. Coast Guard, and the U.S. Attorney's Office, along with other key Federal, State, tribal, local, and foreign law enforcement agencies.

BESTs leverage Federal, State, tribal, local, and foreign law enforcement and intelligence resources to achieve the goals of the BEST. These goals are to:

- Gather and analyze intelligence;
- Identify, disrupt, dismantle and prosecute cross-border smuggling and trafficking organizations; and
- Interdict contraband, weapons, money and persons entering the U.S. illegally.

In furtherance of the BEST mission, U.S. law enforcement agencies coordinate intelligence sharing and investigative leads with representatives from the governments of Mexico and Canada. This coordination better enables the United States Government's ability to attack organizations in a more-coordinated way on both sides of the border. Participating in BEST on the Southwest border is the Mexican law enforcement agency Secretaria de Seguridad Publica. For the Northern border, participating Canadian law enforcement agencies include the Canada Border Services Agency, the Royal Canadian Mounted Police, the Ontario Provincial Police, the Niagara Regional Police Service, and the Toronto Police Service.

The BEST concept was first implemented in Laredo, Texas in January 2006. BESTs were subsequently established in: 1) Tucson, Arizona in March 2006; 2) El Paso, Texas in October 2006; 3) San Diego, California in November 2006; and 4) Rio Grande Valley (Harlingen, Brownsville, and McAllen, Texas) in March 2007.

On February 4, 2008, the first Northern border BEST initiated operations in Blaine, Washington. A second Northern border BEST was subsequently launched in Buffalo, New York on March 4, 2008.

In FY 2008, BESTs were established in three additional locations along the Southwest border. BESTs were established in Phoenix, Arizona in March 2008, in Yuma, Arizona during March 2008, and in Imperial Valley, California in June 2008.

Preliminary results for FY 2008 show that, BESTs were responsible for 918 criminal arrests, 1,229 administrative arrests, 342 indictments, and 320 convictions and has seized 1,599.44 pounds of cocaine, 55,560.71 pounds of marijuana, 120.84 pounds of methamphetamine, 5.47 pounds of crystal methamphetamine, 50.88 pounds of heroin, seized 414 weapons, 288 vehicles, and approximately $8.1 million in United States currency and monetary instruments.

FY 2008 Challenge 8: Transportation Security

The security of the Nation's aviation system is a collaboration of public and private sector elements working together to provide effective protection for travelers and the flow of goods. This coordinated effort to protect the aviation system is designed to defeat threats, reduce vulnerabilities, minimize the consequences of, and expedite the recovery from attacks that might occur. Transportation Security Administration (TSA) screening of persons and property continues to be a vital and successful element of the overall aviation security system. The effectiveness of TSA screening is due to the layered approach to aviation security, greater emphasis on unpredictable screening methods, and systematic improvements implemented in the screening process.

To address the challenge of improvements needed in training; equipment and technology; policy and procedures; and management and supervision, TSA has completed the following:

Checkpoint and Checked Baggage Performance

In support of Office of Security Operations review of options to relieve Supervisory Transportation Security Officers and Lead Transportation Security Officers of as much ancillary administrative responsibilities as possible, a Working Group of Supervisory and lead Transportation Security

Officers and Lead Transportation Security Officers was recently convened. The Working Group's recommendations have been further studied, impacts determined, and vetted with Senior Leadership. At this time, senior leadership decisions are moving through the Office of Security Operations requiring near term alteration of program administrative practices and associated systems.

A standard operating procedure change has been made that allows for more than two passes through the Walk-Through Metal Detector in an attempt to induce divestiture of substantial amounts of metal. Following completion of Hand Held Metal Detector and sensitive area pat-down screening, Transportation Security Officers may now re-process the individual through the Walk-Through Metal Detector to confirm that Walk-Through Metal Detector metal alarms were resolved as a result of additional screening. Additional random pat-downs have also been included in the recent change.

In FY 2008, TSA purchased an additional 117 advanced technology systems and a procurement of an additional 133 systems is pending with plans to procure an additional 332 systems later in the year. The current advanced technology contract is capped at 500 systems per vendor, so a new procurement solicitation has been initiated to be awarded in FY 2009. To date, TSA has deployed 280 systems to 13 airports.

TSA continues to explore options for more effective sensitive area pat-downs, while weighing security concerns with social expectations. Although a new sensitive area pat-down was recently designed, the increased level of intrusiveness inherent in the proposed procedure requires additional field study and a more comprehensive understanding of the impact it will have on the flying public. Toward that end, a pilot is currently underway at several airports that will test alternative sensitive area pat-down procedures. TSA is still in the process of conducting field suitability and effectiveness testing of x-ray backscatter and millimeter wave whole body imaging technologies in operational environments. In addition, TSA continues to work closely with the vendors to ensure our ability to take full advantage of the effectiveness of the imaging, while continuing to afford appropriate protections for the traveling public.

Also in FY 2008, as a result of recently conducted pilots, TSA implemented a change to the alternative bag search protocol which will require all bags to be opened at non-Explosive Detection System checked baggage screening locations.

Future Actions

- Completing Checkpoint Evolution training for over 50,000 employees;
- Continuation of advanced security solutions at the checkpoint;
- Utilizing advanced communication systems for Transportation Security Officers throughout the airport;
- Continuing testing to determine appropriate staffing levels for new technology;
- Utilizing Security Transportation Inspectors for re-certification training. By eliminating contractor support and performing this essential function with Transportation Security Officers, TSA will be able to focus its training resources more directly on Transportation Security Officers; and
- Developing and conducting improvised explosive device Exercise Drills and Kits for checked baggage and checkpoint Transportation Security Officers.

Employee Workplace Issues

TSA has taken proactive steps by establishing the Office of the Ombudsman, the Integrated Conflict Management System, and the National Advisory Council to help identify and address its employees' workplace concerns and to meet the challenges of providing employees with sufficient tools, guidance and communication on the structure, authorities, and oversight responsibilities. As stated in our previous response to OIG, TSA is taking a systems approach that includes skills, structures, and support to build a values based culture, which encompasses conflict management competency, innovation, communication, collaboration, and employee engagement.

TSA issued the Ombudsman Management Directive which clearly identifies the role of the Office of the Ombudsman to plan and execute all necessary activities, including site visits, free from interference; suggest corrective actions to airports and Area Directors as a result of its activities; and follow-up with TSA officials responsible for airport operations to ensure that corrective actions are implemented.

The Office of Ombudsman converted data collected prior to the implementation of the Inquiry Management System to a Microsoft Access database and created a selection of reports that permit more ready extraction and analysis of data. Additional summary reporting formats that will give Federal Security Directors and other senior leadership official's information on the volume, nature and type of contacts received by the Office of the Ombudsman from its first year of operation in 2003 are under development. This report format will list the volume of contacts by type received each quarter. From this data, historical trends and comparisons will be more readily made. A page on the Office of the Ombudsman's SharePoint site is being created that will be populated with the summary reports described above. Summary reports for the first three quarters of FY 2008 were posted to this site by September 2008. Historical quarterly data reports will be made available through this site by the end of the second quarter of FY 2009.

TSA's senior leadership established the National Advisory Council to bridge the gap between field personnel and headquarters. The National Advisory Council has built a communications network across the field by establishing a point of contact at every airport. The points of contact work to foster effective communication between the front-line workforce and headquarters. The National Advisory Council developed many important initiatives including: dual-function bonus; changes to PASS; development of the Voluntary Leave Transfer Program; as well as provided field input to changes in Standard Operating Procedures, technology, safety and training. The National Advisory Council serves as an advisory board that provides direct, unfiltered feedback to the TSA Administrator, Deputy Administrator and Senior Leadership Team. TSA's National Advisory Council is composed of 34 members from among the Transportation Security Officers, Lead Transportation Security Officers, Supervisory Transportation Security Officers, and Behavioral Detection Officers from airports nationwide and 27 members drawn from the Assistant Federal Security Director-Screening and Transportation Security Manager ranks.

Future Actions

- Develop internal practitioners to continue the development of core competencies in conflict management and cooperative problem solving;
- Expand the influence and span of the National Advisory Council by fully engaging the National Advisory Council Network in the gathering of ideas and sharing information;

- Implementation of revised Mid-Level Development Program with defined program components, and accomplished of needs assessment for purposed of program right-sizing and development of new learning tools;
- Complete all program development activities for Senior Leadership Development Program 2 and most activities for Senior Leadership Development Program 3;
- Development of needs analysis and proposal for a new Executive Leadership Development course; and
- Initial selection and development participants for the TSA Career Resident Program and planning for possible nationwide rollout in FY 2010.

Passenger Air Cargo Security

TSA's conducts many programs to ensure the security of air cargo. Some of the programs conducted include the Indirect Air Carrier Standard Security Program, the Aircraft Operator Standard Security Program, Model Security Program, Airport Security Program, Security Threat Assessments, Access Control, Secure Movement of Air Cargo, and Cargo Security Training and Air cargo screening. During FY 2008, TSA completed its deployment of the Transportation Security Inspectors Cargo K9 Handlers and conducted 25 "cargo strike" surges.

Transportation Security Inspectors also conduct "known shipper" inspections of regulated entities that transport cargo on aircraft against various standard security programs and security directives. These programs and directives indicate the baseline requirements necessary to establish a shipper as being known and in compliance with baseline requirements. Known Shippers, or "vetted shipper", status allows entities that have routine business dealings with freight forwarders or air carriers to move cargo onto a passenger aircraft. In contrast, unknown shippers are entities that have conducted limited or no prior business with a freight forwarder or air carrier, and are not considered vetted. Regulated entities can also prove known shipper status through Customer Record, Business History, Contract and Site Visit Verification. The Known Shipper Management System uses commercial databases to verify the legitimacy of shippers. Through FY 2008, more than 1.3 million shippers in the U.S. have been vetted by TSA and approximately 184,351 security threat assessments were completed by freight forwarders and air carriers. The Office of Inspector General is conducting an audit of the Air Cargo Security - Known Shipper Program. TSA anticipates a draft report from the Office of Inspector General in the very near future and benefiting from the recommendations made.

In FY 2008, TSA Implementation of the Certified Cargo Shipper Program in an effort to achieve 50 percent screening air cargo originating in the U.S. transported on passenger aircraft by February 2009 and 100 percent screening by August 2010.

Future Actions

- The TSA will address recommendations from the Office of Inspector General Known Shipper Program audit in FY 2009;
- Publish the Certified Cargo Screening Program Interim Final Rule to implement 9/11 Act mandates to screening 50 percent of air cargo originating in the U.S. and transported on passenger aircraft by February 2009 and 100 percent by August 2010;
- Develop and implement the Air Cargo Data Management Systems – critical to full deployment of the Certified Cargo Security Program;

- Complete deployment of 85 canine teams to the larger airports to support the 100 percent cargo screening mandate of the 9/11 Commission Act; and
- Complete the remaining 14 vulnerability assessments for the 27 Category X airports.

Rail and Mass Transit

The report of the DHS Inspector General on TSA's mass transit security programs cited challenges in four areas:

1. Clarity of the role of TSA Surface Transportation Security Inspectors (STSIs) in the transit security mission;
2. Internal communication and coordination with the STSIs and with access to results of Baseline Assessment for Security Enhancement (BASE) program results the STSIs produce;
3. Coordination with mass transit and passenger rail security partners on Visible Intermodal Prevention and Response (VIPR) operations, with the recommended action that TSA complete Memorandums of Understanding with each security partner; and
4. The lack of security regulations in mass transit and passenger rail.

TSA STSIs play an integral role in the implementation of the mass transit security strategy. Their assessment work advances the strategic priority of elevating the security baseline. The assessment results inform the setting of security priorities and the development and implementation of programs and resource allocations to achieve them, including the Transit Security Grant Program.

In communicating STSIs mission to security partners, TSA has made this connection clear - whether at meetings of the Sector Coordinating Council (SCC), monthly teleconferences with the Peer Advisory Group (PAG), the semi-annual Transit Security Roundtables, and the periodic meetings of Regional Transit Security Working Groups (RTSWG).

To enhance internal communications, Transportation Security Network Management (TSNM) Mass Transit engages with the Surface Transportation Security Inspection Program (STSIP) consistent participation in the bi-weekly STSIP national teleconference, daily coordination with the program director, and briefings at the STSIP annual meetings. This proactive engagement aims to ensure timely awareness and thorough understanding of developments in mass transit and passenger rail security programs and initiatives. An area needing improvement is consistency in ensuring STSIs are aware of meetings involving security partners in their respective areas.

On providing accesses to assessment results, TSNM Mass Transit and the STSIP have set a clear policy of limiting access to those with a need to know to execute security responsibilities pertaining to mass transit and passenger rail. In addition to the STSIs, this group includes members of the Mass Transit Division, officials with responsibilities for the Transit Security Grant Program in Transportation Sector Network Management, and others reviewed on a case-by-case basis as dictated by their security responsibilities. This policy specifically aims to restrict distribution of the results to avoid breaches of information security.

With respect to the VIPR program, TSA has completed an agreement with the mass transit and passenger rail community, as represented by the PAG, on operating guidelines for the deployment of TSA resources to augment security in mass transit and passenger rail. The agreement provides a framework for effective planning, coordination, preparation, execution, and after action review of

VIPR deployments. TSA has distributed the VIPR operating guidelines to the law enforcement chiefs and security directors of the largest 50 mass transit and passenger rail agencies, to the SCC, and to Federal Security Directors and Federal Air Marshal Special Agents in Charge. To enhance the deployment of the various TSA components in VIPR teams, TSA also produced a supporting product that explains the role and capabilities of each VIPR element and provides recommendations on effective deployment of these resources in mass transit and passenger rail. The VIPR operating guidelines and guidance on roles, capabilities, and tactical employment provide the foundation for effective conduct of VIPR operations. Therefore, Memorandums of Understanding with each mass transit and passenger rail agency that could participate in a VIPR deployment are not necessary.

TSA recently issued regulations aimed at strengthening the security of the nation’s freight and passenger rail systems and reducing the risk associated with the transportation of security-sensitive materials. The Rail Security final rule will require freight and passenger rail carriers to designate rail security coordinators and report significant security concerns to the TSA. The rule also will codify TSA’s broad inspection authority. For freight rail, the rule will ensure the positive handoff of security-sensitive materials as well as establish security protocols for custody transfers for security-sensitive material rail cars between receivers of these materials that are located in high threat urban area, shippers of these materials, and rail carriers. To raise the level of security in the freight rail transportation sector ahead of the final rule, both TSA and the U.S. Department of Transportation developed security action items, along with the freight rail industry, to reduce the risk associated with the transportation of Poisonous by Inhalation (PIH) materials. These measures have resulted in an overall risk reduction of more than 60 percent, well above the target reduction of 50%. PIH materials are potentially harmful and include essential chemicals like chlorine and anhydrous ammonia. PIH materials represent less than one percent of all hazardous materials rail shipments.

Under the BASE program, STSIs have now completed 88 assessments, vastly expanding TSA's domain awareness, understanding of security enhancement needs, and abilities to advance effective security programs and resource allocations. The assessments results have enabled TSA to identify the priorities requiring attention and build consensus in such forums as the Government Coordinating Councils, SCC, PAG, and RTSWGs for collaborative risk mitigation efforts. Through such products as the Smart Security Practices compilation, TSA is fostering networking among security partners to expand adoption of the most effective programs, measures, and activities.

TSA recognizes the value that performance-based requirements can yield in security enhancement. Consistent with the requirements of the Implementing Recommendations of the 9/11 Act, TSA has initiated consultation and coordination with security partners for development of regulations on security plans, assessments, and training programs. The results of this outreach, further informed by the continuing assessment results, are being applied in the concerted TSNM effort to produce the required regulations during FY 2009.

Future Actions

- Maintain consistency on TSA's mission and security priorities in all engagements with security partners. Expand involvement of the STSIP in outreach forums such as the SCC, PAG, RTSWG, and Transit Security Roundtable meetings, to ensure understanding of the integrated role STSIs play in the implementation of TSA's security strategy in mass transit and passenger rail;

- Establish primary and alternate internal liaison representatives between TSNM Mass Transit and the STSIP to ensure timely communication and coordination of upcoming meetings and related matters with security partners, whether as individual agencies or in group forums such as the SCC and RTSWG;
- Complete and distribute the VIPR Operations Kit for mass transit and passenger rail security partners and Federal Security Directors and Federal Air Marshal Special Agents in Charge. The kit includes the operating guidelines and guidance on roles, capabilities, and tactical employment. TSA projects distribution of this product will commence in early 2009; and
- Update the summaries of the developing concepts for the pending rulemakings on security training programs and security plans and assessments. Complete consultations with security partners on these updated summaries by the end of 2008. Complete draft for notices of proposed rulemakings in each area in the first quarter of FY 2009.

FY 2008 Challenge 9: Trade Operations and Security

U.S. Customs and Border Protection (CBP) will facilitate about $2 trillion in legitimate trade this year while enforcing U.S. trade laws that protect the economy, health, and safety of the American people. The Office of Inspector General report states, "Modernizing trade systems, using resources efficiently, and managing and forging partnerships with foreign trade and customs organizations pose significant challenges for CBP and DHS. Finding the right balance to fulfilling CBP's mission to secure the Nation's borders and to facilitate the free flow of international trade is a challenge that requires CBP to consistently monitor and evaluate the processes and systems the agency employs to screen and clear the millions of import ocean cargo containers and millions of entries that cross our ports of entry every year. We accomplish this through close partnerships with the trade community, other government agencies, and foreign governments. The following is an update to CBP's trade operations.

<u>The Container Security Initiative</u>

The Container Security Initiative (CSI) enables CBP, in working with host government Customs Services, to examine high-risk maritime containerized cargo at foreign seaports before they are loaded on board vessels destined for the United States. Almost 32,000 seagoing containers arrive and are off loaded at United States seaports each day. The goal is for CBP's overseas CSI teams to review all the manifests before containers are loaded on vessels destined for the United States. Today, CSI has partnered with 32 countries and is operational in 58 ports worldwide in North, South, and Central America; Asia; Europe; South Africa; the Middle East; and the Caribbean.

Future Actions

- There are no current plans to expand CSI further than to the 58 ports they are operating in.

<u>Secure Freight Initiative</u>

The Secure Freight Initiative (SFI) integrated scanning pilot project consists of Radiation Portal Monitors provided by Department of Energy and non-intrusive inspection imaging systems provided by CBP or the host nation, that are used to scan containers as they move through foreign ports. DHS CBP created SFI in partnership with the Secretaries of Energy and State on

December 7, 2006 in order to meet Congressional scanning requirements. SFI is currently operating in four foreign ports scanning 100 percent of all cargo using non-intrusive inspection imaging systems.

Future Actions

- DHS/CBP is finalizing a strategy focused on high-risk trade corridors that entails expanding the concept into new areas, adding more complexity to the challenges noted in DHS's report to Congress on the pilot implementations.

Customs and Trade Partnership Against Terrorism

CBP's Customs Trade Partnership Against Terrorism (C-TPAT) is an integral part of the CBP multi-layered strategy through which CBP works in partnership with the trade community to better secure goods moving through the international supply chain. C-TPAT now has more than 8,700 members and accounts for almost half of all imports into this country. CBP conducted more than 9,690 validations of C-TPAT members since its inception which more than 1,893 were re-validations.

Future Actions

- By the end of calendar year 2008 C-TPAT will complete 3,200 validations, meeting the SAFE Port Act requirements to validate new members within one year of the date of certification and conduct revalidations within 3 years of the date of initial validation; and
- C-TPAT projects that it will complete approximately 3,000 validations in calendar year 2009 and 2010 to meet the SAFE Port Act requirements. Continued membership growth will require CBP to re-examine program resources.

10+2 Security Filing

CBP recognizes the critical need to fully incorporate additional advance trade data information into the targeting environment. In pursuing this objective, CBP is currently in the process of requiring additional supply chain information, which includes critical entry type data, to improve automated targeting capabilities. This new requirement, known officially as the 'Importer Security Filing and Additional Carrier Requirements' or simply "10+2" will significantly increase the scope and accuracy of information gathered on the goods, conveyances and entities involved in the shipment of cargo arriving by vessel into the United States. CBP worked with the trade community through the Departmental Advisory Committee on Commercial Operations to create a new Security Filing in an effort to obtain additional advanced cargo information and enhance our ability to perform risk-based targeting prior to cargo being laden on a vessel overseas. CBP's close partnership with the trade community is the key reason why the "10+2" Security Filing proposal was developed in a smooth and timely fashion. Stakeholder input during the consultative process as well as its participation in the Advance Trade Data Initiative has been instrumental in the successful crafting of the proposal. Additionally, earlier this year, the Committee on Commercial Operations made almost 40 recommendations to CBP on how to implement the security filing or "10+2 Security Filing initiative". CBP carefully studied and considered the Committee on Commercial Operations recommendations and agreed in full and/or in part to a majority of the recommendations.

Future Actions

- There will be no comments on the rule in progress.

Mutual Recognition Partnerships

An important effort to note is the potential mutual recognition of other countries' customs-to-business partnership programs. Creating an international network to exchange information about trusted traders and knowing that those participants are observing specified security standards in the secure handling of goods and relevant information is a win-win for both government and business. In June 2007, CBP signed its first mutual recognition arrangement with New Zealand. In June 2008, CBP signed two additional arrangements, one with Canada and the other one with Jordan.

Future Actions

- CTPAT projects two additional mutual recognition arrangements in FY 2009; and
- While dependent upon the ability of those administrations which have communicated interest to CBP in creating their own industry supply chain security program in accordance with CTPAT, the trend of signing one or two Mutual Recognition Arrangements is expected to continue over the next few years.

Participation in World Trade and World Customs Organizations

CBP provided guidance to the Office of the U.S. Trade Representative on World Trade Organization matters including the Chinese Auto Parts dispute; the Trade Facilitation Negotiating Group; World Trade Organization Accessions for Russia; Yemen, Montenegro, Serbia, and Kuwait; the Anti-Counterfeiting Trade Agreement; and the complaint against China for ineffective intellectual property rights enforcement. In addition, CBP represented the U.S. at the World Customs Organization's 40th and 41st session of the Harmonized System Committee, 36th and 37th Session of the Harmonized System Review Sub-Committee, Technical Committee on Customs Value, and Technical Committee on Rules of Origin. CBP also participated in the development of the Standards Employed by Customs for Uniform Rights Enforcement.

Future Actions

- CBP will continue to support the World Trade Organization in FY 2009 and beyond by providing appropriate trade expertise as needed.

Cargo Security

The Office of Inspector General report states, "Our annual Automatic Targeting System (ATS) review in 2008 focused on a subsystem of ATS, the Cargo Enforcement Reporting and Tracking System (CERTS), which is designed to gather data on cargo examination findings and report on how efficiently examination equipment is being used. We identified the need for improvements in planning, updating, developing and implementing the CERTS system. CBP needs to update the project plan to include the scope of work, and a detailed implementation schedule for system design, developing and testing, and cost estimates past phase one. In addition, CBP bypassed key life cycle reviews designed to ensure end-users have a properly working system and have received management's approval to continue the project." CBP has developed, implemented and is monitoring the updating of CERTS. CBP realigned the key life cycle reviews and updated the Production Readiness Review and the Operational Readiness Review as discussed with the Office of Inspector General. In addition, the latest quality assurance testing was also conducted. Remaining CERTS funding was re-appropriated by DHS and remains an open item as the amount of the appropriation is only projected to last until May 2009.

Future Actions

CBP anticipates the CERTS Project Plan Actions through Phase II cited below will be completed by May 1, 2009. A funding stream has not been identified for Phase III development.

Phase II – Iteration V

- Support for Automated Commercial Environment Post Release Entry Summary, Accounts and Revenue (ESAR 2.2)
- Pre-work/recertification of Initial Decision Point
- Planned released to all users November 11, 2008

Phase II – Iteration VI

- User Interface modifications to support Entry Summary, Accounts and Revenue events
- Initial Decision Point
- Based on recertification of definition/business requirements
- Planned release to all users January 11, 2009

Phase II – Iteration VII

- Support Laboratories and Scientific Services notification
- Integrate CERTS events with ATS Find Queries
- Correct Seal Logic
- Pre-work for In-process/Pending events
- Planned release to all users February 18, 2009

Phase II – Iteration VIII

- In-process/Pending events
- Planned release to all users April 1, 2009

Closeout Phase II activities

- Technology Readiness Review – April 17, 2009
- Production Readiness Review – May 1, 2009

<u>Implementing the World Customs Organization Framework</u>

The World Customs Organization Framework, developed by the World Customs Organization, represents an extraordinary implementation challenge for the customs administration of any country, particularly for one that may not have the resources or subject matter expertise readily available to implement the practices identified in the Framework.

The Framework is a set of standards to secure and facilitate global trade and provides a new avenue in which customs administrations can operate. The Framework will enhance CBP's ability to strengthen the entirety of the global supply chain by assisting countries in strengthening their customs operations. It will also help CBP synchronize its own operations with other trusted customs administrations to meet the challenges of the global economy. This is because the Framework provides standards that, if adopted universally, would provide continuity, consistency, and stability to the customs process.

- In FY 2009, CBP will work with the World Customs Organization to align the Framework with CBP's major strategic goals, including:
  - Harmonizing data requirements of the Framework with those found in the World Customs Organization Data Model;
  - Continuing to develop the Single Window concept;
  - Solidifying relationships with other customs administrations through the negotiation of Mutual Recognition Arrangements; and,
  - Continuing development of a World Customs Organization Trade Recovery Program. This program addresses what steps countries need to take should there be a significant disruption to trade.

Maintaining a Safe and Secure Food Supply

As the value and complexity of our food imports grow, CBP's challenge is to maintain a safe and secure food supply. As with our approach to anti-terrorism, CBP has taken a multi-layered approach to protect the safety of America's food imports. In its newly published CBP Trade Strategy, Objective 3.1 calls for CBP to "Protect U.S. consumers through the secure and trusted import of safe agriculture and goods." CBP will accomplish this by helping to build a prevention-focused model to monitor the entire import lifecycle, while working to expand partnerships and integrating import safety verifications. CBP will continue to leverage its trade expertise, including the use of laboratory services to analyze and verify the health, safety, and admissibility of products prior to release.

Future Actions

- Continuing in FY 2009, CBP is partnering with other Federal agencies to refine our targeting skills, monitor for compliance, and prevent contaminated products from entering the U.S.; and
- CBP is also training its personnel to further identify safety concerns, including food-related threats.

Protecting Against Unfair Trade Practices, Illicit Commercial Enterprises and Unsafe Imports

With the growth of U.S. imports and the risk associated with international trade, CBP must direct an effective trade facilitation and enforcement approach to protect our Nation's economy and people from unfair trade practices, illicit commercial enterprises and unsafe imports.

Future Actions

- In FY 2009 CBP will continue to focus its actions and resources around priority trade issues (antidumping and countervailing duty, agriculture, import safety, intellectual property rights, penalties, revenue, and textile and wearing apparel) that pose a significant risk to the U.S. economy, consumers and stakeholders; and
- CBP will work closely with international partners, including the European Union to carry out Intellectual Property Rights initiatives focused on goods that also present health and safety concerns.

Commercial Trade Fraud Investigations

CBP is primarily responsible for trade operations and security with the support of the U.S. Coast Guard, while ICE leads trade enforcement investigations for DHS. ICE conducts commercial trade fraud investigations, a key element of the overall DHS trade enforcement strategy, and also focuses on priority programs aimed at stopping predatory and unfair trade practices that threaten the United States' economic stability, restrict the competitiveness of U.S. industry in world markets, and places the public health and safety of the U.S. public at risk. Successful cases have produced significant seizures, civil penalties, and criminal prosecutions.

Acronym List

The ***Appendix*** contains a list of acronyms.

Acronym List

AFG – Assistance to Firefighters Grants
A&O – Analysis and Operations
ARTF – Aquatic Resources Trust Fund
ATS – Automated Targeting Systems
BASE – Baseline Assessment for Security Enhancement
BEST – Border Enforcement Security Task Force
BPD – Bureau of Public Debt
B&SA – Bureau & Statistical Analysis
C&A – Certification and Accreditation
CBP – U.S. Customs and Border Protection
CDL – Community Disaster Loan
CERTS – Cargo Enforcement Reporting and Tracking System
CFO – Chief Financial Officer
C.F.R. – Code of Federal Regulations
CGC – Coast Guard Cutter
CIKR – Critical Infrastructure and Key Resources
CIO – Chief Information Officer
COBRA – Consolidated Omnibus Budget Reconciliation Act of 1985
COE – U.S. Army Corps of Engineers
CONOPS – Concept of Operations
COTR – Contract Officer’s Technical Representative
COTS – Commercial Off-the-Shelf
CPIC – Capital Planning and Investment Control
CS&C – Cybersecurity and Communications
CSI – Container Security Initiative
CSRS – Civil Service Retirement System
C-TPAT – Customs-Trade Partnership Against Terrorism
CY – Current Year
DADLP – Disaster Assistance Direct Loan Program
DFIG – Detention Facilities Inspection Group
DHS – Department of Homeland Security
DHS FAA – Department of Homeland Security Financial Accountability Act
DNDO – Domestic Nuclear Detection Office
DOC – Department of Commerce
DOD – Department of Defense
DOI – Department of Interior
DOL – Department of Labor
DRO – Detention and Removal Operations
DRWD – Disaster Reserve Workforce Division

ECIP – Energy Conversation Investment Program
FAR – Federal Acquisition Regulation
FASAB – Federal Accounting Standards Advisory Board
FBwT – Fund Balance with the Treasury
FCRA – Federal Credit Reform Act of 1990
FECA – Federal Employees Compensation Act
FEGLI – Federal Employees Group Life Insurance Program
FEHB – Federal Employees Health Benefits Program
FEMA – Federal Emergency Management Agency
FERS – Federal Employees Retirement System
FFMIA – Federal Financial Managers' Financial Integrity Act
FIRA – Flood Insurance Reform Act
FISMA – Federal Information Security Management Act
FLETC – Federal Law Enforcement Training Center
FMA – Flood Mitigation Assistance
FMFIA – Federal Managers' Financial Integrity Act
FPS – Federal Protective Service
FSIO – Financial Systems Integration Office
FY – Fiscal Year
FYHSP – Future Years Homeland Security Program
GAAP – U.S. Generally Accepted Accounting Principles
GAO – Government Accountability Office
GPO – Grants Policy Oversight
GSA – General Services Administration
HHS – Health and Human Services
HSDN – Homeland Security Data Network
HSGP – Homeland Security Grant Program
HSIN – Homeland Security Information Network
HSPD – Homeland Security Presidential Directive
HS SLIC – Homeland Security State and Local Intelligence Community of Interest
ICCB – Internal Control Coordination Board
ICE – U.S. Immigration and Customs Enforcement
ICGS – Integrated Coast Guard Systems
IDI – Injured Domestic Industries
IEFA – Immigration Examination Fee Account
IHP – Individuals and Household Programs
INA – Immigration Nationality Act
IP – Improper Payment
IPIA – Improper Payments Information Act of 2002
IPP – Infrastructure Protection Program
ISSM – Information System Security Managers

IT – Information Technology
MA – Mission Assignment
MD&A – Management's Discussion and Analysis
MEF – Mission Essential Functions
MERHCF – Medicare-Eligible Retiree Health Care Fund
MGMT – Management Directorate
MRS – Military Retirement System
NAO – National Applications Office
NAR – National CIKR Protection Annual Report
NCSD – National Cyber Security Division
NCTC – National Counterterrorism Center
NDHS – National Disaster Housing Strategy
NEMIS – National Emergency Management Information System
NFIP – National Flood Insurance Program
NIMS – National Incident Management System
NIPP – National Infrastructure Protection Plan
NPPD – National Protection and Programs Directorate
NSC – National Security Cutter
OAM – Office of Acquisition Management
OCFO – Office of the Chief Financial Officer
OCHCO – Office of the Chief Human Capital Officer
OCPO – Office of the Chief Procurement Officer
OHA – Office of Health Affairs
OIG – Office of Inspector General
OMB – Office of Management and Budget
OM&S – Operating Materials and Supplies
OPEB Other Post Retirement Benefits
OPM – Office of Personnel Management
ORB – Other Retirement Benefits
OSLTF – Oil Spill Liability Trust Fund
PA – Public Assistance
PA&E – Program Analysis and Evaluation
PAG – Peer Advisory Group
PART – Program Assessment Rating Tool
PBA – Performance Based Acquisitions
PIA – Privacy Impact Assessment
PKEMRA – Post-Katrina Emergency Management Response Act of 2006
P.L. – Public Law
PMA – President's Management Agenda
PMEF – Primary Mission Essential Functions
POA&M – Plan of Action and Milestones

PPBE – Planning, Programming, Budgeting, and Execution
PP&E – Property, Plant, and Equipment
PY – Prior Year
QHSR – Quadrennial Homeland Security Review
RSI – Required Supplementary Information
RSSI – Required Supplementary Stewardship Information
RTSWG – Regional Transit Security Working Groups
SAT – Senior Assessment Team
SBI – Secure Border Initiative
SBR – Statement of Budgetary Resources
SCC – Sector Coordinating Council
SFFAF – Statement of Federal Financial Accounting Standards
SFI – Secure Freight Initiative
SLFC – State and Local Fusion Center
SMC – Senior Management Council
SFRBTF – Sport Fish Restoration Boating Trust Fund
SORN – System of Records Notice
S&T – Science and Technology Directorate
STSI – Surface Transportation Security Inspectors
STSIP – Surface Transportation Security Inspection Program
TAFS – Treasury Account Fund Symbol
TSA – Transportation Security Administration
TSI – Transportation Security Inspector
TSNM – Transportation Security Network Management
UAS – Unmanned Aerial System
U.S. – United States
U.S.C. – United States Code
US-CERT - United States Computer Emergency Readiness Team
USCG – U.S. Coast Guard
USCIS – U. S. Citizenship and Immigration Services
USSGL – United States Standard General Ledger
USSS – U.S. Secret Service
US-VISIT – U.S. Visitor and Immigrant Status Indicator Technology
VIPR – Visible Intermodal Prevention and Response
WHTI – Western Hemisphere Travel Initiative
WMSL – Maritime Security Cutter, Large
WYO – Write Your Own

The Department of Homeland Security's FY 2008 Annual Financial Report is available at the following website:
http://www.dhs.gov/xabout/budget/editorial_0430.shtm

For more information or to obtain additional copies, contact:

Department of Homeland Security
Office of the Chief Financial Officer
Program Analysis and Evaluation (PA&E)
245 Murray Lane, SW
Mailstop 200
Washington, D.C. 20528

par@dhs.gov
(202) 447-0333

Homeland Security