Department of Homeland Security
Office of Inspector General

Independent Review of the
U.S. Coast Guard's
Reporting of FY 2008 Drug Control Obligations

OIG-09-26

February 2009

Office of Inspector General

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

February 12, 2009

Preface

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

This report presents the results of the review of the Table of Prior Year Drug Control Obligations and related disclosures of the U.S. Coast Guard for the fiscal year ended September 30, 2008, for the Office of National Drug Control Policy. We contracted with the independent public accounting firm KPMG LLP to perform the review. U.S. Coast Guard's management prepared the Table of Prior Year Drug Control Obligations and related disclosures to comply with the requirements of the Office of National Drug Control Policy Circular, *Drug Control Accounting,* dated May 1, 2007. However, due to the U.S. Coast Guard's inability to provide assurance as to the integrity of the financial data contained within the detailed accounting submissions, KPMG LLP was unable to complete the review. As a result, KPMG was unable to provide an opinion on the Table of Prior Year Drug Control Obligations and related disclosures.

We trust the information in this report will continue to result in effective, efficient, and economical operations. We express our appreciation to all of those who contributed to the preparation of this report.

Richard L. Skinner
Inspector General

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January 26, 2009

Ms. Anne Richards
Assistant Inspector General for Audits
Office of the Inspector General
U.S. Department of Homeland Security
1120 Vermont Avenue, NW
Washington, DC 20005

Dear Ms. Richards:

We were engaged to review the Table of Prior Year Drug Control Obligations and related disclosures, and the accompanying management's assertions of the Department of Homeland Security's (DHS) United States Coast Guard (USCG) for the year ended September 30, 2008. USCG management is responsible for the Table of Prior Year Drug Control Obligations and related disclosures, and the assertions.

The Office of National Drug Control Policy (ONDCP) Circular: *Drug Control Accounting* (May 1, 2007), requires management to disclose any material weaknesses or other findings affecting the presentation of data reported. Management reported that it "cannot provide assurances as to the integrity of the financial data contained" in its Table of Prior Year Drug Control Obligations and related disclosures.

In accordance with applicable professional standards, without a positive assertion provided by management we are unable to complete our review of USCG's Table of Prior Year Drug Control Obligations, and related disclosures, and management's assertion. Accordingly, we are unable to provide an Independent Accountants' Report on the Table of Prior Year Drug Control Obligations and related disclosures, and management's assertions pursuant to the requirements of ONDCP Circular: *Drug Control Accounting* (May 1, 2007).

Sincerely,

KPMG LLP

Scot G. Janssen
Partner

U.S. Department of
Homeland Security

United States
Coast Guard

Commandant
United States Coast Guard

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JAN 2 9 2009

Mr. John Shiffer
Department of Homeland Security
Director of Financial Management
Office of the Inspector General
1120 Vermont Avenue, 10th Floor, NW
Washington, D.C. 20005

Dear Mr. Shiffer,

In accordance with the Office of National Drug Control Policy Circular: *Annual Accounting of Drug Control Funds* dated May 1, 2007 and based on KPMG recommended revisions in their January 23, 2009 teleconference call, enclosed is the Coast Guard's revised report of FY 2008 drug control obligations, drug control, methodology and assertions.

If you require further assistance on this information, please contact LCDR Abby Benson at (202) 372-3518.

Sincerely,

T.W. JONES
Captain, U.S. Coast Guard
Chief, Office of Budget and Programs

Enclosures

Copy: DHS Budget Office

DEPARTMENT OF HOMELAND SECURITY
UNITED STATES COAST GUARD
ANNUAL ACCOUNTING OF
FY 2008 DRUG CONTROL FUNDS
6A. DETAILED OBLIGATION SUBMISSION

(a) Table of Prior Year Drug Control Obligations (dollars in millions)

RESOURCE SUMMARY	2008 Actual
Drug Resources by Function:	**Obligations**
• Interdiction	$974.809
• Research and Development	1.341
Total Resources by Function	**$976.150**
Drug Resources by Decision Unit:	
• Operating Expenses (OE)	$752.595
• Reserve Training (RT)	$15.557
• Acquisition, Construction, and Improvements (AC&I)	$206.657
• Research, Development, Test and Evaluation (RDT&E)	$1.341
Total Drug Control Obligations	**$976.150**

(1) Drug Methodology

Over twenty years ago, the Coast Guard designed its cost allocation methodology to systematically allocate funding to the Coast Guard's primary mission areas. This methodology allocated Coast Guard costs based on the time that Coast Guard resources (cutters, aircraft, boats, and personnel) spent on various types of missions. This view of the Coast Guard budget provided valuable insight into the multi-mission use of assets and personnel. However, for many years the only information taken into consideration was the previous year's operational activity. Prior to 1998, operational data (resource hours) and obligation data were downloaded only at the end of the fiscal year to develop mission cost allocations for the year just completed and budgetary projections for current and future years taking into account incremental changes. Starting in 2000 a more improved methodology, known as the Mission Cost Model (MCM) was developed to effectively present Coast Guard missions more accurately using activity based cost accounting principles. Further, the Coast Guard has developed an operating hour baseline as a method to allocate resource hours for each resource class to multiple Coast Guard missions. This is the revised basis for funding allocations in budget projections. The operating hour allocation, or baseline, is developed and modified based upon line item requests, congressional direction and national priorities.

The Coast Guard's drug control funding estimates are computed by closely examining the decision units, or appropriations, that comprise the Coast Guard's drug control budget estimates. These decision units consist of: Operating Expenses (OE); Acquisition, Construction, and Improvement (AC&I); Reserve Training (RT); and Research, Development, Test, and Evaluation (RDT&E).

(1) <u>Drug Methodology (cont.)</u>

Each decision unit contains its own unique spending authority and methodology. For example, AC&I include funding that can last up to five years after appropriation and RDT&E funding does not expire. Unless stipulated by law, OE and RT funding must be spent in the fiscal year it is appropriated and therefore the methodology for these two appropriations is the same.

Operating Expenses

The majority of the funds the Coast Guard allocates to the drug interdiction program are in the Operating Expenses (OE) decision unit. OE funds are used to operate Coast Guard facilities; maintain capital equipment; improve management effectiveness; and recruit, train, and sustain an active duty military and civilian workforce. In the OE budget, the amount allocated to the drug interdiction program is derived by allocating a share of the actual expenditures based upon the amount of time aircraft, cutters, and boats spent conducting drug interdiction activities. The Coast Guard tracks the resource hours spent on each of the 11 Coast Guard programs by using a web-based Abstract of Operations (AOPS) data collection and report system. Coast Guard AOPS data is used to develop the amount of time that each asset class spent conducting each of the Coast Guard's missions. Using financial data gathered from over 3,000 cost centers around the United States along with the Abstract of Operations information, the Coast Guard is able to allocate OE costs to each of the 11 program areas consisting of: Drug Interdiction; Migrant Interdiction; Ports, Waterways and Coastal Security; Other Law Enforcement; Defense Readiness; Search and Rescue; Marine Safety; Ice Operations; Marine Environmental Protection; Living Marine Resources; and Aids to Navigation.

Acquisition, Construction, and Improvements

In scoring drug control funding requests within the zero-based Acquisition, Construction, and Improvement (AC&I) decision unit, professional judgment is used to evaluate every line item project requested in the FY 2008 AC&I budget for its anticipated contribution to Coast Guard's 11 program areas. For each AC&I project, a discrete profile is established to allocate the funding for that project to the various mission areas of the Coast Guard. In most cases, the driver is the percentage of time an asset contributes to the drug control mission as determined from the OE Mission Cost Model (MCM). Otherwise, when a project is not related to any particular asset or series of asset classes, the project fund may benefit the Coast Guard's entire inventory and other expense categories. With this condition, the general OE AOPS MCM percentage is utilized. As with the other three appropriations, once the program percentage spreads are computed for each of these drivers in the FY 2008 AC&I MCM, the total bottom-line mission percentage is applied directly to the AC&I total direct obligations. This percentage allocation is a repeatable mission spread process which the Coast Guard uses throughout its annual budget year presentations, namely OMB's MAX budget system for the President's Budget submission and the CFO's Statement of Net Cost report.

(1) Drug Methodology (cont.)

Reserve Training

The Coast Guard allocates a portion of the Reserve Training (RT) decision unit funds to the drug interdiction program. RT funds are used to support Coast Guard Selected Reserve personnel who support and operate Coast Guard facilities, maintain capital equipment, improve management effectiveness, and assist in sustaining all Coast Guard operations. The final FY 2008 obligations for the RT decision unit are determined using the same methodology used for OE.

Research, Development, Test and Evaluation

The final decision unit is Research, Development, Test and Evaluation (RDT&E). As with the AC&I Appropriation, scoring of drug interdiction funding is accomplished within the zero-based RDT&E decision unit and every line item requested in the FY 2008 RDT&E budget was evaluated for its anticipated contribution to drug interdiction efforts. Each RDT&E project has a discrete driver that is selected to allocate the funding for that project to the various mission areas of the Coast Guard. These drivers are based upon experienced professional judgment. Once the unique program driver is chosen the program percentage spreads as determined from the OE MCM.

(2) Methodology Modifications

The methodology described above has not been modified from the previous year.

(3) Material Weaknesses or Other Findings

As a result of the CFO Act audit and feedback provided in the enclosed Independent Auditors' Report: Exhibit I – Material Weaknesses in Internal Control (Enclosure 1), and as described in the enclosed 2008 U.S. Coast Guard Assurance Statement (Enclosure 2), the Coast Guard has material weaknesses in financial management, financial reporting, and financial systems that impact the assurance of information in our financial reports. As such, we cannot provide assurances as to the integrity of the financial data contained in this report.

The Coast Guard has chartered an Audit Readiness Planning Team (ARPT) which is mapping processes, conducting gap analysis, tracking processes to assertions at the transaction level, and associating deliverables to milestones. Upon completion of this analysis, the Coast Guard will aggressively update Mission Action Plans (MAPS) that guide our implementation of internal controls leading to assurance over financial information. This information is used in the Mission Cost Model (MCM) to produce a portion of this report. Additionally, we will pursue improved internal controls in the collection of our Abstract of Operations information necessary to give assurance to the non-financial data used to produce a portion of this report.

(4) Reprogrammings or Transfers

During FY 2008, the Coast Guard has no reports of transfers or reprogramming actions affecting in excess of $1 million drug-related budget resources.

(5) Other Disclosures

The following provides a synopsis of the United States Coast Guard's FY 2008 Drug Control Funds reporting which describes:

1. The agency's overall mission and the role of drug interdiction efforts within the Coast Guard's multi-mission structure;
2. The Coast Guard's drug control budget submission.

Coast Guard Mission

The Coast Guard is a military service with mandated national security and national defense responsibilities and is the United States' leading maritime law enforcement agency with broad, multi-faceted jurisdictional authority. The Coast Guard is a multi-mission maritime service consisting of 11 complementary program areas: Drug Interdiction; Migrant Interdiction; Ports, Waterways and Coastal Security; Other Law Enforcement; Defense Readiness; Search and Rescue; Marine Safety; Ice Operations; Marine Environmental Protection; Living Marine Resources; and Aids to Navigation.

The Coast Guard faces many of the same challenges as the other four military services when it comes to deciding which assets should be deployed for what missions and where. This is not only true between the broad categories of missions, but also within sub-sets of the various missions the Coast Guard undertakes. For example, assets used for the Enforcement of Laws and Treaties must be divided between drug interdiction and migrant interdiction, as well as enforcement of fishing regulations and international treaties. Due to the multi-mission nature of the Coast Guard and the necessity to allocate the effort of a finite amount of assets, there is a considerable degree of asset "cross-over" between the missions. This crossover contributes to the challenges the Coast Guard faces when reporting costs for the various mission areas.

Coast Guard's Drug Budget

In the annual National Drug Control Strategy (NDCS) Budget Summary, all agencies present their drug control resources broken out by function and decision unit. The presentation by decision unit is the one that corresponds most closely to the Coast Guard's congressional budget submissions and appropriations. It should be noted and emphasized that the Coast Guard does not have a specific appropriation for drug interdiction activities. All drug interdiction operations, capital improvements, reserve support, and research and development efforts are funded out of general Coast Guard appropriations. For the most part, the Coast Guard drug control budget is a reflection of the Coast Guard's overall budget. The Coast Guard's Operating Expenses appropriation budget request is incremental, focusing on the changes from the prior year base

Coast Guard's Drug Budget (cont.)

brought forward. The Coast Guard continues to present supplementary budget information through the use of the Mission Cost Model (MCM), which allocates base funding and incremental requests by mission.

This general purpose MCM serves as the basis for developing drug control budget estimates for the OE and RT appropriations and provides allocation percentages used to develop the drug control estimates for the AC&I and RDT&E appropriations. Similarly, this is the methodology used to complete our annual submission to ONDCP for the NDCS Budget Summary.

DEPARTMENT OF HOMELAND SECURITY
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6B. ASSERTIONS

(1) Obligations by Budget Decision Unit – N/A. As a multi-mission agency, the Coast Guard is exempt from reporting under this section as noted in ONDCP Circular: *Drug Control Accounting*, Sections 6a (1) (b).

(2) Drug Methodology

The Mission Cost Model (MCM) is an estimate of mission costs allocated across Coast Guard's eleven mission/programs, versus actual accounting of drug funded obligations. The information reported is timely and is derived from an allocation process involving the Coast Guard's financial statement information. In Coast Guard's opinion, the methodology outlined below is a reasonable and accurate portrayal of the agency's mission/program presentations, because it is repeatable and supported by the most current financial and abstract of operations data available. The following methodology was applied to derive the drug control information presented in the table in section 6A.

The Coast Guard does not have a discrete drug control appropriation and its financial systems are not structured to accumulate accounting data by operating programs or missions areas. Drug control funding data is developed using a systematic process for the OE and RT appropriations, and a combination of project analysis, subject matter review, and OE-based allocations for the AC&I and RDT&E appropriations.

Data: As outlined in the previous section, the Coast Guard reports its drug control funding to ONDCP for each of the four appropriations or decision units. The mechanics of how each decision unit's drug control data is derived as follows:

- **Operating Expenses (OE) and Reserve Training (RT)** – Budget Authority or Expenditures are allocated to the mission areas of the Coast Guard based upon the output of a Mission Cost Model (MCM). This is basically an OE expenditure driven model that is used in presenting the mission based data shown in the OE and RT budget submissions across the 11 Coast Guard programs. The following data sources feed the FY 2008 OE/RT MCM:

    1) <u>Core Accounting System (CAS)</u> – FY 2008 actual expenses Mission Cost Model uses FY 2007 financial data, adjusted to reflect changes in the Coast Guard's asset inventory from FY 2007 to FY 2008. These expenses are fed into the Standard Rates Model (SRM), along with Coast Guard's operating cost reports of the Engineering Logistics Center (ELC) and Coast Guard Yard and the cost per flight hour report from the Aircraft Repair & Support Center (AR&SC). The SRM uses an activity-based methodology to assign and allocate expenses to the Coast Guard's assets and certain non-asset intensive missions, such as Marine Safety. The resulting total cost pools serve as one of the major inputs to the Mission Cost Model. If current year SRM data is not available, the previous year total cost pools are adjusted to fit the relevant fiscal year's asset inventory. The SRM is reconciled to the Coast Guard's Statement of Net Cost.

(2) Drug Methodology (cont.)

2) Naval Electronics Supply Support System (NESSS) – The Coast Guard Engineering Logistics Center (ELC) and Coast Guard Yard at Baltimore operate a stand alone financial system. Similar to the Core Accounting System, NESSS data is broken down by cost center, unit name, allotment fund code, and dollar amount. NESSS expense data is fed into the SRM and allocated to Coast Guard assets and certain non-asset intensive missions. NESSS financial data is included in the Coast Guard's financial statements.

3) Aviation Maintenance Management Information System (AMMIS) - The Coast Guard Aircraft Repair and Supply Center in Elizabeth City operates a stand alone financial system. Similar to the Core Accounting System, AMMIS data is broken down by cost center, unit name, allotment fund code, and dollar amount. AMMIS expense data is fed into the SRM and allocated to Coast Guard assets and certain non-asset intensive missions. AMMIS financial data is included in the Coast Guard's financial statements.

4) 2008 Abstract of Operations (AOPS) – AOPS is a web-based information system that reports how an asset (aircraft, boat, or cutter) was utilized across various missions of the Coast Guard. Each unit or activity that performs a mission is responsible for including the resource hours in the AOPS database.

5) Other Expenses – The drug related pieces that feed this area of the model are the Tactical Law Enforcement Teams (TACLET), the Law Enforcement Detachments (LEDET) and the Special Projects. The percentage that drives the TACLET /LEDET resource areas are computed from team deployment days divided by the total deployment days in the fiscal year for the drug interdiction mission. The Special Projects percentage driver is formulated from professional judgment regarding how funding is used to support costs related to counter-drug operations such as High Intensity Drug Traffic Area (HIDTA) activities and liaison costs for the Coast Guard's Organized Drug Enforcement Task Force (OCDETF).

6) Mission Cost Model (MCM) Application & Results – The two chief input drivers to the MCM are: 1) The financial costs of each Coast Guard asset and other expenses areas, made up of direct, support and overhead costs; and, 2) The 2008 AOPS hours. The support and overhead costs for each asset and other expenses element is applied to hours projected from the 2008 AOPS. These costs are reflective of the more static conditions of Coast Guard operations relative to the support functions and administrative oversight. The direct costs are applied to the final AOPS hours to show the dynamic flow of operations experienced during fiscal year 2008. The overall affect of the computed amount from the static baseline, and the reality of AOPS, results in a percentage to drive Coast Guard OE expenditures allocated across 11 programs.

(2) Drug Methodology (cont.)

- **Normalize to Budget Authority or Obligations** – The program percentages derived from the MCM are then applied to total OE and RT fiscal year 2008 budget authority and obligations (see Attachments A & B respectively), depending upon the reporting requirement. Budget Authority (BA) is derived from the agency's annual enacted Appropriation and expenditure data is derived from the final financial accounting Report of Budget Execution (SF-133).

- **Acquisition, Construction & Improvements (AC&I)** – AC&I is a multi-year appropriation where funding is available for up to 5 years depending on the nature of the project. The methodology used to develop the drug funding estimate is systematically different than that of OE and RT. AC&I drug funding levels, for either BA or obligations, is developed through an analysis of each project/line item. For each line item, a discrete driver is selected that best approximates the contribution that asset or project, when delivered, will contribute to each of the Coast Guard's 11 programs. The total program/mission area spreads for these drivers are based on the FY 2008 AC&I MCM output. To ensure consistency, the extract used for the analysis of enacted FY 2008 BA is used for the end of year analysis of obligations as well. For FY 2008 AC&I program and mission area spreads, the following data sources and methods were used:

    1) AC&I Mission Cost Model – was developed based on data feeds from the FY 2008 OE/RT MCM model as related in earlier OE and AC&I statements. The following data sets were than required to complete the AC&I MCM:

    2) Drug related percentage – The percentage spread for each driver was extracted from the OE MCM. This information was further analyzed to:

        (a) Ensure a discrete driver representing either a particular asset, series of assets, or mission was applied to each project; or

        (b) A general OE percentage driver was used when the project's outcome was expected to benefit all inventory and/or agency needs.

    3) Mission cost results/application - Once the project drivers were extracted from the OE MCM, they were applied to the total AC&I BA levels derived from the agency's enacted Appropriation Bill in the FY 2008 AC&I MCM. The total allocated mission percentages from the AC&I MCM were than applied to the total AC&I 2008 obligations as reported from the CAS as of September 30, 2008 (see Attachment C).

- **Research, Development, Test & Evaluation (RDT&E) –** RDT&E is a no-year appropriation where funding, once appropriated, may be obligated indefinitely in the future until all balances are expended. The methodology used to develop the drug-funding estimate is similar to AC&I in that drug-funding costs are based on an analysis of each project. The program/mission area percentages are based upon subject matter expert review.

(2) Drug Methodology (cont.)

1) RDT&E Mission Cost Model – was developed based on data feeds from the FY 2008 OE/RT MCM model as in earlier OE and AC&I statements. The following data sets were than required to complete the RDT&E MCM:
2) Drug related percentage – The percentage spread for each driver was extracted from the OE MCM. This information was further analyzed to:
   a) Ensure a discrete driver representing either a particular asset, series of assets or mission was applied to each project or;
   b) A general OE percentage driver was used when the project's outcome was expected to benefit all inventory and/or agency needs.
3) Mission cost results/application - Once the project drivers were extracted from the OE MCM, they were applied to the total RDT&E BA levels derived from the agency's enacted Appropriation Bill in the FY 2008 RDT&E MCM. The total allocated mission percentages from the RDT&E MCM were than applied to the total RDT&E 2008 obligations as reported from the CAS as of September 30, 2008 (See Attachment D). BA data is derived from the agencies enacted Appropriation and expenditure data is extracted from a Finance and Procurement Desktop (FPD) transaction summary report by project. This revised application from previous year's methodology better defines the current state of Coast Guard operations and the management of its personnel and asset inventories.

Other Estimation Methods - Where the MCM allocates a percentage of time/effort expended to a given AC&I project/line item, in some cases changes were made to better represent the drug costs associated. As noted in the AC&I and the RDT&E methodology, experienced professional judgment is sometimes used to change a driver based on specific knowledge that a resource will be used differently than the historical profile indicates. An example of this would be in the change in the allocation of resource hours associated with a new Great Lakes icebreaker. In the past, icebreakers have dedicated a majority of their annual resource hours to ice breaking with the remainder of the annual resource hours being allotted to environmental response. The new icebreaker is being designed as more of a multi-mission asset that will be tasked with aids to navigation, marine safety, and search and rescue missions in addition to its ice breaking activities. This change requires that the MCM allocation for this resource be manually adjusted, based on professional judgment, to reflect the change in the planned operating profile for the new icebreaker.

Financial Systems – Data is derived from CAS, ELC, Coast Guard Yard systems. No other financial systems or information are used in developing program or mission area allocations. The Coast Guard has not fully implemented corrective actions to remediate weaknesses identified by the independent auditors during the annual CFO audits.

Financial Systems (cont.) – As a result, the Coast Guard could not assert to the completeness, existence (validity), accuracy, valuation or presentation of its financial data.

(3) Application of Drug Methodology - The methodology disclosed in this section was the actual methodology used to generate the table required by Section 6A. Documentation on each decision unit is provided**.**

(4) Reprogrammings or Transfers -- During FY 2008, Coast Guard had no transfers or reprogramming actions affecting in excess of $1 million drug-related budget resources.

(5) Fund Control Notices – The FY 2008 data presented herein is associated with drug control funding reported in Coast Guard's FY 2008 financial plan. ONDCP did not issue Coast Guard a Fund Control Notice for FY 2008.

Attachment A

OPERATING EXPENSES (OE)
MISSION COST MODEL OUTPUT:

	(dollars in thousands) FY 2008 Obligations	% of total
1. Search and Rescue (SAR)	733,910	12.01%
2. Marine Safety (MS)	526,133	8.61%
3. Aids to Navigation (ATON)	1,034,133	16.93%
4. Ice Operations (IO)	113,003	1.85%
5. Marine Environmental Protection (MEP)	134,629	2.20%
6. Living Marine Resources (LMR)	582,070	9.53%
7. Drug Interdiction	752,595	12.32%
8. Other Law Enforcement (OTH-LE)	87,773	1.44%
9. Migrant Interdiction	378,626	6.20%
10. Ports, Waterways & Coastal Security (PWCS)	1,360,293	22.26%
11. Defense Readiness	406,500	6.65%
Total OE Obligations	$ 6,109,665	100%

Attachment B

RESERVE TRAINING (RT)
MISSION COST MODEL OUTPUT:

	(dollars in thousands) FY 2008 Obligations	% of total
1. Search and Rescue (SAR)	15,171	12.01%
2. Marine Safety (MS)	10,876	8.61%
3. Aids to Navigation (ATON)	21,377	16.93%
4. Ice Operations (IO)	2,336	1.85%
5. Marine Environmental Protection (MEP)	2,782	2.20%
6. Living Marine Resources (LMR)	12,032	9.53%
7. Drug Interdiction	15,557	12.32%
8. Other Law Enforcement (OTH-LE)	1,814	1.44%
9. Migrant Interdiction	7,827	6.20%
10. Ports, Waterways & Coastal Security (PWCS)	28,117	22.26%
11. Defense Readiness	8,405	6.66%
Total OE Obligations	$ 126,294	100%

ACQUISITION, CONSTRUCTION and IMPROVEMENTS MISSION COST MODEL OUTPUT:

	(dollars in thousands) FY 2008 Obligations	% of total
1. Search and Rescue (SAR)	169,215	15.23%
2. Marine Safety (MS)	41,741	3.76%
3. Aids to Navigation (ATON)	78,650	7.08%
4. Ice Operations (IO)	10,401	0.94%
5. Marine Environmental Protection (MEP)	18,451	1.66%
6. Living Marine Resources (LMR)	160,099	14.41%
7. Drug Interdiction	206,657	18.60%
8. Other Law Enforcement (OTH-LE)	23,469	2.11%
9. Migrant Interdiction	131,247	11.81%
10. Ports, Waterways & Coastal Security (PWCS)	195,809	17.62%
11. Defense Readiness	75,471	6.79%
Total OE Obligations	$ 1,111,210	100%

1/ Includes $31.975 million recoveries of prior year obligations.

RESEARCH, DEVELOPMENT, TEST and EVALUATION MISSION COST MODEL OUTPUT:

	(dollars in thousands) FY 2008 Obligations	% of total
1. Search and Rescue (SAR)	2,021	10.58%
2. Marine Safety (MS)	1,648	8.63%
3. Aids to Navigation (ATON)	3,143	16.46%
4. Ice Operations (IO)	197	1.03%
5. Marine Environmental Protection (MEP)	5,784	30.29%
6. Living Marine Resources (LMR)	1,010	5.29%
7. Drug Interdiction	1,341	7.02%
8. Other Law Enforcement (OTH-LE)	152	0.80%
9. Migrant Interdiction	675	3.53%
10. Ports, Waterways & Coastal Security (PWCS)	2,424	12.69%
11. Defense Readiness	703	3.68%
Total OE Obligations [1/]	$ 19,098	100%

[1/] Includes $1.047 million recoveries of prior year obligations.

ENCLOSURE 1

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:

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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 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.

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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.

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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:

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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'."

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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

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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.

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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:

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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.

ENCLOSURE 2

U.S. Department of Homeland Security
United States Coast Guard

Commandant
United States Coast Guard

2100 Second Street, S.W.
Washington, DC 20593-0001
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Phone: (202) 372-3470
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SEP 2 9 2008

Memo for: Michael Chertoff
Secretary

From: Admiral T. W. Allen
Commandant; (202) 372-4423

Subj: U.S. COAST GUARD 2008 ASSURANCE STATEMENT

Purpose:

In accordance with your delegation of responsibilities to me, I have directed an evaluation of the internal controls at the United States Coast Guard (USCG) 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 and GAO's Standard of Internal Control in the Federal Government. Based on the results of this evaluation, the USCG is providing the enclosed assurance statements.

Background:

Management assurance regarding internal controls is required per OMB Circular A-123 (rev. 12/21/2004). The assurance addresses the following four legislative areas:

FMFIA Section 2, 31 U.S.C. 3512 (d)(2)
Requires agencies to establish and maintain internal controls. The agency head must annually evaluate and report that internal controls are achieving their intended objectives related to the effectiveness and efficiency of operations, the reliability of financial reporting, and compliance with applicable laws and regulations.

DHS Financial Accountability Act P.L. 108-330
Requires agencies to establish and maintain internal controls over financial reporting. The agency head must annually evaluate and report on the effectiveness of the internal controls over financial reporting.

FMFIA Section 4, 31 U.S.C. 3512 (d)(2)(B)
Requires agencies to maintain an integrated financial management system that complies with Federal systems requirements, Federal Accounting Standard Advisory Board Standards (FASAB), and the U.S. Standard General Ledger at the transaction level. The agency head must annually evaluate and report on conformance of financial management systems with Federal requirements.

Subj: U.S. COAST GUARD 2008 ASSURANCE STATEMENT

Reports Consolidation Act, 31 U.S.C. 3516 (e)
Authorizes consolidation of financial and performance management reports by Federal agencies. The agency head must annually evaluate and report on the completeness and reliability of performance data used in the Performance and Accountability Report.

Discussion:

Although the enclosed Coast Guard FY 2008 Assurance Statement does not convey vast improvement over last year, we have made significant strides in improving internal controls, business processes, and our overall approach to audit readiness. As such, we continue to make progress towards remediation of material weaknesses that exist with internal controls over financial reporting. The following areas are particularly noteworthy.

Entity Level Controls:
We continue to improve the Coast Guard's overall control environment. Through a concerted effort to improve internal controls, governance, and collaboration with the Department, we have been able to make strides in fully understanding and remediating the root causes of material weaknesses in our control environment. We have refocused our Senior Management Council (SMC) and Senior Assessment Team (SAT). The Vice Commandant now chairs the SMC and on a monthly basis, she engages key process owners at the Flag Officer and Senior Executive level to ensure unity of audit readiness/remediation effort. Additionally, the DHS CFO is a regular participant in our monthly SMC meetings, which has proven very valuable for both the Coast Guard and DHS. DHS CFO participation increases transparency, best integrates our internal efforts with the Department, and establishes a more robust governance structure. Our SAT brings together appropriate subject matter experts to work specific technical issues, integrate efforts across the enterprise, and make sound, well reasoned recommendations for SMC action. Organizationally, we are reassessing the financial management roles and responsibilities and required competencies throughout the Service. Finally, we have engaged the National Academy for Public Administration to review our overall modernization effort, with a specific focus on the organizational structure and enterprise processes related to financial management.

Investments:
In FY 2008 we will assert our balance sheet investment balance of $2.9 billion is complete, accurate, and properly recorded. This is the first year since the creation of DHS the Coast Guard has been able to support all relevant assertions for this line item, representing approximately 18% of the Service's total assets and nearly 99% of DHS' total investment balance. This accomplishment has a material impact on the Department's consolidated financial statements.

Funds Balance with Treasury:
We continue to make progress towards reconciliation of pay transactions in Funds Balance with Treasury (FBwT). For the first time since DHS was established, in FY 2008 we began to reconcile retired and annuitant military payroll cash disbursements with Treasury. In FY 2009 we will also begin to reconcile active duty and reserve military payroll cash disbursements with Treasury. These, and other remediation efforts, will allow us to properly account for more than $3.2 billion of annual transaction activity.

Property Management:
We continue to make progress in this area and are aggressively using the results of a comprehensive valuation review to validate the initial cost of a significant portion of inventory and Construction-In-Progress (CIP). This effort will allow us to more accurately value property in our financial system. In addition, the Coast Guard prepared 149 property cost documentation packages supporting an initial acquisition cost of $2.45 billion of property, plant, and equipment (PP&E). Once reviewed and accepted, this will bring the total amount of PP&E the Coast Guard has supported in original acquisition cost from $5.25 billion to $7.7 billion, out of a total acquisition cost of $13.6 billion for all PP&E.

Contingent Legal Liabilities:
In FY 2008, we will be able to support all relevant assertions for our contingent legal liabilities balance of almost $250 million. Over the last year we have developed and implemented comprehensive policies, procedures and controls in this area and the effort has yielded positive results, helping to support the Department's overall improvement in consolidated legal liabilities.

Deepwater:
As presented in the Assurance Statement, we have made significant progress in addressing internal control deficiencies in the Deepwater acquisition program. These deficiencies were originally identified in internal and external studies and audits. As a result of these studies/audits, as well as Departmental and Congressional oversight, and prior to the development of a formal Mission Action Plan (MAP), the Coast Guard had already embarked on a significant acquisition reform strategy, codified in a two-year strategic plan, the *Blueprint for Acquisition Reform*. Subsequently, we have developed a MAP with detailed milestones to complement ongoing reform activities and remediate the known remaining acquisition deficiencies. Substantial progress has been made and we continue to implement controls and monitor compliance in areas of acquisition, design, delivery, program management, contractor accountability, human capital, and cost control.

Way Ahead:

The previous examples provide an overview of some of the progress we have made to enhance our audit remediation and control environment. While we have made progress over the past year, challenges remain. To better address those challenges the Vice Commandant directed a comprehensive review of our MAPs going forward. This was done in full cooperation between my CFO and the DHS CFO. Various internal and external reviews had identified concerns with our overall plan and our ability to communicate progress in addressing financial statement material weaknesses. The Audit Readiness Planning Team (ARPT) was chartered by the Vice Commandant in April 2008 to address root cause conditions and develop a holistic, multi-year plan to integrate existing financial management initiatives, implement effective internal controls, remediate and support financial reporting, and achieve audit readiness. The ARPT is a matrixed team of highly experienced Coast Guard, Department and contractor experts with strong governmental accounting backgrounds. We have held weekly meetings with DHS CFO staff throughout this process and are currently working with the DHS CFO to define joint areas for focus in FY 2009 and FY 2010. Additionally, the revision to our Financial Strategy for

Transformation and Audit Readiness (FSTAR) is being drafted by the ARPT and it will provide the roadmap for audit remediation.

One of our top challenges is our need to address significant deficiencies in our current core accounting and related systems. The challenges associated with our financial systems will limit our ability to fully remediate material weaknesses in many financial reporting processes. We will continue to work with the DHS CFO and Resource Management Transformation Office (RMTO) to develop a way-ahead that is fully integrated with Departmental efforts in this area. Until we successfully transition to a new financial system, we will not be able to fully support the balances on our financial statements due to existing systems deficiencies and functionality gaps.

I would be pleased to meet with you and discuss our financial management progress to date and the status of our ongoing work.

Recommendation:

I recommend you include this submission as part of the Department's preparation of its consolidated assurance statement.

Executive Secretariat Clearance:

________________ DATE: ________________

Fred L. Schwien

The Secretary

APPROVED:________________ DATE: ________________

DISAPPROVED: ________________ DATE: ________________

COMMENTS:

Enclosure: U.S. Coast Guard FY 08 Assurance Statements

Dear Secretary Chertoff:

In accordance with your delegation of responsibilities to me, I have directed an evaluation of the internal control at the United States Coast Guard 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 United States Coast Guard provides the following assurance statements.

Reporting Pursuant to FMFIA Section 2. 31 U.S.C.3512 (d)(2)

The United States Coast Guard provides reasonable assurance that internal controls are achieving their intended objectives, with the exception of the following material weakness that was noted:

Material Weakness:

- **Compliance with Laws and Regulations**
  During a prior period, the USCG developed and implemented policy that allowed the use of Operating Expense (OE) funds, up to a predetermined threshold, to address some aspects of shore facilities projects. Subsequent to establishing the policy, the USCG exceeded the predetermined thresholds and acknowledged lack of authority to address these projects with OE funds. The USCG has since rescinded the policy in question and implemented new internal controls and policy to monitor and prevent this from reoccurring.

The following Reportable Condition was noted:

- **Deepwater**
  As previously reported multiple control deficiencies exist in the Deepwater program as identified in external audits and reports. USCG developed a Mission Action Plan with detailed milestones to remediate these deficiencies, and substantial progress has been made. USCG continues to implement controls to address known deficiencies in the following areas: design, acquisition, delivery, program management, contractor accountability, human capital and cost control.

Reporting Pursuant to the DHS Financial Accountability Act. P.L. 108-330

The scope of United States Coast Guard's efforts focused on executing corrective actions to design and implement internal controls pursuant to the DHS Accountability Act as of September 30, 2008.

The United States Coast Guard is unable to provide reasonable assurance that internal control over financial reporting was operating effectively. The following material weaknesses were found and management is updating Mission Action Plans to remediate them:

- **Entity Level Controls:** In 2006, the USCG conducted an assessment of internal controls at the entity level using the Government Accountability Office (GAO) Internal Control and Evaluation Tool. Considerable deficiencies identified in FY 2006 remain in the current year within the following areas: control environment; risk assessment; information and communications; monitoring. In FY 2008, the USCG remediated certain control environment deficiencies with the establishment and execution of a more effective governance structure for financial transformation and oversight, including re-emphasizing the roles and responsibilities of the Senior Management Council and the Senior Assessment Team.

- **Fund Balance with Treasury:** The USCG is unable to fully reconcile its FBwT accounts. USCG cannot produce complete and accurate populations of suspense account transactions, nor distinguish posting from clearing transactions in suspense. Also, the USCG is unable to complete reconciliations of its FBwT related to Military Payroll. The USCG's military payroll system, the Joint Uniform Payroll System (JUMPS) cannot track the payroll data necessary for USCG to reconcile Treasury payment details and produce accurate FBwT reporting. The USCG is unable to fully track and reconcile intra-governmental transactions with its trading partners.

  Progress with FBwT continues through the ongoing development of the Subsidiary Ledger Reconciliation Tool for Active and Reserve payroll and other process improvements to permit the reconciliation of military payroll.

- **Contingent Liabilities:** Significant weaknesses exist in Actuarial Liabilities and Environmental Liabilities:

  o Actuarial Liabilities - USCG does not have controls in place to determine that the underlying data used to calculate Actuarial Liabilities is accurate and complete.
  o Environmental Liabilities - USCG has no documented policies and procedures for Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) cases. USCG does not have sufficient support related to Environmental Liabilities resulting in potentially unrecorded and unidentified liabilities.

  Legal Liabilities, which is another sub-set of Contingent Liabilities, is not part of the material weakness condition due to progress made in developing and implementing improved policies, procedures and controls.

- **Property Management:** There is a general lack of documented policies and procedures related to property management sub-processes and related systems. Deficiencies include the lack of adequate control in Construction-in-Progress, Operating Material and Supplies, and Personal and Real property. In addition, there are severe system limitations and inadequate costing processes.

  Progress with Property Management continues through improved valuation of previously unsubstantiated cost of inventory and construction in progress.

- **General Ledger Management Function: Financial Reporting:** The three primary general ledgers are not fully compliant with the USSGL and contain improper posting logic codes. Limitations of the GL systems, timing issues, and the use of multiple GL systems with different GL accounts, contribute to the inappropriate recording of transactions and a significant number of "on-top" adjustments at month end.

- **Human Resources & Payroll:** The military payroll system (JUMPS) does not provide accurate data to the USCG general ledger. JUMPS does not provide accounting information to reconcile Treasury, payroll and general ledger details. The Post Retirement Benefits sub-process has a pervasive lack of controls and there is no process to verify the actuarial liability.

- **Budgetary Resources Management:** The three general ledger systems are not fully compliant with the USSGL at the transaction level. Two of the three do not interface with the Core Accounting System, except for Tier reporting at the summary GL level. The primary budgetary resource management system is not designed to manage and maintain complete budgetary accounting data and does not permit the necessary level of funds control, creating the risk of Anti-Deficiency Act violations.

- **Receivables Management:** USGC does not record certain balances in the general ledger in accordance with Generally Accepted Accounting Principles (GAAP) as promulgated by the Federal Accounting Standards Advisory Board (FASAB). This is due in large part to its lack of policies and procedures in several key sub-process areas related to accounts receivable.

- **Revenue Management:** USGC does not record certain balances in the general ledger in accordance with Generally Accepted Accounting Principles (GAAP) as promulgated by the Federal Accounting Standards Advisory Board (FASAB). There is no documented standard operating procedure in place to ensure that all projects are closed-out appropriately with all bills and refunds generated as needed.

- **Information Systems:** The FMFIA Section 4 assessment indicates that internal controls over financial systems are inadequate to detect or prevent material errors in the financial statements. A number of non-conformances described in the FMFIA Section 4 assurance statement are a root cause that will limit the USCG's ability to fully remediate material weaknesses in many financial reporting processes. Accordingly, this condition also represents a material weakness in internal control over financial reporting.

Reporting Pursuant to FMFIA Section 4. 31 U.S.C.3512 (d)(2)(B)

The United States Coast Guard's financial management systems do not conform with government-wide requirements. The areas of non-conformance listed below were documented. Management is continuing to execute, and update as appropriate, Mission Action Plans to remediate the following:

- **U.S. Standard General Ledger**
  The designs of the USCG's financial and mixed systems do not reflect financial information classification structures that are consistent with the U.S. Standard General Ledger and provide for tracking of specific program expenditures.

- **Integration of Financial and Mixed Systems**
  The lack of integration of the USCG's financial and mixed systems precludes the use of common data elements to meet reporting requirements, and to collect, store, and retrieve financial information. Similar kinds of transactions are not processed throughout the systems using common processes, which could result in data redundancy and inconsistency.

- **Financial reporting and budgets**
  The USCG's financial and mixed systems do not allow for financial statements and budgets to be prepared, executed, and reported in accordance with the requirements prescribed by OMB, e.g., OMB Circular A-11, preparation and submission of budget estimates, those prescribed by the U.S. Department of Treasury, and/or the Federal Accounting Standards Advisory Board (FASAB).

- **Laws and regulations**
  The USCG's financial and mixed systems do not include a system of internal controls that ensure resource use and financial reporting are consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; reliable data is obtained, maintained, and disclosed in reports; and transactions are processed in accordance with Generally Accepted Accounting Principles (GAAP).

- **System Adaptability**
  The USCG does not evaluate how effectively and efficiently the financial and mixed systems support the USCG's changing business practices and make appropriate modifications to its information systems.

- **Risk assessment and security**
  The USCG does not adequately assess IT security risks or have a documented entity-wide security program plan. For financial and mixed systems that contain "sensitive information" as defined by the Computer Security Act, the USCG has not planned for or incorporated security controls in accordance with OMB Circular A-130. Some of the legacy financial and mixed systems were developed prior to the implementation of some of these regulations and are therefore, not designed to comply with them. Vessel Logistics System (VLS) and Core Accounting System (CAS) are on the OMB high risk list.

- **Documentation and support**
  Adequate technical systems documentation, training, and user support is not consistently available to enable the users of all of the financial and mixed systems to understand, maintain, and operate the systems in an effective and efficient manner.

- **Physical and logical controls**
  The USCG's financial and mixed systems contain weaknesses in the standardization of physical and logical controls, and segregation of duties.

- **Service Continuity**
  The USCG does not adequately assess the criticality and sensitivity of computerized operations, or identify supporting resources, to prevent and/or minimize potential damage from the interruption of service.

- **Software Development**
  The USCG does not consistently apply a defined software development and change control process to software changes and development efforts for all financial and mixed systems. USCG does not perform complete monitoring of the access to, the use of, or the control changes to, systems software. Furthermore, CG financial management and mixed systems do not conform to existing applicable functional requirements.

Reporting Pursuant to the Reports Consolidation Act. Section 3516(e)

The USCG's performance data used in the Performance and Accountability Report are complete and reliable, except for the following material inadequacy:

- **Financial Reporting**: The USCG does not have documentation and adequate controls to support the process to validate that the full cost by strategic goal, as presented in the notes to the consolidated financial statements, is materially consistent with actual costs incurred.

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