



Department of Homeland Security Office of Inspector General

Management Letter for U.S. Customs and Border Protection's FY 2008 Consolidated Financial Statements





Homeland
Security

March 5, 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 management letter for U.S. Customs and Border Protection's (CBP) fiscal year 2008 consolidated financial statement audit. It contains observations and recommendations related to internal controls that did not reach the level of materiality to be reported in the financial statement report. Other internal control deficiencies which are considered significant or material were reported, as required, in KPMG LLP's Independent Auditors' Report, dated December 04, 2008, that was included in CBP's FY 2008 Performance and Accountability Report. The independent public accounting firm KPMG performed the audit and prepared this management letter and is responsible for the attached management letter dated December 4, 2008 and the conclusions expressed in it. We do not express opinions on CBP's financial statements, internal controls, or conclusions on compliance with laws and regulations.

The recommendations herein have been discussed in draft with those responsible for implementation. We trust this report will result in more effective, efficient, and economical operations. We express our appreciation to all of those who contributed to the preparation of this report.


Richard L. Skinner
Inspector General



KPMG LLP
2001 M Street, NW
Washington, DC 20036

December 4, 2008

Office of Inspector General and Chief Financial Officer,
U.S. Department of Homeland Security,
Washington, DC

Chief Financial Officer,
U.S. Customs and Border Protection

Ladies and Gentlemen:

We have audited the consolidated balance sheets of the U.S. Department of Homeland Security's (DHS) Customs and Border Protection (CBP) as of September 30, 2008 and 2007, and the related consolidated statements of net cost, changes in net position, custodial activity and the combined statement of budgetary resources (hereinafter, referred to as "consolidated financial statements") for the years then ended. In planning and performing our audit of CBP's consolidated financial statements, we considered CBP's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements.

In connection with our fiscal year 2008 engagement, we considered CBP's internal control over financial reporting by obtaining an understanding of CBP's internal controls, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our procedures. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982* (FMFIA). The objective of our engagement was not to provide an opinion on the effectiveness of CBP's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of CBP's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects CBP's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally-accepted accounting principles such that there is more than a remote likelihood that a misstatement of CBP's financial statements that is more than inconsequential will not be prevented or detected by CBP's internal control over financial reporting. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by CBP's internal controls.



We noted certain matters involving internal control and other operational matters that are summarized on page 1 in the Table of Financial Management Comments, and presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies. These comments are in addition to the significant deficiencies and material weakness presented in our *Independent Auditors' Report*, dated December 4, 2008, included in the FY 2008 CBP *Performance and Accountability Report*. A description of each internal control finding, and its disposition, as either a significant deficiency or a financial management comment is provided in Appendix A. Our findings related to information technology systems security have been presented in a separate letter to the Office of Inspector General and the DHS Chief Information Officer dated December 4, 2008.

We would be pleased to discuss these comments and recommendations with you at any time. This report is intended for the information and use of DHS and CBP management, the Office of Inspector General, the U.S. Office of Management and Budget, the U.S. Congress, and the Government Accountability Office, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

Department of Homeland Security
U.S. Customs and Border Protection
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September 30, 2008

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FMC 08-01 – Verification of Check Proof Listing (CPL) and certification payments (NFR No. CBP 08-01)

Conditions: In the event that the CBP Supervisor does not certify a payment, the Automated Commercial System (ACS) default setting is activated, which indicates that the payment was certified. Based on our review of the corrective action plan and inquiry with the client we noted this issue has not been corrected for fiscal year 2008.

Recommendations:

We recommend that CBP:

1. Continue using their manual control to ensure verification of payments and avoid activation of the ACS default.

FMC 08-02 – Automated Commercial System (ACS) deficiency over the accumulation of claims against a drawback bond (NFR No. CBP 08-04)

Conditions: ACS does not properly account for bond sufficiency of claims that involve a continuous bond. Specifically, the automated control that prevents a claimant from exceeding the bond amount on file is not operating effectively. As a result, CBP will not have surety against a drawback claimant who claims amounts greater than the bond amount.

We noted several drawback claims that did not have the correct amount of bond liability accumulated. In these cases, the drawback claims were larger than the actual amount accumulated against the bond.

We noted that CBP has a “TIP” procedure, which provided guidelines to access data queries outside of ACS to verify bond sufficiency. This “TIP” is not being communicated effectively to the drawback ports for implementation.

Recommendations:

We recommend that CBP:

1. Continue with the design and implementation of ACE; and
2. While Automated Commercial Environment (ACE) is in development, implement a manual check by the drawback specialist and technicians to query the bond on file related to the claim and verify that there is a sufficient amount on the bond for the claimant to be paid.

FMC 08-03 – Weaknesses in the management of environmental liabilities (NFR No. CBP 08-10)

Conditions: CBP has made significant program changes and improved their overall process related to environmental liabilities. However, we noted the following weaknesses in CBP’s policies and procedures for recognizing environmental liabilities during FY 2008:

- CBP has developed a draft *Environmental Financial Liability Management System Handbook* (the Handbook), procedures for determining cleanup costs for environmental financial liabilities (asbestos containing materials, firing ranges, underground storage tanks, and lead-based paint), liability model bases of estimates, and others. However, development and implementation of some of these policies, procedures, and systems are not complete.
- CBP has re-categorized the risk of loss related to firing ranges as reasonably possible, but has not prepared a basis of estimate supporting this categorization, developed and reported estimates for the liability, or shown that the value is immaterial. As a result, CBP's environmental liability in relation to firing ranges is potentially understated by approximately \$6.1 million as of September 30, 2008. Furthermore, in the Handbook and in the *Procedure for Determining Small Arms Firing Range Cleanup Costs Environmental Financial Liability*, CBP takes the position that "There is no inevitable environmental legal requirement to conduct a cleanup at a small arms firing range. An enforcement order, civil action, National Priorities List (NPL), or third-party claim would be required to initiate any legally required cleanup and thus is the initiating action for determining an environmental liability is probable." This contradicts the definition of a probable environmental liability, as defined in Technical Release 2, in which the Federal government (i.e., the agency) has a probable liability if the agency is aware of the contamination and it is government related and legally liable. Although there is no current legal action, the contamination is government related as the Federal government (i.e. CBP) caused the contamination. The agency then determines the likelihood of loss related to the unasserted claim.
- CBP's Basis of Estimate to the 2008 Lead-Based Paint (LBP) Site Assessment Cost Model only includes assessment-related costs. CBP's draft Handbook and *Procedure for Determining Lead-Based Paint Related Cleanup Costs Environmental Financial Liability* state that LBP in non-residential structures is assumed to be an environmental cost, but not an environmental liability. Thus, CBP is excluding potential cleanup costs for non-residential building LBP cleanup. Although process knowledge may lead CBP to conclude that it will not incur any abatement costs related to LBP, many state and local regulations require performance of the toxicity characteristic leaching procedure (TCLP) to determine whether the waste from these structures is hazardous. At a minimum, the costs associated with these procedures are an environmental liability to CBP, the current owner of the buildings. Due to the fact that LBP and asbestos-containing materials (ACM) were both used in structures until the late 1970s and have a roughly similar unit cost (i.e. dollars per square foot) to abate, CBP's environmental liability in relation to LBP in non-residential structures is potentially understated by as much as the ACM liability that CBP includes in its overall liability, which is approximately \$9 million. We noted that this amount may be lower for abating LBP in non-residential structures. However, CBP has not prepared an evaluation of the costs associated with states in which TCLP testing is required in addition to process knowledge.

Recommendations:

We recommend that CBP:

1. Continue the development and initial implementation of environmental liability management efforts including the policies, procedures, and management software systems for determining cleanup costs for environmental financial liabilities;
2. Develop and report an estimate and a related basis of estimate/likelihood associated with firing ranges. (Determining the likelihood or estimating, accounting standards do not require field surveys.) The existence at uninvestigated sites can be determined based on information from known sites. If survey information is available, it should be considered in developing the estimates and determining the likelihood; and
3. Develop and report an estimate associated with LBP testing and abatement where LBP debris disposal is not permitted by the Environmental Protection Agency or state and local governments. Accounting standards do not require field surveys and existence at uninvestigated sites, but can be determined based on information from known sites.

FMC 08-04 – Failure to perform a full desk review/supervisory review (NFR No. CBP 08-12)

Conditions: We noted weaknesses over the full desk review/supervisory review control during testwork performed throughout fiscal year 2008. At one port, one drawback claim was notated as a “FALSE STAT” hit. Upon inquiry at the port, we noted that the claimant submitted several drawback claims. As this was a first time claimant, multiple claims were marked as a “FIRST HIT”. One of the claims was reviewed by the port as a “FIRST HIT” while the remaining claims were discarded/removed from the “FIRST HIT” sample and marked per the port/drawback specialist as a “FALSE STAT”. Therefore, the remaining claims submitted were not subject to selection as a “STAT HIT”.

In addition, one of the selected drawback claims was subject to supervisory review as it was a “STAT HIT” that exceeded the \$25 thousand threshold. We noted that the claim went through a full desk review (FDR); however, the supervisory review was not completed. We also noted a drawback claim in which two of the consumption entries that were selected as part of the FDR were not reviewed by the drawback specialist.

Recommendations:

We recommend that CBP:

1. Clarify to all drawback specialists the procedures for processing multiple “FIRST HITS” to allow the other related drawback claims the possibility for selection as a “STAT HIT”; and
2. Enforce the drawback guidelines.

FMC 08-05 – Weaknesses in the Fines, Penalties, and Forfeitures (FP&F) process (NFR No. CBP 08-16)

Conditions: During testwork over the FP&F process at eleven ports, we noted inconsistencies in the types of monitoring used as well as the frequency of their use as indicated in the table below:

Monitoring Tool	Frequency	Number of Ports
Action Due Report (F05 Report)	Daily	2
F05 Report	Weekly	1
F05 Report	Semi-monthly	1
Electronic Data Warehouse (EDW)	Daily	1
EDW	Weekly	3
EDW	Semi-monthly	2
F05 Report and EDW	Weekly	1

We noted through inquiry at each port that only two ports retain their EDW queries/F05 reports for a period of one year. Per CBP, there is neither a requirement to indicate review (via sign-off or annotation) nor retain F05 Reports/EDW queries in the Seized Asset Management and Enforcement Procedures Handbook (SAMEPH).

We also noted during our initial walkthrough and process meetings, that CBP headquarters management is not conducting oversight over FP&F as indicated in the SAMEPH. We also noted that the revised SAMEPH has not been issued nor has any guidance to the field been issued regarding the review, annotation, or retention of the F05 report/EDW queries. We noted that during our initial walkthrough as well as during our review of the third quarter Mission Action Plan (MAP) that the SAMEPH is in the process of being revised; however, such revisions have not been approved or issued nor has any guidance to the field been issued regarding the review, annotation, or retention of the F05 report.

Recommendations:

We recommend that CBP:

1. Issue a memorandum to field offices indicating the need for a bi-weekly review of case backlogs through the use of the F05 report or EDW queries. Such reviews should be documented to indicate actions taken based on the report as well as the date of performance of these actions;
2. Update the SAMEPH in a timely manner to include a single, standardized methodology for ascertaining the status of pending cases, including those cases for which immediate action is due. CBP should consider the need for evidence of such review as well as retention of this documentation to prove adequate monitoring of the FP&F process;
3. Update procedures at Headquarters in a timely manner to ensure the monitoring of FP&F cases to create accountability for FP&F Officers' monitoring of outstanding FP&F cases; and
4. Update the procedures at Headquarters, in a timely manner, to ensure the monitoring of FP&F cases and to create accountability for FP&F Officer's review of the F05 report.

These procedures should include a standardized reporting mechanism for ports to follow to allow monitoring of FP&F cases at all levels (local ports, Field Offices, and Headquarters).

FMC 08-06 – Weaknesses in the review of weekly/monthly entry edit reports (NFR No. CBP 08-18)

Conditions: KPMG statistically selected eleven ports and performed control testwork over the entry process. Based on the results of testwork performed at the ports, we noted the following instances of non-compliance with the Customs Directive 5610-004A, as well as the Directive Memorandum QBT-04-092-I:

1. No evidence that the following reports were being processed/reviewed:
 - a. B06 *Rejected/Cancelled Entries* report at 3 ports, including supervisory review,
 - b. B07 *Unpaid/Rejected Entries* report at 2 ports,
 - c. B84 *Budget Clearing Account* report at 2 ports,
 - d. Q07 *Unreported Quota* report at 3 ports, and
 - e. S21 *Weekly Deletion* report at 5 ports, including supervisory review.
2. Lack of segregation of duties at one port; the supervisory review of the S21 report was being conducted by the same person that performed the deletions.
3. Cancelled entries were not matched to the B06 Report at one port and deleted entries were not matched to the S21 Report at one port.
4. Inconsistencies in the review of bypassed and unresolved entry summaries. Each port utilized different data queries at different intervals to review these entry summaries.

Recommendations:

We recommend that CBP:

1. Reinforce the importance of the requirements of Customs Directive 5610-004A through updated directives or other written communications and, if necessary, provide adequate training to ensure that the reports required are in fact being reviewed. Those reports consist of the B06, B07, B84, Q07, and S21;
2. Reinforce the importance and the requirements of Customs Directives 5610-004A through updated directives or other written communications and, if necessary, provide adequate training to ensure that the reports requiring supervisory review (with evidence of signature or initial) are in fact being reviewed by a supervisor. Those reports consist of B06 (Cancellations) and S21;
3. Consider expanding upon the current directives through new directives or other written communications to require evidence (via signature or initial) of periodic supervisor review of the other reports that are required to be processed/reviewed. (Note: these are reports that are required to be reviewed by the Customs Directives noted in recommendation number 1; however, the current directives are silent as to the requirement of a supervisory review). Those reports consist of B07 and B84 as well as the B08, "Late Report";

4. Implement policies and procedures or re-communicate existing policies and procedures through training or other written communications to ensure that the ports have proper segregation of duties over the cancellation and deletion of entries;
5. Develop and implement policies that stipulate the requirement of back-up personnel to process/review reports required by the directives noted in recommendation number 1 and any new directives developed as a result of recommendation number 3; and
6. Consider expanding upon the current directives through new directives or other written communications that require the following reports, or stipulate other mitigating reports/controls such as data queries, be performed on a periodic basis (weekly/monthly): the SS35 *Unresolved Entries*, E16 *Duplicate Importer of Record Numbers*, and a standard bypassed entry summaries report or query. In addition, the new directive or written communication should require supervisory review, with evidence thereof by signature or initial in order to ensure compliance.

FMC 08-07 – Weaknesses in the collections and deposits process (NFR No. CBP 08-26)

Conditions: KPMG statistically selected eleven ports and performed control testwork over the entry process, which includes a review of the collections and deposits process at each port. We noted the following weaknesses in the design, implementation, and operating effectiveness of the controls related to the collections and deposits process:

- At six ports, we noted that personnel who prepared the PCC OTC batch list did not have the final batch list reviewed and approved by an independent verifier. We noted that on August 21, 2008, CBP issued an update to the PCC OTC manual that requires the final batch to be reviewed and approved by an independent verifier;
- At three ports, we noted that personnel who prepared the PCC OTC batch list did not have any independent verification (draft or final batch list) of the deposit before transmission to the bank; and
- At one port, we noted that personnel who prepared the cash deposit did not count the cash to be deposited for accuracy before submitting the deposit to the bank.

Recommendations:

We recommend that CBP:

1. Develop procedures to ensure proper review and approval of all collections and deposits at the ports as well as ensure adherence to the requirements;
2. Ensure that ports are aware of the change mandated by August 21, 2008 memorandum and all current guidance regarding the Collections and Deposits process;
3. Ensure that ports continue to monitor their compliance with CBP policies and procedures; and

4. Update the PCC OTC manual and/or the Collections and Deposit Handbook to ensure proper segregation of duties over the Collections and Deposits process.

FMC 08-08 – Weaknesses in controls over aircraft parts inventory (NFR No. CBP 08-27)

Conditions: Throughout FY 2008, we noted that CBP did not:

- Present the proper classification of the Operating Materials and Supplies (OM&S) balance related to aircraft into (1) OM&S held for use, (2) OM&S held in reserve for future use, and (3) excess, obsolete and unserviceable OM&S (per the Statement of Federal Financial Accounting Standards (SFFAS) No. 3).
- Report a portion of “excess, obsolete and unserviceable” OM&S assets in the total balance of “Inventory and Related Property, Net” reported on the Balance Sheet. Specifically, CBP did not report \$7.9 million of assets within the “excess, obsolete and unserviceable” category.

KPMG notes that upon identification of these issues, CBP adjusted the formatting of their OM&S footnote to include the proper breakouts per SFFAS No. 3 and recorded an adjustment to include the \$7.9 million within the “excess, obsolete and unserviceable” category. In addition, we noted the following weaknesses in the controls over CBP’s Air and Marine Operations (AMO) physical inventory procedures:

- At two locations observed, the inventory counters did not mark items as counted during the inventory.
- At one location observed, the “closed warehouse” concept was not followed. It appeared that normal receipt and issue transactions were being performed during the inventory observation period. Accordingly, inventory parts were being moved and used during the physical inventory. Although it is reasonable that certain parts may be needed during the physical inventory (missions), this process was not done in a controlled and methodical manner.
- At one location observed, the layout of the AMO inventory did not facilitate safeguarding of the aircraft parts. This was apparent as a portion of the warehouse served as a common walkway where all personnel, including those not related to the aircraft parts, were allowed to walk through unescorted. We observed personnel who did not have badge access being allowed to walk through the aircraft parts storage area unescorted.
- At two locations observed, inventory counters did not evaluate materials as excess, obsolete, and unserviceable as a part of the physical inventory procedures. Further, per discussion with site personnel, these evaluations were not being conducted on a regular basis.

Recommendations:

We recommend that CBP:

1. Develop and implement policies and control procedures to ensure that OM&S balances relating to Aircraft parts include all balances, including excess, obsolete and unserviceable OM&S;
2. Implement the necessary procedures to ensure that these balances are reported on the financial statements in compliance with SFFAS No. 3;
3. Develop and disclose in the financial statements its criteria for identifying excess, obsolete, and unserviceable operating materials and supplies, in compliance with SFFAS No. 3, paragraph 49; and
4. Develop and implement policies and control procedures to ensure that AMO inventory observations are reasonably complete and effective and efficient in accomplishing management objectives. Specifically, CBP should consider the following:
 - a. Update the *Materiel Control/Property Control Standard Operating Procedures* to require that items (or areas) are marked as counted. Marking items/areas as counted during an inventory is a widely-accepted practice of sound internal control in order to verify that all items have been counted.
 - b. Reinforce the importance of the *Materiel Control/Property Control Standard Operating Procedures* through updated directives or other written communication and, if necessary, provide adequate training to ensure that the “closed warehouse” concept is followed during inventory counts. Further, reduce the amount of time the inventory takes by actively performing the inventory.
 - c. Consider the reorganization of the layout of inventory facilities to ensure that only authorized personnel have access to the AMO inventory in order to safeguard against waste, loss, unauthorized use, and misappropriation.
 - d. Reinforce the importance of the *Materiel Control/Property Control Standard Operating Procedures* through updated directives or other written communication and, if necessary, provide adequate training to ensure contractors regularly identify materiel as “Excess Materiel Candidates.”

FMC 08-09 – Seized inventory findings (NFR No. CBP 08-28)

Conditions: KPMG statistically selected eleven seized property locations and observed the annual inventory. We noted the following weaknesses:

- At one of the eleven locations, per the review of the certified count sheets following the completion of the inventory, we noted that the difference between the recorded and inventoried weights of two hard narcotic items exceeded the tolerable threshold of 2 percent set forth in the instructions. Only after further inquiry of the seized property officer, the officer subsequently reported the items as discrepancies to Internal Affairs.

- At one of the eleven locations, which was an Office of Border Patrol (OBP) location, we inspected a page of the vault log and noted 15 instances between 6/30/08 and 7/12/08 that personnel accessed the vault without being accompanied by another CBP official as there is no formal requirement for OBP facilities to follow the two employee rule.

Recommendations:

We recommend that CBP:

1. Reiterate, through written memorandums to the field and additional training, the correct procedures for conducting and completing inventories of seized and forfeited property; and
2. Update the SAMEPH to include OBP facilities to follow the same guidelines as the OFO facilities in which no fewer than two CBP employees may enter the temporary storage facility at any time.

FMC 08-10 – Lack of review of importer self-assessment annual notification letters (*NFR No. CBP 08-29*)

Conditions: We selected a random sample of 20 Importer Self Assessment (ISA) participants as of June 30, 2008 and noted that CBP did not complete the following during FY 2008:

- For eight of the twenty participants, CBP did not complete its review of the Annual Notification Letter (to include the internal review checklist and a signed continuation letter).
- For one of the twenty participants, CBP did not prepare a continuation letter signed by the Branch Chief notifying this company that it was approved for continued participation in the ISA program. We noted that CBP did complete its internal review checklist and this company was eligible for continued participation. However, the continuation letter, indicating Branch Chief review and approval of the decision to grant continued participation, was not prepared.

Recommendations:

We recommend that CBP:

1. Update the Office of Strategic Trade (OST) Importer Self-Assessment (ISA) Handbook and/or issue internal guidance to formalize requirements for:
 - a. Completion of the Annual Notification Internal Review Checklist, to include review of the Annual Notification Letter and review of the participant's risk to CBP based on information received from other CBP resources; and
 - b. Issuance of either a Continuation Letter or Removal Letter based on this review.
2. Review all ISA participants timely for eligibility for continued participation in the ISA program in conjunction with their submission of the Annual Notification Letter.

FMC 08-11 – Weaknesses in CBP’s processes related to PP&E asset additions (NFR No. CBP 08-30)

Conditions: We noted the following weaknesses:

- We noted several instances in which CBP utilized Standard General Ledger (SGL) account 7190, ‘other gains’, as a suspense account to record an asset rather than going through the appropriate process of recording an asset against a purchase order within SAP. Situations in which CBP utilizes the suspense account, SGL 7190, occur as a result of deviations from the standard goods receipt process for asset additions. SGL 7190 is used when the Personal Property Specialists (PPS) who receive these assets do not have sufficient accounting training to determine the proper credit account. In these cases, the PPS will record a debit to the asset and a credit to 7190, instead of the appropriate expense account. Through asset additions testwork performed as of 6/30/08, KPMG identified three instances where CBP utilized SGL 7190, other gains, to record an asset. In these cases, CBP recorded a debit to the asset and a credit to SGL 7190, instead of properly posting the credit to the appropriate expense account. This forced CBP to record a manual transaction to debit the SGL 7190 account and credit the appropriate expense account in order to achieve the final net entry for the asset of: Debit – Asset, Credit – Cash, Prepaid Assets, or Accounts Payable. KPMG notes that CBP manually reviews account 7190 and the balance was zero at 9/30/08.
- Proper support for costs of assets recorded within SAP was not available for audit review. During testwork performed as of 6/30/08 and 9/30/08, we noted transactions related to aircrafts built by the U.S. Air Force (USAF) that were moved multiple times between Construction in Progress (CIP) and finished assets during FY 2008. Upon further investigation, we noted that there was a lack of clear communication between USAF and the CBP AMO division, and between AMO and CBP’s Financial Statement Section.

Recommendations:

We recommend that CBP:

1. Minimize the circumstances which would require the use of recording asset additions using the SGL 7190 account. Instead, CBP should attempt to record the entries for adding an asset through the standard goods receipt process so that manual reclassifications can be avoided; and
2. Obtain detailed support for costs incurred when allocating those costs to an asset recorded in SAP.

FMC 08-12 – Misstatement of actuarial Federal Employees’ Compensation Act (FECA) liability (NFR No. CBP 08-31)

Conditions: We noted weaknesses in CBP’s procedures over recording the actuarial FECA liability at 9/30/08. We noted that CBP understated the liability when it was originally recorded as of 9/30/08. This understatement was recorded because CBP did not adequately review the liability balance after all adjusting journal entries were entered. CBP later recorded a top-side adjustment to correct the error.

Recommendations:

We recommend that CBP:

1. Review the actuarial FECA liability to ensure that all adjusting journal entries are entered timely into SAP; and
2. Ensure that the associated balance is reviewed for accuracy.

FMC 08-13 – Misstatement of the year-end accrued leave (*NFR No. CBP 08-32*)

Conditions: KPMG noted weaknesses in CBP's procedures over recording the accrued leave liability at 9/30/08. Specifically, KPMG noted that CBP reported the 6/30/08 accrued leave liability on the 9/30/08 financial statements. As such, the accrued leave liability was misstated by approximately \$14 million on the year end financial statements.

Recommendations:

We recommend that CBP:

1. Develop policies and procedures to ensure that the accrued leave liability is properly recorded at year end; and
2. Ensure that the associated balance is reviewed for accuracy.

U.S. Customs and Border Protection
Crosswalk - Financial Management Comments to NFRs
 September 30, 2008

Component	NFR No.	Description	Disposition				
			Independent Auditors' Report			FMC	
			Material Weakness	Significant Deficiency	Non-Compliance	Page	No.
CBP	08-01	Verification of CPL and certification payments				2	08-01
CBP	08-02	Detection of excessive drawback claims	X				
CBP	08-03	Insufficient retention period for documents that support drawback claims	X				
CBP	08-04	Automated Commercial System (ACS) deficiency over the accumulation of claims against a drawback bond				2	08-02
CBP	08-05	In-bond process deficiencies		X			
CBP	08-06	FFMIA			X		
CBP	08-07	ACS deficiencies over accounts receivable and CBP's ability to effectively monitor collection actions			X		
CBP	08-08	ACS Limitations – Review of prior related drawback claims and selectivity for underlying consumption entries	X				
CBP	08-10	Weaknesses in the management of environmental liabilities				2-4	08-03
CBP	08-11	Overpayment of drawback claims	X				
CBP	08-12	Failure to perform a full desk review/supervisor review				4	08-04
CBP	08-15	Deficiencies in the Bonded Warehouses (BWH) and Foreign Trade Zone (FTZ) processes and procedures		X			
CBP	08-16	Weaknesses in the Fines Penalties, and Forfeitures (FP&F) process				5-6	08-05
CBP	08-17	Deficiencies in the compliance measurement process		X			
CBP	08-18	Weaknesses in the review of weekly/monthly Entry edit reports				6-7	08-06
CBP	08-23	Untimely deobligation of inactive obligations (UDOs)		X			
CBP	08-24	Untimely capitalization of assets from Construction in Process (CIP)		X			
CBP	08-25	Untimely recognition in SAP of assets received for SBI fence construction		X			
CBP	08-26	Weaknesses in the collections and deposits process				7-8	08-07
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CBP	08-28	Seized inventory findings				9-10	08-09
CBP	08-29	Lack of review of importer self-assessment annual notification letters				10	08-10
CBP	08-30	Weaknesses in CBP's processes related to PP&E asset additions				11	08-11
CBP	08-31	Misstatement of actuarial FECA liability				11-12	08-12
CBP	08-32	Misstatement of the year-end accrued leave				12	08-13
CBP	08-33	Weaknesses in recording CIP		X			

U.S. Customs and Border Protection
Status of Prior Year Findings
 September 30, 2008

Component	NFR No.	Description	Disposition	
			Closed	Repeat (07 NFR No.)
CBP	07-01	Verification of CPL and certification payments		CBP-08-01
CBP	07-02	Detection of excessive drawback claims		CBP-08-02
CBP	07-03	Insufficient retention period for documents that support drawback claims		CBP-08-03
CBP	07-04	Automated Commercial System (ACS) deficiency over the accumulation of claims against a drawback bond		CBP-08-04
CBP	07-05	In-bond process deficiencies		CBP-08-05
CBP	07-06	FFMIA		CBP-08-06
CBP	07-07	ACS deficiencies over accounts receivable and CBP's ability to effectively monitor collection actions		CBP-08-07
CBP	07-08	ACS limitations – review of prior related drawback claims and selectivity for underlying consumption entries		CBP-08-08
CBP	07-10	Weaknesses in the management of environmental liabilities		CBP-08-10
CBP	07-11	Overpayment of drawback claims		CBP-08-11
CBP	07-12	Failure to perform a full desk review/supervisor review		CBP-08-12
CBP	07-13	D28 Alert Report	X	
CBP	07-14	Insufficient evaluation criteria for account managers	X	
CBP	07-15	Deficiencies in the Bonded Warehouse (BWH) and Foreign Trade Zone (FTZ) processes and procedures		CBP-08-15
CBP	07-16	Weaknesses in the Fines, Penalties, and Forfeitures (FP&F) process		CBP-08-16
CBP	07-17	Deficiencies in the compliance measurement process		CBP-08-17
CBP	07-18	Weaknesses in the review of weekly/monthly Entry edit reports		CBP-08-18
CBP	07-19	STC finding	X	
CBP	07-20	Byrd disbursements	X	
CBP	07-21	Weaknesses in controls related to asset retirements	X	
CBP	07-22	Untimely capitalization of assets from internal use software development to internal use software	X	

U.S. Customs and Border Protection
Management Response to the Draft Management Letter
September 30, 2008

1331 Pennsylvania Avenue NW
Washington, DC 20229



**U.S. Customs and
Border Protection**

FEB 06 2009

MEMORANDUM FOR: Anne L Richard
Assistant Inspector General for Audit

FROM: Eugene H. Schied
Assistant Commissioner
Office of Finance

SUBJECT: Management Letter for CBP Fiscal Year 2008 Consolidated
Financial Statements

On behalf of U.S. Customs and Border Protection (CBP), I am responding to the draft report titled, "*Management Letter for U.S. Customs and Border Protection's Fiscal Year 2008 Consolidated Financial Statements.*"

CBP has reviewed and concurred with all weaknesses contained in the draft report, with the exception of weaknesses identified for Environmental Liabilities (FMC 08-03) and Air and Marine Aircraft Parts Inventory (FMC 08-08). Our rationale for non-concurrence with the cited weaknesses is provided in the attached memorandums.

Mission Action Plans (MAPs) outlining CBP's strategy to correct agreed-upon weaknesses in the draft report will be prepared and provided to KPMG. CBP will continue to work to resolve all auditor-identified weaknesses.

CBP appreciates the opportunity to review this year's report and looks forward to continuing our strong working relationship with your office.

If you have any questions or would like additional information, please contact me at (202) 344-2300 or a member of your staff may contact Mari Boyd, Executive Director, Financial Operations, at (202) 344-2364.

Eugene H. Schied

Attachments

U.S. Customs and Border Protection
Management Response to the Draft Management Letter
September 30, 2008

U.S. Department of Homeland Security
Washington, DC 20229



U.S. Customs and
Border Protection

Ms. Teresa R. Taber
Manager
KPMG LLP
2001 M Street, NW
Washington, D.C. 20036

Reference: KPMG's Notice of Finding and Recommendation (CBP-08-10), dated
November 3, 2008

Dear Ms. Taber:

I would like to thank you and other representatives of KPMG for recently meeting with U.S. Customs and Border Protection (CBP) staff regarding the above-referenced Notice of Finding and Recommendation (NFR). The meeting allowed CBP to attempt to better understand KPMG's position and to articulate its concerns regarding the three weaknesses identified in a draft of the NFR, dated October 28, 2008. CBP concurs with the NFR's first finding and recommendation that CBP continue developing policies, procedures, and systems for determining cleanup costs for environmental financial liabilities. However, as expressed at the recent meeting with KPMG, CBP does not concur with the NFR's second and third findings and recommendations that it must recognize a cleanup liability for its firing ranges and for lead-based paint (LBP) in its non-residential buildings. Moreover, CBP firmly believes that it has not understated its environmental liabilities. The basis for CBP's non-concurrence with findings and recommendations two and three is set forth in the attached response. See Attachment "A" hereto.

If you have any questions regarding this response, please contact Ruth Zolock, Chief of the Environmental Division Compliance Branch at (202) 344-2167 or Kris Huelsman of the Office of the Assistant Chief Counsel, Indianapolis, at (317) 614-4424.

Sincerely,


Gregory L. Giddens
Executive Director
Facilities Management & Engineering

Enclosure(s)

U.S. Customs and Border Protection
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Attachment "A"

CBP's Written Response to KPMG's NFR, dated November 3, 2008

This is CBP's written response to KPMG's Notice of Finding and Recommendation, dated November 3, 2008, which is identified as CBP-08-10 (the "NFR"). CBP's response also identifies some of the relevant discussions that occurred at a recent meeting regarding a draft of the NFR, held on October 30, 2008, at CBP Headquarters, Ronald Reagan Building, in Washington, D.C. As occurred at the recent meeting, CBP's written response will first address the issue regarding lead-based paint ("LBP") and then address the issue of cleanup liability for firing ranges. CBP is committed to preparing financial statements in accordance with the applicable federal financial accounting standards. We look forward to collaborating with KPMG during Fiscal Year 2009 to achieve resolution on these complicated issues.

A. Liability for Lead-Based Paint for Non-Residential Buildings.

KPMG's NFR identifies a weakness based upon the fact that CBP has excluded from its 2008 financial statement LBP cleanup costs for non-residential buildings. The NFR also asserts that CBP potentially understated its environmental liability by approximately \$9 million due to this alleged weakness. See NFR at p. 3. In particular, KPMG's consultant asserted at the meeting that the potential liability in this regard was based on alleged requirements in the Resource Conservation and Recovery Act ("RCRA")¹ to abate and/or characterize and dispose of LBP as a hazardous waste.

In response to the NFR, CBP offers the following. First, LBP assessment or abatement in non-residential buildings is not required by RCRA and CBP is unaware of any other legal requirement to abate LBP. Second, as stated at the meeting, CBP strongly disagrees with the underlying factual and legal assumptions that are the basis for KPMG's claim that it will likely incur hazardous waste characterization and disposal costs related to LBP in non-residential buildings. For the reasons that follow, it is CBP's opinion that it properly excluded from its financial statement any liability for cleanup of LBP in non-residential buildings and that it does not violate federal financial accounting standards.

As set forth in its NFR, KPMG confirms that the federal financial accounting standards require two elements to be met before an environmental cleanup liability must be recognized in an agency's financial statement. See NFR, at p. 1. The two elements for recognition are that the cleanup liability must be both probable and reasonably estimable (i.e., "measurable"). See Federal

¹ Subchapter III of the Solid Waste Disposal Act, 42 U.S.C. § 6901, et seq.

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Financial Accounting and Auditing Technical Release Number 2, "Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government" (hereafter "Technical Release No. 2").² A liability is "probable" when the following three factors are satisfied: 1) using the due care criteria, the relevant agency is aware of contamination, 2) the relevant agency has determined that the contamination is "government related," and 3) it is more likely than not that the relevant agency is legally liable. See Technical Release No. 2 at p. 4, paragraph no. 2; NFR at p.1. Further, the term "legally liable" is defined in Technical Release No. 2 to mean: "any duty, obligation or responsibility established by statute, regulation, or court decision, or where the agency has agreed, in an interagency agreement, settlement agreement, or similarly legally binding document, to assume responsibility for cleanup costs." Technical Release No. 2 at p.4, footnote 5.

Applying the three factors for a "probable" liability, it is CBP's opinion that it has no need to recognize liability in its 2008 financial statement for LBP in non-residential buildings. In fact, none of the three factors for asserting a "probable" liability are met.³ However, as detailed below, CBP will focus primarily on the third factor of whether a "probable" liability exists, i.e., "legal liability," since it is clear that RCRA presents no requirement to abate LBP in non-residential buildings and, further, the potential for incurring hazardous waste characterization and disposal costs is remote.⁴

Regarding the third factor of legal liability, KPMG has not cited any legal authority that would render CBP liable now or in the future for either assessment or abatement costs of LBP in non-residential buildings.⁵ The term assessment includes the costs of surveying for the presence and amount of LBP in an existing building. The term abatement includes the costs to remove or encapsulate LBP in an existing building. CBP owns residential buildings, and

² Also see Statement of Federal Financial Accounting Standards ("SFFAS") No. 5, and SFFAS No. 6, at ¶ 91.

³ Nor has the "measurable" element been met for recognizing a liability for LBP in non-residential buildings. KPMG claims in the NFR that CBP understated its liability by \$9 million. It appears that KPMG's consultant has used an irrelevant asbestos abatement estimate and presumed that CBP has an equal liability for LBP abatement. First, CBP does not understand the basis for assuming that LBP abatement costs are equal to asbestos abatement costs. Second, assuming that the amount of LBP present in CBP's non-residential buildings is the same as the amount of asbestos present is without any basis in fact.

⁴CBP is not conceding the other two factors required for a "probable" liability with regard to LBP in non-residential buildings, i.e., that the relevant agency is "aware of contamination" and has determined it is "government-related."

⁵ At the meeting, KPMG's consultant generally cited RCRA as requiring abatement of LBP in non-residential buildings, but did not cite to any specific provision of RCRA or any other authority that supports that position. As stated at the meeting, and as reiterated herein, CBP believes that no such obligation exists.

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non-residential buildings such as border patrol stations and other law enforcement facilities. CBP agrees that it must perform an assessment or abatement of LBP on residential dwellings constructed before 1960.⁶ In addition, CBP must potentially perform a risk assessment on residential dwellings built from 1960 to 1977, but only when a sale of a federally-owned dwelling will occur. However, for non-residential buildings, CBP is unaware of any legal requirement under RCRA that mandates performance of LBP assessment or abatement.⁷ Since CBP has no known or anticipated legal requirement to assess or abate LBP in non-residential buildings the third factor for determining a "probable" liability, as required by the federal financial accounting standards, is not satisfied.

Aside from LBP assessment or abatement costs (which apply to LBP in an existing building), KPMG's consultant has also asserted that an environmental cleanup liability exists under RCRA for the costs of characterizing and disposing of hazardous waste (which apply to LBP in the waste of a demolished building).⁸ The basis for KPMG's position that characterization costs will be incurred assumes that three future events are *likely* to occur: 1) CBP would demolish its non-residential buildings at some unidentified date in the future (at the end of its useful life); 2) all of CBP's non-residential buildings contain LBP; and 3) CBP must characterize the "waste" from the demolition. In addition to the first three events, KPMG's position that CBP will incur hazardous waste disposal costs also assumes that the demolition waste is likely to test as "hazardous" (i.e., it will fail TCLP tests) and must be disposed of at a RCRA treatment, storage or disposal ("TSD") facility.

As explained at the meeting, CBP respectfully disagrees with the assumptions underlying KPMG's position regarding alleged future hazardous waste characterization and disposal costs. First, CBP is required by law to follow an excess/surplus property system that prefers the reuse and transfer of property over demolition and presents a significant uncertainty as to whether a demolition of its non-residential buildings would ever occur during CBP's ownership. Moreover, as discussed above, CBP has no known or anticipated legal obligation

⁶ See Residential Lead-Based Paint Hazards Reduction Act of 1992, Title X of Public Law 102-550, 42 U.S.C. § 4822(a)(3); 24 C.F.R. Part 35, Subpart C (Disposition of Residential Property Owned by a Federal Agency Other than HUD). Only three such buildings exist in CBP's property inventory.

⁷ CBP notes that some requirements might apply to child-care facilities under the Toxic Substances Control Act, 15 U.S.C. § 2601, et seq., but CBP does not own any such facilities.

⁸ It appears that KPMG's consultant has confused LBP abatement costs with characterization and disposal costs, as if they were similar or the same. See NFR at pp. 2-3. In fact, they are not the same and are two very different scenarios. As mentioned, abatement is the cost to remove or encapsulate LBP on an existing building. In contrast, characterization and disposal costs would include the cost to perform TCLP testing on the waste from a demolished building, and if hazardous, the cost to dispose of it at a TSD landfill, i.e., a hazardous waste landfill. See NFR at pp. 2-3.

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Management Response to the Draft Management Letter
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to assess the LBP on its non-residential buildings and lacks sufficient information to assume that its non-residential buildings contain LBP at all, or in any given amount.⁹ Next, contrary to the position taken by KPMG here, CBP environmental personnel have determined that very few jurisdictions require demolition waste to be characterized for "hazardous" constituents before disposal and would allow such waste to be disposed of at construction and demolition debris ("C&DD") or solid waste facilities.¹⁰ Only Alaska, Washington, and Illinois appear to require such characterization despite "generator knowledge" that the LBP waste is non-hazardous. Also, it has been the routine practice of the demolition industry to manage LBP building materials as solid waste or C&DD debris and not as hazardous waste.¹¹ Lastly, even if a state required characterization of demolition wastes, based upon the knowledge and experience of CBP environmental personnel, the routine practice of the demolition industry, and the results of two past studies by federal agencies, it is very unlikely that the waste would be characterized as "hazardous."¹²

Equally important to note is that all three assumptions by KPMG's consultant must be considered likely to occur before a "probable" liability exists to characterize LBP wastes. Moreover, four assumptions must be likely to occur before a "probable" liability exists to dispose of hazardous LBP wastes. CBP

⁹ CBP concedes the fact that the age of a building can be used to assume the *potential* presence of LBP, but such an assumption cannot be used to determine the amount of LBP, if any, at a given site without an assessment being performed.

¹⁰ It was claimed by KPMG's consultant that the LBP on a building was required to be characterized under RCRA, a position which is simply not accurate. RCRA only requires the characterization of a "solid waste" and a building with LBP is a product that is being used for its intended purpose until it is demolished, and is not a "solid waste." In addition, KPMG claims that "many state and local regulations require performance of the toxicity characteristic leaching procedure (TCLP) to determine whether the waste from the structure is hazardous." See NFR at pp. 2-3. CBP's research indicates that this statement is also not accurate. Currently available information suggests that only Alaska, Illinois and Washington require characterization (e.g., sampling and TCLP testing) to be performed on construction and demolition debris waste piles that contain LBP, and do not permit the use of "generator knowledge." As a result, a characterization cost might exist if and when a non-residential building containing LBP is demolished in one of those three states. CBP contends that such a scenario is remote because of the unlikely event that the building will be ever be demolished and that it will contain LBP, let alone in one of those three states.

¹¹ Interview with Mike Taylor, Director, National Association of Demolition Contractors.

¹² As mentioned at the meeting, it must be remembered that any LBP samples are mixed in with samples of wood, brick, wallboard, concrete and other common building materials that are not likely to contain lead and this resulting mixture frequently tests out as "non-hazardous." Two studies, one by the U.S. Army Corps of Engineers and one by the U.S. Air Force, collected representative samples and tested building debris for the hazardous waste characteristic for lead. Both studies determined that the material was non-hazardous for lead. Therefore, CBP possesses "generator knowledge" that this material is not hazardous and can be disposed of at a C&DD or solid waste facility and without expending the money for sampling and testing or for disposal at a hazardous waste facility.

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submits that it cannot determine that all three events are likely to occur to require the characterization of LBP wastes because, in the first instance, a significant uncertainty exists as to whether CBP would ever demolish a non-residential building during its ownership of the facility. It is even less likely that, if a demolition were to ever occur, it would be of a non-residential building that contains LBP. Even more remote is the scenario that a non-residential building containing LBP, which will be demolished, happens to be located in Alaska, Washington, or Illinois (where characterization of LBP waste is required, despite generator knowledge). Lastly, the most remote scenario of all, given the available information indicating LBP wastes are non-hazardous, would be that LBP wastes are generated by the demolition of a non-residential building in Alaska, Washington, or Illinois that would fail TCLP tests (and result in CBP incurring disposal costs at a TSD landfill). Therefore, CBP submits that the cost to characterize and dispose of LBP wastes from non-residential buildings is remote.¹³

In sum, CBP is not required to recognize a cleanup liability for LBP in non-residential buildings until sufficient information is presented to meet the three factors that must be present to have a "probable" liability, as required by the federal financial accounting standards. At present, there is no known or anticipated legal requirement that mandates LBP abatement or assessment at these non-residential facilities. As a result, a \$9 million understatement does not exist on CBP's 2008 financial statement as asserted in the NFR. Moreover, we believe that the assumptions made by KPMG regarding the costs to characterize and dispose of LBP as a hazardous waste are so uncertain as to be remote (and immaterial) at this time and no further consideration of these potential costs should be required. Accordingly, CBP respectfully submits that its position in regard to LBP at non-residential sites complies with federal financial accounting standards.

B. Liability for Firing Range Cleanups.

KPMG has asserted in its NFR that CBP must report (i.e., recognize) a cleanup liability for its small-arms firing ranges and that CBP's policy conflicts with federal financial accounting standards by asserting that no cleanup liability is "probable" until, at a minimum, an enforcement order, civil action, etc. has been issued for a given site. KPMG claims that CBP possibly understates its environmental liability for firing range cleanup by approximately \$6.1 million. CBP respectfully disagrees with KPMG's position for the reasons provided below.

¹³ Even if CBP happens to own non-residential buildings in Alaska, Washington, and Illinois that contain LBP and will be demolished at some time in the future, the cost to perform the TCLP testing is only \$134 per sample and is so immaterial that it should not require further consideration.

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CBP submits that it is KPMG's position that appears contrary to the relevant accounting standards. In essence, KPMG's position is that a federal agency must recognize a cleanup liability for sites such as CBP's firing ranges simply because the agency has determined that contamination exists at a site and that it is "government-related." See NFR, at p. 2.¹⁴ Yet, the NFR and the relevant accounting standards confirm that three factors must be satisfied before a "probable" liability exists, not just two. See NFR at p. 1. The factor seemingly missing from KPMG's analysis of the firing range liability is that the relevant agency must be "legally liable," which is not met until, at a minimum, CBP receives an enforcement order, notice of an NPL listing, or some similar event that may require the assessment or cleanup at a given firing range site.

As discussed above, the term "legally liable" is defined, in part, by the relevant accounting standards to mean: "any duty, obligation or responsibility established by statute, regulation, or court decision" See Technical Release No. 2 at p. 4, footnote 5. As with the LBP issue, CBP is unaware of any legal mandate that would affirmatively require it to assess and/or cleanup its firing ranges in the absence of an enforcement order or NPL listing.¹⁵ CBP is not presently aware of any firing range site where it has been ordered to assess and/or cleanup the facility.¹⁶ As such, recognition of a cleanup liability for these sites would not be consistent with the federal financial accounting standards.

As a result, CBP respectfully responds that its position regarding firing ranges is not a weakness in its accounting system. In fact, to follow KPMG's recommendation would appear to present a potential overstatement of CBP's financial liability. While CBP recognizes the potential for liability from its firing ranges, the presently known circumstances surrounding those ranges do not meet the federal financial accounting standards for recognition in the financial statement because a "probable" liability does not exist, based upon reasonably

¹⁴ CBP cannot even concede that hazardous waste contamination exists at any given firing range site, and that it is government-related, without more information. However, to simplify the issues herein, even assuming for the sake of argument that contamination is present at each firing range that is CBP-related, no "probable" liability exists until the third factor is met (i.e., that the Government is "legally liable").

¹⁵ At the recent meeting, KPMG's consultant claimed that RCRA guidance documents considered soil contamination at closed facilities to be a "waste." Even if that were true, it does not change the conclusion that an enforcement action is needed to require CBP to assess and cleanup any given firing range site. CBP explained at the meeting that the CERCLA program and parts of the RCRA program rely upon a discretionary enforcement system to determine which sites present sufficient risk to require assessment/cleanup. In contrast, certain parts of the RCRA program rely on a permit system, which require closure (including assessment and remediation) at the end of the facilities use as a RCRA facility. RCRA treatment, storage and disposal ("TSD") facilities and underground storage tank ("UST") facilities are examples of the latter permitting scenario. The firing ranges at issue are not RCRA permitted facilities and do not have closure obligations similar to the permitted facilities.

¹⁶ As noted at the meeting, despite this fact, CBP takes environmental stewardship seriously and has voluntarily assumed responsibility for cleanup at some firing range sites when appropriate.

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available information.¹⁷ Should new information become available to CBP to change this position for any given firing range, CBP's accounting system and procedures recognize the need to re-categorize a given firing range site and/or identify an amount of liability when it is appropriate to do so.

C. Summary of CBP's response to the NFR

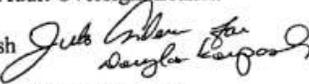
CBP has complied with the federal financial accounting standards in establishing its policies and procedures for recognizing environmental liabilities tied to LBP and firing ranges and does not believe that it has improperly understated liabilities on said items by \$15.1 million, as asserted in the NFR. CBP submits that no known or anticipated legal obligation exists to abate LBP in non-residential buildings. CBP also submits that the likelihood of incurring hazardous waste characterization and disposal costs for LBP in non-residential buildings is too remote and immaterial at this time to require any further consideration. Lastly, CBP has no legal responsibility to recognize a cleanup liability for its firing ranges until, at a minimum, it receives a cleanup order, NPL listing, or some similar enforcement event.

¹⁷ In fact, CBP can certainly argue that the likelihood of incurring assessment and cleanup costs is remote at these firing range sites and that they do not have to be accounted for on CBP's financial statement at all.

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DATE: October 31, 2008

MEMORANDUM FOR: Connie Reynolds-Shine
Director
Office of Finance, Audit Oversight Branch

FROM: Douglas K. Koupash 
Executive Director
CBP Air and Marine, Mission Support

SUBJECT: Responses to Notice of Finding and Recommendation CBP-08-27

CBP Air and Marine (A&M) do not concur with the weaknesses identified in KPMG Notice of Finding and Recommendation number CBP-08-27. A&M responses to the weaknesses are as follows:

1. At both locations observed, we noted that the inventory counters did not mark items as counted during the inventory.

Response: *The CBP approved Material Control and Property Control (MCPC) Procedures MCPC 3800 entitled Annual, Special, and Periodic Inventories used by the aircraft maintenance contractor nor the CBP Personal Property Handbook HB-5200-13B which governs all CBP property management policies require inventory be marked as counted during the inventory counting process. The inventory taker counts the material at each bin location, records the data on the count sheet, then signs and date the count sheet. The count sheets are then given to the supply supervisor who verifies all bins have been counted by the inventory taker. If an extra item is found or if the bin has a shortage the supervisor must reconcile the inventory to determine where the discrepancy occurred and correct the inventory record.*

2. At one location observed, we noted that the "closed warehouse" concept was (as cited above) was not followed. It appeared that normal receipt and issue transactions were being performed during the physical inventory observation period. Accordingly, inventory parts were being moved and used during the physical inventory. Although it is reasonable that certain parts may be needed during the physical inventory (missions), this process was not done in a controlled and methodical manner.

Response: *The formal inventory start date was August 11, 2008 with a completion date of August 22, 2008. On August 11, 2008 all Computerized*

Attachment 1

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Aircraft Reporting and Material Control System (CARMAC) supply transactions that affect the inventory were blocked. If parts were required to support flight operations, they were ordered, issued, turned-in, and shipped according to CBP approved supply procedures. The auditor noted a "closed warehouse" concept was not followed; this concept is impractical at the location where the auditor observed the inventory. This is an operational location the actively engages in real-time missions which requires all aircraft be maintained and ready to fly when needed. Therefore, parts will be issued to the mechanic when the mechanic needs them and parts will arrive from vendors and the supply office will receive them. These procedures have been approved by CBP and are identified in MCPC 3800 and are being followed by the contractor. The process used by A&M is to block CARMAC and limit part issues to a minimum. CARMAC was blocked on August 11 and part issues and receipts were not entered.

3. At one location observed, we noted that the layout of the AMO inventory did not facilitate safeguarding of the aircraft parts. This was apparent as a portion of the warehouse served as a common walkway where all personnel, include those not related to the aircraft parts, were allowed to walk through unescorted. KPMG specifically observed personnel who did not have badges access being allowed to walk through the aircraft parts storage area unescorted.

Response: The warehouse is controlled by an electronic lock that only an authorized security badge will open. Only authorized CBP, contractor managers and supply technicians have access to the warehouse; personnel without authorization must be escorted in. The area adjacent to the warehouse serves as an office where other staff conducts business and on occasion, someone may be allowed in without an escort. The contractor has been informed of the access requirements and will ensure anyone without proper authority will be escorted. This will be a follow-on issue during future evaluations by CBP representatives.

4. At both locations observed, we noted that inventory counters did not evaluate materials as excess, obsolete, and unserviceable as a part of the physical inventory procedures. Further, per discussion with personnel, these evaluations were not being conducted on a regular basis.

Response: MCPC-3800 does not require an evaluation of excess, obsolete, and unserviceable material be accomplished during the physical inventory. The inventory taker counts parts on their count sheets. If a part is unserviceable it is tagged and placed in the unserviceable bin area for disposition. The unserviceable part will be on the count sheet and the inventory taker will count the part; it is not the inventory taker's responsibility to evaluate parts during the count. The evaluation of excess, obsolete, and unserviceable material is described in the MCPC-3850, Excess Supply Procedure and is accomplished monthly by a CBP representative, quality

Attachment 1

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assurance, maintenance, and supply technicians. This evaluation determines if a part can be repaired, used at another location, or disposed. This will be a follow-on issue during future evaluations by CBP representatives.

Attachment 1

Appendix D Report Distribution

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