Department of Homeland Security
Office of Inspector General

Independent Auditor's Report on Auditability Assessment of the Department of Homeland Security's Statement of Budgetary Resources

OIG-09-72

May 2009

Office of Inspector General

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

May 27, 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.

The attached report presents the results of a performance audit to assess the Department of Homeland Security's ability to provide a representation that budgetary accounts, supporting the DHS combined statement of budgetary resources, are fairly stated in accordance with U.S. generally accepted accounting principles. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the audit. KPMG is responsible for the attached report dated May 13, 2009, and the conclusions expressed in it. We do not express opinions on KPMG's conclusions provided in the report.

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

Richard L. Skinner
Inspector General

Department of Homeland Security (DHS) Fiscal Year 2008 Performance Audit Report #1: Statement of Budgetary Resources Auditability Assessment of DHS Components not subject to Full Scope Audits

Prepared for: The Department of Homeland Security Office of the Inspector General

As of Date: April 30, 2009

KPMG LLP
2001 M Street, NW
Washington, DC 20036

May 13, 2009

Ms. Anne Richards
Assistant Inspector General for Audit

Ms. Peggy Sherry
Deputy Chief Financial Officer
Department of Homeland Security:

This report presents the results of our work conducted to address the performance audit objectives, as outlined in our engagement letter dated October 20, 2008, relative to the Department of Homeland Security's ("DHS" or the "Department") components that previously have not been subject to a stand-alone audit or had an auditability assessment of their statement of budgetary resources and related budgetary accounts performed, specifically the United States Coast Guard, Federal Emergency Management Agency, Immigration Customs Enforcement, Citizenship and Immigration Service and Transportation Safety Administration. The objective of this performance audit was to assess and identify potential weaknesses at the specified DHS components that could interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the DHS combined statement of budgetary resources, are fairly stated in accordance with U.S. generally accepted accounting principles in the future fiscal years (FY), after FY 2008. The scope of this performance audit was defined by the DHS Office of the Inspector General and does not represent a comprehensive set of procedures that may be performed on an audit of the statement of budgetary resources. Because of this limitation in the scope of the procedures, all findings that could interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the statement of budgetary resources, are fairly stated in accordance with U.S generally accepted accounting principles may not have been identified. The information in this report was obtained from you and our work was performed during the period of July 3, 2008 through March 6, 2009 and the results are as of September 30, 2008.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

This performance audit did not constitute an audit of financial statements in accordance with *Government Auditing Standards.* KPMG was not engaged to, and did not, render an opinion on the Department's internal controls over financial reporting or over financial management systems (for purposes of the Office of Management and Budget Circular A-127, *Financial Management Systems*, July 23, 1993, as revised). KPMG cautions that projecting the results of our evaluation to future periods is subject to the risks that controls may become inadequate because of changes in conditions or because compliance with controls may deteriorate. We have no obligation to update our report or to revise the information contained therein to reflect events and transactions occurring subsequent to April 30, 2009.

Sincerely,

KPMG LLP

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EXECUTIVE SUMMARY

Since fiscal year (FY) 2004, the scope of the Department of Homeland Security (DHS or the Department) financial statement audit has only included the balance sheet and statement of custodial activity, with the exception of the full scope stand alone financial statement audits for selected DHS components. Consequently, the Department's budgetary accounts, related to the statement of budgetary resources, have only had limited audit coverage. The United States Coast Guard (USCG), Federal Emergency Management Agency (FEMA), Immigration Customs Enforcement (ICE), and the United States Citizenship and Immigration Service (USCIS) have not been subject to a stand-alone audit nor had an auditability assessment of their budgetary accounts performed. The scope of Transportation Security Administration's (TSA) stand-alone audit has been limited to the balance sheet. Due to the lack of audit coverage at these DHS components, potential weaknesses that may interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the DHS statement of budgetary resources, are fairly stated in accordance with United States (U.S.) generally accepted accounting principles may not have been identified and incorporated into the Department's corrective action plans.

The objective of this performance audit was to assess and identify potential weaknesses at the specified DHS components that could interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the DHS combined statement of budgetary resources, are fairly stated in accordance with U.S. generally accepted accounting principles in the future fiscal years, after FY 2008. The scope of this performance audit was defined by the DHS Office of the Inspector General and does not represent a comprehensive set of procedures that may be performed on an audit of the statement of budgetary resources. This performance audit was performed by applying these limited assessment procedures to certain USCG, FEMA, ICE, USCIS, and TSA funds and budgetary accounts comprising line items on the component's statement of budgetary resources that were determined quantitatively and qualitatively material to the DHS consolidated financial statements. These limited assessment procedures included internal control and tests of details performed in conjunction with the financial statement audit as well as analytical procedures and review of supporting documentation. We conducted this performance audit in accordance with the standards applicable to such audits contained in the *Government Auditing Standards,* issued by the Comptroller General of the United States. In performing our assessment procedures, we applied U.S. generally accepted accounting principles as our criteria. However, we also applied criteria from a variety of sources including technical guidance published by the Office of Management and Budget (OMB), e.g., Circulars A-11 and A-123, the Government Accountability Office, e.g., *Standards for Internal Control in the Federal Government*, and applicable Federal laws and regulations, e.g., *Federal Managers Financial Integrity Act* (FMFIA), *Federal Financial Management Improvement Act* (FFMIA).

As our report further describes, we identified weaknesses that have potential to interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the DHS combined statement of budgetary resources, are fairly stated in accordance with U.S. generally accepted accounting principles in the future fiscal years. Our work performed resulted in seven findings that were reported in the form of Notices of Findings and Recommendations (NFRs) to DHS component management. These findings affected USCG, FEMA, TSA and, while varying in the level of severity, all involved internal control deficiencies and lack of supporting documentation affecting whether the budgetary accounts were fairly stated. No findings were identified at USCIS and ICE. Because of the limitation in the scope of the procedures, all findings that could interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the statement of budgetary resources, are fairly stated in accordance with U.S generally accepted accounting principles may not have been identified.

At the USCG, the results of our procedures identified pervasive weaknesses that have potential to interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the DHS combined statement of budgetary resources, are fairly stated in accordance with U.S. generally accepted accounting principles in the future fiscal years. USCG does not have appropriately designed and implemented internal controls over their financial reporting process. We also identified general ledger system deficiencies that have resulted in an inability to produce accurate and complete budgetary financial information for submission to DHS resulting in potentially materially misstated DHS combined statement of budgetary resources (SBR). At FEMA, our assessment procedures resulted in four findings indicating weaknesses affecting line items on the SBR, specifically the fair statement of unliquidated obligations (ULOs) and spending authority from offsetting collections. We also identified internal control deficiencies over the timely de-obligation of certain ULOs and retention of related supporting documentation that may have the potential to interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the DHS combined statement of budgetary resources, are fairly stated in accordance with U.S. generally accepted accounting principles in the future fiscal years. In addition, FEMA is currently not performing a general ledger reconciliation of National Flood Insurance Program revenues and related budgetary resources generated from the sale of flood maps, and as a result is not always able to support the completeness and accuracy of the amounts related to approximately $7.1 million in map sales activity. The results of our assessment procedures indicated that the TSA undelivered orders (UDO) balance might be misstated due to internal control deficiencies related to improper contract management and inconsistent application of established procedures.

In summary, we recommend that USCG, FEMA and TSA management conduct a detailed review of the processes, procedures and internal controls affected by the reported findings to identify the risks and current conditions that preclude management from supporting the related financial statement assertions associated with the statement of budgetary resources. Once this analysis is completed, we recommend identification of the appropriate number of resources needed and implementation of appropriate changes to systems and process/sub-process methodology, to include the design and implementation of internal controls, to mitigate the risks/conditions identified. Once implementation is finished, the internal controls should be tested to determine that they are designed properly and operating effectively. Our specific recommendations related to findings reported are contained in the body of this report.

BACKGROUND

For the fifth year, the Department of Homeland Security's (DHS or Department) independent auditors were unable to render an opinion on the Department's balance sheets as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended. DHS continues to be unable to represent that certain financial statement balances were correct, and was unable to provide sufficient evidence to support its financial statements for these mandatory audits required by the *Chief Financial Officers Act of 1990* as amended by *Department of Homeland Security Financial Accountability Act of 2004*. The fiscal year (FY) 2008 Independent Auditors' Report discusses six significant deficiencies considered material weaknesses, three other significant deficiencies in internal control, and eight instances of non-compliance with laws and regulations.

The DHS Office of the Chief Financial Officer ("OCFO") and DHS component management have responded to these reported deficiencies by developing corrective action plans known as "mission action plans". Although elements and conditions of prior year weaknesses have been corrected, the material weakness conditions at the Department exist in many of the same processes as in prior years. These mission action plans form a comprehensive strategy to implement corrective actions to address these reported deficiencies as well as others identified through internal analysis or other external audits with the goal of improved financial reporting in future fiscal years after FY 2008.

Since FY 2004, the scope of the DHS financial statement audit has only included the balance sheet and statement of custodial activity, with the exception of the full scope stand alone financial statement audits for selected DHS components. Consequently, the Department's budgetary accounts, related to the statement of budgetary resources, have only had limited audit coverage. The United States Coast Guard (USCG), Federal Emergency Management Agency (FEMA), Immigration Customs Enforcement (ICE), and the United States Citizenship and Immigration Service (USCIS) have not been subject to a stand-alone audit nor had an auditability assessment of their budgetary accounts performed. The scope of Transportation Security Administration's (TSA) stand-alone audit has been limited to the balance sheet. Due to the lack of audit coverage at these DHS components, potential weaknesses that may interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the DHS statement of budgetary resources, are fairly stated in accordance with U.S. generally accepted accounting principles may not have been identified and incorporated into the Department's corrective action plans.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The objective of this performance audit was to assess and identify potential weaknesses at the specified DHS components that could interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the DHS combined statement of budgetary resources, are fairly stated in accordance with U.S. generally accepted accounting principles in the future fiscal years, after FY 2008. With the exception of the full scope stand alone financial statement audits, the Department has only had a balance sheet and statement of custodial activity audit since FY 2004, and as such the budgetary accounts of USCG, FEMA, ICE, USCIS and TSA have only had limited audit coverage. By applying certain assessment procedures based on DHS Departmental materiality and specific criteria, our objective was to identify potential weaknesses at these components now that may allow DHS management to include corrective actions in the Department's mission action plans for implementation prior to a future DHS full scope audit. We did not evaluate the outcome of any corrective actions taken by management during our audit, and our findings should not be used to project ultimate results of corrective actions implemented. Recommendations are provided to help address findings identified during our performance audit.

Our procedures were performed according to *Government Auditing Standards* issued by the Comptroller General of the United States; specifically, the standards for performance audits and were designed to leverage the procedures to be performed on the financial statement audit to the extent possible to achieve efficiencies by conducting the performance audit in conjunction with the related financial statement audit procedures. The scope of this performance audit was defined by the DHS Office of Inspector General (OIG) and does not represent a comprehensive set of procedures that may be performed on an audit of the statement of budgetary resources. Because of the limitation in the scope of the procedures, all findings that could interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the DHS combined statement of budgetary resources, are fairly stated in accordance with U.S generally accepted accounting principles may not have been identified.

Scope

The scope of this performance audit, as defined by the DHS OIG, was performed by applying limited assessment procedures to USCG, FEMA, ICE, USCIS and TSA budgetary accounts comprising line items on the component's statement of budgetary resources that were determined quantitatively and qualitatively material to the DHS consolidated financial statements. These limited assessment procedures included internal control and tests of details performed in conjunction with the financial statement audit as well as analytical procedures and review of supporting documentation. Assessment procedures used judgmental sampling and included testing of certain identified funds determined in consultation with the DHS Office of the Inspector General (See table below). Because of this limitation in the scope of the procedures, all findings that could interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the statement of budgetary resources, are fairly stated in accordance with U.S. generally accepted accounting principles may not have been identified.

Methodology

We conducted this performance audit in accordance with the standards applicable to such audits contained in the *Government Auditing Standards,* issued by the Comptroller General of the United States. Our methodology consisted of the following four-phased approach:

Project Initiation and Planning – We attended meetings with the DHS OIG to review the performance audit objective, scope and the planned procedures. Each component audit team introduced the performance audits to the specified DHS components and their management and described our approach, data requests and timeline in conjunction with scheduled financial statement audit status meetings.

Component audit teams consulted with the OIG to identify a sample of unique funds (selected funds) at each component to be subject to our procedures based on quantitative and qualitative considerations. Further, each component audit team obtained the component's FY 2007 statement of budgetary resources (SBR) and identified those component SBR line items and related budgetary accounts, for each of the selected funds, considered material, as issued in the FY 2007 DHS *Annual Financial Report*, by applying the planning materiality guidance issued by the DHS consolidated audit team for the FY 2008 audit of the DHS consolidated financial statements. The component selected funds identified and agreed to by the OIG are listed in the table below.

DHS Component Treasury Appropriation Fund Symbols (Selected Funds) Identified to be Included in Assessment Procedures					
USCG	70X4743 Yard Fund	7080610 Operating Expenses	708/20613 Acquisition, Construction and Improvements	20X8147 USCG – Sport and Fish	Not Used
FEMA	70X0702 Disaster Relief	7060560 State and Local Programs, Office for Domestic Preparedness (ODP)	707/00560 State and Local Programs, ODP	707/80561 Firefighter Assistance Grants, ODP, Border and Transportation Security	70X4236 National Flood Insurance Fund, FEMA
ICE	7060540 Salaries and Expenses	70X0542 Federal Protective Service	Not Used	Not Used	Not Used
USCIS	70X5088 Immigration Examination Fees	Not Used	Not Used	Not Used	Not Used
TSA	707/80550 Aviation Security	706/70550 Aviation Security	70X0550 Aviation Security	70X0508 Expenses	70X5385 Aviation Security Capital Fund

As directed by the OIG, the assessment procedures were integrated into planned audit procedures performed as part of the financial statement audit to the extent possible to maximize efficiencies by performing the performance audit during related financial statement audit procedures.

Data Gathering and Testwork Performed – For each DHS component selected funds' SBR line items considered material by applying the planning materiality guidance issued by the DHS consolidated audit team, component audit teams performed the following:

- Reviewed substantive SBR assessment procedures agreed to by the OIG and identified those procedures to be substantially accomplished as part of the FY 2008 audit of the DHS consolidated balance sheet and statement of custodial activity. For the selected funds material SBR line items and related budgetary accounts for which there was no overlap with the financial statement audit procedures, analytic tests and substantive procedures were performed for each selected fund by SBR line item. Statistical or representative samples were selected for transactions audited as part of the FY 2008 financial statement audit and judgmental samples were selected for transactions tested through incremental procedures performed as part of this performance audit, to include the selected funds.

- Requested additional information necessary to perform the assessment procedures that would not be accomplished as part of the FY 2008 audit of the DHS consolidated balance sheet and statement of custodial activity.

- Performed the incremental procedures over SBR material line items at each component, including selected funds, in addition to those procedures accomplished through control and substantive test work performed as part of the FY 2008 audit of the DHS consolidated balance sheet and statement of custodial activity.

In order to leverage our assessment from planned financial statement audit procedures we used data available and/or already available as part of the financial statement audit. The principal data used in our assessment procedures was as of June 30, 2008.

The timeline for this performance audit was as follows:

- Fieldwork – July 3, 2008 through March 6, 2009. The table below shows the fieldwork timeline by each DHS component.

- Draft Report Issuance – April 29, 2009
- Final Report Issuance – May 13, 2009

Analysis Using Established Criteria – In performing our assessment procedures, to include internal control and tests of details performed in conjunction with the financial statement audit as well as analytical procedures and review of supporting documentation, we applied U.S. generally accepted accounting principles as our criteria. However, we also applied criteria from a variety of sources including technical guidance published by the Office of Management and Budget (OMB), e.g., Circulars A-11 and A-123, the Government Accountability Office, e.g., *Standards for Internal Control in the Federal Government*, and applicable Federal laws and regulations, e.g., *Federal Managers Financial Integrity Act* (FMFIA), *Federal Financial Management Improvement Act* (FFMIA). See the Results section of this report for detailed discussion of criteria related to our findings.

Results – Findings and Recommendations - After conducting our assessment procedures described above and applying the evaluation criteria to each component selected funds' SBR line items considered material, we formulated our findings and recommendations. All findings were communicated to component management through use of a Notification of Findings and Recommendations (NFR) form following the same procedures as used in the financial statement audit. NFRs issued prior to issuance of the *Independent Auditors' Report* on DHS' FY 2008 Financial Statements were considered for inclusion in that report.

FINDINGS AND RECOMMENDATIONS

The results of our assessment procedures identified weaknesses that have potential to interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the DHS combined statement of budgetary resources, are fairly stated in accordance with U.S. generally accepted accounting principles in the future fiscal years. Specifically, we identified seven findings that were reported in the form of NFRs to DHS component management. Five of the seven findings were identified and reported during the course of the FY 2008 financial statement audit and the remaining two were based on incremental procedures performed over the component's material line items including the selected funds. One comprehensive finding incorporating several NFRs and results of incremental procedures based on procedures, including the selected funds, was issued to management for USCG. Of the remaining six findings, four findings were issued to FEMA management and two to TSA management. Two of the FEMA findings were combined in this report as they addressed similar conditions. No findings were issued to USCIS and ICE. A summary of the results and our conclusions follow.

The results of our assessment procedures at the USCG identified weaknesses that have potential to interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the DHS combined statement of budgetary resources, are fairly stated in accordance with U.S. generally accepted accounting principles in the future fiscal years. While remediation is ongoing, USCG does not have appropriately designed and implemented controls over the financial reporting process, to include its budgetary accounts, to ensure that opening balances are accurate and reflected in the proper general ledger system. In addition, USCG does not have an integrated accounting system to comply with FFMIA system requirements and its current processes and systems are unsuccessful in preparing accurate financial statement data partially due to system posting logic issues. Consequently, USCG's current process is not effective to produce accurate and complete budgetary financial information for submission to DHS resulting in potentially materially misstated DHS combined statement of budgetary resources. The USCG account balances reported to DHS, that support the financial statements and opening balances, are not supported at a transaction level and do not agree to the general ledger systems account balances. Further, manual errors have gone undetected and system issues have not been identified and corrected timely that could affect prior periods as well as multiple accounts and financial statement line items, including those on the SBR.

The results of our assessment procedures at FEMA uncovered weaknesses affecting line items on the SBR, specifically the fair statement of unliquidated obligations (ULOs) and spending authority from offsetting collections. Control deficiencies were identified over the timely de-obligation of non-grant related ULOs within the former Grants and Training (G&T) Directorate as well as Mission Assignment (MA) ULOs. In addition, we were unable to obtain sufficient documentation for some of our samples supporting the validity of both, the non-grant G&T ULO files and MA ULO files. Consequently, we were unable to obtain competent evidential matter to support the ULO balance of approximately $404 million related to the legacy G&T non-grant budget object codes as of September 30, 2008. Test work over the non-grant G&T ULOs statistical sample as of June 30th resulted in a known overstatement of $18 million and a most likely overstatement of $39 million. Errors identified in the June 30, 2008 and September 30, 2008 MA ULO statistical sample items resulting in a known overstatement in undelivered orders of $98 million. The projected most likely overstatement based on the statistical sample was $169 million. These deficiencies may have the potential to interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the DHS combined statement of budgetary resources, are fairly stated in accordance with U.S. generally accepted accounting principles in the future fiscal years. While performing assessment procedures over spending authority from offsetting collections, we were unable to obtain supporting documentation for some of our sample items supporting the amount recorded in the FEMA June 30, 2008 SBR. Upon further follow up procedures, we identified that FEMA is currently not performing a general ledger reconciliation of National Flood Insurance Program (NFIP) revenues and related budgetary resources generated from the sale of flood maps and as a result is not always able to support the completeness and accuracy of the amounts related to approximately $7 million in map sales activity recorded on SBR Line 3D1a for Fund 5 (NFIP).

The results of our assessment procedures indicated that TSA's undelivered orders (UDO) balance and related expenditures might be misstated due to internal control deficiencies related to improper contract management and inconsistent application of established procedures. In addition, TSA lacked appropriate internal controls in some cases to support whether an obligation should be classified as a Federal or Non-Federal transaction as of September 30, 2008.

The specific findings and our recommendations related to our assessment procedures over selected funds' SBR line items considered material, to the DHS combined SBR were reported and agreed to with DHS component management and are displayed below in detail as applicable to each DHS component under the scope of this performance audit. Because of the limited scope of the procedures, all findings that could interfere with DHS management's ability to provide a representation that budgetary accounts, supporting the SBR, are fairly stated in accordance with U.S. generally accepted accounting principles may not have been identified.

United States Coast Guard

Finding: Statement of Budgetary Resources

Background: During the previous DHS consolidated financial statement audits, weaknesses were identified in recording transactions related to the commitments, obligations, undelivered orders, and disbursements. During FY 2008, USCG continued its remediation efforts over the financial reporting and budgetary processes. Although improvements were made, KPMG found that many of these prior years' conditions continue to exist and they are included in the condition below.

Condition: USCG has not designed or implemented effective policies, procedures, and internal controls, to support management's assertions associated with the statement of budgetary resources, including opening balances and topside adjustments. With regard to the financial statement assertions, KPMG identified the following:

1. USCG did not implement a sound methodology to establish accurate general ledger systems opening balances for fiscal year 2008. In an attempt to support their financial statements with the general ledger balances, USCG recorded mainly unsupported, summary-level topside adjustments into the Core Accounting System (CAS) prior to the FY 2007 system closes of CAS, the Aviation Logistics Management Information System (ALMIS), and the Naval Engineering Supply Support System (NESSS). The summary topside adjustments recorded into CAS included adjustments to account balances that should have been recorded in ALMIS and NESSS as well. USCG reversed the entries shortly after establishing the fiscal year 2008 opening balances, further calling into question the validity of the procedure itself. In addition, the CAS closing logic did not properly close the nominal accounts into the permanent accounts and establish proper beginning balances. USCG recorded topside journal entries to correct the closing logic deficiencies in the opening balance file submitted to DHS but did not correct the deficiencies in CAS, resulting in inaccurate opening system-level budgetary balances.

2. USCG has not developed and implemented an effective reconciliation process at the general ledger system level to ensure that each FY 2008 system's opening budgetary balances accurately reflect its FY 2007 closing balances. USCG's current reconciliation is performed at the USCG TIER database level and not at the individual general ledger system level; therefore, the reconciliation does not support the overall accuracy of the general ledger systems opening balances.

3. USCG has not fully developed and implemented procedures to validate the entire USCG UDO balance as of September 30, 2008. In addition, USCG did not timely record activity to its UDO balances, as they do not properly define a UDO. USCG only reduces a balance when a payment is made, rather than when goods/services are received/completed.

4. Based on a judgmental sample of 24 CAS, 25 ALMIS, and 32 NESSS UDO balances as of June 30, 2008, we identified the following:

CAS

a) Eleven sample items did not have proper supporting documentation to support the obligation and/or receipt of the goods/services. Therefore, KPMG could not assess if the UDO balance was properly classified, the accuracy of the dollar amount, and/or if the UDO balance was a USCG transaction.

b) Fourteen of the sixteen UDO balances greater than $0 were invalid, resulting in a net $2.1 million overstatement as of June 30, 2008.

c) The miscellaneous obligation document does not indicate when the obligation was incurred due to a system error.

d) The obligation purpose for one of the UDO balances in the amount of $1,000 was not appropriate per the authorizing legislation.

e) One of the sample items has remained recorded as a UDO since FY 1998 due to the CAS appropriation code. The 801 code was used in both FY 1998 and FY 2008 to record obligation and disbursement activity. Therefore, this UDO balance should have been de-obligated at the beginning of FY 2004. The risk exists that other FY 1998 UDO balances are included in the FY 2008 CAS UDO balances.

ALMIS

a) Four UDO balances were invalid, resulting in a $78,600 overstatement as of June 30, 2008.

b) The goods/services for one sample item were partially received/provided, and the UDO balance was not reduced accordingly. Therefore, the UDO balance was overstated by $434,581 as of June 30, 2008.

c) One UDO balance was recorded prior to the authorization of the obligating document. Therefore, the UDO balance was overstated by approximately $2,000 as of June 30, 2008.

NESSS

a) One sample item did not have proper supporting documentation to support the obligation and/or receipt of the goods/services. Therefore, KPMG could not assess if the UDO balance is properly classified, the accuracy of the dollar amount, and/or if the UDO balance is a USCG transaction.

b) Nine UDO balances were invalid, resulting in a $363,000 net overstatement as of June 30, 2008.

c) The process applied in calculating two UDO balances was not applied correctly and resulted in a net overstatement of $321,000. In addition, USCG has not re-evaluated the methodology in two decades; hence, the risk increases that the UDO balance is further inaccurately recorded.

d) The documentation provided for one of the sample items did not indicate when the obligation was incurred.

Additionally, USCG's general ledger accounting systems are not fully compliant with the United States Standard General Ledger (USSGL) requirements at the transaction level. USCG is recording on-top adjustments to the USCG TIER database to (1) eliminate proprietary to budgetary account imbalances without identification of a detailed cause, effect and required corrective action; (2) correct abnormal balances; and (3) correct posting logic deficiencies. These adjustments are not subsequently recorded into the applicable general ledger system to provide an audit trail to the transaction level. In addition, period-end and opening balances are only supported by the USCG TIER database and the three general ledgers do not support the financial statements, including the statement of budgetary resources. In addition, KPMG also noted the following conditions:

- USCG could not produce the CAS posting logic used during FY 2008. In addition, the ineffective processing and effects of scripts, programs or code run within CAS that affect financial data, precludes a complete evaluation of CAS posting logic. Based upon our limited review, the CAS posting logic is incorrect/inappropriate as follows:

  a) USCG inappropriately uses CAS account 4119 (Other Appropriations Realized) for trust fund activity. USCG corrects the inappropriate trust fund balances in account 4119 by subsequently recording unsupported 'ZADJ' on-top adjustments in the USCG TIER database. The adjustments transfer trust fund balances from account 4119 to account 4114, *Appropriated Trust or Special Fund Receipts*. In addition, these adjustments are not recorded into the CAS general ledger.

  b) The CAS posting logic does not properly reclassify expired budgetary balances into account 4650, *Allotments – Expired Authority*. CAS records current year activity to account 4610, *Allotments – Realized Resources*, regardless of whether the appropriation is expired or active, resulting in abnormal balances in account 4610.

- All appropriations received are recorded and maintained in CAS account 4119, *Other Appropriations Realized,* throughout the fiscal year. ALMIS and NESSS do not record the enactment and receipt of appropriated funds. Instead, the Inventory Control Points record only collection and disbursement activity in 1010, *Fund Balance with Treasury* (FBWT), accounts, and record the receipt of allotments from Finance Center by debiting account 4510, *Apportionments*, or its equivalent, and crediting account 4610, *Allotments – Realized Resources*, or its equivalent. This process results in abnormal balances in accounts 1010 and 4510.

- The NESSS Z-series of transaction codes are used to correct posting logic deficiencies and inappropriately adjust account balances. Specifically, transaction code ZAP48 is used to arbitrarily agree the NESSS FBWT balances (and the related budgetary balances) with the Department of Treasury's balances.

Because of the existence of posting logic deficiencies, USCG implemented procedures to perform analytical analysis of the CAS, ALMIS, NESSS, and Coast Guard Academy general ledger balances. However, USCG did not timely complete the general ledger system-level analytical reviews for September 30, 2008.

Criteria: Section 803(a) of FFMIA requires that Federal financial management systems comply with (1) Federal accounting standards, (2) Federal system requirements, and (3) the United States Government Standard General Ledger 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.

United States Standard General Ledger (USSGL) at the transaction level

OMB Circular A-127 requires application of the USSGL at the transaction level. It states that financial events shall be recorded by agencies throughout the financial management system by applying the requirements of the USSGL at the transaction level. Application of the USSGL at the transaction level means that the financial management systems will process transactions following the definitions and defined uses of the general ledger accounts as described for the USSGL. Also, compliance with the standard requires that supporting transactions details for USSGL accounts be readily available. That is, transaction detail supporting USSGL accounts shall be available in the financial management systems and directly traceable to specific USSGL account codes.

Further, as stated in the *Federal Financial Management System Requirements: Core Financial System Requirements (OFFM-NO-0106)*, OMB Circular A-127 requires that each agency establish and maintain a single integrated financial management system. Each agency must have an ongoing financial systems improvement planning process and perform periodic reviews of its financial system capabilities. In addition, each agency must maintain financial management system components that comply with uniform Federal account concepts and standards promulgated by the Federal Accounting Standards Advisory Board (FASAB) in its Statements of Federal Financial Accounting Standards (SFFAS), which constitute generally accepted accounting principles for the Federal Government. In addition, these requirements state that the agency's core financial system must provide automated functionality to maintain a chart of accounts consistent with the USSGL chart of accounts, including the proprietary, budgetary, and memorandum accounts; basic numbering structure, and account titles.

USSGL Treasury Financial Manual Part 1 FY 2008 Supplement, Section I requires that agencies must capture at the transaction level the compliance with USSGL policy and the desired result for proper reporting using the basic 4-digit USSGL account plus applicable attribute domain values (agencies may expand this numbering system to as many digits as necessary to accommodate agency-specific requirements).

Per the Office of Federal Financial Management *Core Financial System Requirements (CFSR),* all transactions to record financial events must post to the general ledger, regardless of the origin of the transaction. The CFSR also states that accounting transactions are to be segregated into accounting periods, and that necessary closing entries are created. With regard to closing entries, it requires that the accounting system: provide a year-end closing process that records USSGL prescribed closing entries in accounting periods separate from other accounting periods; perform multiple closings in a trial/test mode so that users can review the closing results, clear the closing entries and re-run the closing process for both "pre-closing" entries and "closing" entries; generate trial balances that support the review of the closing process run in trial/test mode; and, derive an accounting period's opening balances based on the prior accounting period's closing balances at the USSGL attribute level and maintaining the USSGL attribute information required to satisfy Federal Agencies' Centralized Trial-Balance System I and II, and Government Financial Reporting System reporting requirements in the opening balances.

The Treasury Financial Manual defines an undelivered order as "the amount of goods/service orders, which have not been actually or constructively received and for which amount have [or have not] been paid." Further, a delivered order is defined as "the amount accrued [or paid] for: (1) services performed by employees, contractors, vendors, and other government funds; (2) goods and tangible property received; and (3) programs for which no current service performance is required such as annuities, benefit payments, etc."

In implementing the GAO Standards for Internal Control in the Federal Government, management is responsible for developing the detailed policies, procedures, and practices to fit an agency's operations and to ensure that they are built into an integral part of operations. Internal controls should be clearly documented in management directives, administrative policies, or operating manuals and should be properly managed and maintained. Further, control activities include a wide range of diverse activities, such as reconciliations and the creation and maintenance of related records which provide evidence of execution of those activities as well as appropriate documentation.

Title 44 USC 3101 states that the head of each Federal agency shall make and preserve records containing adequate and proper documentation of essential transactions of the agency.

Effect: USCG's current process is not effective to produce accurate and complete budgetary financial information for submission to DHS resulting in potentially materially misstated DHS consolidated statement of budgetary resources. The USCG TIER account balances that support the financial statements and opening balances are not supported at a transaction level and do not agree to the general ledger systems account balances. Further, manual errors have gone undetected and system issues have not been identified and corrected timely that could affect prior periods as well as multiple accounts and financial statement line items.

Cause: USCG has not designed and implemented appropriate controls over the financial reporting process to ensure that (1) opening balances are accurate and reflected in the proper general ledger system and (2) topside adjustments are valid, complete, accurate, and recorded to the proper general ledger system. Because USCG has not designed a comprehensive, integrated accounting system to comply with the FFMIA system requirements and the USSGL at the transaction level, USCG created unsuccessful workaround solutions in preparing its financial statement data rather than determining and correcting the causes of system posting logic issues. In addition, USCG has not properly analyzed analytic out-of-balance conditions in its 3 general ledger systems to timely research and resolve these variances with proper supporting documentation. Further, USCG has not completed its remediation efforts over the UDO validation process, to include implementing properly designed and fully effective internal controls.

Recommendations: KPMG recommends that the USCG:

1. Conduct a detail review of the financial reporting process, including the topside adjustment process and the development of opening balances.
2. Identify risks and current conditions that preclude management from supporting the identified financial statement assertions associated with the statement of budgetary resources, including topside adjustments and opening balance development.
3. Determine the appropriate number of resources needed who demonstrate the appropriate skills and abilities to perform and manage an effective financial reporting process.
4. Make appropriate changes to systems and process/sub-process methodology, to include the design and implementation of internal controls, to mitigate the risks/conditions identified and ensure compliance with FFMIA requirements.
5. Test the controls to determine that they are designed properly and operating effectively.

To the extent relevant after completing the above steps, KPMG recommends that USCG:

1. Discontinue the use of the pre-2108 spreadsheets and the CG TIER database to record unsupported, topside adjustments. Re-evaluate the current process to develop policies, procedures, and internal controls to determine the cause of each topside adjustment in order to (1) record the adjustment into the proper general ledger system(s), i.e., CAS, NESSS, and ALMIS, (2) calculate the accurate adjustment amount, and (3) identify and maintain the proper documentation that supports the adjustment amount when recorded into the proper general ledger system.
2. Correct the CAS posting logic for closing the nominal accounts into the permanent accounts and establishing opening balances in the accounting system. Develop and implement an effective

reconciliation process at the general ledger system level to ensure that the current year opening balances accurately reflect the prior year closing balances and that these balances agree with the balances reported to DHS.

3. Develop and implement standardized, comprehensive procedures to validate and support the entire UDO balance reported on the USCG statement of budgetary resources.
4. Revise existing policies and procedures, using the appropriate UDO definition and source documentation, to ensure UDO activity is timely and accurately recorded and properly supported. The policies and procedures should include a complete documentation matrix.

Federal Emergency Management Agency

Finding: Untimely De-obligation of and Insufficient Documentation for Non-grant related Unliquidated Obligations within the Former Grants and Training

Background: Effective March 31, 2007, G&T's operations were transferred to FEMA because of the Post-Katrina Emergency Management Reform Act of 2006. Accordingly, certain responsibilities related to the program management of the former G&T operations and certain financial functions (i.e. payment processing) became the responsibility of the FEMA Finance Center under the Office of the Chief Financial Officer.

Condition: We tested 60 legacy G&T non-grant related ULOs as of June 30, 2008 and 90 G&T non-grant related ULOs as of September 30, 2008. During our test work, we determined the validity of the ULOs based on the end of the period of performance.

Our June 30, 2008 test work identified nine non-grant ULOs for which the ULO balance was not valid. Further, the non-grant files tested did not include any documentation to explain or support a delay in the de-obligation process.

During our September 30, 2008 test work, we were unable to obtain competent evidential matter to support the ULO balance of approximately $404 million related to the legacy G&T non-grant budget object codes.

Criteria: In accordance with US Code, Title 31 Section 1554: *Audit, control, and reporting,* "[a]fter the close of each fiscal year, the head of each agency shall submit to the President and the Secretary of the Treasury a report regarding the unliquidated obligations, unobligated balances, canceled balances, and adjustments made to appropriation accounts of that agency during the completed fiscal year… Each report required by this subsection shall… contain a certification by the head of the agency that the obligated balances in each appropriation account of the agency reflect proper existing obligations and that expenditures from the account since the preceding review were supported by a proper obligation of funds and otherwise were proper." Additionally, the regulation requires that "[t]he head of each agency shall establish internal controls to assure that an adequate review of obligated balances is performed."

Effect: FEMA is not performing timely de-obligations of the legacy G&T non-grant ULOs, which could cause an overstatement of ULOs; our June 30th testing resulted in a known overstatement of $17,863,266 and a most likely overstatement of $39,235,027. Additionally, we were unable to complete audit procedures over legacy G&T non-grant ULOs of approximately $404 million as of September 30, 2008.

Cause: As of our test date, management had not effectively implemented policies and procedures to timely de-obligated the amounts in question due to a lack of resources and commitment to other activities.

When legacy G&T operations were absorbed by FEMA in April 2007, no clear lines of responsibility were assigned for the care and maintenance of documentation necessary to support legacy G&T non-grant ULOs.

Recommendation: We recommend that FEMA formalize its document retention policies in support of its review policies and procedures over outstanding ULO balances, including those formerly in G&T, and maintain documents in a manner that will allow them to be readily available for management and audit review.

Finding: Untimely Deobligation of Mission Assignments

Background: In emergency situations where the level of work is beyond the scope of the state and local authorities in which the disaster occurs, it is the responsibility of FEMA, to act as the lead agency to coordinate disaster relief efforts. FEMA uses mission assignments (MAs) to task the appropriate agencies that have the specialized skills or the agencies that can more timely access and /or provide resources to aid in the relief effort as described in the *National Response Framework*, released on January 22, 2008. The conditions below reflect two NFRs, reflecting the results of test work performed as of March 31, 2008 and the second one based on test work performed as of June 30, 2008 and September 30, 2008.

Conditions: FEMA does not have adequately designed controls to ensure sufficient monitoring and timely deobligation and closeout of MAs. During our substantive test work over MA ULO balances as of March 31, 2008, we identified the following:

- 20 of the 60 applicable MA substantive test sample items were past the projected end-date and had no documented activity within the past 90 days. Half (10) of these MAs were closed in the subsequent FY 2008 quarter without additional payment activity. Four of the 20 aforementioned MAs were subsequently closed without any payment activity since inception (including one that dated September 30, 2007). The average number of days without activity since the projected end date was greater than 600 days for the 20 identified exceptions. Additionally, all of these exceptions lacked information in the file sufficient to conclude that the obligation was valid as of March 31, 2008 and should remain open.

During our substantive test work over MA ULO balances as of June 30 and September 30, 2008, we identified the following:

- 17 of the 85 MA sample items tested as of June 30, 2008 were past the projected end date and had no activity within the prior 90 days. 10 of the 17 noted as invalid at June 30, 2008 were subsequently closed in the 4th quarter of FY 2008. The average number of days without activity since the projected end date was 788 days for the 17 identified exceptions. Additionally, all of these exceptions lacked information in the file sufficient for a reasonable person to conclude that the obligation was valid as of June 30, 2008 and should remain open.
- Seven of the 151 MA sample items tested as of September 30, 2008 (85, roll forward samples and 66 new samples) were past the projected end-date and had no activity over the past 90 days. The average number of days without activity since the projected end date was 738 days for the seven identified exceptions.

Criteria: FEMA's Standard Operating Procedure for *Processing Mission Assignment and Interagency Payments for Fund Code 06*, April 2007, establishes the process for MA closeouts. The quarterly review of ULOs lists all MA obligations with an available balance. The Financial Information Analyst or Accountant reviews the MA report or *Mission Assignment Financial Information Tool Report* and other internal records to track activity against the obligation. If no activity has been recorded within the last 90 days, the FEMA Finance Center's payment and finance group initiates the closeout process, by sending the quarterly ULO report to the Region or Headquarters MA Coordinator for action. Note: FEMA drafted new interim guidance procedures in FY 2008; however, the draft was not approved and applicable as of the March 31, 2008.

The FEMA Form 90-129 (Mission Assignment agreement) states in the description of work that the Other Federal Agency (OFA) is responsible for submitting a Mission Assignment Monthly Progress Report to FEMA to include cost data when MAs take more than 60 days to complete, including billing.

According to the *Standards for Internal Control in the Federal Government* (Standards) issued by the Government Accountability Office: (Accurate and Timely Recording of Transactions and Events), "Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records." The Standards further state that, "control activities help to ensure that all transactions are completely and accurately recorded."

Per OMB Circular No. A-11, *Preparation and Submission of Budget Estimates,* section 20.5, "Obligation means a legally binding agreement that will result in outlays, immediately or in the future."

Effect: Errors were identified in the March 31, 2008 MA ULO statistical sample items resulting in a known overstatement in undelivered orders of $183,474,856. The projected most likely overstatement based on the statistical sample was $540,706,896. Errors were also identified in the June 30, 2008 and September 30, 2008 MA ULO statistical sample items resulting in a known overstatement in undelivered orders of $97,689,667. The projected most likely overstatement based on the statistical sample was $168,841,404. The resources restricted for these obligations could be applied to other current or future disaster relief needs.

Cause: FEMA continues to be unable to allocate sufficient resources to implement and perform effective review procedures over MA ULOs. Other Federal Agencies (OFAs) did not always provide FEMA with timely progress reports that included sufficient cost/billing data, nor did they timely respond to validation requests. Sufficient documentary evidence was not obtained and/or documented timely for Mission Assignment Manager follow-up procedures with the OFAs. Clarity of roles, authority and responsibilities also seems to contribute to FEMA not being able to solicit timely information from OFA.

Recommendations: We recommend that the FEMA Finance Center in concert with Regional staff:

- Finalize the development and implementation of documented MA policies and procedures that at a minimum includes the following:
  - Defines the roles and responsibilities of all emergency management and support participants to include (FEMA Finance Center (FFC) staff, Regional Office (RO) Staff, and OFA.
  - Establishes timelines for FFC, RO and OFA monitoring and follow-up response activity.
  - Documents quarterly verification and validation procedures including rationale for validating inactive MAs.

- Enforce the requirement that all OFAs submit not only a progress report when the MA takes more than 60 days to complete, but also a progress report every additional 30 days that the project remains either programmatically or financially incomplete. The report should include an estimated completion date and, when applicable, Form 90-136 should be submitted for extension of the projected end-date whenever the estimate for programmatic completion is more than 30 days.
- Ensure that personnel within FFC continue to perform the quarterly review and require the Regions to follow the established policy for quarterly obligation reviews each quarter to timely determine whether the remaining balance on a MA is valid, or whether a deobligation of the remaining balance is necessary.

Finding: Insufficient Documentation for Fund 5 (the National Flood Insurance Program (NFIP)) Revenues Generated from the Sale of Flood Maps and Recorded in SGL 4266 '*Other Actual Business-Type Collections from Non-Federal Sources'*

Background: The Mitigation Division of FEMA manages the National Flood Insurance Program. Flood maps are available for purchase by individuals, businesses, or professionals through the FEMA Map Service Center (MSC), which is the official government distribution center for the maps. The revenues generated from the sale of the flood maps are recorded in the FEMA financial statements, including the statement of budgetary resources, and reported on Line 3D1a '*Spending Authority from Offsetting Collections, Earned, Collected'* of the SBR.

Conditions: While performing procedures over the statement of budgetary resources as of June 30, 2008, for Line 3D1a '*Spending Authority from Offsetting Collections, Earned, Collected*', KPMG was unable to obtain supporting documentation for three out of the five sample items selected for test work to evidence the amount recorded in the FEMA June 30, 2008 general ledger for Fund 5 (NFIP) in SGL 4266 *Other Actual Business-Type Collections from Non-Federal Sources*.

Criteria: The GAO's *Standards for Internal Control in the Federal Government* (the Standards), states, "Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. All documentation and records should be properly managed and maintained."

Effect: As of June 30, 2008, the date of our test work, FEMA is unable to verify the accuracy, validity and existence of approximately $7.1 million specifically related to flood map sales out of a total line item balance of $2.1 billion for Fund 5 (NFIP) recorded in SGL 4266, *Other Actual Business-Type Collections from Non-Federal Sources'* and reported on SBR Line 3D1a.

Cause: FEMA does not maintain readily available, sufficient documentation of its revenues generated from the sale of flood maps for Fund 5 (NFIP).

Upon further inquiry, we identified that FEMA is currently not performing a general ledger reconciliation of NFIP revenues and related budgetary resources generated from the sale of flood maps.

Recommendations: We recommend that FEMA's Mitigation Division develop and implement policies and procedures that require documentation be maintained relating to the revenues generated from the sale of flood maps.

Additionally, we recommend that FEMA's Office of the Chief Financial Officer perform a general ledger reconciliation of NFIP revenues and related budgetary resources generated from the sale of flood maps.

Transportation Security Administration

Finding: Undelivered Orders Procedures/Documentation

Background: When TSA awards a contract, grant or executes an order for supplies or services, an obligation is created. The contract or award will list the period of performance, amount of the obligation and the purpose. After the period of performance expires, the closeout process begins and excess funds are deobligated. When an obligation is created for employee travel, an employee (or their delegate) enters a travel authorization into Travel Expense Management Service (TSERV). The travel authorization must be signed, approved and certified prior to being data linked (entered into the Core Accounting System (CAS)). The TSA travel policy requires travel authorizations to be data linked prior to the occurrence of travel.

Conditions: TSA lacks sufficient internal controls to ensure contract management policies and procedures are being followed. Specifically, we noted the following instances where contract management policies and procedures failed:

- 2 instances the period of performance of the obligation was not extended until after the expiration of the original period of performance
- 3 instance of an expenditure's billing period extending beyond or outside the period of performance of the obligation
- 1 instance of an untimely deobligation related to a contract whose period of performance had expired over 6 months earlier

Proper adherence to the travel policy did not occur in all instances. Specifically we noted 36 instances where a travel authorization was not recorded prior to travel.

Criteria: *OMB Circular A-123, Management's Responsibility for Internal Control* states that, "As agencies develop and execute strategies for implementing or reengineering agency programs and operations, they should design management structures that help ensure accountability for results. As part of this process, agencies and individual Federal managers must take systematic and proactive measures to develop and implement appropriate, cost-effective internal control. The degree to which studies and analysis are performed will vary depending on the complexity and risk associated with a given program or operation."

OMB Circular A-87, Cost Principles for State, Local, and Indian Tribal Governments, states that pre-award costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the written approval of the awarding agency.

Statement of Federal Financial Accounting Standards No.7, Accounting for Revenue and Other Financing Sources, paragraph 79, states that the status of budgetary resources should disclose the amount of budgetary resources obligated for undelivered orders at the end of the period.

U.S.C. Title 31 Chap 15, Sec. 1554, Audit, control and reporting states, "The head of each agency shall establish internal controls to assure that an adequate review of obligated balances is performed to support the certification required by section 1108(c) of this tile."

GAO, *Principles of Federal Appropriations Law*, (GAO-06-382SP, pp7-3, 7-4 and 7-50), defines an obligation in very general term as an, "action that creates a legal liability or definite commitment on the part of the government, or creates a legal duty that could mature into a legal liability by virtue of an action that is beyond the control of the government. Payment may be made immediately or in the future."

"The issuance of a travel order in itself does not constitute a contractual obligation. The travel order is merely an authorization for the person specified to incur the obligation. The obligation is not incurred until the travel is actually performed or until a ticket is purchased, provided in the latter case the travel is to be performed in the same fiscal year the ticket is purchased."

Effect: TSA's undelivered orders balance and related expenditures may be misstated due to improper contract management and inconsistent application of established procedures.

Cause: TSA initiated corrective actions in fiscal year 2008 to address contract management issues identified in previous years, however, their corrective measures were not fully implemented.

Recommendations: We recommend that TSA:

a) Implement sufficient policies and procedures to include internal controls (e.g. management review) to ensure that contract management policies and procedures are being followed.

b) Implement sufficient policies and procedures to include internal controls (e.g. management review) to ensure that travel policies and procedures are being followed.

Finding: Incorrect classification of Obligations as Federal or Non-Federal

Background: When an obligation is entered into the CAS several pieces of information are required, including the document identification number, the purchase request number, the invoice number, the name of the vendor, and the vendor type. The vendor type must be designated as NONGOV (Non-Fed), Employee or OSDOT (Federal). This designation is made by selecting one of the three options from a drop-down menu. The default designation is NONGOV. In addition, once an obligation is designated as OSDOT (Federal), a federal trading partner code must be entered to ensure that TSA is able to identify, summarize, reconcile and report trading partner information in accordance with the Intragovernmental Business Rules.

Condition: Proper vendor type coding of obligations did not occur in all instances. Specifically, we noted the following 6 of 225 obligation samples, as of September 30, 2008, with a federal vendor and a corresponding vendor type of NONGOV:

- Department of Homeland Security (2)
- US Department of Transportation Administrative Service Center
- General Services Administration (2)
- Department of State

As a result, these Federal transactions lacked the federal trading partner codes necessary for TSA to identify, summarize, reconcile and report trading partner information in accordance with the Intragovernmental Business Rules.

Criteria: OMB Circular No. A-136, *Financial Reporting Requirements*, requires quarterly reconciliation of intragovernmental transactions and submission of intragovernmental balances by trading partner.

Treasury Financial Manual (TFM) Volume 1, Part 2, Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government*, requires reporting agencies to reconcile/confirm intragovernmental activity and balances quarterly for specific reciprocal groupings.

Department of the Treasury Financial Management Service Memorandum M 07-03, dated November 13, 2006, provides guidance to federal agencies for standardizing the processing and recording of intragovernmental activities. Treasury has revised the Intragovernmental Business Rules [TFM, Volume 1, Bulletin 2007-03] to be observed when engaging in intragovernmental exchange activity, fiduciary transactions, and transfers between Federal entities. TFM Bulletin 2007-03 requires:

- The use of the U.S. Treasury's IPAC System by trading partners as the primary system to settle intragovernmental exchange transactions; and, specifically states that if other systems are used to settle intragovernmental transactions, the Rules still apply.
- The inclusion of indicative data on the associated order so that the Seller's performance data regarding the delivery of goods and services and bills can be efficiently matched to the Buyer's order.
- The reporting of intragovernmental transactions by trading partners using the correct/appropriate USSGL account number and correct partner codes as prescribed by the TFM. "Default" coding is not allowed.
- Buyer's accounting system to capture all the detailed transactions associated with the order (e.g., obligations, expenses, payables, and disbursements) for the life of the order.
- Partners to specify certain information in the settlement or performance transaction, along with other indicative data to facilitate reconciliation of intragovernmental reciprocal accounts.

Effect: TSA's federal accounts payable accrual and related expenses may be misclassified due to improper exclusion of federal obligations as the federal accounts payable accrual is partially based on the federal undelivered order balance. Furthermore, if Federal transactions lack federal trading partner codes, TSA is unable to identify, summarize, reconcile and report trading partner information in accordance with the Intragovernmental Business Rules.

Cause: Lack of training or understanding of the nature of the obligation at the coding stage of the recording process.

Recommendation: We recommend that TSA train individuals to ensure proper vendor type coding occurs in all instances.

MANAGEMENT RESPONSE TO REPORT

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

Homeland Security

April 30, 2009

MEMORANDUM FOR: Anne Richards
Assistant Inspector General for Audits

FROM: Larry Bedker
Director, DHS Office of Financial Management

SUBJECT: *Draft Report: Independent Auditor's Report on Auditability Assessment of the Department of Homeland Security's Statement of Budgetary Resources*

Thank you for the opportunity to comment on the *Draft Report: Independent Auditor's Report on Auditability Assessment of the Department of Homeland Security's Statement of Budgetary Resources*. We concur with the report's recommendations and are currently incorporating the audit results into our Mission Action Plans. We appreciate your office's contributions and assessment, and we look forward to working with you as we implement our corrective actions and improve financial reporting to comply with the *DHS Financial Accountability Act.*

Report Distribution

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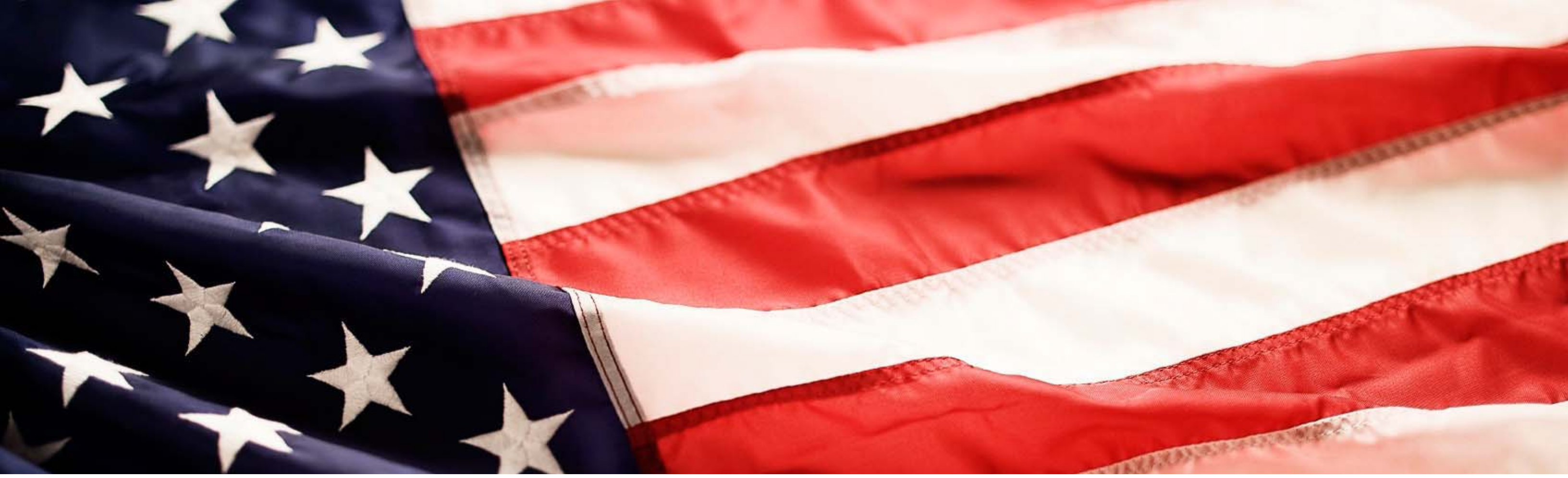

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