

DEPARTMENT OF HOMELAND SECURITY
Office of Inspector General

**Agreed-upon Procedures on DHS’
3rd Quarter Intragovernmental
Activity and Balances**



OIG-07-78

September 2007



KPMG LLP
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Washington, DC 20036

Independent Accountants' Report
on Applying Agreed-upon Procedures

Chief Financial Officer and Inspector General
U.S. Department of Homeland Security:

We have performed the procedures enumerated below, which were agreed to by the Office of the Inspector General, within the Department of Homeland Security (DHS or Department) and the U.S. Department of the Treasury (Treasury), solely to assist Treasury in evaluating the Department's assertion that it properly reported intragovernmental activity and balances in the Department's "F" Transactions File that was submitted to Treasury's Financial Management Service (FMS) as of and for the period ended June 30, 2007. The Department is responsible for reporting the intragovernmental activity and balances of DHS as of and for the period ended June 30, 2007. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants (AICPA). The sufficiency of these procedures is solely the responsibility of the Department and Treasury. Consequently, we make no representation regarding the sufficiency of the procedures described below, either for the purpose for which this report has been requested or for any other purpose.

The procedures we performed and the associated results are as follows:

1. Inspect the Department's policy and procedures and note whether the agency policy and procedures contain:
 - a) Submitting the "F" Transactions File to FMS by the due date as prescribed in the Federal Intragovernmental Transactions Accounting Policies Guide, Appendix F;
 - b) Performing a review of the Material Differences Report received from FMS, and completing the form by placing an "X" in columns 1-6 indicating the reason for reporting or adjustment, including providing explanations to further explain the basis for conclusions;
 - c) Preparation of a Reconciliation Schedule supporting conclusions reached in b. above;
 - d) Review and certification of the Material Differences Report by someone other than the preparer, e.g., CFO or Designee;
 - e) Timely submission of the completed Material Differences Report to FMS;
 - f) Investigation of (i) material differences listed in column 5 of the Material Differences Report and (ii) differences in trading partner explanations provided in the IRAS - Comparative Status of Disposition Report;
 - g) Direct communications with trading partners to resolve differences noted in f(i) and f(ii) above; and
 - h) Documentation of an action plan for resolution based on trading partner communications in f. above.

Results

Inspected the Department's Standard Operating Procedures for Financial Reporting - §19, *Intragovernmental Requirements*, dated August 1, 2007, and noted that such document contained procedures for the following:



- a) Submitting the "F" Transactions File to FMS by the due date as prescribed in the Federal Intragovernmental Transactions Accounting Policies Guide, Appendix F;
 - b) Performing a review of the Material Differences Report received from FMS, and completing the form by placing an "X" in columns 1–6 indicating the reason for reporting or adjustment, including providing explanations to further explain the basis for conclusions;
 - c) Preparation of a Reconciliation Schedule supporting conclusions reached in b. above;
 - d) Review and certification of the Material Differences Report by someone other than the preparer, e.g., CFO or Designee;
 - e) Timely submission of the completed Material Differences Report to FMS;
 - f) Investigation of (i) material differences listed in column 5 of the Material Differences Report and (ii) differences in trading partner explanations provided in the IRAS – Comparative Status of Disposition Report;
 - g) Direct communications with trading partners to resolve differences noted in f(i) and f(ii) above; and
 - h) Documentation of an action plan for resolution based on trading partner communications in f. above.
2. If agency-wide or Departmental written policies and procedures do not exist, inspect the agency's component policy and procedures and note whether the component policy and procedures contain the elements discussed in procedure 1 above.

Results

We did not perform this procedure because the Department has Departmental written policies and procedures that contain the elements discussed in procedure 1 above.

3. Inspect the agency reconciliation for June 30, 2007 and note whether the reconciliation indicates that the "F" Transactions File was submitted to FMS by the most recent required due date. If the reconciliation was submitted subsequent to the due date, indicate the date submitted and obtain from management a written explanation for the late submission.

Results

Inspected the electronic message from the Department to FMS that included the U.S. Department of Homeland Security's 3rd Quarter 2007 Federal Transactions file and noted that the electronic message was submitted to FMS on July 24, 2007, which is on the date required in accordance with the *Treasury Financial Manual Transmittal Letter No. 637 – Volume I*.

4. (a) Inspect the *Material Difference/Status of Disposition Report Fiscal Year: '2007' Quarter '3'* and identify the differences with trading partner 96, United States Army Corps of Engineers (Corps), listed in the column titled "Amount – Material Difference" of the *Material Difference/Status of Disposition Report Fiscal Year: '2007' Quarter '3'*. For each trading partner identified, inspect communication documents from the agency to its trading partners indicating that the agency has discussed the differences with its trading partners.

(b) Obtain the agency's written response on the outcome or status of communications discussed in the step above and include the agency's response in the report.

Results

(a) Inspected the Department's *Material Difference/Status of Disposition Report Fiscal Year: '2007' Quarter '3'* and noted that the differences listed in the column titled "Amount – Material Difference" of the *Material Difference/Status of Disposition Report Fiscal Year: '2007' Quarter '3'* for trading partner 96, the Corps, were \$728,425,453 for reciprocal category 22 and \$754,890,034 for reciprocal category 24. Inspected the Summary of Efforts to



Reconcile Material Differences (Reconciliation Schedule) prepared by the Department for the quarter ended June 30, 2007, and identified a notation on the schedule indicating the Department contacted the Corps by telephone and requested supporting documentation.

- (b) Obtained the Department's response on the status of the communication discussed in the step above, as of August 7, 2007, and included the Department's response as follows: "[We] requested supporting documentation for the activity [the Corps] reported against DHS. [The Corps] was not able to provide their supporting documentation in a timely manner to begin a reconciliation effort between the two agencies."
5. (a) Inspect the *Intragovernmental Reporting & Analysis System – Comparative Status of Disposition Report – 3rd Quarter 2007* and note whether evidence exists that the agency contacted trading partner 96, United States Army Corps of Engineers, to investigate differences in the column titled "Explanation(s)" of the *Intragovernmental Reporting & Analysis System – Comparative Status of Disposition Report – 3rd Quarter 2007*.
- (b) Obtain the agency's written response on the outcome or status of communications discussed in the step above and include the agency's response as an attachment to the report.

Results

- (a) Inspected the Department's *Intragovernmental Reporting & Analysis System – Comparative Status of Disposition Report – 3rd Quarter 2007* and noted that trading partner 96, the Corps', explanation in the column titled "Explanation(s)" of the *Intragovernmental Reporting & Analysis System – Comparative Status of Disposition Report – 3rd Quarter 2007* was "Confirmed Reporting" for reciprocal categories 22 and 24, while the Department's explanation was "Unknown." Inspected the Reconciliation Schedule prepared by the Department for the quarter ended June 30, 2007, and identified a notation on the schedule indicating the Department contacted the Corps by telephone and requested supporting documentation.
 - (b) Obtained the Department's response on the status of the communication discussed in the step above, and included the Department's response as follows: "[We] requested supporting documentation for the activity [the Corps] reported against DHS. [The Corps] was not able to provide their supporting documentation in a timely manner to begin a reconciliation effort between the two agencies. As such, the difference was explained by DHS as unknown."
6. Inspect the agency's written action plans and note whether the action plans contain procedures that the agency plans to perform by September 30, 2007 for the amount in the column titled "Amount – Material Difference" relating to trading partner 96, United States Army Corps of Engineers in the Department's *Material Difference/Status of Disposition Report Fiscal Year: '2007' Quarter '3'* and for the explanation in the column titled "Explanation(s)" of the *Intragovernmental Reporting & Analysis System – Comparative Status of Disposition Report – 3rd Quarter 2007*.

Results

We did not perform this procedure because the Department has not completed a formal action plan to address amounts in the column titled "Amount – Material Difference" in the Department's *Material Difference/Status of Disposition Report Fiscal Year: '2007' Quarter '3'* and explanations in the column titled "Explanation(s)" in the *Intragovernmental Reporting & Analysis System – Comparative Status of Disposition Report – 3rd Quarter 2007*.



7. (a) Inspect the agency's A-123 assessment of the intragovernmental reconciliation process and note whether it contained any material weaknesses, reportable conditions, significant deficiencies, or management comments.
- (b) Inspect the agency's A-123 assessment of the intragovernmental reconciliation process and note whether it contains a corrective action plan for any material weaknesses, reportable conditions, significant deficiencies, or management comments identified in the step above.
- (c) Inspect the agency's A-123 assessment of the intragovernmental reconciliation process and note whether it contains a targeted correction date for the action plans identified in the step above. Attach a copy of the agency's A-123 assessment report and corrective action plan to this agreed-upon procedures report.
- (d) If the agency did not perform an A-123 assessment of the intragovernmental reconciliation process, obtain the agency's A-123 assessment work plan. Inspect the agency's A-123 assessment work plan and note whether the A-123 assessment of the intragovernmental reconciliation process is scheduled.

Results

- (a), (b), and (c) We did not perform these procedures because the Department has not completed an A-123 assessment of its intragovernmental reconciliation process. As a result, we were unable to attach a copy of the Department's A-123 assessment report and corrective action plan to this agreed-upon procedures report.
 - (d) Inspected the Department's A-123 assessment work plan and noted the Department has a multiyear plan for compliance with OMB Circular A-123 dated July 18, 2006. The plan presents the Department's plans to substantially remediate the weaknesses related to intragovernmental balances during FY 2007 and perform an A-123 assessment in support of the Secretary's assurance statement during FY 2008. We examined an electronic communication dated October 3, 2006, that indicated OMB's approval of the plan.
8. (a) Inspect the agency's FY 2006 auditors' report and related FY 2006 management letter and note whether the auditors' report or management letter contain any material weaknesses, reportable conditions, or management letter comments on intragovernmental reconciliation activities.
 - (b) If the agency's FY 2006 auditors' report and related FY 2006 management letter contain any material weaknesses, reportable conditions, or management letter comments on intragovernmental reconciliation activities, list the weakness and associated recommendations.
 - (c) Inspect the agency's corrective action plan for material weaknesses, reportable conditions, or management letter comments on intragovernmental reconciliation activities identified in the step above, and note whether the corrective action plan contains a targeted correction date for each finding. Attach a copy of the agency's FY 2006 auditors' report and related FY 2006 management letter findings related to intragovernmental reconciliation activities and related corrective action plan to this agreed-upon procedures report.

Results

- (a) Inspected the Department's FY 2006 independent auditors' report, dated November 15, 2006, on the Department's consolidated balance sheet and the related statement of custodial activity. The FY 2006 independent auditor's report contained a material weakness related to intragovernmental reconciliation activities. Inspected the Department's draft management



letter, dated December 15, 2006, and noted it did not include any findings on intragovernmental reconciliation activities.

- (b) Exhibit I, *Material Weaknesses in Internal Control*, to the FY 2006 independent auditors' report addresses the material weakness related to the intragovernmental reconciliation process. See Attachment I to this agreed-upon procedures report for the portion of Exhibit I of the FY 2006 independent auditors' report related to the material weakness.
- (c) Inspected Department's Intragovernmental Balances Corrective Action Plan developed to address the findings reported in the FY 2006 independent auditors' report and noted the Corrective Action Plan has a targeted correction date of June 30, 2008.

We were not engaged to, and did not, conduct an examination, the objective of which would be the expression of an opinion on any of the intragovernmental activity and balances reported in the Department's "F" Transaction File that was submitted to FMS as of and for the period ended June 30, 2007, and management's explanations related to the findings in the agreed-upon procedures report. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Department's Office of Inspector General, the Department, and Treasury, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

September 21, 2007

Attachment I

This attachment is an excerpt from Exhibit I of the Department of Homeland Security's (Department) fiscal year 2006 independent auditors' report, dated November 15, 2006, on the Department's consolidated balance sheet and the related statement of custodial activity. This attachment presents the portion of Exhibit I related to the Department's material weakness over intragovernmental balances.

J. Intragovernmental Balances

Background: DHS conducts business with other Federal agencies resulting in intragovernmental receivables, payables, and the reporting of revenues, expenses and transfers from intragovernmental transactions. Federal accounting and reporting regulations require Federal agencies to routinely identify and reconcile intragovernmental balances and transactions with trading partners. These procedures help ensure that intragovernmental balances properly eliminate in the government-wide financial statements.

Conditions: In fiscal year 2005, we reported that DHS did not timely or completely reconcile intragovernmental balances with other Federal entities, particularly the DoD. Consequently, the DHS' *Material Difference/Status of Disposition Certification Report*, submitted to Treasury for September 30, 2005, showed material differences attributable to accounting/reporting errors in excess of \$1.6 billion. These conditions also impacted DHS' ability to accurately report transactions with Federal government trading partners in the financial statements and in the Required Supplementary Information section of the financial statements, as required.

During fiscal year 2006, we noted that DHS did not take action to correct the conditions reported in 2005. OFM has not been able to reconcile intragovernmental asset, liability, and revenue amounts with trading partners, as required by OMB Circular No. A-136, as follows:

- OFM did not coordinate a DHS-wide reconciliation throughout the year of all intragovernmental balances. We noted that DHS, in cooperation with its components, has not developed and adopted effective policies and procedures, or established systems, to completely track, confirm, and reconcile intragovernmental balances and/or transactions with trading partners in a timely manner, which contributed to the material differences, cited below in 2006.
- The *Material Differences Reports* submitted to Treasury identified accounting/reporting errors of approximately \$1.4 billion in both the first and second quarter 2006. These differences were primarily related to activity with the following trading partners: 96-U.S. Army Corps of Engineers and 97-Office of the Secretary of Defense-Defense Agencies. These differences were not fully reconciled/resolved by the following quarter.
- The third quarter *Material Differences Reports* submitted to Treasury identified approximately \$25.4 billion in material differences with trading partners, of which DHS indicated \$25.3 billion related to accounting/reporting errors. Upon investigation, OFM indicated that incorrect data was transmitted to Treasury and resulted in a substantial amount of the errors in the report. OFM has not been able to determine the cause of this incorrect file submission. We also note that as the third quarter Treasury *Material Differences Report* was based on erroneous information, additional trading partner differences may have been identified if accurate information had been provided to Treasury.

Cause/Effect: A lack of resources, and decisions by management to defer corrective action, lead to the lack of reconciliation of intragovernmental differences. OFM's corrective action plan indicates that these conditions will not be fully remediated until fiscal year 2008. Reconciling trading partner activity and balances at least quarterly is necessary to identify material out-of-balance conditions between Federal entities and to support an accurate consolidation of DHS and the Government-wide financial statements.

Criteria: The *Treasury Federal Intragovernmental Transactions Accounting Policies Guide*, dated August 18, 2006 (TFITAPG) states that OMB Circular No. A-136, requires Federal CFO Act and non-CFO Act entities identified in the Treasury Financial Manual 2006, Vol. I, Part 2- Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government*, perform quarterly reconciliations of intragovernmental activity/balances.

Per the TFITAPG, each quarter of Federal agencies are responsible for:

- Establishing and maintaining a structure for intragovernmental transactions (initiating, executing, recording, reconciling, and reporting procedures).
- Documenting and supporting the information recorded in the accounting records related to intragovernmental transactions.
- Recording activity between Federal entities at the transaction level.
- Providing intragovernmental balances (“F” transactions) for all proprietary USSGL accounts to FMS each quarter.
- Reconciling the intragovernmental data in the accounting records to the supporting documentation based on FMS IRAS Reports.
- Representing that all intragovernmental balances have been reconciled and that those balances are presented in the agency’s audited financial statements as instructed by OMB Circular No. A-136.
- Establishing a consistent relationship with their trading partners in order to identify and resolve differences.

The *Treasury Financial Management Service Memorandum M-03-01*, dated October 4, 2002, provides guidance to Federal agencies for standardizing the processing and recording of intragovernmental activities. The *Treasury Federal Intragovernmental Transactions Accounting Policies Guide*, dated October 23, 2002, requires quarterly reconciliation of intragovernmental asset, liability, and revenue amounts with trading partners. Further, the TFM, Section 4706, *Intragovernmental Activity/Balances*, requires reporting agencies to reconcile and confirm intragovernmental activity and balances quarterly for specific reciprocal groupings. It also requires agency financial statements to be presented on a consolidated basis, including the elimination of significant intradepartmental transactions and balances for reporting purposes.

Recommendation:

1. We recommend that DHS OFM
 - a) Develop a Department-wide policy that requires the reconciliation of intragovernmental balances with trading partners in accordance with Treasury requirements;
 - b) Establish a formal documented review and approval process over reconciliation activities performed by OFM to ensure that all intragovernmental balances are identified and differences are being resolved in a timely manner. Procedures should also include obtaining positive confirmation of balances with DHS trading partners;
 - c) Establish a relationship/point of contact with senior management of every trading partner to facilitate the resolution of differences on an on-going basis. For example, perform pro-active reconciliation discussions with trading partners prior to the quarterly submissions of intragovernmental balances to Treasury;
 - d) Review the processes/logic used to generate the “F” transactions report and develop controls to ensure correct data is sent to FMS every quarter; and

- e) Develop a correction action plan that will correct the conditions in fiscal year 2007.
2. We recommend that DHS OFM, develop and implement procedures to positively confirm and reconcile, at least on a quarterly basis, all intragovernmental activity and balances with their intragovernmental trading partners, including DHS component entities, as prescribed by Treasury guidance.

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