

DEPARTMENT OF HOMELAND SECURITY
Office of Inspector General

**Management Letter for the
FY 2006 FLETC Balance Sheet**





Homeland
Security

October 16, 2007

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 published by our office as part of our oversight responsibility to promote economy, efficiency, and effectiveness within the department.

This report presents the management letter for FLETC's FY 2006 balance sheet audit. It contains observations and recommendations related to internal controls that were not required to be reported in the balance sheet report. The independent public accounting firm KPMG LLP (KPMG) performed the audit of FLETC's FY 2006 balance sheet and prepared this management letter. Material weaknesses and other reportable conditions were reported, as required, in KPMG's *Independent Auditor's Report*, dated December 8, 2006, that was included in the FY 2006 FLETC *Performance and Accountability Report*. KPMG is responsible for the attached management letter dated December 31, 2006, and the conclusions expressed in it. We do not express opinions on FLETC's balance sheet or internal control or conclusions on compliance with laws and regulations.

The recommendations have been developed to the best knowledge available to the OIG, and have been discussed in draft with those responsible for implementation. It is our hope that this report will result in more effective, efficient, and economical operations. We express our appreciation to all of those who contributed to the preparation of this report.

A handwritten signature in cursive script that reads "Richard L. Skinner".

Richard L. Skinner
Inspector General



KPMG LLP
2001 M Street, NW
Washington, DC 20036

Inspector General
U.S. Department of Homeland Security

Director
The Federal Law Enforcement Training Center

December 31, 2006

Ladies and Gentlemen:

We have audited the consolidated balance sheet of the U.S. Department of Homeland Security's (DHS) Federal Law Enforcement Training Center (FLETC) as of September 30, 2006 (referred to herein as "balance sheet") and have issued our report thereon dated December 8, 2006. In planning and performing our audit of the balance sheet of FLETC, we considered internal control as a basis for designing our auditing procedures for the purpose of expressing our opinion on the balance sheet but not for the purpose of expressing an opinion on the effectiveness of FLETC's internal control. Accordingly, we do not express an opinion on the effectiveness of FLETC's internal control.

Our audit of the balance sheet of FLETC as of September 30, 2006 disclosed the following material weaknesses, reportable conditions, and instances of compliance and other matters that are described in our auditors' report dated December 8, 2006:

Material Weakness

- A. Financial Reporting
- B. Environmental Cleanup Costs
- C. Capital Lease Liabilities
- D. Valuation of Inventories
- E. Construction in Progress
- F. Accounts Payable

Reportable Conditions

- G. Deferred Revenue
- H. Financial Systems Security



Compliance and Other Matters

- I. Federal Financial Management Improvement Act of 1996 (FFMIA)
- J. Prompt Payment Act (PPA)

We also reported other matters related to compliance with the *Anti-Deficiency Act*.

During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations presented below, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

1. Property, Plant, and Equipment

Background:

FLETC's accounting policy for property, plant, and equipment is to capitalize assets, major renovations, and alterations (PP&E) with a useful life of two or more years and a cost of \$50,000 or more, and to depreciate capitalized assets using the straight-line basis over the life of the asset. This accounting policy for PP&E is unchanged from when FLETC was a component of the Department of the Treasury. After FLETC transferred to DHS, the existing policy was not changed since it complies with the DHS Management Directive (MD) #1120.

Conditions:

- FLETC's \$50,000 capitalization threshold does not appear to be consistent with the intent of SFFAS #6, *Accounting for Property, Plant, and Equipment*.
- In FY's 2004 and 2005, FLETC purchased non-capitalized PP&E costing between \$5,000 and \$49,999 totaling \$3,995,477 and \$5,805,086, respectively. These assets, fitting the definition of PP&E, were individually below the capitalization threshold and were expensed in the year of purchase rather than spreading the assets' cost over the useful life.

Criteria:

Statement of Federal Financial Accounting Standards (SFFAS) #6, *Accounting for Property, Plant, and Equipment*, discusses capitalization thresholds in paragraph 13: "The Board believes that capitalization thresholds should be established by Federal entities rather than centrally by the Board. Because Federal entities are diverse in size and in uses of PP&E, entities must consider their own financial and operational conditions in establishing an appropriate capitalization threshold or thresholds." The Board goes on to explain in Paragraph 149 that, "Instead of setting a specific threshold, the Board has adopted a materiality approach – just as is done in private sector accounting."



Cause/Effect

FLETC's Finance Division has not performed and documented an analysis to justify its \$50,000 capitalization threshold. FLETC's threshold results in significant cost of PP&E being expensed upon purchase rather than over the related useful life of the asset through the depreciation process. Therefore, FLETC's reporting of operating expenses may not accurately reflect the cost of assets required to accomplish its mission. In addition, the reported assets on FLETC's balance sheet do not include all the assets FLETC has in service at any reporting date. A capitalization threshold developed from thoughtful consideration of FLETC's financial and operational conditions would assist in determining the assets FLETC employs in accomplishing its mission, as well as the cost of accomplishing its mission.

Recommendations:

Although FLETC is following the DHS management directive #1120, we recommend that FLETC management perform an analysis to determine whether its established \$50,000 capitalization threshold is appropriate for use in reporting FLETC's financial condition and cost of operations in accordance with SFFAS #6.

Management Response

Management has prepared an official response presented as a separate attachment to this letter. In summary, management did not agree with our finding and recommendation. Management indicated that their current threshold of \$50,000 complies with the Department of Homeland Security Management Directive Number 1120 and as the PP&E balance represents 65% of total assets, the materiality intent of SFFAS #6 have been fully met.

Auditors' Response to Management's Response

Statement of Federal Financial Accounting Standard No. 6, "Accounting for Property, Plant and Equipment" indicates that "because Federal entities are diverse in size and uses of PP&E, entities must consider their own financial and operational conditions in establishing an appropriate capitalization threshold or thresholds." FLETC's Finance Division has not performed and documented an analysis to justify its \$50,000 capitalization threshold. FLETC's threshold results in significant cost of PP&E being expensed upon purchase rather than expensed over the related useful life of the asset through the depreciation process. Therefore, we believe that FLETC should determine its own capitalization threshold in accordance with the standard or analyze and document the rationale for using the current capitalization threshold and how it is appropriate for use in reporting FLETC's financial condition and cost of operations.

2. Contract Review Process

Background:

FLETC Procurement Bulletin 03-004, *Acquisition Review Process*, requires that all contracts must undergo an internal review process. The review process includes ensuring that all applicable Federal Acquisition Regulations have been complied with, the dollar amount of the contract does not exceed the amount committed under the purchase request, the source selection documentation has been properly completed, all proposals have been fairly evaluated, and all contract terms are current. For contracts under \$100,000, the Contracting Officer is the final reviewer. For contracts valued from \$100,000 to \$500,000, the Contracting Officer's Branch Chief performs a first tier review that is submitted to the Contracting Officer. For contracts exceeding \$500,000, the first tier review is followed by a second tier review performed by the Legal Division.

Conditions:

KPMG randomly selected a sample of 45 contracts/purchase orders issued by the Procurement Division during FY 2006 and reviewed the documentation supporting each sample selection to determine whether the contract/purchase order was subjected to the appropriate review prior to issuance. As a result of the procedures performed, KPMG noted the following:

- The *Simplified Acquisition Folder* provides a space for the Contracting Officer to sign, indicating compliance with all requirements for the selection of a vendor for a contract/purchase order. KPMG noted Contracting Officers are not consistently signing the *Simplified Acquisition Folder*. In 13 simplified acquisitions within the 45 contracts/purchase orders selected for testing, FLETC did not show evidence of a valid, signed *Simplified Acquisition Folder*.
- Per FLETC Procurement Bulletin 03-004, *Acquisition Review Process*, acquisitions under \$500,000 require the Contracting Officer complete a review prior to the issuance of the contract/purchase order. To evidence review, the *Simplified Acquisition Branch Checklist*, which is to be included in each simplified acquisition file, provides a space for a reviewer to sign. KPMG noted that Contracting Officers and Branch Chiefs are not consistently signing the *Simplified Acquisition Branch Checklist*. In 28 of 45 items selected for testing, FLETC did not show evidence of a valid, signed *Simplified Acquisition Branch Checklist*.
- KPMG noted one instance where the Procurement Division was unable to locate the procurement file for a sample selection. As a result, KPMG was unable to perform certain procedures on this item other than to trace the documents through the electronic budget review process.



Criteria:

OMB Circular A-123, Management's Responsibility for Internal Control, states that management is responsible for developing and maintaining internal control activities that meet the three objectives of internal control:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations.

Management should implement adequate control activities including policies, procedures and mechanisms in place to help ensure that agency objectives are met. Several examples include: proper segregation of duties (separate personnel with authority to authorize a transaction, process the transaction, and review the transaction); physical controls over assets (limited access to inventories or equipment); proper authorization; and appropriate documentation and access to that documentation.

Cause/Effect:

FLETC does not monitor compliance with contract approval procedures. FLETC is not obtaining the proper degree of assurance that contracts/purchase orders comply with all contracting requirements.

Recommendation:

We recommend that FLETC management conduct periodic assessments of the operating effectiveness of internal controls over contract approvals as part of management's continuous monitoring of internal controls.

Management Response

Management has prepared an official response presented as a separate attachment to this letter. In summary, management has agreed with our findings and its comments were responsive to our recommendations.

3. Fixed Assets Module

Background:

FLETC uses a fixed assets systems module to track its PP&E and calculate depreciation. An account code/sub code combination is assigned to an asset when it is entered into the fixed assets module. The code combination determines which major fixed assets category the asset is tracked in, and determines the useful life required to calculate depreciation.



Condition:

A user of the fixed assets module has the ability to change the useful life field at the point in time an asset is entered into the system.

Criteria:

OMB Circular A-127, *Financial Management Systems*, section 7.e. states: "The agency financial management system shall be able to provide financial information in a timely and useful fashion to (1) support management's fiduciary role; (2) support the legal, regulatory and other special management requirements of the agency; (3) support budget formulation and execution functions; (4) support fiscal management of program delivery and program decision making; (5) comply with internal and external reporting requirements, including, as necessary, the requirements for financial statements prepared in accordance with the form and content prescribed by OMB and reporting requirements prescribed by Treasury; and (6) monitor the financial management system to ensure the integrity of financial data."

Cause/Effect:

The fixed assets module was designed to allow a user to manually edit the asset useful life field during the asset entering process. The ability to change the useful life by-passes the application control that FLETC management relies on to ensure the integrity of PP&E information.

Recommendations:

We recommend that FLETC management take the following steps:

- Disable the user's ability to manually edit the asset's useful life field during the asset entering process.
- Document and implement a process that requires written supervisory approval for any changes made to an asset's useful life after the asset entering process is completed.

Management Response

Management has prepared an official response presented as a separate attachment to this letter. Management did not agree with our recommendations indicating that in order to comply with SFFAS #6, the ability to change an asset's useful life is necessary to properly depreciate the cost of renovation and/or betterment which extends the useful life of an asset. They also indicated that only four Property Management inventory specialists have access to the field, and all changes are reviewed by a Finance PP&E Accountant prior to recording of costs to the general ledger.



Auditors' Response to Management's Response

We believe that the ability to change an asset's useful life by-passes the application control that FLETC management relies on to ensure the integrity of PP&E information. Renovation and/or betterment activities occur subsequent to the initial asset acquisition. As FLETC has a control for all property changes to be reviewed by a Finance PP&E Accountant, we continue to recommend that FLETC disable the user's ability to manually edit the asset's useful life field during the asset entering process and document and implement the process that requires written supervisory approval for any changes made to an asset's useful life after the asset entering process is completed.

4. Debt Collection Improvement Act of 1996

Background:

FLETC has accounts receivable from Federal, State, and local entities primarily for training, meals, and lodging provided in connection with FLETC's mission of providing law enforcement training.

Conditions:

- FLETC only referred 2 outstanding receivable items aged over 180 days to the Treasury Offset Program (TOP) in FY 2006.
- FLETC's 9/30/2006 accounts receivable balance is comprised of approximately 92 non-Federal items that were older than 180 days, totaling approximately \$186,806 of \$16,162,391, or 1.2%.
- KPMG noted 9 non-federal receivables older than 180 days that were not referred to the Treasury TOP program by FLETC.
- FLETC is unable to claim exemption from the Debt Collection Improvement Act (DCIA) filing requirement under any of the available five stated criteria.
- FLETC has not received express permission from the Secretary of the Treasury exempting it from the requirements of the DCIA.

Criteria:

The DCIA (Section 31001 of Public Law 104-134) states: "Any Federal agency that is owed by a person a past due, legally enforceable non tax debt that is over 180 days delinquent, including non tax debt administered by a third party acting as an agent for the Federal Government, shall notify the Secretary of the Treasury of all such non tax debts for purposes of administrative offset."

Additionally, the DCIA allows for an exemption to the requirements of TOP referral for receivables older than 180 days "to any debt or claim that:

- (i) is in litigation or foreclosure;

- (ii) will be disposed of under an asset sales program within 1 year after becoming eligible for sale, or later than 1 year if consistent with an asset sales program and a schedule established by the agency and approved by the Director of Office of Management and Budget;
- (iii) has been referred to a private collection contractor for collection for a period of time determined by the Secretary of the Treasury;
- (iv) has been referred by, or with the consent of, the Secretary of the Treasury to a debt collection center for a period of time determined by the Secretary of the Treasury; or
- (v) will be collected under internal offset, if such offset is sufficient to collect the claim within 3 years after the date the debt or claim is first delinquent.”

DCIA also allows that “any other specific class of debt or claim, as determined by the Secretary of the Treasury at the request of the head of an executive, judicial, or legislative agency or otherwise,” be exempt from referral.

OMB Memorandum 04-10 states:

All Federal agencies, including the executive, judicial, and legislative departments and agencies are subject to the requirements of DCIA, unless exempted by law. In addition, agencies must adhere to the requirements set forth in OMB Circular A-129.

The 23 CFO Act agencies and the Department of Homeland Security are required to review and report annually on their internal standards and policies regarding compromising, writing-down, forgiving or discharging debt. The annual report to OMB shall include: 1) a brief description of the agency’s internal policies regarding the compromising, writing-down, forgiving or discharging debt; 2) a description of the deficiencies in those policies and corrective actions taken or to be taken; 3) a statement as to whether those policies are consistently implemented among the programs within that agency; and 4) a statement as to whether all eligible discharged/closed out debts have been reported to the Internal Revenue Service on Form 1099C by January of the year following the discharge of debt.

For the current and ongoing requirements of OMB M-04-10, Federal agencies must ensure that all of their programs are complying with the following requirements:

- fully participate in centralized offset, that is, the TOP;
- aggressively service and collect delinquent debts;
- denial of direct and indirect loans to delinquent debtors; and
- accurately and timely report on receivables by reporting, certifying, and verifying all required data on the Treasury Report on Receivables (TROR).



Cause/Effect:

FLETC is not allocating the resources necessary to complete the activities required for compliance with the DCIA and OMB Memorandum 04-10. FLETC is not in compliance with the DCIA and is not acting in accordance with OMB Memorandum 04-10.

Recommendations:

We recommend that the FLETC:

- Train its personnel on the DCIA and TOP requirements.
- Implement formal procedures to aggressively pursue the collection of delinquent debts and refer balances older than 180 days to Treasury for collection as required by the DCIA, unless one of the five stated exemptions applies.

Management Response

Management has prepared an official response presented as a separate attachment to this letter. Management did not agree with our finding that the FLETC is not in compliance with the Debt Collection Improvement Act (DCIA). FLETC's analysis of the 8/31/06 Open Billing Report identified only four items meeting DCIA provisions and these four items were being researched in order to be turned over to the Treasury Offset Program (TOP). They believe the remaining debts are for other Federal agencies and therefore, could not have been referred to the TOP. Management further indicated that non-federal law enforcement agencies do not receive funds that could be applied against their debts owed to the FLETC. Therefore, it is FLETC's policy to collect debts internally through persistent follow-up.

Auditors' Response to Management's Response

FLETC is unable to claim exemption from the DCIA filing requirement under any of the available five stated criteria and has not received express permission from the Secretary of the Treasury exempting it from the requirements of the DCIA. Although FLETC indicated that they perform persistent follow-up on delinquent receivables, we identified 92 non-federal accounts receivable balances that were older than 180 days as of September 30, 2006, 9 non-federal receivables that were older than 180 days that were not referred to the Treasury TOP, and only 2 outstanding receivables referred during 2006 to the Treasury TOP by FLETC. Therefore, we continue to recommend that FLETC train its personnel on the DCIA and TOP requirements and implement formal procedures to aggressively pursue the collection of delinquent debts and refer balances older than 180 days to Treasury for collection as required by the DCIA, unless one of the five stated exemptions applies.

Our audit procedures are designed primarily to enable us to form an opinion on the balance sheet, and therefore may not bring to light all weaknesses in policies or procedures that may



Page 10

exist. We aim, however, to use our knowledge of the FLETC's organization gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

RESTRICTED USE

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

Very truly yours,

KPMG LLP



**Homeland
Security**

March 23, 2007

KPMG LLP
Attn: Elizabeth Hacquard
2001 M Street, NW
Washington, DC 20036

Ladies and Gentlemen:

We are providing this letter in connection with your audit of the Federal Law Enforcement Training Center's (FLETC) consolidated balance sheet as of September 30, 2006, and the related Management Letter. In response to the management letter comments, our concurrence or nonoccurrence is as follows:

1. Property, Plant and Equipment

We concur with KPMG's finding that the FLETC's 6-year document destruction policy resulted in a lack of proper support for the cost of property, plant and equipment (PP&E) greater than 6 years old, but still in service.

Effective as of September 2006, the FLETC Finance Division compiles and forwards PP&E support to the FLETC Property Management Division for inclusion in the permanent property records. The Property Management Division is also responsible for the maintenance of the Standard Operating Procedure on Real Property Management, which includes the proper retention schedule.

The FLETC does not concur with KPMG's finding that the \$50,000 capitalization threshold may not be proper. The FLETC complies with the Department of Homeland Security Management Directive Number 1120 which sets forth the \$50,000 threshold (other than software, aircraft, vessels and electronic systems).

Further, the PP&E balance represented 65% of total assets and 96% of assets excluding fund balance with treasury. We believe that the materiality intent of Statement of Federal Financial Accounting Standard (SFFAS) Number 6 has been fully met.

2. Contract Review Process

The FLETC Procurement Division accepts the audit recommendations with qualifications. Many of the documents reviewed were from Artesia, Charleston and Cheltenham and the complete file folder was not forwarded to Glynco, based on

instructions received from the audit reviewers. Since the entire file folders were not available for review; the documents reviewed had been sent back prior to findings being revealed; and the Procurement Division was not notified of the potential findings until after they were officially reported, there was never an opportunity to verify the legitimacy of the finding or to provide clarifications of procedural requirements to the reviewer. However, management oversight is paramount to quality control and the Procurement Division will implement a quality control plan wherein Branch Chiefs will perform random quality control reviews of contract files and simplified procurement files on a quarterly basis and report their findings and corrective action to the Deputy Chief of Procurement.

3. Fixed Assets Module

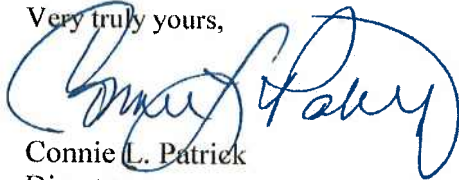
The FLETC does not concur with the KPMG finding that the ability for a user to edit the asset useful life field of the fixed assets module is a lack of an application control. We believe that to comply with SFFAS Number 6, the ability to change an asset's useful life is necessary to properly depreciate the cost of a renovation and/or betterment which extends the useful life of an asset. As for the associated risk, only four Property Management Division inventory specialists have access to the field, and all changes are reviewed by a Finance PP&E Accountant prior to recording of costs to the general ledger.

4. Debt Collection Improvement Act of 1996

We do not concur with the KPMG finding that the FLETC is not in compliance with the Debt Collection Improvement Act (DCIA). We do not agree with the "Conditions" written up and believe only four items were subject to the DCIA provisions based on an analysis of the 8/31/06 Open Billing Report. These four items were being researched in order to be turned over to the Treasury Offset Program (TOP). We believe the remaining debts at that time were for other Federal agencies, and therefore, could not have been referred to the TOP.

Other than Federal grants earmarked for specific purposes, quasi-government and state and local government law enforcement agencies normally do not receive funds for any non-tax payments, salaries or benefits that could be applied against their debts owed to the FLETC. Therefore, it is FLETC's policy to collect debts internally through persistent follow-up. FLETC will continue to follow up on aged receivables and refer any eligible public receivable to the TOP.

Very truly yours,



Connie L. Patrick
Director

Federal Law Enforcement Training Center
Glynco, Georgia 31524

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