# Department of Homeland Security
## Office of Inspector General

# FY 2008 Audit of DHS' Internal Control Over Financial Reporting

OIG-09-10

November 2008

*Office of Inspector General*

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

November 14, 2008

Preface

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

This report addresses the effectiveness of DHS' internal control over financial reporting. It is based on an examination of applicable documents. We performed our examination during the course of DHS' FY 2008 financial statements audit in conjunction with the independent public accountant, KPMG LLP. KPMG was engaged to audit the department's balance sheets as of September 30, 2008 and 2007, and the related statement of custodial activity for the year ended September 30, 2008 (referred to herein as "financial statements"). KPMG was unable to provide an opinion on DHS' financial statements as of September 30, 2008 and 2007.

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.

Richard L. Skinner

Richard L. Skinner
Inspector General

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We have examined the effectiveness of DHS' internal control over financial reporting as of September 30, 2008, based on the criteria established under the *Federal Managers' Financial Integrity Act* (FMFIA). DHS management is responsible for establishing and maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of DHS' internal control based on our examination.

We conducted our examination in accordance with Government Auditing Standards issued by the Comptroller General of the United States and attestation standards established by the American Institute of Certified Public Accountants. Our examination included obtaining an understanding of the internal control over financial reporting and performing such other procedures as we considered necessary in the circumstances. We believe that our examination and the report of the independent auditor provide a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a significant deficiency or combination of significant deficiencies that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. A significant deficiency is a control deficiency or combination of control deficiencies that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected.

During fiscal year 2008, the following material weaknesses were identified by an independent auditor. Due to the issues noted below, additional material weaknesses may exist that have not been reported.

- Financial Reporting;
- Financial Systems General and Application Controls;
- Fund Balance with Treasury;
- Capital Assets and Supplies;

- Actuarial and Other Liabilities; and
- Budgetary Accounting.

Because of the effects of the material weaknesses mentioned above, in our opinion, DHS did not maintain effective internal control as of September 30, 2008, to meet the following objectives: (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements and stewardship information in conformity with Generally Accepted Accounting Principals (GAAP), and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with laws governing the use of budget authority and with other significant laws and regulations that could have a direct and material effect on the financial statements and stewardship information. Consequently, DHS' internal control did not provide reasonable assurance that misstatements, losses, or noncompliance with laws and regulations that are material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis.

Richard L. Skinner

Richard L. Skinner
Inspector General

*Office of the Chief Financial Officer*
**U.S. Department of Homeland Security**
Washington, DC 20528

Homeland Security

November 12, 2008

MEMORANDUM FOR: Richard L. Skinner
Inspector General

FROM: David L. Norquist
Chief Financial Officer

SUBJECT: Fiscal Year (FY) 2008 Internal Controls over Financial Reporting Audit Opinion

Thank you for the opportunity to review your draft audit opinion of the Department's internal control over financial reporting. I agree with your conclusions. Four years ago the *DHS Financial Accountability Act* posed profound challenges to our new Department. Over the years, I am pleased with how we have worked together to implement the Act. As we conclude the fourth year of implementing the Act, the progress the Department has made is significant. That success began with the strong working relationship between our offices, and in particular, Management's *Internal Control Playbook* and your independent performance audits that together identified the root causes and the necessary corrective actions. While challenges remain, for the second consecutive year the Department has made progress by implementing effective corrective actions. The Department has reduced from 16 to 13, the number of Component conditions that contributed to our material weakness conditions as well as fixing the root cause of other weaknesses. For example:

- The Federal Emergency Management Agency (FEMA) reduced the severity on one half of prior year material weaknesses, including:
    - Corrective actions resulted in \$1.8 billion of Mission Assignment deobligations, funding was returned to Disaster Relief Fund for other mission priorities;
    - Conducted inventory counts to be better prepared for the Hurricane Season; and
    - Developed a grant accrual methodology for estimating grant expenses at year end.
- FEMA and U.S. Coast Guard reduced the severity of Departmental Financial Management and Oversight to a reportable condition, a first ever material weakness remediation at U.S. Coast Guard.
- The Transportation Security Administration corrected prior year material weakness conditions related to Other Liabilities and Budgetary Accounting.
- In coordination with the Chief Information Officer, we developed an integrated assessment methodology for information technology general computer controls.

- DHS Office of the Chief Financial Officer sustained FY 2007 progress and for the first time ever does not contribute to a material weakness condition.

The Department has established a Senior Management Council to help ensure progress continues. Thank you for your office's support throughout this audit. I look forward to continued cooperation and progress in the future.

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