

DEPARTMENT OF HOMELAND SECURITY
Office of Inspector General

**Audit of DHS' Corrective Action Plan
Process for Financial Reporting -
Report No. 3**





Homeland
Security

December 4, 2006

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 responsibility to promote economy, efficiency, and effectiveness within the department.

This report is the third of a series of OIG performance audit reports on planned DHS corrective actions to improve internal control. Improving internal control is a critical objective of the DHS Financial Accountability Act (*Public Law 108-330*). The report is based on interviews with employees and officials of relevant agencies and institutions, direct observations, and a review of applicable documents. We contracted with the independent public accounting firm KPMG LLP to perform the audit. KPMG is responsible for the attached auditor's report and the conclusions expressed in it.

The recommendations herein 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".

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August 18, 2006

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KPMG is pleased to submit this performance audit report related to the Department of Homeland Security's (the Department's) corrective action plans developed to address the Property, Plant and Equipment; Operating Materials and Supplies; Undelivered Orders, Accounts and Grants Payable, and Disbursements; Budgetary Accounting; and Intragovernmental and Intradepartmental Balances material weaknesses at the Office of the Chief Financial Officer, United States Coast Guard, Immigration and Customs Enforcement, Transportation Security Administration, and Grants and Training components as reported in the Department's Independent Auditors' Report in the FY 2005 *Performance and Accountability Report*. This performance audit is the third in a series of performance audits that the Department of Homeland Security Office of Inspector General has engaged us to perform for FY 2006. This performance audit was designed to meet the objectives identified in the Background, Objectives, and Scope section of this report.

We conducted this performance audit from July 31, 2006 through August 18, 2006, in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. The purpose of this report is to communicate the results of our performance audit and the related findings and recommendations.

Since August 18, 2006, we have not performed any additional procedures with respect to this performance audit and have no obligation to update this report or to revise the information contained herein to reflect events occurring subsequent to August 18, 2006.

The Department of Homeland Security Office of Inspector General has authorized this report to be sent electronically for the convenience of the Department. However, only the final hard-copy report should be deemed our work product.

KPMG LLP

Executive Summary

Overall, the Department of Homeland Security (the Department) is working to identify and develop effective Corrective Action Plans (CAPs) to address the material weaknesses at the Office of the Chief Financial Officer (OCFO), United States Coast Guard (Coast Guard), Immigration and Customs Enforcement (ICE), Transportation Security Administration (TSA), and Grants and Training (G&T) related to Property, Plant and Equipment; Operating Materials and Supplies; Undelivered Orders, Accounts and Grants Payable and Disbursements; Budgetary Accounting; and Intragovernmental and Intradepartmental Balances (herein referred to as the “material weaknesses”), as reported in the Department’s Independent Auditors’ Report in the FY 2005 *Performance and Accountability Report* (herein referred to as the “FY 2005 Independent Auditors’ Report”). The OCFO, Coast Guard, ICE, TSA, and G&T have drafted CAPs intended to address their respective contribution to these material weaknesses. The Department deems these CAPs as critical steps towards meeting its objective of obtaining an unqualified audit opinion on its consolidated financial statements, as well as on its internal controls over financial reporting. Our performance audit was limited to a review of the CAPs themselves and not the outcomes achieved as a result of conducting the procedures outlined in the CAPs.

Findings and Recommendations

KPMG identified several opportunities to improve the effectiveness of the Department’s CAPs, which should be taken under management’s consideration. KPMG has classified each of these observations into one of the following four categories representing phases which are generally performed to develop and implement an effective CAP:

- Identification of the underlying root cause,
- Development of an effective remediation plan,
- Accountability for establishment and successful implementation of the CAP, and
- Validation of the successful implementation of the CAP.

The recommendations needed, which we identified in relation to the CAPs for these material weaknesses, vary depending on the component, and in some cases on the material weakness itself.

Background, Objectives, and Scope

Background

Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*, states "Federal agencies are subject to numerous legislative and regulatory requirements that promote and support effective internal control. Effective internal control is a key factor in achieving agency missions and program results through improved accountability. Identifying internal control weaknesses and taking related corrective actions are critically important to creating and maintaining a strong internal control infrastructure that supports the achievement of agency objectives."

OMB Circular A-123 builds upon the internal control framework within the *Standards for Internal Control in the Federal Government* (Green Book), issued by the Government Accountability Office (GAO), which defines internal control as "an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- effectiveness and efficiency of operations,
- reliability of financial reporting, and
- compliance with applicable laws and regulations."

Ten material weaknesses associated with internal controls were reported in the Department's Independent Auditors' Report included in the FY 2005 *Performance and Accountability Report*. The Department has undertaken an initiative to develop and implement formal corrective action plans to resolve these material weaknesses. Under this initiative, the Department has issued guidance and has also deployed a web-based software application, Electronic Program Management Office (ePMO), to manage the collection and reporting of CAP information for the Department and its components. Under this initiative, the Department's intent is to develop effective CAPs and position itself to move forward in its objective of obtaining an unqualified audit opinion on its consolidated financial statements, as well as on its internal controls over financial reporting.

The first key milestone in the Department's CAP process was May 31, 2006, whereby all components were required to develop CAPs for each material weakness under the new format for input into ePMO by the Department's OCFO. The second key milestone was the submission of revised CAPs as of June 30, 2006, by July 12, 2006. Effective July 31, 2006, each component is to update its CAPs within ePMO on the last day of each month as of that date.

The format for CAP documentation in ePMO includes a CAP Summary Report and a CAP Detail Report. Within the CAP Summary Report there are sections for a description of the issue, results of the root cause analysis, key success factors and performance measures, resources required, an analysis of the risks and impediments as seen by management and the critical milestones to be achieved for the CAP. The CAP Detail Report provides additional data on the milestones, not only on those identified as critical but also those sub-milestones under a critical milestone. For each milestone (critical or sub), the following data is reflected: due date, percentage of completion, status (e.g., Not Started, Work in Progress and Completed), and the responsible and assigned parties.

Objectives

The objective of this performance audit is to report and evaluate the status and effectiveness of the CAPs for five of the ten material weaknesses that were cited in the Independent Auditors' Report included in the Department's FY 2005 *Performance and Accountability Report*. The five material

weaknesses are: Property, Plant and Equipment; Operating Materials and Supplies; Undelivered Orders, Accounts and Grants Payable, and Disbursements; Budgetary Accounting; and Intragovernmental and Intradepartmental Balances. Our performance audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States, specifically, the standards for performance audits.

This performance audit reports on the status of CAP implementation, as of July 31, 2006, and evaluates the effectiveness of the Department's CAPs developed by the OCFO, Coast Guard, ICE, TSA and G&T to address their respective sections of the five material weaknesses as outlined in the table below:

Material Weakness	Component				
	OCFO	Coast Guard	ICE	TSA	G&T
Property, Plant and Equipment		X			
Operating Materials and Supplies		X			
Undelivered Orders, Accounts and Grants Payable, and Disbursements		X	X	X	X
Budgetary Accounting		X	X		
Intragovernmental and Intradepartmental Balances	X	X	X		

Scope

The scope of this performance audit includes the Department's CAPs, as of July 31, 2006, developed to address certain material weaknesses at select components as outlined in the table above. The Department is in the early stages of its CAP implementation process and will continue to modify its CAPs throughout the year, as appropriate. The scope of this performance audit includes only those material weaknesses shown on the above table and does not include procedures on any of the CAPs associated with any of the other material weaknesses cited in the Department's FY 2005 Independent Auditors' Report. Furthermore, our performance audit was limited to a review of the CAPs themselves and not the outcome achieved as a result of conducting the procedures outlined in the CAPs.

The timeline for this performance audit was as follows:

- Fieldwork – July 31, 2006 through August 18, 2006
- Draft Report Issuance – October 6, 2006
- Final Report Issuance – November 3, 2006

Performance Audit Approach

We performed a variety of procedures over the CAPs for the five material weaknesses. Our methodology consisted of the following four-phased approach:

Phase I – Project Initiation and Planning

We conducted a kick-off meeting with the Department's OIG, OCFO, Coast Guard, ICE, TSA, and G&T components to review the performance audit objectives, scope of the performance audit, and to facilitate the collaboration of participants.

Phase II – Determine the CAP Status of the Five Material Weaknesses

- OCFO, Coast Guard, ICE, TSA, and G&T Interviews

We interviewed OCFO, Coast Guard, ICE, TSA, and G&T personnel to determine their understanding and extent of implementation of their respective component's CAPs as of July 31, 2006, including, but not limited to, the root cause analysis performed, the critical milestones chosen for measurement, and mechanisms to monitor progress in meeting the milestones.

- CAPs and Related Supporting Documentation Reviews

- We reviewed the CAPs (i.e., the detail and summary report) contained within ePMO and any supporting documentation underlying the CAPs maintained by the components.
- We reviewed the Notice of Findings and Recommendations (NFRs) issued during the FY 2005 financial statement audit utilized to generate the FY 2005 Independent Auditors' Report.

Phase III – Evaluate CAP Structure

We reviewed the *DHS Corrective Action Plan Process Guide* (CAP Guide), dated April 28, 2006, and existing internal control monitoring practices and guidance for practices that would serve as our evaluation criteria. We then compared our understanding of the Department's existing CAPs to these practices to identify potential areas for improvement. These findings reflect situations that could negatively impact the Department's remediation of the material weaknesses if additional corrective action is not taken.

The internal control monitoring practices and guidance we reviewed included:

- OMB Circular A-123.
- CAP guides published by other Federal agencies.

We categorized the areas for improvement into one of the four broad phases generally found in an effective CAP process:

- Identification of the underlying root cause is an important action step in the CAP process. Accurate identification of the root cause mitigates the chances of recurrence. Often merely the symptoms of the deficiency are identified rather than the root cause, which increases the difficulty of developing a CAP that successfully resolves the deficiency.

- Development of an effective remediation plan is an appropriate way to remediate an internal control deficiency. A key component of an effective plan is the inclusion of both attainable and measurable milestones to allow both the Department and the component to monitor the remediation process.
- Accountability is vital to the CAP process because it necessitates the establishment of an individual CAP owner who is responsible for its successful implementation. The owner's responsibilities include ensuring that milestones are achieved and that the validation phase is completed.
- Validation is important in order to verify that the CAP has been successfully completed. The CAP should include activities that will provide evidence to support the closure of the CAP. These activities should include documentation reviews, work observations, and performance testing.

Phase IV – Conclusions and Recommendations

After conducting our analysis in Phase III, we formulated our findings and recommendations for each potential area of improvement identified.

Findings and Recommendations

Office of the Chief Financial Officer (OCFO)

Intragovernmental and Intradepartmental Balances

Background:

DHS conducts business with other Federal agencies resulting in the reporting of intragovernmental receivables, payables, transfers, revenues and expenses. Federal accounting and reporting regulations require Federal agencies to routinely identify and reconcile intragovernmental balances and transactions with trading partners to ensure that intragovernmental balances properly eliminate in the government-wide consolidated financial statements. The Department's components also conduct business with each other, resulting in the same type of transactions and balances that must be eliminated against each other to produce accurate consolidated financial statements for the Department.

The OCFO has drafted a CAP intended to address the material weakness on Intragovernmental and Intradepartmental Balances reported in the FY 2005 Independent Auditors' Report. Based on the CAP, completion of all tasks is not scheduled to take place until October 31, 2007. Of the eight tasks currently identified, only one is reflected as being completed as of July 31, 2006, by the OCFO.

Identification:

The OCFO has drafted a CAP intended to address the material weakness on Intragovernmental and Intradepartmental Balances. The Issue Description section includes only a limited explanation of the root cause, coupled with a description of the issue including some examples which support the description. The root causes identified thus far are high-level observations, and do not provide the level of detail necessary to fully develop a CAP and resolve the underlying issues. A comprehensive root cause analysis was not performed by the OCFO in the course of developing the Intragovernmental and Intradepartmental Balances CAP.

Development:

The CAP was primarily developed using interviews and the institutional knowledge of OCFO personnel. Management asserts that the Intragovernmental and Intradepartmental Balances CAP has been considered a low priority by the OCFO, and therefore the CAP lacks a substantive analysis of the conditions resulting in the material weakness and a detailed consideration of the necessary remediating actions by both OCFO and component personnel to correct these conditions. Management acknowledged the deficiencies in the CAP, and attributes these deficiencies to the lack of sufficient personnel to allocate toward the initiative. The OCFO also noted that a CAP workshop relating to the intragovernmental and intradepartmental balances material weakness has not yet taken place, and OCFO personnel do not have the necessary training and skills to develop the CAP. The OCFO expects to participate in the CAP workshop related to intragovernmental and intradepartmental balances scheduled on August 22, 2006. The OCFO has a targeted completion date of August 31, 2006, for the finalization of this CAP, which will be revised based on information obtained during the CAP workshop. The proposed target date for completion of the CAP does not seem feasible given that a root cause analysis has yet to be completed.

The CAP report includes assigned tasks with targeted completion dates; however, since management has not fully and completely identified and developed the CAP tasks, several elements were missing from the CAP and should be considered for inclusion. Without a comprehensive root cause analysis (refer to Identification above) and the addition of the critical missing elements as detailed below, the plan is not comprehensive and could diminish the ultimate effectiveness of the CAP. The critical missing elements are as follows:

- The detailed tasks outlined in the CAP Detail Report are not comprehensive and do not clearly show a linkage to the weakness being corrected or the root cause issues identified (partly due to a lack of a root cause analysis).
- All of the detailed tasks do not clearly identify a means to validate their completion.
- The CAP lacks specific guidance or procedures to ensure the timeliness of data file submissions to the Financial Management System (FMS). It also lacks information related to the manner in which the OCFO will maintain supporting documentation evidencing the timeliness of the submissions.
- There were no management review procedures documented in the CAP ensuring the completeness and accuracy of the consolidated intragovernmental and intradepartmental reconciliation report submitted to Treasury. The CFO or Deputy CFO must sign the Material Differences report in accordance with Treasury guidance; however, no management review procedures are specified in the CAP.
- The tasks and guidance developed thus far focuses little, if at all, on the role of the components in the intragovernmental reconciliation process, and do not appear to include guidance to the components regarding their role, since the intragovernmental reconciliation process must be a collaborative effort between the OCFO and each of the components.
- None of the tasks in the CAP Detail Report have been identified as critical milestones in the CAP Summary Report under this caption.

Certain tasks in the CAP Detail Report include procedures which should be performed during normal business operations and are thus not effective milestones in remediating the material weakness, e.g., one milestone requires the reconciliation and submission of intragovernmental

balances to Treasury. Performance of tasks that comprise a part of normal business operations do not constitute a corrective action.

Management acknowledged these deficiencies in the CAP, and attributed the incomplete status to the direction of resources to other projects deemed to be a higher priority. The CAP addressing the Intragovernmental and Intradepartmental Balances material weakness remains in the early stages of development and implementation. The OCFO has a targeted completion date of August 31, 2006, for the finalization of this CAP, which will be revised based on information as necessary.

Accountability:

Overall responsibility for the CAP has been placed with the Assistant Director of the Financial Reporting Branch within the OCFO's Office of Financial Management. While an individual has been assigned the responsibility of designing and implementing the CAP, management acknowledges that sufficient resources have not been available to fully develop the CAP. Until the CAP is more fully developed, management is unable to determine the extent of resources required to successfully implement the CAP and validate correction. As such, management has not established the linkage of the validation of corrective actions with management's plan for implementation of OMB Circular A-123.

Validation:

The CAP does not include validation procedures to test whether the implemented corrective actions were successful in rectifying the root causes(s) and remediating the material weakness. The OCFO's Intragovernmental and Intradepartmental Balances CAP did include validation procedures to be performed, however, those procedures did not go so far as to require management testing of the implemented corrective actions and to link the validation of corrective actions with the implementation of OMB Circular A-123.

Recommendations

We recommend that the OCFO:

1. Perform a thorough root cause analysis to identify the underlying causes of the material weakness for each element (i.e., intragovernmental and intradepartmental), including a review of financial IT systems, processes and human resources within the OCFO and at the Department's components. The identified root causes should be cross-referenced to the weakness identified by management (as well as those identified by the independent auditor). The OCFO's CAPs should be prioritized for action, to minimize duplication of effort where corrective actions overlap (e.g., correction of IT system posting logic errors may resolve multiple issues, or mitigate the need for process changes). The OCFO should not rely on the independent auditors to identify all of the significant causes of control weaknesses, and should only use the audit to corroborate management's findings.
2. Develop guidance to distribute to the components regarding their role in the collaborative intragovernmental reconciliation process.
3. Make a realistic assessment of the resource requirements (i.e., human and financial) needed to identify the root causes of the material weakness, develop and execute thorough CAPs, and verify completion.

4. Develop detailed milestones which clearly link the material weakness, its root cause(s), and all conditions identified in the NFRs issued by the independent auditor.
5. Include CAP validation procedures to be performed by OCFO personnel. The testing by the independent auditors should not be substituted for management's testing and validation procedures.
6. Integrate the CAPs with the Department's plan for OMB Circular A-123 implementation and the annual Federal Managers Financial Integrity Act (FMFIA) assurance statement. Management's plan for verification of corrective actions should be closely integrated with the Department's controls test work conducted to comply with OMB Circular A-123.

United States Coast Guard (Coast Guard)

Background:

The Coast Guard has drafted CAPs intended to address its sections of the five material weaknesses on Property, Plant and Equipment; Operating Materials and Supplies; Undelivered Orders, Accounts and Grants Payable, and Disbursements; Budgetary Accounting; and Intragovernmental and Intradepartmental Balances, reported in the FY 2005 Independent Auditors' Report.

The CAPs contain a description of the known issues and root causes, management's key success factors and performance measures, general resources required, and in some cases, milestones for corrective actions. The Coast Guard has already or will be attending the respective CAP workshops sponsored by the OCFO, where the CAP approach, future actions, and milestones are discussed.

Identification:

Our observations and comments on the Identification phase of the CAP process at Coast Guard are consistent across all five material weaknesses. Each of the CAPs for the five material weaknesses consist primarily of known conditions identified by the independent auditors, and lack evidence of a detailed review to identify the underlying root causes of the five material weaknesses. The Root Cause section of three of the five CAPs reviewed did not contain a sufficient, comprehensive root cause analysis; on two of the five CAPs, the root cause section was blank.

In order to develop a meaningful actionable CAP that includes identification of resource needs, milestones, performance indicators and accountability, the root cause(s) of the issue must be determined. The CAPs do not extend beyond a general discussion of the problems or the approach to correction, and the underlying causes of the conditions are not described in sufficient detail to allow development of specific actions and milestones. For example, the Coast Guard cites the purchase of spare parts and the inventory methods utilized, along with the personnel used to manage them, as the root cause for the material weakness in the Operating Materials and Supplies CAP Summary Report. The Coast Guard states that it was because of a lack of an inventory specialist and insufficient funding for this position that a weakness exists. There appears to be no clear linkage between the cause and the proposed plan offered to remedy the situation.

The identified causes have not been categorized, cross-referenced to problems identified by management, and/or prioritized for correction. The CAPs do not demonstrate how the proposed solution(s) will correct the material weaknesses. In addition, the CAPs lack specific identification of financial systems and processes that require corrective actions, and an approach to correction.

The key success factors and performance measures identified consist primarily of an array of policies and procedures typically found in a reliable financial reporting process, or are observations

or suggestions by someone knowledgeable of the process, but often lack specific application to the Coast Guard financial reporting systems and processes. The key performance measures and the success factors are often more generic and overarching principles than specific measurable and attainable goals. In some cases, possible corrective actions have been deferred, pending further review, which will result in the development of a full CAP at a future date. For example, the Budgetary Accounting CAP contains a critical milestone of plan completion by December 31, 2007, and states that the CAP is in the planning stage. Currently, each of the Coast Guard's CAPs is merely a plan to develop a plan, instead of a plan to remediate a material weakness.

Furthermore, the tasks listed in the CAP Detailed Reports focus almost exclusively on audit finding recommendations categorized by material weakness in outline format. The database is incomplete as it only includes audit recommendations, which are a small fraction of the total number of issues or root causes that Coast Guard must identify and address. The root causes that are identified in the CAPs appear to be merely the initial steps in the root cause analysis and the implementation of a corrective action plan, and lack sufficient depth to identify the true root causes of the issue.

There is no evidence that a thorough and complete risk analysis was performed in the development of the Coast Guard CAPs. No complete risk management plan was proposed or documented in the five CAPs. In some cases, risks were identified, but no remediation plan was offered.

Development

Property, Plant and Equipment - Management has identified four broad categories of issues that cause the Property, Plant and Equipment material weakness; (1) personnel / training, (2) insufficient and incomplete documentation, (3) poor data integrity, and (4) lack of accountability. The CAP provides evidence that management recognizes that remediation of the material weakness is not a short term project, but will require significant time and effort by the Coast Guard.

The CAP lacks depth in the performance measures, and the steps described to remedy the weakness noted in the FY 2005 Independent Auditors' Report are vague.

The CAP Detail Report contains several tasks, but none of these tasks have been identified as critical milestones, nor are they reflected in the CAP Summary Report under this caption.

Operating Materials and Supplies - The Operating Materials and Supplies CAP states that in FY 2004, policies, procedures, and internal controls relating to physical inventories were not communicated in a timely fashion to the field. The Coast Guard acknowledges that the weakness continued throughout FY 2005 and into FY 2006. The plans to address the deficiency are noted, but are not indicative of proper planning preceding plan execution.

The CAP identifies the need to reduce inventory but notes that substantial supplementary funding is required to accomplish the task. The CAP fails to elaborate on the circumstances requiring supplementary funding (e.g. environmental, hazardous, etc). As a result, there is no direct link between the proposed plan and the resources required to implement the plan.

The CAP proposes a performance-based logistics program in the development and implementation of a logistics transformation process, and indicates that such a program is a key success factor. The CAP fails to adequately discuss the systems that support the logistics base and how they interface with the financial systems, thus putting in question the integrity of the data being fed into the financial statements. No solution is mentioned as to how either one of these is measured or monitored.

The CAP Detail Report contains several tasks, but none of these tasks have been identified as critical milestones, nor are they reflected in the CAP Summary Report under this caption.

Undelivered Orders, Accounts and Grants Payable, and Disbursements – The identified root causes of the material weakness concerning Undelivered Orders, Accounts and Grants Payable, and Disbursements (referred herein as “UDOs”) are unclear when coupled with the statement made in the Issue Description which states as follows: “It gives one a picture of a less than tight and controlled environment where ‘on-top adjustments’ are made void of strong internal controls.” The statement gives the impression that this area is open to abuse. Further development of this CAP is needed to correct this issue.

The Coast Guard has assessed the magnitude of impact regarding the material weakness relating to UDOs and identified a need for cross-functional coordination. However, the CAP Summary and Detailed Report only infer the need for coordination through a reference to offering training to personnel performing the UDOs validation process.

The CAP Detailed Report contains several tasks, but none of these tasks have been identified as critical milestones, nor are they reflected in the CAP Summary Report under this caption.

Budgetary Accounting - The CAP Summary Report does not include any root cause analysis for the material weakness in Budgetary Accounting. In the Issue Description of the CAP for Budgetary Accounting, vague and non-descriptive language is used that could be indicative of a lack of understanding of the underlying issues. Further development of this CAP is needed to correct this issue.

The lack of information concerning a root cause and a generic issue description makes it difficult to ascertain how the Coast Guard measures success. It should be noted that Coast Guard has a complex budget from a vast variety of sources along with over 80 separate Treasury fund symbols. This condition demands an even more detailed and thorough analysis in an effort to correct the material weakness noted in the FY 2005 Independent Auditors’ Report.

The CAP Detail Report contains several tasks, but none of these tasks have been identified as critical milestones, nor are they reflected in the CAP Summary Report under this caption.

Intragovernmental and Intradepartmental Balances – The Coast Guard did not identify the root cause of the Intragovernmental and Intradepartmental Balances material weakness found in the FY 2005 Independent Auditors’ Report. Coast Guard attributes much of the root cause on a failing and inadequate system that includes many inconsistencies. Development of a comprehensive CAP is needed to correct this material weakness.

Complete documentation of all intragovernmental procedures including appropriate internal controls and flow diagrams was listed in the CAP Summary as a key performance measure and due to be completed June 30, 2006, but not mentioned in the CAP Detail Report.

Furthermore, the U.S. Department of the Treasury’s *Treasury Financial Manual* (TFM), Volume I: Federal Agencies, Part II, Section 4706.20 requires the reconciliation and confirmation, on a quarterly basis, of intra-governmental balances on certain reciprocal groupings whereas the CAP only requires periodic reviews and a walkthrough verifying and validating the transactions.

Overall, the CAPs for each of the five material weaknesses lack important details necessary to be an effective plan. The following observations and comments on the Development phase of the CAP process at Coast Guard are consistent across all five material weaknesses.

The Coast Guard CAPs lack:

- Linkage or cross-reference to the material weakness conditions being corrected. Presently, the CAPs refer generally to the group of auditor findings by area, and it is difficult to determine if all of the conditions identified by the auditor are adequately addressed in the CAP;

- Evidence of review and approval by management, together with a description of periodic progress reports to be provided to Coast Guard and OCFO management;
- A fully developed/detailed listing of the tasks to be performed, identification of system deficiencies and corrective actions, and who is accountable for their completion;
- The detailed time-frame (milestones) in which corrective actions are to occur, other than general months/years for a few actions, including the protocol of correction (i.e. systems before processes, etc.);
- Performance metrics/measures for use by management to determine that corrective actions are on track or require modification, and to assign accountability;
- A thorough evaluation of the resources needed – personnel, systems and funding, including the source of those resources;
- Identification and dedication of resources, including supervisors and contract assistance. Presently, personnel associated with the CAP process have other full-time job responsibilities within the Coast Guard. The corrective actions are of a scale that dedicated personnel, including management, are necessary for the plan to be effective in the near-term;
- A description of how the Coast Guard will verify and validate that corrective actions are complete and effective in correcting the conditions that lead to material weaknesses;
- An established linkage of the validation of corrective actions with management’s plan for implementation of OMB Circular A-123; and
- A thorough evaluation of risks and a plan to mitigate the possible negative impacts of such risks as well as a plan to work with and around those inherent risks within the process.

Accountability:

Our observations and comments on the Accountability phase of the CAP process at Coast Guard are consistent across all five material weaknesses. The Coast Guard properly identifies a responsible party for the CAPs and the Coast Guard designee in-charge of each CAP. As such, accountability for the CAP implementation is specified. All of the accountable individuals identified have other duties in addition to the CAP implementation. It is unclear if these individuals would have the support necessary to successfully implement the CAP after the plan is fully developed.

The Coast Guard’s CAPs address resource issues, but inconsistencies are present. The Intragovernmental and Intradepartmental Balances CAP calls for increased funding for improvements. Meanwhile, the FY 2005 Independent Auditors’ Report stated that Coast Guard was not fully utilizing its accounting functionality to identify and track intra-governmental transactions. Coast Guard is calling for additional funding to remedy an issue before a thorough resource requirement assessment is conducted.

Validation:

The Coast Guard approach to the Validation phase of the CAP process is consistent across all five material weaknesses. The Coast Guard CAPs do not include validation procedures to test whether the corrective actions were successful in rectifying the root causes(s) and remediating the material weaknesses. Additionally, the CAPs did not link the validation of corrective actions with management’s plan for implementation of OMB Circular A-123.

Recommendations:

We recommend that the Coast Guard:

7. Perform a comprehensive and thorough root cause analysis fully supported and substantiated by documentation to identify the underlying causes of the five material weaknesses, including a review of financial IT systems, processes and human resources. The identified root causes should be cross-referenced to the weakness identified by management (as well as those identified by the independent auditor). The CAPs should be prioritized for correction, to minimize duplication of effort where corrective actions overlap (i.e., correction of IT system posting logic errors may resolve multiple issues, or mitigate the need for process changes). Coast Guard should not rely on the independent auditors to identify all of the significant causes of control weaknesses, and should only use the audit to corroborate management's findings.
8. Develop CAPs to mitigate and ultimately correct control deficiencies, based on management's own assessment of the issues. The CAPs should include a description of the detailed tasks and milestones, key success and performance metrics, and a designated person accountable for completion of the effort.
9. Make a realistic assessment of the resource requirements (i.e., human and financial) needed to identify the root causes of the material weakness, develop and execute thorough CAPs, and verify completion.
10. Obtain support from executive leadership, since effective corrective action and progress toward corrective action could falter without continuous reinforcement from leadership. A risk management plan needs to be developed.
11. Reconcile database(s) used to document other forms of CAPs or more detailed CAPs with the ePMO database and monitor their completion. Accountability for the results of the CAPs and responsibility for the remediation of material weaknesses needs to be established.
12. Include CAP validation procedures that should be performed by Coast Guard personnel; the work of the independent auditors should not be substituted for management's own testing and validation procedures.
13. Integrate the CAPs with the Department's plan for OMB Circular A-123 implementation and annual FMFIA assurance statement. Management's plan for verification of corrective actions should be closely integrated with the Department's controls test work conducted to comply with OMB Circular A-123.

Immigration and Customs Enforcement (ICE)

Background:

ICE has drafted CAPs intended to address their sections of the three material weaknesses: UDOs; Budgetary Accounting; and Intragovernmental and Intradepartmental Balances (referred herein as "Intragovernmental"), reported in the FY 2005 Independent Auditors' Report.

ICE established the Program Management Office (PMO), which reports to ICE's CFO, to develop and implement a three-year Financial Action Plan (FAP) to manage and monitor efforts to improve ICE's financial management. The FAP addresses the material weaknesses as they relate to ICE which includes the material weaknesses in UDOs, Budgetary Accounting, and Intragovernmental.

In the establishment of the PMO, ICE contracted with a consulting firm to provide expertise and staffing. The primary responsibilities of the PMO are to (1) provide program management

infrastructure to ensure successful FAP execution, (2) provide guidance and support to staff developing project plans and implementing them, and (3) resolve issues and mitigate risks that may hinder the FAP implementation effort. By February 2006, ICE issued its FAP and the process of implementing the corrective actions was launched. Each initiative in the FAP is supported by a Detailed Project Plan that outlines the tasks and milestones to be achieved. When developing the FAP, ICE management considered the FAP to be an evolutionary document that would be periodically updated as needed to consider new facts and circumstances, and to ensure continuous progress is made.

When the Department initiated its Department-wide CAP process in April 2006, ICE was already in the midst of its FAP implementation. To comply with the Department's CAP process, ICE fashioned its CAPs based on the information in its existing FAP. This resulted in some duplication of effort as corrective actions were being documented in both the FAP and the CAPs. In July 2006, ICE management decided to incorporate the CAPs into the overall FAP process, therefore eliminating the need to update both the FAP and the CAP separately. ICE also documents its corrective actions in a Project Plan maintained in Microsoft Project. This Project Plan lists the primary tasks and the subtasks, the number of days the task/subtask should take to complete, and the start and end dates for the task/subtask. The critical milestones in the CAP within ePMO should be consistent with the primary tasks in the Project Plan within Microsoft Project.

Undelivered Orders, Accounts and Grants Payable, and Disbursements (UDOs)

Identification:

Management has segregated the UDOs material weakness into two areas: Invoice Management and Unliquidated Obligations. The area of Unliquidated Obligations is further segregated between the Federal Protective Service (FPS) and non-FPS. When developing the FAP, the PMO performed a root cause analysis which consisted primarily of conducting interviews with personnel and leveraging the institutional knowledge of the ICE personnel in the PMO. The root cause analysis initially focused on the conditions cited by the auditors during the FY 2005 audit. To ensure that the FAP, at a minimum, addressed each of the auditor findings cited during the FY 2005 audit, the FAP contains an appendix which crosswalks each of the auditor findings to the task within each initiative designed to correct the material weakness. Subsequent to the development of the FAP, the PMO expanded its initial root cause analysis which resulted in additional causes being identified.

Development:

The PMO has established a FAP Executive Dashboard which is updated at least monthly to provide a snapshot of the progress and status of each FAP Initiative. For each task/critical milestone within each FAP Initiative, a color coding is used to identify whether the task is complete (blue), on track (green), moderately delayed (yellow), significantly delayed (red) or not started (white). ICE reported in its FAP Executive Dashboard as of August 1, 2006, that the overall status was red for the area of Invoice Management and yellow for the area of Unliquidated Obligations, (both FPS and non-FPS) and that the overall percentage of completion was approximately 20 percent. The dashboard is weighted on the complexity and the number of days assigned to complete each task. For example, within a CAP three out of six tasks may be completed, but the three which have been completed may not be the most complex or time consuming, thus the percentage of completion would be less than 50 percent.

Completion of all tasks is not scheduled to take place until March 30, 2007. Eleven of the nineteen identified tasks were reflected as complete as of July 31, 2006. The CAP for this material weakness

was not given the highest priority by the Department or ICE, and as such, may not be fully and completely developed as evidenced by the following:

- The PMO is considering revisiting the CAP for unliquidated FPS obligations to determine if any milestones and dates should be revised.
- The CAP does not clearly outline how to validate the operating effectiveness of the procedures implemented.
- The CAP is unclear as to which milestone will address the root cause of the program offices not executing receipt and approval of goods and services due to the lack of processes and training.
- The CAP is unclear as to which milestone will address the issue that ICE personnel are not verifying and validating with the program office that the goods/services were received before processing IPAC transactions.
- Management has not established the linkage of the validation of corrective actions with management's plan for implementation of OMB Circular A-123.

Accountability:

An ICE FAP Initiative owner and a PMO liaison have been assigned for each material weakness included in the CAP. ICE senior leadership also has a role in the FAP Initiative.

The PMO, in conjunction with the initiative owner, completed a resource template for each FAP Initiative which identified the resource name, skill set needed by the resource, and the number of hours per week by month for each resource. The resources were categorized as Executive Sponsor, Initiative Owner, or Staff. The resource template included both ICE employees and contracted personnel.

The ICE FAP Initiative owner, and not the PMO, has responsibility for reporting on the task status and documenting evidence to support such status. The PMO is in the process of gathering such evidence for completed tasks from each of the ICE FAP Initiative owners for its own records. Management is unable to establish the linkage of the validation of corrective actions with the management plan for implementation of OMB Circular A-123.

Validation:

ICE includes a validation step at the end of its critical milestones listing. The last step in the UDOs CAP summary calls for the results of the CAP to be validated with the vendors. However, the CAP does not explain how ICE intends to perform such validation procedures, but rather generally states that such a step should be performed.

Budgetary Accounting

Identification:

Management has segregated the Budgetary Accounting material weakness into three areas: Budgetary, FPS, and Shared Services. When developing the FAP, the PMO performed a root cause analysis which consisted primarily of conducting interviews with personnel and leveraging institutional knowledge of the ICE personnel in the PMO. The root cause analysis initially focused on the conditions cited by the auditors during the FY 2005 audit. The FAP contains an appendix which crosswalks each of the auditor findings to the task within each initiative designed to correct the material weakness so to ensure that the FAP addressed each of the auditor findings cited during the FY 2005 audit. Additionally, as the work progresses, management may identify additional root

causes and will update accordingly. Efforts are still being made by the PMO in reviewing and assessing the process detail within one task under the sections of Budgetary Accounting and FPS, respectively, so it is likely that additional root causes may be identified.

Development:

As discussed under the Development section under UDOs, the PMO has established a FAP Executive Dashboard which is updated at least monthly to provide a snapshot of the progress and status of each FAP Initiative. For each of the areas within the Budgetary Accounting material weakness (Budgetary, FPS, and Shared Services), ICE reported in its FAP Executive Dashboard as of August 1, 2006, that the overall status was green for Budgetary and yellow for both FPS and Shared Services, and that the overall percentage of completion was approximately 20 percent.

Based on the CAP, completion of all tasks is not scheduled to take place until September 30, 2007. Of the twelve tasks currently identified, three are being reflected as being completed as of July 31, 2006.

The Budgetary Accounting CAP was not given the highest priority by the Department or ICE in the current year, and this CAP is still under development. Without the root cause analysis being completed (refer to Identification above) and the addition of the missing elements as detailed below, the plan is not comprehensive and could diminish the ultimate effectiveness of the CAP. Accordingly, we observed several elements missing from the CAP that should be considered for inclusion:

- Not all verification and validation methodologies have been determined as the assessment of all related processes has not yet taken place.
- Task 1 and Task 2 within the Shared Services area focus on resolving symptoms instead of the root cause. Furthermore, the estimated completion date for each of these tasks has passed and the completion dates have not been updated.
- Within the area of Shared Services, the development and implementation of an Activity Based Cost Model for service level agreements has been limited to the services provided by ICE's Offices of Financial Management and the Immigration User Fee account and does not include the services provided by other ICE program offices under service level agreements.
- The subtasks of the Activity Based Cost Model do not address the implementation or agreement by the other components.

Accountability:

Refer to the Accountability section under UDOs for a discussion of the roles of personnel within ICE, the completion of resource templates, and the responsibility for supporting the progress made.

Validation:

ICE did not include validation steps among the critical milestones in the Budgetary Accounting CAP. The Budgetary Accounting CAP did not call for any validation steps or procedures to monitor ICE's progress in rectifying the root cause(s) and remediating the material weakness.

Intragovernmental and Intradepartmental Balances:

Identification:

When developing the FAP, the PMO performed a root cause analysis which consisted primarily of interviewing personnel and leveraging institutional knowledge of the ICE personnel in the PMO. The root cause analysis initially focused on the conditions cited by the auditors during the FY 2005 audit. To ensure each of the FY 2005 auditor findings were addressed, the FAP appendix crosswalks each of the findings to the task designed to correct the material weakness. Subsequent to the development of the FAP, the PMO expanded its initial root cause analysis which identified root causes not identified by the auditors.

Development:

As discussed under the Development section under UDOs, the PMO has established a FAP Executive Dashboard which is updated at least monthly to provide a snapshot of the progress and status of each FAP Initiative. ICE reported in its FAP Executive Dashboard as of August 1, 2006 that the overall status was yellow for this CAP, and the overall percentage of completion was approximately 2 percent.

Completion of all tasks is scheduled for December 31, 2006. None of the four tasks were reported as complete as of July 31, 2006.

The Intragovernmental and Intradepartmental Balances CAP was not given the highest priority by the Department or ICE in the current year, and this CAP is still under development. To help ensure the effectiveness of the CAP, the following elements should be considered for inclusion:

- The reconciliation of transactions and balances with other federal agencies. ICE has received no communication from the Department's OCFO as to the role that ICE will have in the Department's reconciliation of intragovernmental transactions and balances.
- Implementation of quarterly procedures to positively confirm and reconcile all intragovernmental activity and balances with intragovernmental trading partners, including other component entities of the Department.

ICE intends to attend the Department's OCFO-sponsored CAP Workshop for Intragovernmental and Intradepartmental Balances on August 22, 2006.

Accountability:

Refer to the Accountability section under UDOs for a discussion of the roles of personnel within ICE, the completion of resource templates, and the responsibility for supporting the progress made.

Validation:

Upon review of the Intragovernmental and Intradepartmental Balances CAP, it was noted that ICE did not include validation steps among the critical milestones. Although, the PMO acknowledged that validation steps should be included in the Validation section and are inherent in any project task.

Recommendations:

We recommend that ICE:

14. Continue to develop tasks within the Intragovernmental CAP, which focus on and address the intragovernmental reconciliation portion of the material weakness and be proactive in soliciting

guidance from the Department's OCFO since the intragovernmental reconciliation process must be a collaborative effort between the OCFO and each of the components.

15. Within the Budgetary Accounting and UDOs CAPs, continue to develop CAPs to mitigate and ultimately correct control deficiencies, based on management's own assessment of the issues. The CAPs should include a description of the detailed tasks and milestones, key success and performance metrics, and a designated person accountable for completion of the effort.
16. Include CAP validation procedures in all CAPs that should be performed by ICE personnel; the work of the independent auditors should not be substituted for management's own testing and validation procedures.
17. Integrate the CAPs with the Department's plan for OMB Circular A-123 implementation and annual FMFIA assurance statement. Management's plan for verification of corrective actions should be closely integrated with the Department's controls test work conducted to comply with OMB Circular A-123.

Transportation Security Administration (TSA)

Background:

TSA created the CAP based on the DHS CAP Guide as well as input from appropriate internal personnel. TSA had implemented a corrective action plan process prior to receiving any formal guidance on ePMO from DHS. Therefore, TSA is using ePMO as a formality and not as the main method of documentation.

Undelivered Orders, Accounts and Grants Payable, and Disbursements (UDOs)

Identification:

TSA has drafted a CAP to address the UDOs material weakness following the CAP format in ePMO. In addition, management has developed a timetable for corrective actions, and assigned specific tasks with due dates to individuals. Management emphasizes the evolutionary nature of the CAP, including their intent to modify and/or add actions as needed to fully correct the identified internal control weaknesses within the timetable specified by Department leadership (September 30, 2007). As the work progresses, management may identify additional root causes and will update accordingly.

TSA did not evaluate the root cause of the UDOs material weakness within the framework of the ePMO system. However, TSA believes that the root cause of the UDOs material weakness was a result of TSA's system migration from the Department of Transportation to the U.S. Coast Guard. During the system conversion, non-critical payments to the public were held for the first few months of the fiscal year, and were released once the conversion was complete. The payment amounts were recorded, sometimes months later, in the Coast Guard accounting system. The system generated reports used by TSA to calculate the actual accrual percentages keyed on the date the payment was entered in the accounting system, not on the date the payment was actually made. This delay in recording transactions, as well as the fact that TSA and Coast Guard were unfamiliar with one another's capabilities/processes, led to the material weakness.

This system migration resulted in inconsistent data. TSA realizes that there is a need for a better understanding of the Coast Guard system processes and report outputs as well as the need to implement consistent processes for determining accruals. This was discussed in the FY 2005

closeout meetings, and continues to be discussed in the FY 2006 Coast Guard and TSA Biweekly meetings.

FY 2004 was the first year that TSA prepared a grant accrual, and, as such, FY 2005 was the first year TSA needed to validate a prior year's accrual. However, TSA did not identify the need to perform this validation activity in the CAP.

Development:

The issue description and root cause analysis are not adequate descriptions of the key issues surrounding the UDOs material weakness. The CAP developed by TSA does not address the UDOs FY2005 audit finding in a manner specific enough to allow for corrective action to take place if the corrective action plan were implemented by TSA.

In order for the CAP to be an effective method of implementing corrective action, specific subtasks should be included to clarify the tasks listed in the ePMO reports. A positive action by TSA is its engagement in monthly reporting dialogues to the Office of Financial Management and updates into ePMO. TSA provides updates to the TSA Management Control Council. There is open communication between the process owners and the Office of Financial Management as to the progress and status of CAP milestones.

TSA does not use an executive dashboard to measure their critical milestones' success outside of the progress listed in the ePMO reports. TSA does make use of a corrective action plan update template which they submit to the Management Control Council. TSA also tracks their progress on the UDOs CAP based on number of tasks completed. They do not evaluate their progress based on the complexity of the task. The steps listed as critical milestones appear to be easily identified as completed or not completed.

Accountability:

There are individual project owners responsible for implementing each critical milestone. However, the accountability for its implementation is limited due to a lack of specific 'project owners' at varying levels of responsibility.

Validation:

TSA included validation steps among the critical milestones. The UDOs CAP Summary calls for testing to demonstrate the corrective actions were completed and an effective process was put in place to prevent reoccurrence. The UDOs CAP Summary includes a milestone for the review and concurrence of the Management Control Council that the deficiency has been corrected.

Recommendations:

We recommend that TSA:

18. Implement milestones in the UDOs CAP that require review of TSA's accounting for UDOs, to determine their accuracy within TSA, and to assess their presentation in the DHS consolidated balance sheet at September 30, 2006.
19. Implement milestones in the UDOs CAP that require the implementation of policies and procedures to annually validate that the methodology used to estimate its grant accrual provides a reasonable estimate of the actual amount owed.

20. Integrate the CAPs with the Department's plan for OMB Circular A-123 implementation and annual FMFIA assurance statement. Management's plan for verification of corrective actions should be closely integrated with the Department's controls test work conducted to comply with OMB Circular A-123.

Grants and Training (G&T)

Background:

G&T uses its accounting services provider's grant management system to support G&T's grant making activities. The grants management system allows grantees to submit their financial status reports electronically via web-based connections.

Undelivered Orders, Accounts and Grants Payable, and Disbursements (UDOs)

Identification:

In section 3.4 of the Department's CAP Process Guide to the components, it states that "management should validate the control deficiency condition and ensure that the condition is the real issue and not a symptom of a larger more severe control deficiency." Because of a lack of documentation, G&T was unable to substantiate that a comprehensive and thorough root cause analysis was performed. While the issues cited in the CAP are in fact possible root causes, without adequate supporting documentation of the root cause analysis, we were unable to determine if management validated the control deficiency condition and if the actual root cause of the material weakness being addressed was properly identified.

Development:

G&T has developed some key performance measures to correct the material weakness noted in the FY 2005 Independent Auditors' Report. G&T has also developed some procedures to aid in the verification and validation process. The critical milestones for this material weakness are not sufficient enough to provide reasonable assurance that the weakness has been corrected. Though progress can be noted, G&T has not implemented sufficient measures to test and validate key milestones.

Accountability:

G&T has no official system in place to track progress of the CAP implementation. Additional work is needed for G&T to properly establish accountability for its CAP for the remediation of the material weakness.

Validation:

G&T included validation steps among the critical milestones. The UDOs CAP Summary includes a procedure that requires G&T to meet quarterly with the Office of Justice Programs (OJP) to gauge progress achieved in reconciling accruals. The UDOs CAP Summary also includes a milestone that G&T conduct quarterly monitoring and review of the grant accrual calculation.

Recommendations:

We recommend that G&T:


21. Perform a comprehensive and thorough root cause analysis fully supported and substantiated by documentation to identify the underlying causes of the material weakness, including a review of financial IT systems, processes and human resources. The identified root causes should be cross-referenced to the weakness identified by management (as well as those identified by the independent auditor). G&T's CAPs should be prioritized for action, to minimize duplication of effort where corrective actions overlap (e.g., correction of IT system posting logic errors may resolve multiple issues, or mitigate the need for process changes). G&T should not rely on the independent auditors to identify all of the significant causes of control weaknesses, and should only use the audit to corroborate management's findings.
22. Develop a CAP to mitigate and ultimately correct control deficiencies, based on management's own assessment of the issues. The CAP should include a description of the detailed tasks and milestones, as well as key success and performance metrics.
23. Integrate the CAP with the Department's plan for OMB Circular A-123 implementation and annual FMFIA assurance statement. Management's plan for verification of corrective actions should be closely integrated with the Department's controls test work conducted to comply with OMB Circular A-123.



Homeland Security

OCT 11 2006

MEMORANDUM FOR: Richard L. Skinner, Inspector General

FROM: David L. Norquist, Chief Financial Officer 

SUBJECT: Audit of DHS' Corrective Action Plan Process for Financial Reporting – Report No. 3

Thank you for the opportunity to comment upon the Audit of DHS' Corrective Action Plan Process for Financial Reporting – Report No. 3. We concur with the report's recommendations and are currently incorporating the audit results into our corrective action plans. We appreciate your office's contributions to our developing corrective action planning process and we look forward to continue our partnership in implementing corrective actions and most importantly the *DHS Financial Accountability Act*.

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