



# **U.S. Department of Homeland Security**

## **Independent Auditors' Report *and* Consolidated Financial Statements**



**Inception date to September 30, 2003  
(Excerpts from the DHS Performance  
and Accountability Report)**

**U.S. DEPARTMENT OF HOMELAND SECURITY**

**Performance and Accountability Report  
Excerpts of Financial Information Part II  
Seven Months Ended September 30, 2003  
Table of Contents**

<b>Description</b>	<b>Page Number</b>
<b>Excerpts of Financial Information Part II</b>	
Independent Auditors' Report.....	44-51
Appendix I - Material Weaknesses in Internal Control .....	52-68
Appendix II - Other Reportable Conditions in Internal Control.....	69-79
Appendix III - Compliance with Laws and Regulations .....	80-81
Appendix IV – Status of Prior Year Findings.....	82-92
Management Response .....	94
Financial Statements .....	95-100
Notes to Financial Statements.....	101-135
Required Supplementary Information (unaudited) .....	136-141
Required Supplementary Stewardship Information (unaudited) .....	142-143
Other Accompanying Information (unaudited) .....	144-146



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## **INDEPENDENT AUDITORS' REPORT**

Secretary and Inspector General  
U.S. Department of Homeland Security:

We have audited the accompanying consolidated balance sheet of the U.S. Department of Homeland Security (DHS) as of September 30, 2003, and the related statement of custodial activity for the seven months then ended. Further, we were engaged to audit the related accompanying consolidated statements of net cost and changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the seven months ended September 30, 2003. In connection with our engagement, we also considered DHS's internal control over financial reporting and tested DHS's compliance with certain provisions of applicable laws and regulations that could have a direct and material effect on these financial statements.

### **Summary**

As stated in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence related to certain financial statement balances, the accompanying consolidated balance sheet and statement of custodial activity present fairly, in all material respects, the financial position of DHS as of September 30, 2003, and the related custodial activity for the seven months then ended, in conformity with accounting principles generally accepted in the United States of America. The scope of our work was not sufficient to enable us to express an opinion on the accompanying consolidated statements of net cost and changes in net position, combined statement of budgetary resources, consolidated statement of financing, and certain information disclosed in Note 10 related to prohibited seized property, for the seven months ended September 30, 2003.

As further described in Note 1 of the consolidated financial statements, DHS was established by the *Homeland Security Act of 2002* (the Act) as an Executive Branch Department of the United States government. Transfers of funds, assets, liabilities, and obligations from twenty-two existing Federal agencies and programs began on March 1, 2003, the effective date of DHS's operations.

As discussed in Notes 2, 9, 11, and 17 of the consolidated financial statements, DHS made certain adjustments to the amounts transferred into DHS from legacy agencies to correct accounting errors and to adopt a change in accounting method.



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# Financial Information



Our consideration of internal control over financial reporting resulted in the following conditions being identified as reportable conditions:

## Reportable Conditions that are Considered to be Material Weaknesses

- A. Financial Management and Personnel
- B. Financial Reporting
- C. Financial Systems Functionality and Technology
- D. Property, Plant, and Equipment
- E. Operating Materials and Supplies
- F. Actuarial Liabilities
- G. Transfers of Funds, Assets, and Liabilities to DHS

## Other Reportable Conditions

- H. Drawback Claims on Duties, Taxes, and Fees
- I. In-bond Movement of Imported Goods
- J. Acceptance and Adjudication of Immigration and Naturalization Applications
- K. Fund Balance with Treasury
- L. Intragovernmental Balances
- M. Strategic National Stockpile
- N. Accounts Payable and Undelivered Orders

The results of our tests of compliance with certain provisions of laws and regulations disclosed instances of noncompliance with the following laws and regulations that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No.01-02, *Audit Requirements for Federal Financial Statements*:

- *Federal Managers' Financial Integrity Act of 1982 (FMFIA)*
- *Federal Information Security Management Act (Electronic Government Act of 2002)*
- *Single Audit Act Amendments of 1996*

DHS is not currently subject to the requirements of the *Chief Financial Officers Act of 1990* (CFO Act) and, consequently, is not required to comply with the *Federal Financial Management Improvement Act of 1996* (FFMIA). Therefore, we are not reporting herein on DHS's compliance with FFMIA. However, our testwork disclosed deficiencies in financial management information systems, the application of federal accounting standards, and recording of financial transactions, related to FFMIA that are presented within our report on internal control over financial reporting.

The following sections discuss our opinion on the accompanying consolidated balance sheet and statement of custodial activity; the reasons why we are unable to express an opinion on the accompanying consolidated statements of net cost and changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the seven months ended September 30, 2003, and Note 10 related to prohibited seized property; our consideration of DHS's internal control over financial reporting; our tests of DHS's compliance with certain provisions of applicable laws and regulations; and management's and our responsibilities.



## Opinion on the Consolidated Balance Sheet and Statement of Custodial Activity

We have audited the accompanying consolidated balance sheet of the U.S. Department of Homeland Security as of September 30, 2003, and the related statement of custodial activity for the seven months then ended. Further, we were engaged to audit the related accompanying consolidated statements of net cost and changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the seven months ended September 30, 2003.

The U.S. Coast Guard, a component entity of DHS, was unable to provide sufficient documentation, prior to the completion of our audit procedures, to support the acquisition value and existence of property, plant, and equipment (PP&E), amounting to \$2.9 billion that is included within the \$9.1 billion net PP&E balance stated in the accompanying consolidated balance sheet. We were unable to observe a sufficient number of the physical counts of operating materials and supplies (OM&S) conducted by the U.S. Coast Guard, and we were unable to satisfy ourselves by other means as to the fairness of the quantities used in the valuation of OM&S, that amounted to \$497 million included within the \$1.2 billion net OM&S, inventory, and stockpile balance stated in the accompanying consolidated balance sheet. The U.S. Secret Service, another component of DHS, and the U.S. Coast Guard were unable to provide sufficient documentation, prior to the completion of our audit procedures, to support retirement and post-employment benefits amounted to \$3.3 billion and \$201 million, respectively, included within the \$25.3 billion military and other retirement balance stated in the accompanying consolidated balance sheet. The amount of PP&E, OM&S, and retirement and post-employment benefits at September 30, 2003, enters into the determination of net position, net cost, status of budgetary resources, the reconciliation of net cost to budgetary obligations, and custodial activity as of and for the seven months ended September 30, 2003.

Several legacy agencies (federal agencies from which component functions were transferred to DHS) continued to provide accounting and administrative services to DHS during the seven months ended September 30, 2003, pursuant to agreements between the agencies. Legacy agencies regularly submitted accounting and financial information to DHS that is reported in the consolidated financial statements. The scope of our audit did not extend to these legacy agencies in sufficient detail to complete procedures over revenue, costs, and related budgetary transactions, provided by them and reported by DHS during the seven months ended September 30, 2003. In addition, we were unable to complete audit procedures over certain revenues, costs, and related budgetary transactions of the U.S. Coast Guard, prior to the completion of the consolidated audit of DHS.

Statement of Federal Financial Accounting Standard No. 3, *Accounting for Inventory and Related Property*, requires financial statement note disclosure of an analysis of prohibited seized property, including weight or item counts on-hand at the beginning of the year, seizures and disposals during the period, and on-hand weight or item counts at the end of the year (see Note 10). Because we were not engaged as auditors until after March 1, 2003, we were not present to observe the physical count of the prohibited seized property in DHS' possession on March 1, 2003, and we were unable to satisfy ourselves through other audit procedures as to beginning inventory quantities or seizures and disposals that occurred during the seven month period ended September 30, 2003.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence related to certain PP&E, OM&S, and retirement and post-employment

# Financial Information



benefits, as discussed in the second paragraph of this section, the accompanying consolidated balance sheet and statement of custodial activity present fairly, in all material respects, the financial position of DHS as of September 30, 2003, and the related custodial activity for the seven months then ended, in conformity with accounting principles generally accepted in the United States of America.

Because of the matters discussed in the second and third paragraphs of this section, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying consolidated statements of net cost and changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the seven months ended September 30, 2003. In addition, because of the matters discussed in the fourth paragraph of this section, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying disclosure in Note 10 of the weight and item counts of prohibited seized property transferred to DHS from legacy agencies on March 1, 2003, and seizures and disposals that occurred during the seven months ended September 30, 2003.

As further described in Note 1 of the consolidated financial statements, DHS was established by the Act on as an Executive Branch Department of the United States government. Transfers of funds, assets, liabilities, and obligations from twenty-two existing Federal agencies and programs began on March 1, 2003, the effective date of DHS's operations.

As discussed in Notes 2, 9, 11 and 17 of the consolidated financial statements, DHS made certain adjustments to the amounts transferred into DHS from legacy agencies to correct accounting errors and to adopt a change in accounting method.

The information in the Management's Discussion and Analysis (MD&A), Required Supplementary Stewardship Information (RSSI), and Required Supplementary Information (RSI) sections is not a required part of the consolidated financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America or OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. Pursuant to OMB instructions, DHS has presented annualized information in the MD&A for the twelve months ended September 30, 2003. In addition, DHS has presented twelve months of data in certain RSSI disclosures. We did not apply certain limited procedures as prescribed by professional standards to the MD&A and RSSI because the annualized information presented includes the five months preceding March 1, 2003, the effective date of DHS operations as an entity. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of RSI. We noted that certain information presented in the RSSI and RSI is based on net cost and budgetary data from the consolidated statements of net cost and changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the seven months ended September 30, 2003, on which we have not expressed an opinion. We also noted that DHS did not present as RSI a schedule of budgetary resources by major budgetary account, as required. In addition, we determined that DHS did not reconcile nonfiduciary accounts with its trading partners, as specified by OMB requirements, which could affect the intragovernmental information presented as RSI. We did not audit the MD&A, RSSI and RSI and, accordingly, we express no opinion on it.

# Financial Information



The information in the Performance Information and Other Accompanying Information Sections are presented for purposes of additional analysis, and is not a required part of the financial statements. The Performance Information and Other Accompanying Information Sections have not been subjected to auditing procedures, and accordingly, we express no opinion on this information.

## **Internal Control over Financial Reporting**

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect DHS's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

In our audit for the seven months ended September 30, 2003, we noted certain matters, described in Appendices I and II, involving internal control over financial reporting and its operation that we consider to be reportable conditions. We believe that reportable conditions A through G presented in Appendix I are material weaknesses. Appendix II represents other reportable conditions H through N.

We noted that DHS management's FMFIA report did not contain material weaknesses that have been reported by us in Appendix I. We also noted weaknesses in the DHS' FMFIA reporting process that are reported in Appendix I within Comment B – *Financial Reporting*.

\* \* \* \* \*

A summary of the status of prior year reportable conditions related to the specific agencies and programs that transferred into DHS, as reported by the legacy agencies in their previous annual report or performance and accountability reports is included as Appendix IV.

We also noted other matters involving internal control over financial reporting and its operation that we will report to the management of DHS and certain component entities.

## **Internal Controls over Required Supplementary Stewardship Information**

We noted certain significant deficiencies in internal control over Required Supplementary Stewardship Information, discussed in Appendix I, that in our judgment, could adversely affect DHS's ability to collect, process, record, and summarize Required Supplementary Stewardship Information.





## Compliance with Laws and Regulations

Our tests of compliance with certain provisions of laws and regulations, as described in the Responsibilities section of this report, disclosed instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02, and are described in Appendix III.

DHS is not subject to the requirements of the CFO Act and, consequently, is not required to comply with the FFMIA. Therefore, we are not reporting herein on DHS's compliance with FFMIA. However, our testwork disclosed deficiencies in financial management information systems and in the application of federal accounting standards related to FFMIA (e.g., OMB Circulars A-127, *Financial Management Systems*, and A-130 *Management of Federal Information Resources*), and recording of financial transactions, that are presented in Appendices I and II of our report on internal control over financial reporting.

## Responsibilities

**Management's Responsibilities** The *Accountability of Tax Dollars Act of 2002* requires DHS to obtain annual financial statement audits.

DHS management is responsible for the financial statements, including:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
- Establishing and maintaining internal controls over financial reporting, and preparing the MD&A (including the performance measures), RSI, and RSSI; and
- Complying with laws and regulations.

In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies. Because of inherent limitations in internal control, misstatements, due to error or fraud, may nevertheless occur and not be detected.

**Auditors' Responsibilities** As discussed in the Opinion section of this report, the scope of our work was not sufficient to enable us to express an opinion on the accompanying consolidated statements of net cost and changes in net position, combined statement of budgetary resources, and consolidated statement of financing for the seven months ended September 30, 2003, and certain information disclosed in Note 10 related to prohibited seized property, for the seven months ended September 30, 2003. Our responsibility is to express an opinion on the consolidated balance sheet of DHS as of September 30, 2003, and the related statement of custodial activity for the seven months then ended, based on our audit. Except as discussed in the Opinion section of this report, we conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated balance sheet and statement of custodial activity are free of material misstatement.



# Financial Information



An audit includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall consolidated financial statement presentation.

We believe that our audit provides a reasonable basis for our opinion on the consolidated balance sheet of DHS as of September 30, 2003, and on the related statement of custodial activity for the seven months then ended.

In planning and performing our audit of the consolidated balance sheet of DHS as of September 30, 2003, and on the related statement of custodial activity for the seven months then ended, we considered DHS's internal control over financial reporting by obtaining an understanding of DHS's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated balance sheet and statement of custodial activity. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin No. 01-02, we considered DHS's internal control over RSSI by obtaining an understanding of the DHS's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over RSSI and, accordingly, we do not provide an opinion thereon.

OMB Bulletin No. 01-02 requires auditors, with respect to internal control related to performance measures determined by management to be key and reported in the MD&A, to obtain an understanding of the design of significant internal controls relating to the existence and completeness assertions. Our audit was not designed to provide an opinion on performance measures, and we do not express such an opinion. As discussed in the Opinion section of the report, we did not apply procedures to the MD&A and performance measures presented therein, because the data presented was for the twelve months ended September 30, 2003, which includes five months preceding the period covered by our audit.

As part of obtaining reasonable assurance about whether DHS's 2003 consolidated balance sheet and statement of custodial activity are free of material misstatement, we performed tests of DHS's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of consolidated balance sheet and statement of custodial activity amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to the DHS. We also note that while OMB Bulletin No. 01-02 requires certain testing and reporting on the compliance requirements of FFMIA, DHS is not subject to those requirements, and as a result, testing for compliance with FFMIA requirements

# Financial Information



was not an objective of our audit. Providing an opinion on compliance with laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

## **Distribution**

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

KPMG LLP

January 30, 2004



## **Appendix I – Material Weaknesses in Internal Control**

### **A. Financial Management and Personnel**

*Background:* The creation of the Department of Homeland Security (DHS) on March 1, 2003, brought together 22 Federal agencies and programs that previously operated within varied financial management environments from other Executive Branch departments. Management activities, such as the assignment of financial management responsibilities, the degree of autonomy to make decisions, the use of integrated reporting systems, and financial reporting procedures were vastly different in the agencies and programs (referred to as Bureaus) that transferred into DHS. Since March 1, 2003, the DHS financial reporting infrastructure, including systems and reporting processes, and its management oversight of financial reporting have remained mostly decentralized, with Bureau finance departments and responsibilities remaining largely intact. As such, many of the Bureaus that came into DHS continued to rely on their former Executive Branch departments (referred to as legacy agencies) to provide accounting services. The DHS Office of the Chief Financial Officer (OCFO) operates with relatively few finance personnel, who principally serve to coordinate financial management policy and consolidate financial information submitted by the Bureaus. For fiscal year (FY) 2004, DHS intends to consolidate most of these accounting operations.

*Conditions:* We noted the following internal control weaknesses related to financial management and personnel:

1. The DHS OCFO has not:
  - Established a hierarchy of financial reporting authority or an entity-wide financial management organization chart that clearly defines roles and responsibilities and assists with the identification of critical human resources needed to ensure that all financial management responsibilities are assigned.
  - Assessed the critical needs of the financial management process to ensure that proper internal controls over financial reporting are designed and operating effectively, as defined by the Comptroller General.
  - Developed standard operating procedures (SOPs) that will result in consolidated financial reports that are consistent, timely, accurate, and in compliance with Federal accounting standards.
  - Hired or contracted qualified personnel to properly perform financial reporting functions of an Executive Branch department CFO's office.
2. The U.S. Coast Guard and the Strategic National Stockpile, both component bureaus of DHS, have weaknesses in financial management oversight that hinder their ability to prepare accurate, complete, and timely financial information for consolidation into the DHS financial statements. At the U.S. Coast Guard, we noted weaknesses related to the financial reporting process, maintenance of financial records, and policies and procedures and some aspects of Federal accounting standards related to repairable property, plant and equipment (PP&E) components, certain types of PP&E improvements and post-employment benefits. These weaknesses, as further explained later in this appendix, indicate the need for increased financial management oversight and skilled personnel. At the Strategic National Stockpile, the accounting process is fragmented and lacks unified financial management oversight. This condition is also further explained later in this appendix.



*Cause/Effect:* Many of the conditions at DHS Headquarters were not unexpected for a newly created organization, especially one as large and complex as DHS. Additionally, the conditions at the U.S. Coast Guard have surfaced because of its greater relative size to DHS compared to its former legacy Executive Branch department. This has brought its financial reporting processes under proportionally greater scrutiny. Nevertheless, the conditions described above have prevented DHS from timely preparation of accurate consolidated financial information and reports during the seven months of operations. DHS will continue to have difficulty complying with Federal accounting standards and requirements, and meeting internal control standards designed to achieve the five essential elements of internal control as defined by the Comptroller General and stated below. In addition, improvements will be necessary to meet the accelerated due dates for FY 2004 financial statement reporting.

*Criteria:* The *Federal Managers' Financial Integrity Act of 1982 (FMFIA)* requires that agencies establish internal controls according to standards prescribed by the Comptroller General and specified in the General Accounting Office's (GAO) *Standards for Internal Control in the Federal Government*. According to these standards, management should ensure that they have an organizational structure that supports the planning, directing, and controlling of operations to meet agency objectives; clearly define key areas of authority and responsibility; and provides for appropriate lines of reporting. Management is to identify the knowledge and skills needed for various jobs and establish good human capital practices. The standards also define internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. The five essential control elements referred to above are: control environment, communication, control activities, risk assessment, and monitoring.

*Recommendations:* We recommend that:

1. The DHS OCFO:

- a) Establish a hierarchy of reporting authority and financial management organization chart, including the designation of key managerial positions within the individual Bureaus and the OCFO.
- b) Assess critical needs related to financial management that should be performed to ensure that financial processes are designed and implemented with proper internal control, including the five essential control elements (i.e., control environment, communication, control activities, risk assessment, and monitoring) as defined by the Comptroller General.
- c) Establish SOPs that will result in consolidated financial reporting that is consistent, timely, accurate, and in compliance with Federal accounting standards and control requirements.
- d) Hire or contract additional accounting personnel that possess complementary technical accounting skills to manage the development and implementation of SOPs and to provide appropriate oversight of the consolidated financial reporting process.
- e) Take a more active oversight role of accounting functions performed outside the DHS entity, particularly at the Strategic National Stockpile.



## 2. The U.S. Coast Guard:

- a) Evaluate the existing financial management organizational structure and conduct an assessment to determine the number of personnel needed along with requisite skills and abilities and make improvements as indicated.
- b) Develop procedures for providing oversight and guidance to operating unit and program offices that provide key financial information.
- c) Establish procedures for performing periodic reviews to assess the sufficiency of financial policies and procedures.

## B. Financial Reporting

*Background:* Financial reporting at DHS is dependent upon the quality of financial reporting at its individual Bureaus and the ability of the OCFO to consolidate information timely and consistently. The consolidation process is accomplished, in large part, by using the Department of the Treasury's (Treasury) *Treasury Information Executive Repository* (TIER), a data warehouse through which DHS Bureaus submit their financial information. TIER interfaces with the CFO Vision software, which is used to prepare DHS consolidated and individual Bureau financial statements. Most Bureau financial systems are not electronically interfaced with TIER, necessitating manual monthly submissions to the OCFO, which inputs the data into TIER. The OCFO is using TIER as a temporary system solution until permanent financial reporting system architecture for DHS can be developed and implemented.

*Conditions:* We noted the following internal control weaknesses related to financial reporting at DHS and its Bureaus:

### 1. The OCFO, together with DHS Bureaus, has not:

- Prepared accurate and timely periodic consolidated financial statements due, in part, to difficulty related to the use of TIER. The implementation and use of TIER and related software have presented challenges, many of which still remain, to the OCFO and the Bureaus. For example, most Bureaus had to configure their systems, processes, and procedures to properly accumulate, edit, and submit data for TIER, but errors continue to occur routinely. Only Bureaus that transferred to DHS from Treasury had policies and procedures already in place to ensure the accurate and timely submission of TIER data.
- Implemented an electronic interface between TIER and the Bureaus that allows for accurate and efficient consolidation of financial data. For example, at the DHS bureau Emergency Preparedness and Response (EPR), the lack of an electronic interface has made already complicated manual closing processes even more complicated and error prone.
- Completed a comparison of the U.S. Standard General Ledger (USSGL) software coding in TIER and its mapping to the CFO Vision software against the Treasury's USSGL roll-ups and financial statement crosswalks, to ensure that DHS' financial statements, as produced by CFO Vision, are presented consistent with applicable accounting standards. For example, we noted that other liabilities were not properly presented in the DHS balance sheet and required revisions to the TIER software to correct the discrepancy.
- Performed an analysis or developed procedures to ensure that all Bureaus are consistently interpreting Treasury's USSGL guidance and consistently applying it to the data submitted for consolidated reporting purposes.

# Financial Information



- Prepared policies and procedures related to timely, complete, and accurate submission of monthly TIER financial information and subsequently perform a reconciliation of TIER and CFO Vision output to the original data submissions to check the accuracy of the TIER processing. The OCFO performs only limited data quality checks for TIER and CFO Vision input and output, although there are some high-level system software checks.
- Prepared comprehensive financial reporting instructions relating to all elements of the DHS Performance and Accountability Report, including the financial statements, related notes, Management Discussion and Analysis (MD&A), Required Supplementary Information (RSI), Required Supplementary Stewardship Information (RSSI), and other financial reporting matters, such as proper identification and reconciliation of intra-department eliminating entries. Some financial statement templates and/or instructions provided to the Bureaus by the OCFO were incomplete or unclear, did not allow sufficient time for the Bureaus to properly implement the requirements, and did not address unique reporting considerations existing in some Bureaus.
- Prepared RSSI correctly by including outcome measures for each stewardship investment discussed, as required.
- Adopted an effective process to compile year-end consolidated financial statements, including all note disclosures, to ensure presentation in accordance with federal accounting standards. DHS does not have effective systems or procedures to accumulate and present cost data by responsibility segment and major program, as required by Statement of Federal Financial Accounting Standard (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards*, or by major budgetary account in RSI, as required. In addition, DHS OCFO has not implemented adequate procedures and controls to compile balances and other financial data reported by the Bureaus into periodic (e.g., quarterly) consolidated financial statements.
- Performed an analysis and informed the Bureaus of laws and regulations that could have a direct and material effect on DHS' consolidated financial statements. In addition, the OCFO has not implemented monitoring controls to determine if the Bureaus are in compliance with laws and regulations.
- Implemented procedures, and related controls, that will ensure accuracy and completeness in the FMFIA reporting process. We noted several discrepancies between information provided by various Bureaus and information reported in DHS's draft Performance and Accountability Report. In addition, we noted that DHS has not reported some material weaknesses that we have reported herein. We also noted a lack of timeliness in reporting by some Bureaus and corrective actions and milestones were not presented for some findings.

## 2. At the U.S. Coast Guard:

- The financial reporting process is complex, labor-intensive, and requires a significant number of “on-top” adjustments (adjustments made to financial statements directly rather than first through general ledger entries). This situation is due in large part to the manual integration of data from three separate general ledger systems, to produce year-end financial information.
- The processes that finance center personnel use for making year-end closing entries do not include sufficient documentation of internal controls, such as management review and approval of adjusting entries. In addition, the software application used to process on-top adjustments does not have sufficient controls such as identifying all entries (debits and credits for USSGL accounts affected) for each adjustment.

# Financial Information



3. At Citizenship and Immigration Services (CIS) and Immigration and Customs Enforcement (ICE) (collectively referred to as CIS/ICE because they share the same accounting operations), EPR, and the U.S. Coast Guard, policies and procedures for exporting data from the general ledger for periodic TIER submissions is not documented, quality control reviews of financial reports are not regularly performed, documentation of on-top adjustments is lacking, and/or TIER input is not routinely reconciled with CFO Vision output provided by DHS Headquarters. In addition, in some cases, the accuracy of financial information is highly dependent on the knowledge and experience of a limited number of key financial personnel, rather than on clearly documented procedures manuals and process flow documentation.

*Cause/Effect:* The rapid formation of DHS and the very limited staffing at the OCFO have prevented the OCFO from fully addressing the conditions noted above. It will take a reasonable period of time for the OCFO to stabilize DHS' financial reporting, prepare standard reporting and control procedures, and perform the necessary analyses to ensure the reliability of financial information. During the period ending September 30, 2003, most Bureaus manually prepared TIER submissions, which increased the likelihood of error. The conditions at U.S. Coast Guard are due in part to an extensive number of Treasury symbols that increases the number accounts that require monitoring. CIS/ICE has been negatively affected by the recent attrition of financial personnel worsened by the lack of documented procedures. EPR has been negatively affected by a lack of clear instructions during the implementation of the TIER upload and account mapping process. Nevertheless, the financial reporting weaknesses described above directly affect the reliability and usefulness of DHS' periodic financial information, the accuracy of the annual consolidated financial statements, and the efficiency of the reporting process.

*Criteria:* Although DHS is not presently subject to the Chief Financial Officers Act, as amended, (CFO Act), its requirements are still relevant to DHS. At agencies subject to this law, CFOs are responsible for maintaining an integrated financial management system, including financial reporting and internal control, that complies with accounting and internal control standards and requirements, and provides for reliable and timely financial information. Furthermore, GAO's *Standards for Internal Control in the Federal Government* requires that internal controls be documented in management directives, administrative policies, or operating manuals, transactions and other significant events also be clearly documented; and information be recorded and communicated timely with those who need it within a timeframe that enables them to carry out their internal control procedures and other responsibilities.

*Recommendations:* We recommend that:

1. The DHS OCFO, in coordination with Bureau financial management:
  - a) Continue to stabilize the consolidation reporting process, and install electronic interfaces between TIER and Bureau systems to ensure timely and accurate financial data consolidation. Written policies and procedures should be developed for exporting data from Bureau general ledger systems to TIER. Development of a DHS integrated financial management system architecture and its implementation should continue.
  - b) Develop and implement internal control policies and procedures to ensure that the TIER and CFO Vision logic is reviewed periodically for accuracy, completeness, and fair presentation. This periodic review will ensure that TIER and CFO Vision are updated for any future modifications made to the Treasury USSGL crosswalks and for future material changes to the nature and presentation of DHS financial statement balances.



# Financial Information



- c) Identify and prepare Department-wide guidance, where needed, to ensure the consistent application of Federal accounting principles and use of Treasury's USSGL.
- d) Establish written policies and procedures that provide reasonable assurance that the inputs and outputs to and from TIER and CFO Vision are materially accurate and complete. These procedures should include periodic Bureau reconciliations of TIER inputs to TIER-produced trial balances and CFO Vision Bureau financial statements, and confirmations to the DHS OCFO that such reconciliations have been completed and reconciling items have been resolved.
- e) Develop and provide the Bureaus comprehensive DHS-specific financial reporting instructions for the Performance and Accountability Report, including financial statements and notes, MD&A, RSI, RSSI, and other financial reporting matters. Implement an OCFO process to prepare MD&A, RSSI and RSI that is in full compliance with required reported standards.
- f) Develop and implement procedures to compile data and prepare accurate and complete consolidated financial statements that contain disclosures required by federal accounting standards. Develop procedures to accumulate and present cost data consistent with the requirements of SFFAS No. 4 in the statement of net cost, and present required budgetary data in the RSI. Prepare pro-forma financial statements prior to year-end that contain all anticipated updates and changes to presentation and note disclosures. Complete the GAO CFO Checklist timely, together with explanations on how required disclosures are addressed in the DHS consolidated financial statements. The Checklist should be prepared at the same time as the pro-forma consolidated financial statements – prior to year-end.
- g) Develop, implement, and monitor procedures for the Bureaus to reconcile intra-DHS eliminations on at least a quarterly basis, beginning in FY 2004.
- h) Develop and implement a procedure with assistance from DHS General Counsel, if considered necessary, to perform an annual review and update of the laws and regulations that could have a direct and material effect on DHS' consolidated financial statements, and to report such laws and regulations to the Bureaus. In addition, develop and implement monitoring and reporting controls to measure Bureau compliance with the laws and regulations that affect DHS' financial reporting.
- i) Develop procedures to ensure the timely performance and accurate reporting of management's assessment of controls and financial management systems in compliance with OMB Circular A-123.

## 2. The U.S. Coast Guard:

- a) Conduct an assessment of its current financial reporting process, with the goal of implementing appropriate internal controls and reducing complexity.
- b) Improve documentation for year-end closing entries, including management review and approval and clear identification of all on-top adjustments with all associated account entries.
- c) Reduce the reliance on the limited number of key personnel by cross training personnel and documenting the financial reporting process.

## 3. The EPR, CIS/ICE and the U.S. Coast Guard:

- a) Employ sufficient financial management and staff and other resources as necessary to ensure that accounting processes from other smaller DHS Bureaus are integrated effectively into BICE, as planned in FY 2004.



- b) Develop policies and procedures for exporting data from the general ledger for periodic TIER submissions, performing quality control reviews, documenting on-top adjustments, and reconciling TIER input with CFO Vision output provided by DHS Headquarters.
- c) Cross-train additional personnel in the financial reporting and TIER submission process, especially in the quality assurance review of the data submitted, to ensure that sufficient resources are available to assist at peak financial reporting periods.
- d) Document key SOPs for significant financial reporting processes.

## C. Financial Systems Functionality and Technology

*Background:* Controls over information technology (IT) and related financial systems are essential elements of financial reporting integrity. Effective general controls in an IT and financial systems environment are typically defined in six key control areas: entity-wide security program planning and management, access control, application software development and change control, system software, segregation of duties, and service continuity. In addition to reliable controls, federal financial management system functionality is important to program monitoring, increasing accountability of financial and program managers, providing better information for decision-making, and increasing the efficiency and effectiveness of services provided by the Federal government.

DHS is currently designing Department-wide IT and financial architectures, to be completed by the end of FY 2005. Until the architectures are complete and the related IT and financial system infrastructure, controls, and processes are implemented, DHS' IT and financial system control environment will continue to consist primarily of the processes and controls in place at the Bureaus.

*Conditions:* We noted the following IT and financial system control and functionality weaknesses at DHS and its Bureaus:

1. Regarding entity-wide security program planning and management:
  - Security certification and accreditation (C&A) programs were not consistently and thoroughly implemented. Complete system inventories were not maintained, and reviews of controls had not been conducted for many systems.
  - Security training and awareness programs were inconsistent.
  - Security plans did not consistently document existing system security controls, were incomplete, or otherwise did not meet requirements set forth in Office of Budget and Management (OMB) Circular A-130, *Management of Federal Information Resources*.
  - Security risk assessments were not regularly performed and were not performed consistently.
2. Regarding access controls:
  - Instances of missing user passwords on key servers and databases, weak user passwords, and weaknesses in user account management were noted. Also, we noted several cases where user accounts were not periodically reviewed for appropriateness, including authorizations to use group user accounts and to identify excessive access privileges.

# Financial Information



- Instances where workstations, servers, or network devices were configured without necessary security patches, or were not configured in the most secure manner. We also identified many user accounts that were not configured for automatic log-off or account lockout.
3. Regarding application software development and change control:
- Instances where Bureaus did not document changes made to applications and related change approvals. Procedures for documenting, approving, and implementing application changes were not consistently in place and applied.
  - Changes to software were not always tested prior to implementation, and movement of changes into the production environment was not always controlled.
4. Regarding system software:
- Instances where policies and procedures for restricting and monitoring access to operating system software were not implemented, or were inadequate. In some cases, the ability to monitor security logs did not exist.
  - Changes to sensitive operating system settings were not always documented.
5. Regarding segregation of duties:
- Instances where individuals were able to perform incompatible functions, such as the changing, testing, and implementing software, without sufficient compensating controls in place.
  - Instances where key security positions were not defined or assigned, and descriptions of positions were not documented or updated.
6. Regarding service continuity:
- Several Bureaus had incomplete business continuity plans and systems with incomplete disaster recovery plans. Some plans did not contain current system information, emergency processing priorities, procedures for backup and storage, or other critical information.
  - Some Bureau service continuity plans were not consistently tested, and individuals did not receive training on how to respond to emergency situations.
7. Regarding financial system functionality:
- Several instances where Bureau financial management systems were not fully compliant with the USSGL at the transaction level. Specific and significant instances of non-compliance are described in other reportable conditions in this appendix and appendix II.
  - Most Bureau financial management systems, are not fully integrated, leading to extensive manual efforts and the need for routine on-top adjustments to generate and report financial information.
  - Bureau financial management systems often do not adequately support managerial cost accounting requirements. Consequently, most Bureaus have difficulty accumulating data in a manner that enables DHS to fully comply with federal accounting standards.

# Financial Information



*Cause/Effect:* Although these weaknesses were inherited from the Bureaus that came into DHS, a current contributing factor is the challenge of merging numerous and varying financial management systems and control environments into a DHS environment. At many of the larger Bureaus, IT and financial system support operations are decentralized, contributing to challenges in integrating DHS IT and financial operations. In addition, financial system functionality weaknesses can be attributed to non-integrated legacy financial systems that do not have the embedded functionality called for by OMB Circular A-127, *Financial Management Systems*.

DHS has taken some steps to begin addressing current IT and financial system issues on a Department-wide basis. For example, DHS has designated a Chief Information Security Officer, issued the *Information Technology Security Program Publication*, and formed a council focused on developing the requirements for Department-wide financial systems and supporting business processes. Nevertheless, collectively, the identified weaknesses limit DHS' ability to ensure that critical financial and operational data is maintained in a manner to ensure confidentiality, integrity, and availability.

*Criteria:* DHS is required to comply with the *Federal Information Security Management Act (FISMA)*, which was passed as part of the *Electronic Government Act of 2002*. FISMA requires that Federal agencies and departments: 1) conduct an annual self-assessment review of their IT security program; 2) develop and implement remediation efforts for identified security weaknesses and vulnerabilities; and 3) report to OMB on the level of compliance. In addition FISMA calls for agencies and departments to comply with the requirements contained within OMB Circular A-130. The National Institute of Standards and Technology (NIST) publications further describe essential criteria for maintaining effective IT system controls. In addition, OMB Circular A-127 prescribes policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems. In particular, OMB Circular A-127 specifies the need for integrated financial systems and to account for financial data using the USSGL at the transaction level.

SFFAS No. 4, requires the classification of revenue and cost information by responsibility segment and major program in the statement of net cost. In addition, Departments are required to present a schedule of budgetary resources by major budgetary account in RSI.

*Recommendations:* We recommend that the DHS CIO, in coordination with the OCFO:

1. For entity-wide security program planning and management:
  - a) Design and implement a DHS-wide security C&A program that encompasses the design and implementation of a DHS-wide security training and awareness program, consistent with OMB and NIST guidance.
  - b) Complete security risk assessments in a consistent manner per OMB guidance.
2. For access control:
  - a) Adopt password controls that meet DHS password requirements and are enforced on all systems.
  - b) Implement password account management process within the Bureaus to ensure the periodic review of accounts.



- c) Design and implement a DHS-wide patch and security configuration process.
  - d) Implement a vulnerability assessment process, where systems are periodically reviewed for security weaknesses.
3. For application software development and change control:
- a) Adopt an entity-wide application change control policy that requires changes to be authorized and tested prior to implementation.
  - b) Adopt policy to require documentation of specific changes and related approvals.
  - c) Adopt policy to require analysis of change requests to ensure consistency with agency policy, user requirements, and implementation schedules.
4. For system software, ensure policies and procedures to monitor and restrict the use of or ability to make changes to operating systems are in place and followed by Bureaus.
5. For segregation of duties, perform an analysis of IT position responsibilities and implement policies and procedures at the Bureau level to improve segregation of duties for IT and accounting functions, including documentation of key security positions.
6. For service continuity:
- a) Require Bureaus to develop and implement complete business continuity plans and system disaster recovery plans.
  - b) Periodically test key service continuity capabilities.
  - c) Design and implement a DHS-wide service continuity-training program.
7. For financial system functionality:
- a) Continue with plans to identify requirements needed to design a department-wide financial system and related business processes that are integrated and reduce the need for manual and on-top adjustments.
  - b) Ensure that new financial systems and business processes are designed and implemented to meet Federal reporting requirements with policies and standards such as those contained in OMB Circular A-127.

## **D. Property, Plant, and Equipment**

*Background:* Property, plant and equipment (PP&E) represents approximately 20 percent of total DHS assets and more than 50 percent of non-monetary assets. DHS uses a wide variety of capital assets to accomplish its mission, some of which are not typically maintained by non-defense agencies, such as aircraft, marine boats and vessels, and explosive detection devices. These assets often have long useful lives, and undergo extensive routine servicing that may increase their value or extend their useful lives. In addition, DHS has several internal use software development projects underway that will result in capitalized software balances in future years. Consequently, application of proper accounting standards to account for PP&E is important to the accuracy of DHS' consolidated financial statements.

# Financial Information



*Conditions:* We noted the following internal control weaknesses related to PP&E at DHS Bureaus:

1. The U.S. Coast Guard has not:
  - Retained original acquisition documentation or sufficient documentation of alternative estimation methodologies and assumptions to support and record \$2.7 billion of PP&E.
  - Properly accounted for depreciation related to improvements made to certain types of PP&E consistent with Federal accounting standards.
  - Established internal financial management policies related to useful lives for certain vessels that are consistent with useful life determinations made by the U.S. Coast Guard's Ship Structure and Machinery Evaluation Board (SSMEB).
  - Properly classified repairable items with useful lives over two years as PP&E instead of operating material and supplies (OM&S) and depreciated these items accordingly.
2. The DHS Bureau Transportation Security Administration (TSA) lacks a comprehensive automated property management system that interfaces and reconciles with the general ledger and does not have adequate policies and procedures that ensure the accuracy of reported acquisitions and disposals of property.
3. The CIS/ICE has not consistently applied procedures to identify and capitalize software development costs or to reclassify software placed into production from software in development. At September 30, 2003, software costs were not considered material to the consolidated financial statements; however, software development costs are expected to increase in future years.

*Cause/Effect:* The U.S. Coast Guard lacks sufficient policies that define documentation requirements for PP&E; sufficient financial management oversight to ensure the proper application of Federal accounting standards related to improvements for certain types of assets and classification of repairable items; and appropriate policy to ensure useful lives for financial reporting are consistent with program/operational criteria. An analysis of repairable items was performed and the U.S. Coast Guard modified its policy and adjusted balances accordingly. TSA relies on several disconnected databases to assist in the tracking, accounting, and financial reporting of PP&E. The result is a complicated asset reporting process at TSA that increases the likelihood of error in the financial statements. CIS/ICE lacks sufficient SOPs that clearly define accounting policies for software costs. Over the next few years, CIS/ICE anticipates spending significant resources developing new software, such as US VISIT. Therefore, the lack of SOPs will increase the risk of financial statement errors due to misapplication of accounting standards for software.

*Criteria:* SFFAS No. 6, *Accounting for Property, Plant, and Equipment:*

- Requires that PP&E be recorded at historical cost with an adjustment recorded for depreciation. In the absence of such information, estimates may be used based on a comparison of similar assets with known values or inflation-adjusted current costs.
- Provides clear requirements for the period over which PP&E and their improvements are to be depreciated, depending upon whether the useful life of the base asset has been extended. The U.S. Coast Guard's *Naval Engineering Manual* specifies the SSMEB as the prime source of information on material condition and remaining service life of cutter and standard boat classes.



# Financial Information



- Defines PP&E as tangible assets that have estimated useful lives of two years or more, are not intended to be sold, and are intended for use by the agency. The U.S. Coast Guard's repairable items have useful lives of 2 years or more. They are generally components of larger equipment, such as the U.S. Coast Guard's vessels, aircraft, and electronic systems (but primarily aircraft) that also have useful lives longer than two years. Classifying repairable items as PP&E means that the cost of this equipment will be systematically and rationally allocated through depreciation over the lives of these assets.

SFFAS No. 10, *Accounting for Internal Use Software*, provides requirements for the capitalization and reporting of software development costs. Although DHS is not subject to the *Federal Financial Management Improvement Act of 1996* (FFMIA), DHS should still ensure that its systems meet federal financial systems requirements, which include the requirement for effective and efficient financial systems. GAO's internal control standards require that internal control and all transactions and other significant events are clearly documented and readily available for examination.

*Recommendations:* We recommend that:

1. The U.S. Coast Guard:
  - a) Develop and document methodologies and assumptions to support the value of the \$2.7 billion in PP&E that is not evidenced by original acquisition or otherwise sufficient documentation.
  - b) Develop and implement policies to ensure the quality, sufficiency, and maintenance of documentation for future PP&E acquisitions and disposals.
  - c) Develop and implement policies and procedures that ensure appropriate depreciation according to Federal accounting standards.
  - d) Account for repairable items as PP&E.
2. The TSA:
  - a) Implement a comprehensive automated property system that interfaces with its general ledger.
  - b) Develop property management policies and procedures for property acquisitions, disposals, retirements, and transfers.
  - c) Establish an effective property management program at all field facilities, applying a Bureau-wide property management policy with associated controls.
3. The CIS/ICE:
  - a) Perform a review of its existing software capitalization policy to determine adequacy, especially given the large anticipated future software development expenditures. The policy should be sufficiently detailed to allow developers and accounting personnel to identify the various phases of the software development lifecycle and the associated accounting treatment, as described in SFFAS No. 10.
  - b) Develop and implement procedures for developers to track and notify accounting personnel when software has been placed into production so that accounting personnel can properly classify and amortize the software costs.





## E. Operating Materials and Supplies

*Background:* OM&S are maintained by the U.S. Coast Guard and Customs and Border Protection (CBP) in significant quantities, and consist of tangible personal property to be consumed in normal operations to service marine equipment, aircraft, and other operating equipment. The majority of the U.S. Coast Guard's OM&S is physically located at either Inventory Control Points (ICPs) or in the field. The U.S. Coast Guard's policy requires regularly scheduled physical counts of OM&S, which are critical to supporting the proper valuation of OM&S and its safekeeping.

*Conditions:* We noted the following internal control weaknesses related to OM&S at the U.S. Coast Guard:

- Internal controls over physical counts were not operating effectively. Personnel at certain field units lacked an understanding of inventory property procedures. At nearly half of the locations we observed, personnel either did not properly resolve all count variances or did not properly approve all adjustments. In addition, items were not always properly bar-coded and tagged. On-hand quantities frequently did not agree to the perpetual inventory records, and procedures did not sufficiently address whether all inventory on-hand was properly recorded in those perpetual records or require timely resolution, which could take up to 45 days. Also, at several field units, minimum statistical sampling requirements necessary to accurately conclude on the existence and completeness of inventory were not met.
- The U.S. Coast Guard's OM&S policy was not periodically reviewed and evaluated to ensure its materiality assertion remains valid. The policy was based on the belief that the value of the OM&S did not represent a material amount. As a result, a material amount of OM&S at field units was expensed upon purchase, rather than when consumed. However, at our request, the U.S. Coast Guard performed an analysis and, as a result, concluded that the aggregate value of such OM&S exceeded their materiality threshold and should have been capitalized.

*Cause/Effect:* The U.S. Coast Guard's policies and procedures for conducting physical inventories are outdated, resulting in ad hoc procedures being performed to complete inventories and excessive time periods taken to resolve variances. Unresolved inventory discrepancies could result in financial statement misstatements that may not be corrected in time to meet accelerated reporting requirements.

The U.S. Coast Guard also does not have a process in place to periodically review its OM&S capitalization threshold policy for field units to ensure that material amounts are identified and appropriately capitalized. During our FY 2003 audit, the U.S. Coast Guard performed an analysis of these amounts and concluded that their materiality assertion was no longer valid. Consequently, the U.S. Coast Guard modified its policy, increased the number of reportable units, and adjusted the OM&S balance accordingly.

*Criteria:* According to GAO's internal control standards, assets at risk of loss or unauthorized use should be periodically counted and compared to control records. Auditing standards require that the auditor observe physical counts of inventories and determine the effectiveness of the counting procedures. SFFAS, No. 3, *Accounting for Inventory and Related Property*, states that OM&S generally should be recorded as an asset and expensed when issued to the end user. An exception is made if the amount of OM&S is immaterial.

# Financial Information



*Recommendations:* We recommend that the U.S. Coast Guard perform the following for:

## 1. *Physical Inventories:*

- a) Update OM&S physical count policies, procedures, and controls and provide training to personnel responsible for conducting physical inventories, including procedures addressing bar-coding and tagging, and require personnel to complete their research into the cause of variances and submit the results of the physical inventories within 15 or fewer calendar days after completion of the physical count.
- b) Conduct a comprehensive review of field-held OM&S to fully assess current procedures relating to the proper identification and classification of OM&S items including items that do not represent OM&S, excess and/or obsolete items, and system-based issues with OM&S applications.
- c) Implement effective oversight and monitoring procedures to ensure that physical inventory counts are performed and evaluated in accordance with policies and procedures.
- d) Consider developing risk-based cycle counting procedures for OM&S.

## *Capitalization of OM&S:*

- a) Capitalize field unit OM&S, consistent with Federal accounting standards and, as appropriate, based on the results of the U.S. Coast Guard's *Study of Field OM&S Reporting Thresholds and Units*.
- b) Implement financial management controls to periodically monitor OM&S, to ensure that appropriate changes and revisions to existing policies can be made in a timely, and in a comprehensive and consistent manner.

## **F. Actuarial Liabilities**

*Background:* We were unable to audit the liability associated with the U.S. Secret Service's (USSS) retiree benefit plan and the U.S. Coast Guard's liability for post-employment military travel benefit at DHS because of insufficient time and/or lack of supporting documentation.

The District of Columbia administers the District of Columbia Police and Fireman's Retirement System for Secret Service Employees (D.C. Pension Plan). The USSS' Uniformed Division and White House Police can elect to join this D.C. Pension Plan up to the day the person retires. The D.C. Pension Plan makes the benefit payments to the retired person and/or their beneficiaries on a pay-as-you-go basis. Active USSS employees who have elected to participate in the D.C. Pension Plan contribute to the plan through salary deductions. The D.C. government is reimbursed each month for benefit payments in excess of salary deductions. The USSS receives a permanent, indefinite appropriation each year to pay the excess of benefit payments over salary deductions.

The U.S. Coast Guard provides an entitlement to its service members to pay the costs associated with travel and transportation of service members, their family members and household goods, at the time of separation from their last duty station to their home or other location. Entitlement is earned upon entry into the military service.

*Conditions:* At the USSS, we noted that the actuarial pension liability for the employees who have elected to participate in the D.C. Pension Plan was not recorded by the USSS or by any other Federal entity, prior to our audit.

# Financial Information



The U.S. Coast Guard did not determine or record the amounts and timing of the future payments consistent with Federal accounting standards.

*Cause/Effect:* USSS management interpreted SFFAS No. 5 to indicate that only the administrative entity, rather than the USSS, should record the actuarial liability for pension plans. However, based on the criteria discussed below, the USSS would materially understate liabilities on the DHS financial statements, as well as the government-wide consolidated financial statements if an amount was not recorded. Consequently, the USSS engaged an actuary to evaluate the plan and compute the liability for future funding cost of the D.C. Pension Plan at September 30, 2003 resulting in an adjustment for \$3.3 billion to record the future liability.

The U.S. Coast Guard had not recognized the travel entitlement as an Other Post-Employment Benefit (OPEB) and as such did not apply the criteria for calculating the liability in accordance with SFFAS No. 5, *Accounting for Liabilities of the Federal Government*.

*Criteria:* SFFAS No. 5 states that pension liabilities should be reported in the financial report of the administrative entity. The liability is the actuarial present value of all future benefits, based on projected salaries and total projected service, less the actuarial present value of future normal cost contributions that would be made for and by the employees under the plan. In the case of the USSS, the District of Columbia, an entity outside of the Federal government, administers the D.C. Pension Plan. However, SFFAS No. 5 also concludes that all elements of pension expense should be recognized in the consolidated financial statements of the U.S. Government, after eliminating intragovernmental transactions. Therefore, in cases where the administrative entity is not a Federal entity, consideration must then be given to the definition of a liability in the Federal government, who is receiving the benefits, who is paying the expense, and where the liability is currently recorded. In this case, the USSS is paying retiree benefit expenses in excess of employee contributions, and it has an obligation to pay these expenses because they represent benefits that employees earn during their employment. Further, under SFFAS No. 5, no other Federal entity can report this liability on DHS' behalf; therefore, this liability must be reported by DHS if material to its financial statements and to ensure its inclusion in the government-wide consolidated financial statements.

*The United States Code*, Title 37, section 404(a)(4), states that a member of a uniformed service is entitled to travel and transportation allowances upon retirement for travel from his last duty station to his home or the place from which he was called or ordered to active duty. This U.S. Coast Guard entitlement represents an OPEB as defined by SFFAS No. 5. SFFAS No. 5 says the employer should recognize an expense and a liability for OPEB when a future outflow or other sacrifice of resources is probable and measurable and the long-term OPEB liability should be based on the amount and timing of future payments discounted to the present value.

*Recommendations:* We recommend that:

1. The USSS:
  - a) Obtain a timely annual actuarial evaluation to calculate its share of the D.C. pension plan expense and liability using an acceptable cost method.
  - b) Record the portion of the D.C. Pension Plan liabilities and expenses that relate to USSS employees in a timely manner.



2. The U.S. Coast Guard should establish procedures for determining the OPEB liability in accordance with SFFAS No. 5, and adjust the resulting liability and related expenses.

## **G. Transfers of Funds, Assets, and Liabilities to DHS**

*Background:* The *Homeland Security Act of 2002* (the Act) and subsequent guidance provided by the OMB and Treasury required legacy agencies to identify and transfer all assets, liabilities, personnel, budgetary funds, and other essential operating and mission-related functions to DHS beginning March 1, 2003. The Act allowed DHS and the legacy agencies up to one year to complete the transfers. To facilitate a smooth transition, DHS entered into several administrative Memorandums of Understanding (MOU) with legacy agencies for continuation of accounting services for certain programs.

*Conditions:* We noted the following matters that affected the funds, assets and liabilities transferred to DHS by legacy agencies. These matters had a direct bearing on DHS's ability to produce accurate and complete consolidated financial statements for the seven months ended September 30, 2003:

- DHS lacked procedures to verify accuracy and completeness of the March 1, 2003 transferred balances. Reliance was placed on legacy agencies to ensure compliance with the Determination Order process provided by OMB, including identification and transfer of appropriate funds. Only limited procedures have been subsequently performed by DHS that would identify discrepancies or instances of non-compliance with the Act or guidance issued by OMB or the Treasury.
- DHS lacked controls to verify that monthly financial reports received from legacy agencies (pursuant to MOUs) accurately and completely represented the financial position, use of budgetary resources, and net costs for the period.
- Some MOUs did not clearly specify the reimbursement terms for services provided to DHS, resulting in at least two instances where DHS was not billed, and therefore did not initially obligate or record an expense for services provided by legacy agencies, until identified during the consolidated financial statement audit.
- After the transfer date, some agencies operating under an MOU with DHS had difficulty providing required financial statement information needed for DHS to produce its operating statements for the seven months ended September 30, 2003.

*Cause/Effect:* The OCFO lacked financial management and staff resources needed to develop, implement, and execute internal controls that would have mitigated or prevented the deficiencies noted above. As a result, DHS placed substantial reliance on the legacy agencies to interpret and comply with the Act and has minimal assurance of compliance with the Act and related regulations as it may affect the DHS consolidated financial statements. Accounting systems' limitations did not allow some legacy agencies to perform proper reporting cut-off at March 1, 2003, and thus ensure that the statement of net cost for the seven months ended September 30, 2003 is accurately stated by DHS. In addition, the rapid start-up of DHS necessitated the use of MOUs to ensure a continuation of financial record keeping and systems support in order to prepare monthly and year-end financial statements. In some cases, DHS was not billed for these services or estimated funds were withheld by the legacy agency, which had the effect of understating transferred assets and net cost for the seven-month period.

# Financial Information



Transition of accounting operations and related systems were to be accomplished over a period of time. Consequently, during the seven months ended September 30 2003, DHS routinely accepted financial data directly from legacy agencies without processes to verify its accuracy and completeness. Therefore, erroneous financial data could have been accepted and reported in the financial statements without being detected and corrected in a reasonable time period or through normal operating procedures.

*Criteria:* GAO's internal control standards require that agencies have internal controls in place to ensure the reliability of their financial reporting. This responsibility extends to services provided by other agencies or other outside organizations. Effective controls also include detection of inaccuracies in financial data prior to acceptance into the accounting system. In addition, SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*, states that when government entities receive goods and services from other government entities without reimbursement, an imputed financing source should be recognized. That financing source should be equal to the imputed cost to the receiving entity and recorded to the extent required by other accounting standards (e.g., recognition of a liability and expense).

*Recommendations:* We recommend that the OCFO:

- a) Continue the transfer of responsibility for accounting operations, currently being performed by legacy agencies, typically through MOUs, to DHS Bureaus. Financial data for all material balances should be received only from accounting centers that are within the DHS control environment, or where DHS can be assured (e.g., through independent audit reports on the service center) that the outside service center has established policies and procedures to accomplish the control objectives defined by the Comptroller General in the *Standards for Internal Control in the Federal Government*.
- b) Alternatively, if DHS is unable to transfer accounting operations for FY 2004, then SOPs, including sufficient controls, should be established to verify the accuracy and completeness of financial data received from legacy agencies, where accounting functions have been outsourced through an MOU.
- c) Initiate and complete a procedure to ensure substantial compliance with the Act. Recognizing that the Act was written to provide flexibility of implementation and accommodate practical interpretation, DHS could obtain this assurance from review and agreement by constituent governmental authorities, such as OMB, Treasury, the U.S. Congress, and legacy agencies.
- d) Perform a calculation of imputed costs that are absorbed by legacy agencies that are not billed to DHS, and record those costs in the DHS financial statements in a timely manner, as necessary, to fairly state financial statement balances.



## **Appendix II – Other Reportable Conditions in Internal Control**

**(Findings A – G are presented in Appendix I)**

### **H. Drawback Claims on Duties, Taxes, and Fees**

*Background:* Drawback is a remittance in whole or in part, of duties, taxes, or fees previously paid by an importer. Drawback typically occurs when the imported goods on which duties, taxes, or fees have been previously paid are subsequently exported from the United States or destroyed prior to entering the commerce of the United States. Depending on the type of claim, the claimant has up to eight years from the date of importation to file for drawback.

*Conditions:* We noted the following internal control weaknesses related to the drawback of duties, taxes, and fees paid by importers at CBP:

- The revenue accounting system, Automated Commercial System (ACS), lacks controls to detect and prevent excessive drawback claims and payments, necessitating inefficient manual processes to compensate. ACS does not have the capability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries or export documentation upon which the drawback claim is based. For example, ACS does not contain electronic edit checks that would flag duplicate claims for export of the same merchandise.
- A single integrated system does not exist to support efficient drawback reviews; therefore, use of multiple systems or data sources is necessary to fully complete a review of a single drawback claim.
- Drawback review policies do not require drawback specialists to review all related drawback claims against the underlying consumption entries to determine whether, in the aggregate, an excessive amount was claimed.
- Policies and procedures addressing the extent and documentation of supervisory reviews performed over drawback claims and payments are not consistently applied in various ports.
- Users with change authorization may override the edit checks that exist in ACS. ACS lacks the capabilities to effectively manage override authority.
- At final liquidation of a drawback claim, ACS does not have a control to prevent a claim from being processed for an erroneous amount.

*Cause/Effect:* Systems are being developed to replace ACS over a number of years. Until new systems are in place, comparisons of entry and export information cannot be performed electronically, and CBP must rely on manual control processes to mitigate these system weaknesses. CBP uses a sampling approach to compare, verify, and match consumption entry and export documentation to drawback claims submitted by importers. However, procedural limitations decrease the effectiveness of this approach. Policies describing the extent and documentation of required supervisory reviews are not always clear, and are therefore subject to broad interpretation, allowing for discretionary override of the established controls. The inherent risk of fraudulent claims or claims made in error is high for the drawback program, and therefore, good internal controls are essential to manage and reduce the risk of erroneous payments.





*Criteria:* The Joint Financial Management Improvement Program (JFMIP) publications and OMB Circular No. A-127, *Federal Financial Systems*, outline the requirements for Federal systems. JFMIP's *Core Financial System Requirements* states that the core financial system must maintain detailed information by account sufficient to provide audit trails and to support billing and research activities. Circular No. A-127 requires that the design of financial systems should eliminate unnecessary duplication of a transaction entry. Wherever appropriate, data needed by the systems to support financial functions should be entered only once and other parts of the system should be updated through electronic means consistent with the timing requirements of normal business/transaction cycles.

The *Improper Payments Information Act of 2002*, effective in FY 2004, requires agencies to assess the risk of erroneous payments, report an estimate of improper payments annually and develop a plan to correct control weaknesses. GAO's internal control standards require management to identify and analyze relevant risks associated with achieving reliable financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations, and then manage the risk. Under FMFIA, management must implement cost-effective controls to safeguard assets and ensure reliable financial reporting. While DHS is not required to comply with FMFIA, the *Revised Implementation Guidance* dated January 4, 2001, states that financial systems should "routinely provide reliable financial information consistently, accurately, and reported uniformly" to support management of current operations. In addition to the regulatory requirements stated above, CBP's *Draft Drawback Handbook*, dated June 2003, states that management reviews are necessary to maintain a uniform national policy of supervisory review.

*Recommendations:* We recommend that CBP:

- a) Implement effective internal controls over drawback claims as part of any new systems initiatives, including the ability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries and export documentation for which the drawback claim is based, and identify duplicate or excessive drawback claims.
- b) Adopt a review methodology to allow a statistical projection from drawback testing.
- c) Revise current policies and procedures to require drawback specialists to review all prior related drawback claims against a designated consumption entry to determine whether, in the aggregate, an excessive amount was claimed against the consumption entries.
- d) Create a query that periodically (e.g., weekly or monthly) generates from ACS a report of all overrides, their amount, and the user who performed the override. In addition, the Headquarters Drawback Program Manager should review the report each period and investigate any override that appears unusual or excessive in amount.
- e) Improve the overall design of the supervisory review of drawback claims by ensuring that all CBP drawback offices adhere to a uniform national policy and consistent procedures for supervisory review.

## **I. In-bond Movements of Imported Goods**

*Background:* Generally, when merchandise arrives in the United States from a foreign country, the importer is required to pay CBP the appropriate duties, taxes, and fees at the port of arrival (port of origin). An exception is made, however, for goods transported "in-bond" from the port of origin to another port (port of destination) within



# Financial Information



the United States. Merchandise traveling in-bond is not subject to duties, taxes, and fees until it reaches the port of destination where it is ultimately released into the commerce or destroyed. The bonded carrier is ultimately obligated by their official bond to ensure the integrity of the merchandise until disposition and the payment of appropriate duty, if any is due. It is CBP's responsibility to control the movement and disposition of in-bond shipments with effective policies and regulations that result in either collection of applicable duties, taxes, and fees at the port of destination or the export of the merchandise. CBP has developed a compliance measurement program, called TINMAN, to select, review and determine overall compliance of in-bond movements.

*Conditions:* We noted the following internal control weaknesses related to in-bond movements of imported goods. CBP:

- Does not have a reliable process of monitoring the movement of in-bond shipments.
- Lacks adequate written SOPs for in-bond processing and use of TINMAN.
- Lacks consistent performance of a compliance measurement program to periodically assess the risk and compute an estimate of underpayment of duties, taxes and fees.

*Cause/Effect:* In most cases, we noted that in-bond imports were opened correctly in the system at the arrival ports; however, the ports do not have the resources to close out all in-bond movements that are received at the destination port. Policies and procedures have not been developed and/or implemented to reliably and accurately track and close in-bond movements in a timely manner. System limitations reduce the effectiveness of physical inspections and the accuracy of in-bond reports. For example, the open in-bond reports may list an open in-bond shipment that has previously been closed, does not exist, or does not reconcile to the original in-bond submission. Much of the in-bond process is manual, placing an added burden on limited resources. Without an adequate process to track and close in-bond movements and an effective compliance measurement program, CBP lacks assurance that: (i) declared quantity and type of cargo moving in-bond is accurate and complete, (ii) cargo actually reaches its scheduled destination, and (iii) calculated and collected revenue for cargo moving in-bond is accurate and complete in relation to the entry summary filing.

*Criteria:* Under FMFIA, management must implement cost-effective controls to safeguard assets and ensure reliable financial reporting. While DHS is not subject to FFMA, the *Revised Implementation Guidance* states that financial systems should "routinely provide reliable financial information consistently, accurately, and reported uniformly" to support management of current operations. In addition, CBP regulations require that all in-bond transactions should be closed out timely to ensure that goods are not diverted into commerce without filing and paying the proper amount of duties, taxes, and fees.

*Recommendations:* We recommend that CBP:

- a) Design in-bond monitoring and reconciliation controls into new systems that will replace ACS in the future.
- b) Develop and implement SOPs that define procedures and responsibilities for the tracking and closing of in-bond movements.
- c) Reinstate the compliance measurement audits over the in-bond program, including a methodology for measurement of results from inspections performed based on TINMAN selection.



## J. Acceptance and Adjudication of Immigration and Naturalization Applications

*Background:* CIS accepts millions of applications annually and typically collects more than \$1 billion in fees from applicants seeking immigration and naturalization services. Applications are received and processed at four service centers, the National Benefits Center, over thirty district offices, and numerous satellite offices. Upon receipt of an application, CIS personnel input the data into a variety of information systems. Numerous ad hoc systems are used to perform monitoring and file tracking functions during the acceptance and adjudication process. To compile and report monthly operating statistics for Congress and other interested parties, CIS makes monthly data calls to its various offices, who then enter the information into the Performance Analysis System (PAS). PAS data also is used as the basis for recording application revenue and deferred revenue. Federal accounting standards require that application revenue must be deferred until adjudication is complete, and consequently the status (e.g., completion) of applications has a direct effect on DHS' consolidated financial statements. The accuracy of pending application inventory records is important to CIS' calculation of deferred revenue and to CIS' operational control over its work-in-process. There are a number of information systems initiatives underway to improve the efficiency of and the quality of management information from the application and adjudication process.

*Conditions:* We noted the following internal control weaknesses related to the acceptance and adjudication of immigration and naturalization applications at CIS:

- CIS lacks SOPs for tracking and reporting the status of applications and related information. As a result, this process is inconsistent across all districts and service centers. For the monthly data call, there is no common protocol for gathering, organizing, and entering data into PAS. Some offices manually compile the data for PAS and others generate the data from their own local systems. The lack of SOPs increases the risk of inconsistency and errors in the data.
- PAS is a data collection system that does not interface with other systems of original data entry, creating significant reporting inefficiencies. It is dependent upon monthly data calls and cannot provide real time information on individual applications or at an aggregate level.
- CIS does not have a policy that requires periodic cycle counts of its pending applications. The lack of such cycle counts in previous years has led to bureau-wide end of the year inventories that have been disruptive to CIS operations and have delayed the completion of year-end financial reporting.

*Cause/Effect:* Due to the concerns over data quality in both the local and national feeder systems, and the monthly PAS reporting process, the Immigration and Naturalization Service, as CIS was known prior to its transfer to DHS, had to perform an extensive service-wide inventory of pending (SWIP) applications. The SWIP had to be performed at nearly all locations in previous years to accurately state deferred revenue in its financial statements. A SWIP is labor-intensive and time-consuming, but necessary in the absence of cycle counts to verify perpetual application inventory systems and determine adjustments to deferred revenue. The lack of integrated systems and use of ad hoc systems create significant inefficiencies and increase the risk of errors and reporting inconsistencies.

*Criteria:* OMB Circular A-127 requires that financial management systems provide effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the systems. Since CIS' various application and adjudication systems support preparation of the financial statements,

# Financial Information



they are considered financial systems. Such systems should have standard data classifications, common processes for similar kinds of transactions, consistent internal control, and a design that eliminates the need for duplicate transaction entry.

*Recommendations:* We recommend that CIS:

- a) Develop Bureau-wide SOPs related to tracking the status of acceptance and adjudication of immigration and naturalization applications. These policies should address specifically how CIS personnel should track the status of all applications from initial acceptance through the ultimate adjudication, to ensure that actual application status and file location are always current. All application types and all locations should be reviewed at least once annually, to ensure that the SOPs for tracking and reporting application status have been consistently applied.
- b) Interface the PAS, a data collection system, with other systems of original data entry, to provide real time information on individual applications or at an aggregate level.
- c) Require all locations to perform cycle counts of pending applications with a frequency (e.g., rotating quarters) that is sufficient to replace the SWIP process used in the past and provides reasonable assurance of the completeness and accuracy of data used to compute deferred revenue. The results of the cycle counts (e.g., the error rate) should be recorded and used to develop a quality assurance function.

## **K. Fund Balance with Treasury**

*Background:* Fund balance with Treasury (FBWT) is a significant account at the U.S. Coast Guard and the largest asset account in DHS' financial statements. FBWT represents funds held by Treasury to fund agency operations and missions.

*Conditions:* The U.S. Coast Guard:

- Did not perform the required reconciliation procedures for its FBWT accounts on a timely basis or the required procedures related to Treasury's FMS 6652, *Statement of Differences*.
- Lacked written SOPs to direct and document the correct reconciliation processes and internal controls to ensure that monthly collection and disbursement activity was reported accurately and timely to the Treasury.

*Cause/Effect:* The U.S. Coast Guard did not complete timely reconciliations because of difficulties in implementing a new financial system that substantially increased reconciling differences and a learning curve involved in using the new system to research and solve discrepancies. The U.S. Coast Guard completed its reconciliations and analysis of significant items and recorded the necessary on top adjustments as of September 30, 2003. However, failure to implement timely and effective reconciliation processes could increase the risks of fraud, waste, and mismanagement of funds; affect the Government's ability to effectively monitor budget execution; and affect the ability to accurately measure the full cost of the Government's programs.

# Financial Information



*Criteria:* Treasury requires agencies to reconcile their FBWT accounts regularly to ensure the integrity and accuracy of agency and government-wide financial reporting.

*Recommendations:* We recommend that the U.S. Coast Guard:

- a) Prepare monthly reconciliations of FBWT, including timely resolution of reconciling differences, that are complete, accurate, and reviewed and approved by management.
- b) Develop written SOPs to direct and document its FBWT reconciliation process. The SOPs should be based on Treasury guidance and tailored to the U.S. Coast Guard's own operations and new financial system.

## **L. Intragovernmental Balances**

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

*Conditions:* We noted that the U.S. Coast Guard, EPR, CBP, USSS, CIS/ICE, and certain programs that are accounted for by legacy agencies, have not developed and adopted effective SOPs or established systems to track, confirm, and reconcile intragovernmental balances and transactions with trading partners. This condition also impacts DHS's ability to accurately report transactions with government trading partners in RSI as required.

*Cause/Effect:* The U.S. Coast Guard's financial system is limited in its ability to completely track activity with government trading partners. Instead the U.S. Coast Guard uses a negative confirmation process, which assumes that if no response is received from trading partners, its records are correct. However, positive confirmations are preferable and provide the best evidence of the accuracy of intragovernmental balances. EPR did complete intragovernmental reconciliations for fiduciary accounts, but did not complete a confirmation and reconciliation process with all trading partners identified in Treasury's *Intragovernmental Fiduciary Transactions Accounting Guide* due to a lack of time and resources. CBP and the USSS have difficulty confirming their activity with trading partners because of limitations in other agency systems that only identify transactions with DHS, not DHS' individual Bureaus. TSA is a new Federal entity and therefore has not had sufficient time or technical resources to formalize some financial SOPs, including intragovernmental reconciliations. The CIS/ICE's financial system is limited in its ability to completely track activity with government trading partners; thus, manual processes have been established. A lack of resources, clear definition of staff responsibilities and an understanding of Treasury guidance are contributing factors to this condition at CIS/ICE.

Reconciling trading partner activity and balances at least quarterly is necessary to identify material out-of-balance conditions between federal entities and to support an accurate consolidation of DHS with the government-wide financial statements.

*Criteria:* The Treasury *Federal Intragovernmental Transactions Accounting Policies Guide*, dated October 23, 2002, requires quarterly reconciliation of intragovernmental asset, liability and revenue amounts with trading



partners. Further, the *Treasury Financial Manual*, Section 4060, *Intragovernmental Activity/Balances*, requires reporting agencies to reconcile/confirm intragovernmental activity and balances quarterly for specific reciprocal groupings. OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*, requires the presentation of transactions with trading partners to be presented in RSI.

*Recommendation:* We recommend that all DHS Bureaus and programs, in conjunction with the DHS OCFO, develop and implement procedures to positively confirm and reconcile, at least on a quarterly basis, all intragovernmental activity and balances with their intragovernmental trading partners, as prescribed by Treasury guidance. In addition, transactions with trading partners should be completely and accurately presented in the Department's Performance and Accountability Report's RSI section.

## **M. Strategic National Stockpile**

*Background:* The Strategic National Stockpile (SNS) is a reserve of medical supplies available for response to a bioterrorist attack or other public health emergency. The *Homeland Security Act of 2002* transferred the assets, liabilities, functions, and personnel of the SNS to DHS. It also amended Section 121 of the *Public Health Security and Bioterrorism Preparedness and Response Act of 2002*, which continued to make the Secretary of Health and Human Services (HHS) responsible for ensuring adequate procedures are followed for SNS accounting, inventory management, and physical security. DHS and HHS have signed an MOU to coordinate their activities with respect to the SNS. The Inventory Management System (IMS) is used to physically track the stockpile inventory.

*Conditions:* We noted the following internal control weaknesses related to the SNS:

- *Fragmented accounting processes and responsibilities* – The accounting process for SNS is currently fragmented and disconnected. Five separate parties (i.e., HHS, Centers for Disease Control [CDC], Department of Veterans Affairs [VA], SNS, and DHS) are involved in some aspect of the SNS accounting process. No agency has full control or complete accounting information needed by DHS to prepare accurate financial statements, and DHS does not have adequate information to properly manage disbursements of SNS funds transferred from HHS. For example, DHS had difficulty obtaining an accounting of SNS proprietary and budgetary accounts as of March 1, 2003 or beyond, and DHS did not receive sufficient information in a timely manner to properly state accounts payable and undelivered orders. DHS has also had difficulty accounting for some funds withheld by HHS to pay for future obligations.
- *Valuation of SNS inventory* – When SNS transferred to DHS, the inventory balance was not valued at historical cost, contained unvalued inventory, and contained fixed asset items that should have been reported as PP&E. As a result, an adjustment of approximately \$485 million to increase the book value of inventory was required.
- *System limitations* – IMS is a stand-alone system and not integrated with the general ledger; therefore, all purchases, deployments, and rotations are updated through emails with supporting documentation sent at a later date, causing an inventory cut-off issue at year-end that required additional procedures to ensure accuracy of year end balances.
- *Policies and procedures* – SNS has only draft SOPs related to system usage and essential accounting processes. We also noted some confusion among accounting personnel regarding their chain of command that resulted, at least in part, from the dual roles of DHS and HHS in SNS activities.

# Financial Information



*Cause/Effect:* The conditions above exist principally because of operational challenges created by the laws related to the creation of DHS, which transferred SNS funds, assets, and liabilities to DHS but also placed responsibility for the adequacy of accounting processes with HHS. DHS, HHS, CDC, VA, and SNS all have pieces of information that determine status of budgetary authority and accounting transactions affecting the SNS. However, clear, singular authority over the accounting functions has not yet been established, leading to a lack of sound financial management. Without a timely reconciliation between DHS, HHS, CDC, VA, and SNS, DHS will be unable to maintain accurate balances for obligations, undelivered orders, and operating expenses, and will have difficulty in maintaining accurate balances for inventory and accounts payable.

Since FY 2001, the value of SNS inventory has increased significantly. The SNS does not have adequate systems or processes to properly track changes in valuation and adjust financial records timely. For example, IMS does not contain an historical cost or have a standard cost module to properly value the inventory. Further, IMS is not an on-line system; therefore, all purchases, deployments, and rotations are updated through emails with supporting documentation sent at a later date, creating significant inefficiencies and increasing the risk of errors and reporting inconsistencies. Although draft SOPs exist related to entry of inventory transactions into IMS, it does not appear all employees are following the standards and not all of the SOPs are formal documents.

*Criteria:* FMFIA and GAO's *Standards for Internal Control in the Federal Government* require that internal controls be documented in management directives, administrative policies, or operating manuals; appropriate lines of reporting be established; transactions and other significant events be clearly documented; and information be recorded and communicated timely with those who need it within a time frame that enables them to carry out their internal control and other responsibilities. According to SFFAS No. 3, *Accounting for Inventory and Related Property*, stockpile inventory should be recorded at historical cost or any other valuation method, which approximate historical cost. OMB Circular A-127 requires agencies to have integrated systems that provide complete, reliable, consistent, timely and useful financial management information or processes that accomplish the same.

*Recommendations:* We recommend that:

The DHS OCFO, in coordination with EPR and the other relevant agencies:

- a) Perform a legal analysis of the pertinent laws and recommend any appropriate changes that would help ensure sound accounting and financial reporting for the SNS.
- b) Develop policy and procedures that require DHS, HHS, CDC, VA, and SNS to periodically reconcile their accounting information and to obtain timely balances for SNS obligations, expenditures, operating expenses, unobligated amounts, accounts payable and any other relevant USSGL accounts. This reconciliation should include the determination of which entity is paying for which goods and services and any amounts that have been withheld by HHS to cover such expenses.
- c) Consider amending the MOU and updating service agreements to re-define responsibilities for accounting functions between DHS, HHS, CDC, VA, and SNS with the objective of minimizing fragmentation of the accounting process, improving timeliness and reliability of financial data, and improving processing efficiencies.
- d) Continue with the development and implementation of a new accounting and inventory system and related SOPs, and establish an appropriate historical baseline for the inventory cost.





- e) Identify all fixed asset items currently included in the SNS inventory, remove them from the inventory balance, and report them as PP&E.
- f) Consider integrating IMS with the general ledger software to improve the accuracy of financial reporting for inventory balances.

## **N. Accounts Payable and Undelivered Orders**

*Background:* Accounts payable and undelivered orders (UDOs) at reporting cut-off dates are significant to the accurate presentation of DHS consolidated financial statements and require good cut-off procedures. With accelerated reporting requirements effective in FY 2004, many Bureaus already have or will need to develop procedures to accurately estimate accounts payable accrual adjustments at yearend. Accurate and complete UDO balances are often an essential component of accounts payable estimates.

*Conditions:* We noted the following internal control weaknesses related to accounts payable and UDOs:

At CIS/ICE:

- We noted an error rate of approximately 50 percent in the source data used to calculate the accounts payable accrual estimate at an interim date, selected for our testwork.
- Field personnel are not always reviewing UDOs as required by internal policies and procedures.

At TSA:

- Procedures are not in place to accurately compute and accrue accounts payable transactions based on actual amounts in a timely manner.
- A reliable method to estimate accrued accounts payable has not been developed.

At U.S Coast Guard:

- The September 30, 2003 UDO balance of \$1.9 billion, as recorded in the U.S. Coast Guard's core accounting system and exclusive of military medical expenses, was overstated. We noted a total of 29 exceptions in our sample of 133 items. Also, the Department of Transportation's Office of Inspector General informed us that the Finance Center's UDO balance that transferred to DHS effective March 1, 2003 was overstated by approximately \$22 million. Finance Center personnel indicated that this was corrected after the balance was transferred.
- Some UDOs related to medical expenses for active duty and reserve personnel were either not valid or should have been reclassified as accounts payable. Also, the amount recorded for accounts payable related to medical expenses associated with retired personnel was overstated. Invalid UDOs and overstated accounts payable represent funds that can be put to better use or returned to the Treasury.
- The initial estimate for the September 30, 2003 accounts payable accrual was misstated due to errors in statistical sampling techniques and the accuracy of the sample items selected.
- At the Aircraft Repair and Supply Center (AR&SC), we noted 6 exceptions out of a sample of 145 items, for which goods or services were received, but the associated UDO balances had not been appropriately reduced.





*Cause/Effect:* Conditions at CIS/ICE resulted from the cyclical nature of validation and verification procedures typically performed, which potentially causes misstated financial statement balances periodically during the year. TSA, as a recently formed entity, has not yet fully developed its SOPs for financial reporting. At the U.S. Coast Guard, program element managers were not performing reviews of open obligations. Also, process and system limitations at the U.S. Coast Guard's AR&SC affect the accuracy of accounting for receipt of goods and services, and could result in an overstatement of UDOs and understatement of payables, expenses and/or assets at the end of an accounting period. Incorrect UDO balances affect (1) the note disclosures related to both the obligated and unobligated fund balances reported for Fund Balance with Treasury and Unexpended Appropriations section of the statement of net position, and (2) the respective balances reported on Standard Form 133, *Report on Budget Execution*, and the statement of budgetary resources.

*Criteria:* SFFAS No. 1, *Accounting for Selected Assets and Liabilities*, requires liabilities to be recognized when goods and services are received or to be recognized based on an estimate of work completed under a contract or agreement. GAO's *Standards for Internal Control in the Federal Government* requires the prompt recording of transactions to maintain their relevance for management in controlling operations and making decisions.

OMB has mandated, through guidance interpreting the *Accountability of Tax Dollars Act* that DHS provide audited financial statements within 45 days after year-end in FY 2004. To comply with this requirement, DHS will need to estimate certain financial statement balances at year-end to meet the accelerated deadline.

*Recommendations:* We recommend that:

1. The CIS/ICE:
  - a) Develop and implement SOPs requiring administrative centers to review the status of all UDOs to ensure they are properly stated, including any adjustments to recognize necessary deobligations.
  - b) Monitor the effectiveness of the control procedures using a risk-based approach to ensure accuracy, completeness and timeliness of accounting for UDOs, including strengthening field management review.
2. The TSA:
  - a) Develop and implement SOPs to streamline the process for recording and accruing accounts payable and UDOs.
  - b) Ensure that accruals for certain items, such as those on a recurring payment schedule, are automatically recorded.
  - c) Develop and implement SOPs for timely recording of estimated accounts payable. Such policies may require contracting officers to review major contracts on a monthly basis to estimate goods received or services incurred.



### 3. The U.S. Coast Guard:

- a) Emphasize to all program element managers the need to perform effective monthly reviews of open obligations.
- b) Develop procedures and controls to ensure that estimates of medical expenses incurred but not yet billed are accurate and supported.
- c) Process transactions for the receipt of goods/services based on the date that AR&SC accepts the goods and services and timely reduce UDO balances.
- d) Improve its estimating procedures by using a statistically valid method, including a random starting point, and establish SOPs to ensure that UDO transactions are properly reviewed.



## **Appendix III – Compliance with Laws and Regulations**

**(Findings A – G and H – N are presented in Appendices I and II, respectively)**

### **Federal Managers' Financial Integrity Act of 1982**

OMB Circular A-123 requires agencies and federal managers to (i) develop and implement management controls; (ii) assess the adequacy of management controls; (iii) identify needed improvements; (iv) take corresponding corrective action; and (v) report annually on management controls (commonly known as management's FMFIA report). We noted that DHS management's FMFIA report did not contain material weaknesses that are reported by us in Appendix I and did not include corrective action plans for all material weaknesses identified in its Performance and Accountability Report. We also noted weaknesses in the DHS' FMFIA reporting process that are reported in Appendix I within Comment B – *Financial Reporting*.

*Recommendations:* We recommend that DHS implement the recommendations provided in Appendix I, in FY 2004.

### **Federal Information Security Management Act**

DHS is required to comply with the *Federal Information Security Management Act* (FISMA), which was enacted as part of the *Electronic Government Act of 2002*. Generally, FISMA requires that Federal agencies and departments: 1) conduct an annual self-assessment review of their IT security program; 2) develop and implement remediation efforts for identified security weaknesses and vulnerabilities; and 3) report to OMB on the level of compliance. FISMA also requires agencies and departments to: 1) provide information security for the systems that support the operations under their control; 2) develop, document and implement an organization-wide information security program; 3) develop and maintain information security policies, procedures and control techniques; 4) provide security training and oversee personnel with significant responsibilities for information security; 5) assist senior officials concerning their security responsibilities; and 6) ensure the organization has sufficient trained personnel to comply with FISMA requirements. We noted instances of non-compliance with FISMA that have been reported by us in Appendix I within Comment C – *Financial Systems Functionality and Technology*.

*Recommendations:* We recommend that DHS follow the recommendations provided in Appendix I, Comment C, in FY 2004.

### **Single Audit Act Amendments of 1996**

As a grant-making agency, EPR is required to comply with certain provisions of OMB Circular A-133, subpart D – *Federal Agencies and Pass-Through Entities* and Appendix B, *Compliance Supplement*. The Circular requires cost-share analysis of applicable grants and communication of program identification information to the recipient. We noted that EPR is not in full compliance with OMB Circular A-133 because certain cost-share analysis and follow-up was not timely performed or provided to State grantees when the percentage of cost share funds paid/unpaid was greater than 20 percent, as required by law. In addition, EPR had not always provided notification of the Catalog of Federal Domestic Assistance (CFDA) number to grant recipients.

# Financial Information



*Recommendations:* We recommend that EPR, perform the following in fiscal year FY 2004:

- a) Ensure that grants management specialists review the results of their cost-share analysis for reasonableness and accuracy, and perform timely follow-up if their analysis indicates potential issues with the cost-share amounts.
- b) Ensure that all grant identifying information and modifications, including CFDA numbers, are communicated to the grant recipient and that such communication be maintained in the applicable grant file.

# Financial Information



## Appendix IV – Status of Prior Year Findings

<u>Bureau and Condition Reported in Prior Year</u>	<u>Recommendation Reported in Prior Year</u>	<u>2003 Status and Disposition</u>	<u>Rationale, If Recommendation Considered Open</u>
<p><b>CBP (formerly U.S. Customs Service)</b></p>			
<p><b>Material Weaknesses:</b></p>			
<p><b>1. Entry Duties and Taxes</b></p>			
<p>Due to suspension of the Compliance Measurement (CM) program for most of 2002, Customs lacks a statistically valid measurement of the effectiveness of its internal controls over the accuracy of entry duties and taxes reported in 2002.</p>	<p>Reinstate the CM program to enable statistical measurement of revenue gap results and overall trade compliance.</p>	<p><b>Closed</b> The CM program was reinstated in FY 2003.</p>	<p>N/A</p>
<p><b>2. Drawback Claims on Duties and Taxes</b></p>			
<p>Customs lacks an automated system to track and compare drawback claims to detect and prevent excessive drawback claims and Customs does not statistically measure a drawback compliance rate.</p>	<p>Implement procedures to prevent excessive drawback claims and to statistically measure drawback compliance.</p>	<p><b>Open</b> Finding repeated in DHS <b>Reportable Condition “H.”</b></p>	<p>System controls to prevent excessive drawbacks will be considered with new systems installations (e.g., ACE). Updated sampling and testing procedures have been drafted and are awaiting approval.</p>
<p><b>3. Financial Systems Security</b></p>			
<p>Customs IT system logical access and security controls need improvement in the areas of network and system configuration, sensitive system administrator authorities granted, software upgrades, and password management.</p>	<p>Improve network and system configurations, review and minimize system administrator authorities granted, install the latest software patches (upgrades) and enforce their stated password management policy.</p>	<p><b>Open</b> Finding repeated in DHS <b>Material Weakness “C.”</b></p>	<p>CBP still needs to resolve vulnerabilities in network and host-based system configurations and improve password management processes, and minimize sensitive system administrator authorities granted.</p>

# Financial Information



<b><u>Bureau and Condition Reported in Prior Year</u></b>	<b><u>Recommendation Reported in Prior Year</u></b>	<b><u>2003 Status and Disposition</u></b>	<b><u>Rationale, If Recommendation Considered Open</u></b>
<p><b>4. Financial Systems Integration</b></p> <p>Core financial systems need to be improved and integrated. These systems include:</p> <p>a) The Automated Commercial System (ACS) cannot provide necessary information on unpaid amounts.</p> <p>b) The Cost Management Information System (CMIS) cannot produce cost information on a regular basis or without significant manual processes.</p> <p>c) The Asset Information Management System (AIMS) cannot properly record transactions for financial reporting purposes.</p> <p>d) Various property management systems do not accurately reflect inventory balances and activity and are not integrated with AIMS.</p> <p><b>Reportable Conditions:</b></p> <p><b>5. Bonded Warehouse and Foreign Trade Zones</b></p> <p>Reviews of bonded warehouse and foreign trade zones operations were not performed in 2002 or were substantially curtailed from the scheduled plan because resources were diverted to other mission related objectives.</p>	<p>Adopt a customer-based accounts receivable subsidiary ledger that is Joint Financial Management Improvement Program (JFMIP) compliant based on a cost / benefit analysis; integrate financial systems and report cost information; implement procedures to record transactions as they occur; and interface property management systems with the general ledger.</p>	<p><b>Open</b> Finding repeated in DHS <b>Material Weakness "C."</b></p>	<p>CMIS processing has been automated and data is produced on a monthly basis. Remaining conditions cited continue to exist and are being considered in the design and implementation of new IT systems.</p>
<p>Reviews of bonded warehouse and foreign trade zones operations were not performed in 2002 or were substantially curtailed from the scheduled plan because resources were diverted to other mission related objectives.</p>	<p>Customs should perform periodic spot-check inspections, using standard national criteria, of bonded warehouses and foreign trade zone operators and perform periodic follow-up reviews to ensure that findings, if any, are corrected.</p>	<p><b>Open</b> Finding repeated in CBP <i>Observations and Recommendations Comments</i> provided to CBP management.</p>	<p>Condition cited continues to exist. CBP is developing standardized guidelines for both bonded warehouses and foreign trade zones using national criteria. Implementation of corrective actions is expected in FY 2004</p>



# Financial Information



<b><u>Bureau and Condition Reported in Prior Year</u></b>	<b><u>Recommendation Reported in Prior Year</u></b>	<b><u>2003 Status and Disposition</u></b>	<b><u>Rationale, If Recommendation Considered Open</u></b>
<p><b>6. In-Bond Movements</b>                      Customs did not adequately monitor in-bond movement and also did not utilize its existing in-bond movement compliance measurement process in 2002.</p>	<p>Develop procedures to properly track and close in-bond movements and reinstate the in-bond movement compliance process.</p>	<p><b>Open</b> Finding repeated in DHS <b>Reportable Condition "I."</b></p>	<p>Conditions cited continue to exist. CBP issued a Directive establishing tighter controls over opening and closing of in-bond. CBP is continuing the TINMAN compliance measurement program and quarterly compliance audits will be reinstated as regularly recurring automated selections.</p>
<p><b>7. Drawback in New York and Newark</b>                      Due to the events of September 11, 2001, Customs lost important entry and drawback records. Consequently, compensating controls were implemented to ensure the accuracy of financial reports. Customs lacked procedures regarding liquidation and verification of certain drawback claims, and the self-inspection program was suspended for 2002.</p>	<p>Implement procedures to properly verify and liquidate drawback claims where the documentation is no longer available and implement a self-inspection program in New York/Newark.</p>	<p><b>Partially Closed</b> Remaining conditions repeated in CBP <i>Observations and Recommendations Comments</i> provided to CBP management.</p>	<p>CBP reinstated the self-inspection program in New York/Newark during FY2003, and the New York/Newark drawback office has implemented procedures to liquidate drawback claims of \$250,000 or more. However, no alternative procedures have been developed related to verifying claims where the support is no longer available.</p>

# Financial Information



<b><u>Bureau and Condition Reported in Prior Year</u></b>	<b><u>Recommendation Reported in Prior Year</u></b>	<b><u>2003 Status and Disposition</u></b>	<b><u>Rationale, If Recommendation Considered Open</u></b>
<b>8. Financial Systems Entity-wide Security</b>			
The supporting documentation in the NDC Mainframe Systems Accreditation Package contains inaccuracies and incomplete and/or unclear process descriptions.	Identify and correct all inaccuracies and deficiencies with regard to completeness and/or clarity in its supporting documentation related to the security package.	<b>Closed</b> Elements of PY findings closed, however other conditions remain open and have been combined with CBP item No. 3 above and repeated with other entity-wide security conditions noted at other Bureaus in DHS <b>Material Weakness "C."</b>	Condition cited continues to exist – see rationale in CBP item No. 3 above.
<b>9. Internal Control over Laws and Regulations</b>			
Customs has not corrected a finding identified in a FY 2000 Inspector General report related to reporting on user fees and all fees it imposes for services and things of value.	Report to Congress regarding COBRA fees for FY 2002 and review user fees for FY 2002 to ensure they reflect actual costs.	<b>Closed</b> Recommendation implemented during FY 2003.	N/A
Certain contracts over \$100,000 in value did not contain an Individual Transaction Plan (ITP), as required by the Department of Treasury Acquisition Regulations.	Prepare an ITP for all contracts over \$100,000.	<b>Closed</b> Recommendation implemented during FY 2003.	N/A

# Financial Information



Bureau and Condition Reported in Prior Year	Recommendation Reported in Prior Year	2003 Status and Disposition	Rationale, If Recommendation Considered Open
<p><b><u>CIS/ICE (formerly Immigration and Naturalization Service [INS]) as of February 28, 2003</u></b></p>			
<p><b>Material Weaknesses:</b></p>			
<p><b>1. Financial Systems Functionality</b></p>			
<p>INS does not have a reliable system that can provide regular, timely and detailed data on the number and value of immigration applications received, pending and completed.</p>	<p>Develop or enforce policies to ensure that all application information is correctly entered into the new file tracking and case management and tracking systems; is consistently retained at all locations; and is reliably tracked within or outside of CIS. Also, new systems should support applicable financial and accounting requirements.</p>	<p><b>Open</b> Finding repeated in DHS <b>Reportable Condition "J."</b></p>	<p>Corrective actions are on-going.</p>
<p><b>2. Accounts Payable</b></p>			
<p>INS has not developed a methodology for recording accounts payable and computing related accrual estimates.</p>	<p>Develop and implement policies and procedures for determining, documenting, testing, and approving accounts payable postings and accrual calculations.</p>	<p><b>Open</b> Finding repeated in DHS <b>Reportable Condition "N."</b></p>	<p>Condition cited continues to exist; however, some improved policies and procedures have been implemented. Condition expected to be fully addressed by FY 2005</p>
<p><b>3. Financial Reporting</b></p>			
<p>INS did not have adequate processes and supporting policies and procedures in place to facilitate the effective reconciliation of certain key account balances.</p>	<p>Strengthen the reporting capabilities of its new Federal Financial Management System and develop and implement policies and procedures to ensure all key account balances are effectively reconciled.</p>	<p><b>Open</b> Findings repeated in CIS <i>Observations and Recommendations Comments</i> provided to CIS management.</p>	<p>Corrective actions are on-going.</p>
<p><b>Reportable Conditions:</b></p>			
<p><b>4. Information Systems</b></p>			
<p>INS had weaknesses in controls over their financial management system and general network that could adversely affect INS' ability to report financial information accurately and reliably.</p>	<p>Implement corrective procedures to address the various weaknesses identified.</p>	<p><b>Open</b> Finding in DHS <b>Material Weakness "C."</b></p>	<p>Corrective actions are on-going.</p>

# Financial Information



Bureau and Condition Reported in Prior Year	Recommendation Reported in Prior Year	2003 Status and Disposition	Rationale, If Recommendation Considered Open
<b>Federal Emergency Management</b>			
<b>Agency [FEMA]</b>			
<b>(a component of DHS EPR Directorate)</b>			
<b>Material Weaknesses:</b>			
<b>1. Information Security</b>			
FEMA had weaknesses in controls over their financial management system and general network that could adversely affect their ability to report financial information accurately and reliably.	Continue with its corrective procedures to address the various weaknesses identified.	<b>Partially Closed</b> Remaining conditions repeated in DHS <b>Material Weakness "C."</b>	Corrective actions are on-going.
<b>2. Financial Systems</b>			
<b>Functionality</b>			
FEMA information management systems are not JFMIP compliant and lack the ability to efficiently perform certain required accounting and reporting functions.	Review and modify its key financial processes to obtain required system functionality.	<b>Partially Closed</b> Remaining conditions repeated in DHS <b>Material Weakness "C."</b>	Corrective actions are on-going.
<b>3. Financial Reporting</b>			
FEMA's financial reporting process does not allow for the timely, routine or accurate preparation of financial statements as a by-product of existing policies and procedures and internal controls.	Assess, document, and improve its financial reporting process to ensure that the financial statements are prepared in a consistent, timely and accurate manner.	<b>Partially Closed</b> Recommendations related to the preparation of a FEMA stand-alone Performance and Accountability Report are no longer applicable. Remaining conditions are repeated in DHS <b>Material Weakness "B."</b>	Corrective actions are on-going.
<b>4. Real and Personal Property</b>			
FEMA does not have a real and personal property management system that adequately meets FEMA's accounting needs or JFMIP requirements.	Continue to implement a JFMIP compliant property management system and to develop policies and procedures to ensure that property related transactions are timely and correctly recorded.	<b>Open</b> Findings repeated in EPR <i>Observations and Recommendations Comments</i> provided to EPR management.	Corrective actions are on-going.

# Financial Information



Bureau and Condition Reported in Prior Year	Recommendation Reported in Prior Year	2003 Status and Disposition	Rationale, If Recommendation Considered Open
<p><b>5. Account Reconciliation</b> FEMA does not have processes to ensure that key account and transaction amounts are consistently and effectively reconciled on a timely basis.</p>	<p>Prepare timely and effective reconciliations of all key accounts and transactions, including those with federal trading partners.</p>	<p><b>Partially Closed</b> Remaining condition related to trading partner reconciliations remains open. Repeated in DHS <b>Reportable Condition "L."</b></p>	<p>Corrective actions are on-going.</p>
<p><b>6. Accounts Receivable</b> FEMA did not have processes to timely identify and record certain accounts receivable.</p>	<p>Strengthen the accounts receivable process, in particular those related to audits and interagency agreements.</p>	<p><b>Closed</b> Recommendation implemented during FY 2003.</p>	<p>N/A</p>
<p><b>Reportable Conditions:</b> <b>7. Cerro Grande</b> FEMA lacked a process to evaluate the accuracy of the new claims estimation methodology and lacked sufficient documentation related to certain claims information.</p>	<p>Perform an analysis to determine the dollar impact on the liability estimate as a result of the new methodology and ensure proper retention of all claims supporting documentation.</p>	<p><b>Closed</b> No new claims were processed in FY03, and the remaining liability amount is not significant to DHS.</p>	<p>N/A</p>

# Financial Information



Bureau and Condition Reported in Prior Year	Recommendation Reported in Prior Year	2003 Status and Disposition	Rationale, If Recommendation Considered Open
<b>Federal Law Enforcement Training Center (FLETC)</b>			
<b>Reportable Conditions:</b>			
<b>1. Policies and Procedures</b>			
Policies and procedures are not in place to require that the procurement department verify budget authority prior to obligating funds or to require that class costs be determined consistently.	Establish policies and procedures that require budget approval prior to making procurements and that require class costs to be determined consistently.	<b>Closed</b> Recommendations implemented during FY 2003.	N/A
<b>2. Laws and Regulations</b>			
Management has not performed risk assessments on key systems as required by OMB Circular A-127 and Government Information Security Reform Act (GISRA).	Perform risk assessments of major systems.	<b>Closed</b> Finding not significant to DHS.	N/A
<b>3. Real Property Accounting</b>			
FLETC lacks a method for consistently recording construction in progress (CIP).	Implement procedures to verify that all fixed assets, including CIP, are properly recorded.	<b>Closed</b> Recommendation implemented during FY 2003.	N/A
<b>4. Laws and Regulations</b>			
FLETC entered into a 20-year non-cancelable lease for the construction and operation of dormitories. FLETC did not perform adequate capital planning as required by OMB Circular A-11. This Circular requires that capital projects be fully funded at their inception and that risks should be carefully analyzed and managed.	Ensure that future capital projects are planned and evaluated so that proper funding can be secured and risks can be managed and reported in accordance with the provisions of OMB Circular A-11.	Open. Findings repeated in DHS <i>Observations and Recommendations Comments</i> provided to DHS management.	Condition cited continues to exist.



# Financial Information



Bureau and Condition Reported in Prior Year	Recommendation Reported in Prior Year	2003 Status and Disposition	Rationale, If Recommendation Considered Open
<b>Transportation Security Administration (TSA)</b>			
<b>Material Weaknesses:</b>			
<b>1. Human Resources</b>			
TSA has not hired a sufficient number of qualified accounting personnel.	Hire an adequate number of qualified accounting personnel.	<b>Closed</b> Recommendation implemented during FY 2003.	N/A
<b>2. Financial Reporting and Systems (related to Third-Party Systems and Applications)</b>			
a) TSA did not delete separated employees from its personnel information management system.	Establish procedures to ensure biweekly reviews of payroll files for separated employees.	<b>Open</b> Finding repeated in DHS <b>Material Weakness "C."</b>	Condition cited continues to exist; however, TSA expects closure in FY 2004.
b) Certain information technology (IT) staff had excessive access to production data and programs and to the operating system.	Modify the access levels of the related IT staff as appropriate.	<b>Open</b> Finding repeated in DHS <b>Material Weakness "C."</b>	Condition cited continues to exist; however, TSA is taking action to address the conditions in FY 2004
c) Risk assessments are either not performed or do not provide sufficient information to effectively manage risks associated with particular vulnerabilities	Develop and perform risk assessments and test the operating effectiveness of the IT security controls.	<b>Open</b> Finding repeated in DHS <b>Material Weakness "C."</b>	Condition cited continues to exist. TSA uses DOT financial information systems and most financial business processes. TSA is working with DOT to correct the condition.
d) TSA does not have the monitoring and evaluation processes in place to meet the requirements of the Federal Managers Financial Integrity Act.	Establish a self-assessment and evaluation process to continually monitor internal control and accounting systems.	<b>Open</b> Finding repeated in DHS <b>Material Weaknesses "B"</b> .	Condition cited continues to exist. TSA will establish internal evaluation processes in FY 2004.
<b>3. Property, Plant, and Equipment (PP&amp;E)</b>			
TSA does not maintain complete and accurate records of its passenger and baggage screening equipment.	Develop policies and procedures to ensure all PP&E is correctly recorded and perform a complete physical inventory of PP&E.	<b>Open</b> Finding repeated in DHS <b>Material Weaknesses "D."</b>	Condition cited continues to exist. TSA is working with DHS to implement an automated property management system, which will track accountable property and resolve the condition. The system is expected to be implemented in FY 2004.

# Financial Information



<u>Bureau and Condition Reported in Prior Year</u>	<u>Recommendation Reported in Prior Year</u>	<u>2003 Status and Disposition</u>	<u>Rationale, If Recommendation Considered Open</u>
<b>4. Financial Management Policies</b>			
a) TSA did not record purchase orders/obligating documents, mostly due to incomplete and erroneous information included on the obligating documents.	Develop and implement procedures to ensure that all required information is correctly included on obligating documents.	<b>Closed</b> Recommendation implemented during FY 2003.	N/A
b) TSA incorrectly expensed some purchases of PP&E that should have been capitalized.	Reemphasize its policies and procedures to ensure that PP&E purchases are appropriately capitalized.	<b>Closed</b> Recommendation implemented during FY 2003.	N/A
c) TSA did not accrue accounts receivable related to its air carrier and passenger security fees.	Establish proper procedures to ensure an accrual for these fees.	<b>Closed</b> Recommendation implemented during FY 2003.	N/A
d) TSA did not have a process to properly disclose the required information related to its leasing arrangements.	Establish a process to monitor its leasing arrangements and obligations to ensure full financial disclosure.	<b>Open</b> Findings repeated in TSA <i>Observations and Recommendations</i> Comments provided to TSA management.	Condition cited continues to exist. TSA intends to establish a database in FY 2004 to track all leases and capture required information for disclosure.
e) TSA did not record certain grant payments appropriately.	Establish policies and procedures to accurately monitor and report grant activity.	<b>Open</b> Findings repeated in TSA <i>Observations and Recommendations</i> Comments provided to TSA management.	Condition cited continues to exist. In FY 2003 and prior years, the DOT managed TSA grants. In FY 2003, TSA began transitioning grants administration functions away from DOT. The transition is expected to be complete in FY 2004 and the condition should be closed at that time.
<b>5. Administration of Screener Contracts</b>			
Policies and procedures have not been established to effectively control and monitor contractor costs and performance.	Develop and implement oversight activities that enforce the verification of contractor cost and pricing data.	<b>Closed</b> Recommendation implemented during FY 2003.	N/A
<b>Reportable Conditions:</b>			
<b>6. Personnel Files</b>			
Personnel files that were requested from the human resources third-party contractor did not contain adequate information.	Implement a time and attendance (T&A) system to ensure that all T&A information is properly recorded in its personnel and payroll system.	<b>Open</b> Findings repeated in TSA <i>Observations and Recommendations</i> Comments provided to TSA management.	Condition cited continues to exist.

# Financial Information



<b><u>Bureau and Condition Reported in Prior Year</u></b>	<b><u>Recommendation Reported in Prior Year</u></b>	<b><u>2003 Status and Disposition</u></b>	<b><u>Rationale, If Recommendation Considered Open</u></b>
<b><u>All Bureau's Compliance with Federal Financial Management Information Act of 1996 (FFMIA)</u></b> Several DHS Bureau's reported noncompliance with FFMIA in the prior year. However, DHS is not subject to FFMIA. Findings related to IT systems, use of the U.S. Standard General Ledger, and application of federal accounting standards, if applicable have been reported with other Bureau findings in Appendices I through IV.	Recommendations are noted above.	<b>Open</b> But not applicable as an FFMIA finding.	N/A

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## Management Response

### U.S. Department of Homeland Security

MEMORANDUM FOR CLARK KENT ERVIN  
INSPECTOR GENERAL

FROM: Andrew Maner  
Chief Financial Officer



SUBJECT: Management Response – Report of the Auditors on the  
Department of Homeland Security Fiscal Year (FY) 2003  
Financial Statements

On behalf of Secretary Ridge, I am responding to the auditor's report on the Department's FY 2003 financial statements included in the Department's FY 2003 Performance and Accountability Report.

We appreciate your efforts to audit the Department's FY 2003 financial statements and provide relevant and objective recommendations on how our office can improve the Department's financial reporting practices. Issuing the Department's Performance and Accountability Report, while achieving a qualified opinion, is an extraordinary achievement given this is our first year of operation. All Department offices, bureaus and directorates are to be commended for their participation in this effort. Moreover, the accompanying report of your auditors would not have been possible without your office's professional assistance, optimism, technical expertise and commitment.

We concur with the seven reportable conditions that are considered to be material weaknesses as well as seven other reportable conditions and the instances of noncompliance with law and regulation contained in the auditor's report. Corrective actions are underway to address those conditions inherited from the 22 agencies that transferred into the Department, effective March 1, 2003. In addition, corrective actions will be prepared to address other inherited weaknesses that were identified for the first time in the auditor's report. We will provide your office with new or updated action plans, as appropriate, to correct these conditions. The affected Department organizational elements will continue to focus on and strive to improve their efforts to address the conditions and noncompliance issues contained in the auditor's report.

The ability of my office to produce auditable financial statements and the ability of your staff to carryout the audit provide clear evidence of the professional, cooperative working relationship between our staffs. I am confident that these effective relationships and partnerships will result in recognizable and measurable improvements and efficiencies in our respective reporting and auditing practices.

## Financial Statements

**Department of Homeland Security**  
**Consolidated Balance Sheet**  
**As of September 30, 2003**  
**(In Millions)**

**ASSETS**

**Intra-governmental Assets**

Fund Balance with Treasury (note 4)	\$27,343
Investments, Net (note 5)	1,546
Advances and Prepayments (note 6)	3,054
Other (note 12)	415
	415

**Total Intra-governmental Assets**

**32,358**

Tax, Duties, and Trade Receivables, Net (note 7)	1,140
Operating Materials and Supplies, Inventory and Stockpile, Net (note 9)	1,162
Property, Plant, and Equipment, Net (note 11)	9,138
Other (note 12)	750
	750

**Total Assets (note 3)**

**\$44,548**

**LIABILITIES**

**Intra-governmental Liabilities**

Due to the Treasury General Fund (note 3)	\$1,209
Accounts Payable	398
Other (note 18)	349
	349

**Total Intra-governmental Liabilities**

**1,956**

Accounts Payable	1,979
Claims and Claims Settlement Liabilities (note 14)	754
Deferred Revenue (note 15)	1,969
Accrued Payroll and Benefits (note 16)	2,275
Military Service and Other Retirement Benefits (note 17)	25,285
Other (note 18)	2,450
	2,450

**Total Liabilities (note 13)**

**36,668**

Commitments and Contingencies (notes 19 and 20)

**Net Position (notes 24 and 25)**

Unexpended Appropriations	23,560
Cumulative Results of Operations	(15,680)
	(15,680)

**Total Net Position**

**7,880**

**Total Liabilities and Net Position**

**\$44,548**

The accompanying notes are an integral part of these statements.



# Financial Information

**Department of Homeland Security**  
**Consolidated Statement of Net Cost (Unaudited)**  
**For the Seven Months Ended September 30, 2003**  
(In Millions)

	Intragovernmental	With the Public	Total
<b>Border and Transportation Security:</b>			
Gross Cost	\$2,476	\$9,545	\$12,021
Less Earned Revenue	(336)	(909)	(1,245)
<b>Net Cost</b>	<b>2,140</b>	<b>8,636</b>	<b>10,776</b>
<b>Emergency Preparedness and Response:</b>			
Gross Cost	390	5,953	6,343
Less Earned Revenue	(28)	(1,161)	(1,189)
<b>Net Cost</b>	<b>362</b>	<b>4,792</b>	<b>5,154</b>
<b>Information Analysis and Infrastructure Protection:</b>			
Gross Cost	9	139	148
Less Earned Revenue	-	-	-
<b>Net Cost</b>	<b>9</b>	<b>139</b>	<b>148</b>
<b>Science and Technology:</b>			
Gross Cost	2	84	86
Less Earned Revenue	-	-	-
<b>Net Cost</b>	<b>2</b>	<b>84</b>	<b>86</b>
<b>United States Coast Guard:</b>			
Gross Cost	481	3,570	4,051
Less Earned Revenue	(110)	(6)	(116)
<b>Net Cost</b>	<b>371</b>	<b>3,564</b>	<b>3,935</b>
<b>United States Secret Service:</b>			
Gross Cost	187	508	695
Less Earned Revenue	(4)	-	(4)
<b>Net Cost</b>	<b>183</b>	<b>508</b>	<b>691</b>
<b>United States Citizenship and Immigration Services:</b>			
Gross Cost	451	829	1,280
Less Earned Revenue	-	(638)	(638)
<b>Net Cost</b>	<b>451</b>	<b>191</b>	<b>642</b>
<b>Departmental Operations and Other:</b>			
Gross Cost	9	80	89
Less Earned Revenue	-	-	-
<b>Net Cost</b>	<b>9</b>	<b>80</b>	<b>89</b>
<b>NET COST OF OPERATIONS (notes 21 and 22)</b>	<b>\$3,527</b>	<b>\$17,994</b>	<b>\$21,521</b>

The accompanying notes are an integral part of these statements.

# Financial Information

**Department of Homeland Security**  
**Consolidated Statement of Changes in Net Position (Unaudited)**  
**For the Seven Months Ended September 30, 2003**  
(In Millions)

	<b>Cumulative Results of Operations</b>	<b>Unexpended Appropriations</b>
	<b>\$0</b>	<b>\$0</b>
<b>Net Position, March 1, 2003</b>		
<b>Legacy Agency Transfers (note 1)</b>		
Appropriations Transferred In	-	37,380
Budgetary Financing Sources: Transfers In without Reimbursement	2,465	-
Other Financing Sources: Net Liabilities Transfer In without Reimbursement	(13,792)	-
<b>Total Legacy Transfers</b>	(11,327)	37,380
Cumulative effect of correction of errors and change in accounting (notes 9, 11 and 17)	(3,401)	-
<b>Adjusted Legacy Transfers</b>	(14,728)	37,380
<b>Budgetary Financing Sources:</b>		
Appropriations Received (note 23)	-	7,501
Other Transfers In	-	762
Appropriations Returned to Treasury (notes 4 and 23)	-	(1,565)
Appropriations Used	20,518	(20,518)
Non-exchange Revenue	946	-
Donations and Forfeitures of Cash and Cash Equivalents	8	-
Transfers Out without Reimbursement	(2,005)	-
Other Budgetary Financing Sources	36	-
<b>Other Financing Sources:</b>		
Transfers In Without Reimbursement	643	-
Imputed Financing Sources	423	-
<b>Total Financing Sources</b>	\$5,841	\$23,560
<b>Net Cost of Operations</b>	(21,521)	-
<b>NET POSITION, September 30, 2003</b>	<b>(\$15,680)</b>	<b>\$23,560</b>

The accompanying notes are an integral part of these statements.

# Financial Information

**Department of Homeland Security**  
**Combined Statement of Budgetary Resources (Unaudited)**  
**For the Seven Months Ended September 30, 2003**  
(In Millions)

**BUDGETARY RESOURCES**

Budget Authority:		
Appropriations Received (note 23)		\$9,459
Borrowing Authority (note 23)		1,635
Net Transfers		23,883
Unobligated Balance:		
Beginning of Period		-
Net Transfers (note 1)		2,930
Spending Authority from Offsetting Collections:		
Earned:		
Collected		2,554
Receivable from Federal Sources		224
Change in Unfilled Customer Orders:		
Advances Received		-
Without Advances From Federal Sources		429
Transfers from Trust Funds		3
Total Spending Authority from Offsetting Collections		<u>3,210</u>
Recoveries of Prior Year Obligations		661
Permanently Not Available (note 23)		<u>(1,558)</u>
<b>TOTAL BUDGETARY RESOURCES</b>		<b><u><u>\$40,220</u></u></b>

**STATUS OF BUDGETARY RESOURCES**

Obligations Incurred (note 23):		
Direct		\$29,413
Reimbursable		<u>1,550</u>
Total Obligations Incurred		<b>30,963</b>
Unobligated Balances Available:		
Apportioned		5,411
Exempt from Apportionment		958
Unobligated Balances Not Available (note 23)		<u>2,888</u>
<b>TOTAL STATUS OF BUDGETARY RESOURCES</b>		<b><u><u>\$40,220</u></u></b>

**RELATIONSHIP OF OBLIGATIONS TO OUTLAYS**

Obligated Balance, Net, Beginning of Period		-
Obligated Balance Transferred, Net (note 1)		\$12,847
Obligated Balance, Net, End of Period:		
Accounts Receivable		(458)
Unfilled Customer Orders from Federal Sources		(722)
Undelivered Orders		16,965
Accounts Payable		<u>3,847</u>
Total Obligated Balance, Net, End of Period		19,632
Outlays:		
Disbursements		22,912
Collections		<u>(2,606)</u>
Total Outlays		<b>20,306</b>
Less: Offsetting Receipts		(1,072)
<b>NET OUTLAYS</b>		<b><u><u>\$19,234</u></u></b>

The accompanying notes are an integral part of these statements.

# Financial Information

**Department of Homeland Security**  
**Consolidated Statement of Financing (Unaudited)**  
**For the Seven Months Ended September 30, 2003**  
(In Millions)

**Resources Used to Finance Activities:**

**Budgetary Resources Obligated**

Obligations Incurred	\$30,963
Spending Authority from Offsetting Collections and Recoveries	<u>(3,871)</u>
Obligations Net of Offsetting Collections and Recoveries	27,092
Offsetting Receipts	<u>(1,072)</u>
Net Obligations	<u>26,020</u>

**Other Resources**

Transfers in without reimbursement	643
Imputed Financing from Costs Absorbed by Others	<u>423</u>

**Total Resources Used to Finance Activities** **27,086**

Resources Used to Finance Items Not Part of the Net Cost of Operations:

Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but not yet Provided	(5,859)
Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations	81
Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	(1,064)
Other resources or adjustments to net obligated resources that do not affect net cost of operations	<u>(531)</u>

**Total Resources Used to Finance Items Not Part of the Net Cost of Operations** **(7,373)**

**Total Resources Used to Finance the Net Cost of Operations** **19,713**

**Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:**

**Resources in the Current Period:**

Increase in Exchange Revenue Receivable from the Public	212
Other	<u>670</u>
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	<u>882</u>

**Components not Requiring or Generating Resources:**

Depreciation and Amortization	446
Revaluation of Assets or Liabilities	189
Other	<u>291</u>
Total Components of Net Cost of Operations that will not Require or Generate Resources	<u>926</u>

**Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period** **1,808**

**Net Cost of Operations** **\$21,521**

The accompanying notes are an integral part of these statements.

# Financial Information

**Department of Homeland Security**  
**Statement of Custodial Activity**  
**For the Seven Months Ended September 30, 2003**  
**(In Millions)**

**Sources of Custodial Revenue**

**Revenue Received**

Duties	\$11,930
User Fees	454
Excise Taxes	1,264
Fines and Penalties	43
Interest	8
<b>Total Revenue Received</b>	<u>13,699</u>
Less: Refunds and Drawback Disbursements (notes 18 and 24)	<u>(558)</u>
Total Sources of Custodial Revenue	13,141
Accrual Adjustment	<u>(3)</u>
<b>Total Custodial Revenue</b>	<u><u>\$13,138</u></u>

**Disposition of Custodial Revenue**

Amounts provided to Non Federal Entities	\$59
Amounts provided to the Treasury General Fund	13,082
Accrual adjustment	<u>(3)</u>
<b>Total Disposition of Custodial Revenue</b>	<u><u>\$13,138</u></u>
<b>Net Custodial Activity</b>	<u><u>\$0</u></u>

The accompanying notes are an integral part of these statements.

## Notes to the Financial Statements

### 1. Creation of the Department of Homeland Security

The U.S. Department of Homeland Security (DHS or Department) was established by the *Homeland Security Act of 2002* (the Act), Public Law 107-296 (the Law), dated March 25, 2002, as an executive department of the United States government. The primary mission of DHS is to:

- Prevent terrorist attacks within the United States;
- Reduce the vulnerability of the United States to terrorism;
- Minimize the damage, and assist in the recovery, from terrorist attacks and natural disasters that occur within the United States;
- Carry out all functions of entities transferred to the Department, including acting as a focal point regarding natural and manmade crises and emergency planning;
- Ensure that the functions of the agencies and subdivisions within the Department that are not related directly to securing the homeland are not diminished or neglected except by a specific, explicit Act of Congress;
- Ensure that the overall economic security of the United States is not diminished by efforts, activities, and programs aimed at securing the homeland; and
- Monitor connections between illegal drug trafficking and terrorism, coordinate efforts to sever such connections, and otherwise contribute to efforts to interdict illegal drug trafficking.

The Law was implemented according to the President's *Department of Homeland Security Reorganization Plan (Reorganization Plan)*, dated November 25, 2002.

On January 24, 2003, the effective date of the Law, and in accordance with the *Reorganization Plan*, the Office of the Secretary of DHS (the Secretary) was established, as well as other key managerial positions. In addition, pursuant to the Law and *Reorganization Plan*, the Secretary established the following four DHS Directorates: Science and Technology; Border and Transportation Security; Emergency Preparedness and Response; and Information Analysis and Infrastructure; and the following Bureaus or suborganizations: U.S. Citizenship and Immigration Services; U.S. Secret Service; U.S. Coast Guard; and Management, including the Office of Inspector General.

Transfers of personnel, facilities, records, assets (including technology systems), obligations, and functions (e.g., authorities, powers, rights, privileges, immunities, programs, projects, activities, duties and responsibilities) from 22 existing Federal agencies and programs, began on March 1, 2003 – the inception date of DHS operations – pursuant to guidance provided to the legacy agencies from the Office of Management and Budget (OMB) and the U.S. Department of Treasury (Treasury). Legacy agencies were instructed to record non-expenditure transfers as of March 1, 2003, using full-accrual basis of accounting, for transferred asset and liability balances and unobligated and unexpended appropriation budgetary balances. In addition, legacy agencies were required by OMB M-03-04, *Memorandum for the Heads of Selected Departments and Agencies*, to complete determination orders, for Secretarial and OMB approval, documenting all assets, liabilities, personnel, and other operational transfer information.

Revenues and expenditures of transferred agencies and programs, related to the five month period October 1, 2002 through February 28, 2003, did not transfer to DHS and are to be reported by the legacy agencies in accordance with Federal Accounting Standards Advisory Board's (FASAB) Technical Bulletin 2003-1, *Questions and Answers Related to Creation of the Department of Homeland Security Act of 2002* (TB 2003-1), and guidance issued by Treasury's Financial Management Service (FMS), *DHS Transfers – 2003 Interim Scenarios*. This Technical Bulletin required legacy agencies to present a sub-total for "net cost of continuing operations" immediately before the presentation of amounts related to transferred operations, that represents revenue and expenditure activity for the five months ended February 28, 2003. TB 2003-1 and FMS guidance requires DHS to recognize the net effect of the assets and liabilities, equal to the book value of the legacy agency, as a "transfers-in" on the consolidated statement of changes in net position.



# Financial Information

## Reporting Entity

The Directorates, Bureaus, offices and programs of DHS (hereafter referred to as Bureaus and suborganizations) and the transferring legacy agency are shown below.

<b>DHS Directorate and Bureau/Office/Program</b>	<b>Legacy Agency</b>
<b>Border and Transportation Security (BTS) Directorate:</b>	
Bureau of Customs and Border Protection (CBP)	Departments of Treasury, Justice, Agriculture (APHIS)
Bureau of Immigration and Customs Enforcement (ICE)	Departments of Justice, Treasury, and GSA (FPS)
Transportation Security Administration (TSA)	Department of Transportation
Federal Law Enforcement Training Center (FLETC)	Department of the Treasury
Agricultural Quarantine Inspection Program	Department of Agriculture (USDA)
Office for Domestic Preparedness (ODP)	Department of Justice
Federal Protection Service (FPS)	General Services Administration (GSA)
<b>Emergency Preparedness and Response (EPR) Directorate:</b>	
Federal Emergency Management Agency (EPR)	Federal Emergency Management Agency (FEMA)
Strategic National Stockpile	Department of Health and Human Services
<b>Science and Technology (S&amp;T) Directorate:</b>	
National Bioweapons Defense Analysis Center (Biowatch)	Department of Defense
Defense Nuclear Non-Proliferation (DNNP)	Department of Energy
Plum Island Animal Disease Center	Department of Agriculture
<b>Information Analysis and Infrastructure (IAIP) Directorate:</b>	
Federal Computer Incident Response Center (FEDCIRC)	General Services Administration
National Infrastructure Protection Center (NIPC)	Department of Justice
Energy Security & Assurance Program	Department of Energy
National Communications System (NCS)	Department of Defense
Critical Infrastructure Assurance Office (CIAO)	Department of Commerce
<b>U.S. Citizenship and Immigration Services (CIS)</b>	Department of Justice
<b>U.S. Secret Service (USSS)</b>	Department of the Treasury
<b>U.S. Coast Guard (USCG)</b>	Department of Transportation
<b>Office of the Inspector General (OIG)</b>	Various
<b>Headquarters Management (MGT)</b>	Various

The accompanying consolidated financial statements and notes thereto reflect the assets, liabilities, revenues, expenses, transfers-in with and without reimbursement and resulting net position and budgetary activity of the Department subsequent to the date of inception (March 1, 2003), which occurred throughout the seven months ended September 30, 2003. Since DHS, as a financial reporting entity of the Federal government, did not exist prior to March 1, 2003, comparative financial information is not available and has not been presented in the financial statements and notes thereto. Details of the proprietary and budgetary transfers-in to DHS from legacy agencies are presented in the Other Accompanying Information section.

## 2. Summary of Significant Accounting Policies

### A. Basis of Accounting and Presentation

The financial statements have been prepared from the accounting records of DHS and its Directorates and Bureaus in conformity with accounting principles generally accepted in the United States, and the OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. Accounting principles generally accepted for federal entities are the standards prescribed by the FASAB, the official accounting standards-setting body of the Federal Government.

These financial statements are provided to meet the requirements of the *Accountability of Tax Dollars Act of 2002*. They consist of the consolidated balance sheet, the consolidated statement of net cost, the consolidated statement of changes in net position, the combined statement of budgetary resources, the consolidated statement of financing, and the consolidated statement of custodial activity. The consolidated statements of net cost, changes in net position, financing, and combined statement of budgetary resources, and all information contained in the notes to the financial statements that relate to these statements, are unaudited.

While these financial statements have been prepared from the books and records of the Department in accordance with the formats prescribed by OMB, these financial statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.

The Department's consolidated financial statements reflect the reporting of entity activities which include appropriations received to conduct its operations and revenue generated from those operations. They also reflect the reporting of certain non-entity (custodial) functions it performs on behalf of the Federal Government and others.

Transactions are recorded on an accrual and a budgetary basis of accounting. The consolidated balance sheet, the consolidated statement of net cost, and the consolidated statement of changes in net position are reported using the accrual basis of accounting. Under the accrual basis, revenues are recorded when earned and expenses are recognized when a liability is incurred, regardless of when cash is exchanged. The combined statement of budgetary resources is reported using the budgetary basis of accounting. Budgetary accounting facilitates compliance with legal constraints and controls over the use of Federal funds. It generally differs from the accrual basis of accounting in that obligations are recognized when new orders are placed, contracts awarded, and services received, that will require payments during the same or future periods. The statement of financing reconciles differences between the budgetary and accrual basis of accounting. Non-entity revenue and refunds are reported on the statement of custodial activity using a modified cash basis. With this method, revenue from cash collections are reported separately from receivable accruals, and cash disbursements are reported separately from payable accruals.

Intragovernmental assets and liabilities result from activity with other Federal agencies. All other assets and liabilities result from activity with parties outside the Federal government, such as domestic and foreign persons, organizations, or governments. Intra-governmental earned revenues are collections or accruals of revenue from other Federal agencies, and intra-governmental costs are payments or accruals to other Federal agencies. Transactions and balances among the Department's entities have been eliminated from the consolidated balance sheet, the consolidated statement of net cost, and the consolidated statement of changes in net position. As provided by OMB Bulletin No. 01-09, the statement of budgetary resources is presented on a combined basis; therefore, intra-departmental transactions and balances have not been eliminated from this statement. In accordance with OMB Bulletin No. 01-09, intra-departmental transactions and balances have been eliminated from all the amounts on the consolidated statement of financing, except for obligations incurred and spending authority from offsetting collections and adjustments, which are presented on a combined basis.

These financial statements should be read with the realization that they are for a component of a sovereign entity, that liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

# Financial Information

## B. Entity Revenue and Financing Sources

The Department receives the majority of funding needed to support its programs through Congressional appropriations. The Department receives annual, multi-year, and no-year appropriations that may be used, within statutory limits, for operating and capital expenditures. Additional funding is obtained through exchange revenues, non-exchange revenues and transfers-in.

Appropriations are recognized as financing sources when related expenses are incurred or assets are purchased. Revenue from reimbursable agreements are recognized when the goods or services are provided by DHS. Prices for goods and services sold to the public are based on recovery of full cost or are set at a market price. Reimbursable work between Federal appropriations is subject to the *Economy Act* (31 U.S.C. 1535) or other statutes authorizing reimbursement. Prices for goods and services sold to other Federal government agencies are generally limited to the recovery of direct cost. DHS recognizes as imputed financing the amount of accrued pension and post-retirement benefit expense for current civilian employees paid on behalf of DHS by the Office of Personnel Management (OPM), as well as amounts paid from the Treasury Judgment Fund in settlement of claims, legal settlements, or court assessments. When costs that are identifiable to DHS and directly attributable to DHS operations are paid for by other agencies, the Department recognizes these amounts as imputed costs.

Exchange revenues are recognized when earned, i.e., goods have been delivered or services have been rendered. Non-exchange revenues are accounted for when DHS is entitled to receipt and primarily consists of user fees collected by CBP to off-set certain costs of operations. Other financing sources, such as donations and transfers of assets without reimbursements also are recognized on the consolidated statement of changes in net position during the period in which they occurred.

Fees for flood mitigation products and services, such as insurance provided through EPR's National Flood Insurance Program (NFIP) are established at rates necessary to sustain a self-supporting program. NFIP premium revenues are recognized ratably over the life of the policies. Deferred revenue relates to unearned premiums that are reserved to provide for the remaining period of insurance coverage.

CIS requires advance payments of the fees for applications or petitions for immigration, nationality, and citizenship benefits. Revenue associated with the application fees received is not considered earned until the processing of the application is completed.

## C. Non-Entity Assets, Revenue, and Disbursements

Non-entity assets are those that are held by the Department but are not available for use by the Department. Non-entity fund balance with Treasury represents funds available to pay refunds and drawback claims of duties, taxes and fees; and other non-entity amounts to be distributed to the Treasury General Fund and other Federal agencies in the future.

Non-entity revenue reported on the Department's statement of custodial activity includes duties, excise taxes, and various fees collected by the CBP and the CIS that are subsequently remitted to Treasury's General Fund or to other Federal agencies. CBP assesses duties, taxes, and fees on goods and merchandise brought into the United States from foreign countries. At the time importers bring merchandise into the United States, they are required to file entry documents. Generally, within ten working days after release of the merchandise into the United States commerce, the importer is to submit an entry document with payment of estimated duties, taxes, and fees. Non-entity tax and trade accounts receivables and custodial revenue is recognized when CBP is entitled to collect duties, user fees, fines and penalties, refunds and drawback overpayments, and interest associated with import/export activity on behalf of the Federal government that have been established as a legally enforceable claim and remain uncollected as of year-end. Generally, CBP records an equal and off-setting liability due to the Treasury General Fund for amounts recognized as non-entity tax and trade receivable and custodial revenue. CBP accrues an estimate of duties, taxes and fees related to commerce released prior to year end where receipt of payment is anticipated subsequent to year end.

Non-entity revenue is recognized when the cash CBP is entitled to collect on behalf of the Federal government is received.

# Financial Information

These revenue collections primarily result from current fiscal year activities. Application fees collected by CIS for nonimmigrant petitions (H1b fees) are recognized at the time of collection.

The significant types of non-entity accounts receivable, custodial revenues as presented in the statement of custodial activity, are described below.

- *Duties*: amounts collected on imported goods and other miscellaneous taxes collected on behalf of the Federal government.
- *Excise taxes*: amounts collected on imported distilled spirits, wines and tobacco products.
- *User fees*: amounts designed to maintain United States harbors, and to defray the cost of other miscellaneous service programs; also includes application fees collected from employers sponsoring nonimmigrant petitions.
- *Fines and penalties*: amounts collected for violations of laws and regulations.
- *Refunds*: of duties, taxes and fees previously paid by an importer/exporter; also includes drawback remittance paid when imported merchandise, for which duty was previously paid, is exported from the United States.

Non-entity receivables are presented net of amounts deemed uncollectible. It is CBP's policy to track and demand payment of estimated duties, taxes, and fees receivable by establishing a liquidated damage case that generally results in fines and penalty receivable. A fine or penalty, including interest on past due balances, is also established when a violation of import/export law is discovered. An allowance for doubtful collections is established for substantially all accrued fines and penalties and related interest, based on the historical experience with resolution of disputed assessments. CBP regulations allow importers to dispute the assessment of duties, taxes, and fees. Receivables related to disputed assessments are not recorded until the protest period expires or when a protest decision has been rendered in CBP's favor.

Refunds and drawback of duties, taxes, and fees are recognized when payment is made. A permanent, indefinite appropriation is used to fund the disbursement of refunds and drawbacks and is recorded as a decrease in the amount transferred to Treasury General Fund reported on the consolidated statement of custodial activity. An accrual adjustment is recorded on the statement of custodial activity to adjust cash collections and refund disbursements with the net increase or decrease of accrued non-entity accounts receivables, net of uncollectible amounts, and refunds payable at year-end.

## **D. Fund Balance with Treasury, Cash, and Other Monetary Assets**

Entity fund balances with Treasury are primarily appropriated, revolving, trust, deposit, receipt, special, and working capital fund amounts remaining as of fiscal year-end from which the Department is authorized to make expenditures and pay liabilities resulting from operational activity, except as restricted by law. The Department does not, for the most part, maintain cash in commercial bank accounts. Certain receipts, however, are processed by commercial banks for deposit into individual accounts maintained at the Treasury. The Department's cash and other monetary assets primarily consist of undeposited collections, imprest funds, cash used in undercover operations, cash held as evidence, seized cash, and drafts in transit, and are presented as a component of other assets in the accompanying consolidated balance sheet.

## **E. Investments, Net**

Investments consist of United States government non-marketable Treasury securities and are reported at cost or amortized cost net of premiums or discounts. The Bureau of Public Debt manages certain trust fund investments, such as the Oil Spill Liability Trust Fund, for DHS. Premiums or discounts are amortized into interest income over the terms of the investment using the effective interest method. No provision is made for unrealized gains or losses on these securities because it is the Department's intent to hold investments to maturity.

## **F. Advances and Prepayments**

Intra-governmental advances consist primarily of EPR's disaster recovery and assistance grants to other federal agencies tasked

# Financial Information

with mission assignments. Advances are expensed when drawn by the grant recipients. At year end, the amount of grant funding unexpended by grant recipients is estimated based on cash transactions reported by the grant administrator used by EPR. It is the Department's policy to advance funds to grant recipients so that recipients may incur expenses related to the approved grant. Advances are made within the amount of the total grant obligation and are intended to cover immediate cash needs.

Advances and prepayments to the public, presented as a component of other assets in the accompanying consolidated balance sheet, consist primarily of EPR's disaster recovery and assistance grants to states and other grants to states of which the largest category is Emergency Management Performance Grants, a consolidation of grant programs that supports state and local emergency management staffs and operations, insurance policy acquisition costs, consisting of commissions incurred at policy issuance, and are amortized over the period in which the related premiums are earned, generally one to three years.

## **G. Tax, Duties, and Trade Receivables, Net**

Tax, duties, and trade receivables consists of import duties, user fees, fines and penalties, refunds and drawback overpayments, which have been established as a legally enforceable claim and remain uncollected as of year-end. These receivables are net of amounts deemed uncollectible which were determined by considering the debtor's payment record and willingness to pay, the probable recovery of amounts from secondary sources, such as sureties, and an analysis of aged receivable activity.

## **H. Accounts Receivable, Net**

Accounts receivable, which are presented as a component of other assets on the consolidated balance sheet, represent amounts owed to the Department by other Federal agencies and the public as the result of the provision of goods and services to them. Intra-governmental accounts receivable results from reimbursable work such as investigative services performed by CIS; passenger processing, trade compliance and enforcement activities performed by CBP; activities to safeguard communities around chemical weapon storage sites performed by EPR; information technology and communication services provided by TSA; and reimbursable services provided to the Department of Defense by USCG, such as repairing of boats or aircraft. Intra-governmental accounts receivable are considered to be fully collectible.

Public accounts receivable consist of amounts due to ICE and CIS from commercial air and sea vessel carriers for immigration user fees, 1931 Act overtime services, surety companies breached surety bonds; reimbursable services and user fees collected and interest assessed by CBP; premiums and restitution due to EPR from Write Your Own (WYO) insurance companies participating in EPR's Federal Insurance and Mitigation Administration flood insurance program and amounts due from insurance policy holders; amounts due to the USCG's Oil Spill Liability Trust Fund to recover costs incurred to respond to oil pollution incidents and to collect civil fines and penalties from parties responsible for oil spills recognized when the claim arises; and security fees assessed by TSA on the public and air carriers. Public accounts receivable are presented net of an allowance for doubtful accounts, which is based on analyses of debtors' ability to pay, specific identification of probable losses, aging analysis of past due receivables, and historical collection experience. Interest due on past due receivables is fully reserved until collected.

## **I. Credit Program Receivables, Net**

Credit program receivables consist of loans outstanding and are recorded in other assets in the accompanying consolidated balance sheet. Loans are accounted for as receivables as funds are disbursed. For loans obligated prior to October 1, 1991, loan principal and interest receivable are reduced by an allowance for estimated uncollectible amounts. The allowance is estimated based on past experience and an analysis of outstanding balances.

Post 1991 obligated direct loans and the resulting receivables are governed by the *Federal Credit Reform Act of 1990* (FCRA). Under FCRA, for direct loans disbursed during a fiscal year, the corresponding receivable is adjusted for subsidy costs. Subsidy costs are an estimated long-term cost to the United States government of its loan programs. The subsidy cost is equal to the

# Financial Information

present value of the estimated cash outflows over the life of the loans minus the present value of the estimated cash inflows, discounted at the applicable Treasury interest rate. Administrative costs such as salaries and contractual fees are not included in the subsidy costs. Subsidy costs can arise from interest rate differentials, interest subsidies, delinquencies and defaults, and other cash flows. EPR calculates the subsidy costs based on a Subsidy Calculator model created by OMB.

Loans receivable are recorded at the present value of the estimated cash inflows less cash outflows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recorded in the allowance for subsidy, which is estimated and adjusted annually, as of year end.

## **J. Operating Materials, Supplies, Inventory, and Stockpile, Net**

Operating materials and supplies (OM&S) are primarily consumed during normal operations to service USCG and CBP vessels and aircraft. They are valued based on the weighted moving average method or on the basis of actual prices paid. OM&S are expensed when consumed or issued for use. Excess, obsolete and unserviceable OM&S are stated at net realizable value net of an allowance based on the condition of various asset categories, as well as USCG and CBP's historical experience with using or disposing of such assets.

Inventories consist primarily of USCG Supply Fund's uniform clothing, subsistence provisions, retail stores, general stores, technical material and fuel, and USCG Yard Fund's supplies. Inventories on hand at year-end are stated at cost using standard price/specific identification, last acquisition price, or weighted average cost methods, which approximates historical cost. Revenue on inventory sales and associated cost of goods sold are recorded when merchandise is sold to the end user. USCG's inventory is restricted to sales within the USCG, and is not available for sale to other government agencies.

The Department maintains stockpiles of strategic and critical materials, including vaccines, biological materials, and other medical treatments to be used by the government in response to local and national emergencies and aid in the recovery from major disasters. Stockpile materials are not held for sale and are valued at historical cost using a weighted average cost flow assumption. DHS's agreements with vendors who produce stockpiled material include routine refreshment for expired goods; therefore, an allowance for obsolescence is not recognized in the accompanying consolidated financial statements.

## **K. Seized and Forfeited Property**

Prohibited seized and forfeited property results primarily from CBP criminal investigations and passenger/cargo processing. Seized property is not considered an asset of the Department and is not reported as such in the Department's financial statements; however, the Department has a stewardship responsibility until the disposition of the seized items are determined, i.e., judicially or administratively forfeited or returned to the entity from which it was seized. Non-prohibited seized property, including monetary instruments, real property, and tangible personal property of others in the actual or constructive possession of DHS will be transferred to the Treasury Forfeiture Fund and is not presented in the accompanying consolidated financial statements of DHS.

Forfeited property is property for which the title has passed to the United States government. As noted above, non-prohibited forfeited property or currency become assets of the Treasury Forfeiture Fund. However, prohibited forfeited items, such as counterfeit goods, narcotics, or firearms, are held by CBP until disposed or destroyed. In accordance with Statement of Federal Financial Accounting Standard (SFFAS) No. 3, *Accounting for Inventory and Related Property*, analyses of changes in seized and forfeited property of prohibited items is disclosed in Note 10.

CBP will also take into custody, without risk or expense, merchandise termed "general order property," which for various reasons cannot be legally entered into the United States commerce. CBP's sole responsibility for the general order property is to ensure it does not enter the commerce of the United States. If general order property remains in CBP custody for a prescribed period of time, without payment of all estimated duties, storage and other charges, it is considered unclaimed and abandoned and can be sold



# Financial Information

by CBP at public auction. Auction sales revenue in excess of charges associated with the sale or storage of the item is remitted to the Treasury General Fund. In some cases, CBP incurs charges prior to the sale and funds these costs from entity appropriations. Regulations permit CBP to offset these costs of sale before returning excess amounts to Treasury.

## L. Property, Plant, and Equipment, Net

DHS's property, plant, and equipment (PP&E) consists of aircraft, vessels, vehicles, land, structures, facilities, leasehold improvements, software, and information technology and other equipment. PP&E is recorded at cost and is depreciated using the straight line method over the estimated useful lives of the assets. In cases where historical cost information was not maintained, PP&E is capitalized using an estimated cost based on the cost of similar assets at the time of acquisition or the current cost of similar assets discounted for inflation since the time of acquisition. The Department owns some of the buildings in which it operates. Other buildings are provided by the GSA, which charges rent equivalent to the commercial rental rates for similar properties.

The Department capitalizes acquisitions of PP&E when the cost equals or exceeds an established threshold and has a useful life of two years or more. Costs for construction projects are recorded as construction-in-progress until completed, and are valued at actual (direct) costs, plus applied overhead and other indirect costs. Capitalized software includes the full cost, including an allocation of indirect costs incurred during the software development stage. DHS is developing capitalization thresholds for consistent use across all Bureaus. For the seven months ended September 30, 2003, the capitalization thresholds of the legacy agencies transferred to DHS were maintained. The ranges of capitalization thresholds used by DHS Bureaus, by primary asset category, are as follows.

<b>Asset Description</b>	<b>Capitalization Threshold</b>
Land	Regardless of cost to \$100,000
Buildings and improvement	\$25,000 to \$200,000
Equipment and capital leases	\$5,000 to \$50,000
Software	\$200,000 to \$750,000

The Department begins to recognize depreciation expense once the asset has been placed in service. Depreciation on buildings and equipment provided by the GSA is not recognized by the Department. Leasehold improvements are depreciated over the shorter of the term of the remaining portion of the lease, or the useful life of the improvement. Buildings and equipment acquired under capital leases are amortized over the lease term. Amortization of capitalized software begins on the date of acquisition if purchased, or when the module or component has been placed in use (i.e., successfully installed and tested) if contractor or internally developed. Land is not depreciated.

In accordance with the FASAB TB 2003-1 and related FMS guidance, PP&E transferred to DHS from legacy agencies during the seven months ended September 30, 2003, pursuant to the *Homeland Security Act of 2002*, were recorded at the net book value of the transferring agency.

## M. Liabilities

Liabilities represent the probable and measurable future outflow or other sacrifice of resources as a result of past transactions or events. Since the Department is a component of the United States government, a sovereign entity, its liabilities cannot be liquidated without legislation that provides resources or an appropriation. Liabilities covered by budgetary resources are those liabilities for which Congress has appropriated funds or funding is otherwise available to pay amounts due. Liabilities not covered by budgetary or other resources represent amounts owed in excess of available, congressionally appropriated funds or other amounts, and there is no certainty that the appropriations will be enacted. The United States government, acting in its sovereign capacity, can abrogate liabilities of the Department arising from other than contracts.



## **N. Environmental Cleanup Costs and Contingent Liabilities**

The Department has responsibility to clean up its sites with environmental contamination, and it is party to various administrative proceedings, legal actions, and tort claims which may result in settlements or decisions adverse to the Federal government. The Department has accrued a liability for future cleanup of environmental hazards when losses are determined to be “probable”, which is generally when the government is legally responsible for creating the hazard or is otherwise related to it in such a way that it is legally liable to clean up the contamination, and the cost can be estimated. These liabilities are a component of other liabilities on the accompanying consolidated balance sheet.

Contingent liabilities are liabilities where the existence or amount of the liability cannot be determined with certainty pending the outcome of future events. The Department recognizes contingent liabilities when loss is probable and reasonably estimable. The Department discloses contingent liabilities in the notes to the consolidated financial statements when the conditions for liability recognition are not met and when loss from future events is more than remote. Payments made from the Treasury Judgment Fund for settlement of DHS legal claims and judgments are recognized as an imputed financing source in the accompanying consolidated statement of net position.

## **O. Grants Liability**

EPR and ODP provide grants to federal, state, and local governments, universities and non-profit organizations for the purpose of building capacity to respond to disasters and emergencies, conduct research into preparedness, and conduct other DHS-related activities. EPR estimates a year-end grant accrual representing the amounts payable to grantees, using historical disbursement patterns over a period of 20 quarters to predict unreported grantee expenditures. The ODP grant liability accrual is estimated using known reported expenditures reported by grantees and the estimated daily expenditure rate for the period subsequent to the latest grantee submission in relation to the cumulative grant amount. Grants liabilities are combined with accounts payable to the public in the accompanying consolidated balance sheet.

## **P. Claims and Claims Settlement Liabilities**

EPR administers NFIP through sale or continuation-in-force of insurance in communities that enact and enforce appropriate flood plain management measures. Claims and claims settlement liability represents an estimate of NFIP losses that are unpaid at the balance sheet date and is based on the loss and loss adjustment expense factors inherent in the NFIP insurance underwriting operations experience and expectations. Estimation factors used by the insurance underwriting operations reflect current case basis estimates and give effect to estimates of trends in claim severity and frequency. These estimates are continually reviewed, and adjustments, reflected in current operations, are made as deemed necessary. Although the insurance underwriting operations believes the liability for unpaid losses and loss adjustment expenses is reasonable and adequate in the circumstances, it is possible that the insurance underwriting operations’ actual incurred losses and loss adjustment expenses will not conform to the assumptions inherent in the estimation of the liability. Accordingly, the ultimate settlement of losses and the related loss adjustment expenses may vary from the amount included in the financial statements.

## **Q. Debt and Borrowing Authority**

Debt is reported within other intra-governmental liabilities and results from the Treasury loans and related interest payable to fund NFIP and Disaster Assistance Direct Loan Program (DADLP) operations. NFIP loan and interest payments are financed by flood premiums and map collection fees. Additional funding for NFIP may be obtained through Treasury borrowing authority of \$1.5 billion. DADLP annually requests borrowing authority to cover the principal amount of direct loans not to exceed \$25 million less the subsidy due from the program account. This borrowing authority is for EPR State Share Loans. Borrowing authority for Community Disaster Loans is requested on an “as needed basis.” At the end of the fiscal year, borrowing authority is reduced by the amount of any unused portion. USCG also has borrowing authority with Treasury for amounts up to \$100 million for the Oil Spill Liability Trust Fund.

# Financial Information

## **R. Annual, Sick, and Other Accrued Leave**

Annual and other vested compensatory leave is accrued as earned and the liability is reduced as leave is taken. At year end, the balances in the accrued leave accounts are adjusted to reflect the liability at current pay rates and leave balances, and are reported within accrued payroll and benefits. Sick leave and other types of non-vested leave are not accrued and are expensed when taken.

## **S. Workers' Compensation**

A liability is recorded for actual and estimated future payments to be made for workers' compensation pursuant to the *Federal Employees' Compensation Act* (FECA). The actual liability is presented as a component of intra-governmental other liabilities, and the actuarial liability is presented within accrued payroll and benefits in the accompanying consolidated balance sheet. The FECA program is administered by the U.S. Department of Labor (DOL), which initially pays valid claims and subsequently seeks reimbursement from Federal agencies employing the claimants. Reimbursement to DOL on payments made occurs approximately two years subsequent to the actual disbursement. Budgetary resources for this intra-governmental liability are made available to the Department as part of its annual appropriation from Congress in the year in which the reimbursement takes place.

Additionally, a liability due to the public is recorded that includes the expected liability for death, disability, medical and miscellaneous costs for approved compensation cases. The liability is determined using an actuarial method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. The Department allocates the actuarial liability to its bureaus based on payment history provided by DOL. The accrued liability is not covered by budgetary resources and will require future funding.

## **T. Military and Other Retirement Benefits**

### **DHS and Bureau Civilian Workforce Pension and Other Benefits:**

The Department recognizes the full annual cost of its civilian employees' pension benefits; however, the assets of the plan and liability associated with pension costs are recognized by the OPM rather than the Department.

Most employees of the Department hired prior to January 1, 1984, participate in the Civil Service Retirement System (CSRS), to which the Department contributed 8.5 percent of base pay for regular CSRS employees, and 9 percent of base pay for law enforcement agents.

Employees hired after December 31, 1983, are automatically covered by FERS and Social Security. FERS also offers a savings plan to which the Department automatically contributes 1 percent of base pay and matches any employee contributions up to an additional 4 percent of base pay. The Department also contributes the employer's matching share for Social Security. For the FERS basic benefit the Department contributed 10.7 percent of base pay for regular FERS employees and 22.7 percent for law enforcement agents.

Similar to CSRS and FERS, OPM rather than the Department reports the liability for future payments to retired employees who participate in the Federal Employees Health Benefits Program and Federal Employees Group Life Insurance Program. The Department is required to report the full annual cost of providing these other retirement benefits (ORB) for its retired employees as well as reporting contributions made for active employees. In addition, the Department recognizes an expense and liability for other post employment benefits (OPEB), which includes all types of benefits provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents.

# Financial Information

The difference between the full annual cost of CSRS or FERS retirement, ORB and OPEB benefits and the amount paid by the Department is recorded as an imputed cost and off-setting imputed financing source in the accompanying consolidated financial statements.

## **USCG - Military Retirement System Liability**

The USCG Military Retirement System (MRS) is a defined benefit plan that covers both retirement pay and health care benefits for all active duty and reserve military members of the USCG. The plan is funded through annual appropriations and, as such, is a pay-as-you-go system. The unfunded accrued liability reported on the accompanying consolidated balance sheet is actuarially determined by subtracting the present value of future employer/employee contributions, as well as any plan assets, from the present value of the future cost of benefits. Current period expense is computed using the aggregate entry age normal actuarial cost method.

A portion of the accrued MRS liability is for the health care of non-Medicare eligible retirees/survivors. Effective October 1, 2002, USCG transferred its liability for the health care of Medicare eligible retirees/survivors to the Department of Defense (DoD) Medicare-Eligible Retiree Health Care Fund (the Fund), which was established in order to finance the health care benefits for the Medicare-eligible beneficiaries of all DoD and non-DoD uniformed services. DoD is considered to be the administrative entity and in accordance with SFFAS No. 5, is required to recognize the liability on the Fund's financial statements. The USCG makes monthly payments to the Fund for current active duty members. Benefits for USCG members who were retired, prior to the establishment of the Fund, are provided by payments from the Treasury to the Fund. The future cost and liability of the Fund is determined using claim factors and claims cost data developed by the DoD, adjusted for USCG retiree and actual claims experience. The USCG uses the current year factors to project costs for all future years, without any assumption about future changes in the factors. The portion of care provided by Military Treatment Facilities (MTFs) varies from year to year. To the extent that costs vary between purchased care and MTFs, total future cost will vary.

## **USCG - Post-employment Military Travel Benefit**

USCG uniformed service members are entitled to travel and transportation allowances for travel performed or to be performed under orders, without regard to the comparative costs of the various modes of transportation upon separation from the service, placement on the temporary disability retired list, release from active duty, or retirement, from his last duty station to his home or the place from which he was called or ordered to active duty, whether or not he is or will be a member of a uniformed service at the time the travel is or will be performed.

USCG recognizes an expense and a liability for this OPEB when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the reporting date. The OPEB liability is measured at the present value of future payments, which requires the USCG to estimate the amount and timing of future payments, and to discount the future outflow using the Treasury borrowing rate for securities of similar maturity to the period over which the payments are to be.

## **U.S. Secret Service - Uniformed Division and Special Agent Pension Liability**

The District of Columbia Police and Fireman's Retirement System (the DC Pension Plan) is a defined benefit plan that covers USSS Uniformed Division and Special Agents. The DC Pension Plan makes the benefit payments to retirees and/or their beneficiaries. The USSS receives permanent, indefinite appropriations each year to pay the excess of benefit payments over salary deductions. The DC Pension Plan is funded through annual appropriations and, as such, is a pay-as-you-go system. The unfunded accrued liability reported on the accompanying consolidated balance sheet is actuarially determined by subtracting the present value of future employer/employee contributions, as well as any plan assets, from the present value of future cost of benefits. Current period expense is computed using the aggregate cost method.

# Financial Information

## U. Use of Estimates

Management has made certain estimates and assumptions in the reporting of assets, liabilities, revenues, expenses, obligations incurred, spending authority from offsetting collections, and note disclosures in the consolidated financial statements. Actual results could differ from these estimates. Significant estimates include: the allocation of trust fund receipts, year-end accruals of accounts and grants payable, contingent legal and environmental liabilities, accrued workers' compensation, allowance for doubtful accounts receivable, allowances for obsolete inventory and OM&S balances, allocations of indirect common costs to construction-in-progress, subsidy re-estimates, deferred revenues, NFIP claims and settlements, MRS and other pension, retirement, and post-retirement benefit assumptions, and certain non-entity receivables and payables related to custodial activities.

## V. Taxes

The Department, as a Federal agency, is not subject to Federal, state or local income taxes and accordingly, no provision for income taxes has been recorded in the accompanying consolidated financial statements.

## W. Corrections of Errors and Change in Accounting Method

The USCG corrected an error in its method of accounting for repairable spare parts after the transfer of assets to DHS on March 1, 2003. A change in accounting was made to associate \$869 million (unaudited) in repairable spare parts with the major PP&E asset class they support, to remove an allowance for OM&S obsolescence of \$125 million (unaudited), and to recognize \$672 million (unaudited) of accumulated depreciation expense on those spare parts, computed on a straight-line basis, using the same useful life as the major asset (see notes 9 and 11).

The Strategic National Stockpile recorded an adjustment to increase inventory by \$485 million to correct an error in method used to value stockpile inventory (see note 9).

The USSS recorded an adjustment to recognize an unfunded liability equal to \$3.3 billion (unaudited) for the future funding requirements of the DC Pension Plan liability (see note 17).

## 3. Non-Entity Assets

Non-entity assets at September 30, 2003, consisted of the following (in millions):

### Intra-governmental:

Fund Balance with Treasury	\$1,720
Other Receivables Due From Treasury (note 12)	109
<b>Total Intra-governmental</b>	<b>1,829</b>

### Public:

Duties and Taxes Receivable, Net (note 7)	1,140
Other	64
<b>Total Public</b>	<b>1,204</b>

<b>Total Non-Entity Assets</b>	<b>3,033</b>
<b>Total Entity Assets</b>	<b>41,515</b>
<b>Total Assets</b>	<b>\$44,548</b>

# Financial Information

Non-entity fund balance with Treasury consists of permanent appropriations, miscellaneous receipts, and portions of special and deposit funds that are available to pay non-entity liabilities presented as a component of other liabilities on the consolidated balance sheet at September 30, 2003, including \$1.4 billion (in deposit fund) of duties collected by CBP on imports of Canadian softwood lumber, for which there is an anti-dumping dispute currently being litigated by interested parties; CBP Injured Domestic Industries (IDI) accrued liability of \$247 million (in special fund), and estimated duty refunds or drawbacks payable of \$98 million. Non-entity fund balance with Treasury also consists of trust-related assets primarily from cash held on behalf of obligors and fees, fines and penalties collected that are managed by CIS.

Non-entity receivables due from Treasury represent an estimate of duty, tax and/or fee refunds and drawbacks that will be reimbursed by a permanent and indefinite appropriation account when payment is made to importers/exporters. Duties and taxes receivable from public represents amounts due from importers for goods and merchandise imported to the United States, and upon collection, will be available to pay the accrued intragovernmental liability due to Treasury General Fund at September 30, 2003 equal to \$1.2 billion.

## 4. Fund Balance with Treasury

### A. Fund Balance with Treasury

Fund balance with Treasury at September 30, 2003, consisted of the following (in millions):

Appropriated Funds	\$23,646
Trust Funds	74
Revolving and Working Capital Funds	237
Special Funds	1,709
Deposit Funds	1,677
<b>Total Fund Balance with Treasury</b>	<b><u>\$27,343</u></b>

Appropriated funds consist of amounts appropriated annually by Congress to fund the operations of DHS and its component Bureaus.

Trust funds are both receipt accounts and one or more expenditure accounts that are designated by law as a trust fund. Trust fund receipts are used for specific purposes, generally to offset to cost of expanding border and port enforcement activities, oil spill related claims and activities, or to hold CIS bond receipts.

Revolving funds are used for continuing cycles of business-like activity, in which the fund charges for the sale of products or services and uses the proceeds to finance its spending, usually without requirement for annual appropriations. The working capital fund is a fee-for-service organization established to support operations of a specific Bureau and costs incurred are fully reimbursable. Also included are the liquidating and financing funds for credit reform and the National Flood Insurance Fund.

Special funds are receipts and/or off-setting receipt funds earmarked for specific purposes including the disbursement of non-entity monies received in connection with antidumping and countervailing duty orders and findings to qualifying IDI. DHS also has special funds for user fees, inspection fees, flood map modernization, subsidy, off-set, and refund transfers.

Deposit funds represent amounts received as an advance that are not accompanied by an order and include non-entity collections that do not belong to the Federal government and for which final disposition has not been determined at year end, including \$1.4 billion of duties collected on imports of Canadian softwood lumber (see note 3).

# Financial Information

## B. Status of Fund Balance with Treasury

As of September 30, 2003, the status of fund balance with Treasury consisted of the following (in millions):

Unobligated Balances:	
Available	\$3,448
Unavailable	2,888
Obligated Balance Not Yet Disbursed	19,642
Non-budgetary Receipt and Deposit Funds	1,365
<b>Total Status of Fund Balance with Treasury</b>	<b>\$27,343</b>

Unobligated balances available, as presented in the combined statement of budgetary resources, includes borrowing authority of \$1.6 billion, and investments of \$1.5 billion. Included in fund balance with Treasury are unavailable restricted balances of \$1.7 billion of non-entity funds, as described in note 3, and user fees account balance of \$640 million, which is restricted by law in its use to offset costs incurred by CBP until authority is granted through appropriations acts.

The unavailable balance also includes amounts appropriated in prior fiscal years that are not available to fund new obligations. The obligated not yet disbursed balance represents amounts designated for payment of goods and services ordered but not received or goods and services received but for which payment has not yet been made. Unliquidated obligations for estimated future disaster costs of \$8.1 billion are also included in obligated balances not yet disbursed. During FY 2003, DHS returned to Treasury \$64.6 million of indefinite no-year authority, and \$1.5 billion in authority permanently unavailable for obligation pursuant to public law (unaudited).

## 5. Investments, Net

DHS' investments at September 30, 2003, consisted of the following (in millions):

Type of Investment	Cost	Unamortized (Premium)/ Discount	Net Investments	Market Value
<b>U.S. Treasury Securities:</b>				
USCG - Non-Marketable, Par Value	\$956	\$9	\$965	N/A
EPR - Non-Marketable, Market-Based	581	-	581	\$581
<b>Total Intra-governmental Investments</b>	<b>\$1,537</b>	<b>\$9</b>	<b>\$1,546</b>	

Unexpended funds in the USCG Oil Spill Liability Trust Fund (Oil Spill Fund) and the Gift Fund are invested by the Bureau of Public Debt in U.S. Government Securities. Interest and principal on invested balances in the USCG's Oil Spill Fund are available for use by the USCG to offset the cost of oil spill clean-up, payment of environmental claims against the fund, and for specific funding of clean-up related operations. EPR maintains investments for the Gifts and Bequests Fund and the NFIP. EPR investments are restricted to Treasury bonds, bills, notes, and overnight securities. The current EPR investments portfolio consists principally of overnight securities, which have neither market value variances nor unamortized premium or discount.

# Financial Information

## 6. Advances and Prepayments – Intra-governmental

Intra-governmental advances and prepayments at September 30, 2003, consisted of the following (in millions):

Disaster Recovery Fund	\$2,816
Other	238
<b>Total Intra-governmental Advances and Prepayments</b>	<b>\$3,054</b>

Advances and prepayments made to the public are presented as a component of other assets on the accompanying balance sheet (see note 12).

## 7. Tax, Duties, and Trade Receivables, Net

Tax, duties, and trade receivables at September 30, 2003, consisted of the following (in millions):

Receivables Category	Gross		Total Net Receivables
	Receivables	Allowance	
Duties	\$1,020	(\$102)	<b>\$918</b>
Excise Taxes	73	(1)	<b>72</b>
User Fees	71	(1)	<b>70</b>
Fines/Penalties	694	(621)	<b>73</b>
Refunds and Drawback	36	(29)	<b>7</b>
<b>Total Tax, Duties, and Trade Receivables, Net</b>	<b>\$1,894</b>	<b>(\$754)</b>	<b>\$1,140</b>

When a violation of import/export law is discovered, a fine or penalty is established, typically for the full value of the merchandise. After receiving the notice of assessment, the importer or surety has a period of time to either file a petition requesting a review of the assessment or pay the assessed amount. Once a petition is received, CBP investigates the circumstances as required by its mitigation guidelines and directives. Until this process has been completed, CBP records an allowance on fines and penalties of approximately 90 percent of the total assessment based on historical experience of fines and penalties mitigation and collection. Duties and taxes receivable are non-entity assets for which there is an offsetting liability due to the Treasury General Fund at September 30, 2003.

## 8. Direct Loans and Loan Guarantees, Non-Federal Borrowers

### A. Summary of Direct Loans to Non-Federal Borrowers (in millions):

	Loans Receivable, Net
<b>Community Disaster Loans</b>	<b>\$14.5</b>

An analysis of loans receivable and the nature and amounts of the subsidy and administrative costs associated with the direct loans is provided in the following sections.



# Financial Information

## B. Direct Loans Obligated Prior to FY 1992 (Present Value Method, in millions):

	Loans Receivable, Gross	Interest Receivable	Allowance for Loan Losses	Value of Assets Related to Direct Loans
Community Disaster Loans	\$ .167	\$ .004	(\$ .017)	\$ .154

## C. Direct Loans Obligated After FY 1991 (in millions):

	Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
Community Disaster Loans	\$130.9	\$54.5	(\$171.0)	\$14.4

## D. Total Amount of Direct Loans Disbursed, Post-1991: None.

## E. Subsidy Expense for Direct Loans by Program and Component (in millions):

Subsidy Expense for New Direct Loans Disbursed: None

Modifications and Reestimates (Prior reporting year):

	Interest Rate Reestimates	Technical Reestimates	Total Reestimates
Community Disaster Loans	\$ -	(\$19)	(\$19)

Total Direct Loan Subsidy Expense:

	Current Year	Prior Year
Community Disaster Loans	\$ -	(\$19)

## F. Direct Loan Subsidy Rates

The direct loan subsidy rates, by component, are as follows:

	Community Disaster Loans	State Share Loans
Interest Subsidy Cost	(0.84) %	(4.48) %
Default Costs	- %	- %
Other	93.01 %	0.38 %

# Financial Information

## G. Schedule for Reconciling Subsidy Cost Allowance Balances (in millions)

Beginning Balance of the Subsidy cost allowance	\$163
Add: subsidy expense for direct loans disbursed during the reporting years by component:	
(a) Interest rate differential costs	-
(b) Other subsidy costs	-
Adjustments:	
(a) Loans written off	-
(b) Subsidy allowance amortization	8
Ending balance of the subsidy cost allowance before reestimates	<u>171</u>
Add subsidy reestimate by component	
(a) Technical/default reestimate	-
<b>Ending balance of the subsidy cost allowance</b>	<b><u><u>\$171</u></u></b>

## H. Administrative Expenses (in millions):

<b>Community Disaster and State Share Loans</b>	<b><u><u>\$ -</u></u></b>
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## 9. Operating Materials, Supplies, Inventory, and Stockpile, Net

Operating materials and supplies (OM&S), inventory, and stockpile, net at September 30, 2003, consisted of the following (in millions):

### OM&S (unaudited)

Items Held for Use	\$417
Items Held for Future Use	80
Excess, Obsolete and Unserviceable Items	10
Less: Allowance for Losses	(10)
<b>Total OM&amp;S, Net</b>	<b><u>497</u></b>

### Inventory

Inventory Purchased for Resale	58
Less: Allowance for Losses	(1)
<b>Total Inventory, Net</b>	<b><u>57</u></b>

**Strategic National Stockpile** **608**

**Total OM&S, Inventory, and Stockpile, Net** **\$1,162**

The USCG corrected an error and changed its method of accounting for exchange and repairable spare parts that were classified as OM&S prior to the transfer of assets to DHS on March 1, 2003 (see Note 11). Part of the correction included the reduction of an allowance for obsolescence of \$125 million associated with these spare parts, that was recorded as a cumulative effect adjustment to the transfer-in from legacy balance in the consolidated statement of changes in net position.

# Financial Information

The USCG has reclassified slow-moving OM&S items from “held for use” to “excess, obsolete and unserviceable” and “held for future use”, and also recognized an allowance to reflect the net realizable value of excess, obsolete and unserviceable items.

The strategic national stockpile inventory balance was adjusted to correct an error in method used to value stockpile inventory prior to the transfer to DHS. The correction increased the value of stockpile inventory transferred-in on March 1, 2003 by \$485 million and was recorded as a cumulative effect adjustment to the balance transferred-in from the legacy agency in the consolidated statement of changes in net position.

## 10. Prohibited Seized Property

Prohibited seized property activity and item counts as of and for the seven months ended September 30, 2003, are as follows:

<b>Seized Property:</b>	<b>Seizure Activity (unaudited)</b>					<b>Seized Property September 30 Weight/Items</b>
	<b>Seven Months Ended September 30, 2003</b>					
Category	<b>Balance March 1, 2003</b>	<b>New Seizures</b>	<b>Remissions</b>	<b>New Forfeitures</b>	<b>Adjustments</b>	
Illegal Drugs:						
Cannabis (marijuana)	1,191	321,745	0	(322,573)	(32)	<b>331</b>
Cocaine	164	19,298	0	(19,280)	(29)	<b>153</b>
Heroin	18	382	0	(381)	3	<b>22</b>
Firearms and Explosives	6,992	2,554	(396)	(1,390)	(3)	<b>7,757</b>
Counterfeit Currency (US/ Foreign)	2,892,538	224,215	(165,877)	0	(97,481)	<b>2,853,395</b>
Pornography	235	153	(3)	(187)	(20)	<b>178</b>
<b>Forfeited Property:</b>	<b>Forfeiture Activity (unaudited)</b>					<b>Forfeited Property September 30 Weight/Items</b>
	<b>Seven Months Ended September 30, 2003</b>					
Category	<b>Balance March 1, 2003</b>	<b>New Forfeitures</b>	<b>Transfers</b>	<b>Destroyed</b>	<b>Adjustments</b>	
Illegal Drugs:						
Cannabis (marijuana)	160,105	322,573	0	(359,768)	(9,379)	<b>113,531</b>
Cocaine	14,309	19,280	(23)	(16,221)	(375)	<b>16,970</b>
Heroin	4,033	381	(31)	(1,373)	(33)	<b>2,977</b>
Firearms and Explosives	292	1,390	(2)	(5)	(335)	<b>1,340</b>
Pornography	89	187	(1)	(202)	7	<b>80</b>

# Financial Information

This schedule is presented for material prohibited (non-valued) seized and forfeited property only. These items are retained and ultimately destroyed by CBP and USSS and are not transferred to the Departments of Treasury or Justice Forfeiture Funds or any other Federal agency. Adjustments include reclassification of property categories and minor adjustments to the balances transferred-in on March 1, 2003. The ending balance for firearms includes only those seized items that can actually be used as firearms. Illegal drugs are presented in kilograms; firearms, explosives, and pornography are presented in number of items; counterfeit currency is presented in number of bills.

USCG also seizes and takes temporary possession of small boats, equipment, contraband, and other illegal drugs. USCG usually disposes of these properties within three days by transfer to CBP (who transfers non-prohibited seized property to the Treasury Forfeiture Fund), the Drug Enforcement Administration, or foreign governments, or by destroying it. Because USCG never takes ownership of the property and keeps it for a short duration, seized property in USCG possession at year end is considered insignificant and therefore is not valued and is not reported in the consolidated financial statements of DHS.

## 11. Property, Plant, and Equipment, Net

Property, plant, and equipment (PP&E), at September 30, 2003, consisted of the following (in millions):

	Service Life	Acquisition Cost	Accumulated Depreciation/Amortization (unaudited)	Total Net Book Value	Unaudited Net Book Value
Land and Land Rights	N/A	\$54	\$ -	\$54	\$40
Improvements to Land	3-50 yrs	7	-	7	-
Construction in Progress	N/A	1,377	-	1,377	665
Buildings, Other Structures, and Facilities	2-50 yrs	1,894	31	1,863	1,084
Equipment:					
ADP Equipment	3-5 yrs	34	6	28	-
Aircraft	10-20 yrs	1,152	102	1,050	617
Vessels	5-10 yrs	2,264	77	2,187	134
Vehicles	3-6 yrs	368	168	200	1
Other Equipment	2-20 yrs	1,803	31	1,772	299
Leasehold Improvements	3-50 yrs	160	7	153	-
Internal Use Software	3-10 yrs	236	34	202	38
Internal Use Software- in Development	N/A	245	-	245	-
<b>Total Property, Plant, and Equipment</b>		<b>\$9,594</b>	<b>\$456</b>	<b>\$9,138</b>	<b>\$2,878</b>

FASAB TB 2003-1 states that "receiving entities will recognize assets and liabilities based on the legacy entities' book values at the time of transfer." Accordingly, transfers of PP&E from legacy agencies to DHS have been recorded at the net book value at the date of transfer. Acquisition cost represents the net book value of the assets transferred-in from other Federal agencies together with the net change in assets from additions and disposals that occurred from March 1, 2003 through September 30, 2003. Accumulated depreciation represents depreciation expense for the seven months ended September 30, 2003.

# Financial Information

The USCG corrected an error and changed its method of accounting for exchange and repair spare parts after the transfer of its assets to DHS. Exchange and repair spare parts valued at \$869 million (unaudited) classified as OM&S at the time of transfer from the legacy agency have been reclassified to PP&E as of March 1, 2003. Repairable spare parts are associated with the major PP&E asset class they support and depreciated on a straight-line basis, using the same useful life as the major asset. In connection with this change the USCG also recognized accumulated depreciation equal to \$672 million (unaudited) and removed an allowance for obsolescence of \$125 million (unaudited) on these spare parts as of March 1, 2003, as a cumulative effect adjustment to the transfer-in from legacy agency balance in the consolidated statement of changes in net position, and included the net effect of \$197 million (unaudited) increase of PP&E as a component of acquisition cost of transfers-in presented in the table above.

## 12. Other Assets

Other assets at September 30, 2003, consisted of the following (in millions):

### Intra-governmental:

Accounts Receivable	\$306
Receivables Due From Treasury	109
<b>Total Intra-governmental</b>	<b>415</b>

### Public:

Accounts Receivable and Related Interest	591
Allowance for Doubtful Accounts	(291)
Advances and Prepayments	365
Cash and Other Monetary Assets	59
Credit Program Receivables, Net (note 8)	15
Other	11
<b>Total Public</b>	<b>750</b>
<b>Total Other Assets</b>	<b>\$1,165</b>

Intra-governmental accounts receivable results from reimbursable work performed by CBP, TSA, ICE, and EPR. Accounts receivable with the public consists of amounts due to CBP, ICE, and EPR for reimbursable services and user fees. Advances and prepayments consist primarily of National Flood Insurance payments made by EPR.

# Financial Information

## 13. Liabilities Not Covered by Budgetary Resources

Liabilities not covered by budgetary resources, as of September 30, 2003, consisted of the following (in millions):

<b>Intra-governmental:</b>	
Accrued Workers' Compensation (note 16)	\$178
Debt owed to Treasury	8
Other	4
<b>Total Intra-governmental</b>	<b>190</b>
<b>Public:</b>	
Military Service and Other Retirement Benefits (note 17)	25,285
Actuarial Workers' Compensation (note 16)	1,125
Accrued Annual Leave	845
Claims and Claims Settlement Expenses – Cerro Grande	44
Other:	
Environmental and Disposal Liabilities (note 20)	98
Contingent Legal Liabilities (note 20)	58
Capital Lease Liability (note 19)	167
Other	3
<b>Total Public</b>	<b>27,625</b>
<b>Total Liabilities Not Covered by Budgetary Resources</b>	<b>\$27,815</b>
<b>Liabilities Covered by Budgetary Resources or Non-Entity Assets</b>	<b>8,853</b>
<b>Total Liabilities</b>	<b>\$36,668</b>

DHS anticipates that the liabilities listed above will be funded from future budgetary resources when required. Budgetary resources are generally provided for annual leave when it is taken.

## 14. Claims and Claims Settlement Liabilities

### National Flood Insurance Program

The liability for unpaid losses and related loss adjustment expenses for the NFIP was \$672 million at September 30, 2003. Activity for the seven months ended September 30, 2003 (unaudited), was as follows (in millions):

Transferred-in NFIP liability (March 1, 2003)	\$59
Incurred losses and increase estimated losses	803
Less: Amounts paid during current period	(190)
<b>Total NFIP Liability at September 30, 2003</b>	<b>\$672</b>

# Financial Information

## Cerro Grande Fire Assistance Act

The U.S. Department of Interior, National Park Service initiated a prescribed burn that resulted in the loss of federal, state, local, Indian tribal and private property. In July 2000, Congress passed the *Cerro Grande Fire Assistance Act* (CGFAA) to compensate as fully as possible those parties who suffered damages from the Cerro Grande Fire.

At September 30, 2003, the estimated claims liability for the CGFAA was \$82 million. The liability for unpaid claims and claim adjustment expenses represents an estimate of the known probable and estimable losses that are unpaid as of September 30, 2003 based on the Final Rules dated March 21, 2001, entitled, the Disaster Assistance: Cerro Grande Fire Assistance, Final Rule, published in the Federal Register Part II at 44 CFR Chapter I, Part 295. This estimated claims liability for September 30, 2003, includes \$44 million, which is unfunded.

## 15. Deferred Revenue

Deferred revenue at September 30, 2003, and CIS application fee activity for the seven months then ended (unaudited), consisted of the following (in millions):

### CIS Application Fees:

March 1, 2003 transferred-in balance	\$829
Collection deposited, March 1 – September 30, 2003	580
Less: earned revenue (completed applications)	(439)
Adjustments for undeposited collections and others	(21)
<b>Total CIS Application Fees</b>	<b>949</b>
EPR Unexpired NFIP premium	1,008
Advances from Others	12
<b>Total Deferred Revenue</b>	<b>\$1,969</b>

CIS requires advance payments of the fees for applications or petitions for immigration, nationality, and citizenship benefits. EPR's deferred revenue relates to unearned NFIP premiums that are reserved to provide for the unexpired period of insurance coverage.

## 16. Workers' Compensation

Claims incurred for the benefit of DHS employees under FECA are administered by DOL and are ultimately paid by DHS. The accrued liability representing money owed for current claims incurred during the seven month period ending September 30, 2003, was equal to \$178 million. Future workers' compensation estimates, generated from an application of actuarial procedures developed by the DOL, for the future cost of approved compensation cases was \$1.1 billion at September 30, 2003. Workers' compensation expense was \$170 million (unaudited) for the seven months ended September 30, 2003.

The DOL calculated the estimated future benefit payments based on several assumptions. The interest rate assumptions utilized to discount the estimated future benefit payments to present value are 3.84 percent in year one and 4.35 percent in year two and thereafter. The wage inflation factors and medical inflation factors used in the calculation are approximately 2.0 percent and 3.5 percent, respectively.



# Financial Information

## 17. Military Service and Other Retirement Benefits

Accrued liability for military service and other retirement benefits at September 30, 2003, consisted of the following (in millions):

USCG Military Retirement and Healthcare Benefits	\$21,745
USCG Post-Employment Military Travel Benefits (unaudited)	201
USSS DC Pension Plan Benefits (unaudited)	3,339
<b>Total Military Service and Other Retirement Benefits Liability</b>	<b>\$25,285</b>

### Military Retirement System Liability

The components of the Military Retirement System (MRS) expense for the seven months ended September 30, 2003, consisted of the following (in millions):

#### Defined Benefit Plan (unaudited):

Normal cost	\$224
Interest on the liability	637
Actuarial gains/(losses)	(122)
Benefits paid (estimated)	(425)
<b>Total Defined Benefit Plan Expense</b>	<b>314</b>

#### Post-retirement Healthcare (unaudited):

Normal cost	\$78
Interest on the liability	123
Gains/(losses) due to change in medical inflation rate assumptions	(54)
<b>Total Post-retirement Healthcare Expense</b>	<b>147</b>

#### **Total MRS Expense for the seven months ended September 30, 2003 (unaudited)**

**\$461**

USCG's military service members (both active duty and reservists) participate in the MRS. USCG receives an annual "Retired Pay" appropriation to fund MRS benefits, thus the MRS is treated as a pay-as-you-go plan. Consequently the plan has no assets. The unfunded accrued liability, presented as a component of the liability for military service and other retirement in the accompanying consolidated balance sheet, represents both retired pay and health care benefits for non-Medicare eligible retirees/survivors. On October 1, 2002, USCG transferred the actuarial liability for payments for the health care benefits of Medicare eligible retirees/survivors to the Department of Defense Medicare-Eligible Retiree Health Care Fund (the Fund). USCG makes monthly payments to the Fund for current service members. An actuarial present value of accumulated plan benefits is derived from the future payments that are attributable, under the retirement plan's provisions, to a participant's credited service as of the valuation date. Credited service is the years of service from active duty base date (or constructive date in the case of active duty reservists) to date of retirement measured in years and completed months. The present value of future benefits is then converted to an unfunded accrued liability by subtracting the present value of future employer/employee normal contributions.

USCG plan participants may retire after 20 years of active service at any age with annual benefits equal to 2.5 percent of retired base pay for each year of credited service up to 75 percent of basic pay. Personnel who became members after August 1, 1986 may elect to receive a \$30,000 lump sum bonus after 15 years of service and reduced benefits prior to age 62.

# Financial Information

Annual disability is equal to the retired pay base multiplied by the larger of (1) 2.5 percent times years of service, or (2) percent disability. The benefit cannot be more than 75 percent of retired pay base.

If a USCG member is disabled, he/she is entitled to disability benefits, assuming the disability is at least 30 percent (under a standard schedule of rating disabilities by Veterans Affairs) and either: (1) the member has 8 years of service, (2) the disability results from active duty, or (3) the disability occurred in the line of duty during a time of war or national emergency or certain other time periods.

The significant actuarial assumptions used to compute the MRS accrued liability are:

- (1) life expectancy is based upon the DoD death mortality table;
- (2) cost of living increases are 3.0 percent annually; and
- (3) annual rate of investment return is 6.25 percent

## **District of Columbia Police and Fireman's Retirement System for Secret Service Employees (unaudited)**

Special agents and personnel in certain job series hired by USSS before January 1, 1984, are eligible to transfer to the District of Columbia Police and Fireman's Retirement System (DC Pension Plan) after completion of ten years of protection related experience. All uniformed USSS officers who were hired before January 1, 1984, are automatically covered under this retirement system. Participants in the DC Pension Plan make contributions of seven percent of base pay with no matching contribution made by USSS. Annuitants of this plan receive benefit payments directly from the DC Pension Plan. The USSS reimburses the District of Columbia for the difference between benefits provided to the annuitants, and payroll contributions received from current employees.

The USSS recorded an adjustment to increase liabilities with an offsetting decrease in cumulative results of operations transferred-in from the legacy agency by \$3.3 billion (unaudited) to recognize an unfunded pension benefits liability equal to the present value of future payments at the DC Pension Plan as of March 1, 2003. This liability is presented as a component of the liability for military service and other retirement benefits in the accompanying consolidated balance sheet. The legacy agency had not previously recognized this liability and accordingly a zero balance was transferred-in on March 1, 2003. SFFAS No. 5 *Accounting for Liabilities of the Federal Government* requires the administrative entity (administrator) to report the actuarial liability. However, the USSS adopted the provisions of SFFAS No. 5 because the administrator, the DC Pension Plan, is not a federal entity and as such the liability for future funding would not otherwise be recorded in the United States government-wide consolidated financial statements.

The adjustment recorded as of March 1, 2003 has been determined using the aggregate cost method. The primary actuarial assumptions used to determine the liability at September 30, 2003 are:

- (1) life expectancy is based upon the 1994 Uninsured Pension (UP94) tables;
- (2) cost of living increases are 3.5 percent annually;
- (3) rates of salary increases are 3.5 percent annually; and
- (4) annual rate of investment return is 7.25 percent

Total expenses related to the DC Pension Plan for the seven months ended September 30, 2003 were \$91.6 million of which \$12.2 million was funded but not paid.

# Financial Information

## 18. Other Liabilities

Other liabilities at September 30, 2003, consisted of the following (in millions):

### Intra-governmental:

Accrued Workers' Compensation	\$178
Advances from Others	77
Employer Benefits Contributions and Payroll Taxes	57
Custodial Liability other than Due to General Fund	19
Debt Owed to Treasury	8
Other Intra-governmental Liabilities	10
<b>Total Intra-governmental Other Liabilities</b>	<b>349</b>

### Public:

Duties for Imports of Canadian Softwood Lumber (note 3)	1,439
Injured Domestic Industries (note 3)	247
Contingent Legal Liabilities (note 20)	75
Capital Lease Liability (note 19)	167
Environmental and Disposal Liabilities (note 20)	98
Refunds and Drawbacks (note 3)	98
Other Public Liabilities	326
<b>Total Public Other Liabilities</b>	<b>2,450</b>

### Total Other liabilities

**\$2,799**

Intra-governmental accrued workers' compensation primarily represents the unfunded FECA liability for current claims. Intra-governmental other liabilities consist principally of current liabilities, while the majority of public other liabilities are considered non-current.

The *Continued Dumping and Subsidy Offset Act of 2000*, calls for CBP to collect and disburse monies received in connection with antidumping and countervailing duty orders and findings to qualifying Injured Domestic Industries (IDI). Antidumping duties are collected when it is determined that a class or kind of foreign merchandise is being released into the U.S. commerce at less than its fair value to the detriment of a U.S. industry. Countervailing duties are collected when it is determined that a foreign government is providing a subsidy to its local industries to manufacture, produce, or export a class or kind of merchandise for import into the U.S. commerce to the detriment of a U.S. industry. Antidumping and countervailing duties collected and due to IDIs at September 30, 2003, totaled \$247 million. Canadian softwood lumber duties of \$1.4 billion are also collected by CBP, and will eventually be distributed, pursuant to rulings by the Department of Commerce. Duties for imports of Canadian softwood lumber is included in non-entity fund balance with Treasury, and represents a non-entity liability for which there is an anti-dumping dispute currently being litigated.

### Refunds and Other Payments

Disbursements from the refunds and drawback account for the seven months ended September 30, 2003, consisted of the following (in millions):

Refunds	\$399
Drawback	159
<b>Total</b>	<b>\$558</b>

# Financial Information

The disbursements include interest payments of \$36 million. In certain instances, a refund may be identified prior to liquidation for amounts remitted by the importer. These refunds are funded from the collections rather than the refunds and drawback account. For the seven months ended September 30, 2003, these refunds totaled \$235 million.

Amounts refunded during the seven months ended September 30, 2003, identified by entry year, consisted of the following (in millions):

Entry Year:	
2003	\$314
2002	84
2001	52
2000	28
Prior Years	80
<b>Total</b>	<b>\$558</b>

The disbursement totals for refunds include antidumping and countervailing duties collected that are refunded pursuant to rulings by the Department of Commerce. These duties are refunded when Commerce issues a decision in favor of the foreign industry.

The total amounts of antidumping and countervailing duties vary from year to year depending on decisions from Commerce. Antidumping and countervailing duty refunds and associated interest refunded for the seven months ended September 30, 2003, consisted of the following (in millions):

Antidumping and countervailing duty refunds	\$57
Interest	13
<b>Total Antidumping and countervailing duty refunds</b>	<b>\$70</b>

## 19. Leases

### Operating Leases (unaudited)

The Department leases various facilities and equipment under leases accounted for as operating leases. Leased items consist of offices, warehouses, vehicles, and other equipment. Much of the office space occupied by the Department is either owned by the Federal government or is leased by GSA from commercial sources. The Department is not committed to continue to pay rent to GSA beyond the period occupied providing proper advance notice to GSA is made and unless the space occupied is designated as unique space only for DHS operations. However, it is expected that DHS will continue to occupy and lease office space from GSA in future years and that the lease charges will be adjusted annually to reflect operating costs incurred by GSA.

# Financial Information

As of September 30, 2003, estimated future minimum lease commitments under operating leases for equipment and GSA controlled leases are as follows (in millions):

	<b>GSA</b>	<b>Non-GSA</b>	<b>Total</b>
FY 2004	\$487	\$47	<b>\$534</b>
FY 2005	485	46	<b>531</b>
FY 2006	489	46	<b>535</b>
FY 2007	493	46	<b>539</b>
FY 2008	490	47	<b>537</b>
Beyond FY 2008	-	52	<b>52</b>
<b>Total future minimum lease payments</b>	<b>\$2,444</b>	<b>\$284</b>	<b>\$2,728</b>

The estimated future lease payments for GSA controlled leases are based on period payment made during 2003. Lease payments to GSA are expected beyond 2008, however, costs cannot be reasonably estimated.

## Capital Leases

DHS maintains nominal capital leases for equipment, buildings, and commercial software license agreements. The liabilities associated with these capital leases and software license agreements are presented as other liabilities in the accompanying consolidated financial statements based upon the present value of the future minimum lease payments. As of September 30, 2003, the aggregate capitalized net cost of buildings subject to capital leases agreements was \$65 million, net of \$2 million accumulated depreciation. As of September 30, 2003, the aggregate capitalized net cost of commercial software license agreements subject to capital leases agreements was \$102 million, net of \$10 million accumulated depreciation.

Certain license agreements are cancelable depending on future funding. Substantially all of the net present value of capital lease obligations and software license agreements are expected to be funded from future sources.

## 20. Contingent Liabilities and Other Commitments

### Legal Contingent Liabilities

The Department is a party to various administrative proceedings, legal actions, and claims brought against it that arise during the normal course of business. Judgements, if any, resulting from such litigation generally will be paid from the Treasury Judgement Fund. Until such claims are resolved, the estimated amount of the probable loss is recognized as a liability. The estimated contingent liability recorded in the accompanying financial statements included with other liabilities for all probable and estimable litigation related claims at September 30, 2003, was \$75 million, of which \$17 million is funded. Asserted and pending legal claims for which loss is reasonably possible was estimated to range from \$3.8 billion to \$3.9 billion, at September 30, 2003. Approximately \$3.4 billion of this estimated range involves cases related to the 1995 bombing of Alfred P. Murrah Federal Building in Oklahoma City, that were transferred to DHS with the Federal Protective Service from the legacy agency.

The Department is subject to various other legal proceedings and claims. In management's opinion, the ultimate resolution of these other actions will not materially affect the Department's financial position or net costs.

# Financial Information

## **Environmental Cleanup Liabilities**

The source of cleanup requirements in determining the environmental liability is based on compliance with Federal and state or local environmental laws and regulations. Environmental cleanup liability of \$98 million, presented with other liabilities in the accompanying consolidated balance sheet consists primarily of fuel storage tank program, fuels, solvents, industrial, and chemicals, and other environmental cleanup associated with normal operations of the USCG. For Plum Island Animal Disease Center, potential environmental liabilities that are not presently estimable could exist due to the facility's age, old building materials used, and other materials associated with the facility's past use as a United States Army installation for coastline defense. Cost estimates for environmental and disposal liabilities are subject to revision as a result of changes in technology and environmental laws and regulations.

## **NFIP Premiums**

NFIP premium rates are generally established for actuarially rated policies with the intent of generating sufficient premiums to cover losses and loss adjustment expenses of a historical average loss year and to provide a surplus to compensate the Insurance Underwriting Operations for the loss potential of an unusually severe loss year due to catastrophic flooding. Notwithstanding the foregoing, subsidized rates are charged on a countrywide basis for certain classifications of insured. These subsidized rates produce a premium somewhat less than the loss and loss adjustment expenses expected to be incurred in a historical average loss year, and do not include a provision for losses that may result from catastrophic flooding. Subsidized rates are used to provide affordable insurance on construction or substantial improvements started on or before December 31, 1974, or before the effective date of the initial Flood Insurance Rate Map (i.e., an official map of a community on which NFIP has delineated both the special hazard areas and the non-subsidized premium zones applicable to the community). Any future loss potential of catastrophic flooding cannot be meaningfully quantified as it relates to insurance policies in effect. Accordingly, the financial statements do not include any provision for this contingent liability.

## **Duty and Trade Refunds**

There are various trade related matters that fall under the jurisdiction of other Federal agencies, such as the Department of Commerce, which may result in refunds of duties, taxes, and fees collected by CBP. Until such time as a decision is reached by the other Federal agencies, CBP does not have sufficient information to estimate a contingent liability amount for trade related refunds under jurisdiction of other Federal agencies. All known refunds as of September 30, 2003, have been recorded.

## **Loaned Aircraft and Equipment**

DHS is generally liable to the DoD for damage or loss to aircraft on loan to CBP. As of September 30, 2003, CBP had 16 aircraft loaned from DoD with an acquisition value of \$94.4 million. No damage or aircraft losses were accrued as of September 30, 2003.

## **21. Consolidated Statement of Net Cost & Net Costs of DHS Sub-organizations (unaudited)**

The Department's consolidated statement of net cost displays information by the Department's program directorates and other sub-organizations. The Department's Strategic Plan was developed during the current fiscal year, and therefore it was not fully applicable to the reporting period. Generally however, the responsibility segments displayed on the Department's consolidated statement of net cost are representative of the strategic missions identified in the Department's Strategic Plan.

The classification of responsibility segments has been determined based on DHS' organization structure and existing responsibility components, such as bureaus, administrations, offices, and divisions within a department. During the period of organizational development (i.e., transfer of programs and operations), the Department accumulated and reported program costs through each responsibility segment. The cost of Department-wide initiatives that would require an allocation of cost from responsibility segments was determined to be insignificant by DHS management.

In addition, intra-Departmental costs and revenues resulting from the provision of goods and services on a reimbursable basis between Departmental responsibility segments are reported as costs by the providing responsibility segment. Such costs and revenues are eliminated in the consolidation process.



## 22. Gross Cost and Earned Revenue by Budget Subfunction (BSF) Classification (unaudited)

Data provided to the Treasury by budget subfunction (BSF) classification for inclusion in the consolidated financial statements of the Federal government, based on the guidance and direction from the Treasury, is presented below. The BSF codes are established by the OMB and the Treasury for government-wide reporting purposes and differ from the classifications used for the Department's segment reporting.

The Department's gross cost and earned revenue by BSF for the seven months ended September 30, 2003, are presented below (in millions):

	National Defense	Pollution Control & Abatement	Agricultural Research & Services	Transportation	Community & Regional Development	Health	Income Security	Administration of Justice	General Government	2003 Total
<b>Agency Gross Cost:</b>										
Gross Cost - Federal	\$11	\$10	\$19	\$1,321	\$319	\$72	\$-	\$2,346	\$32	\$4,130
Less: Intra-Departmental Eliminations	-	-	-	(3)	(3)	-	-	(110)	(9)	(125)
Inter-Departmental Gross Cost - Federal	11	10	19	1,318	316	72	-	2,236	23	4,005
Gross Cost - Public	186	23	98	8,498	5,804	12	124	5,863	100	20,708
Agency Gross Cost	\$197	\$33	\$117	\$9,816	\$6,120	\$84	\$124	\$8,099	\$123	\$24,713
<b>Agency Exchange Revenue:</b>										
Exchange Revenue - Federal	\$-	\$-	\$-	\$231	\$21	\$-	\$-	\$345	\$8	\$605
Less: Intra-Departmental Eliminations	-	-	-	(96)	(2)	-	-	(29)	-	(127)
Inter-Dept. Exchange Revenue - Federal	-	-	-	135	19	-	-	316	8	478
Exchange Revenue - Public	-	-	-	535	1,161	-	-	991	27	2,714
Agency Exchange Revenue	\$-	\$-	\$-	\$670	\$1,180	\$-	\$-	\$1,307	\$35	\$3,192
<b>Agency Net Cost</b>	<b>\$197</b>	<b>\$33</b>	<b>\$117</b>	<b>\$9,146</b>	<b>\$4,940</b>	<b>\$84</b>	<b>\$124</b>	<b>\$6,792</b>	<b>\$88</b>	<b>\$21,521</b>

# Financial Information

## 23. Combined Statement of Budgetary Resources (unaudited)

### Appropriations Received

Appropriations received on the combined statement of budgetary resources (SBR) of \$9,459 million will not match the unexpended appropriations on the consolidated statement of changes in net position (SCNP) of \$7,501 million due to \$1,958 million of trust fund receipts that are not reflected in the unexpended appropriations section of the SCNP.

### Permanently Not Available/Adjustments

Budgetary resources permanently not available on the SBR of \$1,558 million does not agree to the unavailable appropriations returned to Treasury of \$1,565 million on the SCNP due to: (1) reclassification of trust funds from unexpended appropriation to cumulative net results of operations which has no effect on the SBR; (2) authority permanently unavailable that was processed through cumulative results of operations and not unexpended appropriations; (3) repayments of debt that was processed through payables and not unexpended appropriations; and (4) reductions of borrowing authority that have no effect on the proprietary accounts.

### Apportionment Categories of Obligations Incurred

Apportionment categories are determined in accordance with the guidance provided in OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*. Category A represents resources apportioned for calendar quarters. Category B represents resources apportioned for other time periods; for activities, projects, or objectives; or for any combination thereof (in millions).

	Apportionment Category A	Apportionment Category B	Exempt from Apportionment	Total
Obligations Incurred - Direct	\$11,811	\$17,591	\$11	\$29,413
Obligations Incurred - Reimbursable	222	1,328	-	1,550
<b>Total Obligations Incurred</b>	<b>\$12,033</b>	<b>\$18,919</b>	<b>\$11</b>	<b>\$30,963</b>

### Borrowing Authority for EPR

The NFIP has borrowing authority of \$1.5 billion available as of September, 30, 2003. NFIP loans are for a three year term. Interest rates are obtained from the Bureau of Public Debt. Simple interest is calculated monthly, and is offset by any interest rebate, if applicable. Interest is paid semi-annually on October 1 and April 1. Partial loan repayments are permitted. Principal repayments are required only at maturity, but are permitted at any time during the term of the loan. At the end of the Fiscal Year, borrowing authority is reduced by the amount of any unused portion. EPR's liability for borrowed amounts was \$8 million at September 30, 2003.

Under Credit Reform, the unsubsidized portion of direct loans is borrowed from the Treasury. The repayment terms of EPR's borrowing from Treasury are based on the life of each cohort of direct loans. Proceeds from collections of principal and interest from the borrowers are used to repay the Treasury. In addition, an annual re-estimate is performed to determine any change from the original subsidy rate. If an upward re-estimate is determined to be necessary, these funds are available through permanent indefinite authority. Once these funds are appropriated, the original borrowings are repaid to the Treasury.

EPR maintains three funds under the Credit Reform Act:

- 70-4234: Disaster Assistance Direct Loan Financing
- 70-0703: Disaster Assistance Direct Loan Program (no year)
- 70-0703: Disaster Assistance Direct Loan Program (annual)

# Financial Information

## Borrowing Authority for USCG

The USCG has borrowing authority of \$100 million in the form of an advance from the Oil Spill Liability Trust Fund (the Fund). Amounts advanced are repaid to the Fund when, and to the extent, removal costs are recovered by the USCG from the parties responsible for the spill.

## Non-Budgetary, Credit Program, and Financing Account

DHS did not separately present the non-budgetary, credit program, and financing account out on the face of the SBR. DHS has only one financing account in EPR for Disaster Assistance Direct Loan. Information for the seven months ended September 30, 2003, is presented below (in millions):

### Budgetary Resources

Budget Authority:

Borrowing Authority	\$35
Net Transfers, Current Year Authority	2

Spending Authority from Offsetting Collections:

Collected	1
Change in Unfilled Customer Orders	3

Permanently Not Available:

Capital Transfers and Debt Redemption	(4)
Other Assets	(27)

**Total Budgetary Resources** \$10

### Status of Budgetary Resources

Obligations Incurred:

Direct Obligations	\$10
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Unobligated Balance:

Balance Currently Available	3
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Unobligated Balance Not Available:

Other	(3)
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**Total Status of Budgetary Resources** \$10

### Relationship of Obligations to Outlays

Obligated Balance Transferred \$3

Obligated Balance, Net End of Period:

Accounts Receivable	(3)
Undelivered Orders	3

Outlays:

Disbursements	10
Collections	(1)

**Total Outlays** \$9

## **Explanation of Differences between the Combined Statement of Budgetary Resources and the Budget of the United States Government**

The combined statement of budgetary resources (SBR) will not match the *Budget of the United States Government (the Budget)* for fiscal year 2003. The major reason is that the SBR reflects only seven months covering the period from March 1, 2003, to September 30, 2003, whereas *the Budget* has been annualized and covers the period from October 1, 2002, to September 30, 2003. This explanation applies to both the budgetary resources and outlays. A copy of *the Budget* can be obtained from the OMB web site at <http://www.whitehouse.gov/omb>.

### **24. Permanent Indefinite Appropriations**

Permanent indefinite appropriations refer to the appropriations that come from permanent public laws, which authorize the Department to retain certain receipts, rather than the annual appropriation process. The amount appropriated depends upon the amount of the receipts rather than on a specific amount. The Department has two permanent indefinite appropriations as follows:

- CBP has a permanent and indefinite appropriation which is used to disburse tax and duty refunds, and duty drawbacks. Although funded through appropriations, refund and drawback activity is, in most instances, reported as a custodial activity of the Department. This presentation is appropriate because refunds are, in substance, a custodial revenue related activity in that they are a direct result of taxpayer overpayments of their tax liabilities. Federal tax revenue received from taxpayers is not available for use in the operation of the Department and is not reported on the consolidated statement of net cost. Likewise, the resultant refunds of overpayments are not available for use by the Department in its operations. Refunds and drawback disbursements totalled \$558 million for the seven months ended September 30, 2003, and are presented as a reduction of revenue received and netted against amounts provided to the Treasury General Fund on the statement of custodial activity.
- USSS has a permanent and indefinite appropriation which is used to reimburse the District of Columbia Police and Fireman's Retirement System (DC Pension Plan) for the difference between benefits provided to the annuitants (employees) eligible to participate in the DC Pension Plan (see note 17), and payroll contributions received from current employees (unaudited).

These appropriations are not subject to budgetary ceilings established by Congress. CBP's refunds payable at year end are not subject to funding restrictions. Refund payment funding is recognized as appropriations are used.

### **25. Legal Arrangements Affecting the Use of Unobligated Balances of Budget Authority (unaudited)**

Included in the cumulative results of operations for special funds is \$749 million that represents the Department's authority to assess and collect user fees relating to merchandise and passenger processing, to assess and collect fees associated with services performed at certain small airports or other facilities, and to retain amounts needed to offset costs associated with collecting duties, taxes and fees for the Government of Puerto Rico. These special fund balances are restricted by law in their use to offset specific costs incurred by the Department. In addition, the Department is required to maintain \$30 million in its User Fees Account. Part of the passenger fees in the User Fees Account, totaling approximately \$640 million as of September 30, 2003, is restricted by law in its use to offset specific costs incurred by the Department and are available to the extent provided in Appropriation Acts.

The entity trust fund balances result from the Department's authority to use the proceeds from general order items sold at auction to offset specific costs incurred by the Department relating to their sale, to use available funds in the Salaries and Expense Trust Fund to offset specific costs for expanding border and port enforcement activities, and to use available funds from the Harbor Maintenance Fee Trust Fund to offset administrative expenses related to the collection of the Harbor Maintenance Fee.

# Financial Information

## 26. Explanation of the Relationship Between Liabilities Not Covered by Budgetary Resources and the Changes in Components Requiring or Generating Resources in Future Periods (unaudited)

For the seven months ended September, 30, 2003, the *changes in components requiring or generating resources in future periods* was generated from the expense accounts, and is reflected in the other liabilities in the consolidated balance sheet. The option of computing the changes by subtracting the beginning balances from the ending balances of the unfunded liabilities was not used. The liabilities not covered by budgetary resources were transferred to DHS, and are reflected as part of the *Transfers-In/Out Without Reimbursement* section of the consolidated statement of financing.

## 27. Dedicated Collections

### Oil Spill Liability Trust Fund

The Oil Spill Liability Trust Fund (OSLTF) account includes the parent OSLTF fund that is managed by BPD, the USCG Oil Spill Recovery transfer account (70X8349), the USCG Trust Fund Share of Expenses transfer account (7038314), and the USCG Oil Pollution Act (OPA) Claims transfer account (70X8312). These three transfer accounts fund outlays through SF-1151 non-expenditure transfers from the BPD OSLTF parent fund.

### Boat Safety Account

The USCG's Boat Safety Account (70X8149) receives funding from the Department of Interior's Sport Fish Restoration Account, which is funded in part from the Aquatic Resource Trust Fund (ARTF) managed by Bureau of Public Debt (BPD). Funds are available until expended (no-year). Outlays in this account are funded through SF-1151 non-expenditure transfers from the Sport Fish account.

Condensed financial information for the seven months ended September 30, 2003, is presented below (in millions):

	<b>Oil Spill Liability Trust Fund</b>	<b>Boat Safety Account</b>
<b>Assets:</b>		
Investments	\$965	\$ -
Other Assets	48	58
<b>Total Assets</b>	<b>\$1,013</b>	<b>\$58</b>
<b>Liabilities:</b>		
Accounts Payable	\$ -	\$23
Other Liabilities	3	-
<b>Total Liabilities</b>	<b>3</b>	<b>23</b>
<b>Net Position (unaudited):</b>		
Transfers In without Reimbursement	1,000	100
Non-Exchange Revenue	52	-
Less: Program Expenses	(42)	(65)
<b>Net Position</b>	<b>1,010</b>	<b>35</b>
<b>Total Liabilities and Net Position</b>	<b>\$1,013</b>	<b>\$58</b>

## **28. Subsequent Event**

FY 2005 President's Budget request for DHS proposes transferring funding for the Strategic National Stockpile to the Department of Health and Human Services.

## Required Supplementary Information (unaudited)

### Deferred Maintenance

In FY 2003, the Department reported \$504 million in deferred maintenance on general property, plant, and equipment, and heritage assets. This amount represents maintenance on vehicles, vessels, and buildings and structures owned by the Department that was not performed when it should have been or was scheduled to be and which is delayed for a future period.

The Department bureaus use a specific methodology in determining deferred maintenance. This procedure includes reviewing equipment, building, and other structure logistic reports. Upon completion of this step, logistic personnel use a condition assessment survey to determine the status of referenced assets. A five level rating scale (excellent, good, fair, poor and very poor) is used for assessment purposes. Bureau logistic personnel subsequently identify maintenance not performed as scheduled and establish future performance dates. A summary of deferred maintenance at September 30, 2003, is presented below (in millions):

	<b>Deferred Maintenance</b>	<b>Asset Condition</b>
Building & Structures	\$464	Poor to Fair
Equipment (vehicles and vessels)	40	Poor to Fair
<b>Total</b>	<b>\$504</b>	

See accompanying Independent Auditors' Report.

Required Supplementary Information



# Financial Information

## Intra-governmental Assets as of September 30, 2003 (in Millions)

<b>Partner Agency</b>	<b>Fund Balance with Treasury</b>	<b>Investments and Related Interest</b>	<b>Advances and Prepayments</b>	<b>Other</b>
Treasury General Fund	\$ -	\$-	\$ -	\$109
Department of Agriculture	-	-	-	3
Department of Commerce	-	-	10	-
Department of Interior	-	-	8	62
Department of Justice	-	-	11	54
Department of the Navy	-	-	87	(113)
Department of State	-	-	-	23
Department of Treasury	27,343	1,546	32	184
General Services Administration	-	-	-	7
National Science Foundation	-	-	-	8
Department of the Air Force	-	-	-	1
Environmental Protection Agency	-	-	-	5
Department of Transportation	-	-	2,772	40
Dept of Health & Human Services	-	-	37	-
Dept of Housing & Urban Development	-	-	-	1
U.S. Army Corps of Engineers	-	-	-	7
Office of the Secretary of Defense Agencies	-	-	-	40
Other	-	-	97	(16)
<b>Totals</b>	<b>\$27,343</b>	<b>\$1,546</b>	<b>\$3,054</b>	<b>\$415</b>

## Intra-governmental Liabilities as of September 30, 2003 (in Millions)

<b>Partner Agency</b>	<b>Due to Treasury</b>	<b>Accounts Payable</b>	<b>Other</b>
Treasury General Fund	\$1,209	\$-	\$3
Government Printing Office	-	1	-
The Judiciary	-	1	-
Department of Agriculture	-	-	-
Department of Justice	-	17	6
Department of Labor	-	-	184
Department of the Navy	-	78	(10)
Department of State	-	4	5
Department of Treasury	-	5	10
Department of the Army	-	6	-
Office of Personnel Management	-	1	27
Social Security Administration	-	-	2
General Services Administration	-	57	10
Department of the Air Force	-	-	2
Department of Transportation	-	-	34
Department of Health & Human Services	-	24	-
Department of Energy	-	1	(1)
U.S. Army Corps of Engineers	-	20	59
Office of the Secretary of Defense Agencies	-	124	9
Other	-	59	9
<b>Totals</b>	<b>\$1,209</b>	<b>\$398</b>	<b>\$349</b>

See accompanying Independent Auditors' Report.

Required Supplementary Information

## Schedule of Budgetary Resources by Responsibility Segments (in Millions)

	Information					Bureau of		Total
	Border and Transportation Security	Emergency Preparedness & Response	Analysis & Infrastructure Protection	Science & Technology	U.S. Coast Guard	U.S. Secret Service	Citizenship & Immigration Services	
<b>BUDGETARY RESOURCES</b>								
Budget Authority:								
Appropriations Received	\$6,428	\$1,521	\$-	\$-	\$628	\$30	\$702	\$150
Borrowing Authority	-	1,535	-	-	100	-	-	-
Net Transfers	10,675	6,661	155	534	4,064	822	734	238
Unobligated Balance:								
Beginning of Period	-	-	-	-	-	-	-	-
Net Transfers	1,439	50	104	9	1,265	20	7	36
Spending Authority from Offsetting Collections:								
Earned:								
Collected	1,222	1,193	2	-	140	26	(29)	-
Receivable from Federal Sources	148	16	-	-	33	(17)	44	-
Change in Unfilled Customer Orders:								
Advances Received	10	(45)	-	-	31	2	2	-
Without Advances From Federal Sources	387	11	1	-	16	6	1	7
Transfers from Trust Funds	3	-	-	-	-	-	-	3
Total Spending Authority from Offsetting Collections	1,770	1,175	3	-	220	17	18	7
Recoveries of Prior Year Obligations	274	269	4	-	15	35	63	1
Permanently Not Available	(1,462)	(33)	(1)	-	(15)	(47)	-	-
<b>TOTAL BUDGETARY RESOURCES</b>	<b>\$19,124</b>	<b>\$11,178</b>	<b>\$265</b>	<b>\$543</b>	<b>\$6,277</b>	<b>\$877</b>	<b>\$1,524</b>	<b>\$432</b>
								<b>\$40,220</b>

See accompanying Independent Auditors' Report.

Required Supplementary Information

## Schedule of Budgetary Resources by Responsibility Segments (in Millions)

STATUS OF BUDGETARY RESOURCES	Border and Transportation Security	Emergency Preparedness & Response	Information Analysis & Infrastructure Protection	Science & Technology	U.S. Coast Guard	U.S. Secret Service	Bureau of Citizenship & Immigration Services	Departmental Offices & Other	Total
Obligations Incurred:									
Direct	\$14,722	\$7,694	\$243	\$190	\$4,209	\$765	\$1,283	\$307	\$29,413
Reimbursable	1,229	89	3	-	162	11	49	7	1,550
Total Obligations Incurred	15,951	7,783	246	190	4,371	776	1,332	314	30,963
Unobligated Balances Available:									
Appropriated	1,990	1,922	13	353	807	73	145	108	5,411
Exempt from Apportionment	-	9	-	-	949	-	-	-	958
Unobligated Balances Not Available	1,183	1,464	6	-	150	28	47	10	2,888
<b>TOTAL STATUS OF BUDGETARY RESOURCES</b>	<b>\$19,124</b>	<b>\$11,178</b>	<b>\$265</b>	<b>\$543</b>	<b>\$6,277</b>	<b>\$877</b>	<b>\$1,524</b>	<b>\$432</b>	<b>\$40,220</b>

## RELATIONSHIP OF OBLIGATIONS TO OUTLAYS

Obligated Balance, Net, Beginning of Period	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Obligated Balance Transferred, Net	3,826	6,221	46	14	1,949	210	526	55	12,847
Obligated Balance, Net, End of Period:									
Accounts Receivable	(\$229)	(\$24)	\$ -	\$ -	(\$132)	\$ -	(\$73)	\$ -	(\$458)
Unfilled Customer Orders from Federal Sources	(507)	(123)	(2)	-	(77)	(11)	5	(7)	(722)
Undelivered Orders	6,667	7,135	140	118	2,042	197	495	171	16,965
Accounts Payable	1,668	1,059	5	1	656	82	252	124	3,847
<b>Total Obligated Balance, Net, End of Period</b>	<b>\$7,599</b>	<b>\$8,047</b>	<b>\$143</b>	<b>\$119</b>	<b>\$2,489</b>	<b>\$268</b>	<b>\$679</b>	<b>\$288</b>	<b>\$19,632</b>
Outlays:									
Disbursements	\$11,371	\$5,661	\$143	\$85	\$3,816	\$693	\$1,070	\$73	\$22,912
Collections	(1,235)	(1,149)	(2)	-	(219)	(28)	27	-	(2,606)
Total Outlays	10,136	4,512	141	85	3,597	665	1,097	73	20,306
Less: Offsetting Receipts	(9)	(15)	-	-	-	-	(1,048)	-	(1,072)
<b>NET OUTLAYS</b>	<b>\$10,127</b>	<b>\$4,497</b>	<b>\$141</b>	<b>\$85</b>	<b>\$3,597</b>	<b>\$665</b>	<b>\$49</b>	<b>\$73</b>	<b>\$19,234</b>

See accompanying Independent Auditors' Report.

Required Supplementary Information

# Financial Information

## Custodial Activity

Substantially all of the duty, tax, and fee revenues collected by CBP are remitted to various General Fund accounts maintained by Treasury. Treasury further distributes these revenues to other Federal agencies in accordance with various laws and regulations. CBP transfers the remaining revenue (generally less than two percent of revenues collected) directly to other Federal agencies, the Governments of Puerto Rico and the U.S. Virgin Islands, or retains funds as authorized by law or regulations. Refunds of revenues collected from import/export activity are recorded in separate accounts established for this purpose and are funded through permanent indefinite appropriations. These activities reflect the non-entity, or custodial, responsibilities that CBP, as an agency of the Federal government, has been authorized by law to enforce.

CBP reviews selected documents to ensure all duties, taxes, and fees owed to the Federal government are paid and to ensure regulations are followed. If CBP believes duties, taxes, fees, fines, or penalties are due in addition to estimated amounts previously paid by the importer/violator, the importer/violator is notified of the additional amount due. CBP regulations allow the importer/violator to file a protest on the additional amount due for review by the Port Director. A protest allows the importer/violator the opportunity to submit additional documentation supporting their claim of a lower amount due or to cancel the additional amount due in its entirety. Work in progress will continue until all avenues to file a protest have expired or an agreement is reached. During this protest period, CBP does not have a legal right to the importer/violator's assets, and consequently CBP recognizes accounts receivable only when the protest period has expired or an agreement is reached. For FY 2003, CBP had legal right to collect \$1.1 billion of receivables. In addition, there is an additional \$1.65 billion representing records still in the protest phase. CBP recognized as write-offs \$42 million of assessments that DHS has statutory authority to collect at year end, but has no future collection potential. Most of this amount represents fines, penalties, and interest. CBP also estimated that trust funds are neither overstated nor understated as of September 30, 2003.

USCG collects various fines, penalties, and miscellaneous user fees from the public that are deposited to the general fund miscellaneous receipts of the U.S. Treasury. USCG does not collect taxes or duties. As of September 30, 2003, USCG had outstanding general fund receipt receivables due to the Treasury General Fund of \$16 million.

## Segment Information (in millions):

	Working Capital Fund	Revolving Fund: Supply	Revolving Fund: Yard
Fund Balance with Treasury	\$90	\$12	\$51
Accounts Receivable	1	14	1
Property, Plant and equipment	28	-	55
Other Assets	10	41	(45)
<b>Total Assets</b>	<b>\$129</b>	<b>\$67</b>	<b>\$62</b>
Accounts Payable	\$1	\$13	(\$3)
Other Liabilities	7	-	9
<b>Total Liabilities</b>	<b>8</b>	<b>13</b>	<b>6</b>
Cumulative Results of Operations	121	54	56
<b>Total Liabilities and Net Position</b>	<b>\$129</b>	<b>\$67</b>	<b>\$62</b>
<b>Total Costs</b>	<b>\$16</b>	<b>\$3</b>	<b>\$8</b>
Exchange Revenue	26	7	7
<b>Excess of Revenues and Financing Sources over Costs</b>	<b>\$10</b>	<b>\$4</b>	<b>(\$1)</b>

**See accompanying Independent Auditors' Report.**

Required Supplementary Information

# Financial Information

The Department's Working Capital Fund (WCF) is a fee-for-service entity that is fully reimbursable. The WCF provides a variety of support services primarily to the Department's bureaus, and to other Federal entities. The WCF operates on a revolving fund basis, whereby current-operating expenses charged to the customer finance the cost of goods and services. The overall financial goal of the fund is to fully cover the operating expenses while building a minimal capital improvement reserve.

The USCG Yard revolving fund (Yard Fund) finances the industrial operations at the USCG Yard in Curtis Bay, Maryland and other USCG industrial sites. The Yard Fund is financed by payments from CG and other domestic and foreign military customers. The USCG Supply Fund revolving fund (Supply Fund) finances the procurement of uniform clothing, commissary provisions at USCG dining facilities, general stores, technical material, and fuel for vessels over 180 feet in length. The fund is financed by payments from the USCG and other domestic customers.

## **Risk Assumed Information**

We have performed an analysis of the contingencies associated with the unearned premium reserve for the National Flood Insurance Program (NFIP). That analysis shows that the unearned premium reserve is greater than the combined values of (i) the estimated present value of unpaid expected losses and (ii) other operating expenses associated with existing policy contracts. Therefore, we can state that the likelihood is probable that the unearned premium reserve will be adequate to pay future losses and other operating expenses associated with existing policy contracts. However, there is always a chance that, given the volatile nature of flooding, the volume of flood losses in the next year could exceed the unearned premium reserve.

Our estimate of the present value of unpaid expected losses is based on a loss ratio (losses to premium) which is then multiplied by the current unearned premium reserve. This loss ratio is derived from the NFIP actual historical premium, historical losses, and historical mix of business, each adjusted to today's level. More specifically, historical premiums have been adjusted to reflect the premium levels of the present by making adjustments for historical rate changes and historical changes in coverage amounts. Historical losses have been adjusted for inflation, using inflation indexes such as the Consumer Price Index as well as chain price indexes, to reflect the values that historical losses would settle at if they were settled today. In addition, the historical mix of business is adjusted to reflect today's mix of business. Examples of how the historical mix of business has changed are the fact that today there are proportionately fewer pre-firm policies versus post-firm policies in force compared to in the past, and today there are proportionately more preferred risk policies in force than there have been historically.

**See accompanying Independent Auditors' Report.**

Required Supplementary Information

## Required Supplementary Stewardship Information (unaudited)

### Heritage Assets

USCG and CBP maintain heritage assets, located in the United States and Puerto Rico. Heritage assets are property, plant and equipment that have historical or national significance; cultural, educational, or artistic importance; or significant architectural characteristics. Heritage assets are generally expected to be preserved indefinitely. Multi-use heritage assets have more than one purpose such as an operational purpose and historical purpose. The physical quantity information for the multi-use heritage assets is included in supplemental stewardship reporting for heritage assets.

The following table summarizes activity related to Heritage Assets from October 1, 2002, to September 30, 2003 (in number of units).

	USCG	CBP	Total
<b>Beginning Balance</b>	20,293	4	<b>20,297</b>
Additions	55	-	<b>55</b>
Withdrawals	(729)	-	<b>(729)</b>
<b>Ending Balance</b>	<b>19,619</b>	<b>4</b>	<b>19,623</b>

USCG possesses artifacts that can be divided into four general areas: ship's equipment, lighthouse and other aids-to-navigation items, military uniforms, and display models. The addition of artifacts is the result of gifts to USCG.

- Ship's equipment is generally acquired when the ship is decommissioned and includes small items such as sextants, ship's clocks, wall plaques, steering wheels, bells, binnacles, engine order telegraphs, and ship's name boards. Conditions vary, but much is worn out from decades of use.
- Aids-to-navigation items include fog and buoy bells, lanterns, lamp changing apparatus, and lighthouse lenses. Buoy equipment tends to be worn out and is usually acquired only when new technology makes it obsolete. Classical lighthouse lenses vary greatly in condition. The condition is normally dependent on how long the item has been out of service and not maintained. Most of the good lenses go to local museums or USCG bases as display items.
- Military uniforms are generally donated by retired USCG members, and include clothing as well as insignia and accoutrements. Most clothing is in fair to good condition, particularly full dress items which saw little daily wear.
- Display models are mostly of USCG vessels and aircraft. These are often builders' models. In addition to being accurate and valuable, they are generally in very good condition. Builders' models are acquired by USCG as part of the contracts with the ship or aircraft builders. The withdrawal of display models was due to wear and tear.

The USCG also has non-collection type heritage assets, such as sunken vessels and aircraft under the property clause of the U.S. Constitution, Articles 95 and 96 of the International Law of the Sea Convention, and the sovereign immunity provisions of Admiralty law. Despite the passage of time or the physical condition of these assets, they remain Government-owned until the Congress of the United States formally declares them abandoned. The USCG desires to retain custody of these assets to safeguard the remains of crew members who were lost at sea, to prevent the unauthorized handling of explosives or ordnance which may be aboard, and to preserve culturally valuable relics of the USCG's long and rich tradition of service to our nation in harm's way.

**See accompanying Independent Auditors' Report.**  
Required Supplementary Stewardship Information

# Financial Information

Buildings and Structures - As a matter of public law and policy, USCG does not acquire or retain heritage buildings and structures without an operational use. Most real property, even if designated as historical, is acquired for operational use and is transferred to other government agencies or public entities when no longer required for operations. Of the USCG buildings and structures designated as heritage, including memorials, recreational areas and other historical areas, over two-thirds are multi-use heritage. The remaining are historical lighthouses, which are no longer in use and awaiting disposal; their related assets; and a gravesite. CBP also has four multi-use heritage assets located in Puerto Rico. All multi-use heritage assets are reflected on the consolidated balance sheet.

Financial information for multi-use heritage assets is presented in the principal statements and notes. Deferred maintenance information for heritage assets and general PP&E is presented in the required supplementary information.

## Stewardship Investments (in Millions)

	Non-Federal Property	Human Capital	Research and Development
<b>March 1 – September 30, 2003</b>	<b>\$242</b>	<b>\$25 *</b>	<b>\$45 *</b>

\* These amounts also include costs incurred from October 1, 2002 to February 28, 2003.

Non-federal property investment represents funds provided by TSA for facility modifications, in cooperation with airport authorities, state and local governments, to improve the security infrastructure of the Nation's airports.

Human Capital investment represents costs of training and professional development provided by EPR's National Fire Academy and Emergency Management Institute. Training is provided to emergency management "first responders" at the state and local fire and emergency response community and its allied professionals.

Research and Development (R&D) investment primarily consists of USCG's R&D program costs to develop and evaluate technologies, materials, and human factors directly related to improving the performance of USCG's operations. It also includes R&D costs of EPR's United States Fire Administration (USFA), the mission of which is to promote and improve fire prevention and life safety.

**See accompanying Independent Auditors' Report.**  
Required Supplementary Stewardship Information



## Other Accompanying Information (unaudited)

### Estimated Disaster Costs

One of EPR's primary missions under the *Robert T. Stafford Disaster Relief and Emergency Assistance Act* (P.L. 93-288, as amended) (Stafford Act) is to respond to major disasters and emergencies, including terrorist acts committed on the United States. By law, all requests for disaster assistance are made by the governor of the affected state. If the impact of the disaster warrants federal assistance, the Director of EPR submits a recommendation to the President of the United States (the President) for a formal declaration of a major disaster or an emergency.

The Federal government does not have legal or financial responsibility until a declaration is made. Costs from many natural disasters do not meet the definition of a liability for financial reporting purposes until the government formally acknowledges financial responsibility for costs from the event and an exchange or non-exchange transaction has occurred. In the case of government-acknowledged events such formal acceptance of financial responsibility by the federal government occurs when the President declares a disaster.

The EPR Disaster Finance Center tracks all of the disasters that have been declared since FY 1989 under the guidance of the Stafford Act. Cost projections are built based on historical data disasters including direct and allocated indirect cost.

Cost projections are compared against current obligations and expenditures incurred to provide EPR with budgeting information, and to prepare appropriation requests to Congress. EPR has projected the total costs of the declared disasters to be approximately \$45 billion as of September 30, 2003, of which approximately \$43.6 billion has been obligated and \$35.5 billion paid or accrued. Should all projected remaining costs be paid or accrued by EPR, an additional \$9.5 billion in expenses would be recorded. Information regarding the disaster cost projections as of September 30, 2003 is summarized below (in millions):

### Estimated Future Disaster Cost (unaudited)

#### Unfunded Cost:

Cost Projections	\$45,034
Obligations	(43,618)
<b>Net Unfunded Costs – future disasters</b>	<b><u>1,416</u></b>

#### Unliquidated Obligations:

Obligations	43,618
Expenditures Incurred	(35,487)
<b>Net Unliquidated Obligations</b>	<b><u>8,131</u></b>

<b>Remaining Projected Expense</b>	<b><u><u>\$9,547</u></u></b>
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See accompanying Independent Auditors' Report.

Other Accompanying Information

# Financial Information

## Transfers In for the Creation of DHS

Transfers of assets, liabilities, obligations, and unobligated balances from 22 existing Federal agencies and programs began on March 1, 2003, the inception date of DHS operations. Legacy agencies were instructed to record non-expenditure transfers as of March 1, 2003, using full-accrual basis accounting, for transferred asset and liability balances and unobligated and unexpended appropriation budgetary balances. Below are the DHS' balance sheet, statement of changes in net position, and statement of budgetary resources as of March 1, 2003.

### Balance Sheet

	<b>March 1, 2003 Balances Transferred-in</b>	<b>Effect of Correction of Errors</b>	<b>Adjusted Transferred-in Balances</b>
<b>Assets</b>			
Fund Balance with Treasury	\$39,846	\$ -	\$39,846
Other Assets:			
Intra-governmental	6,450	-	6,450
Public	11,941	(62)	11,879
Total Other Assets	18,391	(62)	18,329
<b>Total Assets</b>	<b>\$58,237</b>	<b>(\$62)</b>	<b>\$58,175</b>
<b>Liabilities</b>			
Intra-governmental	\$3,722	\$ -	\$3,722
Public	28,462	3,339	31,801
<b>Total Liabilities</b>	<b>\$32,184</b>	<b>\$3,339</b>	<b>\$35,523</b>
<b>Net Position</b>			
Unexpended Appropriations	37,380	-	37,380
Cumulative Results from Operations	(11,327)	(3,401)	(14,728)
<b>Total Net Position</b>	<b>\$26,053</b>	<b>(\$3,401)</b>	<b>\$22,652</b>

### Statement of Changes in Net Position

	<b>March 1, 2003 Balances Transferred-in</b>	<b>Effect of Correction of Errors</b>	<b>Adjusted Transferred-in Balances</b>
<b>Budgetary Financing Sources</b>			
Appropriations Transferred-in, net	\$37,381	\$ -	\$37,381
<b>Other Financing Sources</b>			
Transfers-in Without Reimbursement	2,465	-	2,465
<b>Reconciliation to Fund Balance with Treasury</b>	<b>\$39,846</b>	<b>\$ -</b>	<b>\$39,846</b>
<b>Transfers-in Without Reimbursement</b>			
Total Other Assets	\$18,391	(\$62)	\$18,329
Total Liabilities	32,184	3,339	35,523
<b>Transfers-in Without Reimbursement, Net</b>	<b>(\$13,793)</b>	<b>(\$3,401)</b>	<b>(\$17,194)</b>

See accompanying Independent Auditors' Report.

Other Accompanying Information

# Financial Information

## Statement of Budgetary Resources

	March 1, 2003 Balances Transferred-in	Effect of Correction of Errors	Adjusted Transferred-in Balances
<b>Budgetary Resources</b>			
Budget Authority			
Borrowing Authority	\$1,500	\$ -	\$1,500
Transfers, Net	23,833	-	23,833
Unobligated Balance Transferred, Net	2,649	-	2,649
Spending Authority from Offsetting Collections	21	-	21
<b>Total Budgetary Resources</b>	<b>\$28,003</b>	<b>\$ -</b>	<b>\$28,003</b>

## Status of Budgetary Resources

<b>Status of Budgetary Resources</b>			
Unobligated Balance			
Apportioned	\$4,736	\$ -	\$4,736
Exempt from Apportionment	727		727
Unobligated Balance Not Available	22,540	-	22,540
<b>Total Status of Budgetary Resources</b>	<b>\$28,003</b>	<b>\$ -</b>	<b>\$28,003</b>

## Components of Obligated Balances Transferred

<b>Components of Obligated Balances Transferred</b>			
Undelivered Orders	\$11,105	\$ -	\$11,105
Accounts Receivable	(255)	-	(255)
Unfilled Customer Orders from Federal Sources	(463)	-	(463)
Accounts Payable	2,460	-	2,460
<b>Total Net Obligated Balances Transferred</b>	<b>\$12,847</b>	<b>\$ -</b>	<b>\$12,847</b>

On the statement of budgetary resources, *total budgetary resources* of \$28,003 along with *obligated balance, undelivered orders* of \$11,105 total \$39,108. On the balance sheet, the *fund balance with Treasury* is \$39,846. The difference is attributed to the transfer of fund balance with Treasury with liabilities that were not processed as a non-expenditure transfer, but were processed as such by *Statement of Transactions* (SF-224). There was no budgetary impact.

On the statement of changes in net position, budgetary financing sources, *appropriations transferred in, net* of \$37,380 and other financing sources, *transfers in without reimbursement* of \$2,465 total \$39,845. On the balance sheet, *fund balance with Treasury* is \$39,846, which agrees except for a rounding difference.

Borrowing authority transferred-in reflects only the borrowing authority carried forward from FEMA. Current year borrowing authority was not transferred. It was removed from the legacy agency and reestablished in DHS.

See accompanying Independent Auditors' Report.

Other Accompanying Information