



# Financial Information

The ***Financial Information*** section demonstrates our commitment to effective stewardship over the funds DHS receives to carry out its mission, including compliance with relevant financial management legislation. It includes the ***Independent Auditors' Report***— an independent auditors' report on the Balance Sheet and Statement of Custodial Activity—as well as the Department's ***Annual Financial Statements*** and accompanying ***Notes to the Financial Statements***. The audit report is provided by the Department's Office of Inspector General.



## Message from the Chief Financial Officer

November 15, 2010



This Annual Financial Report (AFR) is our principal financial statement of accountability to the President, Congress and the American public. The AFR gives a comprehensive view of the Department's financial activities and demonstrates the Department's stewardship of taxpayer dollars.

For the fifth consecutive year, the annual audit shows the Department continues to make progress. Most significantly, disclaimer conditions have been reduced from ten to one and material weaknesses in internal controls over financial reporting have been reduced by more than half.

To demonstrate strong stewardship and accountability, the Department ended the practice of conducting stand-alone audits at our Components in FY 2010, except at U.S. Customs and Border Protection, which is one of the largest collectors of tax revenue for the U.S. Government. This strategy allowed our Components to direct staff resources to developing and implementing corrective actions for pervasive material weaknesses, increasing risk management processes, and building standard Department-wide business processes.

Over the past year the Department worked to be responsive to the transitioning landscape of financial management throughout the federal government while continuing to improve the completeness, timeliness and accuracy of all our financial information and make it available to the public. Consistent with the Administration and Secretary's objectives for the American Recovery and Reinvestment Act we created jobs while making America safer by obligating \$2.7 billion dollars.

The financial management community throughout DHS has consistently shown a commitment to accountability, accuracy, and stewardship. I am extremely proud of the Department's accomplishments over the past year. Looking forward, we will continue to build upon our successes and strive toward the highest levels of transparency and accountability.

Sincerely,

A handwritten signature in black ink that reads "Peggy Sherry". The signature is fluid and cursive.

Peggy Sherry  
Deputy Chief Financial Officer



## Introduction

The principal financial statements included in this report are prepared pursuant to the requirements of the *Government Management Reform Act of 1994* (Pub. L. 103-356) and the *Chief Financial Officers Act of 1990* (Pub. L. 101-576), as amended by the *Reports Consolidation Act of 2000* (Pub. L. 106-531). Other requirements include the Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*. The responsibility for the integrity of the financial information included in these statements rests with the management of DHS. The Department's Inspector General selected an independent certified public accounting firm to audit the Balance Sheet and the Statement of Custodial Activity. The independent auditors' report accompanies the principal financial statements. These financial statements include the following:

- The **Balance Sheets** present, as of September 30, 2010 and 2009, those resources owned or managed by DHS that represent future economic benefits (assets), amounts owed by DHS that will require payments from those resources or future resources (liabilities), and residual amounts retained by DHS comprising the difference (net position).
- The **Statements of Net Cost** present the net cost of DHS operations for the fiscal years ended September 30, 2010 and 2009. DHS net cost of operations is the gross cost incurred by DHS less any exchange revenue earned from DHS activities.
- The **Statements of Changes in Net Position** present the change in DHS's net position resulting from the net cost of DHS operations, budgetary financing sources, and other financing sources for the fiscal years ended September 30, 2010 and 2009.
- The **Statements of Budgetary Resources** present how and in what amounts budgetary resources were made available to DHS during FY 2010 and FY 2009, the status of these resources at September 30, 2010 and 2009, the changes in the obligated balance, and outlays of budgetary resources for the fiscal years ended September 30, 2010 and 2009.
- The **Statements of Custodial Activity** present the disposition of custodial revenue collected and disbursed by DHS on behalf of other recipient entities for the fiscal years ended September 30, 2010 and 2009.
- The **Notes to the Financial Statements** provide detail and clarification for amounts on the face of the financial statements for the fiscal years ended September 30, 2010 and 2009.

### Limitations of Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Department, pursuant to the requirements of Title 31, United States Code, Section 3515(b) relating to financial statements of Federal agencies. While the statements have been prepared from the books and records of the entity in accordance with generally accepted accounting principles (GAAP) for Federal agencies and the formats prescribed by OMB, the 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 statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.



## Financial Statements

**Department of Homeland Security  
Balance Sheets  
As of September 30, 2010 and 2009  
(In Millions)**

	<u>2010</u> (Unaudited)	<u>2009</u> (Unaudited) (Restated)
<b>ASSETS</b>		
<b>Intragovernmental</b>		
Fund Balance with Treasury (Notes 2 and 3)	\$60,822	\$57,172
Investments, Net (Note 5)	3,482	3,417
Accounts Receivable (Note 6)	326	369
Other (Note 13)		
Advances and Prepayments	2,225	2,688
<b>Total Intragovernmental</b>	<b>\$66,855</b>	<b>\$63,646</b>
Cash and Other Monetary Assets (Notes 2 and 4)	61	57
Accounts Receivable, Net (Notes 2 and 6)	491	449
Taxes, Duties, and Trade Receivables, Net (Notes 2 and 7)	2,459	1,874
Direct Loans, Net (Note 8)	85	55
Inventory and Related Property, Net (Note 9)	499	435
General Property, Plant, and Equipment, Net (Note 11)	19,074	17,697
Other (Note 13)		
Advances and Prepayments	573	591
<b>TOTAL ASSETS</b>	<b>\$90,097</b>	<b>\$84,804</b>
Stewardship Property, Plant, and Equipment (Note 12)		
<b>LIABILITIES</b>		
<b>Intragovernmental</b>		
Accounts Payable	\$2,174	\$2,179
Debt (Note 15)	18,505	19,004
Other (Note 18)		
Due to the General Fund	2,475	1,969
Accrued FECA Liability	374	370
Other	501	720
<b>Total Intragovernmental</b>	<b>\$24,029</b>	<b>\$24,242</b>
Accounts Payable	2,571	2,793
Federal Employee and Veterans' Benefits (Note 16)	48,317	39,425
Environmental and Disposal Liabilities (Note 17)	1,061	1,012
Other (Notes 18, 19, 20, and 21)		
Accrued Payroll and Benefits	2,217	1,936
Deferred Revenue and Advances from Others	2,650	2,629
Unliquidated Antidumping and Countervailing Duties	127	106
Insurance Liabilities	482	508



**Department of Homeland Security  
Balance Sheets  
As of September 30, 2010 and 2009  
(In Millions)**

	<u>2010</u> <u>(Unaudited)</u>	<u>2009</u> <u>(Unaudited)</u> <u>(Restated)</u>
Refunds and Drawbacks	129	126
Other	2,013	1,725
<b>Total Liabilities</b>	<b>\$83,596</b>	<b>\$74,502</b>
Commitments and Contingencies (Notes 18, 19, 20, and 21)		
<b>NET POSITION</b>		
Unexpended Appropriations		
Unexpended Appropriations-Other Funds	\$51,612	\$49,283
Cumulative Results of Operations		
Cumulative Results of Operations-Earmarked Funds (Note 22)	(13,816)	(15,410)
Cumulative Results of Operations-Other Funds	(31,295)	(23,571)
<b>Total Net Position</b>	<b>\$6,501</b>	<b>\$10,302</b>
<b>TOTAL LIABILITIES AND NET POSITION</b>	<b>\$90,097</b>	<b>\$84,804</b>

The accompanying notes are an integral part of these statements.



**Department of Homeland Security  
Statements of Net Cost  
For the Years Ended September 30, 2010 and 2009  
(In Millions)**

<b>Directorates and Other Components (Notes 23 and 24)</b>	<b><u>2010</u> (Unaudited)</b>	<b><u>2009</u> (Unaudited) (Restated)</b>
 <i><b>U.S. Customs and Border Protection</b></i>		
Gross Cost	\$11,775	\$10,672
Less Earned Revenue	(152)	(166)
<b>Net Cost</b>	<b>11,623</b>	<b>10,506</b>
 <i><b>U.S. Coast Guard</b></i>		
Gross Cost	12,975	12,274
Less Earned Revenue	(897)	(432)
<b>Net Cost</b>	<b>12,078</b>	<b>11,842</b>
 <i><b>U.S. Citizenship and Immigration Services</b></i>		
Gross Cost	2,531	2,329
Less Earned Revenue	(2,418)	(2,696)
<b>Net Cost</b>	<b>113</b>	<b>(367)</b>
 <i><b>Federal Emergency Management Agency</b></i>		
Gross Cost	14,207	14,748
Less Earned Revenue	(3,681)	(3,193)
<b>Net Cost</b>	<b>10,526</b>	<b>11,555</b>
 <i><b>Federal Law Enforcement Training Center</b></i>		
Gross Cost	410	450
Less Earned Revenue	(36)	(36)
<b>Net Cost</b>	<b>374</b>	<b>414</b>
 <i><b>National Protection and Programs Directorate</b></i>		
Gross Cost	2,061	2,032
Less Earned Revenue	(828)	(822)
<b>Net Cost</b>	<b>1,233</b>	<b>1,210</b>
 <i><b>U.S. Immigration and Customs Enforcement</b></i>		
Gross Cost	5,750	5,173
Less Earned Revenue	(229)	(166)
<b>Net Cost</b>	<b>5,521</b>	<b>5,007</b>



**Department of Homeland Security  
Statements of Net Cost  
For the Years Ended September 30, 2010 and 2009  
(In Millions)**

	<u>2010</u> <u>(Unaudited)</u>	<u>2009</u> <u>(Unaudited)</u> <u>(Restated)</u>
<b>Directorates and Other Components (Notes 23 and 24)</b>		
<i>Office of Health Affairs</i>		
Gross Cost	231	414
Less Earned Revenue	-	-
<b>Net Cost</b>	<u>231</u>	<u>414</u>
<i>Departmental Operations and Other</i>		
Gross Cost	1,880	1,776
Less Earned Revenue	(6)	(2)
<b>Net Cost</b>	<u>1,874</u>	<u>1,774</u>
<i>U.S. Secret Service</i>		
Gross Cost	1,782	1,818
Less Earned Revenue	(15)	(16)
<b>Net Cost</b>	<u>1,767</u>	<u>1,802</u>
<i>Science and Technology Directorate</i>		
Gross Cost	887	968
Less Earned Revenue	(5)	(4)
<b>Net Cost</b>	<u>882</u>	<u>964</u>
<i>Transportation Security Administration</i>		
Gross Cost	6,631	6,991
Less Earned Revenue	(2,145)	(2,243)
<b>Net Cost</b>	<u>4,486</u>	<u>4,748</u>
<i>Total Department of Homeland Security</i>		
Gross Cost	61,120	59,645
Less Earned Revenue	<u>(10,412)</u>	<u>(9,776)</u>
Net Cost Before Loss on Pension, ORB, or OPEB		
Assumption Changes	50,708	49,869
Loss on Pension, ORB, or OPEB Assumption Changes (Note 16)	5,675	-
<b>NET COST OF OPERATIONS</b>	<u>\$56,383</u>	<u>\$49,869</u>

The accompanying notes are an integral part of these statements.



**Department of Homeland Security  
Statement of Changes in Net Position  
For the Year Ended September 30, 2010  
(In Millions)**

	<b>2010 (Unaudited)</b>			Consolidated Total
	Earmarked Funds	All Other Funds	Eliminations	
<b>Cumulative Results of Operations</b>				
Beginning Balances	\$(15,410)	\$(23,571)	\$ -	\$(38,981)
<b>Budgetary Financing Sources</b>				
Appropriations Used	-	45,757	-	45,757
Non-exchange Revenue	3,611	5	-	3,616
Donations and Forfeitures of Cash and Cash Equivalents	2	-	-	2
Transfers In/Out Without Reimbursement	(1,964)	1,738	-	(226)
Other	(5)	-	-	(5)
<b>Other Financing Sources</b>				
Donations and Forfeitures of Property	-	3	-	3
Transfers In/Out Without Reimbursement	(13)	133	-	120
Imputed Financing	76	1,179	191	1,064
Other	-	(78)	-	(78)
Total Financing Sources	1,707	48,737	191	50,253
Net Cost of Operations	(113)	(56,461)	(191)	(56,383)
Net Change	1,594	(7,724)	-	(6,130)
<b>Cumulative Results of Operations</b>	<b>(13,816)</b>	<b>(31,295)</b>	<b>-</b>	<b>(45,111)</b>
<b>Unexpended Appropriations</b>				
Beginning Balance	-	49,283	-	49,283
<b>Budgetary Financing Sources</b>				
Appropriations Received (Note 28)	-	48,824	-	48,824
Appropriations Transferred In/Out	-	47	-	47
Other Adjustments	-	(785)	-	(785)
Appropriations Used	-	(45,757)	-	(45,757)
Total Budgetary Financing Sources	-	2,329	-	2,329
<b>Total Unexpended Appropriations</b>	<b>-</b>	<b>51,612</b>	<b>-</b>	<b>51,612</b>
<b>NET POSITION</b>	<b>\$(13,816)</b>	<b>\$20,317</b>	<b>\$ -</b>	<b>\$6,501</b>

The accompanying notes are an integral part of these statements.





**Department of Homeland Security  
Statement of Changes in Net Position  
For the Year Ended September 30, 2009  
(In Millions)**

	<u>2009</u>			
	(Unaudited) (Restated)			
	Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
<b>Cumulative Results of Operations</b>				
Beginning Balances	\$(19,359)	\$(23,056)	\$ -	\$(42,415)
Adjustments:				
Correction of Errors (Note 32)	-	(43)	-	(43)
Beginning Balance, as Adjusted	(19,359)	(23,099)	-	(42,458)
<b>Budgetary Financing Sources</b>				
Appropriations Used	-	49,300	-	49,300
Non-exchange Revenue	3,526	4	-	3,530
Donations and Forfeitures of Cash and Cash Equivalents	3	-	-	3
Transfers In/Out Without Reimbursement	(1,835)	1,640	-	(195)
Other	-	(62)	-	(62)
<b>Other Financing Sources</b>				
Donations and Forfeitures of Property	-	4	-	4
Transfers In/Out Without Reimbursement	12	(1)	-	11
Imputed Financing	54	932	226	760
Other	-	(5)	-	(5)
Total Financing Sources	1,760	51,812	226	53,346
Net Cost of Operations	2,189	(52,284)	(226)	(49,869)
Net Change	3,949	(472)	-	3,477
<b>Cumulative Results of Operations</b>	<b>(15,410)</b>	<b>(23,571)</b>	<b>-</b>	<b>(38,981)</b>
<b>Unexpended Appropriations</b>				
Beginning Balances	-	55,239	-	55,239
<b>Budgetary Financing Sources</b>				
Appropriations Received (Note 28)	-	46,067	-	46,067
Appropriations Transferred In/Out	-	(2,064)	-	(2,064)
Other Adjustments	-	(659)	-	(659)
Appropriations Used	-	(49,300)	-	(49,300)
Total Budgetary Financing Sources	-	(5,956)	-	(5,956)
<b>Total Unexpended Appropriations</b>	<b>-</b>	<b>49,283</b>	<b>-</b>	<b>49,283</b>
<b>NET POSITION</b>	<b>\$(15,410)</b>	<b>\$25,712</b>	<b>\$ -</b>	<b>\$10,302</b>

The accompanying notes are an integral part of these statements.



**Department of Homeland Security  
Statements of Budgetary Resources  
For the Years Ended September 30, 2010 and 2009  
(In Millions)**

	<u>2010</u> (Unaudited)		<u>2009</u> (Unaudited) (Restated)	
	<u>Budgetary</u>	<u>Non- Budgetary Credit Reform Financing Accounts</u>	<u>Budgetary</u>	<u>Non- Budgetary Credit Reform Financing Accounts</u>
<b>BUDGETARY RESOURCES</b>				
Unobligated Balance, Brought Forward, October 1	\$13,383	\$ -	\$21,431	\$4
Recoveries of Prior Year Unpaid Obligations	4,463	-	4,280	-
Budget Authority:				
Appropriations (Note 28)	55,852	-	52,839	-
Borrowing Authority (Note 26)	-	-	-	51
Spending Authority from Offsetting Collections:				
Earned:				
Collected	9,913	33	9,542	88
Change in Receivables from Federal Sources	(79)	-	124	-
Change in Unfilled Customer Orders:				
Advances Received	(230)	-	280	-
Without Advance From Federal Sources	418	(33)	(506)	(30)
Previously Unavailable	30	-	-	-
Expenditure Transfers from Trust Funds	48	-	48	-
Subtotal	<u>65,952</u>	<u>-</u>	<u>62,327</u>	<u>109</u>
Nonexpenditure Transfers, Net; Anticipated and Actual	1,105	-	(1,576)	-
Temporarily Not Available Pursuant to Public Law	(32)	-	(4)	-
Permanently Not Available	<u>(1,671)</u>	<u>-</u>	<u>(1,212)</u>	<u>(47)</u>
<b>TOTAL BUDGETARY RESOURCES</b>	<b><u>\$83,200</u></b>	<b><u>\$ -</u></b>	<b><u>\$85,246</u></b>	<b><u>\$66</u></b>
<b>STATUS OF BUDGETARY RESOURCES</b>				
Obligations Incurred (Note 25):				
Direct	\$63,344	\$ -	\$67,636	\$66
Reimbursable	4,668	-	4,227	-
Subtotal	<u>68,012</u>	<u>-</u>	<u>71,863</u>	<u>66</u>
Unobligated Balance:				
Apportioned	10,190	-	7,706	-
Exempt from Apportionment	5	-	5	-
Subtotal (Note 3)	<u>10,195</u>	<u>-</u>	<u>7,711</u>	<u>-</u>
Unobligated Balance Not Available (Note 3)	<u>4,993</u>	<u>-</u>	<u>5,672</u>	<u>-</u>
<b>TOTAL STATUS OF BUDGETARY RESOURCES</b>	<b><u>\$83,200</u></b>	<b><u>\$ -</u></b>	<b><u>\$85,246</u></b>	<b><u>\$66</u></b>



**Department of Homeland Security  
Statements of Budgetary Resources  
For the Years Ended September 30, 2010 and 2009  
(In Millions)**

	<u>2010</u> (Unaudited)		<u>2009</u> (Unaudited) (Restated)	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
<b>CHANGE IN OBLIGATED BALANCE</b>				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, October 1	\$46,764	\$294	\$47,103	\$323
Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(2,044)	(293)	(2,427)	(323)
Total Unpaid Obligated Balance, Net	44,720	1	44,676	-
Obligations Incurred, Net	68,012	-	71,863	66
Gross Outlays	(61,646)	(34)	(67,897)	(95)
Obligated Balance Transferred, Net				
Actual Transfers, Unpaid Obligations	(26)	-	(25)	-
Total Unpaid Obligated Balance Transferred, Net	(26)	-	(25)	-
Recoveries of Prior Year Unpaid Obligations, Actual	(4,463)	-	(4,280)	-
Change in Uncollected Customer Payments from Federal Sources	(340)	34	383	30
Obligated Balance, Net, End of Period				
Unpaid Obligations	48,641	261	46,764	294
Uncollected Customer Payments from Federal Sources	(2,384)	(260)	(2,044)	(293)
Total, Unpaid Obligated Balance, Net, End of Period	<u><b>\$46,257</b></u>	<u><b>\$1</b></u>	<u><b>\$44,720</b></u>	<u><b>\$1</b></u>
<b>NET OUTLAYS</b>				
Gross Outlays	\$61,646	\$34	\$67,897	\$95
Offsetting Collections	(9,731)	(33)	(9,870)	(88)
Distributed Offsetting Receipts	(6,328)	-	(5,213)	-
<b>NET OUTLAYS</b>	<u><b>\$45,587</b></u>	<u><b>\$1</b></u>	<u><b>\$52,814</b></u>	<u><b>\$7</b></u>

The accompanying notes are an integral part of these statements.



**Department of Homeland Security  
Statements of Custodial Activity  
For the Years Ended September 30, 2010 and 2009  
(In Millions)**

	<u>2010</u> <u>(Unaudited)</u>	<u>2009</u> <u>(Unaudited)</u>
<b>Revenue Activity (Note 31)</b>		
Sources of Cash Collections:		
Duties	\$25,284	\$22,633
User Fees	1,508	1,405
Excise Taxes	2,880	2,555
Fines and Penalties	64	63
Interest	6	25
Miscellaneous	179	127
<b>Total Cash Collections</b>	<u>29,921</u>	<u>26,808</u>
Accrual Adjustments	<u>636</u>	<u>(392)</u>
<b>Total Custodial Revenue</b>	<u><b>30,557</b></u>	<u><b>26,416</b></u>
<b>Disposition of Collections</b>		
Transferred to Others:		
Federal Entities:		
U.S. Department of Agriculture	8,490	7,698
U.S. Department of Labor	146	94
U.S. Department of State	70	70
National Science Foundation	91	89
Treasury General Fund Accounts	19,749	17,373
Other Federal Agencies	27	30
Non-Federal Entities:		
Government of Puerto Rico	-	2
Other Non-Federal Entities	26	13
(Increase)/Decrease in Amounts Yet to be Transferred	597	(433)
Refunds and Drawbacks (Notes 18 and 31)	1,279	1,367
Retained by the Department	82	113
<b>Total Disposition of Custodial Revenue</b>	<u><b>30,557</b></u>	<u><b>26,416</b></u>
<b>Net Custodial Activity</b>	<u><u><b>\$ -</b></u></u>	<u><u><b>\$ -</b></u></u>

The accompanying notes are an integral part of these statements.

## Notes to the Financial Statements (Unaudited)

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## Notes to the Financial Statements (Unaudited)

### 1. Summary of Significant Accounting Policies

#### A. Reporting Entity

The Department of Homeland Security (DHS or the Department) was established by the *Homeland Security Act of 2002* (HSA), Pub. L. 107-296, dated November 25, 2002, as an executive department of the U.S. Federal Government. DHS leads efforts to achieve a safe, secure, and resilient homeland by countering terrorism and enhancing our security; securing and administering our borders; enforcing and administering our immigration laws; protecting our cyber networks and critical infrastructure; and ensuring resilience from disasters. Additionally, DHS contributes in many ways to elements of broader U.S. national and economic security while fulfilling its other five homeland security missions and is constantly striving to mature and strengthen the homeland security enterprise. The Department includes the following financial reporting Components<sup>1</sup>:

- **U.S. Customs and Border Protection (CBP)**
- **U.S. Coast Guard (USCG)**
- **U.S. Citizenship and Immigration Services (USCIS)**
- **Federal Emergency Management Agency (FEMA)**
- **Federal Law Enforcement Training Center (FLETC)**
- **National Protection and Programs Directorate (NPPD)**, including the Federal Protective Service (FPS)
- **U.S. Immigration and Customs Enforcement (ICE)**
- **Office of Health Affairs (OHA)**
- **Departmental Operations and Other**, including the Management Directorate (MGMT), the Office of the Secretary, the Office of the Inspector General (OIG), the Domestic Nuclear Detection Office (DNDO), the Office of Intelligence and Analysis, and the Office of Operations Coordination and Planning
- **U.S. Secret Service (USSS)**
- **Science and Technology Directorate (S&T)**
- **Transportation Security Administration (TSA)**

On October 28, 2009, the President of the United States signed the *FY 2010 Homeland Security Appropriations Act* (Pub. L. 111-83), which included a provision transferring FPS from ICE to NPPD. The realignment allows FPS to focus on its primary mission—securing Federal buildings by performing building security assessments and deploying appropriate countermeasures—while enabling ICE to focus on the enforcement of immigration and customs laws. As a result of the transfer, we made certain reclassifications to the FY 2009 financial statements and related footnotes to conform to FY 2010 presentation.

The Department received supplemental appropriations during FY 2009 as a result of *The American Recovery and Reinvestment Act of 2009* (Recovery Act) (Pub. L. 111-5). Seven DHS Components received funding to carry out Recovery Act programs in support of the Department's mission.

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<sup>1</sup> Financial reporting Components are to be distinguished from direct report Components presented in the Department's organization chart.



MGMT received funding for the consolidation of DHS headquarters; CBP received funding to modernize infrastructure and enhance border security technology; ICE received funding for tactical communications upgrades; TSA received funding for enhanced security technology; the U.S. Coast Guard received funding for bridge alteration construction and shore, facility and vessel modernization; FEMA received funding for port, transit, and fire station construction grants and additional funding for the Emergency Food and Shelter program; and OIG received funding for oversight and audit of programs, grants, and projects funded under the Recovery Act. Additional Recovery Act information can be found at [www.recovery.gov](http://www.recovery.gov).

## **B. Basis of Presentation**

These financial statements are prepared to report the consolidated financial position, net cost of operations, changes in net position, custodial activity, and combined budgetary resources of the Department pursuant to the *Government Management Reform Act of 1994* and the *Chief Financial Officers Act of 1990*, as amended by the *Reports Consolidation Act of 2000*.

The Department's financial statements have been prepared from the accounting records of the Department based on guidance in United States generally accepted accounting principles (GAAP) and OMB Circular A-136, *Financial Reporting Requirements*. GAAP for Federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board, the official accounting standards-setting body of the Federal Government.

The Department's financial statements reflect the reporting of Departmental activities, including appropriations received to conduct operations and revenue generated from operations. The financial statements also reflect the reporting of certain non-entity (custodial) functions performed by the Department on behalf of the Federal Government.

Intragovernmental assets and liabilities result from activity with other Federal entities. All other assets and liabilities result from activity with parties outside the Federal Government, such as domestic and foreign persons, organizations, or governments. Intragovernmental earned revenues are collections or accruals of revenue from other Federal entities, and intragovernmental costs are payments or accruals to other Federal entities. Transactions and balances among the Department's Components have been eliminated in the consolidated presentation of the Balance Sheets, Statements of Net Cost, Statements of Changes in Net Position, and the Statements of Custodial Activity. The Statements of Budgetary Resources are reported on a combined basis; therefore, intradepartmental balances have not been eliminated.

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.

These financial statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity, whose 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 U.S. Government acting in its capacity as a sovereign entity.



### **C. Basis of Accounting**

Transactions are recorded on an accrual and a budgetary 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. Budgetary accounting facilitates compliance with legal constraints and the controls over the use of Federal funds. The balances and activity of budgetary accounts are used to prepare the Statements of Budgetary Resources. The Statements of Custodial Activity are reported using the modified cash basis. With this method, revenue from cash collections is reported separately from receivable accruals, and cash disbursements are reported separately from payable accruals.

### **D. Use of Estimates**

Preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of consolidated financial statements, and the reported amounts of revenues and claims and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include: the 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 operating materials and supplies (OM&S) balances; allocations of indirect common costs to construction-in-progress; capitalized property, plant, and equipment; depreciation; subsidy re-estimates; deferred revenues; National Flood Insurance Program (NFIP) insurance liability; actuarial assumptions related to workers' compensation; military and other pension, retirement and post-retirement benefit assumptions; allowances for doubtful duties, fines, penalties, and certain non-entity receivables; and payables related to custodial activities and undeposited collections.

### **E. Entity and Non-Entity Assets**

Entity assets are assets the Department has the authority to use in its operations. The authority to use funds in an entity's operations means either Department management has the authority to decide how funds are used or management is legally obligated to use funds to meet entity obligations (e.g., salaries and benefits).

Non-entity assets are assets held by the Department but not available for use by the Department. An example of a non-entity asset is the portion of Fund Balance with Treasury that consists of special and deposit funds, permanent appropriations, and miscellaneous receipts that are available to pay non-entity liabilities.

For additional information, see Note 2, Non-Entity Assets.





## **F. Fund Balance with Treasury**

Fund Balance with Treasury represents the aggregate amount of the Department's accounts with the U.S. Department of the Treasury (Treasury) available to pay current liabilities and finance authorized purchases, except as restricted by law. The Department's Fund Balance with Treasury balances are primarily appropriated, revolving, trust, deposit, receipt, and special fund amounts remaining as of the end of the fiscal year. Fund Balance with Treasury does not include fiduciary amounts (see Note 1.Y., Fiduciary Activities).

For additional information, see Note 3, Fund Balance with Treasury.

## **G. Cash and Other Monetary Assets**

The Department's cash and other monetary assets primarily consist of undeposited collections, imprest funds, cash used in undercover operations, cash held as evidence, cash held by insurance companies, and seized cash and monetary instruments.

The Department does maintain cash in commercial bank accounts. Insurance companies receive and process certain receipts and disbursements for FEMA. Treasury processes the remainder of the receipts and disbursements.

For additional information, see Note 4, Cash and Other Monetary Assets.

## **H. Investments, Net**

Investments consist of U.S. Government nonmarketable par value and market-based Treasury securities and are reported at cost or amortized cost net of premiums or discounts. Premiums or discounts are amortized into interest income over the terms of the investment using the effective interest method or the straight-line method, which approximates the interest method. No provision is made for unrealized gains or losses on these securities because it is the Department's intent to hold these investments to maturity.

For additional information, see Note 5, Investments, Net.

## **I. Accounts Receivable, Net**

Accounts receivable represents amounts due to the Department from other Federal agencies and the public. In general, intragovernmental accounts receivable arise from the provision of goods and services to other Federal agencies and are expected to be fully collected.

Accounts receivable due from the public typically results from various immigration and user fees, premiums and restitution from insurance companies and policyholders, breached bonds, reimbursable services, and security fees. 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, or historical collection experience.

For additional information, see Note 6, Accounts Receivable, Net.



## **J. Advances and Prepayments**

Intragovernmental advances, presented as a component of other assets in the accompanying Balance Sheets, consist primarily of disaster recovery and assistance advances to other Federal agencies.

Advances and prepayments to the public, presented as a component of other assets in the accompanying Balance Sheets, consist primarily of disaster recovery and assistance grants to States and other grant activity. Advances are expensed as they are used by the recipients.

For additional information, see Note 13, Other Assets.

## **K. Direct Loans, Net**

Direct loans are loans issued by the Department to local governments. FEMA, the only DHS Component with loan activity, operates the Community Disaster Loan Program to support local governments that have suffered a substantial loss of tax and other revenue as a result of a major disaster and demonstrate a need for Federal financial assistance in order to perform governmental functions. Under the program, FEMA transacts direct loans to local governments that meet statutorily set eligibility criteria. Loans are accounted for as receivables as funds are disbursed.

All of the Department's loans are post-1991 obligated direct loans, and the resulting receivables are governed by the *Federal Credit Reform Act of 1990 (FCRA)* (Pub. L. 101-508). Under FCRA, for direct loans disbursed during a fiscal year, the corresponding receivable is adjusted for subsidy costs. Subsidy costs are estimated long-term costs to the U.S. Government for its loan programs. The subsidy cost is equal to the 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. Subsidy costs can arise from interest rate differentials, interest subsidies, delinquencies and defaults, and other cash flows. The Department calculates the subsidy costs based on a subsidy calculator model created by OMB.

Loans receivable are recorded at the present value of the estimated net cash flows. 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. Interest receivable is the total interest that has accrued on each of the outstanding loans, less any cancellations that may have been recorded due to the FEMA cancellation policy as described in 44 Code of Federal Regulations (CFR) Section 206.366.

For additional information, see Note 8, Direct Loans, Net.

## **L. Inventory and Related Property, Net**

Operating materials and supplies are tangible personal property consumed during normal operations. Department OM&S consist primarily of goods consumed during the service of vessels and aircraft. OM&S at the U.S. Coast Guard aircraft warehouses in Elizabeth City, North Carolina, and vessel warehouses in Baltimore, Maryland are accounted for using the consumption method. OM&S held at the U.S. Coast Guard field units is accounted for using the purchase method. Excess, obsolete, and unserviceable OM&S are stated at net realizable value net of an allowance,



which is based on the condition of various asset categories as well as historical experience with using and disposing of such assets. OM&S held at CBP consist of aircraft, marine, and secure border initiative (SBI) operating materials and supplies to be used in CBP's operations. CBP's OM&S are accounted for using the consumption method.

Repairable spares are classified as property, plant, and equipment (PP&E). Repairable spares consist of repairable components that are repeatedly repaired and put back into service. Repairable spares are valued based on a moving average cost flow assumption. The cost is depreciated along with the major PP&E asset (e.g., aircraft, vessel, boat) they support. Normal repair costs are expensed in the period incurred.

Inventory is tangible personal property held for sale or used in the process of production for sale. Inventories on hand at year-end are stated at cost using standard price/specific identification, first-in/first-out, or moving 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. Department inventories consist primarily of the U.S. Coast Guard Supply Fund—which provides uniform clothing, subsistence provisions, retail stores, technical material, and fuel—and the U.S. Coast Guard Industrial Fund, which provides inventory for the repair of U.S. Coast Guard and other Government agency ships and vessels.

Stockpile materials are critical materials held due to statutory requirements for use in national emergencies. The Department's stockpile materials held by FEMA include goods that would be used to respond to national disasters (e.g., water, meals, cots, blankets, tarps, and blue roof sheeting). Inventory at year-end is stated at historical cost using the weighted average method.

For additional information, see Note 9, Inventory and Related Property, Net.

### **M. Seized and Forfeited Property**

Seized property falls into two categories: prohibited and nonprohibited. Prohibited seized property includes illegal drugs, contraband, and counterfeit items that cannot legally enter into the commerce of the United States. Prohibited seized property results primarily from criminal investigations and passenger/cargo processing. Nonprohibited seized property includes items that are not inherently illegal to possess or own, such as monetary instruments, real property, and tangible personal property of others.

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 is determined (i.e., judicially or administratively forfeited or returned to the entity from which it was seized).

Forfeited property is seized property for which the title has passed to the U.S. Government. Prohibited forfeited items such as counterfeit goods, narcotics, or firearms are held by the Department until disposed of or destroyed. Nonprohibited forfeited property is transferred to the Treasury Forfeiture Fund.

An analysis of changes in seized and forfeited property of prohibited items is presented in Note 10, Seized and Forfeited Property.



## N. General Property, Plant, and Equipment, Net

The Department's PP&E consists of aircraft, vessels, vehicles, land, structures, facilities, leasehold improvements, software, information technology, and other equipment. PP&E is recorded at cost. The Department capitalizes PP&E acquisitions 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. In cases where historical cost information was not maintained, PP&E is capitalized using an estimated cost methodology consistent with Statement of Federal Financial Accounting Standards (SFFAS) No. 35, *Estimating the Historical Cost of General Property, Plant, and Equipment*. Estimated cost may be 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 U.S. Coast Guard uses market analysis as a reasonable alternative valuation method to record PP&E assets when the historical cost is unknown. For unique or uncommon assets, formal appraisals are conducted to determine acquisition cost. The Department owns some of the buildings in which Components operate. Other buildings are provided by the General Services Administration (GSA), which charges rent equivalent to the commercial rental rates for similar properties.

Internal-use software includes purchased commercial off-the-shelf software (COTS), contractor-developed software, and internally developed software. For COTS software, the capitalized costs include the amount paid to the vendor for the software. For contractor-developed software, the capitalized costs include the amount paid to a contractor to design, program, install, and implement the software. For internally developed software, capitalized costs include the full costs (direct and indirect) incurred during the software development phase. Costs incurred during the preliminary design and post-implementation/operational phases are expensed in the period incurred. In addition, CBP applies capital lease accounting concepts to software license fee agreements that give CBP the "right to use" internal-use software.

The schedule of capitalization thresholds shown below is a summary of the range of capitalization rules used by the Components. DHS policy allows Components to continue using legacy thresholds and capitalization rules for assets acquired prior to October 1, 2007. For assets acquired on or after October 1, 2007, Components use the DHS capitalization policy unless: 1) adopting it would cause a material misstatement of the standalone financial statements, 2) it would cause the Component to not be in compliance with GAAP, or 3) certain assets, such as repairable spares held by the U.S. Coast Guard, do not reasonably conform to DHS policy.



The ranges of capitalization thresholds and service life used by Components, by primary asset category, are as follows (unaudited):

<b>Asset Description</b>	<b>Capitalization Threshold</b>	<b>Service Life</b>
Land	Zero to \$200,000	Not Applicable
Improvements to land	Zero to \$200,000	2 years to 40 years
Buildings	\$50,000 to \$200,000	6 years to 40 years
Equipment	\$25,000 to \$200,000	2 years to 74 years
Capital leases and leasehold improvements	\$50,000 to \$200,000	2 years to 40 years
Software	\$50,000 to \$750,000	2 years to 7 years

The Department begins to recognize depreciation expense once the asset has been placed in service. Depreciation is calculated on a straight-line method for all asset classes over their estimated useful lives. Land is not depreciated. 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 is calculated using the straight-line method and 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. There are no restrictions on the use or convertibility of general PP&E.

For additional information, see Note 11, General Property, Plant, and Equipment, Net.

**O. Stewardship Property, Plant, and Equipment**

Stewardship PP&E includes heritage assets that generally are not included in general PP&E presented on the Balance Sheet. Heritage assets are unique due to their historical or natural significance; cultural, educational, or artistic importance; or significant architectural characteristics. In general, heritage assets are expected to be preserved indefinitely. The Department’s heritage assets consist primarily of historical artifacts, artwork, buildings, and structures owned by the U.S. Coast Guard. The cost of improving, reconstructing, or renovating heritage assets is recognized as an expense in the period incurred. Similarly, the cost to acquire or construct a heritage asset is recognized as an expense in the period incurred. Due to their nature, heritage assets are not depreciated because matching costs with specific periods would not be meaningful.

Heritage assets can serve two purposes: a heritage function and a general government operational function. If a heritage asset serves both purposes, but is predominantly used for general government operations, the heritage asset is considered a multi-use heritage asset, which is included in general PP&E on the Balance Sheet. DHS depreciates its multi-use heritage assets over their useful life. The Department’s multi-use heritage assets consist of buildings and structures owned by CBP, U.S. Coast Guard, and FEMA.

For additional information, see Note 12, Stewardship Property, Plant, and Equipment.



## P. Liabilities

Liabilities represent the probable and measurable future outflow or other use of resources as a result of past transactions or events. Liabilities covered by budgetary resources are those liabilities for which Congress has appropriated funds or for which 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, where there is no certainty that the appropriations will be enacted. The U.S. Government, acting in its sovereign capacity, can annul liabilities of the Department arising from any transaction or event other than contracts.

## Q. Contingent Liabilities

The Department has disclosed contingent liabilities where the conditions for liability recognition have not been met and the likelihood of unfavorable outcome is more than remote. The Department has accrued contingent liabilities where a loss is determined probable and the amount can be reasonably estimated. The Department does not accrue for possible losses related to cases where the potential loss cannot be estimated or the likelihood of an unfavorable outcome is less than probable. Other contingencies exist where losses are reasonably possible and an estimate can be determined or an estimate of the range of possible liability can be determined. Contingent liabilities considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee is disclosed.

For additional information, see Note 21, Commitments and Contingent Liabilities.

***Environmental Cleanup Costs.*** Environmental liabilities consist of environmental remediation, cleanup, and decommissioning. The liability for environmental remediation is an estimate of costs necessary to bring a known contaminated asset into compliance with applicable environmental standards. Accruals for environmental cleanup costs are the costs of removing, containing, and/or disposing of hazardous wastes or materials that, because of quantity, concentration, or physical or chemical characteristics, may pose a substantial present or potential hazard to human health or the environment.

For all PP&E in service as of October 1, 1997, DHS recognizes the estimated total cleanup costs associated with the PP&E when the cleanup costs are probable and reasonably estimable. The estimate may be subsequently adjusted for material changes due to inflation/deflation or changes in regulations, clean-up plans, or technology. The applicable costs of decommissioning DHS's existing and future vessels are considered cleanup costs.

For additional information, see Note 17, Environmental and Disposal Liabilities.

## R. Grants Liabilities and Cooperative Agreements

The Department awards grants and cooperative agreements to state and local governments, universities, nonprofit organizations, and private-sector companies to build their capacity to respond to disasters and emergencies; conduct research into preparedness; enhance and ensure the security of passenger and cargo transportation by air, land, or sea; and support other Department-related activities. The Department estimates the year-end grant and cooperative agreement accrual for unreported recipient expenditures using historical disbursement data. Grants and cooperative



agreement liabilities are combined with accounts payable to the public in the accompanying Balance Sheets.

### **S. Insurance Liabilities**

Insurance liabilities are the result of the Department's sale or continuation-in-force of NFIP, which is managed by FEMA. The NFIP insurance liability represents an estimate based on the loss and loss adjustment expense factors inherent to the NFIP Insurance Underwriting Operations. Actual incurred losses and loss adjustment expenses may 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 estimate reported in the financial statements.

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 Insurance Underwriting Operations for the loss potential of an unusually severe loss year due to catastrophic flooding.

Notwithstanding the foregoing, subsidized rates have historically been charged on a countrywide basis for certain classifications of the insured. These subsidized rates produce a premium less than the loss and loss adjustment expenses expected to be incurred in a historical average loss year. The subsidized rates do not include a provision for losses 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 nonsubsidized premium zones applicable to the community).

For additional information, see Note 18, Other Liabilities, and Note 20, Insurance Liabilities.

### **T. Debt and Borrowing Authority**

Debt is reported within Intragovernmental Liabilities and results from Treasury loans and related interest payable to fund NFIP and Disaster Assistance Direct Loan Program (DADLP) operations of FEMA. Most of this debt is not covered by current budgetary resources. The premiums collected by FEMA for the NFIP are not sufficient to cover the debt repayments. Congress will need to enact legislation to provide funding to repay the Treasury Department or to forgive the debt.

Borrowing authority is in budgetary status for use by FEMA for NFIP purposes, and community disaster loans and transfers have been made to the Fund Balance with Treasury for these purposes.

For more information, see Note 15, Debt and Note 26, Available Borrowing Authority.

### **U. Accrued Payroll and Benefits**

**Accrued Payroll.** Accrued payroll consists of salaries, wages, and other compensation earned by the employees but not disbursed as of September 30. The liability is estimated for reporting purposes based on historical pay information.



**Leave Program.** Earned annual and other vested compensatory leave is accrued as it is earned and reported on the Balance Sheet. The liability is reduced as leave is taken. Each year, the balances in the accrued leave accounts are adjusted to reflect the liability at current pay rates and leave balances. Sick leave and other types of nonvested leave are not earned benefits. Accordingly, nonvested leave is expensed when used.

**Federal Employees Compensation Act.** The *Federal Employees Compensation Act (FECA)* (Pub. L. 103-3) provides income and medical cost protection to covered Federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA program is administered by the U.S. Department of Labor (DOL), which pays valid claims and subsequently seeks reimbursement from the Department for these paid claims.

The FECA liability consists of two elements. The first element, accrued FECA liability, is based on actual claims paid by DOL but not yet reimbursed by the Department. The Department reimburses DOL for the amount of actual claims as funds are appropriated for this purpose. In general, there is a two- to three-year time period between payment by DOL and reimbursement to DOL by the Department. As a result, the Department recognizes an intragovernmental liability for the actual claims paid by DOL and to be reimbursed by the Department.

The second element, actuarial FECA liability, is the estimated liability for future benefit payments and is recorded as a component of Federal Employee and Veterans' Benefits. This liability includes death, disability, medical, and miscellaneous costs. DOL determines the actuarial FECA liability annually, as of September 30, using an actuarial method that considers historical benefit payment patterns, wage inflation factors, medical inflation factors, and other variables. The projected annual benefit payments are discounted to present value using the OMB economic assumptions for 10-year Treasury notes and bonds. The actuarial FECA liability is not covered by budgetary resources and will require future funding.

For more information on the actuarial FECA liability, see Note 16, Federal Employee and Veterans' Benefits. For additional information on the accrued FECA liability, accrued payroll, and accrued leave, see Note 18, Other Liabilities.

## **V. Federal Employee and Veterans' Benefits**

The Department's Federal employee and veterans' benefits consist of civilian employees' pension programs, other retirement benefits (ORB), and other post-employment benefits (OPEB), as well as the Military Retirement System (MRS), post-employment military travel benefits, and Uniformed Division and Special Agent Pension. Civilian employees' pension programs, ORB and OPEB are administered by the Office of Personnel Management (OPM) and do not represent a liability for the Department.

The Department recognizes liabilities and expenses for MRS, post-employment military travel benefits, and Uniformed Division and Special Agent Pension. SFFAS No. 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*, effective for FY 2010, requires display of gains and losses from changes in long-term assumptions used to measure these





liabilities as a separate line item on the Statement of Net Cost. SFFAS No. 33 also requires additional disclosure of the reconciliation of beginning and ending liability balances.

***Civilian Pension and Other Post-Employment 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 OPM rather than the Department. Accordingly, DHS does not display gains and losses from changes in long-term assumptions used to measure these liabilities on the Statement of Net Cost.

Most Federal employees of DHS hired prior to January 1, 1984, participate in the Civil Service Retirement System (CSRS), to which the Department contributes 7 percent of base pay for regular CSRS employees and 7.5 percent of base pay for law enforcement agents. The majority of employees hired after December 31, 1983, are covered by the Federal Employees Retirement System (FERS) and Social Security. For the FERS basic annuity benefit, the Department contributes 11.2 percent of base pay for regular FERS employees and 24.9 percent for law enforcement agents. A primary feature of FERS is that it also offers a defined contribution plan (Federal Thrift Savings Plan) to which the Department automatically contributes 1 percent of base pay and matches employee contributions up to an additional 4 percent of base pay. The Department also contributes the employer's Social Security matching share for FERS participants.

Similar to CSRS and FERS, OPM 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 reports both the full annual cost of providing these ORB for its retired employees and reporting contributions made for active employees. In addition, the Department recognizes the cost for OPEB, including all types of benefits provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents.

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

***Military Retirement System Liability.*** The U.S. Coast Guard MRS is a defined benefit plan that includes pension benefits, disability benefits, and survivor benefits and covers all retired active duty and reserve military members of the U.S. Coast Guard. The plan is a pay-as-you-go system funded through annual appropriations. The actuarial unfunded accrued liability reported on the accompanying Balance Sheet is determined by subtracting the sum of the present value of future employer normal costs and any plan assets from the present value of the future benefits expected to be paid. The normal cost (current period expense) is computed using the individual entry age normal actuarial cost method.

***Military Health System for Retirees and Beneficiaries Liability.*** There are two categories of the Military Healthcare liability for the U.S. Coast Guard retirees and beneficiaries. The first is the Military Healthcare liability for the Medicare-eligible U.S. Coast Guard military retirees and beneficiaries. The U.S. Department of Defense (DOD) is the administrative entity for the Medicare-Eligible Retiree Health Care Fund (MERHCF) and, in accordance with SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, is required to recognize the liability on the MERHCF's financial statements. The U.S. Coast Guard makes annual payments to fund benefits for the current active duty members and their spouses who will receive benefits when they reach



Medicare-eligibility. The future cost and liability of the MERHCF is determined using claim factors and claims cost data developed by DOD, adjusted for U.S. Coast Guard retiree and actual claims experience. The DOD Board of Actuaries calculates all MERHCF assumptions, and the Defense Finance and Accounting Service provides accounting and investment services for the fund. The U.S. Coast Guard receives per-member amounts (reserve and active duty member amounts separately) to be contributed to the MERHCF from the DOD Board of Actuaries office and pays its share, depending on its demography.

The second category is the Military Healthcare liability for the pre-Medicare-eligible retirees and beneficiaries. The benefits are funded on a pay-as-you-go basis. There are no assets in this plan as benefits are paid in full as they become due from the current year appropriations.

***Post-Employment Military Travel Benefit.*** U.S. Coast Guard uniformed service members and their family or survivors are authorized a one-time transfer benefit to the members' home of address upon separation or retirement to include permanent disability and preretirement death in service. The allowances are provided whether or not the member is on active duty at the time of travel and without regard to the comparative costs of the various modes of transportation.

The U.S. Coast Guard treats this entitlement as an ORB. The U.S. Coast Guard recognizes an expense and a liability for this benefit 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 liability for this benefit is determined in the same manner as the liability for the MRS by subtracting the sum of the present value of future normal costs from the present value of the future entitlements expected to be paid. The normal cost is computed using the individual entry age normal actuarial cost method.

***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 benefit payments to retirees and/or their beneficiaries. USSS receives permanent, indefinite appropriations each year to pay the excess of benefit payments over salary deductions. The DC Pension Plan is a pay-as-you-go system funded through annual appropriations. The unfunded accrued liability reported on the accompanying 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.

For more information on civilian pension and OPEB, MRS liability, post-employment military travel benefits, and Uniformed Division and Special Agent Pension liability, see Note 16, Federal Employee and Veterans' Benefits.

## **W. Earmarked Funds**

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources that remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes and must be accounted for separately from the Federal Government's general revenues.

Earmarked non-exchange revenue and other financing sources, including appropriations and net cost of operations, are shown separately on the Statements of Changes in Net Position. The portion



of cumulative results of operations attributable to earmarked funds is shown separately on both the Statements of Changes in Net Position and the Balance Sheets.

For additional information, see Note 22, Earmarked Funds, and Note 5, Investments, Net.

## X. Revenue and Financing Sources

**Appropriations.** The Department receives the majority of funding 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 is recognized when the goods or services are provided by the Department. 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 agencies is subject to the *Economy Act* (31 United States Code (U.S.C.) 1535). Prices for goods and services sold to other Federal Government agencies are generally limited to the recovery of direct cost.

**Allocation Transfers.** The Department is a party to allocation transfers with other Federal agencies as both a transferring (parent) entity and a receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. In general, all financial activity related to these allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations, and budget apportionments are derived. The Department allocates funds, as the parent, to the Department of Health and Human Services. During FY 2008, OMB granted an exemption from reporting this fund as a parent for FY 2008 and future periods. Therefore, financial activity related to these funds is not reported in the DHS financial statements and related footnotes. DHS receives allocation transfers, as the child, from GSA, the U.S. Department of Transportation, and the Environmental Protection Agency.

**Exchange and Non-exchange Revenue.** Exchange revenues are recognized when earned and are derived from transactions where both the Government and the other party receive value (i.e., goods have been delivered or services have been rendered). Non-exchange revenues from user fees are recognized as earned in accordance with the *Consolidated Omnibus Budget Reconciliation Act of 1985* (COBRA) (Pub. L. 99-272), as amended. Non-exchange revenues also arise from transfers-in with and without financing sources and donations from the public. Other financing sources, such as donations and transfers of assets without reimbursements, are recognized on the Statements of Changes in Net Position during the period in which the donations and transfers occurred.

Deferred revenue is recorded when the Department receives payment for goods or services which have not been fully rendered. Deferred revenue is reported as a liability on the Balance Sheets until earned. Fees for flood mitigation products and services, such as insurance provided through FEMA's NFIP, are established at rates 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 Insurance Underwriting Operations for the loss potential of an unusually severe loss year due to catastrophic flooding. NFIP premium revenues are recognized ratably over the life of the policies. Deferred revenue relates to unearned premiums reserved to provide for the remaining period of insurance coverage. USCIS requires advance payments of the fees for adjudication of applications or petitions for immigration and naturalization benefits.

***Imputed Financing Sources.*** In certain instances, operating costs of DHS are paid out of funds appropriated to other Federal agencies. For example, OPM, by law, pays certain costs of retirement programs, and certain legal judgments against DHS are paid from a judgment fund maintained by the Treasury. When costs that are identifiable to DHS and directly attributable to DHS operations are paid by other agencies, DHS recognizes these amounts as operating expenses. DHS also recognizes an imputed financing source on the Statements of Changes in Net Position to indicate the funding of DHS operations by other Federal agencies.

***Custodial Activity.*** Non-entity revenue, disbursements, and refunds are reported on the Statement of Custodial Activity using a modified cash basis. Non-entity revenue reported on the Department's Statement of Custodial Activity include duties, excise taxes, and various non-exchange fees collected by CBP that are subsequently remitted to the Treasury General Fund or to other Federal agencies. Duties, user fees, fines, and penalties are assessed pursuant to the provisions of 19 U.S.C.; nonimmigrant petition fees and interest under 8 U.S.C.; and excise taxes under 26 U.S.C.

CBP assesses duties, taxes, and fees on goods and merchandise brought into the United States from foreign countries. The custodial revenue is recorded at the time of collection. These revenue collections primarily result from current fiscal year activities. CBP records an equal and offsetting liability due to the Treasury General Fund for amounts recognized as non-entity tax and trade receivables. Non-entity tax and trade accounts receivables are 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 specifically identifiable, legally enforceable claim and remain uncollected as of year-end. 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. The portions of the fees that are subsequently remitted to other Federal agencies are recorded as custodial revenue at the time of collection.

Non-entity receivables are presented net of amounts deemed uncollectible. CBP tracks and enforces payment of estimated duties, taxes, and fees receivable by establishing a liquidated damage case that generally results in fines and penalties receivable. A fine or penalty, including interest on past-due balances, is 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. The amount is based on past experience in resolving disputed assessments, 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. 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 a protest decision is 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.



Disbursements are recorded as a decrease in the amount transferred to Federal entities as reported on the Statements of Custodial Activity.

An accrual adjustment is recorded on the Statements 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.

For additional information, see Note 7, Taxes, Duties, and Trade Receivables, Net, and Note 31, Custodial Revenues.

#### **Y. Fiduciary Activities**

Fiduciary activities are Federal Government activities that relate to the collection or receipt—and the subsequent management, protection, accounting, investment and disposition—of cash or other assets in which non-Federal individuals or entities have an ownership. Federal accounting standards require the Department to distinguish the information relating to its fiduciary activities from all other activities. Fiduciary activities are not recognized on the accompanying financial statements. The Department’s fiduciary activities are currently immaterial, and therefore, no additional disclosure is necessary.

#### **Z. Taxes**

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

#### **AA. Restatements and Reclassifications**

In FY 2010, the Department restated certain FY 2009 balances and made certain reclassifications to FY 2009 balances to conform to FY 2010 presentation. For additional information, see Note 32, Restatements and Note 1. A., Reporting Entity.



## 2. Non-Entity Assets

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

	2010 (Unaudited)	2009 (Unaudited) (Restated)
Intragovernmental:		
Fund Balance with Treasury	\$1,327	\$1,415
Total Intragovernmental	<u>1,327</u>	<u>1,415</u>
Cash and Other Monetary Assets	8	10
Accounts Receivable, Net	23	17
Taxes, Duties, and Trade Receivables, Net	2,459	1,874
Total Public	<u>2,490</u>	<u>1,901</u>
Total Non-Entity Assets	3,817	3,316
Total Entity Assets	86,280	81,488
<b>Total Assets</b>	<b><u>\$90,097</u></b>	<b><u>\$84,804</u></b>

Non-entity Fund Balance with Treasury consists of certain special and deposit funds, permanent and indefinite appropriations, and miscellaneous receipts that are available to pay non-entity liabilities. Non-entity assets (also discussed in Notes 3, 4, 6, and 7) are offset by non-entity accrued liabilities at September 30, 2010 and 2009. Taxes, duties and trade receivables from the public represent amounts due from importers for goods and merchandise imported to the United States.



### 3. Fund Balance with Treasury

#### A. Fund Balance with Treasury

Fund Balance with Treasury at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Appropriated Funds	\$54,407	\$51,844
Trust Funds	573	28
Revolving, Public Enterprise, and Working Capital Funds	851	428
Special Funds	4,264	4,223
Deposit Funds	727	649
<b>Total Fund Balance with Treasury</b>	<b>\$60,822</b>	<b>\$57,172</b>

Appropriated funds consist of amounts appropriated annually by Congress to fund the operations of the Department. Appropriated funds include clearing funds totaling \$151 million and \$(32) million at September 30, 2010 and 2009, respectively (unaudited), which represent reconciling differences with Treasury balances.

Trust funds include both receipt accounts and expenditure accounts that are designated by law as a trust fund. Trust fund receipts are used for specific purposes, in general to offset the cost of expanding border and port enforcement activities and oil spill related claims and activities. For additional information, see Note 22, Earmarked Funds.

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. A public enterprise revolving fund is an account that is authorized by law to be credited with offsetting collections from the public and those monies are used to finance operations. The Working Capital Fund is a fee-for-service fund established to support operations of Department Components. Also included are the financing funds for credit reform and the National Flood Insurance Fund.

Special funds are funds designated for specific purposes including the disbursement of non-entity monies received in connection with antidumping and countervailing duty orders due to qualifying Injured Domestic Industries (IDI). The Department also has special funds for immigration and naturalization user fees and CBP user fees, as well as inspection fees, flood map modernization subsidy, and off-set and refund transfers. For additional information, see Note 22, Earmarked Funds.

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.



**B. Status of Fund Balance with Treasury**

The status of Fund Balance with Treasury at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Budgetary Status		
Unobligated Balances:		
Available	\$10,195	\$7,711
Unavailable	4,993	5,672
Obligated Balance Not Yet Disbursed	46,258	44,721
Total Budgetary Status	<u>61,446</u>	<u>58,104</u>
Reconciling Adjustments:		
Receipt, Clearing, and Deposit Funds	929	712
Borrowing Authority	(1,427)	(1,427)
Investments	(3,436)	(3,375)
Receivable Transfers and Imprest Fund	(317)	(270)
Receipts Unavailable for Obligation	2,117	1,960
Authority Temporarily Precluded from Obligation	46	43
SFRBTF; Oil Spill Liability Trust Fund	1,464	1,425
<b>Total Fund Balance with Treasury</b>	<b><u><u>\$60,822</u></u></b>	<b><u><u>\$57,172</u></u></b>

Portions of the Unobligated Balances Available, Unavailable, and Obligated Balance Not Yet Disbursed contain CBP's user fees of \$715 million and \$732 million at September 30, 2010 and 2009, respectively (unaudited), which are restricted by law in its use to offset costs incurred by CBP.

Portions of the Unobligated Balance Unavailable include amounts appropriated in prior fiscal years that are not available to fund new obligations, including expired funds. However, the amounts can be used for upward and downward adjustments for existing obligations in future years. The Obligated Balance Not Yet Disbursed 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.

Since the following line items do not post to budgetary status accounts, certain adjustments are required to reconcile the budgetary status to nonbudgetary Fund Balance with Treasury as reported in the accompanying Balance Sheets:

- Receipt, clearing, and deposit funds represent amounts on deposit with Treasury that have no budget status at September 30, 2010 and 2009.





- Borrowing authority is in budgetary status for use by FEMA for NFIP purposes and community disaster loans, but transfers have not yet been made to the Fund Balance with Treasury account for these purposes.
- Budgetary resources have investments included; however, the money has been moved from the Fund Balance with Treasury asset account to Investments.
- Receivable transfers of currently invested balances increase the budget authority at the time the transfer is realized; however, obligations may be incurred before the actual transfer of funds.
- Imprest funds represent funds moved from Fund Balance with Treasury to Cash and Other Monetary Assets with no change in the budgetary status.
- For receipts unavailable for obligations, authorizing legislation may specify that obligations are not available until a specified time in the future or until specific legal requirements are met.
- Authority temporarily precluded from obligation is offsetting collections that become unavailable for obligation until specific legal requirements are met.
- Sport Fish Restoration Boating Trust Fund (SFRBTF) is a Treasury-managed fund. This fund receives revenues transferred from custodial activities of the Treasury, which are deposited in a Treasury account (see Note 22).

4. Cash and Other Monetary Assets

Cash and Other Monetary Assets at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Cash	\$60	\$56
Seized Monetary Instruments	1	1
<b>Total Cash and Other Monetary Assets</b>	<b>\$61</b>	<b>\$57</b>

DHS cash includes cash held by others, imprest funds, undeposited collections, seized cash deposited, and the net balance maintained by insurance companies for flood insurance premiums received from policyholders. Seized Monetary Instruments are held until disposition. As of September 30, 2010 and 2009, restricted non-entity cash and other monetary assets were \$8 million and \$10 million, respectively (unaudited).



### 5. Investments, Net

Investments at September 30, 2010, consisted of the following (in millions) (unaudited):

Type of Investment:	Amortization Method	Cost	Amortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value Disclosure
Intragovernmental Securities:						
Oil Spill Liability Trust Fund	Effective interest method	\$1,500	\$34	\$8	\$1,542	N/A
Sport Fish Restoration Boating Trust Fund	Effective interest method	1,938	1	1	1,940	N/A
Total Nonmarketable		3,438	35	9	3,482	N/A
<b>Total Investments, Net</b>		<b>\$3,438</b>	<b>\$35</b>	<b>\$9</b>	<b>\$3,482</b>	<b>N/A</b>

Investments at September 30, 2009, consisted of the following (in millions) (unaudited):

Type of Investment:	Amortization Method	Cost	Amortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value Disclosure
Intragovernmental Securities:						
Oil Spill Liability Trust Fund	Effective interest method	\$1,396	\$36	\$ -	\$1,432	N/A
Sport Fish Restoration Boating Trust Fund	Effective interest method	1,984	1	-	1,985	N/A
Total Nonmarketable		3,380	37	-	3,417	N/A
<b>Total Investments, Net</b>		<b>\$3,380</b>	<b>\$37</b>	<b>\$ -</b>	<b>\$3,417</b>	<b>N/A</b>

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds (Oil Spill Liability Trust Fund, SFRBTF, and General Gift Fund) for the U.S. Coast Guard. The cash receipts collected from the public for an earmarked fund are deposited in the Treasury, which uses the cash for general Federal Government purposes. Treasury securities are issued to the U.S. Coast Guard as evidence of its receipts. Treasury securities associated with earmarked funds are an asset to the U.S. Coast Guard and a liability to the Treasury.

Treasury securities provide the U.S. Coast Guard with authority to draw upon the Treasury to make future benefit payments or other expenditures. For additional information, see Note 22, Earmarked Funds.

**6. Accounts Receivable, Net**

Accounts Receivable, Net, at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited) (Restated)
Intragovernmental	<b>\$326</b>	<b>\$369</b>
With the Public:		
Accounts Receivable	682	664
Allowance for Doubtful Accounts	(191)	(215)
	<b>491</b>	<b>449</b>
<b>Accounts Receivable, Net</b>	<b>\$817</b>	<b>\$818</b>

Intragovernmental accounts receivable results from reimbursable work performed by the Department. Accounts receivable with the public consist of amounts due for reimbursable services, aviation security fees due to TSA, receivables related to the Deepwater Horizon oil spill, and other user fees.

**7. Taxes, Duties, and Trade Receivables, Net**

Taxes, Duties, and Trade Receivables consisted of the following (in millions):

As of September 30, 2010 (Unaudited):

Receivables Category	Gross Receivables	Allowance	Total Net Receivables
Duties	\$2,162	\$(139)	\$2,023
Excise Taxes	121	(6)	115
User Fees	133	4	137
Fines/Penalties	716	(607)	109
Antidumping and Countervailing Duties	641	(566)	75
Refunds and Drawbacks	1	(1)	-
<b>Total Taxes, Duties, and Trade Receivables, Net</b>	<b>\$3,774</b>	<b>\$(1,315)</b>	<b>\$2,459</b>



As of September 30, 2009 (Unaudited):

Receivables Category	Gross Receivables	Allowance	Total Net Receivables
Duties	\$1,650	\$(146)	\$1,504
Excise Taxes	106	(6)	100
User Fees	117	(7)	110
Fines/Penalties	736	(660)	76
Antidumping and Countervailing Duties	497	(413)	84
<b>Total Taxes, Duties, and Trade Receivables, Net</b>	<b>\$3,106</b>	<b>\$(1,232)</b>	<b>\$1,874</b>

When a violation of import/export law is discovered, a fine or penalty is established. CBP assesses a liquidated damage or penalty for these cases to the maximum extent of the law. 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, net of interest, on fines and penalties of approximately 85 percent and 90 percent at September 30, 2010 and 2009, respectively (unaudited) of the total assessment based on historical experience of fines and penalties mitigation and collection. Duties and taxes receivables are non-entity assets for which there is an offsetting liability Due to the General Fund (see Note 18). The increase is primarily due to an escalation in import activity into the United States during FY 2010, which resulted in an increase in receivables related to entry.

### 8. *Direct Loans, Net*

DHS's loan program consists of Community Disaster Loans (CDLs) administered by FEMA. CDLs may be authorized to local governments that have suffered a substantial loss of tax and other revenues as a result of a major disaster and have demonstrated a need for financial assistance in order to perform their municipal operating functions.

The loans are made at the current Treasury rate for a term of five years and cannot exceed 25 percent of the annual operating budget of the local government for the fiscal year in which the major disaster occurred. The exception is the Special CDL for Hurricanes Katrina and Rita, where the interest rate on the loan is less than the Treasury rate, and the amount of the loan cannot exceed 50 percent of the annual operating budget of the local government for the fiscal year in which the major disaster occurred. In addition, CDLs may exceed \$5 million and may not be cancelled in accordance with the following *Stafford Act* amendments: the *Community Disaster Loan Act of 2005* (Pub. L. 109-88) and the *U.S. Troop Readiness, Veteran's Care, Katrina Recovery, and Iraq Accountability Appropriations Act* (Pub. L. 110-28). Since the 2006 Cohort is still disbursing, the balance remains in the program account to cover costs of undisbursed loans. Disbursements are tracked by cohort as determined by the date of obligation rather than disbursement



**A. Summary of Direct Loans to Non-Federal Borrowers at September 30 (in millions):**

	2010 (Unaudited)	2009 (Unaudited)
	Loans Receivable, Net	Loans Receivable, Net
<b>Community Disaster Loans</b>	<b>\$85</b>	<b>\$55</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.

**B. Direct Loans Obligated After FY 1991 (in millions):**

As of September 30, 2010 (Unaudited):	Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
<b>Community Disaster Loans</b>	<b>\$1,074</b>	<b>\$113</b>	<b>\$(1,102)</b>	<b>\$85</b>

As of September 30, 2009 (Unaudited):	Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
<b>Community Disaster Loans</b>	<b>\$1,041</b>	<b>\$83</b>	<b>\$(1,069)</b>	<b>\$55</b>

**C. Total Amount of Direct Loans Disbursed, Post-1991 (in millions):**

	2010 (Unaudited)	2009 (Unaudited)
<b>Community Disaster Loans</b>	<b>\$34</b>	<b>\$89</b>

**D. Subsidy Expense for Direct Loans by Program and Component (in millions):**

**Subsidy Expense for New Direct Loans Disbursed as of September 30 (in millions):**

	Interest Differential	Defaults and Other	Total
Community Disaster Loans 2010 (Unaudited)	\$6	\$27	<b>\$33</b>
Community Disaster Loans 2009 (Unaudited)	\$14	\$73	<b>\$87</b>

**Total Direct Loan Subsidy Expense**

	2010 (Unaudited)	2009 (Unaudited)
<b>Community Disaster Loans</b>	<b>\$33</b>	<b>\$87</b>



**E. Direct Loan Subsidy Rates at September 30 (in millions):**

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

	2010 (Unaudited)	2009 (Unaudited)
	Community Disaster Loans	Community Disaster Loans
Interest Subsidy Cost	2.84%	5.04%
Default Costs	- %	- %
Other	90.98%	88.90%

**F. Schedule for Reconciling Subsidy Cost Allowance Balances at September 30 (in millions):**

	2010 (Unaudited)	2009 (Unaudited)
Beginning balance of the subsidy cost allowance	\$1,069	\$987
Add subsidy expense for direct loans disbursed during the reporting years by component:		
Interest rate differential costs	6	14
Other subsidy costs	27	73
Adjustments:		
Subsidy allowance amortization	-	-
Ending balance of the subsidy cost allowance before reestimates	1,102	1,074
Add subsidy reestimate by component		
Technical/default reestimate	-	(5)
<b>Ending balance of the subsidy cost allowance</b>	<b>\$1,102</b>	<b>\$1,069</b>

**G. Administrative Expenses at September 30 (in millions):**

	2010 (Unaudited)	2009 (Unaudited)
<b>Community Disaster Loans</b>	<b>\$0.7</b>	<b>\$0.8</b>



**9. Inventory and Related Property, Net**

Inventory and Related Property, Net at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited) (Restated)
	<u>          </u>	<u>          </u>
Operating Materials and Supplies (OM&S)		
Items Held for Use	\$315	\$253
Items Held for Future Use	31	39
Excess, Obsolete and Unserviceable Items	42	37
Less: Allowance for Losses	(18)	(36)
Total OM&S, Net	<u>370</u>	<u>293</u>
 Inventory		
Inventory Purchased for Resale	71	79
Less: Allowance for Losses	(3)	(2)
Total Inventory, Net	<u>68</u>	<u>77</u>
 Stockpile Materials Held in Reserve	<u>61</u>	<u>65</u>
 <b>Total Inventory and Related Property, Net</b>	<u><b>\$499</b></u>	<u><b>\$435</b></u>



**10. Seized and Forfeited Property**

Prohibited seized property item counts as of September 30 and seizure and forfeiture activity for FY 2010 and 2009 are as follows:

<b>Seizure Activity</b>						
Fiscal Year Ended September 30, 2010 (Unaudited)						
Seized Property Category:	Beginning Balance	New Seizures	Remissions	New Forfeitures	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	1,163	1,203,104	-	(1,203,504)	1,094	1,857
Cocaine	174	23,955	-	(23,968)	8	169
Heroin	5	4,674	-	(4,673)	2	8
Ecstasy	34	787	-	(786)	(26)	9
Steroids	97	1,331	(812)	(280)	242	578
Firearms and Explosives (in number of items)	1,379	2,259	(1,267)	(763)	(126)	1,482
Counterfeit Currency (US/Foreign, in number of items)	4,198,926	1,631,500	-	-	(1,256,271)	4,574,155
<b>Forfeiture Activity</b>						
Fiscal Year Ended September 30, 2010 (Unaudited)						
Forfeited Property Category:	Beginning Balance	New Forfeitures	Transfers	Destroyed	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	126,052	1,203,504	(543)	(471,500)	(741,488)	116,025
Cocaine	19,037	23,968	(123)	(66,259)	47,978	24,601
Heroin	2,270	4,673	(36)	(1,118)	296	6,085
Ecstasy	1,417	786	(46)	(1,140)	90	1,107
Steroids	39	280	-	(300)	(2)	17
Firearms and Explosives (in number of items)	412	763	(576)	(1)	49	647





<b>Seizure Activity</b>						
Fiscal Year Ended September 30, 2009 (Unaudited)						
Seized Property Category:	Beginning Balance	New Seizures	Remissions	New Forfeitures	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	1,037	1,062,594	-	(1,065,252)	2,784	1,163
Cocaine	215	26,012	-	(26,428)	375	174
Heroin	8	1,556	-	(1,558)	(1)	5
Ecstasy	33	1,147	-	(1,146)	-	34
Steroids	145	326	-	(364)	(10)	97
Firearms and Explosives (in number of items)	873	1,651	(303)	(784)	(58)	1,379
Counterfeit Currency (US/Foreign, in number of items)	3,676,346	1,574,547	-	-	(1,051,967)	4,198,926

<b>Forfeiture Activity</b>						
Fiscal Year Ended September 30, 2009 (Unaudited)						
Forfeited Property Category:	Beginning Balance	New Forfeitures	Transfers	Destroyed	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	116,600	1,065,252	(1,833)	(525,453)	(528,514)	126,052
Cocaine	35,374	26,428	(212)	(24,057)	(18,496)	19,037
Heroin	7,066	1,558	(48)	(1,374)	(4,932)	2,270
Ecstasy	1,575	1,146	-	(1,145)	(159)	1,417
Steroids	42	364	-	(368)	1	39
Firearms and Explosives (in number of items)	408	784	(773)	(7)	-	412



This schedule is presented only for material prohibited (nonvalued) seized and forfeited property. These items are retained and ultimately destroyed by CBP and USSS and are not transferred to the U.S. Departments of Treasury or Justice Asset Forfeiture Funds or other Federal agencies. The ending balance for firearms includes only those seized items that can actually be used as firearms. Illegal drugs are presented in kilograms, and a portion of the weight includes packaging, which often cannot be reasonably separated from the weight of the drugs since the packaging must be maintained for evidentiary purposes. The adjustments are caused by changes during the year to the beginning balances of cases. Also, a prior year case can change legal status or property type. For example, a case considered forfeited could be re-opened and changed to seized status or a drug property type may change on a case.

The U.S. Coast Guard and ICE also seize and take temporary possession of small boats, equipment, firearms, contraband, and other illegal drugs. The U.S. Coast Guard and ICE usually dispose of these properties within three days by destroying it or by transfer to CBP (who transfers the proceeds from the sale of nonprohibited seized property to the Treasury Forfeiture Fund); the Drug Enforcement Administration; other Federal, state and local law enforcement agencies; or foreign governments. Seized property in U.S. Coast Guard and ICE possession at year-end is not considered material and therefore is not itemized and is not reported in the financial statements of the Department.

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

General Property, Plant, and Equipment (PP&E) consisted of the following (in millions):

As of September 30, 2010 (Unaudited):	Service Life	Gross Cost	Accumulated Depreciation/ Amortization	Total Net Book Value
Land and Land Rights	N/A	\$191	N/A	\$191
Improvements to Land	2-40 yrs	1,800	177	1,623
Construction in Progress	N/A	4,782	N/A	4,782
Buildings, Other Structures and Facilities	6-40 yrs	5,279	2,499	2,780
Equipment:				
Automated Data Processing Equipment	5 yrs	453	322	131
Aircraft	12-35 yrs	5,373	2,697	2,676
Vessels	5-74 yrs	6,052	2,963	3,089
Vehicles	3-8 yrs	862	573	289
Other Equipment	2-30 yrs	5,688	3,627	2,061
Assets Under Capital Lease	2-40 yrs	69	26	43
Leasehold Improvements	2-40 yrs	761	297	464
Internal Use Software	2-7 yrs	2,077	1,606	471
Internal Use Software - in Development	N/A	474	N/A	474
<b>Total General Property, Plant, and Equipment, Net</b>		<b>\$33,861</b>	<b>\$14,787</b>	<b>\$19,074</b>



As of September 30, 2009 (Unaudited) (Restated):	Service Life	Gross Cost	Accumulated Depreciation/ Amortization	Total Net Book Value
Land and Land Rights	N/A	\$177	N/A	\$177
Improvements to Land	2-40 yrs	1,256	90	1,166
Construction in Progress	N/A	5,964	N/A	5,964
Buildings, Other Structures and Facilities	6-40 yrs	4,817	2,341	2,476
Equipment:				
Automated Data Processing Equipment	5 yrs	419	272	147
Aircraft	12-35 yrs	3,478	1,828	1,650
Vessels	5-74 yrs	5,255	2,643	2,612
Vehicles	3-8 yrs	826	538	288
Other Equipment	2-30 yrs	5,275	3,346	1,929
Assets Under Capital Lease	2-40 yrs	79	32	47
Leasehold Improvements	2-40 yrs	620	182	438
Internal Use Software	2-7 yrs	1,671	1,380	291
Internal Use Software - in Development	N/A	512	N/A	512
<b>Total General Property, Plant, and Equipment, Net</b>		<b>\$30,349</b>	<b>\$12,652</b>	<b>\$17,697</b>



## 12. Stewardship Property, Plant, and Equipment

DHS's Stewardship PP&E is comprised of U.S. Coast Guard, CBP, USCIS, TSA, and FEMA heritage assets located in the United States, including the Commonwealth of Puerto Rico. Physical unit information related to heritage assets as of September 30 consisted of the following (in number of units):

2010 (Unaudited)	Beginning Balance	Additions	Withdrawals	Total
<b>Collection-type Assets</b>				
USCG	19,768	207	(423)	19,552
CBP	2	-	-	2
USCIS	5	-	-	5
TSA	3	-	-	3
<b>Non-collection-type Assets</b>				
USCG	60	-	-	60
<b>Multi-use Heritage Assets</b>				
USCG	784	-	(20)	764
CBP	4	-	-	4
FEMA	1	-	-	1
<b>Total Stewardship Property, Plant and Equipment</b>				
	<b>20,627</b>	<b>207</b>	<b>(443)</b>	<b>20,391</b>
<hr/>				
2009 (Unaudited) (Restated)	Beginning Balance	Additions	Withdrawals	Total
<b>Collection-type Assets</b>				
USCG	19,607	281	(120)	19,768
CBP	2	-	-	2
USCIS	5	-	-	5
TSA	3	-	-	3
<b>Non-collection-type Assets</b>				
USCG	60	-	-	60
<b>Multi-use Heritage Assets</b>				
USCG	796	-	(12)	784
CBP	4	-	-	4
FEMA	1	-	-	1
<b>Total Stewardship Property, Plant and Equipment</b>				
	<b>20,478</b>	<b>281</b>	<b>(132)</b>	<b>20,627</b>



The Department's Stewardship PP&E primarily consists of U.S. Coast Guard's heritage assets, which are unique due to historical, cultural, artistic, or architectural significance. These assets are used to preserve and to provide education on U.S. Coast Guard history and tradition.

The U.S. Coast Guard possesses a wide range of heritage assets, such as ship's equipment, lighthouse and other aids-to-navigation/communication items, military uniforms, ordnance, artwork, and display models. Historical artifacts are also gifted to the U.S. Coast Guard. Withdrawals occur when items have deteriorated through damage due to moving and transportation, storage or display, or environmental degradation. Withdrawals are also made when the U.S. Coast Guard curatorial staff, in conjunction with the U.S. Coast Guard historian, determines that an artifact does not meet the needs of the collection. U.S. Coast Guard collectible heritage assets can be categorized as follows:

- Artifacts include ship's equipment (sextants, bells, binnacles, etc.); decommissioned aids-to-navigation and communication equipment (buoy bells, lighthouse lenses, lanterns, etc.); personal-use items (uniforms and related accessories); and ordnance (cannons, rifles, and Lyle guns).
- Artwork consists of the U.S. Coast Guard's collection of World War II combat art as well as modern art depicting both historical and modern U.S. Coast Guard activities.
- Display models are mostly of U.S. Coast Guard vessels and aircraft. These are often builders' models acquired by the U.S. Coast Guard as part of the contracts with the ship or aircraft builders.

U.S. Coast Guard non-collection type heritage assets include sunken vessels and aircraft, as stipulated in the property clause of the U.S. Constitution, Articles 95 and 96 of the *International Law of the Sea Convention*, *Sunken Military Craft Act*, 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 U.S. Coast Guard desires to retain custody of these assets to safeguard the remains of crew members lost at sea, to prevent the unauthorized handling of explosives or ordnance that may be aboard, and to preserve culturally valuable artifacts of the U.S. Coast Guard.

U.S. Coast Guard's real property heritage assets are used in operations. Some examples are historic lighthouses and buildings still in use.

CBP possesses a wide range of documents and artifacts that are unique due to historical, cultural, artistic, or architectural significance. CBP aggregates its personal property heritage assets as documents and artifacts and reflects its real property as a number of physical units. These assets are used to preserve and to educate about CBP's history and tradition. Documents consist of dated tariff classifications, CBP regulations, ledgers of Collectors of Customs, and Customs pamphlets. Artifacts include antique scales, dated pictures of Customs inspectors, aged tools used to sample imported commodities such as wood bales and bulk grain, and dated Customs uniforms, badges, and stamps. In addition, CBP has four multi-use heritage assets located in Puerto Rico, which consist of customs houses that facilitate the collection of revenue for the Department.



USCIS stewardship assets consist of an archive of five different types of immigration and naturalization files that can be used to trace family lineages. USCIS has established a Genealogy Program to allow the public access to the records on a fee-for-service basis. Archived records available through the Genealogy Program include: naturalization certificate files, alien registration forms, visa files, registry files, alien files numbered below eight million, and documents dated prior to May 1951.

TSA possesses architectural or building artifacts that include concrete pieces that belonged to western wall of the Pentagon, subway rails from the Port Authority Trans-Hudson subway station located below the World Trade Center, and the steel facade from the exterior of one of the World Trade Center Towers that were destroyed by the terrorist attacks of September 11, 2001. As the lead agency protecting the Nation's transportation systems to ensure freedom of movement for people and commerce, TSA uses this property for the purpose of educating individuals about its history, mission, values, and culture.

FEMA has one multi-use heritage asset, the National Fire Academy, which is used by the U.S. Fire Administration for training in Emmitsburg, Maryland. The National Fire Academy develops, delivers, and manages educational and training programs to support the DHS and FEMA goals to help state and local response agencies prevent, mitigate, prepare for, and respond to local, regional, and national emergencies.

When heritage assets are functioning in operational status, the U.S. Coast Guard classifies these as multi-use heritage assets in accordance with SFFAS No. 6, *Accounting for Property, Plant and Equipment*. All multi-use heritage assets are reflected on the Balance Sheet as general PP&E and are depreciated over their useful life. Deferred maintenance and condition information for heritage assets and general PP&E are presented in the required supplementary information. When multi-use heritage assets are no longer needed for operational purposes, they are reclassified as heritage assets, where most are transferred to other Government agencies or public entities.

**13. Other Assets**

Other Assets at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Intragovernmental:		
Advances and Prepayments	\$2,225	\$2,688
Total Intragovernmental	<u>2,225</u>	<u>2,688</u>
Public:		
Advances and Prepayments	573	591
Total Public	<u>573</u>	<u>591</u>
 <b>Total Other Assets</b>	 <u><u>\$2,798</u></u>	 <u><u>\$3,279</u></u>

Intragovernmental Advances and Prepayments primarily consist of FEMA’s Disaster Relief Fund disaster assistance advances to other Federal agencies (principally the U.S. Department of Transportation) responsible for restoration efforts of the New York City region transportation system.

The Department provides advance funds to public grant recipients to incur expenses related to the approved grant. Advances are made within the amount of the total grant obligation.



#### 14. Liabilities Not Covered by Budgetary Resources

Liabilities Not Covered by Budgetary Resources at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited) (Restated)
Intragovernmental:		
Debt (Note 15)	\$18,276	\$18,525
Due to the General Fund (Note 18)	2,475	1,969
Accrued FECA Liability (Note 18)	374	370
Other	34	73
Total Intragovernmental	<u>21,159</u>	<u>20,937</u>
Public:		
Federal Employee and Veterans' Benefits:		
Actuarial FECA Liability (Note 16)	1,938	1,826
Military Service and Other Retirement Benefits (Note 16)	46,379	37,599
Environmental and Disposal Liabilities (Note 17)	1,018	987
Other:		
Accrued Payroll and Benefits (Note 18)	1,168	1,065
Insurance Liabilities (Note 20)	482	508
Contingent Legal Liabilities (Note 21)	540	242
Capital Lease Liability (Note 19)	51	71
Other	91	7
Total Public	<u>51,667</u>	<u>42,305</u>
Total Liabilities Not Covered by Budgetary Resources	72,826	63,242
Liabilities Covered by Budgetary Resources	10,770	11,260
<b>Total Liabilities</b>	<b><u>\$83,596</u></b>	<b><u>\$74,502</u></b>

The Department anticipates that the liabilities listed above will be funded from future budgetary resources when required, except for Due to the General Fund, which is funded by future custodial collections. Effective with FY 2010 reporting, Due to the Treasury General Fund is reported as a liability not covered by budgetary resources. FY 2009 information was reclassified to also report Due to the Treasury General Fund as a liability not covered by budgetary resources.





**15. Debt**

Debt at September 30 consisted of the following (in millions):

As of September 30, 2010 (Unaudited)	Beginning Balance	Net Borrowing	Ending Balance
<b>Debt to the Treasury General Fund:</b>			
Debt for the NFIP	\$19,000	\$(499)	\$18,501
Debt for Credit Reform	4	-	4
Total Debt to the Treasury General Fund	\$19,004	\$(499)	\$18,505
<b>Total Debt</b>	<b>\$19,004</b>	<b>\$(499)</b>	<b>\$18,505</b>

As of September 30, 2009 (Unaudited)	Beginning Balance	Net Borrowing	Ending Balance
<b>Debt to the Treasury General Fund:</b>			
Debt for the NFIP	\$17,719	\$1,281	\$19,000
Debt for Credit Reform	-	4	4
Total Debt to the Treasury General Fund	\$17,719	\$1,285	\$19,004
<b>Total Debt</b>	<b>\$17,719</b>	<b>\$1,285</b>	<b>\$19,004</b>

DHS’s intragovernmental debt is owed to Treasury’s Bureau of Public Debt (BPD) and consists of borrowings to finance claims under NFIP and borrowings to finance FEMA’s credit reform programs (Disaster Assistance Direct Loan Program). The decrease in debt is attributable to FEMA repayments of their NFIP loan during FY 2010.

NFIP loans from Treasury are typically for a three-year term. Interest rates are obtained from the BPD and range by cohort year from 0.38 percent to 4.75 percent (unaudited) as of September 30, 2010, and from 0.13 percent to 4.75 percent (unaudited) as of September 30, 2009. Interest is paid semi-annually on October 1 and April 1. Interest is accrued based on the loan balances reported by BPD. Principal repayments are required only at maturity but are permitted any time during the term of the loan. Flood premiums from policy holders and map collection fees are intended to repay loan principal and interest payments due to Treasury; however, due to the size of the debt incurred for damages sustained for Hurricanes Katrina and Rita, premiums received are only sufficient to cover the interest payments. Congress will need to enact legislation to provide funding to repay the Treasury Department or to forgive the debt.

Under Credit Reform, the unsubsidized portion of direct loans is borrowed from the Treasury. The repayment terms of FEMA’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 reestimate is performed to determine any change from the original subsidy rate. If an upward reestimate is determined to be necessary, these funds are available through permanent indefinite authority, which is to be approved by OMB. Once these funds are



appropriated, the original borrowings are repaid to Treasury. The weighted average interest rates for FY 2010 and FY 2009 were 2.76 percent and 4.75 percent (unaudited), respectively.

### 16. Federal Employee and Veterans' Benefits

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

	2010 (Unaudited)	2009 (Unaudited) (Restated)
U.S. Coast Guard Military Retirement and Healthcare Benefits	\$42,476	\$33,761
USSS DC Pension Plan Benefits	3,833	3,769
U.S. Coast Guard Post-Employment Military Travel Benefits and Other	70	69
Actuarial FECA Liability	1,938	1,826
<b>Total Federal Employee and Veterans' Benefits</b>	<b>\$48,317</b>	<b>\$39,425</b>

#### A. Reconciliation of Beginning and Ending Liability Balances for Pensions, ORB, and OPEB

The reconciliation of beginning and ending liability balances for pensions, ORB, and OPEB for the year ended September 30, 2010 consisted of the following (in millions) (unaudited):

	USCG Defined Benefit Plan	USCG Post- Retirement Healthcare	USSS Defined Benefit Plan	Total
Beginning Liability Balance:	\$26,801	\$6,960	\$3,770	\$37,531
Expenses:				
Normal Cost	1,189	528	244	1,961
Interest on the Liability Balance	1,555	392	-	1,947
Actuarial Losses/(Gains):				
From Experience	626	(80)	63	609
From Assumption Changes	4,557	1,118	-	5,675
Other	113	-	(1)	112
Total Expense	8,040	1,958	306	10,304
Less Amounts Paid	1,080	203	243	1,526
<b>Ending Liability Balance</b>	<b>\$33,761</b>	<b>\$8,715</b>	<b>\$3,833</b>	<b>\$46,309</b>

**B. U.S. Coast Guard Military Retirement and Healthcare Benefits**

The components of the MRS expense for the year ended September 30, 2009 consisted of the following (in millions):

	2009 (Unaudited) (Restated)
Defined Benefit Plan:	
Normal Cost	\$731
Interest on the Liability	1,584
Actuarial Losses/(Gains)	642
Actuarial Assumption Change	(264)
Total Defined Benefit Plan Expense	<u>\$2,693</u>
Post-retirement Healthcare:	
Normal Cost	\$333
Interest on the Liability	395
Other Actuarial (Gains)/Losses	1,507
Actuarial Assumption Change	(232)
Total Post-retirement Healthcare Expense	<u>2,003</u>
<b>Total MRS Expense</b>	<b><u>\$4,696</u></b>

**U.S. Coast Guard.** The U.S. Coast Guard’s military service members (both current active duty and reserve duty) participate in the MRS. The U.S. Coast Guard receives an annual “Retired Pay” appropriation to fund MRS benefits. The retirement system allows voluntary retirement for active members upon credit of at least 20 years of active service at any age. Reserve members may retire after 20 years of creditable service with benefits beginning at age 60. Reserve members may retire earlier if they perform certain active service after January 1, 2008. The U.S. Coast Guard’s Military Health Services System (Health Services Plan) is a post-retirement medical benefit plan that covers all current active duty and reserve members of the U.S. Coast Guard.

The accrued Military Health Services System liability is for the health care of non-Medicare eligible retirees and beneficiaries. Effective October 1, 2002, the U.S. Coast Guard transferred its liability for the health care of Medicare eligible retirees/beneficiaries to the DOD MERHCF, which was established to finance the health care benefits for the Medicare-eligible beneficiaries of all DOD and non-DOD uniformed services.

The unfunded accrued liability, presented as a component of the liability for military service and other retirement benefits in the accompanying Balance Sheet, represents both retired pay and health care benefits for non-Medicare eligible retirees/survivors. The present value of future benefits is the actuarial present value of the future payments that are expected to be paid under the retirement plan’s provisions. 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 accrued liability by subtracting the present value of future employer/employee normal contributions. U.S. Coast Guard 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. 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. Annual disability is equal to the retired pay base multiplied by the larger of 2.5 percent times years of service or the percentage of member disability. If a U.S. Coast Guard member is disabled, the member 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 the member has one month and one day of service; the disability results from active duty; or 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 accrued pension and healthcare liability are as follows:

- life expectancy and expected future service are based upon the DOD decrement (mortality, disability, withdrawal, and retirement) tables, as adjusted to reflect actual U.S. Coast Guard experience;
- DOD decrement tables are only used for mortality. Disability, withdrawal, and retirement tables were developed based on actual U.S. Coast Guard experience study of 9/30/2009;
- cost of living increases are 3.0 percent annually (only for the retirement plan);
- healthcare cost increase assumptions are based on the annual liability report provided by DOD and vary, depending on the year and type of care;
- annual rate of investment return is 5.75 percent; and
- the discount rate of 5.75 percent (not the same as an annual rate of return, a concept that only applies to the funded plan) was in effect prior to the current valuation; however, the current valuations determined in accordance with SFFAS No. 33 are slightly different for each plan, with the retirement plan being 4.75 percent and the health care plan being 4.65 percent.

The increase in Federal employee and veteran's benefit liability is due to the U.S. Coast Guard changing the assumptions used to calculate the Retired Pay and Military Care Actuarial liability.

**U.S. Secret Service.** Special agents and other USSS personnel in certain job series hired as civilians 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 Secret Service employment and 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 7 percent of base pay with no matching contribution made by USSS. Annuitants of this plan receive benefit payments directly from the DC Pension Plan. USSS reimburses the District of Columbia for the difference between benefits provided to the annuitants and payroll contributions received from current employees. This liability is presented as a component of the liability for military service and other retirement benefits in the accompanying Balance Sheet. SFFAS No. 5 requires the administrative entity (administrator) to report the actuarial liability. However, USSS records a liability 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 Government-wide consolidated financial statements.

The primary actuarial assumptions used to determine the liability at September 30, 2010, are:

- life expectancy is based upon the RP 2000 Combined Healthy Mortality Table;
- cost of living increases are 3.5 percent annually;
- rates of salary increases are 3.5 percent annually;
- annual rate of investment return is 7.25 percent; and
- rates of withdrawal for active service by gender and age.

Total expenses related to the DC Pension Plan for the fiscal years ended September 30, 2010 and 2009, were \$244 million and \$237 million, respectively (unaudited).

### **C. Actuarial FECA Liability**

The actuarial FECA liability represents the estimated liability for future workers' compensation and includes the expected liability for death, disability, medical, and miscellaneous costs for approved cases. Future workers' compensation estimates for the future cost of approved compensation cases, which are generated from an application of actuarial procedures developed by DOL, were approximately \$1,938 million and \$1,826 million at September 30, 2010 and 2009, respectively (unaudited).

## ***17. Environmental and Disposal Liabilities***

Environmental and disposal liabilities at September 30, 2010 and 2009, are \$1,061 million and \$1,012 million, respectively (unaudited and restated). The Department is responsible for remediating its sites with environmental contamination and is party to various administrative proceedings, legal actions, and tort claims that may result in settlements or decisions adverse to the Federal Government. The source of remediation requirements to determine the environmental liability is based on compliance with Federal, state, or local environmental laws and regulations. The major Federal laws covering environmental response, cleanup, and monitoring are the *Comprehensive Environmental Response, Compensation and Liability Act* (Pub. L. 96-510) and the *Resource Conservation and Recovery Act* (Pub. L. 94-580).

The U.S. Coast Guard completed a study of its lighthouses in FY 2009, identifying from various historical lists of lighthouses with potential liability. Based on this study, the U.S. Coast Guard created a cost methodology for estimating cleanup cost for various categories of lighthouse environmental liability. A total of 1,539 lighthouses were confirmed and recorded as a probable environmental and disposal liability of \$794 million (unaudited) for FY 2010.

In accordance with the *Consolidated Security, Disaster Assistance, and Continuing Appropriations Act, 2009* (Pub. L. 110-329), the Secretary of Homeland Security has directed the administrator of GSA to sell through public sale all real and related personal property and transportation assets that support the Plum Island Animal Disease Center operations. The probable environmental remediation cost of the center is recognized as \$8 million (unaudited) for S&T. In addition, the



Facility Closure and Transition Study indicates a reasonably possible range of liability of approximately \$8 million to \$30 million (unaudited).

The Department's remaining environmental liabilities are due to light stations, fuel storage tanks, underground storage tanks, buildings containing asbestos and/or lead-based paint, firing ranges, fuels, solvents, industrial chemicals, and other environmental cleanup associated with normal operations of CBP, FLETC, TSA, the U.S. Coast Guard, FEMA and S&T.

The Department has an unrecognized environmental liability of \$98 million (unaudited) as of September 30, 2010, and \$93 million (unaudited) for September 30, 2009, for U.S. Coast Guard vessels that have a reasonable possibility of being converted into marine artificial reefs; however, decisions on these conversions have not occurred. The preparation process includes the removal of all grease and buoyant material that might be harmful to the marine environment.

Cost estimates for environmental and disposal liabilities are subject to revision as a result of changes in inflation, technology, environmental laws and regulations, and plans for disposal.

**18. Other Liabilities**

Other Liabilities at September 30 consisted of the following (in millions):

<b>As of September 30, 2010 (Unaudited)</b>	<u>Current</u>	<u>Non- Current</u>	<u>Total</u>
<b>Intragovernmental:</b>			
Due to the General Fund (Note 2)	\$2,475	\$ -	\$2,475
Accrued FECA Liability	165	209	374
Advances from Others	216	-	216
Employer Benefits Contributions and Payroll Taxes	237	-	237
Other Intragovernmental Liabilities	46	2	48
<b>Total Intragovernmental Other Liabilities</b>	<b>\$3,139</b>	<b>\$211</b>	<b>\$3,350</b>
<b>Public:</b>			
Accrued Payroll and Benefits (See B. below)	\$2,217	\$ -	\$2,217
Deferred Revenue and Advances from Others (See B. below)	1,941	709	2,650
Unliquidated Antidumping and Countervailing Duties (Notes 3, and 7)	127	-	127
Insurance Liabilities (Note 20)	401	81	482
Refunds and Drawbacks	129	-	129
Contingent Legal Liabilities (Note 21)	693	34	727
Capital Lease Liability (Note 19)	6	45	51
Other	1,225	10	1,235
<b>Total Other Liabilities with the Public</b>	<b>6,739</b>	<b>879</b>	<b>7,618</b>
<b>Total Other Liabilities</b>	<b>\$9,878</b>	<b>\$1,090</b>	<b>\$10,968</b>
<b>As of September 30, 2009 (Unaudited) (Restated)</b>	<u>Current</u>	<u>Non- Current</u>	<u>Total</u>
<b>Intragovernmental:</b>			
Due to the General Fund (Note 2)	\$1,969	\$ -	\$1,969
Accrued FECA Liability	76	294	370
Advances from Others	447	-	447
Employer Benefits Contributions and Payroll Taxes	190	1	191
Other Intragovernmental Liabilities	17	65	82
<b>Total Intragovernmental Other Liabilities</b>	<b>\$2,699</b>	<b>\$360</b>	<b>\$3,059</b>



**Public:**

Accrued Payroll and Benefits (See B. below)	\$1,936	\$ -	\$1,936
Deferred Revenue and Advances from Others (See B. below)	1,405	1,224	2,629
Unliquidated Antidumping and Countervailing Duties (Notes 3 and 7)	106	-	106
Insurance Liabilities (Note 20)	175	333	508
Refunds and Drawbacks	126	-	126
Contingent Legal Liabilities (Note 21)	469	20	489
Capital Lease Liability (Note 19)	23	48	71
Other	1,158	7	1,165
<b>Total Other Liabilities with the Public</b>	<b>\$5,398</b>	<b>\$1,632</b>	<b>\$7,030</b>
<b>Total Other Liabilities</b>	<b>\$8,097</b>	<b>\$1,992</b>	<b>\$10,089</b>

**A. Intragovernmental Other Liabilities**

**Due to the General Fund.** Amounts due to the Treasury General Fund represent duty, tax, and fees collected by CBP to be remitted to various General Fund accounts maintained by Treasury.

**Workers' Compensation.** Claims incurred for the benefit of Department employees under FECA are administered by DOL and are ultimately paid by the Department. The accrued FECA liability represents money owed for current claims. Reimbursement to DOL for payments made occurs approximately two years subsequent to the actual disbursement. Budgetary resources for this intragovernmental liability are made available to the Department as part of its annual appropriation from Congress in the year in which the reimbursement takes place. Workers' compensation expense was \$165 million and \$161 million, respectively (unaudited), for the fiscal years ended September 30, 2010 and 2009.

**B. Other Liabilities with the Public**

**Accrued Payroll and Benefits.** Accrued Payroll and Benefits at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Accrued Funded Payroll and Benefits	\$967	\$841
Accrued Unfunded Leave	1,155	1,047
Unfunded Employment Related Liabilities	13	18
Other	82	30
<b>Total Accrued Payroll and Benefits</b>	<b>\$2,217</b>	<b>\$1,936</b>





**Deferred Revenue and Advances from Others.** Deferred Revenue and Advances From Others for the periods ended September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
USCIS Application Fees	\$711	\$781
FEMA Unearned NFIP Premium	1,911	1,837
Advances from Others	28	11
<b>Total Deferred Revenue</b>	<b>\$2,650</b>	<b>\$2,629</b>

USCIS requires payments of fees for applications or petitions for immigration and naturalization benefits at the time of filing. FEMA’s deferred revenue relates to unearned NFIP premiums recognized over the term of the period of insurance coverage.

**Unliquidated Antidumping and Countervailing Duties and Injured Domestic Industries.** The *Continued Dumping and Subsidy Offset Act (CDSOA) of 2000* (Pub. L. 106-387, Title X), enacted in FY 2001, calls for CBP to collect and disburse monies received in connection with antidumping and countervailing duty orders and findings to qualifying IDI. Antidumping duties are collected when it is determined that a class or kind of foreign merchandise is being released into the U.S. economy 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. Due to the repeal of CDSOA in the Deficit Reduction Omnibus Reconciliation Act of 2005, only duties collected prior to October 1, 2007, will eventually be distributed to affected U.S. companies, pursuant to rulings by the U.S. Department of Commerce (DOC).

**Other Liabilities.** Other public liabilities consist primarily of deposit and suspense fund liability.

## 19. Leases

### A. Operating Leases

The Department leases various facilities and equipment under leases accounted for as operating leases. Leased items consist of offices, warehouses, vehicles, and other equipment. The majority of 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 paying rent to GSA beyond the period occupied, providing that proper advance notice to GSA is made and unless the space occupied is designated as unique to Department operations. However, it is expected the Department will continue to occupy and lease office space from GSA in future years, and lease charges will be adjusted annually to reflect operating costs incurred by GSA.



As of September 30, 2010, estimated future minimum lease commitments under operating leases, which are non-cancelable, for equipment and GSA controlled leases were as follows (in millions) (unaudited):

	Land and Buildings	Vehicles and Equipment	Total
FY 2011	\$207	\$1	\$208
FY 2012	201	1	202
FY 2013	190	1	191
FY 2014	166	1	167
FY 2015	147	-	147
After FY 2015	421	-	421
<b>Total Future Minimum Lease Payments</b>	<b>\$1,332</b>	<b>\$4</b>	<b>\$1,336</b>

The estimated future lease payments for operating leases are based on lease contract terms considering payments made during the year ended September 30, 2010.

### B. Capital Leases

The Department maintains capital leases for buildings and commercial software license agreements. The liabilities associated with capital leases and software license agreements are presented as other liabilities in the accompanying financial statements based upon the present value of the future minimum lease payments.

Certain license agreements are cancelable depending on future funding. Substantially all of the net present value of capital lease obligations and software license agreements will be funded from future sources. As of September 30, the summary of assets under capital lease was as follows (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Land and Buildings	\$69	\$69
Vehicles and Equipment	-	10
Software	116	152
Accumulated Amortization	(142)	(160)
<b>Assets under Capital Lease, Net</b>	<b>\$43</b>	<b>\$71</b>



As of September 30, 2010, estimated future minimum lease payments under capital leases, which were all non-GSA, were as follows (in millions) (unaudited):

	<u>Land and Buildings</u>
FY 2011	\$6
FY 2012	6
FY 2013	6
FY 2014	6
FY 2015	6
After FY 2015	<u>46</u>
<b>Total Future Minimum Lease Payments</b>	<b>76</b>
Less: Imputed Interest and Executory Costs	<u>25</u>
<b>Total Capital Lease Liability</b>	<b><u>\$51</u></b>

**20. Insurance Liabilities**

Insurance liabilities for the periods ended September 30, 2010 and 2009, were \$482 million and \$508 million, respectively (unaudited), and consist primarily of NFIP insurance liabilities.

The insurance liability for unpaid losses and related loss adjustment expenses and amounts paid for the year ended September 30 consisted of the following (in millions):

	<u>2010</u>	<u>2009</u>
	<u>(Unaudited)</u>	<u>(Unaudited)</u>
Beginning Balance	\$508	\$5,531
Change in Incurred Losses	1,132	(1,825)
Less: Amounts Paid During Current Period	<u>(1,158)</u>	<u>(3,198)</u>
<b>Total Insurance Liability</b>	<b><u>\$482</u></b>	<b><u>\$508</u></b>

The NFIP insurance liability, the majority of the insurance liability reported, represents an estimate of NFIP 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 periodically reviewed, and adjustments, reflected in current operations, are made as deemed necessary.



## 21. Commitments and Contingent Liabilities

### A. Legal Contingent Liabilities

The Department is a party in various administrative proceedings, legal actions, and tort claims that may ultimately result in settlements or decisions adverse to the Federal Government. These contingent liabilities arise in the normal course of operations, and their ultimate disposition is unknown.

In the opinion of the Department’s management and legal counsel, based on information currently available, the expected outcome of legal actions, individually or in the aggregate, will not have a materially adverse effect on the Department’s financial statements, except for the legal actions described below (in millions).

	Accrued Liabilities	Estimated Range of Loss	
		Lower End	Upper End
FY 2010			
Probable	\$727	\$727	\$1,140
Reasonably Possible		\$100,431	\$101,424

The claims above relate to the *Federal Tort Claims Act* (Pub. L. 79-601), Oil Spill Liability Trust Fund, and various customs laws and regulations. The estimated contingent liability recorded in the accompanying financial statements included with other liabilities for all probable and reasonably estimable litigation-related claims at September 30, 2010, was \$727 million (unaudited), of which \$187 million (unaudited) was funded.

Asserted and pending legal claims for which loss was reasonably possible is estimated to range from \$100 billion (unaudited) to \$101 billion (unaudited) at September 30, 2010. This is mainly due to the claim related to FEMA formaldehyde contamination in trailers where the plaintiffs seek to recover damages for personal injuries allegedly resulting from exposure to formaldehyde while residing in temporary emergency housing units.

As of September 30, 2010, legal claims exist for which the potential range of loss could not be determined; however, the total amount claimed is not material to the financial statements. In addition, other claims exist for which the amount claimed and the potential range of loss could not be determined.

### B. Duty and Trade Refunds

There are various trade-related matters that fall under the jurisdiction of other Federal agencies, such as the DOC, which may result in refunds of duties, taxes, and fees collected by CBP. Until a decision is reached by the other Federal agencies, CBP does not have sufficient information to estimate a contingent liability amount, if any, for trade-related refunds under jurisdiction of other Federal agencies in addition to the amount accrued on the accompanying financial statements. All known duty and trade refunds as of September 30, 2010 and 2009, have been recorded.

### C. Loaned Aircraft and Equipment

The Department is generally liable to DOD for damage or loss to aircraft on loan to CBP and vessels on loan to the U.S. Coast Guard. As of September 30, 2010 and 2009, CBP had 17 aircraft loaned from DOD with a replacement value of up to \$25 million (unaudited) per aircraft. As of September 30, 2010, the U.S. Coast Guard had seven vessels on loan from DOD with a replacement value of \$84 million (unaudited).

### D. Other Contractual Arrangements

In addition to future lease commitments disclosed in Note 19, the Department is committed under contractual agreements for goods and services that have been ordered but not yet received (undelivered orders) at fiscal year-end. Aggregate undelivered orders for all Department activities are disclosed in Note 30. In accordance with the *National Defense Authorization Act for Fiscal Year 1991* (Pub. L. 101-510), the Department is required to automatically cancel obligated and unobligated balances of appropriated funds five years after a fund expires. Obligations that have not been paid at the time an appropriation is cancelled may be paid from an unexpired appropriation that is available for the same general purpose. As of September 30, 2010, DHS estimates total payments related to cancelled appropriations to be \$146 million (unaudited), of which \$72 million (unaudited) for contractual arrangements may require future funding.

TSA entered into a number of *Letters of Intent for Modifications to Airport Facilities* with 11 major airports in which TSA may reimburse the airports for 90 percent (estimated total of \$1.5 billion (unaudited)) of the costs to modify the facilities for security purposes. These letters of intent would not obligate TSA until funds have been appropriated and obligated. TSA received \$200 million in both FY 2010 and FY 2009 (unaudited) under this program. These funds are available for payment to the airports upon approval by TSA of an invoice for the modification costs incurred. As of September 30, 2010, TSA has received invoices or documentation for costs incurred totaling \$13 million (unaudited) for the invoices that have not yet been paid.



## 22. Earmarked Funds

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources that remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities or purposes. SFFAS No. 27, *Identifying and Reporting Earmarked Funds*, defines the following three criteria for determining an earmarked fund: 1) a statute committing the Federal Government to use specifically identified revenues and other financing sources only for designated activities, benefits, or purposes; 2) explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and 3) a requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguished the earmarked fund from the Federal Government's general revenues.

There are no transactions between earmarked funds that require elimination in consolidation. Earmarked funds consisted of the following (in millions) (unaudited):

	<b>Sport Fish Restoration Boating Trust Fund</b>	<b>Immigration Examination Fees</b>	<b>National Flood Insurance Program</b>	<b>Oil Spill Liability Trust Fund</b>	<b>All Other Earmarked Funds</b>	<b>Total Earmarked Funds</b>
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### Balance Sheet as of September 30, 2010

#### ASSETS

Fund Balance with							
Treasury	\$715	\$(3)	\$1,533	\$714	\$566	\$1,536	\$5,061
Investments, Net	-	1,940	-	-	1,542	-	3,482
Accounts Receivable	93	140	4	4	195	60	496
Taxes Receivable	81	-	-	-	-	1	82
Other	-	-	139	559	7	74	779
<b>Total Assets</b>	<b>\$889</b>	<b>\$2,077</b>	<b>\$1,676</b>	<b>\$1,277</b>	<b>\$2,310</b>	<b>\$1,671</b>	<b>\$9,900</b>

#### LIABILITIES

Other Liabilities	\$100	\$1,283	\$1,036	\$20,840	\$305	\$152	\$23,716
<b>Total Liabilities</b>	<b>\$100</b>	<b>\$1,283</b>	<b>\$1,036</b>	<b>\$20,840</b>	<b>\$305</b>	<b>\$152</b>	<b>\$23,716</b>



	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	Oil Spill Liability Trust Fund	All Other Earmarked Funds	Total Earmarked Funds
<b>NET POSITION</b>							
Cumulative Results of Operations	\$789	\$794	\$640	\$(19,563)	\$2,005	\$1,519	\$(13,816)
<b>Total Liabilities and Net Position</b>	<b>\$889</b>	<b>\$2,077</b>	<b>\$1,676</b>	<b>\$1,277</b>	<b>\$2,310</b>	<b>\$1,671</b>	<b>\$9,900</b>

**Statement of Net Cost for the Year Ended September 30, 2010**

Gross Program Costs	\$398	\$133	\$2,368	\$2,457	\$405	\$1,035	\$6,796
Less: Earned Revenues	-	-	(2,433)	(3,285)	(516)	(449)	(6,683)
<b>Net Cost of Operations</b>	<b>\$398</b>	<b>\$133</b>	<b>\$(65)</b>	<b>\$(828)</b>	<b>\$(111)</b>	<b>\$586</b>	<b>\$113</b>

**Statement of Changes in Net Position for the Year Ended September 30, 2010**

<b>Net Position Beginning of Period</b>	\$811	\$850	\$506	\$(20,388)	\$1,441	\$1,370	\$(15,410)
Net Cost of Operations	(398)	(133)	65	828	111	(586)	(113)
Non-exchange Revenue	1,759	638	-	-	550	664	3,611
Other	(1,383)	(561)	69	(3)	(97)	71	(1,904)
Change in Net Position	(22)	(56)	134	825	564	149	1,594
<b>Net Position, End of Period</b>	<b>\$789</b>	<b>\$794</b>	<b>\$640</b>	<b>\$(19,563)</b>	<b>\$2,005</b>	<b>\$1,519</b>	<b>\$(13,816)</b>

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	Oil Spill Liability Trust Fund	All Other Earmarked Funds	Total Earmarked Funds
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**Balance Sheet as of September 30, 2009 (restated)**

**ASSETS**

Fund Balance with Treasury	\$732	\$5	\$1,479	\$362	\$10	\$1,439	\$4,027
Investments, Net	-	1,985	-	-	1,432	-	3,417
Accounts Receivable	99	151	7	7	141	116	521
Taxes Receivables	65	-	-	-	-	-	65
Other	-	-	117	556	-	62	735
<b>Total Assets</b>	<b>\$896</b>	<b>\$2,141</b>	<b>\$1,603</b>	<b>\$925</b>	<b>\$1,583</b>	<b>\$1,617</b>	<b>\$8,765</b>

**LIABILITIES**

Other Liabilities	\$85	\$1,291	\$1,097	\$21,313	\$142	\$247	\$24,175
<b>Total Liabilities</b>	<b>\$85</b>	<b>\$1,291</b>	<b>\$1,097</b>	<b>\$21,313</b>	<b>\$142</b>	<b>\$247</b>	<b>\$24,175</b>



	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	Oil Spill Liability Trust Fund	All Other Earmarked Funds	Total Earmarked Funds
<b>NET POSITION</b>							
Cumulative Results of Operations	\$811	\$850	\$506	\$(20,388)	\$1,441	\$1,370	\$(15,410)
<b>Total Liabilities and Net Position</b>	<b>\$896</b>	<b>\$2,141</b>	<b>\$1,603</b>	<b>\$925</b>	<b>\$1,583</b>	<b>\$1,617</b>	<b>\$8,765</b>

**Statement of Net Cost for the Year Ended September 30, 2009 (restated)**

Gross Program Costs	\$399	\$124	\$2,278	\$(224)	\$153	\$1,160	\$3,890
Less: Earned Revenues	-	-	(2,707)	(2,900)	(27)	(445)	(6,079)
<b>Net Cost of Operations</b>	<b>\$399</b>	<b>\$124</b>	<b>\$(429)</b>	<b>\$(3,124)</b>	<b>\$126</b>	<b>\$715</b>	<b>\$(2,189)</b>

**Statement of Changes in Net Position for the Year Ended September 30, 2009 (restated)**

<b>Net Position Beginning of Period</b>	\$847	\$903	\$17	\$(23,648)	\$1,171	\$1,351	\$(19,359)
Net Cost of Operations	(399)	(124)	429	3,124	(126)	(715)	2,189
Non-exchange Revenue	1,619	658	-	134	491	624	3,526
Other	(1,256)	(587)	60	2	(95)	110	(1,766)
Change in Net Position	(36)	(53)	489	3,260	270	19	3,949
<b>Net Position, End of Period</b>	<b>\$811</b>	<b>\$850</b>	<b>\$506</b>	<b>\$(20,388)</b>	<b>\$1,441</b>	<b>\$1,370</b>	<b>\$(15,410)</b>

**Customs User Fees**

When signed in April 1986, COBRA (Pub. L. 99-272) authorized CBP to collect user fees for certain services. The law initially established processing fees for air and sea passengers, commercial trucks, rail cars, private vessels and aircraft, commercial vessels, dutiable mail packages, and CBP broker permits. An additional fee category for processing barges and bulk carriers for Canada and Mexico, contained in tax reform legislation, was added later that year.

In addition to the collection of user fees, other changes in CBP procedures were enacted due to the COBRA statute. Most importantly, provisions were included for providing nonreimbursable inspectional overtime services and paying for excess pre-clearance costs from COBRA user fee collections.

The *Customs and Trade Act of 1990* amended the COBRA legislation to provide for the hiring of inspectional personnel, the purchasing of equipment, and the covering of related expenses with any surplus monies available after overtime and excess pre-clearance costs are satisfied. Expenditures from the surplus can only be used to enhance the service provided to those functions for which fees are collected. The fees for certain customs services are provided by 19 USC § 58c. The authority to use these funds is contained in the annual DHS Appropriations Act.



### **Sport Fish Restoration and Boating Trust Fund (SFRBTF)**

The SFRBTF, previously known as the Aquatic Resources Trust Fund, was created by Section 1016 of the *Deficit Reduction Act of 1984* (Pub. L. 98-369). Two funds were created under this act, the Boating Safety Account and the Sport Fish Restoration Account. The SFRBTF has been the source of budget authority for the boat safety program for many years through the transfer of appropriated funds. The SFRBTF is a Treasury-managed fund and provides funding to states and other entities to promote boating safety and conservation of U.S. recreational waters.

This fund receives revenues transferred from custodial activities of the Treasury, which are deposited in a Treasury account. The revenues are derived from a number of sources, including motor boat fuel tax, excise taxes on sport fishing equipment, and import duties on fishing tackle and yachts. Three agencies share in the available portion of the revenue: Fish and Wildlife Service in the U.S. Department of Interior (Treasury Account Fund Symbol (TAFS) 14X8151); the U.S. Army Corps of Engineers (TAFS 96X8333); and the U.S. Coast Guard (TAFS 70X8149 and TAFS 70X8147).

The most recent reauthorization of SFRBTF and expenditure of Boating Safety funds for the National Recreational Boating Safety Program was enacted in 2005 in the *Safe, Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users* (Pub. L. 109-59) and the *Sportfishing and Recreational Boating Safety Amendments Act of 2005* (Pub. L. 109-74).

### **Immigration Examination Fees**

In 1988, Congress established the Immigration Examination Fee Account (IEFA), and the fees deposited into the IEFA have been the primary source of funding for providing immigration and naturalization benefits and other benefits as directed by Congress. The *Immigration and Nationality Act* (INA) (Pub. L. 82-414, Section 286(m)) provides for the collection of fees at a level that will ensure recovery of the costs of providing adjudication and naturalization services, including the costs of providing similar services without charge to asylum applicants and other immigrants. The INA also states that the fees may recover administrative costs. This revenue remains available to provide immigration and naturalization benefits and allows the collection, safeguarding, and accounting for fees.

The primary sources of revenue are the application and petition fees that are collected during the course of the fiscal year and deposited into the Immigration Examinations Fee Account (TAFS 70X5088). In addition, USCIS provides specific services to other Federal agencies, such as production of border crossing cards for the U.S. Department of State, that result in the collection of other revenues arising from intragovernmental activities.

### **National Flood Insurance Program**

The NFIP was established by the *National Flood Insurance Act of 1968* (Pub. L. 90-448). The purpose of NFIP is to better indemnify individuals for flood losses through insurance, reduce future flood damages through state and community floodplain management regulations, and reduce Federal expenditures for disaster assistance and flood control.



The NFIP requires all partners (Write Your Own (WYO) companies) in the program to submit financial statements and statistical data to the NFIP Legacy Systems Services on a monthly basis. This information is reconciled, and the WYO companies are required to correct any variances.

The NFIP is an insurance program for which the Department pays claims to policyholders that experience flood damage due to flooding within the rules and regulations. The WYO companies that participate in the program have authority to use Departmental funds (revenue and other financing sources) to respond to the obligations of the policyholders. Congress has mandated that the NFIP funds are used only to pay claims and claims-related loss adjustment expenses caused by flooding.

The NFIP sources of revenue and other financing comes from premiums collected to insure policyholder's homes and the borrowing authority provided to the program from Congress. The resources are inflows to the Government and are not the result of intragovernmental flows.

The *Flood Disaster Protection Act of 1973* (Pub. L. 93-234) expanded the authority of FEMA and its use of the NFIP to grant premium subsidies as an additional incentive to encourage widespread state, community, and property owner acceptance of the program requirements.


The *National Flood Insurance Reform Act of 1994* (Pub. L. 103-325) reinforced the objective of using insurance as the preferred mechanism for disaster assistance by expanding mandatory flood insurance purchase requirements and by effecting a prohibition on further flood disaster assistance for any property where flood insurance, after having been mandated as a condition for receiving disaster assistance, is not mandated.

The *Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004* (Pub. L. 108-264) provides additional tools for addressing the impact of repetitive loss properties on the National Flood Insurance Fund. It introduced a pilot project through FY 2009 that defines severe repetitive loss properties, authorizes additional funds for mitigation projects, and mandates a 50 percent increase of premiums for property owners who decline a mitigation offer, along with an appeal process. Since the inception of the program in 2008, FEMA has awarded more than \$97 million for the mitigation of severe repetitive loss properties. For FY 2008, approximately \$35 million was awarded, with the remaining \$62 million awarded in FY 2009. It also modifies the Flood Mitigation Assistance program by doubling the annual authorized funding level and directing it to give priority to those properties that are in the best interest of the National Flood Insurance Fund.

### **Oil Spill Liability Trust Fund**

The Oil Spill Liability Trust Fund (OSLTF) was originally established under § 9509 of the Internal Revenue Code of 1986. The *Oil Pollution Act of 1990 (OPA)* (Pub. L. 101-380) authorized the use of the money or the collection of revenue necessary for its maintenance.

Fund uses defined by the OPA include removal costs incurred by the U.S. Coast Guard and the Environmental Protection Agency; state access for removal activities; payments to Federal, state, and Indian tribe trustees to conduct natural resource damage assessments and restorations; payment of claims for uncompensated removal costs and damages; research and development (subject to congressional appropriations); and other specific appropriations by the Congress.



The OSLTF has three major funds: the Principal Fund (TAFS 70X8185), Emergency Fund (TAFS 70X8349), and Claims Fund (TAFS 70X8312). All revenue is deposited directly into the Principal Fund. The recurring and nonrecurring revenue are derived from a number of sources, including barrel tax, interest from U.S. Treasury investments, cost recoveries, and fines and penalties. The Emergency Fund is available for Federal on-scene coordinators (FOSCs) to respond to discharges and for Federal trustees to initiate natural resource damage assessments. The Emergency Fund is a recurring \$50 million available to the President annually. The fund remains available until expended. Claimants may file oil spill related claims against the Claims Fund if the responsible party is not identified or denies the claims. The maximum amount that can be paid from the Claims Fund with respect to any single incident shall not exceed \$1 billion. Once the maximum payout has been reached for the incident, no additional funds can be disbursed from the OSLTF for that specific incident.

***Deepwater Horizon Oil Spill.*** On April 20, 2010, the offshore drilling platform, Deepwater Horizon, exploded and sank 52 miles southeast of Venice, Louisiana. An estimated 4.9 million barrels of oil leaked from the sunken platform's undersea ruptured pipe. The states of Louisiana, Mississippi, Alabama, Florida, and Texas were affected by the spill. The cost of clean-up and damages is unprecedented.

There are currently five identified responsible parties and two guarantors for the Deepwater Horizon oil spill. Liability is joint and severable under the OPA (33 USC 2701 et.seq). The OPA and the *Clean Water Act* (33 U.S.C. 1321 et.seq) direct the responsible parties to conduct clean-up operations, and to advertise and pay claims for damages specified by the OPA. Under the OPA, the responsible party is liable for costs associated with the containment or clean-up of the spill, property damage, loss of government revenue, loss of profits or earning capacity, loss of subsistence use of natural resources, increased state and local public service costs, and damages to natural resources resulting from the spill. In addition, the OPA and applicable Federal legislation and regulations provide the U.S. Coast Guard with broad responsibilities and authorities regarding oil spill response oversight on the navigable waters of the United States. The U.S. Coast Guard has been designated as the FOSC to respond to this disaster. As FOSC, the U.S. Coast Guard directs and coordinates the response activities of all Federal agencies. The U.S. Coast Guard has entered into various reimbursable agreements with other Federal agencies.

In responding to the Deepwater Horizon oil spill, British Petroleum (BP), a responsible party, established a process designed to pay individual, business, and governmental claims for compensable costs under OPA. BP transferred responsibility for administration and payment of individual and business claims to the Gulf Coast Claims Facility (GCCF) in August 2010. BP has agreed to establish a \$20 billion escrow account to be funded over the next three years to pay spill related costs, including claims paid by the GCCF, however, establishment of this account does not represent a cap or floor on any amount that may ultimately be paid by BP.

The OSLTF provides emergency funding resources to the FOSC for oil removal, and to Federal trustees for initial natural resource damage assessment activities, up to amounts specified under OPA section 6002(b) (33 U.S.C. 2752(b)). In June 2010, the President of the United States signed into law an amendment to section 6002(b) allowing multiple budgetary authority advances from the OSLTF for the Deepwater Horizon oil spill response and Federal natural resource damage assessment activities limited only by the statutory per-incident cap at 26 U.S.C. 9509(c)(2). Through September 30, 2010, the OSLTF has advanced \$600 million to the FOSC to fund the



FOSC oil removal activities in response to the Deepwater Horizon oil spill. In addition, the U.S. Coast Guard has obligated \$22 million out of the advance amounts to the Federal Lead Administrative Trustee to initiate the assessment of natural resource damages, as provided by OPA section 6002(b).

The status of OSLTF available funds, costs incurred by the Federal Government, and billings to the responsible parties as of September 30, 2010, is described below.

**Status of OSLTF Funds and Costs Incurred and Billed.** The FOSC has obligated \$589 million of the funding advanced by the OSLTF, of which \$554 million has been expended through September 30, 2010. Of the amounts expended, \$518 million has been billed to the responsible parties as of September 30, 2010. The billed amounts encompass actual FOSC expenditures; including costs of all U.S. Coast Guard personnel, ships, aircraft, and cutters directly supporting the FOSC; and funds obligated by the FOSC to other Federal, state, and local government agencies. All the obligations and expenditures to date are considered billable and fully collectible from the responsible parties. Funds are obligated by the FOSC to other Federal, state, and local government agencies via FOSC approved Pollution Removal Funding Authorizations or Military Interdepartmental Purchase Requests that provide reimbursable funding authority.

**Contingent Liabilities.** The OSLTF, which is administered by the U.S. Coast Guard National Pollution Funds Center (NPFC), may be available to pay claims for OPA specified costs and damages, not paid by BP, or another responsible party. Under OPA, claimants are required to present their claims first to the responsible parties (or the GCCF for Deepwater Horizon costs); and if not compensated, they may then file an action in court or file a claim against the OSLTF through the NPFC. NPFC anticipates recovery, from the responsible party, of all costs ultimately paid, if any, including costs incurred in adjudicating paid claims.

### All Other Earmarked Funds

The balances and activity reported for all other earmarked funds result from the funds listed below. Information related to these earmarked funds can be located in the Department's appropriations legislation or the statutes referenced.

- 70X0715: Radiological Emergency Preparedness Program, Federal Emergency Management Agency, Department of Homeland Security
- 70X5089: U.S. Customs and Border Protection, Land Border Inspection Fees, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70\_5087: U.S. Customs and Border Protection, Immigration User Fees, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5126: Breach Bond/Detention Fund, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5378: Student and Exchange Visitor Program, Border and Transportation Security, Department of Homeland Security; 110 Stat. 3009-706, Sec. (e)(4)(B)
- 70X5382: Immigration User Fee Account, BICE, Department of Homeland Security; 116 Stat. 2135
- 70X5385: Aviation Security Capital Fund, Transportation Security Administration, Department of Homeland Security; 117 Stat. 2567(h)(1)



- 70\_5389: H-1B and L Fraud Prevention and Detection Account, U.S. Citizenship and Immigration Service, Department of Homeland Security; 8 U.S.C. § 1356(s)
- 70X5390: Unclaimed Checkpoint Money, Transportation Security Administration, Department of Homeland Security; 118 Stat. 1317-1318, Sec.515(a)
- 70X5398: H-1B and L Fraud Prevention and Detection, U.S. Immigration and Customs Enforcement, Department of Homeland Security; Pub. L. 108-447, 118 Stat. 3357, Sec. 426(b)(1)
- 70X5451: Immigration Enforcement Account, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5542: Detention and Removal Operations, U.S. Immigration and Customs Enforcement, Department of Homeland Security; 8 USC 1356(m)-(n); Pub. L. 107-296, Sec. 476c
- 70X5545: Airport Checkpoint Screening Fund, Transportation Security Administration, Department of Homeland Security; Pub. L. 110-161
- 70X5595: Electronic System for Travel Authorization (ESTA) Fees, U.S. Customs and Border Protection, Department of Homeland Security; Pub. L. 110-53, 121 Stat. 344; Pub. L. 111-145, 124 Stat. 56
- 70\_5694: User Fees, Small Airports, U.S. Customs Service, Department of Homeland Security; 116 Stat. 2135
- 70X8244: Gifts and Donations, Department Management, Department of Homeland Security; 116 Stat. 2135
- 70\_8314: Trust Fund Share of Expenses, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8533: General Gift Fund, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8870: Harbor Maintenance Fee Collection, U.S. Customs Service, Department of Homeland Security; 116 Stat. 2135
- 70\_5106: H-1 B Nonimmigrant Petitioner Account, U.S. Citizenship and Immigration Service, Department of Homeland Security; 116 Stat. 2135
- 70X8360: Gifts and Bequests, Federal Law Enforcement Training Center, Department of Homeland Security; 116 Stat. 2135
- 70X8420: Surcharge Collections, Sales of Commissary Stores, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8428: Coast Guard Cadet Fund, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X5543: International Registered Traveler Program Fund, U.S. Customs and Border Protection, Department of Homeland Security; 121 Stat. 2091-2092



### 23. Intragovernmental Costs and Exchange Revenue

For the year ended September 30, 2010 (in millions) (Unaudited)

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
<i>U.S. Customs and Border Protection</i>			
Gross Cost	\$3,247	\$8,528	\$11,775
Less Earned Revenue	(40)	(112)	(152)
<b>Net Cost</b>	<b>3,207</b>	<b>8,416</b>	<b>11,623</b>
<i>U.S. Coast Guard</i>			
Gross Cost	1,150	11,825	12,975
Less Earned Revenue	(137)	(760)	(897)
<b>Net Cost</b>	<b>1,013</b>	<b>11,065</b>	<b>12,078</b>
<i>U.S. Citizenship and Immigration Services</i>			
Gross Cost	722	1,809	2,531
Less Earned Revenue	(3)	(2,415)	(2,418)
<b>Net Cost</b>	<b>719</b>	<b>(606)</b>	<b>113</b>
<i>Federal Emergency Management Agency</i>			
Gross Cost	1,207	13,000	14,207
Less Earned Revenue	(364)	(3,317)	(3,681)
<b>Net Cost</b>	<b>843</b>	<b>9,683</b>	<b>10,526</b>
<i>Federal Law Enforcement Training Center</i>			
Gross Cost	61	349	410
Less Earned Revenue	(34)	(2)	(36)
<b>Net Cost</b>	<b>27</b>	<b>347</b>	<b>374</b>
<i>National Protection and Programs Directorate</i>			
Gross Cost	414	1,647	2,061
Less Earned Revenue	(828)	-	(828)
<b>Net Cost</b>	<b>(414)</b>	<b>1,647</b>	<b>1,233</b>
<i>U.S. Immigration and Customs Enforcement</i>			
Gross Cost	1,477	4,273	5,750
Less Earned Revenue	(73)	(156)	(229)
<b>Net Cost</b>	<b>1,404</b>	<b>4,117</b>	<b>5,521</b>
<i>Office of Health Affairs</i>			
Gross Cost	150	81	231
Less Earned Revenue	-	-	-
<b>Net Cost</b>	<b>150</b>	<b>81</b>	<b>231</b>

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
<i>Departmental Operations and Other</i>			
Gross Cost	\$680	\$1,200	\$1,880
Less Earned Revenue	(6)	-	(6)
<b>Net Cost</b>	<b>674</b>	<b>1,200</b>	<b>1,874</b>
<i>U.S. Secret Service</i>			
Gross Cost	442	1,340	1,782
Less Earned Revenue	(15)	-	(15)
<b>Net Cost</b>	<b>427</b>	<b>1,340</b>	<b>1,767</b>
<i>Science and Technology Directorate</i>			
Gross Cost	408	479	887
Less Earned Revenue	(3)	(2)	(5)
<b>Net Cost</b>	<b>405</b>	<b>477</b>	<b>882</b>
<i>Transportation Security Administration</i>			
Gross Cost	1,386	5,245	6,631
Less Earned Revenue	-	(2,145)	(2,145)
<b>Net Cost</b>	<b>1,386</b>	<b>3,100</b>	<b>4,486</b>
<b>Total Department of Homeland Security</b>			
Gross Cost	11,344	49,776	61,120
Less Earned Revenue	(1,503)	(8,909)	(10,412)
Net Cost Before Loss on Pension, ORB, or OPEB Assumption Changes	9,841	40,867	50,708
Loss on Pension, ORB, or OPEB Assumption Changes	-	5,675	5,675
<b>Net Cost</b>	<b>\$9,841</b>	<b>\$46,542</b>	<b>\$56,383</b>



For the year ended September 30, 2009 (in millions) (Unaudited) (Restated)

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
<b><i>U.S. Customs and Border Protection</i></b>			
Gross Cost	\$2,876	\$7,796	\$10,672
Less Earned Revenue	(45)	(121)	(166)
<b>Net Cost</b>	<b>2,831</b>	<b>7,675</b>	<b>10,506</b>
<b><i>U.S. Coast Guard</i></b>			
Gross Cost	907	11,367	12,274
Less Earned Revenue	(187)	(245)	(432)
<b>Net Cost</b>	<b>720</b>	<b>11,122</b>	<b>11,842</b>
<b><i>U.S. Citizenship and Immigration Services</i></b>			
Gross Cost	640	1,689	2,329
Less Earned Revenue	(8)	(2,688)	(2,696)
<b>Net Cost</b>	<b>632</b>	<b>(999)</b>	<b>(367)</b>
<b><i>Federal Emergency Management Agency</i></b>			
Gross Cost	1,866	12,882	14,748
Less Earned Revenue	(259)	(2,934)	(3,193)
<b>Net Cost</b>	<b>1,607</b>	<b>9,948</b>	<b>11,555</b>
<b><i>Federal Law Enforcement Training Center</i></b>			
Gross Cost	49	401	450
Less Earned Revenue	(35)	(1)	(36)
<b>Net Cost</b>	<b>14</b>	<b>400</b>	<b>414</b>
<b><i>National Protection and Programs Directorate</i></b>			
Gross Cost	422	1,610	2,032
Less Earned Revenue	(779)	(43)	(822)
<b>Net Cost</b>	<b>(357)</b>	<b>1,567</b>	<b>1,210</b>
<b><i>U.S. Immigration and Customs Enforcement</i></b>			
Gross Cost	1,298	3,875	5,173
Less Earned Revenue	(55)	(111)	(166)
<b>Net Cost</b>	<b>1,243</b>	<b>3,764</b>	<b>5,007</b>
<b><i>Office of Health Affairs</i></b>			
Gross Cost	355	59	414
Less Earned Revenue	-	-	-
<b>Net Cost</b>	<b>355</b>	<b>59</b>	<b>414</b>



Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
<i>Departmental Operations and Other</i>			
Gross Cost	\$570	\$1,206	\$1,776
Less Earned Revenue	(2)	-	(2)
<b>Net Cost</b>	<b>568</b>	<b>1,206</b>	<b>1,774</b>
<i>U.S. Secret Service</i>			
Gross Cost	450	1,368	1,818
Less Earned Revenue	(16)	-	(16)
<b>Net Cost</b>	<b>434</b>	<b>1,368</b>	<b>1,802</b>
<i>Science and Technology Directorate</i>			
Gross Cost	528	440	968
Less Earned Revenue	(3)	(1)	(4)
<b>Net Cost</b>	<b>525</b>	<b>439</b>	<b>964</b>
<i>Transportation Security Administration</i>			
Gross Cost	1,157	5,834	6,991
Less Earned Revenue	(1)	(2,242)	(2,243)
<b>Net Cost</b>	<b>1,156</b>	<b>3,592</b>	<b>4,748</b>
<b>Total Department of Homeland Security</b>			
Gross Cost	11,118	48,527	59,645
Less Earned Revenue	(1,390)	(8,386)	(9,776)
<b>Net Cost</b>	<b>\$9,728</b>	<b>\$40,141</b>	<b>\$49,869</b>

Intragovernmental costs represent exchange transactions made between two reporting entities within the Federal Government and are presented separately from costs with the public (exchange transactions made between the reporting entity and a non-Federal entity). Intragovernmental exchange revenue is disclosed separately from exchange revenue with the public. The criteria used for this classification requires that the intragovernmental expenses relate to the source of goods and services purchased by the reporting entity and not to the classification of related revenue. For example, with “exchange revenue with the public,” the buyer of the goods or services is a non-federal entity. With “intragovernmental costs,” the buyer and seller are both Federal entities. If a Federal entity purchases goods or services from another Federal entity and sells them to the public, the exchange revenue would be classified as “with the public,” but the related costs would be classified as “intragovernmental.” The purpose of this classification is to enable the Federal Government to provide consolidated financial statements, and not to match public and intragovernmental revenue with costs that are incurred to produce public and intragovernmental revenue.



## ***24. Suborganization Costs by DHS Missions and Goals***

Operating costs are summarized in the Statement of Net Cost by responsibility segment, as applicable to the reporting period. A responsibility segment is the Component that carries out a mission or major line of activity, and whose managers report directly to Departmental management.

In FY 2010, net cost of operations is the gross (i.e., total) cost incurred by the Department, excluding any gains and losses from changes in long-term assumptions used to measure Federal civilian and military employee pensions, other retirement benefits (ORB), and other postemployment benefits (OPEB), including veterans' compensation, less any exchange (i.e., earned) revenue. Gains and losses from changes in long-term assumptions used to measure Federal civilian and military employee pensions, ORB, and OPEB are reported on a separate line item in accordance with SFFAS No. 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*.

In FY 2010, the Department completed the Quadrennial Homeland Security Review (QHSR), which established a unified, strategic framework for homeland security missions and goals, and also conducted a Bottom-Up Review (BUR) to align programmatic activities and organizational structure to those missions and goals. Since the QHSR and the BUR reflect the most comprehensive assessment and analysis of Homeland Security to date, the Department has elected to use them as basis for integrating FY 2010 net cost to performance information. The Department is currently developing an appropriate cost model within the QHSR framework that will be used to present DHS suborganization costs by mission and goals in future disclosures.



## 25. Apportionment Categories of Obligations Incurred: Direct versus Reimbursable Obligations

Apportionment categories are determined in accordance with the guidance provided in OMB Circular No. 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).

<b>Year Ended September 30, 2010 (Unaudited):</b>	<b>Apportionment Category A</b>	<b>Apportionment Category B</b>	<b>Exempt from Apportionment</b>	<b>Total</b>
Obligations Incurred - Direct	\$34,501	\$27,823	\$1,020	\$63,344
Obligations Incurred - Reimbursable	4,003	654	11	4,668
<b>Total Obligations Incurred</b>	<b>\$38,504</b>	<b>\$28,477</b>	<b>\$1,031</b>	<b>\$68,012</b>

<b>Year Ended September 30, 2009 (Unaudited) (Restated):</b>	<b>Apportionment Category A</b>	<b>Apportionment Category B</b>	<b>Exempt from Apportionment</b>	<b>Total</b>
Obligations Incurred - Direct	\$32,668	\$33,740	\$1,294	\$67,702
Obligations Incurred - Reimbursable	3,303	914	10	4,227
<b>Total Obligations Incurred</b>	<b>\$35,971</b>	<b>\$34,654</b>	<b>\$1,304</b>	<b>\$71,929</b>

The increase in reimbursable obligations incurred was the result of data center consolidation and information technology improvements at MGMT and FEMA's international aid efforts in response to the Haiti earthquake.

## 26. Available Borrowing Authority

At the beginning of FY 2010, the Department, through FEMA's NFIP, had available borrowing authority of \$1,427 million (unaudited). During FY 2010, FEMA did not use any borrowing authority, which leaves a balance of \$1,427 million (unaudited). For FY 2009, FEMA had a beginning balance of \$3,415 million (unaudited) in borrowing authority. During FY 2009, FEMA received \$51 million (unaudited) in new borrowing authority, used \$1,992 million (unaudited) in borrowing authority, and had a decrease of \$47 million (unaudited) in indefinite borrowing authority, leaving a balance of \$1,427 million (unaudited). FEMA 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.

## 27. Permanent Indefinite Appropriations

Permanent indefinite appropriations refer to the appropriations that result from permanent public laws, which authorize the Department to retain certain receipts. The amount appropriated depends upon the amount of the receipts rather than on a specific amount. The Department has three permanent indefinite appropriations, which are not subject to budgetary ceilings established by Congress:



- CBP has a permanent and indefinite appropriation that 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 custodial activity of the Department. Refunds are custodial revenue-related activity in that refunds are a direct result of overpayments of taxes, duties, and fees. CBP's refunds payable at year-end are not subject to funding restrictions. Federal tax revenue received from taxpayers is not available for use in the operation of the Department and is not reported on the Statement of Net Cost. Likewise, the refunds of overpayments are not available for use by the Department in its operations.
- USSS has a permanent and indefinite appropriation that is used to reimburse the DC Pension Plan for the difference between benefits to participants in the DC Pension Plan (see Note 16) and payroll contributions received from current employees.
- USCIS has permanent authority to use immigration and naturalization application fees to pay costs of providing adjudication and naturalization services, including the costs of providing services without charge to asylum applicants and other immigrants and costs associated with the collection, safeguarding, and accounting for fees. USCIS also has the authority to transfer certain fees to other Federal agencies, including the Department of Labor, the Department of State, and the National Science Foundation. The transferred funds are earmarked for immigration fraud prevention and domestic training programs intended to reduce the need for foreign workers under the H-1B visa program.

## ***28. Legal Arrangements Affecting the Use of Unobligated Balances***

Unobligated balances whose period of availability has expired are not available to fund new obligations. Expired unobligated balances are available to pay for current period adjustments to obligations incurred prior to expiration. For a fixed appropriation account, the balance can be carried forward for five fiscal years after the period of availability ends. At the end of the fifth fiscal year, the account is closed and any remaining balance is canceled and returned to Treasury. For a no-year account, the unobligated balance is carried forward indefinitely until specifically rescinded by law or the head of the agency concerned or the President determines that the purposes for which the appropriation was made have been carried out and disbursements have not been made against the appropriation for two consecutive years.

Included in the cumulative results of operations for special funds is \$924 million (unaudited) and \$1 billion (unaudited) at September 30, 2010 and September 30, 2009, respectively, 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; to retain amounts needed to offset costs associated with collecting duties; and 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. Part of the passenger fees in the User Fees Account, totaling approximately \$743 million (unaudited) and \$784 million (unaudited) at September 30, 2010 and 2009, respectively, is restricted by law in its use to offset specific costs incurred by the Department and are available to the extent provided in Department 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.

The table below provides a reconciliation for the difference between Appropriations Received on the Statement of Budgetary Resources and the Statement of Changes in Net Position for the year ended September 30 (in millions).

	2010 (Unaudited)	2009 (Unaudited)
Statement of Budgetary Resources – Appropriations Received	\$55,852	\$52,839
Permanent and Indefinite Appropriations	(1,350)	(1,409)
User Fees, Immigration Fees, and Trust Funds, Net	(5,835)	(5,632)
Other	157	269
<b>Statement of Changes in Net Position – Appropriations Received</b>	<b>\$48,824</b>	<b>\$46,067</b>



## 29. Explanation of Differences between the Statement of Budgetary Resources and the Budget of the U.S. Government

The table below documents the material differences between the FY 2009 Statement of Budgetary Resources (SBR) and the actual amounts reported for FY 2009 in the Budget of the U.S. Government. Since the FY 2010 financial statements will be reported prior to the release of the Budget of the U.S. Government, DHS is reporting for FY 2009 only. Typically, the Budget of the U.S. Government with the FY 2010 actual data is published in February of the subsequent year. Once published, the FY 2010 actual data will be available on the OMB web site at:

[www.whitehouse.gov/omb](http://www.whitehouse.gov/omb).

	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
<b>FY 2009 Actual Balances per the FY 2011 President's Budget (in millions) (Unaudited)</b>	<b>\$84,768</b>	<b>\$70,471</b>	<b>\$5,213</b>	<b>\$56,945</b>
<b>Reconciling Items:</b>				
Accounts that are expired that are not included in Budget of the United States.	1,590	174	-	-
Distributed Offsetting Receipts not included in the Budget of the United States.	-	-	-	(5,213)
Refunds and drawbacks not included in the Budget of the United States.	922	226	-	226
Byrd Program (Continued Dumping and Subsidy Offset) not included in the Budget of the United States.	1,217	1,217	-	1,092
Biodefense Countermeasure Program included in the Budget of the United States.	(3,194)	(161)	-	(224)
Miscellaneous Differences	9	2	-	(5)
<b>Per the 2009 SBR (Unaudited)</b>	<b>\$85,312</b>	<b>\$71,929</b>	<b>\$5,213</b>	<b>\$52,821</b>

### 30. *Undelivered Orders, Unpaid, End of Period*

An unpaid undelivered order exists when a valid obligation has occurred and funds have been reserved but the goods or services have not been delivered. Undelivered orders for the periods ended September 30, 2010 and 2009, were \$43,445 million (unaudited) and \$41,566 million (unaudited and restated), respectively.

### 31. *Custodial Revenues*

The Department collects revenue from a variety of duties, excise taxes, and various other fees. Collection activity primarily relates to current-year activity. Non-entity revenue reported on the Department's Statement of Custodial Activity include duties, excise taxes, and various non-exchange fees collected by CBP and user fees collected by USCIS that are subsequently remitted to the Treasury 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.

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 collected on behalf of the Federal Government.
- **User fees:** amounts designed to maintain U.S. harbors and to defray the cost of other miscellaneous service programs. User fees include application fees collected from employers sponsoring nonimmigrant petitions.
- **Excise taxes:** amounts collected on imported distilled spirits, wines, and tobacco products.
- **Fines and penalties:** amounts collected for violations of laws and regulations.

Refunds are amounts due to the importer/exports as a result of overpayments of duties, taxes, fees, and interest. Refunds include drawback remittance paid when imported merchandise, for which duty was previously paid, is exported from the United States.

Tax disbursements from the refunds and drawbacks account, broken out by revenue type and by tax year, were as follows for the fiscal years ended September 30, 2010 and 2009 (in millions) (unaudited):



	<b>2010 Tax Disbursements</b>			
	Tax Year			
	2010	2009	2008	Prior Years
Customs duties	\$767	\$154	\$74	\$284
Total non-exchange revenue refunded	767	154	74	284
Exchange revenue refunded	-	-	-	-
Total tax refunds and drawbacks disbursed	<b>\$767</b>	<b>\$154</b>	<b>\$74</b>	<b>\$284</b>

	<b>2009 Tax Disbursements</b>			
	Tax Year			
	2009	2008	2007	Prior Years
Customs duties	\$755	\$176	\$71	\$365
Total non-exchange revenue refunded	755	176	71	365
Exchange revenue refunded	-	-	-	-
Total tax refunds and drawbacks disbursed	<b>\$755</b>	<b>\$176</b>	<b>\$71</b>	<b>\$365</b>

The disbursements include interest payments of \$35 million and \$85 million for the fiscal years ended September 30, 2010 and 2009, respectively (unaudited).

The disbursement totals for refunds include antidumping and countervailing duties collected that are refunded pursuant to rulings by DOC. These duties are refunded when the DOC issues a decision in favor of the foreign industry. See Note 18, Other Liabilities, for more information.

The total amounts of antidumping and countervailing duties vary from year to year depending on decisions from DOC. Antidumping and countervailing duty refunds (included in total refunds presented above) and associated interest refunded for the fiscal years ended September 30, 2010 and 2009, consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Antidumping and Countervailing Duty Refunds	\$43	\$29
Interest	-	1
<b>Total Antidumping and Countervailing Duty Refunds</b>	<b>\$43</b>	<b>\$30</b>



## 32. Restatements

### A. USCIS Restatement (Unaudited)

**Contingent Liabilities.** The Department restated the FY 2009 financial statements to correct the contingent liabilities balance due to a change in status. The status of the contingent liability changed due to a clause included in the *FY 2010 Appropriations Act*. This correction was recorded in the USCIS financial statements but was not received in time to be recorded in the Department FY 2009 *Annual Financial Report (AFR)*, thus requiring adjustments to each of the principal financial statements and related footnotes, except for the Statement of Budgetary Resources and Statement of Custodial Activity, as follows:

- A.1 – Decrease other non-governmental liabilities by \$100 million;
- A.2 – Decrease operating expense by \$100 million; and
- A.3 – Increase cumulative results of operations – earmarked funds and net position by \$100 million.

### B. U.S. Coast Guard Restatement (Unaudited)

**Accounts Payable.** The Department restated the FY 2009 financial statements to correct the accounts payable balances. The FY 2009 medical accrual to DOD facilities was corrected to be reported as a Federal accounts payable. This restatement required adjustments to the Balance Sheet, as follows:

- B.1 – Increase intragovernmental accounts payable by \$72 million; and
- B.2 – Decrease non-governmental accounts payable by \$72 million.

**Inventory.** The Department restated the FY 2009 financial statements to correct errors in the reporting of the Coast Guard Field Units operating materials and supplies. Correction of these errors required adjustments to the Balance Sheet and Statement of Changes in Net Position and related footnotes as follows:

- B.3 – Decrease inventory and related property, net by \$127 million;
- B.4 – Decrease cumulative results of operations – other funds and net position by \$127 million;
- B.5 – Increase operating expense by \$30 million; and
- B.6 – Decrease beginning balance FY 2009 cumulative results of operations by \$97 million.

**Actuarial Liability.** The Department restated the FY 2009 financial statements to correct errors in the actuarial liabilities for the U.S. Coast Guard's Military Retirement, Military Health, and Post-Employment benefit balances. The overstatements of actuarial liabilities were caused by data importation and database construction errors. Correction of these estimates required adjustments to each of the principal financial statements and related footnotes, except for the Statement of Budgetary Resources and Statement of Custodial Activity, as follows:



- B.7 – Decrease Federal employee and veteran benefits by \$1,588 million;
- B.8 – Decrease operating expense by \$1,588 million; and
- B.9 – Increase cumulative results of operations – other funds and net position by \$1,588 million.

### C. FLETC Restatement (Unaudited)

**Environmental Disposal Liabilities.** The Department restated the FY 2009 financial statements to correct errors in the environmental and disposal liabilities. The understatement of environmental and disposal liabilities was caused by additional cleanup costs that were recorded in the FLETC financial statements but were not received in time to be recorded in the published Department FY 2009 AFR, thus requiring adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Budgetary Resources and the Statement of Custodial Activity, as follows:

- C.1 – Increase environmental disposal liabilities by \$1 million;
- C.2 – Increase operating expense by \$1 million; and
- C.3 – Decrease cumulative results of operations – other funds and net position by \$1 million.

**Retirement Costs.** The Department restated the FY 2009 financial statements to correct errors in retirement costs. A correction in OPM retirement costs was recorded in the FLETC financial statements but was not received in time to be recorded in the published Department FY 2009 AFR, thus requiring adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Budgetary Resources and the Statement of Custodial Activity, as follows:

- C.4 – Decrease imputed financing by \$6 million; and
- C.5 – Decrease operating expense by \$6 million.

**Unexpended Appropriations.** The Department restated the FY 2009 financial statements to correct errors in unexpended appropriations due to invalid appropriations posted in reimbursable funds. A correction to unexpended appropriations was recorded in the FLETC financial statements but was not received in time to be recorded in the published Department FY 2009 AFR, thus requiring adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Budgetary Resources and the Statement of Custodial Activity, as follows:

- C.6 – Increase unexpended appropriations – other funds by \$6 million;
- C.7 – Increase operating expense by \$6 million;
- C.8 – Decrease cumulative results of operations – other funds and net position by \$6 million; and
- C.9 – Increase other adjustments by \$6 million.

### D. TSA Restatement (Unaudited)

**Accounts Payable.** The Department restated the FY 2009 financial statements to correct errors in the Accounts Payable balance due to under-accruing for TSA's Other Transaction Agreements and purchase card disbursements. The correction was recorded in the TSA financial statements but was



not received in time to be recorded in the published Department FY 2009 AFR. This error required correcting adjustments to each of the principal financial statements and related footnotes, except for the Statement of Budgetary Resources and Statement of Custodial Activity, as follows:

- D.1 – Increase non-governmental accounts payable by \$55 million;
- D.2 – Decrease unexpended appropriations - other funds by \$47 million;
- D.3 – Increase appropriations used by \$47 million;
- D.4 – Increase operating expense by \$55 million;
- D.5 – Decrease cumulative results of operations – earmarked funds and net position by \$3 million; and
- D.6 – Decrease cumulative results of operations – other funds and net position by \$5 million.

**Personal Property and Equipment.** The Department restated the FY 2009 financial statements to correct errors in property, plant, and equipment balances and transactions, as described below:

- Property-related goods and services were received but not accrued/paid at the end of the fiscal year; and
- TSA erroneously applied the incorrect useful life for certain equipment.

Correction of these errors required adjustments to each of the principal financial statements and related footnotes, except for the Statement of Budgetary Resources and Statement of Custodial Activity, as follows:

- D.7 – Decrease general property, plant, and equipment, net by \$4 million;
- D.8 – Decrease operating expense by \$38 million;
- D.9 – Decrease cumulative results of operations – other funds and net position by \$4 million; and
- D.10 – Decrease beginning balance FY 2009 cumulative results of operations by \$42 million.

**Transportation Security Equipment (TSE).** During FY 2009, TSA performed a subsequent analysis of the other direct costs associated with TSE to determine if they were capitalized. This analysis revealed that TSA had understated its TSE balance. The correction of this error required adjustments to each of the principal financial statements and related footnotes, except the Statement of Budgetary Resources and Statement of Custodial Activity, as follows:

- D.11 – Increase general property, plant, and equipment, net by \$155 million;
- D.12 – Increase cumulative results of operations – other funds and net position by \$155 million;
- D.13 – Decrease operating expense by \$58 million; and
- D.14 – Increase beginning balance FY 2009 cumulative results of operations by \$97 million.

**Stewardship Property, Plant and Equipment.** During FY 2010, TSA identified collection-type heritage assets that were not reported during FY 2009. This resulted in changes to FY 2009 balances in Note 12, Stewardship Property, Plant and Equipment.



### **E. Other Restatements (Unaudited)**

The Department recorded miscellaneous restatements to correct various errors as follows:

- E.1 – Increase unexpended appropriations – other funds by \$5 million;
- E.2 – Decrease cumulative results of operations – other funds and net position by \$5 million;
- E.3 – Increase appropriations used by \$1 million;
- E.4 – Decrease other financing sources by \$6 million;
- E.5 – Increase other adjustments by \$6 million;
- E.6 – Increase spending authority from offsetting collections-earned-collected by \$1 million;
- E.7 – Increase obligations incurred direct by \$1 million;
- E.8 – Increase obligations incurred, net by \$1 million;
- E.9 – Decrease gross outlays by \$1 million;
- E.10 – Increase net outlays-gross outlays by \$1 million; and
- E.11 – Decrease offsetting collections by \$1 million.

The Department restated FY 2009 balances primarily as a result of actions completed to correct financial management weaknesses reported in prior financial statement audit reports. The Department is taking corrective actions related to the causes of the restatements.



<b>BALANCE SHEET, in millions</b>	<b>Original 2009</b>	<b>Effects of Restatements</b>	<b>Restated 2009</b>	<b>Description Reference</b>
<b>ASSETS</b>				
<b>Intragovernmental</b>				
Fund Balance with Treasury	\$57,172	\$ -	\$57,172	
Investments, Net	3,417	-	3,417	
Accounts Receivable	369	-	369	
Other				
Advances and Prepayments	2,688	-	2,688	
Due from Treasury	-	-	-	
<b>Total Intragovernmental</b>	<b>\$63,646</b>	<b>\$ -</b>	<b>\$63,646</b>	
Cash and Other Monetary Assets	57	-	57	
Accounts Receivable, Net	449	-	449	
Taxes, Duties, and Trade Receivables, Net	1,874	-	1,874	
Direct Loans, Net	55	-	55	
Inventory and Related Property, Net	562	(127)	435	B.3
General Property, Plant and Equipment, Net	17,546	151	17,697	D.7, D.11
Other				
Advances and Prepayments	591	-	591	
<b>TOTAL ASSETS</b>	<b>\$84,780</b>	<b>\$24</b>	<b>\$84,804</b>	
<b>LIABILITIES</b>				
<b>Intragovernmental</b>				
Accounts Payable	\$2,107	\$72	\$2,179	B.1
Debt	19,004	-	19,004	
Other				
Due to the General Fund	1,969	-	1,969	
Accrued FECA Liability	370	-	370	
Other	720	-	720	
<b>Total Intragovernmental</b>	<b>\$24,170</b>	<b>\$72</b>	<b>\$24,242</b>	
Accounts Payable	2,810	(17)	2,793	B.2, D.1
Federal Employee and Veteran Benefits	41,013	(1,588)	39,425	B.7
Environmental and Disposal Liabilities	1,011	1	1,012	C.1
Other				
Accrued Payroll	1,936	-	1,936	
Deferred Revenue and Advances from Others	2,629	-	2,629	
Unliquidated Antidumping and Countervailing Duties	106	-	106	
Insurance Liabilities	508	-	508	
Refunds and Drawbacks	126	-	126	
Other	1,825	(100)	1,725	A.1
<b>Total Liabilities</b>	<b>\$76,134</b>	<b>\$(1,632)</b>	<b>\$74,502</b>	



<b>BALANCE SHEET, in millions</b>	<b>Original 2009</b>	<b>Effects of Restatements</b>	<b>Restated 2009</b>	<b>Description Reference</b>
<b>Net Position</b>				
Unexpended Appropriations – Other Funds	\$49,319	\$(36)	\$49,283	C.6, D.2, E.1
Cumulative Results of Operations – Earmarked Funds	(15,507)	97	(15,410)	A.3, D.5
Cumulative Results of Operations – Other Funds	(25,166)	1,595	(23,571)	B.4, B.9, C.3, C.8, D.6, D.9, D.12, E.2
<b>Total Net Position</b>	<b>\$8,646</b>	<b>\$1,656</b>	<b>\$10,302</b>	
<b>TOTAL LIABILITIES AND NET POSITION</b>	<b>\$84,780</b>	<b>\$24</b>	<b>\$84,804</b>	

<b>STATEMENT OF NET COST, in millions</b>	<b>Original 2009</b>	<b>Effects of Restatements</b>	<b>Restated 2009</b>	<b>Description Reference</b>
<b>Directorates and Other Components</b>				
<i>U.S. Customs and Border Protection</i>				
Gross Cost	\$10,672	\$ -	\$10,672	
Less Earned Revenue	(166)	-	(166)	
<b>Net Cost</b>	<b>10,506</b>	<b>-</b>	<b>10,506</b>	
<i>U.S. Coast Guard</i>				
Gross Cost	13,832	(1,558)	12,274	B.5, B.8
Less Earned Revenue	(432)	-	(432)	
<b>Net Cost</b>	<b>13,400</b>	<b>(1,558)</b>	<b>11,842</b>	
<i>U.S. Citizenship and Immigration Services</i>				
Gross Cost	2,429	(100)	2,329	A.2
Less Earned Revenue	(2,696)	-	(2,696)	
<b>Net Cost</b>	<b>(267)</b>	<b>(100)</b>	<b>(367)</b>	
<i>Federal Emergency Management Agency</i>				
Gross Cost	14,748	-	14,748	
Less Earned Revenue	(3,193)	-	(3,193)	
<b>Net Cost</b>	<b>11,555</b>	<b>-</b>	<b>11,555</b>	
<i>Federal Law Enforcement Training Center</i>				
Gross Cost	449	1	450	C.2, C.5, C.7
Less Earned Revenue	(36)	-	(36)	
<b>Net Cost</b>	<b>413</b>	<b>1</b>	<b>414</b>	
<i>National Protection and Preparedness Directorate *</i>				
Gross Cost	2,032	-	2,032	
Less Earned Revenue	(822)	-	(822)	
<b>Net Cost</b>	<b>1,210</b>	<b>-</b>	<b>1,210</b>	
<i>U.S. Immigration and Customs Enforcement *</i>				
Gross Cost	5,173	-	5,173	
Less Earned Revenue	(166)	-	(166)	
<b>Net Cost</b>	<b>5,007</b>	<b>-</b>	<b>5,007</b>	

\* As discussed in Note 1, Summary of Significant Accounting Policies, the FY 2009 financial statements have been reclassified to conform with the FY 2010 presentation.



STATEMENT OF NET COST, in millions	Original 2009	Effects of Restatements	Restated 2009	Description Reference
<i>Office of Health Affairs</i>				
Gross Cost	414	-	414	
Less Earned Revenue	-	-	-	
<b>Net Cost</b>	<b>414</b>	<b>-</b>	<b>414</b>	
<i>Departmental Operations and Other</i>				
Gross Cost	1,776	-	1,776	
Less Earned Revenue	(2)	-	(2)	
<b>Net Cost</b>	<b>1,774</b>	<b>-</b>	<b>1,774</b>	
<i>U.S. Secret Service</i>				
Gross Cost	1,818	-	1,818	
Less Earned Revenue	(16)	-	(16)	
<b>Net Cost</b>	<b>1,802</b>	<b>-</b>	<b>1,802</b>	
<i>Science and Technology</i>				
Gross Cost	968	-	968	
Less Earned Revenue	(4)	-	(4)	
<b>Net Cost</b>	<b>964</b>	<b>-</b>	<b>964</b>	
<i>Transportation Security Administration</i>				
Gross Cost	7,032	(41)	6,991	D.4, D.8, D.13
Less Earned Revenue	(2,243)	-	(2,243)	
<b>Net Cost</b>	<b>4,789</b>	<b>(41)</b>	<b>4,748</b>	
<b>NET COST OF OPERATIONS</b>	<b>\$51,567</b>	<b>\$(1,698)</b>	<b>\$49,869</b>	





<b>STATEMENT OF CHANGES IN NET POSITION, in millions</b>	<b>Original 2009</b>	<b>Effects of Restatements</b>	<b>Restated 2009</b>	<b>Description Reference</b>
<b>Cumulative Results of Operations</b>				
Beginning Balances	\$(42,415)	\$ -	\$(42,415)	
Adjustments:				
Correction of Errors	-	(43)	(43)	B.6, D.10, D.14
Beginning Balance, as adjusted	\$(42,415)	\$(43)	\$(42,458)	
<b>Budgetary Financing Sources:</b>				
Appropriations Used	49,252	48	49,300	D.3, E.3
Non-Exchange Revenue	3,530	-	3,530	
Donations and Forfeitures of Cash and Cash Equivalents	3	-	3	
Transfers in/out without Reimbursement	(195)	-	(195)	
Other	(56)	(6)	(62)	E.4
<b>Other Financing Sources (Non-Exchange):</b>				
Donations and Forfeitures of Property	4	-	4	
Transfers in/out Reimbursement	11	-	11	
Imputed Financing	766	(6)	760	C.4
Other	(5)	-	(5)	
Total Financing Sources	53,309	36	53,346	A.2, B.5, B.8, C.2, C.5, C.7, D.4, D.8, D.13
Net Cost of Operations	(51,567)	1,698	(49,869)	
Net Change	1,742	1,735	3,477	
<b>Cumulative Results of Operations</b>	<b>(40,673)</b>	<b>1,692</b>	<b>(38,981)</b>	
<b>Unexpended Appropriations:</b>				
Beginning Balances	55,239	-	55,239	
<b>Budgetary Financing Sources:</b>				
Appropriations Received	46,067	-	46,067	
Appropriations transferred in/out	(2,064)	-	(2,064)	
Other Adjustments	(671)	12	(659)	C.9, E.5
Appropriations Used	(49,252)	(48)	(49,300)	D.3, E.3
Total Budgetary Financing Sources	(5,920)	(36)	(5,956)	
<b>Total Unexpended Appropriations</b>	<b>49,319</b>	<b>(36)</b>	<b>49,283</b>	
<b>NET POSITION</b>	<b>\$8,646</b>	<b>\$1,656</b>	<b>\$10,302</b>	



STATEMENT OF BUDGETARY RESOURCES, in millions	Original 2009		Effects of Restatements		Restated 2009		Description Reference
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	
<b>BUDGETARY RESOURCES</b>							
Unobligated Balance, Brought Forward, October 1	\$21,431	\$4	\$ -	\$ -	\$21,431	\$4	
Recoveries of Prior Year Unpaid Obligations	4,280	-	-	-	4,280	-	
Budget Authority:							
Appropriations	52,839	-	-	-	52,839	-	
Borrowing Authority	-	51	-	-	-	51	
Spending Authority from Offsetting Collections:							
Earned:							
Collected	9,541	88	1	-	9,542	88	E.6
Change in Receivable from Federal Sources	124	-	-	-	124	-	
Change in Unfilled Customer Orders:							
Advances Received Without Advance from Federal Sources	280	-	-	-	280	-	
Sources	(506)	(30)	-	-	(506)	(30)	
Expenditure transfers from Trust Funds	48	-	-	-	48	-	
Subtotal	62,326	109	1	-	62,327	109	
Non-expenditure Transfers, Net; Anticipated and Actual	(1,576)	-	-	-	(1,576)	-	
Temporarily Not Available Pursuant to Public Law	(4)	-	-	-	(4)	-	
Permanently Not Available	(1,212)	(47)	-	-	(1,212)	(47)	
<b>TOTAL BUDGETARY RESOURCES</b>	<b>\$85,245</b>	<b>\$66</b>	<b>\$1</b>	<b>\$ -</b>	<b>\$85,246</b>	<b>\$66</b>	



STATEMENT OF BUDGETARY RESOURCES, in millions	Original 2009		Effects of Restatements		Restated 2009		Description Reference
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	
<b>STATUS OF BUDGETARY RESOURCES</b>							
Obligations Incurred:							
Direct	\$67,635	\$66	\$1	\$ -	\$67,636	\$66	E.7
Reimbursable	4,227	-	-	-	4,227	-	
Subtotal	71,862	66	1	-	71,863	66	
Unobligated Balance:							
Apportioned	7,706	-	-	-	7,706	-	
Exempt from Apportionment	5	-	-	-	5	-	
Subtotal	7,711	-	-	-	7,711	-	
Unobligated Balance Not Available	5,672	-	-	-	5,672	-	
<b>TOTAL STATUS OF BUDGETARY RESOURCES</b>	<b>\$85,245</b>	<b>\$66</b>	<b>\$1</b>	<b>\$ -</b>	<b>\$85,246</b>	<b>\$66</b>	



STATEMENT OF BUDGETARY RESOURCES, in millions	Original 2009		Effects of Restatements		Restated 2009		Description Reference
	Budgetary	Non- Budgetary Credit Reform Financing Accounts	Budgetary	Non- Budgetary Credit Reform Financing Accounts	Budgetary	Non- Budgetary Credit Reform Financing Accounts	
<b>CHANGE IN OBLIGATED BALANCE</b>							
Obligated Balance, Net							
Unpaid Obligations Brought Forward, October 1	\$47,103	\$323	\$ -	\$ -	\$47,103	\$323	
Less: Uncollected Customer Payments from Federal Sources, brought forward, October 1	(2,427)	(323)	-	-	(2,427)	(323)	
Total Unpaid Obligated Balance, Net	44,676	-	-	-	44,676	-	
Obligations Incurred, Net	71,862	66	1	-	71,863	66	E.8
Less: Gross Outlays	(67,896)	(95)	(1)	-	(67,897)	(95)	E.9
Obligated Balance Transferred, Net							
Actual Transfers, Unpaid Obligations	(25)	-	-	-	(25)	-	
Total Unpaid Obligated Balance Transferred, Net	(25)	-	-	-	(25)	-	
Recoveries of Prior Year Unpaid Obligations, Actual	(4,280)	-	-	-	(4,280)	-	
Change in Uncollected Customer Payments from Federal Sources	383	30	-	-	383	30	
Obligated balance, Net End of Period							
Unpaid obligations	46,764	294	-	-	46,764	294	
Less: Uncollected customer payments from Federal Sources	(2,044)	(293)	-	-	(2,044)	(293)	
Total, unpaid obligated balance, net end of period	<b>\$44,720</b>	<b>\$1</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$44,720</b>	<b>\$1</b>	



STATEMENT OF BUDGETARY RESOURCES, in millions	Original 2009		Effects of Restatements		Restated 2009		Description Reference
	Budgetary	Non- Budgetary Credit Reform Financing Accounts	Budgetary	Non- Budgetary Credit Reform Financing Accounts	Budgetary	Non- Budgetary Credit Reform Financing Accounts	
<b>NET OUTLAYS</b>							
Gross Outlays	\$67,896	\$95	\$1	\$ -	\$67,897	\$95	E.10
Less: Offsetting Collections	(9,869)	(88)	(1)	-	(9,870)	(88)	E.11
Less: Distributed Offsetting Collections	(5,213)	-	-	-	(5,213)	-	
<b>NET OUTLAYS</b>	<b>\$52,814</b>	<b>\$7</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$52,814</b>	<b>\$7</b>	



### 33. Reconciliation of Net Cost of Operations (Proprietary) to Budget

The Reconciliation of Net Cost of Operations to Budget reconciles the Department’s Resources Used to Finance Activities (first section), which consists of the budgetary basis of accounting Net Obligations plus the proprietary basis of accounting Other Resources, to the proprietary basis of accounting Net Cost of Operations. The second section, Resources Used to Finance Items Not Part of the Net Cost of Operations, reverses out items included in the first section that are not included in Net Cost of Operations. The third section, Components of Net Cost of Operations that Will Not Require or Generate Resources in the Current Period, adds items included in the Net Cost of Operations that are not included in the first section.

The third section’s subsection, Components Requiring or Generating Resources in Future Periods, includes costs reported in the current period that are included in the Liabilities Not Covered by Budgetary Resources reported in Note 14. This subsection does not include costs reported in prior fiscal years that are also included in Liabilities Not Covered by Budgetary Resources.

The reconciliations of net cost of operations to budget for FY 2010 and FY 2009 are as follows:

	2010 (Unaudited)	2009 (Unaudited) (Restated)
	<u>          </u>	<u>          </u>
<b>Resources Used to Finance Activities</b>		
<b>Budgetary Resources Obligated</b>		
Obligations Incurred (Note 25)	\$68,012	\$71,929
Less: Spending Authority from Offsetting Collections and Recoveries	(14,533)	(13,826)
Obligations Net of Offsetting Collections and Recoveries	<u>53,479</u>	<u>58,103</u>
Less: Offsetting Receipts	(6,328)	(5,213)
Net Obligations	<u>47,151</u>	<u>52,890</u>
<b>Other Resources</b>		
Donations and Forfeiture of Property	3	4
Transfers In (Out) Without Reimbursement	120	11
Imputed Financing from Costs Absorbed by Others	1,064	760
Other	(78)	(5)
Net Other Resources Used to Finance Activities	<u>1,109</u>	<u>770</u>
<b>Total Resources Used to Finance Activities</b>	<u><b>\$48,260</b></u>	<u><b>\$53,660</b></u>



**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	\$1,192	\$(491)
Resources that Fund Expenses Recognized in Prior Periods	27	6,090
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations:		
Credit Program Collections that Increase Liabilities for Loan Guarantees or Allowances for Subsidy	33	88
Other	(3,504)	(2,172)
Resources that Finance the Acquisition of Assets	3,664	5,241
Other Resources or Adjustments to Net Obligated Resources that Do Not Affect Net Cost of Operations	1,229	1,436
<b>Total Resources Used to Finance Items Not Part of the Net Cost of Operations</b>	<u>2,641</u>	<u>10,192</u>
 <b>TOTAL RESOURCES USED TO FINANCE THE NET COST OF OPERATIONS</b>	 <u><b>\$45,619</b></u>	 <u><b>\$43,468</b></u>

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

**Components Requiring or Generating Resources in Future Periods**

Increase in Annual Leave Liability	\$109	\$100
Increase in Environmental and Disposal Liability	49	-
Increase in Exchange Revenue Receivable from the Public	(7)	1
Upward/Downward reestimates of credit subsidy expense	-	(5)
Other		
Increase in Actuarial Pension Liability	7,024	1,785
Increase in Actuarial Health Insurance Liability	1,754	2,051
Increase in USCG Military Post-Employment PCS Benefits and Other	1	-
Other	377	324
Total Components of Net Cost of Operations that Will Require or Generate Resources in Future Periods	9,307	4,256
<b>Components not Requiring or Generating Resources</b>		
Depreciation and Amortization	1,560	1,541
Revaluation of Assets or Liabilities	48	208
Other	(151)	396
Total Components of Net Cost of Operations that Will Not Require or Generate Resources	1,457	2,145
<b>Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period</b>	<u><b>10,764</b></u>	<u><b>6,401</b></u>
 <b>NET COST OF OPERATIONS</b>	 <u><u><b>\$56,383</b></u></u>	 <u><u><b>\$49,869</b></u></u>



## Required Supplementary Stewardship Information (Unaudited)

### *Stewardship Investments*

Stewardship investments are substantial investments made by the Federal Government for the benefit of the Nation. When incurred, stewardship investments are treated as expenses in calculating net cost, but they are separately reported as Required Supplementary Stewardship Information to highlight the extent of investments that are made for long-term benefit. The Department's expenditures (including carryover funds expended in FY 2010) in Human Capital, Research and Development, and Non-Federal Physical Property are shown below:

<b>Summary of Stewardship Investments (in millions) (unaudited)</b>					
	<b>FY 2010</b>	<b>FY 2009</b>	<b>FY 2008</b>	<b>FY 2007</b>	<b>FY 2006</b>
Research and Development	\$980	\$852	\$880	\$1,115	\$1,144
Human Capital	93	104	96	82	36
Non-Federal Physical Property	286	420	204	394	(118)
<b>Total</b>	<b>\$1,359</b>	<b>\$1,376</b>	<b>\$1,180</b>	<b>\$1,591</b>	<b>\$1,062</b>

#### **1. Investments in Research and Development**

Investments in research and development represent expenses incurred to support the search for new or refined knowledge and ideas. The intent of the investment is to apply or use such knowledge to develop new or improved products and processes with the expectation of maintaining or increasing national productive capacity or yielding other future benefits. TSA, U.S. Coast Guard, and S&T have made significant investments in research and development.

#### **TSA**

TSA has invested within three categories of applied research projects. These applied research projects include:

- Human factors research intended to enhance screener capabilities and increase human system effectiveness.
- Ongoing certification testing of screening technologies including Explosive Detection System and Explosives Trace Detection technology.
- Infrastructure protection research related to using biometrics for passenger access controls.

#### **U.S. Coast Guard**

The U.S. Coast Guard Research & Development Program invests in the application of research and development projects. The following are some of the major ongoing developmental projects:

- Develop a means to certify a shipboard system to insure aquatic nuisance species are eradicated before entering U.S. waters.



- Further develop the at-sea biometrics system that can identify individuals encountered at sea. Partner with and leverage the databases of other Government agencies.
- Adapt the U.S. Coast Guard Tactical Modeling (TME) for simulation-based analysis of operations in the Arctic. Develop and demonstrate the TME model's capabilities to provide decision support for analysts and researchers examining tactical alternatives for the Arctic theater of operations.
- Install prototypes and conduct a technology demonstration of a tidal generator as a source of electrical power for U.S. Coast Guard Station Eastport, Maine.
- Expand existing sensor modeling and simulation tools to incorporate multiple U.S. Coast Guard sensors against a wider range of targets from air, surface, and/or shore-based platforms to support analysis of multi-sensor searches in coordinated search and surveillance operations.

Significant accomplishments in development:

- Delivered a report, "Feasibility of Developing a Protocol for Automated Protist Analysis," that supported continued automated protest analysis work in ballast water treatment systems development.
- Explored capability for development of 10-print system that includes multi-modal biometrics (10-fingerprint, facial photo, and possibly an iris image) to be tested for potential fleet-wide deployment on cutter assets for multi-mission use. Work began on representation of full system data flow for current Biometrics at Sea System operations, maintenance, and support.
- Demonstrated the Arctic Tactical Modeling Environment, a prototype simulation model that measures the relative effectiveness of various force-deployment options in the Arctic Region. The proof-of concept analysis illustrated how the mode could be used to examine the U.S. Coast Guard's ability to achieve surface asset patrol area presence under changing scenarios and adding new resupply facilities.
- Baselined existing sensor modeling and simulation tool capabilities and documented target inventories (existing modes). This provided a listing of the gaps in Multi-Sensor Performance Prediction. Delivered high-level summary of the approach used and the results achieved, including a suggested meta-structure for integrating the software components that are currently used.

The following major new applications developments are ongoing:

- Develop and evaluate the most promising capabilities and techniques for recovering heavy viscous oil on the ocean floor and integrate those capabilities and techniques with heavy oil detection systems.
- Develop equipment and a detailed and accepted group of methodologies that can be used successfully to detect, track, and recover oil in ice-filled waters in all conditions in order to minimize the damage to the environment caused by spilled oil in extreme cold, either in the Arctic Region or the northern states in the United States.
- Explore the U.S. Coast Guard's needs with regard to alternative energy systems and the extent these systems are currently used throughout the U.S. Coast Guard. Baseline the carbon footprint of selected U.S. Coast Guard afloat assets. Investigate potential "green"



technology projects for powering U.S. Coast Guard afloat assets and the technologies that have the potential for providing renewable energy while lowering the carbon footprint.

- Investigate and develop modeling approaches that provide more efficacy in board-based decision support for current and future acquisition activities.
- Conduct a review of distress notification methods and determine the most effective methods and systems, or combinations, and propose carriage regulation changes that allow alternatives or a combination of alternatives to current requirements that are found to be less than effective.

Significant accomplishments in research:

- Evaluated test plans for adaptation of the existing dredge system technique for recovering heavy oil from the ocean floor. Prepared papers for Oil Spill Response conferences to communicate progress in heavy oil recovery technique research.
- Facilitated an Arctic Workshop that brought cold weather/Arctic and oil spill response subject matter experts and identified and prioritized issues with respect to preventing/mitigating oil-in-ice scenarios.
- Applied specific cost-estimating documents and material, such as the GAO guide and Work Breakdown Structure templates, to the development of the U.S. Coast Guard's *Cost Strategy and Cost Handbook*. This provided a high-level overview of U.S. Coast Guard and DHS requirements for cost estimating.

## **S&T**

The S&T Directorate has a research portfolio investment integrated through its divisions. For example, the Directorate conducts research in many areas to support the Department's missions to defend against chemical and biological threats, including protecting infrastructure and transportation systems from explosives, preparing the nation to respond to large- and small-scale events, and protecting the critical systems that run our financial and electrical power systems, to name a few. The S&T Directorate also develops new standards, educates the next-generation workforce, and conducts testing and evaluation activities to further increase the security of the nation.

Significant accomplishments in development include:

The development of a levee breaching plug represents one of the S&T Directorate's successes in developing technology to improve homeland security. Rapid repair of breaching levees is one priority identified by the S&T Directorate's customers. In FY 2009, S&T demonstrated a scaled prototype solution for rapidly closing a levee breach using a water-filled tube. This levee plug was deployed from a floating platform and guided into place where, due to the rushing water, it conformed to the breach and reduced the flow of water by approximately 95 percent.

In FY 2010, the S&T Directorate Domain Name System Security Extensions (DNSSEC) Signer software became commercially available. The DNSSEC Signer appliance is a turnkey "DNSSEC-in-a-box" solution that eliminates most, if not all, of the concerns associated with DNSSEC deployment. These concerns include complexity, cost, correct configurations, and security, and they are all addressed by the DNSSEC Signer. The successful deployment of DNSSEC will offer assured Internet communications, thwarting a large number of current Internet



attacks. The S&T Directorate also delivered secure wireless devices that will help secure wireless transmission for process control systems (PCSs). Improving security for PCSs is critical as they control water supply, electrical power, gas and oil pipelines, and other distributed processes.

## **2. Investments in Human Capital**

Investments in human capital include expenses incurred for programs to educate and train first responders. These programs are intended to increase or maintain national productive capacity as evidenced by outputs and outcomes. Based on a review of the Department's programs, FEMA and TSA have made significant investments in human capital.

### **FEMA**

FEMA has invested resources in educational, training, and professional development in the following areas:

- The National Fire Academy has been developed by FEMA to promote the professional development of the fire and emergency response community and its allied professionals. The National Fire Academy also develops and delivers educational and training courses with a national focus to supplement and support state and local fire service training programs.
- The Emergency Management Institute (EMI) serves as the national focal point for the development and delivery of emergency management training to enhance the capabilities of Federal, state, local, and tribal government officials, volunteer organizations, and the public and private sectors to minimize the impact of disasters on the American public. EMI curricula are structured to meet the needs of this diverse audience, with an emphasis on how the various elements work together in emergencies to save lives and protect property.
- The Center for Domestic Preparedness (CDP) is a Federal training center that specializes in providing advanced hands-on, all-hazards training for emergency responders. Its purpose is the "preparation of first responders by building, sustaining, and improving their capability to respond to all hazards." The CDP offers training to America's Federal, state, local, tribal, and private emergency responders—to include responders working in rural jurisdictions—in their missions to prevent, deter, respond to, and recover from terrorist acts, especially those involving weapons of mass destruction or hazardous materials. The CDP's training programs offer a selection of 43 courses and a fully certified, multi-disciplined instructional staff with an average of 19 years of experience in their respective emergency response fields. The CDP is the only congressionally chartered Weapons of Mass Destruction training center for civilians.

### **TSA**

TSA's Highway Watch Cooperative Agreement with the American Trucking Association (ATA) expanded ATA's Highway Watch program, which taught highway professionals to identify and report safety and security situations on our Nation's roads. The program provided training and communications infrastructure to prepare 400,000 transportation professionals to respond in the event they or their cargo are the target of a terrorist attack and to share valuable intelligence with TSA if they witness potential threats. The intelligence allows Federal agencies and industry stakeholders to quickly move to prevent an attack or to immediately respond if an attack occurs.



### 3. Investments in Non-Federal Physical Property

Investments in non-Federal physical property are expenses included in the calculation of net cost incurred by the reporting entity for the purchase, construction, or major renovation of physical property owned by State and local governments. TSA has made significant investments in non-Federal physical property.

#### TSA

*Airport Improvement Program.* To help facilitate Explosive Detection System (EDS) installations, TSA purchases and installs in-line EDS equipment through a variety of funding mechanisms, including congressionally authorized Letters of Intent (LOI). Since the modifications tend to be costly, the LOI is used to offset the costs incurred by commercial service airports for the modifications. TSA has issued 12 LOIs for 12 agreements to provide for the facility modifications necessary to accommodate in-line EDS screening solutions.

*Airport Renovation Program.* Under this program, TSA employs other transaction agreements (OTAs) to fund the installation of integrated and non-integrated EDS and explosive trace detection equipment as well as improvements to be made to the existing systems in the baggage handling area. These OTAs establish the respective cost-sharing obligations and other responsibilities of TSA and the specific entity (board, port, or authority) conducting the installations or improvements. All work will be completed in order to achieve compliance with the *Aviation and Transportation Security Act (ATSA)*, Pub. L. 107-71, November 19, 2001.

*American Recovery and Reinvestment Act.* TSA entered into OTAs with 36 airports. These agreements are funded by the *American Recovery and Reinvestment Act*. In FY 2009 and FY 2010, TSA obligated \$629.9 million: \$568 million for the electronic baggage screening program and \$61.9 million for closed circuit television cameras.

*Air Cargo.* On August 3, 2007, President Bush signed into law the *Implementing Recommendations of the 9/11 Commission Act of 2007 (9/11 Act)*, Pub. L. 110-53. The 9/11 Act required TSA to establish a system for industry to screen 100 percent of cargo transported on passenger aircraft in the United States at the piece-level, commensurate with passenger baggage. TSA met this requirement in August 2010. To comply, TSA has entered into OTAs with 47 freight forwarders totaling \$36.8 million.

*Intercity Bus Security Program.* This program provided funds to improve security for intercity bus operators and passengers. TSA awarded grants based on the following program categories:

- Vehicle-specific security enhancements to protect or isolate the driver, such as alarms and security mirrors.
- Monitoring, tracking, and communication technologies for over-the-road buses.
- Implementation and operation of passenger and baggage screening programs at terminals and over-the-road buses.
- Development of an effective security assessment/security plan that identifies critical security needs and vulnerabilities.



- Training for drivers, dispatchers, ticket agents, and other personnel in recognizing and responding to criminal attacks and terrorist threats, evacuation procedures, passenger screening procedures, and baggage inspection.



## Required Supplementary Information (Unaudited)

### 1. *Deferred Maintenance*

The Department Components use condition assessment to determine the deferred maintenance for each class of asset. The procedure includes reviewing equipment, building, and other structure logistic reports. Component logistic personnel identify maintenance not performed as scheduled and establish future performance dates. Logistic personnel use a condition assessment survey to determine the status of referenced assets according to the range of conditions shown below.

**Good.** Facility/equipment condition meets established maintenance standards, operates efficiently, and has a normal life expectancy. Scheduled maintenance should be sufficient to maintain the current condition. There is no deferred maintenance on buildings or equipment in good condition.

**Fair.** Facility/equipment condition meets minimum standards but requires additional maintenance or repair to prevent further deterioration, to increase operating efficiency, and to achieve normal life expectancy.

**Poor.** Facility/equipment does not meet most maintenance standards and requires frequent repairs to prevent accelerated deterioration and to provide a minimal level of operating function. In some cases, this includes condemned or failed facilities.

Based on periodic condition assessments, an indicator of condition is the percentage of facilities and items of equipment in each of the good, fair, or poor categories.

Deferred maintenance as of September 30, 2010, on general property, plant, and equipment and heritage assets was estimated to range from \$995 million (unaudited) to \$1,222 million (unaudited), and the condition of these assets ranges from poor to good. These amounts represent 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 performed but was delayed for a future period.

In FY 2009, the Department reported estimated deferred maintenance ranging from \$1,065 million (unaudited) to \$1,295 million (unaudited) on general property, plant, and equipment and heritage assets with a range of poor to good condition. These amounts represent 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 performed but was delayed for a future period.



A summary of deferred maintenance, by asset class, at September 30, 2010, follows (in millions) (unaudited):

	Low estimate	High estimate	Asset Condition
Building & Structures	\$828	\$1,012	Good to Poor
Equipment (vehicles and vessels)	92	112	Good to Fair
Equipment (Other)	69	84	Good to Fair
Heritage assets	6	14	Good to Poor
<b>Total</b>	<b>\$995</b>	<b>\$1,222</b>	

**2. Statement of Budgetary Resources**

The principal Statement of Budgetary Resources combines the availability, status, and outlays of the Department’s budgetary resources during FY 2010 and FY 2009. Presented on the following pages is the disaggregation of this combined information by DHS Components, which represent the responsibility segments that carry out the Department’s missions. As discussed in Note 1, Summary of Significant Accounting Policies, the FY 2009 financial statements have been reclassified to conform with the FY 2010 presentation.



## 2. Statement of Budgetary Resources

### Schedule of FY 2010 Budgetary Resources by Responsibility Segments (in millions) (unaudited) (page 1 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
<b>BUDGETARY RESOURCES</b>													
Unobligated Balance, Brought Forward, October 1	\$3,067	\$1,994	\$886	\$4,201	\$155	\$596	\$40	\$340	\$443	\$142	\$171	\$1,348	<b>\$13,383</b>
Recoveries of Prior Year Obligations	458	211	135	2,783	11	359	6	114	115	9	97	165	<b>4,463</b>
Budget Authority:													
Appropriations	12,944	10,353	2,649	12,228	291	5,792	139	1,635	1,318	1,727	1,007	5,769	<b>55,852</b>
Borrowing Authority	-	-	-	-	-	-	-	-	-	-	-	-	-
Spending Authority from Offsetting Collections:													
Earned:													
Collected	1,586	419	32	3,819	134	174	38	652	1,087	15	90	1,900	<b>9,946</b>
Change in Receivable from Federal Sources	(21)	3	(34)	6	(15)	9	-	2	(29)	4	(3)	(1)	<b>(79)</b>
Change in Unfilled Customer Orders:													
Advance Received	1	(14)	1	(285)	-	(1)	-	49	1	-	17	1	<b>(230)</b>
Without Advance from Federal Sources	(7)	205	(3)	24	16	(35)	-	92	16	10	72	(5)	<b>385</b>
Previously Unavailable	-	-	-	30	-	-	-	-	-	-	-	-	<b>30</b>
Expenditure Transfers from Trust Funds	3	45	-	-	-	-	-	-	-	-	-	-	<b>48</b>
Subtotal	14,506	11,011	2,645	15,822	426	5,939	177	2,430	2,393	1,756	1,183	7,664	<b>65,952</b>
Nonexpenditure Transfers, Net; Anticipated and Actual	297	785	7	(15)	-	(1)	(2)	21	(3)	16	-	-	<b>1,105</b>
Temporarily Not Available Pursuant to Public Law	-	-	-	(32)	-	-	-	-	-	-	-	-	<b>(32)</b>
Permanently Not Available	(536)	(303)	(5)	(591)	(5)	(63)	-	(43)	(56)	(28)	(11)	(30)	<b>(1,671)</b>
<b>TOTAL BUDGETARY RESOURCES</b>	<b>\$17,792</b>	<b>\$13,698</b>	<b>\$3,668</b>	<b>\$22,168</b>	<b>\$587</b>	<b>\$6,830</b>	<b>\$221</b>	<b>\$2,862</b>	<b>\$2,892</b>	<b>\$1,895</b>	<b>\$1,440</b>	<b>\$9,147</b>	<b>\$83,200</b>
<b>STATUS OF BUDGETARY RESOURCES</b>													
Obligations Incurred:													
Direct	13,554	10,871	2,637	16,368	354	5,922	161	1,786	1,283	1,729	1,112	7,567	<b>63,344</b>
Reimbursable	1,591	419	23	220	98	156	40	805	1,114	29	168	5	<b>4,668</b>
Subtotal	15,145	11,290	2,660	16,588	452	6,078	201	2,591	2,397	1,758	1,280	7,572	<b>68,012</b>
Unobligated Balance:													
Apportioned	64	2,198	372	5,079	108	201	15	199	367	76	154	1,357	<b>10,190</b>
Exempt from Apportionment	-	2	-	3	-	-	-	-	-	-	-	-	<b>5</b>
Subtotal	64	2,200	372	5,082	108	201	15	199	367	76	154	1,357	<b>10,195</b>
Unobligated Balance Not Available	2,583	208	636	498	27	551	5	72	128	61	6	218	<b>4,993</b>
<b>TOTAL STATUS OF BUDGETARY RESOURCES</b>	<b>\$17,792</b>	<b>\$13,698</b>	<b>\$3,668</b>	<b>\$22,168</b>	<b>\$587</b>	<b>\$6,830</b>	<b>\$221</b>	<b>\$2,862</b>	<b>\$2,892</b>	<b>\$1,895</b>	<b>\$1,440</b>	<b>\$9,147</b>	<b>\$83,200</b>





Schedule of FY 2010 Budgetary Resources by Responsibility Segments (in millions) (unaudited) (page 2 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
<b>CHANGE IN OBLIGATED BALANCES</b>													
Obligated Balance, Net													
Unpaid Obligations Brought Forward, October 1	\$4,568	\$3,985	\$971	\$26,588	\$178	\$2,074	\$491	\$1,820	\$1,542	\$296	\$1,036	\$3,509	\$47,058
Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(200)	(178)	(47)	(915)	(126)	(121)	(9)	(360)	(270)	(8)	(92)	(11)	(2,337)
Total Unpaid Obligated Balance, Net	4,368	3,807	924	25,673	52	1,953	482	1,460	1,272	288	944	3,498	44,721
Obligations Incurred, Net	15,145	11,290	2,660	16,588	452	6,078	201	2,591	2,397	1,758	1,280	7,572	68,012
Gross Outlays	(14,194)	(10,391)	(2,529)	(13,960)	(417)	(5,729)	(247)	(2,334)	(2,183)	(1,685)	(1,056)	(6,955)	(61,680)
Obligated Balance Transferred, Net	-	-	-	26	-	-	-	-	-	-	-	-	26
Recoveries of Prior Year Unpaid Obligations	(458)	(211)	(135)	(2,783)	(11)	(359)	(6)	(114)	(115)	(9)	(97)	(165)	(4,463)
Change in Uncollected Customer Payments from Federal Sources	28	(209)	37	(30)	(1)	26	-	(94)	13	(15)	(68)	7	(306)
Obligated Balance, Net End of Period													
Unpaid Obligations	5,061	4,672	966	26,407	202	2,064	440	1,963	1,641	360	1,164	3,962	48,902
Uncollected Customer Payments from Federal Sources	(172)	(386)	(9)	(945)	(127)	(95)	(10)	(454)	(257)	(23)	(161)	(5)	(2,644)
Total, Unpaid Obligated Balance, Net, End of Period	4,889	4,286	957	25,462	75	1,969	430	1,509	1,384	337	1,003	3,957	46,258
<b>NET OUTLAYS</b>													
Net Outlays													
Gross Outlays	14,194	10,391	2,529	13,960	417	5,729	247	2,334	2,183	1,685	1,056	6,955	61,680
Offsetting Collections	(1,591)	(450)	(33)	(3,533)	(134)	(174)	(38)	(701)	(1,088)	(15)	(107)	(1,900)	(9,764)
Distributed Offsetting Receipts	(2,467)	(488)	(2,777)	(175)	-	(168)	-	(2)	1	-	-	(252)	(6,328)
Net Outlays	\$10,136	\$9,453	\$(281)	\$10,252	\$283	\$5,387	\$209	\$1,631	\$1,096	\$1,670	\$949	\$4,803	\$45,588



Schedule of FY 2009 Budgetary Resources by Responsibility Segments (in millions) (unaudited and restated) (page 1 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
<b>BUDGETARY RESOURCES</b>													
Unobligated Balance, Brought Forward, October 1	\$2,549	\$1,792	\$971	\$13,573	\$140	\$525	\$10	\$305	\$543	\$63	\$174	\$790	\$21,435
Recoveries of Prior Year Obligations	371	167	77	3,055	12	183	6	91	112	-	55	151	4,280
Budget Authority:													
Appropriations	13,186	9,864	2,353	7,778	333	5,334	2,332	1,790	1,158	1,750	934	6,027	52,839
Borrowing Authority	-	-	-	51	-	-	-	-	-	-	-	-	51
Spending Authority from Offsetting Collections:													
Earned:													
Collected	1,598	486	29	3,569	141	158	33	542	991	23	40	2,020	9,630
Change in Receivable from Federal Sources	11	9	35	26	10	20	(1)	(8)	21	(1)	3	(1)	124
Change in Unfilled Customer Orders:													
Advance Received	-	3	-	282	-	(1)	-	(2)	-	(1)	(1)	-	280
Without Advance From Federal Sources	(92)	(24)	(4)	(467)	(12)	(30)	5	97	(40)	(4)	37	(2)	(536)
Previously Unavailable	-	-	-	-	-	-	-	-	-	-	-	-	-
Expenditure Transfers from Trust Funds	3	45	-	-	-	-	-	-	-	-	-	-	48
Subtotal	14,706	10,383	2,413	11,239	472	5,481	2,369	2,419	2,130	1,767	1,013	8,044	62,436
Nonexpenditure Transfers, Net; Anticipated and Actual	321	246	(17)	(26)	-	11	(2,176)	35	30	-	-	-	(1,576)
Temporarily Not Available Pursuant to Public Law	-	-	-	(4)	-	-	-	-	-	-	-	-	(4)
Permanently Not Available	(279)	(249)	(9)	(594)	(4)	(13)	-	(47)	(7)	(11)	(14)	(32)	(1,259)
<b>TOTAL BUDGETARY RESOURCES</b>	<b>\$17,668</b>	<b>\$12,339</b>	<b>\$3,435</b>	<b>\$27,243</b>	<b>\$620</b>	<b>\$6,187</b>	<b>\$209</b>	<b>\$2,803</b>	<b>\$2,808</b>	<b>\$1,819</b>	<b>\$1,228</b>	<b>\$8,953</b>	<b>\$85,312</b>
<b>STATUS OF BUDGETARY RESOURCES</b>													
Obligations Incurred:													
Direct	\$13,075	\$9,859	\$2,528	\$22,959	\$289	\$5,443	\$131	\$1,861	\$1,323	\$1,661	\$971	\$7,602	\$67,702
Reimbursable	1,527	486	21	83	176	154	39	601	1,035	17	85	3	4,227
Subtotal	14,602	10,345	2,549	23,042	465	5,597	170	2,462	2,358	1,678	1,056	7,605	71,929
Unobligated Balance:													
Apportioned	64	1,565	422	3,251	134	287	36	238	326	53	166	1,164	7,706
Exempt from Apportionment	-	2	-	3	-	-	-	-	-	-	-	-	5
Subtotal	64	1,567	422	3,254	134	287	36	238	326	53	166	1,164	7,711
Unobligated Balance Not Available	3,002	427	464	947	21	303	3	103	124	88	6	184	5,672
<b>TOTAL STATUS OF BUDGETARY RESOURCES</b>	<b>\$17,668</b>	<b>\$12,339</b>	<b>\$3,435</b>	<b>\$27,243</b>	<b>\$620</b>	<b>\$6,187</b>	<b>\$209</b>	<b>\$2,803</b>	<b>\$2,808</b>	<b>\$1,819</b>	<b>\$1,228</b>	<b>\$8,953</b>	<b>\$85,312</b>



Schedule of FY 2009 Budgetary Resources by Responsibility Segments (in millions) (unaudited and restated) (page 2 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
<b>CHANGE IN OBLIGATED BALANCES</b>													
Obligated Balance, Net													
Unpaid Obligations brought forward, Oct 1	\$5,378	\$3,887	\$1,049	\$26,796	\$161	\$2,070	\$758	\$1,612	\$1,316	\$346	\$1,107	\$2,946	<b>\$47,426</b>
Uncollected customer payments from federal sources, brought forward, Oct 1	(280)	(193)	(16)	(1,357)	(128)	(131)	(5)	(272)	(288)	(14)	(52)	(14)	<b>(2,750)</b>
Total unpaid obligated balance, net	5,098	3,694	1,033	25,439	33	1,939	753	1,340	1,028	332	1,055	2,932	<b>44,676</b>
Obligations incurred, net	14,602	10,345	2,549	23,042	465	5,597	170	2,462	2,358	1,678	1,056	7,605	<b>71,929</b>
Gross Outlays	(15,041)	(10,081)	(2,550)	(20,169)	(435)	(5,423)	(430)	(2,163)	(2,008)	(1,729)	(1,072)	(6,891)	<b>(67,992)</b>
Obligated balance transferred, net	-	-	-	(25)	-	-	-	-	-	-	-	-	<b>(25)</b>
Recoveries of Prior Year Unpaid Obligations	(371)	(167)	(77)	(3,055)	(12)	(183)	(6)	(91)	(112)	-	(55)	(151)	<b>(4,280)</b>
Change in uncollected customer payments from Federal Sources	81	16	(31)	441	1	9	(5)	(88)	20	6	(40)	3	<b>413</b>
Obligated balance, net end of Period													
Unpaid Obligations	4,569	3,985	971	26,588	178	2,060	491	1,820	1,556	295	1,036	3,509	<b>47,058</b>
Uncollected customer payments from Federal Sources	(200)	(178)	(47)	(915)	(126)	(121)	(9)	(360)	(270)	(8)	(92)	(11)	<b>(2,337)</b>
Total, unpaid obligated balance, net, end of period	4,369	3,807	924	25,673	52	1,939	482	1,460	1,286	287	944	3,498	<b>44,721</b>
<b>NET OUTLAYS</b>													
Net Outlays													
Gross Outlays	15,041	10,081	2,550	20,169	435	5,423	430	2,163	2,008	1,729	1,072	6,891	<b>67,992</b>
Offsetting collections	(1,601)	(534)	(30)	(3,850)	(141)	(157)	(33)	(540)	(990)	(23)	(39)	(2,020)	<b>(9,958)</b>
Distributed offsetting receipts	(2,281)	(26)	(2,485)	(5)	-	(154)	-	(11)	-	-	-	(251)	<b>(5,213)</b>
<b>Net Outlays</b>	<b>\$11,159</b>	<b>\$9,521</b>	<b>\$35</b>	<b>\$16,314</b>	<b>\$294</b>	<b>\$5,112</b>	<b>\$397</b>	<b>\$1,612</b>	<b>\$1,018</b>	<b>\$1,706</b>	<b>\$1,033</b>	<b>\$4,620</b>	<b>\$52,821</b>



### ***3. Statement of Custodial Activity***

Substantially all duty, tax, and fee revenues collected by CBP are remitted to various General Fund accounts maintained by Treasury and the U.S. Department of Agriculture. Treasury further distributes these revenues to other Federal agencies in accordance with various laws and regulations. CBP either transfers the remaining revenue (generally less than one percent of revenues collected) directly to other Federal agencies or the Governments of Puerto Rico and the U.S. Virgin Islands. Refunds of revenues collected from import/export activities 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 all regulations are followed. If CBP determines 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 the claim of a lower amount due or to cancel the additional amount due in its entirety. 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 2010 and FY 2009, CBP had legal right to collect \$2.5 billion and \$1.9 billion of receivables, respectively (unaudited). In addition, there were \$2.4 billion and \$2.2 billion representing records still in the protest phase for FY 2010 and FY 2009, respectively (unaudited). CBP recognized as write-offs \$43 million and \$397 million, respectively (unaudited), of assessments that the Department had statutory authority to collect at September 30, 2010 and 2009, but have no future collection potential. Most of this amount represents fines, penalties, and interest.

### ***4. Risk Assumed Information***

The Department has performed an analysis of the contingencies associated with the unearned premium reserve for the NFIP. The underlying calculation estimates the amount of subsidy in the total rates, removes the expense load, and applies the results to the unearned premium reserve. The range is designed to straddle the resulting estimate of unpaid expected losses by \$500 to \$550 million (unaudited).

Actual flood losses are highly variable from year to year. For the majority of years, this unearned premium reserve is adequate to pay the losses and expenses associated with this unearned premium. In those years with catastrophic flooding, the reserve will prove inadequate, and the average across all years will be inadequate because of the subsidies in premium levels.



## Independent Auditors' Report

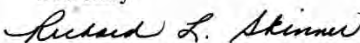
Office of Inspector General

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

# Homeland Security

NOV 12 2010

MEMORANDUM FOR: The Honorable Janet Napolitano  
Secretary

FROM:   
Richard L. Skinner  
Inspector General

SUBJECT: *Independent Auditor's Report on DHS' FY 2010 Financial  
Statements and Internal Control over Financial Reporting*

The attached report presents the results of the Department of Homeland Security's (DHS) financial statement audits for fiscal years (FY) 2010 and 2009 and the results of an examination of internal control over financial reporting of the balance sheet as of September 30, 2010, and the statement of custodial activity for FY 2010. These are mandatory audits required by the *Chief Financial Officers Act of 1990*, as amended by the *Department of Homeland Security Financial Accountability Act of 2004*. This report is incorporated in the department's FY 2010 *Annual Financial Report*. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the integrated audit.

Generally, the department continued to show modest improvement in financial reporting during FY 2010, but still has much work to do. Many of DHS' challenges in financial management and reporting can be attributed to the original stand-up of a complex executive branch agency without adequate organizational expertise in financial management and accounting. Consequently, for the sixth year, KPMG was unable to express an opinion on the department's balance sheet and statement of custodial activity. Additionally, KPMG was unable to perform procedures necessary to form an opinion on DHS' internal control over financial reporting of the FY 2010 balance sheet and statement of custodial activity.

### Summary

KPMG was unable to express an opinion on the department's balance sheets as of September 30, 2010 and 2009, and the related statements of custodial activity for the years then ended. DHS was unable to represent that certain financial statement balances were correct and was unable to provide sufficient evidence to support its financial statements. Additionally, KPMG was unable to perform the examination procedures necessary to form an opinion on DHS' internal control over financial reporting of the balance sheet as of September 30, 2010, and the statement of custodial activity for the year then ended.



The FY 2010 Independent Auditor's Report discusses six significant deficiencies considered to be material weaknesses, two other significant deficiencies in internal control, and six instances of non-compliance with laws and regulations, as follows:

**Significant Deficiencies That Are Considered To Be Material Weaknesses**

- Financial Management and Reporting
- Information Technology Controls and System Functionality
- Fund Balance with Treasury
- Property, Plant, and Equipment
- Actuarial and Other Liabilities
- Budgetary Accounting

**Other Significant Deficiencies**

- Entity-Level Controls
- Custodial Revenue and Drawback

**Non-compliance with Laws and Regulations**

- *Federal Managers' Financial Integrity Act of 1982 (FMFIA), and laws and regulations supporting OMB Circular No. A-50, Audit Follow-up, as revised*
- *Federal Financial Management Improvement Act of 1996 (FFMIA)*
- *Single Audit Act Amendments of 1996, and laws and regulations supporting OMB Circular No. A-50, Audit Follow-up, as revised*
- *Chief Financial Officers Act of 1990*
- *Anti-deficiency Act*
- *Government Performance and Results Act of 1993*

**Moving DHS' Financial Management Forward**

While the auditors noted improvement toward correction of internal control weaknesses, the increase in audit scope related to auditing internal control over financial reporting resulted in our independent auditors identifying significant departmental challenges that have a pervasive impact on the effectiveness of internal control over consolidated financial reporting. Specifically:

- Development and implementation of effective information and communication processes to help ensure that technical accounting issues are identified, analyzed and resolved in a timely manner. For example, development of an accounting position and/or responses to our questions at the U.S. Customs and Border Protection (CBP), Federal Emergency Management Agency (FEMA) and Transportation Security Administration (TSA), is often a time-consuming process, that spans several months, even for some less complex matters;



- Generally, the components continue to be dependent on the external financial statement audit to discover and resolve technical accounting issues;
- Field and operational personnel do not always share responsibilities for, or are not held accountable for, financial management matters that affect the financial statements, including adhering to accounting policies and procedures and performing key internal control functions in support of financial reporting; and
- The Department's financial Information Technology (IT) system infrastructure is aging and has limited functionality, which is hindering the Department's ability to implement efficient corrective actions and produce reliable financial statements that can be audited. Weaknesses in the general control environment are interfering with more extensive use of IT application controls to improve efficiencies in operations and reliability of financial information.

In FY 2010, the department reduced the number of conditions leading to the independent auditors' disclaimer of opinion on DHS' financial statements from two to one. As a result, TSA no longer contributes to the disclaimer condition. However, the department was unable to represent that its financial statements as of, and for the year ended, September 30, 2010, were presented in conformity with U.S. generally accepted accounting principles due to conditions existing in FY 2009 that remained at the U.S. Coast Guard (Coast Guard) throughout FY 2010. The Coast Guard was unable to provide sufficient evidence to support any of the account balances presented in the balance sheet consequently the independent auditor was unable to render an opinion. All six material weakness conditions and five instances of noncompliance with laws and regulations from FY 2009 were repeated in FY 2010. During the FY 2010 the independent auditors identified an additional noncompliance with laws and regulations. The department did not comply with the *Government Performance and Results Act of 1993*.

In FY 2010, Coast Guard made limited progress with implementing aspects of its *Financial Strategy for Transformation and Audit Readiness* (FSTAR) in the areas necessary to assert to the completeness, existence, and accuracy of PP&E, actuarial liabilities, and fund balance with Treasury balances. In addition to its planned FSTAR initiatives for FY 2010, the Coast Guard performed additional remediation efforts over discrete elements of its balance sheet. This "balance sheet strategy" was designed to achieve additional account balance assertions. As a result, Coast Guard was able to assert to more than \$43 billion of its balance sheet. However, Coast Guard was unable to accomplish all aspects of its planned remediation efforts. As a result the Coast Guard was unable to fully remediate prior year control weaknesses and the auditor again reported that the Coast Guard contributed to all six material weaknesses and the significant deficiency regarding entity-level controls. During FY 2010, the DHS made modest progress in remediating weaknesses and remains committed to focusing on remediation efforts at the Coast Guard, (CBP), FEMA, U.S. Immigrations and Customs Enforcement (ICE), and TSA. However, FEMA Information Technology management may not have a complete understanding of its control deficiencies because FEMA reported that it had closed 28 information technology controls and system functionality weakness conditions but the independent auditors concurred with



management's conclusion on only 5 of the conditions reported as closed. The remaining 23 weakness conditions were reissued to FEMA. The OIG also noted that, unlike in previous years, the department sustained progress made in FY 2009 throughout FY 2010.

\*\*\*\*\*

KPMG is responsible for the attached independent auditor's report dated November 13, 2010, and the conclusions expressed in the report. We do not express opinions on financial statements or internal control or conclusions on compliance with laws and regulations.

Consistent with our responsibility under the *Inspector General Act*, we are providing copies of this report to appropriate congressional committees with oversight and appropriation responsibilities over the department. In addition, we will post a copy of the report on our public website.

We request that the Office of the Chief Financial Officer provide us with a corrective action plan that demonstrates progress in addressing the report's recommendations.

We appreciate the cooperation extended to the auditors by the department's financial offices. Should you have any questions, please call me, or your staff may contact Anne Richards, Assistant Inspector General for Audits, at 202-254-4100.

Attachment





**Department of Homeland Security  
Office of Inspector General**

**Independent Auditors' Report on DHS'  
FY 2010 Financial Statements and  
Internal Control over Financial  
Reporting**



OIG-11-09

November 2010



Washington, DC 20528

NOV 12 2010



**Homeland  
Security**

Preface

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

The attached report presents the results of the DHS financial statements audits for fiscal years (FY) 2010 and 2009 and the results of an examination of internal control over financial reporting of the balance sheet as of September 30, 2010, and the statement of custodial activity for FY 2010. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the audits. The contract required that KPMG perform its audits according to generally accepted government auditing standards and guidance from the Office of Management and Budget and the Government Accountability Office. KPMG was unable to provide an opinion on DHS' balance sheets as of September 30, 2010 and 2009, or on DHS' internal control over financial reporting of the FY 2010 balance sheet and statement of custodial activity. The FY 2010 auditors' report discusses eight significant deficiencies in internal control, of which six are considered material weaknesses, and five instances of noncompliance with laws and regulations. KPMG is responsible for the attached draft auditors' report and the conclusions expressed in the report. We do not express opinions on DHS' financial statements or provide conclusions on compliance with laws and regulations.

The recommendations herein have been discussed in draft with those responsible for implementation. We trust this report will result in more effective, efficient, and economical operations. We express our appreciation to all of those who contributed to the preparation of this report.

*Richard L. Skinner*  
Richard L. Skinner  
Inspector General



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

**Excerpts from the DHS Annual Financial Report**

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KPMG LLP  
2001 M Street, NW  
Washington, DC 20036

### INDEPENDENT AUDITORS' REPORT

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

We were engaged to audit the accompanying balance sheets of the U.S. Department of Homeland Security (DHS or Department) as of September 30, 2010 and 2009, and the related statements of custodial activity for the years then ended (referred to herein as "financial statements"). We were also engaged to examine the Department's internal control over financial reporting of the balance sheet as of September 30, 2010, and statement of custodial activity for the year then ended. In connection with our audit engagement, we also considered DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on the balance sheet as of September 30, 2010 and the related statement of custodial activity for the year ended. We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources, for the years ended September 30, 2010 and 2009 (referred to herein as "other fiscal year (FY) 2010 and 2009 financial statements"), or to examine internal control over financial reporting over the other FY 2010 financial statements.

#### Summary

As stated in our Report on the Financial Statements, the scope of our work was not sufficient to express an opinion on the DHS balance sheets as of September 30, 2010 and 2009, or the related statements of custodial activity for the years then ended.

As discussed in Notes IV and IN, DHS adopted Statement of Federal Financial Accounting Standard (SFFAS) No. 33, *Pensions, Other Retirement Benefits, and Other Post-employment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*, and SFFAS No. 35, *Estimating the Historical Cost of General Property, Plant, and Equipment* (SFFAS No. 35) as of October 1, 2009.

As stated in our Report on Internal Control over Financial Reporting, we were unable to perform procedures necessary to form an opinion on DHS' internal control over financial reporting of the FY 2010 balance sheet and statement of custodial activity.

Material weaknesses in internal control over financial reporting, as defined in the Report on Internal Control over Financial Reporting section of this report, have been identified in the following areas:

- Financial Management and Reporting
- Information Technology Controls and Financial System Functionality
- Fund Balance with Treasury
- Property, Plant, and Equipment
- Actuarial and Other Liabilities
- Budgetary Accounting.

Significant deficiencies, as defined in the Report on Internal Control over Financial Reporting section of this report, have been identified in the following areas:

- Certain Entity Level Controls
- Custodial Revenue and Drawback.

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed instances of noncompliance or other matters in the following areas 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. 07-04, *Audit Requirements for Federal Financial Statements*, as amended:



- *Federal Managers' Financial Integrity Act of 1982 (FMFIA)*, and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-up*, as revised
- *Federal Financial Management Improvement Act of 1996 (FFMIA)*
- *Single Audit Act Amendments of 1996*
- *Chief Financial Officers Act of 1990*
- *Anti-deficiency Act*
- *Government Performance and Results Act of 1993*.

We also reported other matters related to compliance with the *Anti-deficiency Act* at the National Protection and Programs Directorate (NPPD), U.S. Secret Service (USSS), U.S. Coast Guard (Coast Guard), and the Management Directorate.

Other deficiencies in internal control, potentially including additional material weaknesses and significant deficiencies, and other instances of non-compliance may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DHS' balance sheets as of September 30, 2010 and 2009, and the related statements of custodial activity for the years then ended, had we been able to perform all procedures necessary to express an opinion on DHS' internal control over financial reporting of the balance sheet as of September 30, 2010, and statement of custodial activity for the year then ended, and had we been engaged to audit the other FY 2010 and 2009 financial statements, and to examine internal control over financial reporting of the other FY 2010 financial statements.

The following sections discuss the reasons why we are unable to express an opinion on the accompanying DHS financial statements; why we were unable to express an opinion on internal control over financial reporting of the balance sheet as of September 30, 2010, and statement of custodial activity for the year then ended; our tests of DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements and other matters; and management's and our responsibilities.

**Report on the Financial Statements**

We were engaged to audit the accompanying balance sheets of the U.S. Department of Homeland Security as of September 30, 2010 and 2009, and the related statements of custodial activity for the years then ended. These financial statements are the responsibility of DHS management.

The Coast Guard was unable to provide sufficient evidential matter that support transactions and certain balance sheet accounts including fund balance with Treasury, accounts receivable, inventory and related property, general property, plant and equipment including heritage assets and stewardship land, certain actuarially-derived liabilities, environmental and other liabilities, and net position, as reported in the accompanying DHS balance sheets as of September 30, 2010 and 2009. The total assets and liabilities of the Coast Guard, as reported in the accompanying DHS balance sheets, were \$20.3 billion and \$18.7 billion, or 23 and 22 percent of total DHS consolidated assets, and were \$46.4 billion and \$37.8 billion, or 56 and 51 percent of total DHS consolidated liabilities as of September 30, 2010 and 2009, respectively.

The Transportation Security Administration (TSA) was unable to provide sufficient evidential matter that supports certain general property, plant, and equipment balances and related effects on net position, as reported in the accompanying DHS balance sheets as of September 30, 2009. The TSA general property, plant, and equipment balances reported in the accompanying DHS balance sheets were \$997 million as of September 30, 2009, or 6 percent of DHS' consolidated general property, plant, and equipment as of September 30, 2009.

It was impractical to extend our procedures sufficiently to determine the extent, if any, to which the DHS balance sheets as of September 30, 2010 and 2009, and the related statements of custodial activity for the years then ended, may have been affected by the matters discussed in the two preceding paragraphs. Accordingly, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements and the related notes thereto.

We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the years ended September 30, 2010 and 2009, and accordingly, we do not express an opinion on these other FY 2010 and 2009 financial statements.



As discussed in Note 32, DHS restated its FY 2009 financial statements to correct multiple errors identified by U.S. Citizenship and Immigration Services, TSA, Coast Guard, Federal Law Enforcement Training Center, and Federal Emergency Management Agency that required adjustment of balances previously reported in DHS' FY 2009 financial statements. Because of the matters discussed in the second and third paragraphs of the Report on the Financial Statements regarding our audits at the Coast Guard and TSA, we were unable to audit the restatements identified by the Coast Guard and TSA, and accordingly, we have not concluded on the appropriateness of this accounting treatment or the restatement of the DHS balance sheet as of September 30, 2009. In addition, DHS did not present the Statements of Net Cost as of September 30, 2010 and 2009 by major program, goals and outputs as described in a strategic and performance plan, and also omitted certain related financial statement disclosures, required by OMB Circular No. A-136, *Financial Reporting Requirements*, as amended.

As discussed in Notes 1V and 1N, DHS adopted Statement of Federal Financial Accounting Standard (SFFAS) No. 33, *Pensions, Other Retirement Benefits, and Other Post-employment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*, and SFFAS No. 35, *Estimating the Historical Cost of General Property, Plant, and Equipment* (SFFAS No. 35) as of October 1, 2009.

The information in the Management's Discussion and Analysis (MD&A), Required Supplementary Stewardship Information (RSSI), and Required Supplementary Information (RSI) sections of the DHS FY 2010 AFR is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We were unable to complete limited procedures over MD&A, RSSI, and RSI as prescribed by professional standards because of the limitations on the scope of our audit described in the second and third paragraphs of this section of our report. Certain information presented in the MD&A, RSSI, and RSI is based on other FY 2010 and 2009 financial statements on which we have not expressed an opinion. We did not audit the MD&A, RSSI, and RSI, and accordingly, we express no opinion on it. However, we noted that DHS did not include summary performance information that is aligned with its FY 2010 strategic goals and other information, within the MD&A section of the FY 2010 AFR, as required by OMB Circular No. A-136, *Financial Reporting Requirements*, as amended. DHS recently completed a quadrennial review for the purpose of developing an updated strategic plan around new priorities established by the Secretary.

The information in the Other Accompanying Information section of DHS' FY 2010 AFR is presented for purposes of additional analysis, and are not a required part of the financial statements. This information has not been subjected to auditing procedures, and accordingly, we express no opinion on it.

#### **Report on Internal Control over Financial Reporting**

We were engaged to examine the Department's internal control over financial reporting of the balance sheet as of September 30, 2010, and statement of custodial activity for the year then ended, based on the criteria established in OMB Circular No. A-123, *Management's Responsibility for Internal Control* (OMB Circular No. A-123), Appendix A. DHS management is responsible for establishing and maintaining effective internal control over financial reporting, and for its assertion on the effectiveness of internal control over financial reporting, included in the FY 2010 DHS *Secretary's Assurance Statement*, included in MD&A on page 29 of the DHS FY 2010 AFR, as required by OMB Circular No. A-123. We were not engaged to examine and report on internal control over financial reporting at the DHS component level.

The FY 2010 DHS *Secretary's Assurance Statement*, states that the Department was unable to provide assurance that internal control over financial reporting was operating effectively at September 30, 2010. This conclusion is based on the Department's evaluation and analysis of control deficiencies in the Coast Guard, TSA, Federal Emergency Management Agency, U.S. Customs and Border Protection, and U.S. Immigration and Customs Enforcement that in combination represent Departmental material weaknesses. In addition, the Coast Guard was unable to provide documentation of key processes, risk assessments, or evidence supporting the existence of internal controls, and Management acknowledges that pervasive material weaknesses exist in key financial processes, and is therefore unable to make an assertion on the effectiveness of internal control over financial reporting in key financial statement processes.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. Material weaknesses in internal control over financial reporting have been identified in the following areas:

- Financial Management and Reporting
- Information Technology Controls and Financial Systems Functionality
- Fund Balance with Treasury
- Property, Plant, and Equipment
- Actuarial and Other Liabilities
- Budgetary Accounting

Deficiencies at the Coast Guard that are considered to be material weaknesses at the consolidated level, when aggregated with deficiencies existing at other components, are presented in Exhibit I. Deficiencies at other DHS components that contribute to material weaknesses at the consolidated level, when aggregated with deficiencies existing at the Coast Guard, are presented in Exhibit II.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. Our consideration of internal control was for the purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in DHS' internal control that might be significant deficiencies. However, in accordance with *Government Auditing Standards*, we are required to report significant deficiencies in internal control identified during our examination. Significant deficiencies have been identified in the following areas:

- Other Entity Level Controls
- Custodial Revenue and Drawback

Exhibit III presents significant deficiencies at the consolidated level.

Because of the limitation on the scope of our examination described in the second paragraph of the Report on the Financial Statements section, and the second paragraph of the Report on Internal Control over Financial Reporting section, the scope of our work was not sufficient to enable us to express, and we do not express an opinion on the effectiveness of DHS' internal control over financial reporting of the balance sheet as of September 30, 2010, and related statement of custodial activity for the year then ended. It was impractical to extend our procedures sufficiently to determine the extent, if any, to which the FY 2010 balance sheet and statement of custodial activity may have been affected by these circumstances. We were not engaged to examine internal controls over financial reporting of the accompanying statements of net cost, changes in net position, and budgetary resources, for the year ended September 30, 2010. Additional deficiencies in internal control over financial reporting, potentially including additional material weaknesses and significant deficiencies, may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DHS' internal control over financial reporting of the FY 2010 balance sheet and statement of custodial activity, and had we been engaged to audit the other FY 2010 and 2009 financial statements, and to examine internal control over financial reporting over the other FY 2010 financial statements.

The FY 2010 DHS *Secretary's Assurance Statement*, states that the Department identified five material weaknesses in internal control over financial reporting, which differs from the number of material weaknesses identified by us during our FY 2010 audit. The reasons for this difference are provided in Exhibit IV, Comment I.

A summary of the status of FY 2009 material weaknesses and significant deficiencies is included as Exhibit V. We also noted certain additional deficiencies involving internal control over financial reporting and its operation that we will report to the management of DHS in a separate letter.

**Report on Compliance and Other Matters**

In connection with our engagement to audit of the balance sheet of DHS as of September 30, 2010, and statement of custodial activity for the year then ended, we performed tests of DHS' compliance with certain provisions of



laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the balance sheet amounts as of September 30, 2010, and the related statement of custodial activity for the year then ended, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, as amended, including the provisions referred to in Section 803(a) of FFMLA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to DHS. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our engagement, and accordingly, we do not express such an opinion.

Management is responsible for complying with laws, regulations, contracts and grant agreements applicable to DHS.

The results of certain of our tests of compliance exclusive of those referred to in the FFMLA, disclosed the following six instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04, as amended, and are described in Exhibit IV:

- *Federal Managers' Financial Integrity Act of 1982* (FMFIA), and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-up*, as revised
- *Federal Financial Management Improvement Act of 1996* (FFMLA)
- *Single Audit Act Amendments of 1996*
- *Chief Financial Officers Act of 1990*
- *Anti-deficiency Act*
- *Government Performance and Results Act of 1993*.

The results of our other tests of compliance exclusive of those referred to in FFMLA, disclosed no other instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04, as amended.

The results of our tests of FFMLA disclosed instances described in Exhibits I, II, and III where DHS' financial management systems did not substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.

As discussed in our Reports on the Financial Statements and Internal Control over Financial Reporting, the scope of our work was not sufficient to express an opinion on the balance sheets as of September 30, 2010 and 2009, and the related statements of custodial activity for the years then ended, or to express an opinion on the effectiveness of internal control over financial reporting of the balance sheet as of September 30, 2010 and the related statement of custodial activity for the year then ended. Accordingly, other instances of noncompliance with laws, regulations, contracts, and grant agreements may have been identified and reported, had we been able to perform all procedures necessary to complete our audit of the financial statements and examination of internal control over financial reporting of the balance sheet as of September 30, 2010 and the related statements of custodial activity for the year then ended, and had we been engaged to audit the other FY 2010 and 2009 financial statements and to examine internal control over financial reporting over the other FY 2010 financial statements. In addition, because of the matters discussed in the second paragraph of our report on the financial statements, we were unable to complete tests of compliance over the Prompt Payment Act and Titles 10, 14, 31 (as related to the *Anti-deficiency Act*), and 37 of the United States Code at the Coast Guard.

**Other Matters:** Management of the NPPD, USSS, Coast Guard, and the Management Directorate have initiated reviews of certain collections, classification and use of funds, expenditures and/or obligations recorded that may identify a violation of the *Anti-deficiency Act*, or other violations of appropriation law in FY 2010 or in previous years.

#### **Management's Response to Internal Control and Compliance Findings**

DHS management has indicated in a separate letter immediately following this report that it concurs with the findings presented in Exhibits I, II, III, and IV of our report. We did not audit DHS' response, and accordingly, we express no opinion on it.





**Restricted Use**

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

KPMG LLP

November 12, 2010



**Independent Auditors' Report**  
**Introduction to Exhibits on Internal Control and Compliance and Other Matters**

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Our report on internal control over financial reporting and compliance and other matters is presented in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. The internal control weaknesses and findings related to compliance with certain laws, regulations, contracts, and grant agreements presented herein were identified during our engagement to audit the U.S. Department of Homeland Security (Department or DHS)'s the balance sheet as of September 30, 2010, and statement of custodial activity for the year then ended (financial statements), and to examine internal control over financial reporting of those financial statements. We were not engaged to audit the Department's fiscal year (FY) 2010 statements of net cost, changes in net position, and budgetary resources (referred to as other FY 2010 financial statements), or to examine internal controls over financial reporting of the other FY 2010 financial statements. Our findings and the status of prior year findings are presented in five exhibits:

- Exhibit I** Significant deficiencies in internal control identified at the United States Coast Guard (Coast Guard). All of the significant deficiencies reported in Exhibit I are considered material weaknesses at the DHS consolidated level when combined with other significant deficiencies reported in Exhibit II.
- Exhibit II** Significant deficiencies in internal control identified throughout the Department or at other DHS components (components other than Coast Guard are collectively referred to as DHS Civilian Components). All of the significant deficiencies reported in Exhibit II are considered material weaknesses at the DHS consolidated level when combined with other significant deficiencies reported in Exhibit I.
- Exhibit III** Significant deficiencies that are not considered a material weakness at the DHS consolidated financial statement level.
- Exhibit IV** Instances of noncompliance with certain laws, regulations, contracts, and grant agreements that are required to be reported under *Government Auditing Standards* or Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.
- Exhibit V** The status of our findings reported in FY 2009.

As stated in our Independent Auditors' Report, the scope of our work was not sufficient to enable us to express an opinion on the effectiveness of DHS' internal control over financial reporting of the balance sheet as of September 30, 2010, and related statement of custodial activity for the year then ended. In addition, the scope of our work was not sufficient to express an opinion on the financial statements that we were engaged to audit; consequently, additional deficiencies in internal control over financial reporting, potentially including additional material weaknesses and significant deficiencies, may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DHS' internal control over financial reporting of the financial statements, and had we been engaged to audit the other FY 2010 financial statements, and to examine internal control over financial reporting of the other FY 2010 financial statements.

The determination of which findings rise to the level of a material weakness is based on an evaluation of how deficiencies identified in all components, considered in aggregate, may affect the DHS balance sheet as of September 30, 2010, or the related statement of custodial activity for the year then ended.

We have also performed follow-up procedures on findings identified in previous engagements to audit the DHS financial statements. All of the significant deficiencies identified and reported in Exhibit I for the Coast Guard are repeated from our FY 2009 and FY 2008 report, and include updates for new findings resulting from our 2010 procedures. To provide trend information for the DHS Civilian Components, Exhibits II and III contain Trend Tables next to the heading of each finding. The Trend Tables in Exhibits II and III depict the severity and current status of findings by component that has contributed to that finding from FY 2008 through FY 2010.



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A summary of our findings in FY 2010 and FY 2009 are presented in the Tables below:

**Table 1** Presents a summary of our internal control findings, by component, for FY 2010.

**Table 2** Presents a summary of our internal control findings, by component, for FY 2009.

We have reported six material weaknesses and two significant deficiencies at the Department level in FY 2010, shown in Table 1.

**TABLE 1 – SUMMARIZED DHS FY 2010 INTERNAL CONTROL FINDINGS**

Comments / Financial Statement Area		DHS Consol.	CG	CBP	USCIS	FEMA	FLETC	ICE	NPPD	TSA
			Military							
Material Weakness:			Exhibit I	Exhibit II						
A	Financial Management and Reporting	MW								
B	IT Controls and System Functionality	MW								
C	Fund Balance with Treasury	MW								
D	Property, Plant and Equipment	MW								
E	Actuarial and Other Liabilities	MW								
F	Budgetary Accounting	MW								
Significant Deficiencies:			Exhibit III							
G	Other Entity-Level Controls	SD								
H	Custodial Revenue and Drawback	SD								

**TABLE 2 – SUMMARIZED DHS FY 2009 INTERNAL CONTROL FINDINGS**

Comments / Financial Statement Area		DHS Consol.	CG	CBP	USCIS	FEMA	FLETC	ICE	NPPD	TSA
			Military							
Material Weakness:			Exhibit I	Exhibit II						
A	Financial Management and Reporting	MW								
B	IT Controls and System Functionality	MW								
C	Fund Balance with Treasury	MW								
D	PP&E and OMS	MW								
E	Actuarial and Other Liabilities	MW								
F	Budgetary Accounting	MW								
Significant Deficiencies:			Exhibit III							
G	Other Entity-Level Controls	SD								
H	Custodial Revenue and Drawback	SD								

	Control deficiency findings are <i>more significant</i> to the evaluation of effectiveness of controls at the Department-Level
	Control deficiency findings are <i>less significant</i> to the evaluation of effectiveness of controls at the Department-Level
	<b>MW</b> Material weakness at the Department level exists when all findings are aggregated
	<b>SD</b> Significant deficiency at the Department level exists when all findings are aggregated

All components of DHS, as defined in Note 1A – *Reporting Entity*, to the financial statements, were included in the scope of our engagement to audit the consolidated balance sheet of DHS as of September 30, 2010, and the related statement of custodial activity for the year then ended, and to examine internal control over financial reporting of those financial statements. Accordingly, our engagement to audit and examine internal control considered significant account balances, transactions, and accounting processes of other DHS components not listed above. Control deficiencies identified in other DHS components that are not identified in the table above did not individually, or when combined with other component findings, contribute to a significant deficiency at the DHS consolidated financial statement level.



**Independent Auditors' Report**

**Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

**I-A Financial Management and Reporting**

*Background:* In fiscal year (FY) 2010, we were engaged to perform an examination of internal controls over financial reporting. The auditors' objective in an examination of internal control is to form an opinion on the effectiveness of internal control. When planning our examination, we gave appropriate emphasis to testing entity-level controls, such as management's risk assessment and monitoring processes, and other control environment elements that exist throughout the Department. Four Department-wide control environment conditions were identified through our examination procedures that have a pervasive influence on the control environment and effectiveness of control activities at the United States Coast Guard (Coast Guard). This Exhibit should be read in conjunction with the Department-wide conditions and recommendations described in Comment II-A, *Financial Management and Reporting*.

In previous years, we reported that the Coast Guard had several internal control deficiencies that led to a material weakness in financial reporting. In response, the Coast Guard developed its *Financial Strategy for Transformation and Audit Readiness (FSTAR)*, which is a comprehensive plan to identify and correct conditions that are causing control deficiencies, and in some cases preventing the Coast Guard from preparing auditable financial statements.

The Coast Guard made progress in FY 2010, by completing its planned corrective actions over selected internal control deficiencies. Specifically, remediation efforts associated with accrued payroll, pension, and medical liabilities allowed management to make assertions on the completeness and accuracy of more than \$43 billion of accrued liabilities, which represents more than 50 percent of DHS' total liabilities. The FSTAR calls for continued remediation of control deficiencies and reconciliation of balances in FY 2011. Consequently many of the financial reporting deficiencies we reported in the past remain uncorrected at September 30, 2010.

*Conditions:*

- 1 In FY 2010, certain entity-level control weaknesses, that may interfere with the timely completion of corrective actions planned for FY 2011 and beyond, continued to exist. While progress has been made, the Coast Guard has not completed the:
  - Development and implementation of effective policies, procedures, internal controls, and information and communication processes to ensure that data supporting financial statement assertions are complete and accurate, that transactions are accounted for consistent with generally accepted accounting principles (GAAP), and that technical accounting issues are identified, analyzed and resolved in a timely manner. For example, the development and implementation of an accounting position over post-employment travel benefits, totaling less than one percent of liabilities took several months to complete. This condition is a potentially serious impediment to the Coast Guard's objective of producing an auditable balance sheet next year;
  - Adoption of an on-going Coast Guard-wide risk assessment by financial, IT, and program personnel that addresses all significant financial statement line items; and
  - Implementation of adequate monitoring controls over headquarters, units, and areas/districts with significant financial activity, including those controls associated with management override.
- 2 The Coast Guard does not have properly designed, implemented, and effective policies, procedures, processes, and controls surrounding its financial reporting process, as necessary to:
  - Support beginning balances, year-end close-out, and the cumulative results of operations analysis in its general ledgers individually and/or in the aggregate;
  - Ensure that transactions and accounting events at Coast Guard headquarters, units, and areas/districts are appropriately supported and accounted for in its general ledgers;
  - Ensure that accounts receivable balances exist, are complete and accurate, and properly presented in the financial statements. For example, underlying data supporting accounts receivable balances is not maintained, reimbursable related activity is not identified timely, and accounts receivable activity is not properly recorded in the financial statements on a timely basis;



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**Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

- Ensure financial statement information and related disclosures submitted for incorporation in the DHS financial statements are accurate and complete; and
- Ascertain that intragovernmental activities and balances are identified and differences, especially with agencies outside DHS, are being resolved in a timely manner in coordination with the Department's Office of Financial Management (OFM).

*Cause/Effect:* The Coast Guard has thorough and highly procedural processes for identifying and resolving technical accounting issues, and/or responding to auditor inquiries. This process often results in exceptionally long time periods devoted to issue resolution, which can extend to several months or even years, to resolve a single matter. In some cases, the issues are not material to the financial statements, but still require long time periods to resolve. This approach interferes with the timely completion of financial reports, and the availability of auditable accounting positions. In addition, insufficient controls over financial reporting could create an environment where an *Anti-deficiency Act* violation could occur.

The Coast Guard has not developed and implemented an effective general ledger system. The Core Accounting System (CAS), Aircraft Logistics Management Information System (ALMIS), and Naval Engineering Supply Support System (NESSS) general ledgers do not comply with the requirements of the *Federal Financial Management Improvement Act* (FFMIA). The general ledgers do not allow for compliance with the United States Standard General Ledger (USSGL) at the transaction level, and period-end and opening balances are not supported by transactional detail in the three general ledgers. The conditions described below in Comment **I-B, Information Technology Controls and Financial Systems Functionality** contribute to the financial reporting control deficiencies, and make correction more difficult.

Because of the conditions noted above, the Coast Guard was unable to provide reasonable assurance that internal controls over all financial reporting processes are operating effectively, and has acknowledged that pervasive material weaknesses continue to exist in some key financial processes. Consequently, the Coast Guard cannot be reasonably certain that its financial statements are reliable, or assert to the completeness, existence, accuracy, valuation, rights and obligations, or presentation of their financial data related to their balances of fund balance with Treasury, accounts receivable, general property, plant, and equipment, including heritage assets and stewardship land, environmental and other liabilities, and net position as reported in the Department's balance sheets as of September 30, 2010 and 2009.

*Criteria:* FFMIA Section 803(a) requires that each agency shall implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. FFMIA is intended to ensure that agencies use financial management systems that provide reliable, timely, and consistent information.

The *Federal Managers' Financial Integrity Act of 1982* (FMFIA) requires that agencies establish internal controls according to standards prescribed by the Comptroller General. These standards are specified in the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government (Standards)*. These standards define internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

The GAO *Standards* require that internal controls be documented in management directives, administrative policies or operating manuals; transactions and other significant events 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 and other responsibilities. The GAO *Standards* also identify the control environment as one of the five key elements of control, which emphasizes the importance of conscientiousness in management's operating philosophy and commitment to internal control. These standards cover controls such as human capital practices, supervisory reviews, policies, procedures, monitoring, and segregation of duties.

The Treasury *Federal Intragovernmental Transactions Accounting Policies Guide*, dated August 13, 2010, states that Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*, as revised, require Federal CFO Act and non-CFO Act entities identified in the Treasury



**Independent Auditors' Report**

**Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

Financial Manual (TFM) 2010, Vol. I, Part 2, Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government*, to perform quarterly reconciliations of intragovernmental activity/balances. TFM, Section 4706, *Intragovernmental Requirements*, requires reporting agencies to reconcile and confirm intragovernmental activity and balances quarterly for specific reciprocal groupings. TFM Bulletin 2007-03, *Intragovernmental Business Rules*, also provides guidance to Federal agencies for recording and reconciling intragovernmental activities.

*Recommendations:* We recommend that the Coast Guard:

1. Continue the implementation of the FSTAR, as planned;
2. Develop and implement effective policies, procedures, and internal controls to ensure that technical accounting issues are identified, analyzed, and resolved in a timely manner. The Coast Guard should be able to discuss initial accounting positions with basic rationale and supporting facts within one week of issue identification. Final resolution, may take longer depending on the complexity of the issues and impact on the Department, however even difficult cases should be resolved in substantially less time;
3. Improve entity-level controls by fully implementing a formal risk assessment process, evaluating and updating processes used to communicate policies and ensure that all transactions are recorded completely and accurately, and improve monitoring controls over financial data supporting the general ledger and financial statements;
4. Implement accounting and financial reporting processes including an integrated general ledger system that is FFMI compliant; and
5. Establish new or improve existing policies, procedures, and related internal controls to ensure that:
  - a. The year-end close-out process, reconciliations, and financial data and account analysis procedures are supported by documentation, including evidence of effective management review and approval, and beginning balances in the following year are determined to be reliable and auditable;
  - b. All accounting transactions and balances are properly reflected in the financial statements and consistent with GAAP;
  - c. Accounts receivable balances exist, are complete and accurate, and properly presented in the financial statements;
  - d. Financial statement disclosures submitted for incorporation in the DHS financial statements are accurate and complete; and
  - e. All intragovernmental activity and balances are accurately reflected in the financial statements, and differences are being resolved in a timely manner in coordination with the Department's OFM.

**I-B Information Technology Controls and Financial Systems Functionality**

*Background:* Information Technology (IT) general and application controls are essential for achieving effective and reliable reporting of financial and performance data. IT general controls (ITGC) are tested using the objectives defined by the GAO's *Federal Information System Controls Audit Manual (FISCAM)*, in five key control areas: security management, access control, configuration management, segregation of duties, and business continuity. Our procedures included a review of the Coast Guard's key ITGC environments.

We also considered the effects of financial systems functionality when testing internal controls, because key Coast Guard financial systems are not compliant with FFMI and are no longer supported by the original software provider. Functionality limitations add to the challenge of addressing systemic internal control weaknesses, and strengthening the control environment at the Coast Guard.

**Independent Auditors' Report****Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

In FY 2010, our IT audit work identified 28 IT findings, of which 10 were repeat findings from the prior year and 18 were new findings. In addition, we determined that Coast Guard remediated eight IT findings identified in previous years. Specifically, the Coast Guard took actions to improve aspects of its user recertification process, data center physical security, and scanning for system vulnerabilities. The Coast Guard's remediation efforts have enabled us to expand our testwork into areas that previously were not practical to test, considering management's acknowledgment of the existence of control deficiencies. Most of the new findings relate to IT systems that were added to our examination scope this year.

*Conditions:* Our findings related to financial systems controls and functionality are as follows:

*Related to IT controls:*

*Condition:* We noted that Coast Guard's core financial system configuration management process controls are not operating effectively, and continue to present risks to DHS financial data confidentiality, integrity, and availability. Financial data in the general ledger may be compromised by automated and manual changes that are not adequately controlled. For example, the Coast Guard uses an IT scripting process to make updates to its core general ledger software, as necessary, to process financial data. During our FY 2010 testing, we noted that some previously identified control deficiencies were remediated (particularly with the implementation of a new script change management tool in the second half of FY 2010), while other deficiencies continued to exist. The remaining control deficiencies vary in significance. However, three key areas that impact the Coast Guard IT script control environment are:

- Script testing requirements – Limited testing requirements exist to guide Coast Guard staff in the development of test plans and guidance over the functional testing that should be performed;
- Script testing environment – Not all script changes were tested in the appropriate test environments, as required; and
- Script audit logging process – The Coast Guard's core system databases are logging changes to tables as well as successful and unsuccessful logins. However, no reconciliation between the scripts run and the changes made to the database tables is being performed to monitor the script activities and ensure that all scripts run have been approved.

In addition, we noted weaknesses in the script change management process as it relates to the Internal Control over Financial Reporting (ICFR) process (e.g., the financial statement impact of the changes to FINCEN core accounting system through the script change management process). The Coast Guard has not fully developed and implemented procedures to ensure that a script, planned to be run in production, has been through an appropriate level of review by a group of individuals thoroughly assessing if the script would have a financial statement impact. Furthermore, the rationale documenting the impact of the script, whether deemed as having financial impact or not, is not documented and retained for internal assessment or audit purposes. Internal controls that ensure the reliability of the scripting process must be effective throughout the year, but most importantly during the year-end close-out and financial reporting process.

All of our ITGC findings are described in detail in a separate *Limited Official Use* (LOU) letter provided to the Coast Guard and DHS management.

*Related to financial system functionality:*

We noted that certain financial system functionality limitations are contributing to control deficiencies reported elsewhere in Exhibit I, are inhibiting progress on corrective actions for Coast Guard, and are preventing the Coast Guard from improving the efficiency and reliability of its financial reporting processes. Some of the financial system limitations lead to extensive manual and redundant procedures to process transactions, to verify the accuracy of data, and to prepare financial statements. Systemic conditions related to financial system functionality include:

- As noted above, Coast Guard's core financial system configuration management process is not operating effectively due to inadequate controls over IT scripts. The IT script process was instituted as a solution primarily to compensate for system functionality and data quality issues;



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**Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

- Financial system audit logs are not readily generated and reviewed, as some of the financial systems are lacking the capability to perform this task efficiently;
- Production versions of operational financial systems are outdated and do not provide the necessary core functional capabilities (e.g., general ledger capabilities); and
- Financial systems functionality limitations are preventing the Coast Guard from establishing automated processes and application controls that would improve accuracy, reliability, and facilitate efficient processing of certain financial data such as:
  - Ensuring proper segregation of duties and access rights such as automating the procurement process to ensure that only individuals who have proper contract authority can approve transactions or setting system access rights within the fixed asset subsidiary ledger;
  - Maintaining sufficient data to support Fund Balance with Treasury related transactions, including suspense activity;
  - Maintaining adequate posting logic transaction codes to ensure that transactions are recorded in accordance with GAAP; and
  - Tracking detailed transactions associated with intragovernmental business and eliminate the need for default codes such as Trading Partner Identification Number that cannot be easily researched.

*Cause/Effect:* The IT system development activities did not incorporate adequate security controls during the initial implementation more than seven years ago. The current IT configurations of many Coast Guard financial systems cannot be easily reconfigured to meet new DHS security requirements. The existence of these IT weaknesses leads to added dependency on the other mitigating manual controls to be operating effectively at all times. Because mitigating controls often require more human involvement, there is an increased risk that human error could materially affect the financial statements. In addition, the Coast Guard's core financial systems are not FFMIA compliant with the Federal Government's Financial System Integration Office (FSIO) requirements. See Comment I-A, *Financial Management and Reporting*, for a discussion of the related conditions causing significant noncompliance with the requirements of FFMIA. Configuration management weaknesses are also among the principle causes of the Coast Guard's inability to support its financial statement balances for audit purposes.

*Criteria:* The *Federal Information Security Management Act (FISMA)* passed as part of the *E-Government Act of 2002*, provides guidance that Federal entities maintain IT security programs in accordance with National Institute of Standards and Technology (NIST) guidance.

OMB Circular No. A-130, *Management of Federal Information Resources*, establishes policy for the management of Federal information resources.

FFMIA is intended to ensure that agencies use financial management systems that provide reliable, timely, and consistent information. The purpose of FFMIA is to (1) provide for consistency of accounting by an agency from one fiscal year to the next, and uniform accounting standards throughout the Federal Government, (2) require Federal financial management systems to support full disclosure of Federal financial data, including the full costs of Federal programs and activities, (3) increase the accountability and credibility of federal financial management, (4) improve performance, productivity, and efficiency of Federal Government financial management, and (5) establish financial management systems to support controlling the cost of Federal Government.

OMB Circular No. A-123, *Management's Responsibility for Internal Control*, states, "Agency managers should continuously monitor and improve the effectiveness of internal control associated with their programs. This continuous monitoring, and other periodic evaluations, should provide the basis for the agency head's annual assessment of and report on internal control, as required by FFMIA." This Circular indicates that "control weaknesses at a service organization could have a material impact on the controls of the customer organization. Therefore, management of cross-servicing agencies will need to provide an annual assurance statement to its customer agencies in advance to allow its customer agencies to rely upon that assurance statement. Management of cross-servicing agencies shall test the controls over the activities





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for which it performs for others on a yearly basis. These controls shall be highlighted in management's assurance statement that is provided to its customers. Cross-servicing and customer agencies will need to coordinate the timing of the assurance statements."

DHS *Sensitive Systems Policy Directive, 4300A*, as well as the DHS *4300A Sensitive Systems Handbook* documents policies and procedures adopted by DHS intended to improve the security and operation of all DHS IT systems including the Coast Guard IT systems.

The GAO's FISCAM provides a framework and recommended audit procedures that are used to conduct the IT general control test work.

*Recommendations:* We recommend that the DHS Office of Chief Information Officer, in coordination with the Office of the Chief Financial Officer (OCFO), implement the recommendations in our LOU letter provided to the Coast Guard and DHS management. In that letter, we provide more detailed recommendations to effectively address the deficiencies identified in the configuration management process.

Additionally, regarding IT controls, we recommend that the Coast Guard:

1. Develop and implement policies and procedures that address open aspects of script testing, including documentation of test documents;
2. Develop training that addresses all aspects of script testing (including documentation of test documents) and provide training to appropriate CM staff;
3. Develop a resource plan with associated supporting business case(s) to address the database audit logging requirements;
4. Develop procedures and perform regular account revalidation for the script management tool to ensure privileges remain appropriate; and
5. Conduct an assessment over the ICFOR process related to identifying and evaluating scripts that have a financial statement impact. This assessment can be included in the configuration management oversight process as part of USCG's annual A-123 efforts, or performed independent of the A-123 process. We recommend that this assessment (1) be performed early in the FY 2011, in time to remediate deficiencies before the end of the third quarter, and (2) involve process documentation and sufficient testing to fully assess both design and operating effectiveness of controls. The objective being to have a reliable process and internal controls in place that allow the auditor to test, and rely on those controls, during the fourth quarter of FY 2011.

**I-C Fund Balance with Treasury**

*Background:* Fund Balance with Treasury (FBWT) at the Coast Guard totaled approximately \$6.5 billion, or approximately 10.7 percent of total DHS FBWT at September 30, 2010. The majority of these funds represented appropriated amounts that were obligated, but not yet disbursed, as of September 30, 2010. In FY 2009, we reported a material weakness in internal control over FBWT at the Coast Guard. In FY 2010, the Coast Guard corrected some FBWT control deficiencies; specifically issues associated with payroll related transactions, and revised its remediation plan to include additional corrective actions that are scheduled to occur after FY 2010. Consequently, most of the conditions stated below are repeated from our FY 2009 report.

*Conditions:* The Coast Guard has not developed a comprehensive process, to include effective internal controls, to ensure that all FBWT transactions are recorded in the general ledger timely, completely, and accurately. For example, the Coast Guard:

- Did not properly design and implement FBWT monthly activity reconciliations and/or could not provide detail transaction lists reconciled to the general ledger for amounts reported to Treasury for all Coast Guard Agency Location Codes;



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- Has not been able to substantiate the completeness and accuracy of all inputs to the SF 224 process;
- Recorded adjustments to the general ledger FBWT accounts or activity reports submitted to Treasury, including adjustments to agree Coast Guard balances to Treasury amounts, that were unsupported;
- Does not have an effective process for clearing suspense account transactions related to FBWT due to over-reliance on vendor-provided data. The Coast Guard lacks documented and effective policies and procedures and internal controls necessary to support the completeness, existence, and accuracy of suspense account transactions. In addition, certain issues persist with industrial service orders (ISOs) and credit cards that preclude a complete and accurate population of suspense detail; and
- Does not have well established procedures to perform routine analytical comparisons between accounts, particularly budgetary accounts that should have a direct relationship with FBWT accounts.

*Cause/Effect:* The Coast Guard had not designed and implemented accounting processes, including a financial system that complies with federal financial system requirements, as defined in OMB Circular No. A-127, *Financial Management Systems*, as revised, and the requirements of the *Joint Financial Management Improvement Program (JFMIP)*, now administered by the FSIO, to fully support the FY 2010 FBWT activity and balance as of September 30, 2010. Failure to implement timely and effective reconciliation processes could increase the risk of undetected errors and/or violations of appropriation laws, including instances of undiscovered *Anti-deficiency Act* violations or fraud, abuse, and mismanagement of funds, which could lead to inaccurate financial reporting and affect DHS' ability to effectively monitor its budget status.

*Criteria:* Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*, paragraph 39 states, "Federal entities should explain any discrepancies between fund balance with Treasury in their general ledger accounts and the balance in the Treasury's accounts and explain the causes of the discrepancies in footnotes to financial statements. (Discrepancies due to time lag should be reconciled and discrepancies due to error should be corrected when financial reports are prepared). Agencies also should provide information on unused funds in expired appropriations that are returned to Treasury at the end of a fiscal year."

*Per Fund Balance with Treasury Reconciliation Procedures, a Supplement to the Treasury Financial Manual, TFM 2-5100*, Section V, "Federal agencies must reconcile their SGL 1010 account and any related subaccounts [...] on a monthly basis (at minimum) [...] Federal agencies must [...] resolve all differences between the balances reported on their G/L FBWT accounts and balances reported on the [Government-wide Accounting system (GWA)]." In addition, "An agency may not arbitrarily adjust its FBWT account. Only after clearly establishing the causes of errors and properly documenting those errors, should an agency adjust its FBWT account balance. If an agency must make material adjustments, the agency must maintain supporting documentation. This will allow correct interpretation of the error and its corresponding adjustment."

Section 803(a) of FFMLA requires that each agency shall implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. FFMLA is intended to ensure that agencies use financial management systems that provide reliable, timely, and consistent information.

The GAO *Standards* hold that transactions should be properly authorized, documented, and recorded completely and accurately.

*Recommendations:* We recommend that the Coast Guard continue to implement remediation efforts associated with establishing policies, procedures, and internal controls to ensure that FBWT transactions are recorded accurately completely, and in a timely manner, and that all supporting documentation is



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**Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

maintained for all recorded transactions. The Coast Guard remediation efforts should include procedures to:

1. Ensure that appropriate supporting documentation is maintained and readily available to support all aspects of appropriation activity (e.g., warrants, transfers, rescissions, etc.) and opening 2011 FBWT balances;
2. Perform complete and timely FBWT reconciliations using the Treasury Government-wide Accounting tools. Adequate documentation should be maintained and readily available for all data (e.g., receipts, disbursements, journal entries, etc.) used in the reconciliation process. Documentation should be sufficient to support items at the transactional level, and enable transactions and balances to be reconciled to the general ledger, as appropriate;
3. Better manage its suspense accounts to include researching and clearing items carried in suspense clearing accounts in a timely manner during the year, and maintaining proper supporting documentation in clearing suspense activity;
4. Perform analytical procedures over budgetary and proprietary activity related to the FBWT process; and
5. Review any IT related application (e.g., system generated reports) or general controls (e.g., change management) associated with the FBWT process.

**I-D Property, Plant, and Equipment**

*Background:* The Coast Guard maintains approximately 51 percent of all DHS property, plant, and equipment (PP&E), including a large fleet of boats and vessels. Many of the Coast Guard's assets are constructed over a multi-year period, have long useful lives, and undergo extensive routine servicing that may increase their value or extend their useful lives. In FY 2010, the Coast Guard continued to execute remediation efforts as documented in FSTAR to address the PP&E process and control deficiencies, specifically those associated with vessels, small boats, and aircraft. However, FSTAR procedures are scheduled to occur over a multi-year timeframe. Consequently, many of the conditions cited below have been repeated from our FY 2009 report.

DHS Stewardship PP&E primarily consists of Coast Guard heritage assets, which are PP&E that are unique due to historical or natural significance, cultural, educational, or artistic (e.g., aesthetic) importance, or architectural characteristics. Coast Guard heritage assets consist of both collection type heritage assets, such as artwork and display models, and non-collection type heritage assets, such as lighthouses, sunken vessels, and buildings.

*Conditions:* The Coast Guard has not:

*Regarding PP&E:*

- Established its opening PP&E balances necessary to prepare a balance sheet as of September 30, 2010. Inventory procedures were performed in 2010 to assist in the substantiation of existence and completeness of PP&E balances; however, they were not performed over all asset classes (e.g., real property). Furthermore, in cases where original acquisition documentation has not been maintained, the Coast Guard has not fully implemented methodologies and assumptions to support the value of all PP&E;
- Implemented appropriate controls and related processes to accurately, consistently, and timely record additions to PP&E and construction in process (CIP), (including all costs necessary to place the asset in service e.g., other direct costs), transfers from other agencies, disposals in its fixed asset system, and support the valuation and classification of repairable PP&E;
- Implemented accurate and complete asset identification, system mapping, and tagging processes that include sufficient detail (e.g., serial number) to clearly differentiate and accurately track physical assets to those recorded in the fixed asset system;



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- Developed and implemented a process to identify and evaluate all lease agreements to ensure that they are appropriately categorized as operating or capital, and properly reported in the financial statements and related disclosures;
- Properly accounted for improvements and impairments to buildings and structures, capital leaseholds, selected useful lives for depreciation purposes, and appropriate capitalization thresholds, consistent with GAAP; and
- Identified and tracked all instances where accounting is not in compliance with GAAP (usually due to immateriality), and prepare a non-GAAP analysis that supports managements accounting policies. This analysis should be maintained and available for audit.

*Regarding Stewardship PP&E:*

- Fully designed and implemented policies, procedures, and internal controls to support the completeness, existence, accuracy, and presentation assertions over data utilized in developing required financial statement disclosures and related supplementary information for Stewardship PP&E.

*Cause/Effect:* The Coast Guard has had difficulty establishing its opening PP&E balances primarily because of poorly designed policies, procedures, and processes implemented more than a decade ago, combined with ineffective internal controls. PP&E was not properly tracked or accounted for many years preceding the Coast Guard's transfer to DHS in 2003, and now the Coast Guard is faced with a formidable challenge of performing retroactive analysis in order to properly establish the existence, completeness, and accuracy of PP&E. Furthermore, the fixed asset module of the Coast Guard's CAS is not updated timely for effective tracking and reporting of PP&E on an ongoing basis. As a result, the Coast Guard is unable to accurately account for its PP&E, and provide necessary information to DHS OFM for consolidated financial statement purposes.

The Coast Guard management deferred correction of the Stewardship PP&E weaknesses reported in previous years, and acknowledged that the conditions we reported in prior years remained throughout FY 2010. The lack of comprehensive and effective policies and controls over the identification and reporting of Stewardship PP&E could result in misstatements in the required financial statement disclosures and related supplementary information for Stewardship PP&E.

*Criteria:* SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, provides the general requirements for recording and depreciating property, plant, and equipment. SFFAS No. 6 was recently amended by SFFAS No. 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23*, which clarifies that "reasonable estimates of original transaction data historical cost may be used to value general PP&E... Reasonable estimates may be used upon initial capitalization as entities implement general PP&E accounting for the first time, as well as by those entities who previously implemented general PP&E accounting." Additionally, SFFAS No. 35 "allows the use of reasonable estimates when an entity determines it is necessary to revalue general PP&E assets previously reported." The Federal Accounting Standards Advisory Board (FASAB)'s Federal Financial Accounting Standards Interpretation No. 7, dated March 16, 2007, defines "items held for remanufacture" as items "in the process of (or awaiting) inspection, disassembly, evaluation, cleaning, rebuilding, refurbishing and/or restoration to serviceable or technologically updated/upgraded condition. Items held for remanufacture may consist of: Direct materials, (including repairable parts or subassemblies [...]) and Work-in-process (including labor costs) related to the process of major overhaul, where products are restored to 'good-as-new' condition and/or improved/upgraded condition. 'Items held for remanufacture' share characteristics with 'items held for repair' and items in the process of production and may be aggregated with either class. Management should use judgment to determine a reasonable, consistent, and cost-effective manner to classify processes as 'repair' or 'remanufacture'."

SFFAS No. 29, *Heritage Assets and Stewardship Land*, provides the requirements for the presentation and disclosure of heritage assets. In summary, this standard requires that heritage assets and stewardship land information be disclosed as basic information in the notes to the financial statements, except for condition information, which is reported as required supplementary information (RSI).

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FFMIA Section 803(a) requires that each agency shall implement and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. OMB Circular No. A-127 prescribes the standards for federal agencies' financial management systems.

*Recommendations:* We recommend that the Coast Guard:

*Regarding PP&E:*

1. Continue to implement remediation efforts associated with establishing PP&E balances, including designing and implementing inventory procedures over all PP&E categories and implementing methodologies, including the use of SFFAS No. 35, to support the value of all PP&E;
2. Implement appropriate controls and related processes to accurately and timely record additions to PP&E and CIP, transfers from other agencies, improvements, impairments, capital leases, depreciable lives, disposals in its fixed asset system, and valuation and classification of repairable PP&E;
3. Implement processes and controls to record any identifying numbers in the fixed asset system at the time of asset purchase to facilitate identification and tracking; and to ensure that the status of assets is accurately tracked in the subsidiary ledger;
4. Develop and implement a process to identify and evaluate all lease agreements to ensure that they are appropriately categorized as operating or capital, and are properly reported in the financial statements and related disclosures;
5. Ensure that appropriate supporting documentation is maintained and readily available to support PP&E life-cycle events (e.g., improvements, in-service dates, disposals, etc.); and
6. Perform and document a non-GAAP analysis for all instances where accounting policies are not in compliance with GAAP.

*Regarding stewardship PP&E:*

7. Design and implement policies, procedures, and internal controls to support the completeness, existence, accuracy, and presentation and disclosure assertions related to the data utilized in developing disclosure and related supplementary information for Stewardship PP&E that is consistent with GAAP.

**I-E Actuarial and Other Liabilities**

*Background:* The Coast Guard maintains medical and post-employment travel benefit programs that require actuarial computations to record related liabilities for financial reporting purposes. The 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 Coast Guard. The medical plan covers active duty, reservists, retirees/survivors, and their dependents that are provided care at Department of Defense (DoD) medical facilities. The post-employment travel benefit program pays for the relocation (i.e., travel and shipment of household goods) of uniformed service members to their home station upon separation from the Coast Guard. Annually, participant and cost data is extracted by the Coast Guard from its records and provided to an actuarial firm as input for the liability calculations. The accuracy of the actuarial liability, as reported in the financial statements, is dependent on the accuracy and completeness of the underlying participant and cost data provided to the actuary, as well as the reasonableness of the assumptions used.

The Coast Guard estimates accounts payable by adjusting the prior year revised accounts payable accrual estimate by the percentage change in budgetary authority for the current fiscal year. The revised prior year estimate is the mid-point of the range in which the accrual should fall based on an analysis of actual payments made subsequent to September 30 of the prior year. The calculation is based on the results of a statistical sample for a portion of the subsequent disbursement population and a judgmental sample for the other portion.



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The Coast Guard's environmental liabilities consist of environmental remediation, cleanup, and decommissioning. The environmental liabilities are categorized as relating to shore facilities or vessels. Shore facilities include any facilities or property other than ships (e.g., buildings, fuel tanks, lighthouses, small arms firing ranges, etc.).

*Conditions:* We noted the following internal control weaknesses related to actuarial and other liabilities.

*Regarding actuarial liabilities:*

The Coast Guard had not implemented sufficient internal controls to ensure that information used by the actuary to calculate the pension benefit liability was complete, accurate, and properly used in actuarial valuation calculations until later in FY 2010. In early FY 2010, adjustments to the prior year pension benefit liability were identified by both the actuarial service provider and the Coast Guard, which highlighted this control weakness. During FY 2010, management implemented new internal controls that they believe will address these deficiencies.

The Coast Guard has not:

- Developed and implemented sufficient ongoing internal controls to ensure that information used by the actuary to calculate the actuarial medical benefit liability is complete and accurate. During FY 2010, the Coast Guard implemented various mitigating internal control and substantive procedures to address these conditions, however did not design or implement a sufficient long-term internal control solution; and
- Implemented effective policies, procedures, and controls to ensure the completeness and accuracy of relocation claims provided to, and used by, the actuary for the calculation of the post-employment travel benefit liability.

*Regarding accounts payable and payroll estimates:*

- Designed a methodology used to estimate accounts payable that considers and uses all applicable current year data. As a result, current year data that may have a significant impact on the estimate could be overlooked;
- Fully implemented effective controls to ensure that services have been provided to qualified Coast Guard members prior or subsequent to the payment of medical related invoices. As a result, medical related year-end accounts payable amounts and data utilized in the calculation of medical incurred but not reported estimates may be misstated, and improper payments may be made to service providers. During FY 2010, the Coast Guard implemented detective procedures to review invoices paid in FY 2010, however they did not review historical invoices (i.e., invoices paid prior to FY 2010) used in the incurred but not reported calculation nor implement a sufficient long-term internal control solution to address these conditions; and
- Designed and implemented a process to properly calculate and record civilian related payroll liabilities until fiscal year-end.

*Regarding environmental liabilities:*

- Fully supported the completeness, existence, and accuracy assertions of the data utilized in developing the estimate for the FY 2010 environmental liability account balance; and
- Fully developed, documented, and implemented the policies and procedures in developing, preparing, and recording the environmental liability estimates related to shore facilities and vessels.

*Cause/Effect:* The Coast Guard did not perform a comprehensive review over information provided by actuarial service providers to ensure the completeness and accuracy of their calculation of pension benefit liabilities. Additionally, ineffective policies, procedures, and controls exist to ensure the completeness and accuracy of relocation claims provided to, and used by, the actuary for the calculation of post-employment benefit liabilities.



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The Coast Guard's methodology used to estimate accounts payable is based on the prior year estimate, validated via a subsequent payment analysis, and does not consider or use all applicable current year data. Additionally, the information provided by medical service providers is not sufficient for the Coast Guard to perform detailed reviews prior to payment, and as such, modifications may be necessary to existing service agreements.

The Coast Guard has not fully developed, documented, and implemented policies and procedures to develop, prepare, and record environmental liability estimates in accordance with applicable accounting standards.

The process to record civilian related payroll accruals was not designed or operating effectively until fiscal year-end, leading to misstatements in quarterly financial statements.

*Criteria:* According to SFAS No. 5, *Accounting for Liabilities of the Federal Government*, paragraph 79, Other Retirement Benefits (ORB) include all retirement benefits other than pension plan benefits. Per paragraph 88, the ORB liability should be reported using the aggregate entry-age normal method. The liability is the actuarial present value of all future benefits less the actuarial future present value of future cost contributions that would be made for and by the employees under the plan.

According to SFAS No. 5, paragraph 95, the employer entity should recognize an expense and a liability for other post-employment benefits (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. Further, the long-term OPEB liability should be measured at the present value of future payments, which requires the employer entities to estimate the amount and timing of future payments, and to discount the future outflow over the period for which the payments are to be made.

The GAO *Standards* hold that transactions should be properly authorized, documented, and recorded completely and accurately. SFAS No. 1, paragraph 77 states, "When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of the goods. If invoices for those goods are not available when financial statements are prepared, the amounts owed should be estimated."

FASAB Technical Release No. 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*, states that an agency is required to recognize a liability for environmental cleanup costs as a result of past transactions or events when a future outflow or other sacrifice of resources is probable and reasonably estimable. "Probable" is related to whether a future outflow will be required. "Reasonably estimable" relates to the ability to reliably quantify in monetary terms the outflow of resources that will be required.

*Recommendations:* We recommend that the Coast Guard:

*Regarding actuarial liabilities:*

1. Continue to assess the effectiveness of controls implemented during FY 2010 to ensure that information used by the actuary to calculate the pension benefit liability is complete, accurate, and properly used in actuarial valuation calculations;
2. Develop and implement sufficient internal controls to ensure that information used by the actuary to calculate the actuarial medical benefit liability is complete and accurate; and
3. Implement effective policies, procedures, and controls to ensure the completeness and accuracy of information provided to the actuary to develop the post-employment travel benefit liability.

*Regarding accounts payable and payroll estimates:*

4. Analyze and make appropriate improvements to the methodology used to estimate accounts payable and support all assumptions and criteria with appropriate documentation to develop and subsequently validate the estimate for financial reporting;
5. Implement effective internal controls to ensure that services have been provided to qualified Coast Guard members prior or subsequent to the payment of medical invoices; and



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6. Continue to assess the effectiveness of internal controls implemented over payroll at fiscal year-end

*Regarding environmental liabilities:*

7. Develop and implement policies, procedures, processes, and controls to ensure the identification and recording of all environmental liabilities, to define the technical approach, to establish cost estimation methodology, and to develop overall financial management oversight of its environmental remediation projects. Consider the "Due Care" requirements defined in FASAB Technical Release No. 2. The policies should include:

- a. Procedures to ensure the proper calculation and review of cost estimates for consistency and accuracy in financial reporting, including the use of tested modeling techniques, use of verified cost parameters, and assumptions;
- b. Periodically validate estimates against historical costs; and
- c. Ensure that detailed cost data is maintained and reconciled to the general ledger.

**I-F Budgetary Accounting**

*Background:* Budgetary accounts are a category of general ledger accounts where transactions related to the receipt, obligation, and disbursement of appropriations and other authorities to obligate and spend agency resources are recorded. Each Treasury Account Fund Symbol (TAFS) with separate budgetary accounts must be maintained in accordance with OMB and Treasury guidance. The Coast Guard has over 90 TAFS covering a broad spectrum of budget authority, including annual, multi-year, and no-year appropriations; and several revolving, special, and trust funds.

*Conditions:* We noted the following internal control weaknesses related to budgetary accounting, many of which were repeated from our FY 2009 report. The Coast Guard has not:

- Fully implemented policies, procedures, and internal controls over the Coast Guard's process for validation and verification of undelivered order (UDO) balances. Recorded obligations and UDO balances were not always complete, valid, or accurate, and proper approvals and supporting documentation are not always maintained;
- Finalized and implemented policies and procedures to monitor unobligated commitment activity in CAS throughout the fiscal year. Currently, the Coast Guard only performs a year-end review to reverse commitments that are no longer valid; and
- Designed and implemented effective procedures, processes, and internal controls to verify the completeness and accuracy of the year-end obligation "pipeline" which are obligations executed on or before September 30 but not recorded in the Coast Guard's CAS, and to record all executed obligations. These deficiencies affected the completeness, existence, and accuracy of the year-end "pipeline" adjustment that was made to record obligations executed before year end.

*Cause/Effect:* Several of the Coast Guard's budgetary control weaknesses can be corrected by modifications or improvements to the financial accounting system, process improvements, and strengthened policies and internal controls. Weak controls in budgetary accounting, and associated contracting practices increase the risk that the Coast Guard could violate the *Anti-deficiency Act* and overspend its budget authority. The financial statements are also at greater risk of misstatement. Reliable accounting processes surrounding obligations, UDOs, and disbursements are essential for the accurate reporting of accounts payable in the DHS consolidated financial statements. The untimely release of commitments may prevent funds from being used for other purposes.

*Criteria:* According to the Office of Federal Financial Management's *Core Financial System Requirements*, dated January 2006, an agency is responsible for establishing a system for ensuring that it does not obligate or disburse funds in excess of those appropriated or authorized, and "the Budgetary Resource Management function must support agency policies on internal funds allocation methods and controls." The *Federal Acquisition Regulation (FAR)* Section 1.602 addresses the authorities and





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**Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard**

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responsibilities granted to contracting officers. Treasury's USSGL guidance at TFM S2 10-02 (dated August 2010) specifies the accounting entries related to budgetary transactions.

FFMIA Section 803(a) requires that each agency shall implement and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. OMB Circular No. A-127, as revised, prescribes the standards for federal financial management systems.

*Recommendations:* We recommend that the Coast Guard:

1. Continue to improve policies, procedures, and the design and effectiveness of controls related to processing obligation transactions, including periodic review and validation of UDOs. Emphasize to all fund managers the need to perform effective reviews of open obligations, obtain proper approvals, and retain supporting documentation;
2. Finalize policies and procedures to periodically review commitments, and make appropriate adjustments in the financial system; and
3. Improve procedures, processes, and internal controls to verify the completeness and accuracy of the year-end obligation "pipeline" adjustment to record all executed obligations for financial reporting.



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**Exhibit II – Material Weaknesses – DHS Civilian Components**

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**II-A Financial Management and Reporting**

*Department-wide Entity-Level Controls affecting Financial Reporting:*

*Background:* We were engaged to perform an integrated audit in fiscal year (FY) 2010, which is an audit of the financial statements integrated with an examination of internal control over financial reporting. The auditors' objective in an examination of internal control is to form an opinion on the effectiveness of internal control. We used the criteria defined in the Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, to evaluate effectiveness of internal control. OMB Circular No. A-123, and other similar control criteria such as *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), emphasizes the importance of entity-level controls as well as control activities over key financial statement processes. Consequently, when planning our examination, we gave appropriate emphasis to testing entity-level controls, such as management's risk assessment and monitoring processes, and other control environment elements that exist throughout the Department of Homeland Security (DHS or the Department). In FY 2009, we noted that the Department lacked a sufficient number of management personnel with the requisite financial accounting knowledge and background to ensure that its financial statements are prepared accurately and in compliance with generally accepted accounting principles. Throughout FY 2010, the Department executed a staffing plan to fill gaps in Department-wide skill sets, increasing the number of accounting and financial management personnel with essential technical competencies. Four Department-wide control environment conditions were identified through our examination procedures that have a pervasive influence on the effectiveness of controls. Those common themes are described below; however, they also contribute to several of the conditions presented throughout Exhibits I – IV.

*Conditions:* We identified the following Department-wide control environment weaknesses that have a pervasive effect on the effectiveness of internal controls over consolidated financial reporting:

- Development and implementation of effective information and communication processes to help ensure that technical accounting issues are identified, analyzed and resolved in a timely manner. For example, development of an accounting position and/or responses to our questions at the U.S. Customs and Border Protection (CBP), Federal Emergency Management Agency (FEMA) and Transportation Security Administration (TSA) at various times throughout the audit, is often a time-consuming process, that spans several months, even for some less complex matters;
- Generally, the components continue to be dependent on the external financial statement audit to discover and resolve technical accounting issues;
- Field and operational personnel do not always share responsibilities for, or are not held accountable for, financial management matters that affect the financial statements, including adhering to accounting policies and procedures and performing key internal control functions in support of financial reporting; and
- The Department's financial Information Technology (IT) system infrastructure is aging and has limited functionality, which is hindering the Department's ability to implement efficient corrective actions and produce reliable financial statements that can be audited. Weaknesses in the general control environment are interfering with more extensive use of IT application controls to improve efficiencies in operations and reliability of financial information.

*Recommendations:* We recommend that the Department's Office of the Chief Financial Officer (OCFO), with the support of the Deputy Secretary and Under Secretary for Management, develop and implement actions to:

- I. Design and implement strategies to ensure that technical accounting issues are identified, analyzed, and resolved in a timely manner. DHS components, working with Office of Financial Management (OFM) support, should be able to discuss initial accounting positions, with basic rationale and supporting facts, within one to two days of issue identification. Final resolution, may take longer depending on the complexity of the issues and impact on the Department, however, even difficult matters should be resolved in substantially less time;



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2. Consider realignment of some recently hired financial accounting and reporting personnel to devote more resources to technical accounting issue resolution, and reduce reliance on the external audit;
3. Expand the annual risk assessment process to involve field and operational personnel, to identify potential accounting and financial reporting issues, including accounting systems, processes, and infrastructure, where problems are likely to occur due to changing operations and programs; and
4. Continue the assessment of the Department's financial IT system infrastructure, with the objective of improving the effectiveness of IT controls, both general and application, and IT functionality in support of timely and accurate financial reporting. In the interim, consider opportunities to expand use of application controls to help ensure completeness, accuracy, authorization, and validity of financial transactions reported in the financial statements.

Financial Management and Reporting (TSA and FEMA):

*Background:* The TSA is in the final stages of establishing baseline accounting policies, procedures, and processes, with well-designed and effective internal controls. In FY 2010, TSA made progress by hiring accounting personnel, and completing the reconciliation of its balance sheet accounts. In addition, TSA addressed matters that have led to misstatements in the financial statements in previous years. Again in FY 2010, this progress was achieved through the exceptional efforts of a few people in the OFM, reliance on external contractor expertise, and reliance on the external audit to identify issues. Consequently, some entity-level and financial reporting control weaknesses reported in FY 2009 continued to exist, however measurable progress has been made FY 2010, allowing us to downgrade the severity of this control deficiency.

FEMA's accounting and financial reporting processes must support multi-faceted operations such as temporary assistance funds, disaster relief loans, national flood insurance programs, stockpiles of essential supplies, mission assignments to other federal agencies for restoration and reconstruction, and grants to state and local governments. While FEMA has taken positive steps in FY 2010 to correct control deficiencies that we have reported in the past, certain financial reporting control deficiencies continued to exist throughout the year.

CBP substantially corrected control deficiencies affecting financial reporting that we reported in FY 2009. However, some entity-level control deficiencies continue to exist, and have been reported in Comment III-G, *Other Entity-Level Controls*.

Conditions:

I. TSA:

- Has not fully developed its financial reporting process with sufficient policies, procedures, and internal controls to ensure the reliability of financial statements. For example, we noted that TSA:
  - Has not distributed the financial reporting workload to ensure that skill sets are aligned with tasks, make optimal use of newly hired resources, and improve the financial reporting internal control structure;
  - Lacks effective internal controls, including supervisory reviews and monitoring, at some significant process-level risk points, e.g., where there is a risk of material error within a process;
  - Does not perform sufficient procedures, or have established compensating controls, working in coordination with the Agency's OMB A-123 process, that would identify abnormalities in

	2010	2009	2008
DHS-HQ	N/A	N/A	C
TSA			
FEMA			
CBP	C		N/A

Key – Trend Table	
C	Deficiencies are corrected
	Deficiencies are less severe*
	Deficiencies are more severe*
* See Introduction	



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#### Exhibit II – Material Weaknesses – DHS Civilian Components

account balances and correct errors that may occur. Instead, Office of Financial Management (OFM) is dependent on receiving accurate data, from various sources within TSA, some of which may not have fully effective internal controls (see comment II-D, *Property, Plant, and Equipment*); and

- Remains dependent on the external financial statement audit process, or outside contractors, to identify risks of misstatement, account balance errors, and provide feedback on corrective action plans.

- Is not fully compliant with the United States Government Standard General Ledger (USSGL) requirements at the transaction level. For example, TSA did not record property-related adjustments into the applicable general ledger accounts at the appropriate fund account symbol to provide an audit trail to the transaction level; and
- Is unable to fully identify and present its intragovernmental balances and transactions by trading partner.

#### 2. FEMA:

- Did not have adequate processes and controls throughout the year to ensure that all adjustments were fully researched, substantiated, documented, and/or appropriately reviewed prior to preparation and submission of financial data to the Department. For example, FEMA performs manual adjustments to correct attributes for certain financial activity, primarily related to the Grants Program Directorate (GPD). These adjustments are not fully substantiated;
- Did not have well designed controls throughout the year over financial reporting to the Department using the Treasury Information Repository System (TIER) system, and did not always maintain evidence of the control procedures performed. For example, we noted that FEMA:
  - Did not properly document its verification that TIER beginning balances were accurate and agreed to prior year TIER ending balances;
  - Did not perform the June TIER to Integrated Financial Management Information System (IFMIS) reconciliation at the Treasury Account Fund Symbol (TAFS) level in June, and investigate discrepancies that existed between the TIER balances on the reconciliation and the submitted TIER trial balance;
  - Did not maintain evidence of supervisory review of the TIER file in the TIER holding area before it was moved to the TIER repository prior to the third quarter of FY 2010; and
  - Did not prepare and review the initial and final TIER to the IFMIS reconciliations prior to submission of the TIER file to the DHS TIER repository prior to the fourth quarter of FY 2010.
- Did not properly complete the Government Accountability Office (GAO) Financial Audit Manual (FAM) 2010 – Checklist for Federal Accounting, and the supervisory review control was not effective in identifying errors in the checklist.

*Cause/Effect:* TSA continued to devote substantial resources to remediation of control deficiencies and reconciliation of balance sheet accounts in FY 2010, which placed greater than normal demands on the staff. Technical accounting staff were often committed to projects, and TSA was unable to make optimal use of its newly hired resources in a review and monitoring capacity. As a result, in some cases, adjustments to correct errors in accounts were recorded without appropriate supporting analysis, documentation, and reviews.

FEMA's IT systems are outdated and have limited capacity for modification. (See comment II-B, *Information Technology Controls and Financial System Functionality*.) Consequently, FEMA must rely more heavily on manual analyses and adjustments to accurately prepare financial statements. With accelerated time-frames for reporting, particularly at year-end, the likelihood that a material error will occur increases. Additionally, prior to the fourth quarter of FY 2010, FEMA had not devoted adequate resources to correct the errors related to GPD. Further, prior to the third quarter of FY 2010, FEMA did not



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have formal documented processes for various financial reporting activities, including the timely completion and documentation of all TIER-related control activities.

*Criteria:* OMB Circular No. A-123 defines internal control and provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal control. In particular, management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. The documentation for internal control, all transactions, and other significant events should be readily available for examination. Further, relevant, reliable, and timely information should be communicated to relevant personnel at all levels within an organization. It is also crucial that an agency communicate with outside organizations. In addition, the Circular states that management should identify both internal and external risks, and analyze those risks for their potential effect on the agency.

The *Federal Financial Managers Improvement Act of 1996* (FFMIA) Section 803(a) requires that each agency shall implement financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the USSGL at the transaction level. FFMIA is intended to ensure that agencies use financial management systems that provide reliable, timely, and consistent information.

OMB Circular No. A-50, *Audit Follow-Up*, states that corrective action taken by management on resolved findings and recommendations is essential to improving the effectiveness and efficiency of Government operations. Each agency shall establish systems to assure the prompt and proper resolution and implementation of audit recommendations. These systems shall provide for a complete record of action taken on both monetary and nonmonetary findings and recommendations.

Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, paragraph 164, states that financial reporting “should help report users make relevant comparisons among similar federal reporting units, such as comparisons of the costs of specific functions or activities. Comparability implies that differences among financial reports should be caused by substantive differences in the underlying transactions or organizations rather than by the mere selection of different alternatives in accounting procedures or practices.”

Per Section 18 of the DHS OFM *Component Requirements Guide for Financial Reporting*, each component must “report Component information in accordance with the OMB financial reporting requirements, including OMB Circular No. A-136, *Financial Reporting Requirements* (as updated).”

The Treasury *Federal Intragovernmental Transactions Accounting Policies Guide*, dated August 13, 2010, states that OMB Circular No. A-136, *Financial Reporting Requirements*, as revised, require Federal CFO Act and non-CFO Act entities identified in the Treasury Financial Manual (TFM) 2010, Vol. I, Part 2, Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government*, to perform quarterly reconciliations of intragovernmental activity/balances. TFM, Section 4706, *Intragovernmental Requirements*, requires reporting agencies to reconcile and confirm intragovernmental activity and balances quarterly for specific reciprocal groupings. TFM Bulletin 2007-03, *Intragovernmental Business Rules*, also provides guidance to Federal agencies for recording and reconciling intragovernmental activities.

*Recommendations:* We recommend that:

1. TSA:
  - a. Consider redistribution of the workload to further integrate newly hired personnel with accounting skills into the financial reporting processes. As restructuring or realignment of staffing is considered, responsibilities can be better matched with technical skills;
  - b. Ensure that the annual risk assessment process is fully utilized to identify risk-points where control weaknesses exist and update policies and procedures to mitigate risk of error in the financial statements. This may also involve added supervisory reviews and monitoring controls at significant process-level risk points, particularly where the risk of misstatement exists outside of the OFM;



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- c. Strengthen monitoring controls, such as account relationship or flux analysis, to help identify and investigate potential errors in financial statements;
  - d. Develop policies and procedures to ensure compliance with the USSGL requirements at the transaction level. Specifically, the procedures should ensure that adjustments to the general ledger system are recorded at the appropriate fund account symbol and include the correct budgetary and proprietary entries; and
  - e. Work with its accounting service provider to ensure that the proper trading partner code is recorded for each intragovernmental transaction. Until such time, TSA should continue to perform its manual process for the identification and reporting of intragovernmental activities and balances.
2. FEMA:
- a. Fully implement new processes and controls to ensure that manual adjustments are fully researched, substantiated, documented, and/or appropriately reviewed prior to preparation and submission of financial data to the Department;
  - b. Complete the full implementation of the new TIER to IFMIS reconciliation processes and controls;
  - c. Formally document and implement policies and procedures for opening and closing funds, including requirements to maintain all supporting documents; and
  - d. Develop and implement procedures over the preparation and review of the GAO FAM 2010 – Checklist for Federal Accounting.

**II-B Information Technology Controls and Financial System Functionality**

*Background:* Effective IT general and application controls and financial systems functionality are essential for achieving accurate and reliable reporting of financial and performance data. As part of the DHS financial statement audit, we evaluated select IT general controls using the objectives defined by GAO's *Federal Information System Controls Audit Manual* (FISCAM), in five key control areas: security management, access control, configuration management, segregation of duties, and business continuity. In addition to IT general controls, we evaluated select application controls, which are controls supporting the structure, policies, and procedures that apply to the use, operability, interface, edit, and monitoring controls of a financial application. We also considered the effects of financial system functionality when testing internal controls. Many key DHS financial systems are not compliant with FFMA and OMB Circular Number A-127, *Financial Management Systems* (as revised and effective on October 1, 2009). DHS financial system functionality limitations add to the Department's challenges of addressing systemic internal control weaknesses, and limit the Department's ability to effectively and efficiently process and report financial data.

	2010	2009	2008
CBP			
USCIS			
FEMA			
FLETC			
ICE			N/A
TSA	C		
See page II.2 for table explanation			

During our FY 2010 assessment of IT general and application controls and financial system functionality, we noted that the DHS Civilian Components made some progress in remediation of IT findings we reported in FY 2009. We have closed approximately 30 percent of our prior year IT findings. In FY 2010, we identified approximately 140 findings, of which more than 60 percent are repeated from last year. Further, nearly one-third of our repeat findings were for IT deficiencies that management represented were corrected during FY 2010. Disagreements with managements self assessment occurred almost entirely at FEMA, and only occasionally in other components.

The findings identified below are a cross-representation of the nature of IT general control deficiencies identified throughout the Department's components. Many represent a single instance of an identified



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deficiency at one component, and may not be representative of the general control environment in other components.

*Conditions:* Our findings related to IT controls and financial systems functionality follow:

*Related to IT controls:*

1. *Access controls:*

- Deficiencies in management of application and/or database accounts, network, and remote user accounts:
  - System administrator root access to financial applications was not properly restricted, logged, and monitored;
  - Strong password requirements were not enforced;
  - User account lists were not periodically reviewed for appropriateness, inappropriate authorizations and excessive user access privileges were allowed at some DHS components, and users were not disabled or removed promptly upon personnel termination;
  - Emergency and temporary access was not properly authorized, and contractor development personnel were granted conflicting access to implement database changes;
  - Initial and modified access granted to application and/or database, network, and remote users was not properly documented and authorized; and
  - The process for authorizing and managing remote virtual private network (VPN) access to external state emergency management agencies, and component contractors, did not comply with DHS and component requirements.
- Ineffective safeguards over logical and physical access to sensitive facilities and resources:
  - While performing after-hours physical access testing, we identified the following unsecured items: Government credit cards; financial system user IDs and passwords; computer laptops; and server names and IP addresses; and
  - While performing social engineering testing, we identified instances where DHS employees provided their system user names and passwords to an auditor posing as a help desk employee.
- Ineffective or insufficient use of available audit logs:
  - Logs of auditable events are not being reviewed to identify potential incidents, or were reviewed by those with conflicting roles;
  - Logging of application and/or database events required to be recorded was not enabled;
  - Documented procedures for audit log follow-up do not meet DHS requirements; and
  - Evidence of audit log reviews was not retained.

2. *Configuration management*

- Lack of documented policies and procedures:
  - To prevent users from having concurrent access to the development, test, and production environments of the system at four DHS components; and
  - Configuration, vulnerability, and patch management plans have not been established and implemented, or did not comply with DHS policy;
- Vulnerabilities were identified during periodic internal scans and related corrective actions were not reported and tracked in accordance with DHS policy; and



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- Security patch management and configuration deficiencies were identified during the vulnerability assessment on hosts supporting the key financial applications and general support systems.
3. *Security management:*
- Systems certification and accreditation:
    - Several component financial and associated feeder systems as well as general support systems were not properly certified and accredited, in compliance with DHS policy;
    - Compliance with the Federal Desktop Core Configuration (FDCC) security configurations is in progress, but has not been completed; and
    - An instance where Interconnection Security agreements was not documented.
  - Roles and responsibilities have not been clearly defined:
    - Instances of security roles and responsibilities are not adequately defined for financial applications and general support systems; and
    - System boundaries have not been adequately and completely defined within the System Security Plan.
  - Lack of policies and procedures:
    - One instance of incomplete or inadequate policies and procedures associated with computer incident response capabilities;
    - Procedures for exit processing of transferred/terminated personnel, including contractors, had not been established; and
    - Lack of component policies and procedures for IT-based specialized security training.
  - Lack of compliance with existing policies:
    - Several instances where background investigations of federal employees and contractors employed to operate, manage and provide security over IT systems were not being properly conducted;
    - Lack of compliance with DHS computer security awareness training requirements;
    - Non-disclosure agreements were not completed at one DHS component; and
    - A complete and accurate listing of workstations could not be provided at one DHS component and as a result anti-virus protection is not installed on all workstations.
4. *Contingency Planning:*
- Instances where incomplete or outdated business continuity plans and systems with incomplete or outdated disaster recovery plans were noted at four DHS components. Some plans did not contain current system information, emergency processing priorities, procedures for backup and storage, or other critical information;
  - Service continuity plans were not consistently and/or adequately tested, and individuals did not receive training on how to respond to emergency situations at four DHS components;
  - An alternate processing site has not been established for high risk systems; and
  - Appropriate authorization to access backup media was not made available.
5. *Segregation of Duties:*
- Financial system users had conflicting access rights as the Originator, Funds Certification Official, and an Approving Official profile;





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**Exhibit II – Material Weaknesses – DHS Civilian Components**

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- Lack of evidence to show that least privilege and segregation of duties controls exist; and
- Policy and procedures to define and implement segregation of duties were not properly developed and/or implemented.

These control findings, including other significant deficiencies are described in greater detail in a separate *Limited Official Use* letter provided to DHS management.

*Related to financial system functionality:*

We noted that in some cases, financial system functionality is inhibiting DHS' ability to implement and maintain internal controls, notably IT applications controls supporting financial data processing and reporting. Financial system functionality limitations also contributes to other control deficiencies reported in Exhibits I, II and III, and can make compliance with FFMA and OMB Circular A-127 more difficult. Financial system functionality conditions include:

- Inability to modify IT system core software, and install controls to prevent duplicate payments. The component identified two instances where duplicate payments were made in FY 2009 and FY 2010, and the funds needed to be recovered;
- The financial systems in one component cannot be configured to:
  - Prevent, detect, and correct excessive refunds;
  - Provide summary information of the total unpaid assessments for duties, taxes, and fees by individual importer; and
  - Report information on outstanding receivables, the age of receivables, or other data necessary for management to fully monitor collection actions; and
- Two inventory tracking systems are not fully integrated with the financial system of record; and
- Several financial systems do not have the necessary functionality to enforce DHS-required system security requirements. For example, one system does not have the functionality to enforce policy requirements related to password complexity, account lockout, and profiles changes. In addition, a system does not have the functionality to track new users or user profile changes.

*Cause/Effect:* The IT control weaknesses have resulted from systemic challenges in complying with DHS security policies, which is complicated by many components' financial systems inability to offer the necessary functionality. One key Department financial system was migrated to a new operating platform during FY 2010, which will help alleviate some control weaknesses and functionality limitations. However, DHS broad and systemic IT weaknesses and financial system functionality limitations will not be fully addressed until the Department implements a stable centralized financial system platform. DHS is currently planning such a platform - the Transformation and Systems Consolidation (TASC) initiative, which is designed to consolidate and integrate mission-essential enterprise financial, acquisition, and asset management systems. However, the time and resources needed to implement TASC and address IT control weaknesses will take several years.

The conditions supporting our findings collectively limit DHS' ability to ensure that critical financial and operational data is kept secure and is maintained in a manner to ensure confidentiality, integrity, and availability. Many of these weaknesses, especially those in the area of access and configuration management controls, may result in material errors in DHS' financial data that are not detected in a timely manner and in the normal course of business. In addition, as a result of the presence of IT control weaknesses and financial system functionality weaknesses, there is added pressure on other mitigating controls to be operating effectively at all times. Because mitigating controls often require more manually performed procedures, there is an increased risk of human error that could materially affect the financial statements.



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*Criteria:* The *Federal Information Security Management Act (FISMA)* passed as part of the *E-Government Act of 2002*, provides guidance that Federal entities maintain IT security programs in accordance with National Institute of Standards and Technology (NIST) guidance.

OMB Circular Number A-130, *Management of Federal Information Resources*, establishes policy for the management of Federal information resources.

FFMIA is intended to ensure that agencies use financial management systems that provide reliable, timely, and consistent information. The purpose of FFMIA is to: (1) provide for consistency of accounting by an agency from one fiscal year to the next, and uniform accounting standards throughout the Federal Government; (2) require Federal financial management systems to support full disclosure of Federal financial data, including the full costs of Federal programs and activities; (3) increase the accountability and credibility of federal financial management; (4) improve performance, productivity and efficiency of Federal Government financial management; and (5) establish financial management systems to support controlling the cost of Federal Government. FFMIA requirements are complemented by specific financial system policies and standards contained in OMB Circular Number A-127, as revised on October 1, 2009.

DHS *Sensitive Systems Policy Directive 4300A*, as well as the *DHS 4300A Sensitive Systems Handbook*, documents policies and procedures adopted by DHS intended to improve the security and operation of all DHS IT systems.

*Recommendations:* We recommend that the DHS Office of the Chief Information Officer, in coordination with the OCFO, make necessary improvements to the Department's financial management systems. Specific recommendations are provided in a separate *Limited Official Use* letter provided to DHS management.

**II-C Not Used**

**II-D Property, Plant, and Equipment (TSA and CBP)**

*Background:* TSA manages passenger and baggage X-ray, explosives detection, and other equipment as part of its mission. This equipment, which is in every major U.S. airport, is owned and maintained by TSA. The costs required to procure, ship, temporarily store, install, operate, and maintain this equipment are substantial and consume a large portion of TSA's annual operating budget. Unique accounting processes and systems are necessary to track the status and accumulate costs, and to accurately value, account for, and depreciate the equipment. TSA completed the reconciliation of its property, plant and equipment (PP&E) accounts in FY 2010 and was able to assert to that its PP&E balances at September 30, 2010 are fairly stated in the DHS FY 2010 AFR. TSA made some progress remediating controls deficiencies however was not able to fully address all of the conditions that existed in FY 2009.

CBP has acquired substantial new technology, facilities, and other assets in recent years through purchase and construction. CBP's increased assets include construction of border fencing (both physical and virtual), purchase of inspection equipment at ports of entry, and new construction at port of entry facilities.

USCIS, ICE and NPPD corrected the PP&E conditions we reported in FY 2009.

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

- I. TSA:
  - Has not implemented policies, procedures, and controls to properly identify risks and potential errors related to general property, equipment, and software balances, as necessary, to maintain the accuracy and completeness of those account balances. For example, we noted that TSA did not accurately and completely account for internal use software, other direct costs (ODC) incurred to transport, store, and install screening equipment at airports, and depreciation expense throughout

	2010	2009	2008
CBP	Green	Red	Green
FEMA	N/A	C	Red
TSA	Red	Red	Red
USCIS	C	Green	N/A
ICE	C	Green	N/A
NPPD	C	Green	N/A
See page II.2 for table explanation			



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FY 2010. Several adjustments totaling in excess of \$100 million, some of which were auditor-identified adjustments, were required to fairly state PP&E accounts affected by these items:

- Has not fully adopted sufficient procedures to properly document, track, and value capital assets on an on-going basis. For example, we noted that TSA lacks sufficient policies and procedures to:
  - Perform a periodic analysis of idle assets stored in a warehouse and adjust the carrying value of those assets to net realizable value (NRV), if necessary, as required by GAAP;
  - Ensure that assets warehoused are inventoried and reported in the financial statements timely and accurately;
  - Identify and account for assets below the capitalization threshold (i.e., peripheral equipment);
  - Ensure asset additions, disposals, and transfers are recorded in the general ledger timely and accurately; and
- Continues to have weaknesses in coordination and communication (including training, oversight, and monitoring) with personnel outside of the OFM that contribute to control weaknesses in processes dependent on operations.

2. CBP:

- Does not have adequate accounting policies, procedures, processes, and controls to properly account for new equipment purchases and transfers, construction, or disposal of assets in a timely manner. For example, CBP did not:
  - Consistently record construction-in-process (CIP) to its construction projects per the observed percentage of completion (POC);
  - Transfer assets from CIP to "in-use" assets in a timely manner; and
  - Record some asset additions and disposals in accordance with its policy.
- Did not properly perform and/or document several physical annual inventories related to real and personal property.

*Cause/Effect:* TSA focused primarily on correcting the conditions that prevented management from asserting to the accuracy and completeness of certain PP&E balances as of September 30, 2009, and relatively less time was devoted to correcting related control deficiencies in FY 2010. Further, time constraints caused TSA to record some adjustments before a proper review was performed. These conditions led to a number of errors in the financial statements that were discovered during our audit. In some cases, TSA was dependent on input and feedback from outside contractors, and the auditor for interpretation and application of accounting standards to resolve difficult accounting issues related to the development of its opening balance sheet. This deficiency is also related to the conditions described in Comment II-A, *Financial Management and Reporting*.

CBP does not have documented and/or fully implemented policies and procedures, or does not have sufficient oversight of its policies and procedures, to ensure that all PP&E transactions are recorded timely and accurately. As a result, CBP's PP&E balance may be misstated by the recording of transactions, which are incorrect, unsupported, or untimely. Also, CBP IT systems lack functionality to track and account for assets in various stages of completion and deployment leading to increased manual involvement to accurately report assets. This deficiency is also related to the conditions described in Comment II-A, *Financial Management and Reporting*, and Comment II-B, *Information Technology Controls and Financial System Functionality*.

*Criteria:* SFFAS No. 10, *Accounting for Internal Use Software*, provides requirements for the capitalization and reporting of internal use software development costs. According to paragraph 16, the capitalizable cost should include "... the full cost (direct and indirect cost) incurred during the software development stage." Per SFFAS No. 10, paragraphs 18-20, "For COTS [Commercial off-the-shelf] software, capitalized cost should include the amount paid to the vendor for the software. For contractor-developed software, capitalized cost should include the amount paid to a contractor to design, program,



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#### Exhibit II – Material Weaknesses – DHS Civilian Components

install, and implement the software. Material internal cost incurred by the federal entity to implement the COIS or contractor-developed software and otherwise make it ready for use should be capitalized [...] Costs incurred after final acceptance testing has been successfully completed should be expensed."

SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, paragraph 17, states, "Property, plant, and equipment consists of tangible assets, including land, that meet the following criteria: they have estimated useful lives of 2 years or more; they are not intended for sale in the ordinary course of operations, and they have been acquired or constructed with the intention of being used, or being available for use by the entity." Per paragraph 26, "All general PP&E shall be recorded at cost. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use." Paragraph 34 requires, "In the case of constructed PP&E, the PP&E shall be recorded as construction work in progress until it is placed in service, at which time the balance shall be transferred to general PP&E." Per paragraph 35, "Depreciation expense is calculated through the systematic and rational allocation of the cost of general PP&E, less its estimated salvage/residual value, over the estimated useful life of the general PP&E. Depreciation expense shall be recognized on all general PP&E, except land and land rights of unlimited duration." Per paragraphs 38, "In the period of disposal, retirement, or removal from service, general PP&E shall be removed from the asset accounts along with associated accumulated depreciation/amortization. Any difference between the book value of the PP&E and amounts realized shall be recognized as a gain or a loss in the period that the general PP&E is disposed of, retired, or removed from service."

GAO's *Standards for Internal Control in the Federal Government (Standards)* requires that internal control and all transactions and other significant events be clearly documented and readily available for examination. The Joint Financial Management Improvement Program (JFMIP), *Property Management Systems Requirements*, states that the agency's property management system must create a skeletal property record or have another mechanism for capturing information on property in transit from the providing entity (e.g., vendor, donor, lender, grantor, etc.).

*Recommendations:* We recommend that:

1. TSA:
  - a. Develop and implement policies and procedures to properly identify risks, potential errors, and account for, monitor, and report general property, equipment, and internal use software balances;
  - b. Develop and implement sufficient procedures to properly document, track, and value assets on an on-going basis; and
  - c. Improve coordination and communication with personnel outside of the Office of Financial Management to ensure that actions regarding updates to the capital asset subsidiary ledger are properly reflected in accordance with GAAP.
2. CBP:
  - a. Develop, document, and communicate policies and procedures for classifying, recording, and reviewing all capital transactions, particularly for new construction, to ensure that the financial statements are materially correct and presented in accordance with GAAP. Consideration should be given to the adequacy of policies to account for CIP, including methodologies to apply overhead charges, and establishing an appropriate useful life for annual depreciation charges;
  - b. Emphasize the need to record asset additions and disposals in accordance with established policy;
  - c. Consider adding supervision and monitoring controls to ensure that all intended corrective actions are effective and functioning properly;
  - d. Establish and implement a standardized process that is integrated with its financial system of record in order to facilitate the timely recording of new assets placed into service; and
  - e. Improve guidance for the performance and documentation of PP&E inventories.



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Exhibit II – Material Weaknesses – DHS Civilian Components

II-E Actuarial and Other Liabilities (FEMA)

Background: FEMA is recognized as the primary grant-making component of DHS, managing multiple Federal disaster and non-disaster grant programs.

Conditions: We noted the following internal control weaknesses related to other liabilities at FEMA:

- Does not have sufficient policies and procedures in place to fully comply with the *Single Audit Act Amendments of 1996* (*Single Audit Act*) and related OMB Circular No. A-133, *Audits of States, Local Governments, and Nonprofit Organizations* (OMB Circular A-133) (see Comment IV-K, *Single Audit Act Amendments of 1996*).
- Does not maintain accurate and timely documentation related to site visits/desk reviews performed for grantees. Specifically, our control testwork performed over a sample of 60 site visits/ desk reviews performed during the six-month period ended March 31, 2010, identified 35 exceptions related to documentation; and
- Does not consistently follow-up with grantees who have failed to submit quarterly financial and/or programmatic reports timely.

	2010	2009	2008
FEMA			
FLETC	C	C	
ICE	C	C	
S&T	C	C	
TSA	C		C
See page II.2 for table explanation			

Cause/Effect: FEMA has not implemented policies and procedures over its grant program in order ensure compliance with the *Single Audit Act* and OMB Circular A-133. In addition, while GPD guidance and grant monitoring policies and procedures were disseminated in early FY 2009, all regions have not yet achieved the same level of control conscientiousness when it comes to documentation of grantee monitoring. As a result, misreported grantee expenses may not be detected, which would impact the fair presentation of FEMA's grant accrual balances, undelivered orders, and expenses.

Criteria: OMB Circular No. A-123 states, "Management is responsible for developing and maintaining effective internal control. Effective internal control provides assurance that significant weaknesses in the design or operation of internal control, that could adversely affect the agency's ability to meet its objectives, would be prevented or detected in a timely manner. [...] Management should identify internal and external risks that may prevent the organization from meeting its objectives. When identifying risks, management should take into account relevant interactions within the organization as well as with outside organizations."

The *Single Audit Act Amendments of 1996*, Section 7502 (f)(1)(B) states, "Each Federal agency which provides Federal awards to a recipient shall... review the audit of a recipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to Federal awards provided to the recipient by the Federal agency." Chapter 75, Section 7504 requires each federal awarding agency to "monitor non-Federal entity use of Federal awards."

OMB Circular No. A-133, Subpart D, provides for the responsibilities of federal agencies and pass-through entities for audits of states, local governments, and non-profit organizations.

Recommendations: We recommend that:

- I. FEMA:
  - a. Implement policies and procedures to ensure full compliance with the *Single Audit Act* and the related OMB Circular No. A-133; and
  - b. Continue to provide comprehensive financial monitoring plans and expand guidance to regional staff responsible for conducting financial monitoring visits and obtaining and reviewing required quarterly grantee reports.



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**Exhibit II – Material Weaknesses – DHS Civilian Components**

**II-F Budgetary Accounting (FEMA and CBP)**

*Background:* Budgetary accounts are a category of general ledger accounts where transactions related to the receipt, obligation, and disbursement of appropriations and other authorities to obligate and spend agency resources are recorded. DHS has over 350 separate TAFS combined, each with separate budgetary accounts that must be maintained in accordance with OMB and Treasury guidance. The TAFS cover a broad spectrum of budget authority, including annual, multi-year, and no-year appropriations, and several revolving, special, and trust funds. Accounting for budgetary transactions in a timely and accurate manner is essential to managing the funds of the Department and preventing overspending of allotted budgets.

	2010	2009	2008
CBP			
FEMA			
TSA	N/A	N/A	C
See page II.2 for table explanation			

In FY 2010, FEMA improved its processes and internal controls over the obligation and monitoring process; however, some control deficiencies remain.

CBP has implemented policies and procedures requiring the timely review and deobligation of funds when the contracts have expired or are complete. However, CBP has not been effective in adhering to its policy or in monitoring compliance.

*Conditions:* We noted the following internal control weaknesses related to budgetary accounting at FEMA and CBP:

1. FEMA:
  - Did not effectively monitor the status of its obligations as part of its normal operations to ensure timely deobligation when appropriate;
  - Could not readily provide all supporting documentation for undelivered orders (UDO)s, other than mission assignments, interagency agreements, and non-disaster grants tested at June 30, 2010 and September 30, 2010. We noted that for certain portions of the population, significant effort was required to coordinate and identify the responsible parties, to access certain files, or to provide information in a form that clearly supported the balances reported in the financial statements; and
  - Was required to correct numerous erroneous entries recorded by the Budget Planning & Analysis Division (BPAD) or to record transactions that should have been recorded by the BPAD but were not.
2. CBP is not enforcing its policies and procedures (Directive 1220-011C) to monitor and deobligate or close-out its obligations in a timely manner. We noted that CBP did not properly deobligate inactive undelivered orders for several items we tested as of September 30, 2010. In addition, when completing its review and certification of UDOs as of December 31, 2009, CBP marked the majority of its UDOs as not yet reviewed.

*Cause/Effect:* FEMA's administrative functions are geographically separated from programmatic operations which make locating certain UDO documentation difficult. Additionally, FEMA's new UDO annual certification and quarterly validation processes are not fully effective. Without supporting documentation, FEMA is unable to support the validity of certain UDO balances. Certain personnel within the BPAD do not have the necessary skills or training to correctly record budgetary entries in FEMA's general ledger. As a result, FEMA's financial information submitted to DHS may contain significant budgetary account errors if they are not detected by the OCFO.

CBP did not properly monitor all open obligations, and consequently, government funds may be committed and not made available to CBP for other Federal expenditures for longer periods of time than necessary. In addition, CBP's financial statements will not properly reflect the status of obligations.

*Criteria:* According to GAO *Standards*, "transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final

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classification in summary records.” Further, “control activities help to ensure that all transactions are completely and accurately recorded.” In addition, “internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination [...] All documentation and records should be properly managed and maintained.”

US Code Title 31 Section 1501 states that “an amount shall be recorded as an obligation of the United States Government only when supported by documentary evidence of (1) a binding agreement between an agency and another person (including an agency) that is (a) in writing, in a way and form, and (b) Executed before the end of the period of availability for obligation of the appropriation or fund used for specific goods to be delivered, real property to be bought or leased, or work or service to be provided.” Section 1554, Audit, control and reporting states, “The head of each agency shall establish internal controls to assure that an adequate review of obligated balances is performed...”

CBP Directive 1220-011C states that all obligation records must be reconciled to supporting documentation at the close of each quarter and that additionally, a semi-annual review of specific populations of obligations must be performed and the status for each record identified to assure that only valid obligations remain open.

*Recommendations:* We recommend that:

1. FEMA:
  - a. Modify and complete the implementation of the new UDO annual certification and quarterly validation processes to ensure that outstanding obligations are reviewed for validity quarterly;
  - b. Continue to improve procedures for storing and locating documentation supporting UDO information, including points of contact, so that supporting information is readily available for management review and audit purposes; and
  - c. Dedicate the appropriate resources to adequately staff, train, and supervise BPAD personnel to ensure that the BPAD is properly recording all necessary budgetary transactions.
2. CBP:
  - a. Implement improved procedures to ensure full compliance with CBP Directive 1220-011C to ensure that obligations are reconciled to supporting documentation on a quarterly basis and are reviewed for validity on a semi-annual basis.



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**Exhibit III – Significant Deficiencies – All DHS Components**

**III-G Other Entity-Level Controls (USCG, FEMA and CBP)**

*Background:* In the past three years, the Department of Homeland Security (DHS or the Department) has undertaken and completed several steps designed to strengthen its entity and process level internal controls, and thereby improve the reliability of financial reporting. These steps are documented in the *Internal Control over Financial Reporting Playbook* and in component level Mission Action Plans (MAPs) prepared annually. The Department's Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, assessment is also designed to assist with the remediation of control deficiencies.

	2010	2009	2008
USCG			
FEMA			
CBP		NA	NA
TSA	C		
See page II.2 for table explanation			

The comments below should be read in conjunction with Comments I-B and II-B, *Information Technology Controls and Financial System Functionality*, which describe other entity-level control weaknesses related to Department and Component IT systems. United States Coast Guard (Coast Guard) and Department-wide entity-level control deficiencies that contribute to the Department's material weakness in financial reporting are presented in Comments I-A and II-A, *Financial Management and Reporting*, respectively.

The Coast Guard continues to make progress in remediation of control deficiencies that are important to its objective of becoming auditable in FY 2011. Some of the conditions cited below are repeated from FY 2009 and remain important to the Coast Guard's continued success in reconciling opening balances, and installing policies and procedures to support sustainable accounting processes and reliable financial reporting. The Coast Guard continues to follow the *Financial Strategy for Transformation and Audit Readiness* (FSTAR) updated in FY 2009. The FSTAR is a comprehensive plan to identify and correct the root causes of control deficiencies.

FEMA made continued progress toward correction of its entity-level control deficiencies in FY 2010. While progress has been made, some entity-level control deficiencies identified at FEMA in previous years continued during FY 2010, and are repeated below.

CBP's investment in accounting and financial reporting infrastructure did not keep pace with its significant expansion in capital assets in prior years, creating an environment where financial statement errors are more likely to occur. In FY 2010, CBP management recognized that its operations continue to experience rapid and large scale growth and took action to bring the resources allocated to its financial management in line with this growth. However, our audit determined that some entity-level control deficiencies continued to exist, which impair CBP's ability to produce timely, reliable financial information throughout the fiscal year.

*Conditions:* We noted the following internal control weaknesses related to other entity-level controls:

1. Coast Guard:

- Has not developed adequate policies, procedures, or controls associated with monitoring, training, and continual education courses associated with personnel with financial duties;
- Does not have standardized job descriptions that include the identification and definition of tasks required, for particular assignments that have financial duties;
- Does not have policies that are operating effectively for hiring and evaluating financial employees, as management does not maintain adequate documentation for certain hiring requirements and periodic performance evaluations; and
- Has not developed adequate controls with the Standards of Ethical Conduct to a) ensure that recent changes in the Coast Guard environment are included, and b) track and monitor compliance, including document retention for the investigation of any violation and corrective actions taken to ensure proper filing and review of the Confidential Disclosure Reports and ethics training requirements.



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**Exhibit III – Significant Deficiencies – All DHS Components**

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2. FEMA:

- Has not developed sufficiently effective methods of communication to ensure that significant financial-related system development and acquisition projects involve all relevant stakeholders, including the Office of the Chief Financial Officer (OCFO), to ensure the projects meet organizational mission needs and functional and technical requirements;
- Has not provided adequate monitoring and oversight of its National Flood Insurance Program (NFIP) contractor to ensure the implementation and maintenance of required security controls for NFIP information systems;
- Has not completed its documentation and/or update of formal policies and procedures (including desk manuals) for several of the roles, responsibilities, processes, and functions performed within FEMA;
- Has not committed sufficient resources to ensure that personnel attend required ethics training; and
- Has not developed sufficient policies and procedures to properly designate position sensitivity for positions that use, develop, or operate IT systems; track the status of background investigations; and maintain related documentation.

3. CBP:

- Does not timely resolve or have proper oversight of financial management issues, particularly, when the information resides with and/or is controlled and maintained by a contractor, to ensure that policies are followed and transactions are recorded accurately and timely in the general ledger. The lack of oversight contributed to the following conditions:
  - Operating materials and supply purchases were not properly recorded in a timely manner;
  - Financial information received from contractors was not always timely, reliable, and complete;
  - Inaccurate reporting of the percentage of completion of construction projects in the first half of FY 2010; and
  - Ultimate resolution of accounting issues related to SBInet were not finalized until the final weeks of the fiscal year.

*Cause/Effect:* Coast Guard management has acknowledged that longstanding procedural, control, personnel, IT and cultural issues have impeded progress toward installing an effective financial management structure. Coast Guard has developed, and is in the process of implementing, a multi-year MAP (FSTAR) that addresses entity-level controls, see comment I-A, *Financial Management and Reporting*.

In FY 2010, FEMA devoted substantial resources to developing certain policies and procedures, including those related to financial reporting. Consequently, FEMA devoted comparatively less attention to correcting other control deficiencies in FY 2010. Decentralized and informal background investigation processes present potential risks to FEMA's operations and IT systems.

In its FY 2010 representations made to the Secretary pursuant to the *DHS Financial Accountability Act*, the Coast Guard stated that they cannot provide reasonable assurance that internal control over financial reporting are operating effectively.

CBP does not have an effective process in place to timely review and analyze contractor information that could potentially impact the financial statements. As a result, CBP is unable to address changes in its operations that could potentially result in errors or omissions in the financial statements, or misapplication of GAAP may go undetected throughout the year.

*Criteria:* OMB Circular No. A-123, as revised, states that internal controls are the organization, policies, and procedures that agencies use to help program and financial managers achieve results and safeguard the integrity of their programs.



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**Exhibit III – Significant Deficiencies – All DHS Components**

The *Federal Managers' Financial Integrity Act of 1982 (FMFIA)* requires that agencies establish internal controls according to standards prescribed by the Comptroller General. These standards are established in the GAO's *Standards for Internal Control in the Federal Government (Standards)*. The GAO defines 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 GAO *Standards* identify the control environment as one of the five key elements of control, which emphasizes the importance of conscientiousness in management's operating philosophy and commitment to internal control. These standards cover controls such as human capital practices, supervisory reviews, policies, procedures, monitoring, and segregation of duties.

DHS 4300A *Sensitive Systems Handbook*, sets forth requirements related to background investigations for federal employees and contractors requiring access to DHS systems.

FEMA Directive Number 112-1, *Directives Management System*, sets forth the procedures for initiating, authorizing and updating FEMA directives. Page 5 of Directive states that the Directives Management System Point-of-Contact (DMS-POC) is responsible for "Establishing a biennial re-certification process for the review of their organization's functional area directives by using FEMA Form 112-1-1-1 Management Directives Review Report, and providing notification to the Directives Management Office."

*Recommendations:* We recommend that:

1. Coast Guard:
  - a. Review and enhance, if necessary, the entity-level planned actions in its FSTAR to include steps to fully assess entity-level controls, develop effective corrective actions, and implement improved financial processes and systems.
2. FEMA:
  - a. Develop and implement agency-wide communication protocols to ensure that significant financial-related system development and acquisition projects involve all relevant stakeholders, including the OCFO;
  - b. Develop and implement monitoring procedures over the NFIP contractor to ensure the implementation and maintenance of required controls for NFIP information systems;
  - c. Complete the efforts underway to ensure that formal policies and procedures (including desk manuals) are documented and current for all significant roles, responsibilities, processes, and functions performed within FEMA;
  - d. Complete development and implementation of procedures and dedicate resources to provide, track compliance with, and monitor the annual and new hire ethics training requirements; and
  - e. Develop and implement policies and procedures to properly designate position sensitivity for all positions that use, develop, or operate IT systems; track the status and completion of background investigations; and maintain related documentation.
3. CBP:
  - a. Executive senior management needs to emphasize the importance of the financial statements to all program offices to ensure they provide the information necessary to identify and address risks and issues related to CBP's operations which could possibly lead to misstatements on CBP's financial statements; and
  - b. CBP program offices should conduct an assessment relating to their financial reporting requirements to ensure they have the proper resources and processes to timely and accurately provide the information requested for the CBP Financial Statements.



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**Exhibit III – Significant Deficiencies – All DHS Components**

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**III-H Custodial Revenue and Drawback (CBP Only)**

*Background:* CBP collects approximately \$29.5 billion in annual import duties, taxes, and fees on merchandise arriving in the United States from foreign countries (identified below as the Entry Process). Receipts of import duties and related refunds are presented in the statement of custodial activity in the DHS financial statements.

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.

Our findings on the Entry Process include In-bond, Bonded Warehouse, Foreign Trade Zones, and the Trade Compliance Measurement Program (TCM). In-bond entries occur when merchandise is transported through one port; however, the merchandise does not officially enter U.S. commerce until it reaches the intended port of destination. Bonded Warehouses (BW) are facilities, under the joint supervision of CBP and the Bonded Warehouse Proprietor, used to store merchandise that has not made entry into the United States commerce. Foreign Trade Zones (FTZ) are secured areas under CBP supervision that are used to manufacture goods that are considered outside of the United States commerce for duty collection.

TCM is the primary method by which CBP measures risk in the areas of trade compliance and revenue collection. CBP utilizes the TCM program to measure the effectiveness of its control mechanisms deployed, and its execution in collecting revenues rightfully due to the U.S. Department of the Treasury.

*Conditions:* We noted the following internal control weaknesses related to custodial activities at CBP:

*Related to drawback:*

- The Automated Commercial System (ACS) lacks automated controls to detect and prevent excessive drawback claims and overpayments, necessitating inefficient manual processes that do not effectively compensate for these automated controls;
- ACS lacks controls to prevent the overpayment of drawback claims at the summary line level;
- Drawback review policies do not require drawback specialists to review all, or a statistically valid sample, of prior drawback claims against a selected import entry to determine whether, in the aggregate, an excessive amount was claimed;
- Drawback review policy and procedures allow drawback specialists, with supervisory approval, to judgmentally decrease the number of underlying consumption entries (UCEs) randomly selected for review, which decreases the review's effectiveness. Further, CBP's sampling methodology for selecting UCEs is not considered to be statistically valid; and
- The period for document retention related to a drawback claim is only three years from the date of payment, based on statutory requirements set by Congress. However, there are several situations that could extend the life of the drawback claim well beyond three years.

*Related to the Entry Process:*

- CBP is unable to determine the status of the in-bond shipments and lacks policies and procedures that require monitoring the results of in-bond audits and require the review of overdue air in-bonds. Although port personnel are required to review some overdue in-bonds, there is no requirement to completely resolve overdue items;
- In-bond cargo examinations were not performed at the ports in FY 2010 because CBP failed to manually reset its system that selects in-bond cargo examinations at the beginning of fiscal year;
- CBP does not perform an analysis to determine the overall compliance rate of the in-bond program. CBP does not analyze the rate and types of violations found to determine the effectiveness of the in-bond program, and does not identify a projected total amount of uncollected



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duties and fees on in-bond merchandise that has physically entered U.S. commerce without formal entry to ensure there is not a potentially significant loss of revenue;

- TCM oversight guidelines do not provide complete coverage over the TCM program. CBP implemented a consistent set of procedures for performing TCM reviews, during FY 2010, however, there are weaknesses in the oversight and monitoring of the TCM program at the port and CBP headquarter locations; and
- Current BW and FTZ Compliance Review Manuals lack specific guidance for ports to determine the appropriate risk assessment of a BW or FTZ. In addition, HQ review of the BWs and FTZs assessment results does not provide CBP with objective data related to the effectiveness of compliance reviews, common discrepancies found and the risks associated with those discrepancies, and techniques for mitigating risks.

*Cause/Effect:* IT system functionality and outdated IT systems contribute to the weaknesses identified above, also see Comment II-B, *Information Technology Controls and Financial System Functionality*. For example, CBP is unable to determine the status of the in-bond shipments with the information available within ACS, and CBP does not have the ability to run an oversight report to determine if ports have completed all required audits. For drawback, much of the process is manual until IT system functionality improvements are made, placing an added burden on limited resources.

The inability to effectively and fully monitor the in-bond process and verify the arrival of in-bond merchandise at the port could lead to loss of revenue due to uncollected duties and fees on in-bond merchandise that has physically entered U.S. commerce without formal entry.

The weaknesses in the CM program could result in CBP incorrectly evaluating the effectiveness of its control environment over the collections of duties, taxes, and fees.

It is possible that BWH/FTZ operators and users may be able to operate BWHs and FTZs that contain merchandise that CBP has no or limited knowledge about.

*Criteria:* Under FMFIA, management must implement cost-effective controls to safeguard assets and ensure reliable financial reporting. OMB's *Implementation Guidance for FMFIA*, dated January 9, 2009, states that financial systems should "routinely provide reliable financial information consistently, accurately, and uniformly."

OMB Circular No. A-127, *Financial Management Systems*, prescribes the standards for Federal agencies' financial management systems. The Office of Federal Financial Management's *Core Financial System Requirements*, dated January 2006, states that the core financial system must maintain detailed information sufficient to provide audit trails and to support reconciliation and research activities.

The *Improper Payments Information Act of 2002* requires agencies to annually review programs and activities and identify any that may be susceptible to significant improper payment. Whenever an agency estimates that improper payments may exceed \$10 million, it must also provide a report on what actions are being taken to reduce such payments. In addition to the statutory requirements stated above, CBP's *Drawback Handbook*, dated July 2004, states that management reviews are necessary to maintain a uniform national policy of supervisory review.

OMB Circular No. A-50, *Audit Follow-Up*, states that corrective action taken by management on resolved findings and recommendations is essential to improving the effectiveness and efficiency of Government operations. Each agency shall establish systems to assure the prompt and proper resolution and implementation of audit recommendations. These systems shall provide for a complete record of action taken on both monetary and nonmonetary findings and recommendations.

CFR 19, Ch. I, Section 111.23, which addresses documents that support import entries, states that: (1) "... records must be retained by a broker in accordance with the provisions of this part and part 163 of this chapter within the broker district that covers the Customs port to which they relate unless the broker chooses to consolidate records at one or more other locations, and provides advance notice of that consolidation to Customs..." and (2) "... the records described in paragraph (a)(1) of this section, other than powers of attorney, must be retained for at least 5 years after the date of entry."



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**Exhibit III – Significant Deficiencies – All DHS Components**

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*Recommendations:* We recommend that CBP:

1. *Related to drawback:*

- a. Implement effective internal controls over drawback claims as part of any new system 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. Develop and implement automated controls to prevent overpayment of a drawback claim; and
- c. Pilot statistically valid drawback claim review programs at each Drawback Center. Analyze the results of the pilots and determine the benefit of full implementation of the programs.

2. *Related to the Entry Process:*

- a. Increase headquarters oversight of the in-bond process by (a) analyzing the summary of post-audits conducted and associated results, (b) ensuring the system that selects in-bond cargo examinations is manually reset beginning of the fiscal year;
- b. Develop or re-emphasize formal requirements for all ports to continue to run and completely resolve overdue in-bond items and maintain documentation of the resolution;
- c. Resolve errors related to the universe of overdue air in-bonds. Issue guidance and require ports to and completely resolve overdue air in-bonds;
- d. Analyze the in-bond program annually to determine an overall compliance rate of the in-bond program;
- e. Provide additional detail in the TCM guidelines, specifying the use of the monitoring report, data queries, and any other tools to provide complete coverage over the TCM program;
- f. Develop standard operating procedures for conducting risk assessments for all BWs and FTZs. In addition, develop standardized procedures for HQ or field office oversight to ensure compliance review schedules are being reviewed timely and provide effective training to ensure that all ports are aware of updates and changes to the program and can consistently execute all requirements presented in the compliance review manuals and handbooks; and
- g. Continue the implementation of a national database of BWs and FTZs and develop procedures to ensure completeness.



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**Exhibit IV – Compliance and Other Matters – All DHS Components**

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All of the compliance and other matters described below are repeat conditions from FY 2009, except IV-N - *Government Performance and Results Act of 1993*, which is new in FY 2010.

**IV-I Federal Managers' Financial Integrity Act of 1982 (FMFIA) and Laws and Regulations Supporting OMB Circular No. A-50, Audit Follow-Up, as revised**

Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, requires agencies and Federal managers to: (1) develop and implement internal controls; (2) assess the adequacy of internal controls; (3) separately assess and document internal control over financial reporting; (4) identify needed improvements; (5) take corresponding corrective action; and (6) report annually on internal controls. During fiscal year (FY) 2010 and 2009, the Department of Homeland Security (DHS or the Department) developed an annual *Internal Control Playbook* to implement corrective actions and support management assurances by performing tests of design and operating effectiveness of entity level controls and other financial accounting and reporting processes. DHS' implementation of OMB Circular No. A-123 facilitates compliance with the *Federal Managers' Financial Integrity Act of 1982* (FMFIA). The *DHS Financial Accountability Act of 2004* requires DHS to submit an annual audit opinion of internal control over financial reporting. The Secretary of DHS has stated in the Secretary's Assurance Statement dated November 12, 2010, as presented in Management's Discussion and Analysis (MD&A) of the Department's 2010 *Annual Financial Report* (AFR), that based on the material weaknesses identified from the OMB Circular A-123 assessment, the Department provides no assurance that internal control over financial reporting was operating effectively as of September 30, 2010.

The FY 2010 DHS *Secretary's Assurance Statement*, states that the Department identified five material weaknesses in internal control over financial reporting, which differs from the number of material weaknesses identified by us during our FY 2010 audit. The reasons for this difference are related to the timing of management's assurance statement, which is as of September 30, 2010. Management believes that they have corrected the control deficiencies related to actuarial liabilities we reported in Exhibit I-E. Further, management has classified the remaining controls deficiencies we identify in Exhibit I-E together with Financial Reporting. Consequently, as reported in the FY 2010 AFR, Other Accompanying Information, management has reassessed, and thereby removed, the material weakness related to Human Resource Management at the U.S. Coast Guard.

In addition, OMB Circular No. A-50, as revised, provides guidance for use by executive agencies when considering reports issued by Inspectors General, other executive branch audit organizations, the Government Accountability Office (GAO), and non-Federal auditors, where follow up is necessary. Corrective action taken by management on findings and recommendations is essential to improve the effectiveness and efficiency of government operations, and to support the objectives of sound fiscal management. As described above, the DHS OCFO has developed an extensive corrective action plan that requires each component to develop and execute corrective actions to address all material weaknesses in internal controls. This strategy is documented in the *Internal Control Playbook*. Progress is monitored by the Under Secretary for Management (USM) and the CFO, and regularly reported to OMB and other outside stakeholders, such as Congressional Committees. We noted that each component has complied with the DHS directive to develop corrective actions, and they have been reviewed and approved by the USM and CFO. All DHS components have made progress toward remediation of material internal control weaknesses; however, as shown in Exhibits I, II and III, deficiencies identified in prior years have not been fully corrected in FY 2010.

While we noted the Department overall has taken positive steps toward full compliance with FMFIA, OMB Circular No. A-123, OMB Circular No. A-50, and the *DHS Financial Accountability Act*, the Department has not fully established effective systems, processes, policies, and procedures to ensure that internal controls are operating effectively throughout the Department.

**Recommendation:** We recommend that the Department continue its corrective actions to address internal control deficiencies, in order to ensure full compliance with FMFIA and its OMB-approved plan for implementation of Circular No. A-123, in future years. We also recommend that DHS continue to follow and complete the actions defined in the *Internal Control Playbook*, to ensure that audit recommendations are resolved timely and corrective action plans addressing all DHS audit findings are developed and implemented together with appropriate supervisory review in FY 2011.

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**Exhibit IV – Compliance and Other Matters – All DHS Components**

**IV-J Federal Financial Management Improvement Act of 1996 (FFMIA)**

FFMIA Section 803(a) requires that agency Federal financial management systems comply with (1) applicable Federal accounting standards; (2) Federal financial management system requirements; and (3) the United States Government Standard General Ledger (USSGL) at the transaction level. FFMIA emphasizes the need for agencies to have systems that can generate timely, reliable, and useful information with which to make informed decisions to ensure ongoing accountability.

While we noted the Department overall has taken positive steps toward full compliance with FFMIA, the Coast Guard, US Customs and Border Protection (CBP), the Federal Emergency Management Agency (FEMA), the Federal Law Enforcement Training Center (FLETC), U.S. Immigration and Customs Enforcement (ICE), and TSA did not fully comply with at least one of the requirements of FFMIA. The reasons for noncompliance are reported in Exhibits I, II, and III. The Secretary of DHS has stated in the Secretary's Assurance Statements dated November 12, 2010 that the Department's financial management systems do not substantially conform to government wide requirements mandated by FFMIA. The Department's remedial actions and related timeframes are also presented in that section of the FY 2010 AFR.

An element within FFMIA Federal system requirements is ensuring security over financial management information. This element is addressed further in the *Federal Information Security Management Act of 2002* (FISMA), which was enacted as part of the *E-Government Act of 2002*. FISMA requires the head of each agency to be responsible for (1) providing information security protections commensurate with the risk and magnitude of the harm resulting from unauthorized access, use, disclosure, disruption, modification, or destruction of (i) information collected or maintained and (ii) information systems used or operated; (2) complying with the requirements of the Act and related policies, procedures, standards, and guidelines, including (i) information security standards under the United States Code, Title 40, Section 11331 and (ii) information security standards and guidelines for national security systems; and (3) ensuring that information security management processes are integrated with agency strategic and operational planning processes.

We noted weaknesses in financial systems security, reported by us in Comments **I-B** and **II-B**, *Information Technology Controls and Financial System Functionality*, which impact the Department's ability to fully comply with FISMA.

*Recommendation:* We recommend that DHS improve its financial management systems to ensure compliance with the FFMIA, and implement the recommendations provided in Exhibits I, II, and III, in FY 2011.

**IV-K Single Audit Act Amendments of 1996 (Single Audit)**

FEMA is the only DHS component that has a significant grant making operation. OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires agencies awarding grants to ensure they receive grantee reports timely and to follow-up on *Single Audit* findings to ensure that grantees take appropriate and timely action. Although FEMA has adopted procedures to monitor grantees and their audit findings, FEMA did not fully comply with provisions in OMB Circular No. A-133 in FY 2010. We noted that FEMA does not always obtain and review grantee *Single Audit* reports in a timely manner, or follow-up on questioned costs and other matters identified in these reports. Because *Single Audits* typically are performed by other entities outside of DHS, procedures related to these reports are not always entirely within the control of DHS and its components.

*Recommendations:* We recommend that:

- I. FEMA further develop and implement procedures to ensure compliance with its policy to obtain and review grantee *Single Audit* reports in a timely manner, and follow-up on questioned costs and other matters identified in these reports. We also recommend that FEMA perform the following in FY 2011:
  - a. Further develop and implement a tracking system to identify each grantee for which a *Single Audit* is required, and the date the audit report is due;
  - b. Use the tracking system to ensure audit reports are received timely, and follow-up when reports are overdue; and



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**Exhibit IV – Compliance and Other Matters – All DHS Components**

- c. Perform reviews of grantee audit reports, issue-related management decisions, and ensure that the grantees take appropriate corrective action, on a timely basis.

**IV-L. Chief Financial Officers Act of 1990**

The *DHS Financial Accountability Act of 2004* made DHS subject to the *Chief Financial Officers Act of 1990*, as amended, which requires DHS to submit to the Congress and OMB audited financial statements annually. DHS' Office of the Inspector General (OIG) has engaged an independent auditor to audit the September 30, 2010 balance sheet and related statement of custodial activity. Other financial statements, including the statements of net cost, changes in net position, and budgetary resources, are not currently auditable. DHS must be able to represent that its balance sheet is fairly stated, and obtain at least a qualified opinion before it is practical to extend the audit to other financial statements.

*Recommendation:* We recommend that DHS and its components continue to implement the Mission Action Plans described in DHS' *Internal Control Playbook* (see Comment IV – I, *Federal Managers' Financial Integrity Act of 1982*, above) to remediate the FY 2010 material weaknesses and significant deficiencies, and improve its policies, procedures, and processes, as necessary, to allow management to assert that all financial statements are fairly stated in compliance with accounting principles generally accepted in the United States, and are ready for an independent audit.

**IV-M. Anti-deficiency Act (ADA)**

Various management reviews and OIG investigations are on-going within the Department and its components that may identify ADA violations. The Coast Guard management continues to work to resolve four potential ADA violations relating to funds used in advance of an approved apportionment from OMB, funds used for construction and improvement projects, funds that may be been inappropriately administered the funding for modifications to fixed price contracts, and the improper execution of the obligation and disbursement of funds for the lease of passenger vehicles. National Protection and Programs Directorate (NPPD) management is continuing their review, initiated in FY 2007, over the classification and use of certain funds that may identify an ADA violation. The GAO reported that the United States Secret Service (USSS) spending, in one fund, exceeded the amount budgeted in its fiscal year 2009 Presidential Candidate Nominee Protection PPA. The Management Directorate is currently investigating whether rental charges incurred in FY 2008 and FY 2009 were not properly committed or obligated.

*Recommendations:* We recommend that the Department, along with the OIG and the other components, complete the internal reviews currently planned or being performed, and properly report the results in compliance with the ADA, if necessary.

**IV-N. Government Performance and Results Act of 1993**

The *Government Performance and Results Act of 1993* requires each agency to prepare performance plans that include a description of the operational processes, skills and technology, and the resources required to meet the goals, and a description of the means used to verify and validate the measured results. In addition, the AFR should include performance indicators established in the annual strategic and performance plan, the actual performance achieved compared with the prior year goals, and an evaluation of the current year performance plan with respect to success in achieving the performance goals. DHS recently completed a quadrennial review for the purpose of developing an updated strategic plan around new priorities established by the Secretary. However the Department has not formally revised and adopted a new strategic plan. Since DHS has not updated its strategic plan, the Statements of Net Cost as of September 30, 2010 and 2009 have not been presented by major program, goals and outputs, and certain related financial statement disclosures, required by OMB Circular No. A-136, *Financial Reporting Requirements*, as amended, are not included in the FY 2010 AFR. In addition, DHS is did not include summary performance information that is aligned with its strategic goals and other information, within the MD&A section of the FY 2010 AFR.

*Recommendation:* We recommend that DHS develop policies and procedures to ensure full compliance with the *Government Performance Results Act of 1993* in FY 2011.





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Exhibit V – Status of Prior Year Findings

Summary of Conditions As Reported in the 2009 DHS Annual Financial Report	Fiscal Year 2010 Status/ Disposition
<i>Material Weaknesses:</i>	
<b>A. Financial Reporting</b>	
<p><b>A.1</b> There are several Department of Homeland Security (DHS or Department) Department-wide control environment weaknesses affecting financial reporting. The Department lacks a sufficient number of accounting and financial management personnel with core technical competencies to ensure financial statements are prepared accurately and in compliance with generally accepted accounting principles. DHS's accounting and financial reporting infrastructure have not received investments in proportion to the Department's rapid growth. The Department's IT infrastructure is aging and has limited functionality.</p>	<p><b>Partially Repeated</b> (Exhibit II-A)</p>
<p><b>A.2</b> The Coast Guard had not developed and implemented an effective general ledger system. The general ledgers are not compliant with the United States Government Standard General Ledger (USSGL). The Coast Guard had deficiencies in its policies, procedures, and controls surrounding its financial reporting process, and did not have adequate beginning balance or year-end close out procedures or cumulative results of operations analysis. The Coast Guard did not have adequate policies or procedures to ensure that transactions are appropriately supported and accounted for in its general ledgers. The Coast Guard did not have effective policies and procedures to identify the cause and resolve abnormal balances and account relationship discrepancies, e.g. budgetary to proprietary reconciliations. The Coast Guard did not have a process to reconcile and resolve differences between intragovernmental transactions with its Federal trading partners.</p>	<p><b>Partially Repeated</b> (Exhibit I-A)</p>
<p><b>A.3</b> TSA did not have a sufficient number of accounting personnel with technical accounting proficiencies to perform essential accounting and financial reporting functions, ensure segregation of duties, and identify financial reporting issues on a timely basis. TSA had not developed and implemented procedures to fully analyze the effects of its accounting policies to ensure full compliance with GAAP. TSA is not compliant with the USSGL requirements at the transaction level. TSA did not fully reconcile its intragovernmental balances with trading partners.</p>	<p><b>Partially Repeated</b> (Exhibit II-A)</p>
<p><b>A.4</b> FEMA did not have sufficient experienced financial managers and staff to ensure segregation of duties in financial reporting roles. FEMA's financial reporting process was complex and required numerous "on-top" adjustments. FEMA did not have effective policies and procedures to identify the cause and resolve abnormal balances and account relationship discrepancies, e.g. budgetary to proprietary reconciliations.</p>	<p><b>Partially Repeated</b> (Exhibit II-A)</p>
<p><b>A.5</b> CBP did not have sufficient resources or infrastructure to ensure proper and timely accounting and reporting. CBP did not have effective policies to properly account for and timely report significant new activities. CBP did not have an annual risk assessment process to timely identify and address new accounting standards.</p>	<p><b>Corrected</b></p>



**Independent Auditors' Report**  
**Exhibit V – Status of Prior Year Findings**

<u>Summary of Conditions</u> <u>As Reported in the 2009 DHS Annual Financial Report</u>		<u>Fiscal Year 2010</u> <u>Status/Disposition</u>
<b>B. Information Technology General and Application Controls</b>	DHS and its components had IT and financial system security control weaknesses in access controls, change controls, and service continuity.	<b>Repeated</b> (Exhibits I-B and II-B)
<b>C. Fund Balance with Treasury (FBWT)</b>	The Coast Guard had not developed a comprehensive process to ensure all FBWT are recorded in the general ledger timely, completely and accurately. The Coast Guard did not maintain adequate supporting documentation that validated the accuracy for at least three of the six Agency Location Codes FBWT reconciliations. The Coast Guard recorded unsupported adjustments to general ledger FBWT accounts. The Coast Guard did not have an effective process for clearing suspense account transactions. The Coast Guard was unable to provide military payroll data to support payroll transactions processed through the FBWT account and did not have policies for processing and documenting military and civilian payroll transactions.	<b>Repeated</b> (Exhibit I-C)
<b>D. Property, Plant, and Equipment</b>		
<b>D.1</b>	The Coast Guard had not consistently applied policies and procedures to ensure appropriate documentation is maintained to support Property Plant & Equipment (PP&E) acquisitions and their existence, and the methodologies and assumptions, to support the value of PP&E where documentation has not been maintained, has not been developed. The Coast Guard has not implemented appropriate controls to accurately, consistently, and timely record additions to PP&E and construction in process, transfers, disposals, and valuation and classification of repairable PP&E. The Coast Guard has not implemented accurate and complete asset identification, system mapping, and tagging processes for fixed assets, and has not properly accounted for some improvements and impairments to buildings and structures, capital leases, and selected useful lives. For Operating Materials and Supplies (OM&S), the Coast Guard had not implemented policies, procedures, and internal controls to support the assertions related to the OM&S account balances, or fully designed and implemented procedures over physical counts of OM&S. The Coast Guard has not properly identified recorded OM&S, or established processes and controls to fully support the calculated value of certain types of OM&S to approximate historical cost. The Coast Guard had not implemented policies, procedures or internal controls to support assertions related to stewardship PP&E.	<b>Partially Repeated</b> (Exhibit I-D)
<b>D.2</b>	TSA did not have policies and procedures to properly account for, monitor, and report PP&E related transactions, including other direct costs, idle or impaired assets, or peripheral equipment. TSA did not have policies or procedures to ensure assets are recorded, depreciated, and disposed of on a timely basis, identify heritage assets, or reconcile the subsidiary ledger.	<b>Repeated</b> (Exhibit II-D)



Independent Auditors' Report  
Exhibit V – Status of Prior Year Findings

<u>Summary of Conditions As Reported in the 2009 DHS Annual Financial Report</u>	<u>Fiscal Year 2010 Status/Disposition</u>
<b>D.3</b> CBP did not have adequate accounting policies, procedures, processes or controls to properly account for equipment purchases, transfers, construction or to allocate indirect costs to construction projects. CBP did not properly perform several physical annual inventories of real and personal property.	<b>Partially Repeated</b> (Exhibit II-D)
<b>D.4</b> USCIS did not have adequate policies, procedures, or internal controls to ensure leasehold improvements, internal use software and software in development.	<b>Corrected</b>
<b>D.5</b> NPPD did not have adequate policies, procedures, or internal controls to ensure hardware purchased by contractors was accurately and timely recorded in the general ledger.	<b>Corrected</b>
<b>D.6</b> ICE did not have policies or procedures to properly account for internal use software or software in development in accordance with applicable accounting standards.	<b>Corrected</b>
<b>E. Actuarial and Other Liabilities</b>	
<b>E.1</b> The Coast Guard did not have an effective process to ensure the completeness and accuracy of data provided to, and used by, the actuary for the calculation of medical and postemployment benefit liabilities, and reconciliations between subsidiary and general ledgers for medical expenditures were not effective. The Coast Guard did not have an effective process to prevent overpayments for medical services. The Coast Guard did not have effective processes to account for military personnel data changes, which impacts the completeness and accuracy of leave and payroll accruals as well as data used for actuarial projections. The Coast Guard did not have a reliable methodology to estimate accounts payable. The Coast Guard did not support the completeness, existence, and accuracy assertions of the data utilized in developing the environmental liability estimate.	<b>Partially Repeated</b> (Exhibit II-E)
<b>E.2</b> FEMA did not have sufficient policies and procedures in place to fully comply with the <i>Single Audit Act Amendments of 1996</i> and related OMB Circular No. A-133, <i>Audits of States, Local Governments, and Nonprofit Organizations</i> .	<b>Partially Repeated</b> (Exhibit II-E)
<b>E.3</b> TSA had not developed policies or procedures to accurately estimate its OTA accrued liability at year-end. TSA did not have policies or procedures to ensure accounts payable accruals are complete and accurate. TSA did not perform an independent analysis of vendor confirmations for which an accrual is based to determine accuracy of the confirmation.	<b>Corrected</b>



**Independent Auditors' Report**  
**Exhibit V – Status of Prior Year Findings**

<b>Summary of Conditions</b>		<b>Fiscal Year 2010</b>
<b>As Reported in the 2009 DHS Annual Financial Report</b>		<b>Status/ Disposition</b>
<b>F Budgetary Accounting</b>		
<b>F.1</b>	The Coast Guard did not have effective policies, procedures and internal controls over Coast Guard's process for validation and verification of UDO balances to ensure that recorded obligations were valid, accurate, recorded timely, and that proper approvals and supporting documentation is maintained. The Coast Guard had not implemented procedures and controls to monitor unobligated commitment activity during the fiscal year. The Coast Guard did not have properly designed and implemented procedures, processes, and internal controls to verify the completeness and accuracy of the year-end obligation pipeline adjustment to record all executed obligations. The Coast Guard did not have controls to ensure procurement transactions are only processed by contracting officers with appropriate warrant authority.	<b>Repeated</b> (Exhibit I-F)
<b>F.2</b>	FEMA did not consistently monitor the status of its obligations as part of its normal operations and ensure the timely deobligation of mission assignments and grants. In addition, FEMA could not provide all supporting documentation for the sample of UDOs other than mission assignments and grant UDOs. Significant effort was required to identify the responsible parties and to access certain files or provide information to clearly support the balances reported in the financial statements.	<b>Partially Repeated</b> (Exhibit II-F)
<b>F.3</b>	CBP did not enforce its policies and procedures to monitor and deobligate or close-out its obligations in a timely manner.	<b>Repeated</b> (Exhibit II-F)
<i>Other Significant Deficiencies:</i>		
<b>G. Entity Level Controls</b>		
<b>G.1</b>	The Coast Guard did not have adequate policies, procedures or controls associated with training for personnel with financial duties. The Coast Guard did not have standardized job descriptions or policies for hiring and evaluating financial employees. The Coast Guard did not have adequate controls with the Standards of Conduct to track and monitor compliance. The Coast Guard did not have an entity-wide policy to address management override of internal controls.	<b>Repeated</b> (Exhibit I-A and III-G)



Independent Auditors' Report  
Exhibit V – Status of Prior Year Findings

Summary of Conditions As Reported in the 2009 DHS Annual Financial Report	Fiscal Year 2010 Status/ Disposition
<p><b>G.2</b> FEMA had not sufficiently developed effective methods of communication throughout the agency to ensure that significant financial-related events outside of the OCFO are timely communicated, including review and monitoring of its National Flood Insurance Program. FEMA did not complete the placement of sufficient financial and accounting resources related to mission assignments. FEMA had not completed documentation of policies and procedures for several roles, responsibilities, processes and functions within the agency. FEMA had not committed sufficient resources to ensure that personnel attend required ethics training. FEMA had not developed sufficient policies and procedures to designate position sensitivity for positions using, developing, or operating IT systems or track and maintain the status of background investigations.</p>	<p><b>Partially Repeated</b> (Exhibit II-A and Exhibit III-G)</p>
<p><b>G.3</b> TSA had not implemented an agency-wide policy to address intervention of management override of internal controls.</p>	<p><b>Corrected</b></p>
<p><b>H. Custodial Revenue and Drawback</b></p>	
<p>The CEP Automated Commercial System (ACCS) lacked automated controls to detect and prevent excessive drawback claims and overpayments, necessitating inefficient manual processes that do not effectively compensate for these automated controls. The CBP's drawback review policies did not require drawback specialists to review all or a statistically valid sample of related drawback claims against the underlying consumption entries to determine whether, in the aggregate, an excessive amount was claimed. CBP was unable to determine the status of in-bond shipments and lacks policies and procedures that require monitoring of the results of in-bond audits. CBP did not perform an analysis to determine the potential loss of revenue through the in-bond process. CBP Compliance Measurement oversight guidance did not provide complete coverage over the CM program. There were inconsistencies in the performance of risk assessments of Bonded Warehouses and Foreign Trade Zones.</p>	<p><b>Repeated</b> (Exhibit III-I)</p>



**Independent Auditors' Report**  
**Exhibit V – Status of Prior Year Findings**

<u>Summary of Conditions</u> <u>As Reported in the 2009 DHS Annual Financial Report</u>	<u>Fiscal Year 2010</u> <u>Status/Disposition</u>
<i>Compliance and Other Matters:</i>	
<p><b>I. Federal Managers' Financial Integrity Act of 1982 and Laws and Regulations Supporting OMB Circular No. A-50, Audit Follow-up, as revised</b></p> <p>The Coast Guard had not fully established effective systems, processes, policies, and procedures to develop and implement internal accounting and administrative controls and conformance of accounting systems. In addition, the Federal Law Enforcement Training (FLETC), National Preparedness Directorate (NPPD), and TSA's control assessment processes require improvement to ensure full compliance with FIMFIA.</p>	<p><b>Partially Repeated</b> (Exhibit IV-I)</p>
<p><b>J. Federal Financial Management Improvement Act of 1996</b></p> <p>We noted that DHS and each significant component did not fully comply with at least one of the requirements of FFMIA. In addition, we noted weaknesses in financial systems security, which impact the Department's ability to fully comply with FMSMA.</p>	<p><b>Repeated</b> (Exhibit IV-J)</p>
<p><b>K. Single Audit Act Amendments of 1996,</b></p> <p>DHS and its components did not have procedures in place to fully comply with provisions in OMB Circular No. A-133 that require them to timely obtain and review grantee Single Audit reports and follow up on questioned costs and other matters identified in these reports.</p>	<p><b>Repeated</b> (Exhibit IV-K)</p>
<p><b>L. Chief Financial Officers Act of 1990</b></p> <p>The <i>DHS Financial Accountability Act of 2004</i> made DHS subject to the <i>Chief Financial Officers Act of 1990</i>, as amended, which requires DHS to submit to the Congress and OMB audited financial statements annually. DHS engaged an independent auditor to audit the September 30, 2009, consolidated balance sheet and statement of custodial activity only.</p>	<p><b>Repeated</b> (Exhibit IV-L)</p>



Independent Auditors' Report  
Exhibit V – Status of Prior Year Findings

	<u>Summary of Conditions</u> <u>As Reported in the 2009 DHS Annual Financial Report</u>	<u>Fiscal Year 2010</u> <u>Status/Disposition</u>
<b>M.</b>	<b><i>Anti-deficiency Act</i></b>  TEMA had initiated a preliminary review of certain expenditures in FY 2008 that may have violated the <i>Anti-deficiency Act</i> (ADA). The Coast Guard management continued to work to resolve two potential ADA violations. NPPD management continued to review the classification and use of certain funds that may identify an ADA violation as well as certain fees collected for attendance at a DHS-sponsored conference. United States Secret Service (USSS) performed a review of certain salaries and expenses that may identify a violation of ADA. In addition, various other management reviews and OIG investigations are on-going within the Department and its components that may identify ADA violations.	<b>Repeated</b> (Exhibit IV-M)



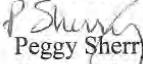
Office of the Chief Financial Officer  
U.S. Department of Homeland Security  
Washington, DC 20528



**Homeland  
Security**

November 12, 2010

MEMORANDUM FOR: Richard L. Skinner  
Inspector General

FROM:   
Peggy Sherry  
Deputy Chief Financial Officer

SUBJECT: Fiscal Year (FY) 2010 Financial and Internal Controls Audit

Thank you for the opportunity to comment on the Independent Public Accountant's audit of our balance sheets, the related statement of custodial activities and internal controls as of September 30, 2010 and 2009. We agree with the Independent Public Accountant's conclusions.

Although the report indicates that DHS still faces financial management challenges, the auditor noted the Department's progress in improving the quality and reliability of our financial reporting. During FY 2010, our Components implemented corrective actions that significantly improved key financial management and internal control areas. As we grow closer to obtaining an audit opinion on the consolidated balance sheet and statement of custodial activities, DHS will discover additional opportunities for financial management improvement and will continue to strengthen internal controls and accountability.

The FY 2010 audit results show that our corrective actions are working, and we are already focusing our efforts on the remaining issues before us. I want to thank you for your efforts and the continued dedication by your staff to work collaboratively in addressing our challenges. As we continue our steadfast progress, I look forward to working with the Office of Inspector General and the Independent Public Accountant.



**Appendix A**  
**Management's Response**

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



November 12, 2010

MEMORANDUM FOR: Richard L. Skinner  
Inspector General

FROM: *P. Sherry*  
Peggy Sherry  
Deputy Chief Financial Officer

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**Appendix B**  
**Report Distribution**

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