



Department of Homeland Security Office of Inspector General

Independent Review of the U.S. Coast Guard's Reporting of FY 2010 Drug Control Obligations



Office of Inspector General

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



**Homeland
Security**

JAN 26 2011

Preface

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

This report presents the results of the review of the Table of Prior Year Drug Control Obligations and related disclosures of the U.S. Coast Guard for the fiscal year ended September 30, 2010, for the Office of National Drug Control Policy. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the review. U.S. Coast Guard management prepared the Table of Prior Year Drug Control Obligations and related disclosures to comply with requirements of the Office of National Drug Control Policy Circular, *Drug Control Accounting*, dated May 1, 2007. Due to the U.S. Coast Guard's inability to provide assurance as to the integrity of the financial data in the detailed accounting submissions, KPMG was unable to complete its review and report on the Table of Prior Year Drug Control Obligations and related disclosures.

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.

A handwritten signature in blue ink that reads "Anne L. Richards".

Anne L. Richards
Assistant Inspector General for Audits



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Washington, DC 20036

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January 18, 2011

Ms. Anne Richards
Assistant Inspector General for Audits
Office of the Inspector General
U.S. Department of Homeland Security
1120 Vermont Avenue, NW
Washington, DC 20005

Dear Ms. Richards:

We were engaged to review the Table of Prior Year Drug Control Obligations and related disclosures, and the accompanying management's assertions of the Department of Homeland Security's (DHS) United States Coast Guard (USCG) for the year ended September 30, 2010. USCG management is responsible for the Table of Prior Year Drug Control Obligations, related disclosures, and the assertions.

The Office of National Drug Control Policy (ONDCP) Circular, *Drug Control Accounting*, dated May 1, 2007, requires management to disclose any material weaknesses or other findings affecting the presentation of data reported and to make certain assertions related to the financial systems supporting the drug methodology used in compilation of the Table of Prior Year Drug Control Obligations and related disclosures. Management reported that it cannot provide assurances as to the integrity of the financial data contained in its Table of Prior Year Drug Control Obligations and related disclosures; and management has not provided an assertion that the financial systems supporting the drug methodology yield data that fairly present, in all material respects, aggregate drug-related obligation estimates.

In accordance with applicable professional standards, without certain representations made by management, including the integrity of the financial data and its systems, we are unable to complete our review of USCG's Table of Prior Year Drug Control Obligations, related disclosures, and management's assertions. Accordingly, we are unable to provide an Independent Accountants' Report on the USCG's Table of Prior Year Drug Control Obligations, related disclosures, and management's assertions for the year ended September 30, 2010, pursuant to the requirements of ONDCP Circular, *Drug Control Accounting* (May 1, 2007).

Sincerely,

Scot G. Janssen,
Partner

U.S. Department of
Homeland Security

United States
Coast Guard



Commandant
United States Coast Guard

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Mr. John D. Shiffer
Department of Homeland Security
Financial Management Division
Office of the Inspector General
1120 Vermont Avenue, 11th Floor, NW
Washington, D.C. 20005

JAN 18 2011

Dear Mr. Shiffer,

In accordance with the Office of National Drug Control Policy Circular: *Annual Accounting of Drug Control Funds* dated May 1, 2007, enclosed is the Coast Guard's report of FY 2010 drug control obligations, drug control, methodology and assertions. Per your KPMG auditor's guidance received on January 11th, 2011, my staff addressed this request for additional supporting documentation and changes to the FY 2010 Annual Accounting of Drug Control Funds, dated December 2nd, 2010.

If you require further assistance on this information, please contact LCDR Rebecca Ore at (202) 372-3512.

Sincerely,

A handwritten signature in blue ink, appearing to read "T.A. Sokalzuk".

T.A. SOKALZUK
Captain, U.S. Coast Guard
Chief, Office of Budget and Programs

Copy: DHS Budget Office

Enclosures:

- (1) USCG FY 2010 Detailed Accounting Submission
- (2) Independent Auditors' Report Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard
- (3) 2010 USCG Assurance Statement

**DEPARTMENT OF HOMELAND SECURITY
UNITED STATES COAST GUARD
Detailed Accounting Submission of FY 2010 Drug Control Funds**

DETAILED ACCOUNTING SUBMISSION

A. Table of FY 2010 Drug Control Obligations

RESOURCE SUMMARY	2010 Actual
Drug Resources by Drug Control Function:	Obligations
• Interdiction	\$836.395
• Research and Development	\$1.737
Total Resources by Function	\$838.132
Drug Resources by Budget Decision Unit:	
• Operating Expenses (OE)	\$692.493
• Reserve Training (RT)	\$13.545
• Acquisition, Construction, and Improvements (AC&I)	\$130.357
• Research, Development, Test and Evaluation (RDT&E)	\$1.737
Total Drug Control Obligations	\$838.132
<i>Interagency Crime and Drug Enforcement [non-add]</i>	<i>[\$0.871]</i>

1. Drug Methodology

In FY 2000, a methodology known as the Mission Cost Model (MCM) was developed to present United States Coast Guard (Coast Guard) missions using activity based cost accounting principles. The MCM is an estimate of mission costs allocated across Coast Guard's 11 mission/programs. The information reported is timely and is derived from an allocation process involving the Coast Guard's financial statement information. Further, the Coast Guard has developed an operating hour baseline as a method to approximate the future allocation of resource hours for each asset class to multiple Coast Guard missions. This is the basis for funding allocations in budget projections. The operating hour allocation, or baseline, is developed and modified based upon budget line item requests and national priorities. Coast Guard is required to report its drug control funding to ONDCP in four appropriations, categorically called decision units. The Coast Guard's drug control funding estimates are computed by closely examining the decision units that are comprised of: Operating Expenses (OE); Reserve Training (RT); Acquisition, Construction, and Improvement (AC&I); and Research, Development, Test, and Evaluation (RDT&E). Each decision unit contains its own unique spending authority and methodology.

1. Drug Methodology (cont.)

For example, AC&I includes funding that remains available for obligation up to five years after appropriation and RDT&E includes funding which does not expire. Unless stipulated by law, OE and RT funding must be spent in the fiscal year it is appropriated and therefore, the methodologies for these two appropriations are referred hereafter as the OE/RT MCM. The mechanics of the MCM methodology used to derive the drug control information for each decision unit's drug control data is derived follows.

Operating Expenses and Reserve Training

The majority of the funds the Coast Guard allocates to the drug interdiction program are in the OE decision unit. OE funds are used to operate Coast Guard facilities; maintain capital equipment; improve management effectiveness; and recruit, train, sustain, and compensate, an active duty military and civilian workforce. In the OE budget, the amount allocated to the drug interdiction program is derived by allocating a share of the actual expenditures based upon the percentage of time aircraft, cutters, and boats spent conducting drug interdiction activities. The Coast Guard tracks the resource hours spent on each of the 11 Coast Guard statutory missions by using a web-based Abstract of Operations (AOPS) data collection and report system. Coast Guard AOPS data is used to develop the amount of time each asset class spends conducting each Coast Guard mission. Using financial data gathered from over 3,000 cost centers around the United States along with the AOPs information, the Coast Guard is able to allocate OE costs to each of the 11 statutory missions consisting of: Drug Interdiction; Migrant Interdiction; Ports, Waterways and Coastal Security; Other Law Enforcement; Defense Readiness; Search and Rescue; Marine Safety; Ice Operations; Marine Environmental Protection; Living Marine Resources; and Aids to Navigation.

The Coast Guard allocates a portion of RT decision unit funds to the drug interdiction program. RT funds are used for Coast Guard Selected Reserve personnel who augment Coast Guard operations. Since RT functionally assists OE funded operations, the RT funding mission attribution assumes an OE mission allocation spread. The following data sources feed the FY 2010 OE/RT MCM:

- 1) Core Accounting System (CAS) – FY 2010 actual expenses MCM uses FY 2007 financial data, adjusted to reflect changes in the Coast Guard's asset inventory from FY 2007 to FY 2010. These expenses are fed into the Standard Rates Model (SRM), along with Coast Guard's operating cost reports of the Surface Forces Logistics Center (SFLC) and the cost per flight hour report from the Aviation Logistics Center (ALC). The SRM uses an activity-based methodology to assign and allocate expenses to the Coast Guard's assets and certain non-asset intensive missions. The resulting total cost pools serve as one of the major inputs to the MCM. If current year SRM data is not available, the previous year total cost pools are adjusted to fit the relevant fiscal year's asset inventory. The SRM is reconciled to the Coast Guard's Statement of Net Cost.
- 2) Naval Electronics Supply Support System (NESSS) – The SFLC at Baltimore operates a stand-alone financial system. Similar to the CAS, NESSS data is broken down by cost center, unit name, allotment fund code, and dollar amount. NESSS expense data is fed into the SRM and allocated to Coast Guard assets and certain non-asset intensive missions. NESSS financial data is included in the Coast Guard's financial statements.

1. Drug Methodology (cont.)

- 3) Aviation Maintenance Management Information System (AMMIS) - The ALC operates a stand-alone financial system. Similar to the CAS, AMMIS data is broken down by cost center, unit name, allotment fund code, and dollar amount. AMMIS expense data is fed into the SRM and allocated to Coast Guard assets and certain non-asset intensive missions. AMMIS financial data is included in the Coast Guard's financial statements.
- 4) FY 2010 Abstract of Operations– AOPS is a web-based information system that reports how an asset (aircraft, boat, or cutter) was utilized across various missions of the Coast Guard. Each unit or activity that performs a mission is responsible for including the resource hours in the AOPS database.
- 5) Other Expenses – The drug related pieces that feed this area of the model are the Tactical Law Enforcement Teams (TACLET), Law Enforcement Detachments (LEDET) and Special Projects. The percentage that drives the TACLET / LEDET resource areas is computed from team deployment days divided by the total deployment days in the fiscal year for the drug interdiction mission. The Special Projects percentage driver is formulated from professional judgment regarding how funding is used to support costs related to counter-drug operations such as High Intensity Drug Traffic Area activities and liaison costs for the Organized Crime Drug Enforcement Task Force.

Mission Cost Model Application & Results – The two chief input drivers to the MCM are:

- Financial costs of each Coast Guard asset and other expenses areas, made up of direct, support and overhead costs.
- FY 2010 AOPS hours – The support and overhead costs for each asset and other expenses element is applied to hours projected from the FY 2010 AOPS. These costs are reflective of the more static conditions of Coast Guard operations relative to the support functions and administrative oversight. The direct costs are applied to the final AOPS hours to show the dynamic flow of operations experienced during FY 2010. The overall affect of the computed amount from the static baseline and reality of AOPS results in a percentage to drive Coast Guard OE expenditures allocation across 11 statutory missions.

Normalize to Budget Authority or Obligations – The program percentages derived from the MCM are then applied to total OE and RT FY 2010 budget authority and obligations (see Attachments A & B, respectively), depending upon the reporting requirement. Budget Authority (BA) is derived from the agency's annual enacted appropriation and expenditure data is derived from the final financial accounting Report on Budget Execution (SF-133).

1. Drug Methodology (cont.)

Acquisition, Construction, and Improvements

AC&I is a multi-year appropriation where funding may be available for up to five years depending on the nature of the project. The methodology used to develop the drug funding estimate is systematically different than that of OE and RT. AC&I drug funding levels, for either BA or obligations, is developed through an analysis of each project/line item. For each line item, a discrete driver is selected that best approximates the contribution that asset or project, when delivered, will contribute to each of the Coast Guard's 11 statutory missions. In most cases, the driver used in scoring drug control funding requests within the zero-based AC&I decision unit is assigned based on professional judgment characterized by asset and/or mission percentages produced in the OE/RT MCM. Otherwise, when a project is not related to any particular asset or series of asset classes, the project fund may benefit the Coast Guard's entire inventory and other expense categories. With this condition, the general OE AOPS MCM percentage is utilized. As with the other three appropriations, once the program percentage spreads are computed for each of these drivers in the FY 2010 AC&I MCM, the total bottom-line mission percentage is applied directly to the AC&I total direct obligations. For FY 2010 AC&I program and mission area spreads, the following data sources and methods were used:

AC&I Mission Cost Model – Developed based on data feeds from the FY 2010 OE/RT MCM model as related in earlier OE statements. The following data sets were then required to complete the AC&I MCM:

- 1) Drug related percentage – The percentage spread for each driver was extracted from the OE/RT MCM. This information was further analyzed to:
 - (a) Ensure a discrete driver representing either a particular asset, series of assets, or mission was applied to each project; or
 - (b) A general OE percentage driver was used when the project's outcome was expected to benefit all inventory and/or agency needs.

Mission cost results/application - Once the project drivers were extracted from the OE/RT MCM, they were applied to the total AC&I BA levels derived from the agency's enacted appropriation bill in the FY 2010 AC&I MCM. The total allocated mission percentages from the AC&I MCM were then applied to the total AC&I FY 2010 obligations as reported from the CAS as of September 30, 2010 (Attachment C).

Research, Development, Test and Evaluation

RDT&E is a no-year appropriation where funding, once appropriated and apportioned, may be obligated indefinitely in the future until all balances are expended. The methodology used to develop the drug-funding estimate is similar to AC&I in that drug-funding costs are based on an analysis of each project where program/mission area percentages are based upon subject matter expert review of every line item presented in the FY 2010 request. As with the other three appropriations, once the program percentage spreads are computed for each of these drivers in the FY 2010 RDT&E MCM, the total bottom-line mission percentage is applied directly to the RDT&E total direct obligations.

1. Drug Methodology (cont.)

For FY 2010 RDT&E program and mission area spreads, the following data sources and methods were used:

RDT&E Mission Cost Model – Developed based on data feeds from the FY 2010 OE/RT MCM model as in earlier OE and AC&I statements. The following data sets were then required to complete the RDT&E MCM:

- 1) Drug related percentage – The percentage spread for each driver was extracted from the OE/RT MCM. This information was further analyzed to:
 - a) Ensure a discrete driver representing either a particular asset, series of assets or mission was applied to each project or;
 - b) A general OE percentage driver was used when the project's outcome was expected to benefit all inventory and/or agency needs.
- 2) Mission cost results/application - Once the project drivers were extracted from the OE/RT MCM, they were applied to the total RDT&E BA levels derived from the agency's enacted Appropriation Bill in the FY 2010 RDT&E MCM. The total allocated mission percentages from the RDT&E MCM were then applied to the total RDT&E 2010 obligations as reported from the CAS as of September 30, 2010 (Attachment D). BA data is derived from the agencies enacted Appropriation and expenditure data is extracted from a Finance and Procurement Desktop transaction summary report by project.

2. Methodology Modifications

The methodology described above is consistent with the previous year.

3. Material Weaknesses or Other Findings

As identified in the Department of Homeland Security (DHS) Chief Financial Officers (CFO) Act of 1990 audit and feedback provided in the enclosed FY 2010 Independent Auditors' Report: Exhibit I – Material Weaknesses in Internal Control (Enclosure 2) and described in the enclosed 2010 U.S. Coast Guard Assurance Statement (Enclosure 3), the Coast Guard has material weaknesses in financial management, financial reporting, and financial systems that impact the assurance of information in our financial reports. As such, we cannot provide assurances as to the integrity of the financial data contained in this report.

The Coast Guard chartered an Audit Readiness Planning Team (ARPT) in 2008 to develop the Financial Strategy for Transformation and Audit Readiness (FSTAR). FSTAR contains the comprehensive Mission Action Plans that guide our implementation of internal controls leading to assurance over financial information. This effort seeks to attack the root causes and long term solutions of the identified material weaknesses and other financial management issues. Additionally, we will pursue improved internal controls in the collection of our Abstract of Operations information necessary to give assurance to the non-financial data used to produce a portion of this report.

4. Reprogrammings or Transfers

During FY 2010, the Coast Guard had no reports of transfers or reprogramming actions affecting drug related budget resources in excess of \$1 million.

5. Other Disclosures

The following provides a synopsis of the United States Coast Guard's FY 2010 Drug Control Funds reporting which describes:

1. The agency's overall mission and the role of drug interdiction efforts within the Coast Guard's multi-mission structure; and
2. The Coast Guard's Drug Budget Submission.

Coast Guard Mission

The Coast Guard is a military service with mandated national security and national defense responsibilities and the United States' leading maritime law enforcement agency with broad, multi-faceted jurisdictional authority. Due to the multi-mission nature of the Coast Guard and the necessity to allocate the effort of a finite amount of assets, there is a considerable degree of asset "cross-over" between missions. This crossover contributes to the challenges the Coast Guard faces when reporting costs for its mission areas.

Coast Guard's Drug Budget Submission

In the annual National Drug Control Strategy (NDCS) Budget Summary, all agencies present their drug control resources broken out by function and decision unit. The presentation by decision unit is the one that corresponds most closely to the Coast Guard's congressional budget submissions and appropriations. It should be noted and emphasized that the Coast Guard does not have a specific appropriation for drug interdiction activities. As such, there are no financial accounting lines for each of Coast Guard's 11 statutory missions. All drug interdiction operations, capital improvements, reserve support, and research and development efforts are funded out of general Coast Guard appropriations.

For the most part, the Coast Guard drug control budget is a reflection of the Coast Guard's overall budget. The Coast Guard's OE appropriation budget request is incremental, focusing on the changes from the prior year base brought forward. The Coast Guard continues to present supplementary budget information through the use of the MCM, which allocates base funding and incremental requests by mission.

This general purpose MCM serves as the basis for developing drug control budget estimates for the OE and RT appropriations and provides allocation percentages used to develop the drug control estimates for the AC&I and RDT&E appropriations and the process is repeatable. Similarly, this is the same methodology used to complete our annual submission to the Office of National Drug Control Policy (ONDCP) for the NDCS Budget Summary.

B. Assertions

1. **Obligations by Budget Decision Unit** – N/A. As a multi-mission agency, the Coast Guard is exempt from reporting under this section as noted in ONDCP Circular: *Drug Control Accounting*, Section 6a (1) (b).
2. **Drug Methodology** – The Coast Guard does not have a discrete drug control appropriation and its financial systems are not structured to accumulate accounting data by operating programs or missions areas. In the Coast Guard’s opinion, the percentage allocation results derived from its MCM methodology are based on the most current financial and abstract of operations data available. Although we cannot provide assurances as to the integrity of the financial data contained in this report, the methodology is a repeatable mission spread process which the Coast Guard uses throughout its annual budget year presentations. These include: the Office of Management and Budget’s (OMB) MAX budget update of Coast Guard’s President’s Budget submission and the DHS CFO Statement of Net Cost report.

Other Estimation Methods: In some cases, where the MCM allocates a percentage of time/effort expended to a given AC&I project/line item, changes were made to better represent the drug costs associated. As noted in the AC&I and the RDT&E methodology, experienced professional judgment is sometimes used to change a driver based on specific knowledge that a resource will be used differently than the historical profile indicates.

Financial Systems: Data are derived from CAS and SFLC systems. No other financial system or information are used in developing program or mission area allocations. The Coast Guard has not fully implemented corrective actions to remediate weaknesses identified by the independent auditors during the annual DHS CFO Act audits. As a result, the Coast Guard could not assert to the completeness, existence (validity), accuracy, valuation or presentation of its financial data.

3. **Application of Drug Methodology** - The methodology disclosed in this section was the actual methodology used to generate the table required by ONDCP Circular: *Drug Control Accounting* May 1, 2007 Section 6A. Documentation on each decision unit is provided.
4. **Reprogrammings or Transfers** - During FY 2010, Coast Guard had no transfers or reprogramming actions affecting drug-related budget resources in excess of \$1 million. The FY 2010 data presented herein is associated with drug control funding reported in Coast Guard’s FY 2010 financial plan.
5. **Fund Control Notices** –ONDCP did not issue Coast Guard a Fund Control Notice for FY 2010.

**OPERATING EXPENSES (OE)
MISSION COST MODEL OUTPUT:**

	(dollars in thousands)	
	FY 2010	
	Obligations	% of total
1. Search and Rescue (SAR)	807,481	11.75%
2. Marine Safety (MS)	641,398	9.33%
3. Aids to Navigation (ATON)	1,075,140	15.64%
4. Ice Operations (IO)	171,243	2.49%
5. Marine Environmental Protection (MEP)	254,321	3.70%
6. Living Marine Resources (LMR)	618,957	9.01%
7. Drug Interdiction	692,493	10.08%
8. Other Law Enforcement (OTH-LE)	96,802	1.41%
9. Migrant Interdiction	516,245	7.51%
10. Ports, Waterways & Coastal Security (PWCS)	1,308,551	19.04%
11. Defense Readiness	689,833	10.04%
Total OE Obligations	\$ 6,872,464	100%

**RESERVE TRAINING (RT)
MISSION COST MODEL OUTPUT:**

	(dollars in thousands)	
	FY 2010	
	Obligations	% of total
1. Search and Rescue (SAR)	15,600	12.22%
2. Marine Safety (MS)	12,545	9.82%
3. Aids to Navigation (ATON)	21,030	16.47%
4. Ice Operations (IO)	2,299	1.80%
5. Marine Environmental Protection (MEP)	4,975	3.90%
6. Living Marine Resources (LMR)	12,106	9.48%
7. Drug Interdiction	13,545	10.61%
8. Other Law Enforcement (OTH-LE)	1,893	1.48%
9. Migrant Interdiction	9,319	7.30%
10. Ports, Waterways & Coastal Security (PWCS)	25,595	20.04%
11. Defense Readiness	8,794	6.89%
Total RT Obligations	\$ 127,701	100%

**ACQUISITION, CONSTRUCTION and IMPROVEMENTS
(AC&I) MISSION COST MODEL OUTPUT:**

	(dollars in thousands)	
	FY 2010	
	Obligations	% of total
1. Search and Rescue (SAR)	161,016	11.75%
2. Marine Safety (MS)	40,661	2.97%
3. Aids to Navigation (ATON)	34,120	2.49%
4. Ice Operations (IO)	29,537	2.16%
5. Marine Environmental Protection (MEP)	75,390	5.50%
6. Living Marine Resources (LMR)	110,600	8.07%
7. Drug Interdiction	130,357	9.51%
8. Other Law Enforcement (OTH-LE)	11,381	0.83%
9. Migrant Interdiction	178,026	12.99%
10. Ports, Waterways & Coastal Security (PWCS)	180,311	13.16%
11. Defense Readiness	419,198	30.59%
Total AC&I Obligations	\$ 1,370,597	100%

Note: Includes -\$68.732 million recoveries of prior year obligations.

**RESEARCH, DEVELOPMENT, TEST and EVALUATION
(RDT&E) MISSION COST MODEL OUTPUT:**

	(dollars in thousands)	
	FY 2010	
	Obligations	% of total
1. Search and Rescue (SAR)	3,504	14.29%
2. Marine Safety (MS)	4,994	20.36%
3. Aids to Navigation (ATON)	1,099	4.48%
4. Ice Operations (IO)	164	0.67%
5. Marine Environmental Protection (MEP)	3,760	15.33%
6. Living Marine Resources (LMR)	896	3.65%
7. Drug Interdiction	1,737	7.08%
8. Other Law Enforcement (OTH-LE)	173	0.71%
9. Migrant Interdiction	1,065	4.34%
10. Ports, Waterways & Coastal Security (PWCS)	1,281	5.22%
11. Defense Readiness	5,852	23.86%
Total RDT&E Obligations	\$ 24,525	100%

Note: Includes -\$417 thousand recoveries from prior year obligations.

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;

Independent Auditors' Report
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

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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 FFMIA 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 FFMIA 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.

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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 (ICOFR) 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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- 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, I 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 FFMIA 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 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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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 SFFAS 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 SFFAS 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. SFFAS 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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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.

Dear Secretary Napolitano:

In accordance with your delegation of responsibilities to me, I have directed an evaluation of the internal controls at the United States Coast Guard (USCG) in effect during the fiscal year ended September 30, 2010 (FY 2010). This evaluation was conducted in accordance with OMB Circular No. A-123, *Management's Responsibility for Internal Control*, Revised December 21, 2004. Based on the results of this evaluation, the USCG provides the following assurance statements.

In FY 2010, the USCG's response to the Deepwater Horizon Oil Spill incident has been historic in nature and of national significance. The USCG has taken steps to develop and complete tests of design for accounts receivable (AR) and accounts payable (AP) relating to the Deepwater Horizon Oil Spill incident. Results of tests of design indicated that 39 out of 41 key controls around Deepwater Horizon AR and AP are designed appropriately to prevent and/or detect material misstatements from occurring in the USCG financial statements ending September 30, 2010. The USCG has implemented compensating controls and corrective action to fix the two controls that were not designed effectively, and will test the operational effectiveness of the internal controls in October. The USCG has billed and collected from the responsible party for all Deepwater Horizon Oil Spill expenditures from the Oil Spill Liability Trust Fund.

Reporting Pursuant to FMFIA Section 2. 31 U.S.C.3512 (d)(2)

The United States Coast Guard provides reasonable assurance that internal controls are achieving their intended objectives, with the exception of the following material weaknesses:

- **Compliance with Laws and Regulations:** The USCG has identified and reported Anti-Deficiency Act (ADA) violations in FY 2010 that occurred during prior fiscal years. The USCG has continued to collaborate with DHS and has adhered to DHS policy with regards to resolving these issues. In FY 2010, the USCG developed enterprise-wide policies and procedures for assessing risk, testing effectiveness of controls, and monitoring laws and regulations to align with the DHS' internal control program. The USCG will continue to improve controls over manual overrides, the tracking of funds, and budget execution. In addition, USCG will continue to improve monitoring policies and procedures that will assist in the prevention and detection of potential future ADA violations.
- **Internal Controls Over Financial Reporting (ICOFR):** As detailed under the DHS Financial Accountability Act (FAA) below.
- **Financial Management Systems:** As detailed under the FMFIA Section 4 below.

Reporting Pursuant to the DHS Financial Accountability Act. P.L. 108-330

As outlined in the DHS guidance, the scope of the United States Coast Guard's assessment of ICOFR included performing tests of operational effectiveness throughout FY 2010 for areas that are ready for audit, and focused on corrective actions for areas with material weaknesses.

Tests of Operational Effectiveness (TOEs):

- **Fund Balance with Treasury (FBWT) – Military Payroll:** In FY 2010, the USCG performed tests of design (TODs) and tests of effectiveness (TOEs) over significant Military Payroll processes. While the results of testing enabled the USCG to reduce the significance of noted deficiencies from a Material Weakness, a number of controls continue to operate ineffectively and will require additional remediation activity before they can be relied upon.

The United States Coast Guard is unable to provide reasonable assurance that ICOFR are operating effectively. The following material weaknesses and significant deficiencies were found:

Material Weaknesses:

- **Fund Balance with Treasury (FBWT):** The USCG is unable to fully reconcile non-payroll related FBWT accounts, produce complete and accurate populations of suspense account transactions, and distinguish postings from clearing transactions in suspense. In FY 2010, the USCG successfully reconciled FBWT for military payroll, clearing the prior year's material weakness condition for three of the Coast Guard's six agency location codes.
- **Property Management:** The USCG is unable to assert to internal controls over the Acquisition, Construction, and Improvement (AC&I) Construction in Progress (CIP) and Real Property processes. In FY 2010, the USCG supported the accuracy of the Personal Property balance, executed a second annual physical inventory, and performed physical inventory observation procedures. The USCG capitalized \$2.2 Billion in operational assets and cleared all zero balance AC&I legacy projects. Finally, the USCG cleared the material weakness for Operating Materials and Supplies (OM&S) by changing the accounting treatment of field-held OM&S to the purchases method, evaluating inventory procedures and results, evaluating valuation support for OM&S, and asserting to the completeness, existence, and valuation of the OM&S balance.
- **General Ledger (GL) Management Function:** The three primary USCG general ledgers are not fully compliant with the United States Standard General Ledger (USSGL) at the transaction level and contain improper posting logic codes. Two of the three systems do not interface with the Core Accounting System (CAS), except for Treasury Information Executive Repository (TIER) reporting at the summary GL level. Limitations of the GL systems, timing issues, and the use of multiple GL systems with different GL accounts, contribute to the inappropriate recording of transactions and require the USCG to post a significant number of on-top adjustments at month's end.
- **Budgetary Resources Management:** The primary budgetary resource management system is not designed to manage and maintain complete budgetary accounting data and does not permit the necessary level of funds control, creating a risk for unidentified ADA violations.
- **Receivables Management:** The USCG does not record certain balances in the general ledger in accordance with Generally Accepted Accounting Principles (GAAP) as promulgated by the Federal Accounting Standards Advisory Board (FASAB). In spite of the significant systems limitations, USCG will re-engineer several key sub-process areas related to accounts receivable and develop compensating controls to support this balance in FY 2011.
- **Revenue Management:** The USCG does not record certain balances in the general ledger in accordance with GAAP as promulgated by FASAB. In spite of the significant systems limitations, USCG will re-engineer several key sub-process areas related to revenue management and develop compensating controls to support this balance in FY 2011.
- **Accounts Payable (AP):** The USCG does not record certain balances in the general ledger in accordance with GAAP as promulgated by the FASAB. In spite of the significant systems limitations, USCG will re-engineer several key sub-process areas related to accounts payable and develop compensating controls to support this balance in FY 2011. FY 2010 remediation activities over the AP Trust Fund processes included: documenting process flows; documenting the design of the control activities and operating environment; development of process cycle memos; and limited controls and substantive testing over the Oil Spill Liability Trust Fund (OSLTF) and the Sport Fish Restoration and Boating Trust Fund (SFRBTF). In FY 2010, USCG successfully executed enhanced statistical sampling procedures and business processes for the AP accrual estimate.
- **Environmental Liabilities:** The USCG lacks sufficient documented policies and procedures for Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) cases. The

USCG does not have sufficient support related to environmental liabilities resulting in potentially unrecorded and unidentified liabilities.

- **Financial Systems:** The USCG does not have an adequate comprehensive, integrated accounting system to comply with the Federal Financial Management Improvement Act (FFMIA) system requirements and the USSGL at the transaction level. In FY 2010, the USCG assessed and performed internal control testing on general controls. However, consistent with the prior year, the lack of testing on application controls does not provide assurance that internal controls over financial systems are adequate to detect or prevent material errors in the financial statements. A number of non-conformances are a root cause that will limit the USCG's ability to fully remediate material weaknesses in many financial reporting processes. Accordingly, this condition also represents a material weakness in internal control over financial reporting.

Resolution of prior year Material Weaknesses:

- **Actuarial Liabilities:** The USCG has fully remediated the Actuarial Medical and Pension Liabilities amounts one year ahead of schedule. This was the result of an extraordinary effort that included implementing internal controls, increasing data integrity, conducting substantive testing, and improving the quality of medical billings from the Department of Defense.

In addition, the USCG has remediated and tested key components of Entity Level Controls and Military Payroll, and, as a result, has reduced these areas from Material Weaknesses in FY 2009 to Significant Deficiencies in FY 2010:

- **Entity Level Controls (ELC):** USCG has not implemented a Management Control Program (MCP) that includes an integrated monitoring function for internal controls across the entity. Ongoing remediation efforts, including the assessment and implementation of the MCP, will address remaining ELC deficiencies. In FY 2010, the USCG conducted an assessment of internal controls at the entity level using the Government Accountability Office (GAO) Internal Control Management and Evaluation Tool. The USCG also established a Comptroller/Director of Financial Operations position and an Internal Controls Working Group (ICWG). In addition, the USCG implemented a risk assessment strategy, completed a follow-up Financial Transformation Change Management Survey, and continued to track external audit recommendations from the Office of Inspector General (OIG) and GAO. The USCG also established 83 new financial management positions across the enterprise as provided in the FY2010 Appropriations.
- **Military Payroll:** As a result of TODs and TOEs conducted over military human resources processes, 138 out of 161 key controls were found to be designed and operating effectively. A Decision Memo, signed by CG-1, CG-6, and CG-8 on June 21, 2010, identified 9 critical internal control enhancements that will remediate a number of the remaining control deficiencies. Ongoing remediation efforts included the implementation of required segregation of duties and enhanced training for personnel that manage HR Data.
- **Contingent Legal Liabilities (CLL):** Consistent with prior year, the USCG continues to remediate identified internal control deficiencies in CLL.

Reporting Pursuant to FMFIA Section 4. 31 U.S.C.3512 (d)(2)(B)

The United States Coast Guard's financial management systems do not conform with government-wide requirements. The areas of non-conformance listed below were documented. USCG is continuing to execute and update, as appropriate, mission action plans (MAPs) to remediate the following:

- **U.S. Standard General Ledger (USSGL):** The designs of the USCG's financial and mixed systems do not reflect financial information classification structures that are consistent with the USSGL and provide for tracking of specific program expenditures.

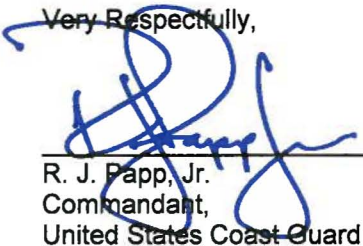
- **Integration of Financial and Mixed Systems:** The lack of integration of the USCG's financial and mixed systems precludes the use of common data elements to meet reporting requirements, and to collect, store, and retrieve financial information. Similar kinds of transactions are not processed throughout the systems using common processes, which could result in data redundancy and inconsistency.
- **Financial Reporting and Budgets:** The USCG's financial and mixed systems do not allow for financial statements and budgets to be prepared, executed, and reported in accordance with the requirements prescribed by the OMB, the U.S. Department of Treasury, and/or the FASAB.
- **Laws and Regulations:** The USCG's financial and mixed systems do not include a system of internal controls that ensures: resource use and financial reporting are consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; reliable data is obtained, maintained, and disclosed in reports; and transactions are processed in accordance with GAAP.
- **System Adaptability:** The USCG does not evaluate how effectively and efficiently the financial and mixed systems support USCG's changing business practices and make appropriate modifications to its information systems.
- **Risk Assessment and Security:** The USCG has legacy financial and mixed systems that were developed without the benefit of today's security practice requirements. Because USCG lacks modern security evaluation software, intensive manual intervention is required to ensure proper security controls, oversight, and auditing occurs to meet OMB and DHS security policies. Some of the legacy financial and mixed systems were developed prior to the implementation of some of these regulations, and are therefore, not designed to comply with them.
- **Documentation and Support:** Adequate systems maintenance, technical systems documentation, training, and user support is not consistently available to enable users of all of the financial and mixed systems to understand, maintain, and operate the systems in an effective and efficient manner.
- **Physical and Logical Controls:** The USCG's financial and mixed systems contain weaknesses in the standardization of physical and logical controls and segregation of duties.

Reporting Pursuant to the Reports Consolidation Act. Section 3516(e)

The United States Coast Guard provides reasonable assurance that the performance data used in the s Annual Financial Report is complete and reliable, except for the following material weaknesses that were found:

- **Financial Reporting:** The USCG does not have documentation and adequate controls to support the process to validate that the full cost by strategic goal, as presented in the notes to the consolidated financial statements, is materially consistent with actual costs incurred.

Very Respectfully,



R. J. Papp, Jr.
Commandant,
United States Coast Guard

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