

DEPARTMENT OF HOMELAND SECURITY
Office of Inspector General

**FY 2007 Audit of DHS' Internal Control
Over Financial Reporting**

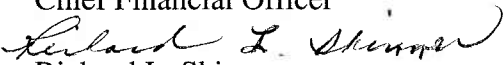




**Homeland
Security**

NOV 15 2007

MEMORANDUM FOR: The Honorable David Norquist
Chief Financial Officer

FROM: 
Richard L. Skinner
Inspector General

SUBJECT: Independent Auditors' Report on DHS' FY 2007 Internal Controls
over Financial Reporting

The attached report presents our independent auditors' opinion on the Department of Homeland Security's (DHS) internal controls over financial reporting as of September 30, 2007. The Department of Homeland Security Financial Accountability Act (The Act) (P.L. 108-330) Section 4, requires that the Secretary of Homeland Security include an audit opinion of DHS' internal controls over its financial reporting in each performance and accountability report beginning after fiscal year 2005. DHS management is responsible for establishing and maintaining effective internal control over financial reporting in accordance with criteria established under the Federal Managers' Financial Integrity Act (FMFIA). Our responsibility is to express an opinion on the effectiveness of DHS' internal control based on our examination.

In our report on internal control as of September 30, 2006, we reported that DHS' internal controls over financial reporting were ineffective because of material weaknesses reported in the Secretary's Assurance Statement and the Independent Auditor's Report. Although deficiencies were identified in the same areas in fiscal year 2007, we recognize DHS efforts towards meeting its goals for the correction of material weaknesses and compliance with FMFIA.

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

Attachment

Office of Inspector General

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



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Preface

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

This report addresses the effectiveness of DHS' internal control over financial reporting. It is based on a review of applicable documents. We performed our review during the course of DHS' FY 2007 financial statement audit in conjunction with the independent public accountant, KPMG LLP. KPMG was engaged to audit the Department's balance sheet as of September 30, 2007 and 2006, and the related statement of custodial activity for the year ended September 30, 2007 (referred to herein as "financial statements"). KPMG was unable to provide an opinion on DHS' financial statements as of September 30, 2007 and 2006.

It is our hope that this report will result in more effective, efficient, and economical operations. We express our appreciation to all of those who contributed to the preparation of this report

A handwritten signature in cursive script that reads "Richard L. Skinner".

Richard L. Skinner
Inspector General



**Homeland
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NOV 15 2007

We have examined the effectiveness of DHS' internal control over financial reporting as of September 30, 2007 based on the criteria established under the Federal Managers' Financial Integrity Act (FMFIA). DHS management is responsible for establishing and maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of DHS' internal control based on our examination.

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

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

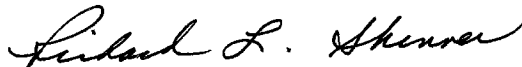
A material weakness is a significant deficiency or combination of significant deficiencies that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. A significant deficiency is a control deficiency or combination of control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

During fiscal year 2007, the following material weaknesses were identified by an independent auditor. Due to the issues noted below, additional material weaknesses may exist that have not been reported.

- Financial Management and Entity-Level Controls;
- Financial Reporting;
- Financial Systems Security;
- Fund Balance with Treasury;
- Capital Assets and Supplies;

- Actuarial and Other Liabilities;
- Budgetary Accounting.

Because of the effects of the material weaknesses mentioned above, in our opinion, DHS did not maintain effective internal control as of September 30, 2007, to meet the following objectives: (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements and stewardship information in conformity with GAAP, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with laws governing the use of budget authority and with other significant laws and regulations that could have a direct and material effect on the financial statements and stewardship information. Consequently, DHS' internal control did not provide reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis.




Richard L. Skinner
Inspector General



Homeland Security

November 15, 2007

MEMORANDUM FOR: Richard L. Skinner, Inspector General

FROM: David L. Norquist, Chief Financial Officer 

SUBJECT: FY 2007 Internal Controls over Financial Reporting Audit

Thank you for the opportunity to review your draft audit opinion of the Department's internal controls over financial reporting. I agree with your conclusions. I am pleased with how we have worked together to implement the *Department of Homeland Security Financial Accountability Act*. As we conclude the third year of implementing the Act, the progress the Department has made is remarkable. That success began with the strong working relationship between our offices, and in particular, Management's *Internal Control Over Financial Reporting Playbook* and your independent performance audits that together identified the root causes and the necessary corrective actions. While challenges remain, the Department has shown its ability to implement corrective actions, as evidenced by the following FY 2007 achievements:

- Strengthened the control environment and bolstered oversight functions with the strong support of the Department's Secretary and Under Secretary for Management;
- Executed year two of the Department's multi-year plan for OMB Circular No. A-123, resulting in the Secretary's first ever assurance statement on the design effectiveness of internal controls over financial reporting;
- Partnered with the Under Secretary for Management, Chief Information Officer, and Chief Information Security Officer, to achieve compliance with the *Federal Information Security Management Act*;
- Corrected material weakness conditions for Legal Liabilities and reduced the severity of Capitalization of Internal Use Software to a significant deficiency condition;
- Corrected TSA's Financial Reporting material weakness condition and reduced the severity of TSA's Capital Assets and Other Liabilities conditions to significant deficiencies;
- Sustained FY 2006 progress at ICE and eliminated all remaining ICE material weakness conditions;
- Designed Department-wide financial reporting process improvements; and
- Developed Department-wide financial management policies and procedures.

Thank you for your office's support throughout this audit. I look forward to continued cooperation and progress in the future.

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