Department of Homeland Security
Office of Inspector General

Independent Auditors' Report on DHS' FY 2011 Financial Statements and Internal Control over Financial Reporting

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Washington, DC 20528

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Homeland Security

Preface

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

The attached report presents the results of the DHS financial statements audit for fiscal year (FY) 2011 and the results of an examination of internal control over financial reporting of the balance sheet as of September 30, 2011, and the statement of custodial activity for FY 2011. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the audits. The contract required that KPMG perform its audits according to generally accepted government auditing standards and guidance from the Office of Management and Budget and the Government Accountability Office. KPMG expressed a qualified opinion on DHS' balance sheet as of September 30, 2011, and the statement of custodial activity for FY 2011. However, KPMG was unable to complete procedures necessary to form an opinion on DHS' internal control over financial reporting of the balance sheet as of September 30, 2011, and statement of custodial activity for FY 2011. The report discusses nine significant deficiencies in internal control, of which five are considered material weaknesses, and six instances of noncompliance with laws and regulations. KPMG is responsible for the attached report and the conclusions expressed in the report. We do not express opinions on DHS' financial statements or provide conclusions on compliance with laws and regulations.

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

Charles K. Edwards
Acting Inspector General

U.S. DEPARTMENT OF HOMELAND SECURITY

Excerpts from the DHS Annual Financial Report

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KPMG LLP
2001 M Street, NW
Washington, DC 20036

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying balance sheet of the U.S. Department of Homeland Security (DHS or Department) as of September 30, 2011 and the related statement of custodial activity for the year then ended (referred to herein as the "fiscal year (FY) 2011 financial statements"). The objective of our audit was to express an opinion on the fair presentation of these financial statements. We were also engaged to examine the Department's internal control over financial reporting of the balance sheet as of September 30, 2011, and statement of custodial activity for the year then ended. In connection with our audit, we also considered DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on the FY 2011 financial statements.

We were also engaged to audit the accompanying balance sheet of the DHS as of September 30, 2010 and the related statement of custodial activity for the year then ended (referred to herein as the "FY 2010 financial statements"). We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources, for the years ended September 30, 2011 and 2010 (referred to herein as "other FY 2011 and 2010 financial statements"), or to examine internal control over financial reporting over the other FY 2011 financial statements.

Summary

Except as discussed in our Report on the Financial Statements, we concluded that the balance sheet as of September 30, 2011 and the related statement of custodial activity for the year ended, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles. The scope of our work was not sufficient to express an opinion on the DHS balance sheet as of September 30, 2010 or the related statement of custodial activity for the year then ended.

As discussed in note 15 of the FY 2011 financial statements, the Department has intergovernmental debt of approximately $17.8 billion used to finance the *National Flood Insurance Program* (NFIP). Due to the subsidized nature of the NFIP, the Department has determined that future insurance premiums and other anticipated sources of revenue may not be sufficient to repay this debt. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As stated in our Report on Internal Control over Financial Reporting, we were unable to perform procedures necessary to form an opinion on DHS' internal control over financial reporting of the balance sheet as of September 30, 2011 and the related statement of custodial activity for the year then ended.

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

- Financial Reporting
- Information Technology Controls and Financial System Functionality
- Property, Plant, and Equipment
- Environmental and Other Liabilities
- Budgetary Accounting

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

- Entity-Level Controls
- Fund Balance with Treasury
- Grants Management

- Custodial Revenue and Drawback

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed the following instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended:

- *Federal Managers' Financial Integrity Act of 1982*
- *Federal Financial Management Improvement Act of 1996*
- *Single Audit Act Amendments of 1996*
- *Chief Financial Officers Act of 1990*
- *Anti-deficiency Act*
- *Government Performance and Results Act of 1993*

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

The following sections discuss our opinion on the accompanying DHS FY 2011 financial statements; why we are unable to express an opinion on the DHS FY 2010 financial statements; why we were unable to express an opinion on internal control over financial reporting of the balance sheet as of September 30, 2011, and statement of custodial activity for the year then ended; our tests of DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements and other matters; and management's and our responsibilities.

Report on the Financial Statements

We have audited the accompanying balance sheet of the U.S. Department of Homeland Security as of September 30, 2011, and the related statements of custodial activity for the year then ended. We were also engaged to audit the accompanying balance sheet of the DHS as of September 30, 2010 and the related statement of custodial activity for the year then ended.

The Coast Guard has adopted a multi-year plan to reconcile its balance sheet accounts, obtain sufficient evidential matter that support historical transactions, and prepare auditable financial statements. Pursuant to this plan, the Coast Guard did not assert to the reliability of general property, plant, and equipment including heritage and stewardship assets, environmental liabilities, and the related effects, if any, on other balances presented in the accompanying balance sheet at September 30, 2011. Coast Guard general property, plant, and equipment including heritage and stewardship assets, and environmental liabilities as reported in the accompanying FY 2011 financial statements were $9.9 billion and $973 million, respectively as of September 30, 2011. It was not practicable to extend our auditing procedures sufficiently to satisfy ourselves as to the fairness of these balances.

In our opinion, except for the effects on the FY 2011 financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to apply adequate procedures to general property, plant, and equipment including heritage and stewardship assets, environmental liabilities, and related other balances presented in the accompanying balance sheet at September 30, 2011, as discussed in the preceding paragraph, the FY 2011 financial statements referred to above present fairly, in all material respects, the financial position of DHS as of September 30, 2011 and its custodial activity for the year then ended, in conformity with U.S. generally accepted accounting principles.

In FY 2010, the Coast Guard was unable to provide sufficient evidential matter that support transactions and certain balance sheet accounts including fund balance with Treasury, accounts receivable, inventory and related property, general property, plant and equipment including heritage and stewardship assets, certain actuarially-derived liabilities, environmental and other liabilities, and net position, as reported in the accompanying DHS balance sheet as of September 30, 2010. It was impractical to extend our procedures sufficiently to determine the extent, if any, to which the DHS balance sheet as of September 30, 2010, and the related statement of custodial activity for the year then ended, may have been affected by the matters discussed in this paragraph. Accordingly, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the FY 2010 financial statements and the related notes thereto. The total assets and liabilities of the Coast Guard, as reported in the accompanying DHS FY 2010 financial statements were $20.3 billion or 23 percent of total DHS consolidated assets, and were $46.4 billion or 56 percent of total DHS consolidated liabilities as of September 30, 2010.

We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the years ended September 30, 2011 and 2010, and accordingly, we do not express an opinion on these other FY 2011 and 2010 financial statements.

As discussed in note 15 of the FY 2011 financial statements, the Department has intergovernmental debt of approximately $17.8 billion used to finance the *National Flood Insurance Program*. Due to the subsidized nature of the NFIP, the Department has determined that future insurance premiums, and other anticipated sources of revenue, may not be sufficient to repay this debt. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 24, DHS did not present the Statements of Net Cost as of September 30, 2011 and 2010 by major program, goals and outputs as described in a strategic and performance plan, and also omitted certain related financial statement disclosures, required by OMB Circular No. A-136, *Financial Reporting Requirements*, as amended.

The information in the Management's Discussion and Analysis (MD&A), Required Supplementary Stewardship Information (RSSI), and Required Supplementary Information (RSI) sections of the DHS FY 2011 Annual Financial Report (AFR) is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We were unable to complete limited procedures over MD&A, RSSI, and RSI as prescribed by professional standards because of the limitations on the scope of our audit described in the second and fourth paragraphs of this section of our report. Certain information presented in the MD&A, RSSI, and RSI is based on other FY 2011 and 2010 financial statements on which we have not expressed an opinion. We did not audit the MD&A, RSSI, and RSI, and accordingly, we express no opinion on it. However, we noted that DHS did not include summary performance information that is aligned with approved and adopted strategic goals within the MD&A section of the FY 2011 AFR, as required by OMB Circular No. A-136, *Financial Reporting Requirements*, as amended. DHS recently completed a quadrennial review for the purpose of developing an updated strategic plan around new priorities established by the Secretary.

The information in the Other Accompanying Information section of DHS' FY 2011 AFR is presented for purposes of additional analysis, and is not a required part of the financial statements. This information has not been subjected to auditing procedures, and accordingly, we express no opinion on it.

Report on Internal Control over Financial Reporting

We were engaged to examine the Department's internal control over financial reporting of the balance sheet as of September 30, 2011, and statement of custodial activity for the year then ended, based on the criteria established in OMB Circular No. A-123, *Management's Responsibility for Internal Control* (OMB Circular No. A-123), Appendix A. DHS management is responsible for establishing and maintaining effective internal control over financial reporting, and for its assertion on the effectiveness of internal control over financial reporting, included in the FY 2011 DHS *Secretary's Assurance Statement*, included in MD&A on page 34 of the DHS FY 2011 AFR, as required by OMB Circular No. A-123. We did not test all controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

The FY 2011 DHS *Secretary's Assurance Statement* states that the Department was unable to provide assurance that internal control over financial reporting was operating effectively at September 30, 2011. This conclusion is based on the Department's evaluation and analysis of control deficiencies at the Coast Guard, Transportation Security Administration, Federal Emergency Management Agency, U.S. Customs and Border Protection, U.S. Immigration and Customs Enforcement, and other components that in combination represent Departmental material weaknesses. In addition, management acknowledges that pervasive material weaknesses exist in key financial processes, and has devoted attention on remediation of those material weaknesses during FY 2011. Management is therefore unable to make an assertion on the effectiveness of internal control over financial reporting in key financial statement processes.

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

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

- Financial Reporting
- Information Technology Controls and Financial Systems Functionality
- Property, Plant, and Equipment
- Environmental and Other Liabilities
- Budgetary Accounting

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

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

- Entity-Level Controls
- Fund Balance with Treasury
- Grants Management
- Custodial Revenue and Drawback.

Deficiencies in all components that contribute to a significant deficiency at the consolidated level, when aggregated, are presented in Exhibit III.

Because of the limitation on the scope of our audit described in the second paragraph of the Report on the Financial Statements section, and the nature of managements assertion on the effectiveness of internal control over financial reporting described in the second paragraph of the Report on Internal Control over Financial Reporting section, the scope of our examination was not sufficient to enable us to express, and we do not express an opinion on the effectiveness of DHS' internal control over financial reporting of the balance sheet as of September 30, 2011, and related statement of custodial activity for the year then ended. It was impractical to extend our procedures sufficiently to determine the extent, if any, to which the FY 2011 financial statements may have been affected by these circumstances.

We were not engaged to examine internal controls over financial reporting of the accompanying statements of net cost, changes in net position, and budgetary resources, for the year ended September 30, 2011. Other deficiencies in internal control, potentially including additional material weaknesses and significant deficiencies, may have been identified and reported had we been able to apply sufficient audit procedures to property, plant, and equipment including heritage and stewardship assets, and environmental liabilities balances, as described in the second paragraph of our Report on the Financial Statements; had we been able to perform all procedures necessary to express an opinion on DHS' internal control over financial reporting of the FY 2011 financial statements; and had we been engaged to audit the other FY 2011 and 2010 financial statements and to examine internal control over financial reporting of the other FY 2011 financial statements.

A summary of the status of FY 2010 material weaknesses and significant deficiencies is included as Exhibit V. We also noted certain additional deficiencies involving internal control over financial reporting and its operation that we will report to the management of DHS in a separate letter.

Report on Compliance and Other Matters

The results of certain of our tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed the following six instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04, and are described in Exhibit IV:

- *Federal Managers' Financial Integrity Act of 1982*
- *Federal Financial Management Improvement Act of 1996*
- *Single Audit Act Amendments of 1996*
- *Chief Financial Officers Act of 1990*
- *Anti-deficiency Act*
- *Government Performance and Results Act of 1993*

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

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

Other instances of noncompliance with laws, regulations, contracts, and grant agreements may have been identified and reported, had we been able to apply sufficient audit procedures to property, plant, and equipment including heritage and stewardship assets, and environmental liabilities balances as described in the second paragraph of our Report on the Financial Statements; perform all procedures necessary to complete our examination of internal control over financial reporting of the balance sheet as of September 30, 2011 and the related statements of custodial activity for the year then ended; and had we been engaged to audit the other FY 2011 financial statements and to examine internal control over financial reporting over the other FY 2011 financial statements.

Other Matters: Management of the NPPD, Coast Guard, and Management Directorate have initiated reviews of certain collections, classification and use of funds, expenditures and/or obligations recorded that may identify a violation of the *Anti-deficiency Act*, or other violations of appropriation law in FY 2011 or in previous years.

Responsibilities

Management's Responsibilities. Management is responsible for the financial statements; establishing and maintaining effective internal control; and complying with laws, regulations, contracts, and grant agreements applicable to DHS.

Auditors' Responsibilities. Our responsibility is to express an opinion on the FY 2011 financial statements of DHS based on our audit. Except as discussed in the second paragraph of our Report on Financial Statements above, we conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 07-04. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit also includes:

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

KPMG

We believe that our audit provides a reasonable basis for our opinion.

As part of obtaining reasonable assurance about whether DHS' FY 2011 financial statements are free of material misstatement, we performed tests of DHS' compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the balance sheet amounts as of September 30, 2011, and the related statement of custodial activity for the year then ended, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to DHS. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit, and accordingly, we do not express such an opinion.

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

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

KPMG LLP

November 11, 2011

Our report on internal control over financial reporting and compliance and other matters is presented in accordance with *Government Auditing Standards,* issued by the Comptroller General of the United States. The internal control weaknesses and findings related to compliance with certain laws, regulations, contracts, and grant agreements presented herein were identified during our audit of the U.S. Department of Homeland Security (Department or DHS)'s balance sheet as of September 30, 2011, and statement of custodial activity for the year then ended (financial statements), and to examine internal control over financial reporting of those financial statements. We were not engaged to audit the Department's fiscal year (FY) 2011 statements of net cost, changes in net position, and budgetary resources (referred to as other FY 2011 financial statements), or to examine internal controls over financial reporting of the other FY 2011 financial statements. Our findings and the status of prior year findings are presented in five exhibits:

Exhibit I Significant deficiencies in internal control identified at the United States Coast Guard (Coast Guard). All of the significant deficiencies reported in Exhibit I are considered material weaknesses at the DHS consolidated level, when combined with other significant deficiencies reported in Exhibit II.

Exhibit II Significant deficiencies in internal control identified throughout the Department or at other DHS components (components other than Coast Guard are collectively referred to as DHS Civilian Components). All of the significant deficiencies reported in Exhibit II are considered material weaknesses at the DHS consolidated level, when combined with other significant deficiencies reported in Exhibit I.

Exhibit III Significant deficiencies that are not considered a material weakness at the DHS consolidated financial statement level.

Exhibit IV Instances of noncompliance with certain laws, regulations, contracts, and grant agreements that are required to be reported under *Government Auditing Standards* or Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

Exhibit V The status of our findings reported in FY 2010.

Criteria *Index of Financial Reporting and Internal Control Criteria*

As stated in our Independent Auditors' Report, the scope of our work was not sufficient to enable us to express an opinion on the effectiveness of DHS' internal control over financial reporting of the balance sheet as of September 30, 2011, and related statement of custodial activity for the year then ended. Consequently, additional deficiencies in internal control over financial reporting, potentially including additional material weaknesses and significant deficiencies, may have been identified and reported, had we been able to perform all procedures necessary to express an opinion on DHS' internal control over financial reporting, and had we been engaged to audit the other FY 2011 financial statements, and to examine internal control over financial reporting of the other FY 2011 financial statements.

The determination of which findings rise to the level of a material weakness is based on an evaluation of how deficiencies identified in all components, considered in aggregate, may affect the DHS balance sheet as of September 30, 2011, or the related statement of custodial activity for the year then ended.

We have also performed follow-up procedures on findings identified in previous engagements to audit the DHS financial statements. To provide trend information for the DHS Civilian Components, Exhibits II and III contain Trend Tables next to the heading of each finding. The Trend Tables in Exhibits II and III depict the severity and current status of findings, by component that has contributed to that finding from FY 2009 through FY 2011.

The criteria supporting our findings, such as references from technical accounting standards, various rules and regulations, including requirements issued by the Office of Management and Budget and the U.S. Treasury, and internal Departmental and component directives, is presented in the *Index of Financial Reporting and Internal Control Criteria* behind Exhibit V.

A summary of our findings in FY 2011 and FY 2010 are presented in the Tables below:

Table 1 Presents a summary of our internal control findings, by component, for FY 2011.
Table 2 Presents a summary of our internal control findings, by component, for FY 2010.

We have reported five material weaknesses and four significant deficiencies at the Department level in FY 2011, shown in Table 1.

TABLE 1 – SUMMARIZED DHS FY 2011 INTERNAL CONTROL FINDINGS

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

TABLE 2 – SUMMARIZED DHS FY 2010 INTERNAL CONTROL FINDINGS

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

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

All components of DHS, as defined in Note 1A – *Reporting Entity,* to the financial statements, were included in the scope of our audit of the consolidated balance sheet of DHS as of September 30, 2011, and the related statement of custodial activity for the year then ended, and our engagement to examine internal control over financial reporting of those financial statements. Accordingly, our audit and engagement to examine internal control considered significant account balances, transactions, and accounting processes of other DHS components not listed above. Control deficiencies identified in other DHS components that are not identified in the table above did not individually, or when combined with other component findings, contribute to a material weakness or significant deficiency at the DHS consolidated financial statement level.

I-A Financial Reporting

Background: In previous years, we reported that the U.S. Coast Guard (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 that includes various Mission Action Plans (MAPs) designed 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 fiscal year (FY) 2011, by completing its planned corrective actions over selected internal control deficiencies. Specifically, the Coast Guard implemented new policies and procedures, and automated tools to improve internal controls and the reliability of its financial statements throughout FY 2011. These remediation efforts allowed management to make new assertions in FY 2011 related to the auditability of its financial statement balances, including $6.3 billion of fund balance with Treasury. The FSTAR calls for continued remediation of control deficiencies and reconciliation of balances in FY 2012. Consequently, some conditions of the financial reporting control weaknesses that we reported in the past remain uncorrected at September 30, 2011.

Conditions: 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 balance and year-end close-out related activity, and the cumulative results of operations analysis in its general ledgers individually and/or in the aggregate.
- Ensure that all journal entries and edit queries impacting the general ledger are adequately researched and supported. Specifically, documenting that adequate research regarding the underlying cause(s) was performed, and maintaining the appropriate transactional-level supporting detail.
- Ensure that all accounts receivable balances exist, are complete and accurate, and properly presented in the financial statements. For example, the underlying data used to support accounts receivable balances was not always accurate (e.g., incorrect standard rates applied), reimbursable activity may not be identified and recorded timely due to intra-governmental reconciliation difficulties, and accounts receivable activity is not always properly recorded in the financial statements on a timely basis.
- Ensure all financial statement information (e.g., statement of net cost, statement of budgetary resources, statement of changes in net position) and related disclosures submitted for incorporation in the DHS consolidated financial statements are accurate and complete.
- Ascertain that intra-governmental activities and balances are identified, monitored, properly recorded, 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 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 of 1996* (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. Some remediation initiatives implemented in FY 2011 were not fully implemented for the entire year, and the FSTAR calls for continued remediation in FY 2012.

Because of the conditions noted above, the Coast Guard and the Department were unable to provide reasonable assurance that internal controls over financial reporting were operating effectively at September 30, 2011, and has acknowledged that pervasive material weaknesses and various internal control deficiencies continue to exist in some key financial processes. Consequently, the Coast Guard cannot assert to the reliability of general property, plant, and equipment, environmental liabilities, and their related effects, if any, on other balances presented in the Department's financial statements as of September 30, 2011.

Criteria: Presented in *Index of Financial Reporting and Internal Control Criteria* behind Exhibit V.

Recommendations: We recommend that the Coast Guard:

1. Continue the implementation of the FSTAR and completion of MAPs, as planned;
2. Implement accounting and financial reporting processes including an integrated general ledger system that is FFMIA compliant; and
3. 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 journal entries and edit queries impacting the general ledger are adequately researched and supported;
    c. Accounts receivable balances are complete and accurate, and properly presented in the financial statements;
    d. Financial statement disclosures submitted for incorporation in the Department of Homeland Security (DHS or Department) financial statements are accurate and complete; and
    e. All intra-governmental activities and balances are reconciled on a timely basis, accurately reflected in the financial statements, and differences are resolved in a timely manner in coordination with the Department's Office of Financial Management (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 (ITGCs) are tested using the objectives defined by the U.S. Government Accountability Office (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 ITGCs. We noted that financial system limitations contribute to the Coast Guard's challenge of addressing systemic internal control weaknesses, strengthening the control environment, and complying with relevant Federal financial system requirements and guidelines, notably FFMIA, Office of Management and Budget (OMB) Circular A-127, *Financial Management Systems*, and DHS policies.

In FY 2011, our ITGC control testing identified 21 findings, of which 16 were repeat findings from the prior year and 5 were new findings. In addition, we determined that Coast Guard remediated 12 findings identified in previous years. Specifically, the Coast Guard took actions to improve aspects of its IT security controls, including password configurations, data center physical security, and audit log reviews.

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

Related to IT controls:

Conditions: We noted that IT security access controls and configuration management controls supporting Coast Guard's financial systems are not operating effectively, and continue to present risks to DHS financial data confidentiality, integrity, and availability. Financial data in the Coast Guard general ledgers may be compromised by automated and manual changes that are not adequately controlled. For example, the Coast Guard uses an IT scripting process to address functionality and data quality issues within its core financial system, as necessary, to process and report financial data. During our FY 2011 testing, we noted that some previously identified IT scripting control deficiencies were remediated, while other deficiencies continue to exist. Four key areas continue to impact the Coast Guard IT script control environment, as follows:

- Script testing – limited guidance exists to guide Coast Guard staff in the development of test plans and to support the completion of functional testing;
- Script audit logging – controls supporting audit logs are not consistently implemented to log privileged user actions, and to ensure that only approved scripts are executed;
- Script approvals and recertification – the recertification reviews conducted by the Coast Guard were not comprehensive to include all user roles associated with the Mashups and Dimensions systems. Additionally, the documentation retained in support of the reviews was not adequately completed in accordance with policy throughout the year; and
- Script recording – test and production data is not consistently recorded, and there are limited controls to ensure data accuracy. Additionally, field reconciliation discrepancies are not always consistently documented and explained.

We also 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 Coast Guard's 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 to fully assess if it has a financial statement impact.

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 many cases where financial system functionality is inhibiting the Coast Guard's ability to implement and maintain internal controls, notably IT application controls supporting financial data processing and reporting. Financial system functionality limitations increase the difficulty of compliance with Federal financial system requirements and guidelines, notably FFMIA and OMB Circular A-127. Examples of financial system functionality conditions we identified 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.
- Financial system audit logs are not readily generated and reviewed, as some of the financial systems continue to lack the capability to perform this task efficiently.
- The Coast Guard is unable to routinely query its various general ledgers to obtain a complete population of financial transactions, and consequently must create many manual custom queries that delay financial processing and reporting processes.
- A key Coast Guard financial system is limited in processing overhead cost data and depreciation expenses in support of the property, plant and equipment (PP&E) financial statement line item.
- Production versions of financial systems are outdated and do not provide the necessary core functional capabilities (e.g., general ledger capabilities).
- 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 generally accepted accounting principles (GAAP); and
- Tracking detailed transactions associated with intragovernmental business and eliminating the need for default codes such as Trading Partner Identification Number that cannot be easily researched.

Cause/Effect: The current system configurations for many Coast Guard financial systems cannot be easily reconfigured to meet FFMIA, OMB Circular A-127, and DHS security requirements. The conditions supporting our findings collectively limit the Coast Guard's ability to process, store, and report financial data in a manner to ensure accuracy, confidentiality, integrity, and availability. Some of the weaknesses may result in material errors in the Coast Guard's financial data that are not detected in a timely manner through the normal course of business. In addition, because of the presence of IT control and financial system functionality weaknesses, there is added pressure on mitigating controls to operate effectively. Because mitigating controls are often more manually focused, there is an increased risk of human error that could materially affect the financial statements. See Comment **I-A**, *Financial Reporting,* for a discussion of the related conditions causing noncompliance with the requirements of FFMIA. Configuration management weaknesses are also among the principle causes of the Coast Guard's inability to support certain financial statement balances for audit purposes.

Criteria: Presented in *Index of Financial Reporting and Internal Control Criteria* behind Exhibit V.

Recommendations: We recommend that the DHS Office of Chief Information Officer (OCIO), in coordination with the Office of the Chief Financial Officer (OCFO):

1. Continue to develop and implement policies, procedures, and processes to address scripting weaknesses, including weaknesses related to functional testing, audit logging, approvals, and recertifications, and the documentation and review of script records.
2. For new and updated script procedures, revise associated trainings and provide the training to impacted staff.
3. Continue to improve the script change management process and other associated internal controls as they relate to the financial statement impact of the changes to the CAS suite of financial databases.
4. Make necessary improvements to financial management systems and supporting IT security controls.

Specific recommendations are provided in a separate *Limited Official Use* letter provided to Coast Guard management.

I-C Property, Plant, and Equipment

Background: The Coast Guard maintains approximately 49 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. 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.

In FY 2011, the Coast Guard continued to execute remediation efforts to address PP&E process and control deficiencies, specifically those associated with vessels, small boats, aircraft, and select construction in process (CIP) projects, and also related to the inventory of heritage assets. Inventory procedures were performed in FY 2011 to assist in the substantiation of existence and completeness of PP&E balances, however, they were not performed over all asset classes (e.g., land, buildings and other structures, and electronic equipment). Additionally, an analysis to ensure the proper accounting of internal use software has not yet been completed. Remediation efforts are scheduled to occur over a multi-year timeframe beyond FY 2011. Consequently, many of the conditions cited below have been repeated from our FY 2010 report.

Conditions: The Coast Guard has not:

Regarding PP&E:

- Established accurate and auditable PP&E balances as of September 30, 2011. 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, (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, CIP activity, 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 assets system.
- 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.
- Identified and tracked all instances where PP&E accounting is not in compliance with GAAP and prepared a non-GAAP analysis that supports management's accounting policies. This analysis should be maintained and available for audit.

Regarding Heritage Assets:

- 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 heritage assets.

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, and IT functionality difficulties, See Comment **I-B**, Information Technology Controls and Financial Systems Functionality.PP&E was not properly accounted for or tracked, for many years preceding the Coast Guard's transfer to DHS in FY 2003, and now the Coast Guard is faced with the formidable challenge of performing retroactive analyses in order to properly establish the existence, completeness, and accuracy of PP&E. Additionally, the fixed asset module of the Coast Guard's general ledger accounting system 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 (heritage assets) weaknesses reported in previous years, and acknowledged that the conditions we reported in prior years remained throughout FY 2011. 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: Presented in Index of Financial Reporting and Internal Control Criteria behind Exhibit V.

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 Statement of Federal Financial Accounting Standard (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, transfers from other agencies, improvements, impairments, capital leases, indirect costs, depreciable lives, disposals in its fixed assets system, and valuation and classification of repairable PP&E. Additionally, continue to implement remediation efforts associated with control over the completeness, existence, accuracy, and valuation of all CIP related balances;
3. Adhere to procedures to timely update the fixed asset module of the Coast Guard's general ledger accounting system to improve tracking and reporting of PP&E on an ongoing basis. 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:

1. 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 disclosures and related supplementary information for Stewardship PP&E that is consistent with GAAP.

I-D Environmental and Other Liabilities

Background: The Coast Guard's environmental liabilities consist of environmental remediation, cleanup, and decommissioning and represent approximately $973 million or 93 percent of total DHS environmental liabilities. 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.). During FY 2011, the Coast Guard continued to implement a multi-year remediation plan to address process and control deficiencies related to environmental liabilities. In FY 2011, progress was made with respect to implementation of policies and procedures; however, the majority of the conditions cited in our FY 2010 report remain.

The Coast Guard estimates accounts payable by adjusting the prior year accrual estimate based on an analysis of actual payments made subsequent to September 30 of the prior year.

The Coast Guard's contingent legal liability balance is comprised of estimates associated with various administrative proceedings, legal actions, and tort claims that arise in the normal course of Coast Guard operations.

A component of Coast Guard's accrued payroll and benefits liability balance is annual leave. Annual leave is composed of earned annual and other vested compensatory leave that is accrued as it is earned. Subsequently, as leave is taken, the liability is reduced.

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

The Coast Guard has not:

Regarding environmental liabilities:

- Fully supported the completeness, existence, and accuracy assertions of the data utilized in developing the estimate for the FY 2011 environmental liabilities account balance.
- Fully implemented policies and procedures to develop, prepare, record, and periodically review environmental liability estimates related to shore facilities and vessels. Specifically, procedures to confirm the existence of and legal liability for environmental damage/contamination sites, ensure the completeness of the environmental site universe, and verify the historical accuracy of assumptions used and estimates made for environmental liabilities.

Regarding other liabilities:

- Designed a methodology used to estimate accounts payable that considers and uses all potentially relevant current year data. As a result, current year data that may have a significant impact on the estimate could be overlooked and not identified until a true-up is performed in the subsequent year.
- Ensured that policies and procedures associated with management's review of the underlying data supporting contingent legal and payroll liability (i.e., unfunded leave) balances are fully implemented and operating effectively. Specifically, deficiencies in management's review attributed to errors in the underlying data supporting the interim contingent legal liability and unfunded leave balances.

Cause/Effect: The Coast Guard has not fully completed its remediation plans to develop, document, and implement policies and procedures to, prepare, and record environmental liability estimates in accordance with applicable accounting standards. As a result, the Coast Guard is unable to assert to the accuracy of its environmental liability balances as stated in the September 30, 2011 balance sheet, and provide necessary information to OFM for DHS financial statement purposes.

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. Without consideration of applicable current year data, a misstatement in the accounts payable estimate may occur and not be identified in a timely manner (i.e., until a true-up is performed in a subsequent period).

The Coast Guard did not fully adhere to existing policies and procedures associated with the review of underlying data supporting interim contingent legal and payroll liability balances. A lack of adequate management review over the underlying data supporting account balances increases the risk that a misstatement may go undetected.

Criteria: Presented in *Index of Financial Reporting and Internal Control Criteria* behind Exhibit V.

Recommendations: We recommend that the Coast Guard:

Regarding environmental liabilities:

Fully 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 Federal Accounting Standards Advisory Board (FASAB) Technical Release No. 2 *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government* The policies should include procedures to:

1. 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;
2. Periodically validate estimates against historical costs; and

3. Ensure that detailed cost data is maintained and reconciled to the general ledger.

Regarding other liabilities:

1. Analyze and make appropriate improvements to the methodology used to estimate accounts payable to include potentially relevant current year data, and support all assumptions and criteria with appropriate documentation used to develop and subsequently validate the estimate for financial reporting; and
2. Adhere to existing policies and procedures associated with the review of underlying data supporting contingent legal and accrued payroll and benefits liabilities.

I-E 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 U.S. Treasury guidance. The Coast Guard has over 80 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, which were repeated from our FY 2010 report. The Coast Guard has not:

- Fully implemented policies, procedures, and internal controls over its 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 are not always maintained.
- Finalized and implemented policies and procedures to monitor unobligated commitment activity in CAS throughout the fiscal year.
- 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: A lack of fully implemented policies, procedures, and internal controls surrounding commitments, obligations, UDOs, delivered orders, and disbursements has caused various control gaps in the internal control environment. Weak controls in budgetary accounting, and associated contracting practices increase the risk that the Coast Guard misstates budgetary balances, and unintentionally violate the Anti-deficiency Actby overspending its budget authority. Also, the untimely release of commitments may prevent funds from being used for other more critical needs.

Criteria: Presented in Index of Financial Reporting and Internal Control Criteria behind Exhibit V.

Recommendations: We recommend that the Coast Guard:

1. Continue to improve policies, procedures, and the design and effectiveness of controls in both accounting and contracting related to processing obligation transactions, and periodic review and validation of UDOs. Emphasize to all fund and program 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.

II-A Financial Reporting (TSA, USCIS)

	2011	2010	2009
TSA			
FEMA	C		
USCIS		N/A	N/A
CBP	C	C	

Key – Trend Table	
C	Deficiencies are corrected
N/A	No deficiencies reported
	Deficiencies are less severe*
	Deficiencies are more severe*
* See Introduction	

Background: The Transportation Security Administration (TSA) has adopted a multi-year effort to develop and install the appropriate financial reporting processes, together with proper internal controls over financial reporting (ICOFR). In fiscal year (FY) 2011, TSA made progress by hiring accounting personnel, and substantially completing the reconciliation of its balance sheet accounts. However, TSA has not fully implemented all of the planned processes, and associated internal controls. Consequently, some financial reporting control weaknesses reported in FY 2010 continued to exist, and some new deficiencies were identified.

The United States Citizen and Immigration Service (USCIS) requires advance payments of the fees for adjudication of applications or petitions for immigration and naturalization benefits. These advance receipts account for the majority of deferred revenue reported in the Department of Homeland Security (DHS or Department) financial statements. In FY 2011, the Department implemented a change in accounting to report the user fees collected by USCIS as exchange revenue on the statement of net cost. Previously, these user fees were reported as revenue on the statement of custodial activity. This change resulted in an immaterial correction of an error in the presentation of user fees as reported in previous years, and identification of a control deficiency in the financial reporting process at USCIS.

FEMA implemented corrective actions in financial reporting processes, and substantially remediated the conditions we reported in FY 2010.

Conditions: We noted the following internal control weaknesses related to Financial Reporting at TSA and USCIS.

1. TSA:

   - Has not fully developed its financial reporting process with sufficient policies, procedures, and internal controls to ensure the reliability of certain significant financial statement balances. For example, we noted that TSA:

     - Has ineffective internal controls, including supervisory reviews and monitoring, at some significant process-level risk points, e.g., where there is a risk of material error within a process;
     - Lacks some policies and procedures to ensure that changes in accounting policies and methodologies are reviewed, tested, and vetted prior to adoption;
     - Has not distributed the financial reporting workload to ensure that resources and skills are aligned with tasks, making optimal use of technical resources, and improving internal controls over financial reporting;
     - Is unable to fully identify and present its intragovernmental balances and transactions by trading partner; and
     - Is not fully compliant with the United States Government Standard General Ledger (USSGL) requirements at the transaction level.

2. USCIS:

   - Did not update its accounting policies and practices in a timely manner to address a change in financial accounting which arose from a change in legislation. USCIS' presentation of certain fees as custodial revenue should have been presented as exchange revenue since FY 2005, when the change in legislation occurred.

- Did not have sufficient policies and procedures, or documentation supporting the process used to develop adjustments to deferred revenue. This process was previously performed by an outside contractor.

Cause/Effect: TSA hired a number of accounting staff during the current year, which required substantial training and oversight by existing employees during the process. Additionally accounting staff were often committed to projects or focusing on remediation of control deficiencies, as such, TSA was unable to make optimal use of its technical resources in a review and monitoring capacity. As a result, in some cases, adjustments to correct errors in accounts were recorded without appropriate supporting analysis, documentation, and reviews.

USCIS Financial Management Division (FMD) was aware of the change in legislation in FY 2005 that affected the accounting for certain fees collected, but did not finalize the change in accounting to match the legislation until this year. USCIS and DHS Office of Financial Management (OFM) decided to delay making the change pending further guidance from various outside sources such as the Office of Management and Budget (OMB) and Department of Treasury. While the guidance was ultimately useful, the accounting change should be made in the same year as the triggering event (change in legislation in this case). In addition, USCIS was unable to perform certain functions previously done by an outside contractor, due to a lack of documentation describing the procedures, resulting in errors in interim financial statements.

Criteria: Presented in Index of Financial Reporting and Internal Control Criteria behind Exhibit V.

Recommendations: We recommend that:

1. TSA:
   a. Expand the annual risk assessment process to identify risk-points where control weaknesses exist and update policies and procedures to mitigate risk of error in the financial statements;
   b. Develop formal policies and procedures to ensure that changes in accounting policies and methodologies are reviewed, tested, and vetted prior to adoption, and ensure compliance with the USSGL requirements at the transaction level;
   c. Update annual performance plans for staff to outline goals and expected results that align to implementing corrective actions, maintaining internal controls, mitigating risks identified through the annual risk assessment process and maintaining routine communication with organizations that impact financial reporting; and
   d. Work with its accounting service provider to ensure that the proper trading partner code is recorded for each intragovernmental transaction.
2. USCIS:
   a. Work with DHS OFM to identify and implement necessary changes to accounting policies in the reporting period that the triggering event occurs; and
   b. Establish additional controls, either manual or automated, to ensure all steps in the monthly and quarterly deferred revenue estimation process are completed accurately and timely.

II-B Information Technology Controls and Financial System Functionality (CBP, USCIS, FEMA, ICE)

	2011	2010	2009
CBP			
USCIS			
FEMA			
FLETC	C		
ICE			
TSA	C	C	

See page II.2 for table explanation

Background: As part of the DHS financial statement integrated audit, we evaluated select Information Technology (IT) general controls (ITGC) using the objectives defined by U.S. Government Accountability Office (GAO)'s *Federal Information System Controls Audit Manual* (FISCAM), in five key control areas: security management, access control, configuration management, segregation of duties, and business continuity. In addition to ITGC's, we evaluated select application controls, which are controls supporting the structure, policies, and procedures that apply to the use, operability, interface, edit, and monitoring controls of a financial application. We also considered the effects of financial system functionality when testing internal controls. Many key DHS financial systems are not compliant with *Federal Financial Management Improvement Act of 1996* (FFMIA) and OMB Circular Number A-127, *Financial Management Systems* (as revised and effective on October 1, 2009). DHS financial system functionality limitations add to the Department's challenges of addressing systemic internal control weaknesses, and limit the Department's ability to effectively and efficiently process and report financial data.

During our FY 2011 assessment of IT general and application controls, we noted that the DHS Civilian Components made progress in remediation of IT findings we reported in FY 2010. We have closed approximately 30 percent of our prior year IT findings. ICE, FEMA, and FLETC made the most progress in closing IT findings from the prior year. As evidence of further progress made by DHS, we identified approximately one-half of the number of new findings in FY 2011 compared to the number of new findings identified in FY 2010. The majority of these new deficiencies were noted at CBP.

However, at the end of FY 2011, over approximately 135 IT control weaknesses existed, of which more than 65 percent are repeated from last year. Approximately 25 percent of our repeat findings were for IT deficiencies that management represented were corrected during FY 2011.

The primary (circle) bullets listed below each FISCAM heading are a cross-representation of the nature of IT general control deficiencies identified throughout the Department's components. The secondary (dash) bullets represent single or multiple occurrence findings in one or more components.

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

Related to IT controls:

1. Access controls:

- Deficiencies in management of application and/or database accounts, network, and remote user accounts.
  - System administrator root access to financial applications was not properly restricted, logged, and monitored. Emergency and temporary access was not properly authorized, and contractor development personnel were granted conflicting access to implement database changes;
  - Complex password configurations were not implemented and\or enforced;
  - User account lists were not periodically reviewed for appropriateness, improper authorizations and excessive user access privileges were allowed at some DHS components, and users were not disabled or removed promptly upon personnel termination; and
  - The process for authorizing and managing virtual private network (VPN) access to external state emergency management agencies, and component contractors, did not comply with DHS and component requirements.
- Ineffective safeguards over logical and physical access to sensitive facilities and resources.

  - During after-hours physical security walkthroughs, we identified the following unsecured items: Personally Identifiable Information (PII); credit cards; financial system passwords; laptops; sensitive documentation, and server names and IP addresses; and
  - While performing social engineering testing, we identified instances where DHS employees provided their system user names and passwords to an auditor posing as a help desk employee.
- Lack of generation, review, and analysis of system audit logs and adherence to DHS requirements.

2. Configuration management:

- Lack of documented policies and procedures.
  - Financial systems change control documentation was not updated to represent the current operating environment, including sensitive user functions, roles and privileges; and
  - Configuration, vulnerability, and patch management plans have not been established and implemented, or did not comply with DHS policy.
- Security patch management and configuration deficiencies were identified during the vulnerability assessment on the platforms supporting the key financial applications and general support systems.

3. Security management:

- Systems certification and accreditation were not completed and maintained, or documented.
  - Several component financial and associated feeder systems as well as general support systems, were not properly certified and accredited, in compliance with DHS policy;
  - Compliance with the Federal Desktop Core Configuration (FDCC) security configurations is in progress, but has not been completed; and
  - System security plans and annual evaluations were not completed and maintained.
- IT Security personnel lack mandatory role-based training or compliance is not documented and monitored.
- Background investigations of federal employees and contractors employed to operate, manage and provide security over IT systems were not being properly conducted.

4. Contingency Planning:

- Service continuity plans were not tested nor updated to reflect the current environment, and an alternate processing site has not been established for high risk systems.
- Authorized access to backup media was not periodically reviewed and updated; at one component procedures to periodically test backups was not implemented.

5. Segregation of Duties:

- Lack of evidence to show that least privilege and segregation of duties controls exist, including policies and procedures to define conflicting duties and access rights.

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

Related to financial system functionality:

We noted many cases where financial system functionality is inhibiting DHS' ability to implement and maintain internal controls, notably IT application controls supporting financial data processing and reporting. Financial system functionality limitations also contribute to other control deficiencies reported in Exhibits I, II, and III, and compliance findings presented in Exhibit IV. We noted persistent and pervasive financial system functionality conditions at all of the significant DHS components in the following general areas:

- Lack of integration between the core financial systems and key feeder systems, such as property management systems, leading to errors and inefficiencies in the processing and reporting of financial data.

- Inability of financial systems to process, store, and report financial and performance data to facilitate decision making, safeguarding and management of assets, and prepare financial statements that comply with generally accepted accounting principles (GAAP).

- Technical configuration limitations, such as outdated systems that are no longer fully supported by the software vendors, impairing DHS' ability to fully comply with policy in areas such as IT security controls, notably password management, audit logging, user profile changes, and the restricting of access for off-boarding employees and contractors.

- System capability limitations prevent or restrict the use of applications controls to replace less reliable, more costly manual controls. Or in some cases, require additional manual controls to compensate for IT security or control weaknesses.

Cause/Effect: Many financial system and IT control weaknesses have resulted from DHS' long-standing inability to upgrade its financial system capabilities. The Transformation and Systems Consolidation (TASC) initiative, postponed during FY 2011, is the latest DHS financial systems modernization effort to be postponed, delayed, or canceled. DHS broad and systemic financial system and IT control limitations will not be fully addressed until DHS and/or the components implement a stable financial system platform. Once a new strategy and plan are developed, it will likely take DHS several years to implement process and system improvements.

The conditions supporting our findings collectively limit DHS' ability to process, store, and report financial data in a manner to ensure accuracy, confidentiality, integrity, and availability. Many of the weaknesses may result in material errors in DHS' financial data that are not detected in a timely manner through the normal course of business. In addition, because of the presence of IT control and financial system functionality weaknesses; there is added pressure on mitigating controls to operate effectively. Because mitigating controls are often more manually focused, there is an increased risk of human error that could materially affect the financial statements.

Recommendations: We recommend that the DHS Office of the Chief Information Officer (OCIO), in coordination with the Office of the Chief Financial Officer (OCFO), make necessary improvements to the Department's financial management systems and supporting IT security controls. Specific recommendations are provided in a separate Limited Official Use letter provided to DHS management.

II-C Property, Plant, and Equipment (TSA, CBP, MGMT)

	2011	2010	2009
TSA			
CBP			
MGMT		N/A	N/A
FEMA	N/A	N/A	
USCIS	C	C	
ICE	C	C	
NPPD	C	C	

See page II.2 for table explanation

Background: TSA owns a substantial number and variety of assets that are used for passenger screening at airports throughout the United States. TSA is also developing new software to support various mission related objectives, such as Secure Flight. The costs required to procure, ship, temporarily store, install, operate, and maintain this equipment and software are substantial and consume a large portion of TSA's annual operating budget. Unique accounting processes and systems are necessary to track the status and accumulate costs, and to accurately value, account for, and depreciate and amortize the equipment and software.

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

Management Directorate (MGMT) underwent a process in FY 2011 to identify assets that had been inappropriately expensed in prior fiscal years, resulting in a corrective adjustments made in the financial statements, and the identification of a control deficiency.

Conditions: We noted the following internal control weaknesses related to PP&E at TSA, CBP, and MGMT:

1. TSA:

   - Has not implemented policies, procedures, and controls to properly identify risks and potential errors related to general property, equipment, internally developed software, asset additions and disposals, and other direct costs incurred to transport, store and install screening equipment at airports, as necessary, to maintain the accuracy and completeness of those account balances. Several adjustments some of which were auditor-identified, were required to fairly state PP&E accounts affected by these items.

   - Controls were not fully effective to properly track and record all assets at U.S. airports and at the Federal Air Marshal Facility, accurately in the system of record, and to properly track, reconcile, and value idle assets.

   - Controls were not fully effective to accurately depreciate assets on a continuous basis.

   - Lacks effective higher level controls, including supervisory reviews, reconciliations and monitoring, of property, plant, and equipment, and to ensure that balances recorded in the general ledger were supported by available supporting documentation.

2. CBP:

   - Does not have adequate accounting policies, procedures, processes, and controls to properly account for new equipment purchases and transfers, construction, depreciation, or disposal of assets in a timely manner. For example, CBP did not:

     - Accurately record and correctly classify construction-in-process (CIP) to reflect the correct assets, and current status of construction or percentage of completion of long-term projects throughout the year;

     - Transfer certain assets from CIP to "in-use" assets in a timely manner;

     - Record some asset additions and disposals in accordance with its policy; and

     - Record transactions affecting PP&E timely, and based on complete documentation that is retained for audit, and reflected in the proper USSGL account.

   - Did not properly perform and/or document certain real and personal physical inventories in accordance with standard operating procedures.

3. MGMT:

   - Does not have adequate asset management processes and controls in place to record and track PP&E at the transaction level.

   - Does not have processes and controls in place to maintain sufficient asset tracking records, as well as conduct periodic inventories.

Cause/Effect: TSA focused primarily on developing and implementing new policies and remediating control deficiencies in the current year. At the same time, TSA hired a number of new employees during the current year which required additional oversight and training on new processes. As a consequence a general lack of coordination and communication (including training, oversight, and monitoring) with some key personnel outside of the TSA OFM contributed to control deficiencies that exist over PP&E at TSA. These conditions led to a number of errors in the financial statements that were discovered during our audit.

This deficiency is also related to the conditions described in Comment **II-A**, *Financial Reporting* and Comment **III-F**, *Entity-Level Controls.*

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

MGMT's reliance on manual compensating controls over asset management increases the risk of misstatement in the PP&E balance. MGMT does not have fully developed asset management policies and procedures for recording and reporting PP&E balances in the financial statements, and relies on a labor intensive process to analyze and make manual adjustments to record PP&E for financial reporting purposes.

Criteria: Presented in *Index of Financial Reporting and Internal Control Criteria* behind Exhibit V.

Recommendations: We recommend that:

1. TSA:
    a. Strengthen existing policies and procedures to properly identify risks, potential errors, and account for, monitor, and report general property, equipment, internal use software balances, asset additions and disposals, and other direct costs;
    b. Develop and implement sufficient procedures to properly document, track, and value in-use and idle assets on an on-going basis;
    c. Enhance controls to ensure that depreciation is accurately computed and recorded on a continuous basis; and
    d. Enhance controls to ensure that balances recorded in the general ledger are supported by available supporting documentation that can be readily available for management and auditor review as needed.
2. CBP:
    a. Develop, document, and communicate policies and procedures for classifying, recording, and reviewing all capital transactions, particularly for construction projects, to ensure that the financial statements are materially correct and presented in accordance with GAAP. Consideration should be given to the adequacy of policies to account for CIP, including methodologies to apply overhead charges, and establishing an appropriate useful life for annual depreciation charges;
    b. Determine whether existing policies and procedures for recording asset additions, reclassifications, and retirements are sufficient. Revise policies where necessary, including retention of supporting documentation and authorization of transactions, and communicate policies throughout CBP;
    c. Develop supervisory and monitoring controls to ensure that erroneous transactions are identified and remediated promptly;
    d. Determine and request the necessary system changes to CBP's financial IT system to facilitate the timely and accurate recording of asset additions and reclassifications; and
    e. Improve guidance for the performance and documentation of PP&E inventories.
3. MGMT:
    a. Finalize and implement asset management policies and procedures over recording and processing PP&E activity, including an automated asset property management process and controls to record and track PP&E at the transaction level.
    b. Implement policies and processes to conduct periodic inventories of PP&E.

II-D Not Used

II-E Budgetary Accounting (FEMA)

	2011	2010	2009
FEMA			
CBP	C		

See page II.2 for table explanation

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

In FY 2011, FEMA continued to improve its processes and internal controls over the obligation and monitoring process; however, some control deficiencies remain.

CBP implemented corrective actions in budgetary accounting processes in FY 2011, and substantially remediated the conditions we reported in FY 2010.

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

- Did not effectively monitor the status of its obligations as part of its normal operations to ensure timely deobligation when appropriate.
- Lacks enforcement of existing policy, around the obtaining approvals, recording obligations, and making payments.
- Could not readily provide all supporting documentation for undelivered orders (UDO), tested at June 30, 2011 and September 30, 2011. We noted that for certain portions of the population, significant effort was required to coordinate and identify the responsible parties, to access certain files, or to provide information in a form that clearly supported the balances reported in the financial statements.
- Was required to correct erroneous entries recorded by the Budget Planning & Analysis Division (BPAD) or to record transactions that should have been recorded by the BPAD but were not.
- Did not properly review budgetary funding transactions recorded in the general ledger.

Cause/Effect: FEMA's UDO annual certification and quarterly validation processes are not effectively implemented. Additionally, FEMA's administrative functions are geographically separated from programmatic operations which make consistent enforcement of policy challenging. Certain offices within FEMA do not have effective document maintenance policies and procedures, making the location of certain UDO documentation difficult. Without supporting documentation, FEMA is unable to support the validity of certain UDO balances. Certain personnel within the BPAD do not have the necessary skills or training to correctly record budgetary entries in FEMA's general ledger. In addition, BPAD budgetary funding transaction review procedures implemented in the current year were not consistently adhered to. As a result, FEMA's financial information submitted to DHS may contain significant budgetary account errors if they are not detected by the FEMA's OCFO.

Criteria: Presented in Index of Financial Reporting and Internal Control Criteria behind Exhibit V.

Recommendations: We recommend that FEMA:

1. Adhere to the established UDO annual certification and quarterly validation processes to ensure that outstanding obligations are properly classified and reviewed for validity quarterly;
2. Enforce existing policies to ensure that all obligations are approved and recorded and that all payments made are supported by appropriate documentation;

3. Continue to improve procedures for storing and locating documentation supporting UDO information, including points of contact, so that supporting information is readily available for management review and audit purposes;
4. Dedicate the appropriate resources to adequately staff, train, and supervise BPAD personnel to ensure that the BPAD is properly recording all necessary budgetary transactions; and
5. Fully implement new review procedures for budgetary funding transactions recorded in the general ledger.

III-F Entity-Level Controls (TSA, FEMA)

	2011	2010	2009
TSA		C	
USCG	C		
FEMA			
CBP	C		NA

See page II.2 for table explanation

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

The comments below should be read in conjunction with Comment **II-B**, *Information Technology Controls and Financial System Functionality*, which describe entity-level control weaknesses related to Department and Component IT systems.

The Transportation Security Administration (TSA) makes extensive use of capital assets and new technologies to perform its mission. As a result, accounting for certain assets and activities require inputs from operating and program personnel who are outside the traditional financial accounting processes. In addition, considering TSA's business, the appropriate application of some accounting standards can be complex, requiring extensive knowledge of both TSA's business activities and accounting standards.

Federal Emergency Management Agency (FEMA) made continued progress toward correction of its entity-level control deficiencies in FY 2011. While progress has been made, some entity-level control deficiencies identified at FEMA in previous years continued during FY 2011, and are repeated below.

The U.S. Coast Guard (Coast Guard) made continued progress following its *Financial Strategy for Transformation and Audit Readiness* (FSTAR) plan, see comment **I-A**, *Financial Reporting*.

Conditions: We noted the following internal control weaknesses related to entity-level controls at TSA, Coast Guard, and FEMA:

1. TSA:

   - Has not fully developed processes to proactively manage risks identified through the annual risk assessment process, and to monitor adherence to financial management policies and procedures of staff that reside outside the Office of Financial Management.
   - Lacks reliable processes to identify changes in business operations that could also result in changes to accounting processes or financial reporting in a timely manner.

2. FEMA:

   - Has not certified its formal policies and procedures on a biennial basis to validate they are accurate and current, as required by FEMA Directive No. 112-1.
   - Has not committed sufficient resources to ensure that personnel attend required ethics training.
   - Has not developed sufficient policies and procedures to properly conduct and track the status of background investigations and maintain related documentation.

Cause/Effect: TSA has not yet fully developed its processes and controls throughout the agency to ensure accurate and complete information is identified and reported to the Office of Financial Management (OFM). Consequently, TSA was at times dependent on the external financial statement audit process to identify business process changes with financial reporting impact and the associated risks of misstatement or account balance errors in the financial statements.

In FY 2011, FEMA devoted substantial resources to remediating certain IT findings. Consequently, FEMA devoted comparatively less attention to correcting other control deficiencies in FY 2011. Decentralized and informal background investigation processes continue to present potential risks to FEMA's operations and IT systems.

Criteria: Presented in Index of Financial Reporting and Internal Control Criteria behind Exhibit V.

Recommendations: We recommend that:

1. TSA:

    a. Develop and adopt policies and procedures to improve coordination and communication and provide guidance to certain program managers, engineers, and accountants, who are outside of the OFM, but who provide key financial data necessary to accurately present account balances, in compliance with accounting standards. This may involve training for Business Resource Managers within the operational TSA organizations to better equip them to recognize events that may impact financial reporting, and to ensure appropriate communications to manage financial statement risk; and

    b. Develop and implement sufficient procedures to timely identify changes in business processes that could result in changes to accounting processes or financial reporting.

2. FEMA:

    a. Complete the efforts underway to ensure that formal policies and procedures are catalogued, reviewed, and certified on a biennial basis in accordance with FEMA Directive No. 112-1;

    b. Complete development and implementation of procedures and dedicate resources to provide, track compliance with, and monitor the annual and new hire ethics training requirements; and

    c. Develop and implement policies and procedures to properly track the status and completion of background investigations and maintain related documentation.

III-G Fund Balance with Treasury (Coast Guard only)

	2011	2010	2009
USCG			

See page II.2 for table explanation

Background: As noted in comment **I-A**, Financial Reporting, Fund Balance with Treasury (FBWT) at the Coast Guard totaled approximately $6.3 billion, or approximately 11 percent of total DHS FBWT at September 30, 2011. The majority of these funds represented appropriated amounts that were obligated, but not yet disbursed, as of September 30, 2011. In FY 2010, we reported a material weakness in internal control over FBWT at the Coast Guard. In FY 2011, the Coast Guard corrected several significant FBWT control deficiencies, specifically issues associated with the accuracy and completeness of the SF 224 process. Consequently, we consider the remaining control deficiencies, all of which were reported in our FY 2010 report, to be less severe, but important enough to warrant management's attention.

Conditions: We noted the following internal control deficiencies associated with FBWT:

Coast Guard:

- Did not properly implement the FBWT monthly activity reconciliation process for two or more of its Agency Location Codes (ALC). Specifically, during a reconciliation of certain ALC's in September, adjustments to the general ledger FBWT were made without performing sufficient research to identify the underlying reconciling items and transactions were reported against the wrong appropriation.

- Does not have a process in place to provide transaction-level supporting documentation for all reconciling items associated with the Government-wide Accounting (GWA) reconciliation. For example, some intragovernmental transactions are recorded solely based on information obtained from the vendor without verification by Coast Guard. As a result, charges are incurred and reported against funds without appropriately verified supporting documentation.

- Did not follow existing policies and procedures to ensure that transactions are adequately researched, then applied against the appropriate funding source. Specifically, we noted an instance where transactions were incorrectly applied to the operating expense fund.

Cause/Effect: The Coast Guard has not developed and implemented accounting processes to fully support all reconciling items associated with FBWT activity. 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: Presented in *Index of Financial Reporting and Internal Control Criteria* behind Exhibit V.

Recommendations: We recommend that the Coast Guard:

1. Perform complete and timely FBWT reconciliations using the Treasury GWA 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;
2. Implement procedures to ensure that intragovernmental transactions are recorded based on information obtained from the vendor and after verification by Coast Guard; and
3. Ensure existing policies and procedures related to the clearance of transactions are adhered to.

III-H Grants Management (FEMA only)

	2011	2010	2009
FEMA			
See page II.2 for table explanation			

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

Conditions: We noted the following internal control weaknesses related to grants management at FEMA:

- Does not have sufficient policies and procedures in place to fully comply with the *Single Audit Act Amendments of 1996* (*Single Audit Act*) and related OMB Circular No. A-133, *Audits of States, Local Governments, and Nonprofit Organizations* (OMB Circular A-133) (see Comment **IV-L**, *Single Audit Act Amendments of 1996*).
- Does not maintain accurate and timely documentation related to site visits/desk reviews performed for grantees. Specifically, our control testwork performed over a sample of 71 site visits/desk reviews performed during the nine-month period ended June 30, 2011, identified 11 exceptions related to documentation.
- Does not consistently follow-up with grantees who have failed to submit quarterly financial and/or programmatic reports timely.
- Does not have a process in place to create and track comprehensive lists of FEMA grants that are eligible for close-out.

Cause/Effect: FEMA has not implemented policies and procedures over its grant program in order ensure compliance with the *Single Audit Act* and OMB Circular A-133. In addition, FEMA has not implemented effective monitoring procedures over certain grant activities and the maintenance of related documentation. As a result, misreported grantee expenses may not be detected, which may impact the fair presentation of FEMA's grant accrual balances, undelivered orders, and expenses. Further, the diversity of grant programs and systems within FEMA causes difficulty in assembling a comprehensive status of grants eligible for close-out, which could result in untimely closure of grants and an overstatement of undelivered orders.

Criteria: Presented in *Index of Financial Reporting and Internal Control Criteria* behind Exhibit V.

Recommendations: We recommend that FEMA:

1. Implement policies and procedures to ensure full compliance with the Single Audit Act and the related OMB Circular No. A-133;
2. Implement monitoring procedures over completing financial site visits, obtaining and reviewing required quarterly grantee reports, and maintaining related documentation; and
3. Develop and implement procedures to create and track comprehensive lists of FEMA grants that are eligible for close-out.

III-I Custodial Revenue and Drawback (CBP Only)

	2011	2010	2009
CBP			
See page II.2 for table explanation			

Background: Customs and Border Protection (CBP) collects approximately $33.9 billion in annual import duties, taxes, and fees on merchandise arriving in the United States from foreign countries (identified below as the Entry Process). Receipts of import duties and related refunds are presented in the statement of custodial activity in the DHS financial statements.

Drawback is a remittance, in whole or in part, of duties, taxes, or fees previously paid by an importer. Drawback typically occurs when the imported goods on which duties, taxes, or fees have been previously paid, are subsequently exported from the United States or destroyed prior to entering the commerce of the United States.

Our findings over the Entry Process include conditions identified in In-bond, Bonded Warehouse and Foreign Trade Zones. In-bond entries occur when merchandise is transported through one port; however, the merchandise does not officially enter U.S. commerce until it reaches the intended port of destination. Bonded Warehouses (BW) are facilities, under the joint supervision of CBP and the Bonded Warehouse Proprietor, used to store merchandise that has not made entry into the United States commerce. Foreign Trade Zones (FTZ) are secured areas under CBP supervision that are used to manufacture goods that are considered outside of the United States commerce for duty collection.

The conditions cited below have existed for several years; however, through FY 2009 CBP's planned remediation for many of these conditions were tied to systems modernization through the Automated Commercial Environment (ACE). In FY 2010, funding for the implementation of ACE was reduced; therefore, CBP has modified and extended the time-frame for remediation of these conditions.

In previous years, weaknesses in the Trade Compliance Measurement (TCM) program were cited; however, in FY 2010 a module in ACE was implemented and a significant number of TCM deficiencies were remediated in FY 2011. Additionally, conditions surrounding In-bond cited below are expected to be remediated by the final planned ACE deployment in January 2012.

For the remaining conditions in Drawback, BW, and FTZ, a systems fix is currently unfunded. However, improvements have been made in the controls surrounding BW's and FTZ's, specifically at the BW and FTZ facilities. Furthermore, in FY 2010 and FY 2011, CBP began to reassess the Drawback conditions and started an extensive review of the Drawback process as a whole.

Conditions: We noted the following internal control weaknesses related to custodial activities at CBP:

Related to drawback:

- The Automated Commercial System (ACS) lacks the controls necessary to prevent, or detect and correct excessive drawback claims. The programming logic in ACS does not link drawback claims to imports at a detail level. In addition, ACS does not have the capability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries and export documentation upon which the drawback claim is based. Further, ACS has not been configured to restrict drawback claims to 99 percent of each entry summary.

- Drawback review policies do not require drawback specialists to review all, or a statistically valid sample, of prior drawback claims against a selected import entry to determine whether, in the aggregate, an excessive amount was claimed.

Related to the Entry Process:

- CBP is unable to determine the status of the in-bond shipments and lacks policies and procedures that require monitoring the results of in-bond audits and require the review of overdue air in-bonds. CBP does not formally analyze the rate and types of violations found, to determine the effectiveness of the in-bond program, and does not identify a projected total amount of uncollected duties and fees on in-bond merchandise that has physically entered U.S. commerce without formal entry to ensure there is not a potentially significant loss of revenue.

- In-bond cargo examinations were not performed at some ports in FY 2011 because of the low frequency of in-bond cargo examinations generated by CBP's system that selects in-bond examinations and audits.

- Headquarters has developed national databases which contain an inventory of all BWs and FTZs; however, these databases are not currently used to document the assessed risk of each BW or FTZ, scheduled compliance reviews, or the results of compliance reviews. Annually, CBP headquarters distributes a memo to the ports with the intention of notifying the ports of compliance results; however, the FY 2011 memo provided limited information of the overall findings on the program effectiveness.

Cause/Effect: IT system functionality and outdated IT systems contribute to the weaknesses identified above, in Comment **II-B**, Information Technology Controls and Financial System Functionality. For example, CBP is unable to determine the status of the in-bond shipments with the information available within ACS, and CBP does not have the ability to run an oversight report to determine if ports have completed all required audits. CBP cannot perform a comprehensive analysis to determine the overall compliance rate of the in-bond program. For drawback, much of the process is manual until IT system functionality improvements are made, placing an added burden on limited resources.

The inability to effectively and fully monitor the in-bond process and verify the arrival of in-bond merchandise at the ports could lead to loss of revenue due to uncollected duties and fees on in-bond merchandise that has physically entered U.S. commerce without formal entry.

CBP does not have the ability to perform a complete analysis over the effectiveness of the BW and FTZ programs. CBP headquarters cannot effectively monitor the BW/FTZ program if a complete population of all BWs and FTZs is not compiled. This risk of undetected exceptions to, and deviations from, CBP headquarters guidance cannot be mitigated by the review of the annual port surveys since these surveys cannot be compiled prior to fiscal year-end.

Criteria: Presented in Index of Financial Reporting and Internal Control Criteria behind Exhibit V.

Recommendations: We recommend that CBP:

1. Related to drawback
   a. Since the incorporation of drawback processing is not in the near term schedule for the ACE production, CBP should continue to pursue alternative compensating controls and measures that may ultimately identify the potential revenue loss exposure to CBP. These alternative internal controls over drawback claims may lead to the ability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries and export documentation for which the drawback claim is based, and identify duplicate or excessive drawback claims;
   b. Develop and implement automated controls to prevent overpayment of a drawback claim; and
   c. Analyze current policies and procedures performed at the Drawback Centers. Determine the benefit of current procedures and revise as necessary.

2. *Related to the Entry Process:*

   a. CBP headquarters should continue to monitor, perform outreach, and review the in-bond process to ensure a high in-bond compliance rate;

   b. Once a planned new in-bond compliance system is deployed, certain monitoring reports will cease to exist; therefore, CBP should develop and issue formal requirements for all ports to follow under the new system;

   c. Continue the implementation of a national database of BWs and FTZs and develop procedures to ensure completeness of compliance reviews; and

   d. Increase CBP headquarters monitoring over the BW and FTZ compliance review program by developing a method to determine the program's overall effectiveness.

All of the compliance and other matters described below are repeat conditions from FY 2010.

IV-J *Federal Managers' Financial Integrity Act of 1982* (FMFIA)

Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, requires agencies and Federal managers to: (1) develop and implement internal controls; (2) assess the adequacy of internal controls; (3) separately assess and document internal control over financial reporting; (4) identify needed improvements; (5) take corresponding corrective action; and (6) report annually on internal controls. During fiscal year (FY) 2011 and 2010, the Department of Homeland Security (DHS or Department) developed an annual *Internal Control Playbook* to implement corrective actions and support management assurances by performing tests of design and operating effectiveness of entity level controls and other financial accounting and reporting processes. DHS' implementation of OMB Circular No. A-123 facilitates compliance with the *Federal Managers' Financial Integrity Act of 1982* (FMFIA). The *DHS Financial Accountability Act of 2004* requires DHS to submit an annual audit opinion of internal control over financial reporting. The Secretary of DHS has stated in the Secretary's Assurance Statement dated November 11, 2011, as presented in Management's Discussion and Analysis (MD&A) of the Department's 2011 *Annual Financial Report* (AFR), that based on the material weaknesses identified from the OMB Circular A-123 assessment, the Department provides no assurance that internal control over financial reporting was operating effectively as of September 30, 2011.

While we noted the Department overall has taken positive steps toward full compliance with FMFIA, OMB Circular No. A-123, and the *DHS Financial Accountability Act* of 2004, the Department has not fully established effective systems, processes, policies, and procedures to ensure that internal controls are operating effectively throughout the Department.

Recommendation: We recommend that the Department continue its corrective actions to address internal control deficiencies, in order to ensure full compliance with FMFIA and its OMB- Circular No. A-123 in future years. We also recommend that DHS continue to follow and complete the actions defined in the *Internal Control Playbook*, to ensure that audit recommendations are resolved timely and corrective action plans addressing all DHS audit findings are developed and implemented together with appropriate supervisory review in FY 2012.

IV-K *Federal Financial Management Improvement Act of 1996* (FFMIA)

FFMIA Section 803(a) requires that agency Federal financial management systems comply with (1) applicable Federal accounting standards; (2) Federal financial management system requirements; and (3) the United States Government Standard General Ledger (USSGL) at the transaction level. FFMIA emphasizes the need for agencies to have systems that can generate timely, reliable, and useful information with which to make informed decisions to ensure ongoing accountability.

While we noted the Department overall has taken positive steps toward full compliance with FFMIA, the Coast Guard, US Customs and Border Protection, the Federal Emergency Management Agency (FEMA), U.S. Immigration and Customs Enforcement, and Transportation Security Administration did not fully comply with at least one of the requirements of FFMIA. The reasons for noncompliance are reported in Exhibits I, II, and III. The Secretary of DHS has stated in the Secretary's Assurance Statements dated November 11, 2011 that the Department's financial management systems do not substantially conform to government wide requirements mandated by FFMIA. The Department's remedial actions and related timeframes are also presented in the FY 2011 AFR.

An element within FFMIA Federal system requirements is ensuring security over financial management information. This element is addressed further in the *Federal Information Security Management Act of 2002* (FISMA), which was enacted as part of the *E-Government Act of 2002.* FISMA requires the head of each agency to be responsible for (1) providing information security protections commensurate with the risk and magnitude of the harm resulting from unauthorized access, use, disclosure, disruption, modification, or destruction of (i) information collected or maintained and (ii) information systems used or operated; (2) complying with the requirements of the Act and related policies, procedures, standards, and guidelines, including (i) information security standards under the United States Code, Title 40, Section

11331 and (ii) information security standards and guidelines for national security systems; and (3) ensuring that information security management processes are integrated with agency strategic and operational planning processes.

We noted weaknesses in financial systems security, reported by us in Comments **I-B** and **II-B**, *Information Technology Controls and Financial System Functionality*, which impact the Department's ability to fully comply with FISMA.

Recommendation: We recommend that DHS improve its financial management systems to ensure compliance with the FFMIA, and implement the recommendations provided in Exhibits I, II, and III, in FY 2012.

IV-L ***Single Audit Act Amendments of 1996* (*Single Audit*)**

FEMA is the only DHS component that has a significant grant making operation. OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* requires agencies awarding grants to ensure they receive grantee reports timely and to follow-up on *Single Audit* findings to ensure that grantees take appropriate and timely action. Although FEMA has adopted procedures to monitor grantees and their audit findings, FEMA did not fully comply with provisions in OMB Circular No. A-133 in FY 2011. We noted that FEMA does not always obtain and review grantee *Single Audit* reports in a timely manner, or follow-up on questioned costs and other matters identified in these reports. Because Single Audits typically are performed by other entities outside of DHS, procedures related to these reports are not always entirely within the control of DHS and its components.

Recommendations: We recommend that:

1. FEMA further develop and implement procedures to ensure compliance with its policy to obtain and review grantee Single Audit reports in a timely manner, and follow-up on questioned costs and other matters identified in these reports. We also recommend that FEMA perform the following in FY 2012:
   a. Further develop and implement a tracking system to identify each grantee for which a *Single Audit* is required, and the date the audit report is due;
   b. Use the tracking system to ensure audit reports are received timely, and follow-up when reports are overdue; and
   c. Perform reviews of grantee audit reports, issue-related management decisions, and ensure that the grantees take appropriate corrective action, on a timely basis.

IV-M ***Chief Financial Officers Act of 1990***

The *DHS Financial Accountability Act of 2004* made DHS subject to the *Chief Financial Officers Act of 1990*, as amended, which requires DHS to submit to the Congress and OMB audited financial statements annually. DHS' Office of the Inspector General (OIG) has engaged an independent auditor to audit the September 30, 2011 balance sheet and related statement of custodial activity. Other financial statements, including the statements of net cost, changes in net position, and budgetary resources, are not currently auditable. DHS must be able to represent that its balance sheet is fairly stated, and obtain at least a qualified opinion before it is practical to extend the audit to other financial statements.

Recommendation: We recommend that DHS and its components continue to implement the Mission Action Plans described in DHS' *Internal Control Playbook* (see Comment **IV – J**, *Federal Managers' Financial Integrity Act of 1982*, above) to remediate the FY 2011 material weaknesses and significant deficiencies, and improve its policies, procedures, and processes, as necessary, to allow management to assert that all financial statements are fairly stated in compliance with accounting principles generally accepted in the United States, and are ready for an independent audit in FY 2012.

IV-N ***Anti-deficiency Act* (ADA)**

Various management reviews and OIG investigations are on-going within the Department and its components that may identify ADA violations. The Coast Guard management continues to work to resolve four potential ADA violations relating to (1) funds used in advance of an approved apportionment from OMB, (2) funds used for construction and improvement projects, (3) funds that may have been inappropriately administered for modifications to fixed price contracts, and (4) the improper execution of the obligation and disbursement of funds for the lease of passenger vehicles. National Protection and Programs Directorate (NPPD) management is continuing their review, initiated in FY 2007, over the classification and use of certain funds that may identify an ADA violation. The Management Directorate is currently investigating whether rental charges incurred in FY 2009 were not properly committed or obligated.

Recommendations: We recommend that the Department, along with the OIG and the other components, complete the internal reviews currently planned or being performed, and properly report the results in compliance with the ADA, if necessary.

IV-O *Government Performance and Results Act of 1993*

The *Government Performance and Results Act of 1993* requires each agency to prepare performance plans that include a description of the operational processes, skills and technology, and the resources required to meet the goals, and a description of the means used to verify and validate the measured results. DHS completed the FY 2010 Quadrennial Homeland Security Review (QHSR) for the purpose of developing an updated strategic plan around priorities established by the Secretary. However the Department has not approved a new strategic plan based on the QHSR. Since DHS has not approved its strategic plan, the Statements of Net Cost for the year ended September 30, 2011 and 2010 have not been presented by major program, goals and outputs, and certain related financial statement disclosures, required by OMB Circular No. A-136, *Financial Reporting Requirements* are not complete. In addition, the information included in the FY 2010 Annual Performance Report (published in FY 2011) is aligned with the QHSR but not an approved strategic plan.

Recommendation: We recommend that DHS approve the strategic plan aligned with the QHSR to ensure full compliance with the *Government Performance Results Act of 1993* in FY 2012.

FY 2010 Control Deficiencies As Reported	Summary of Significant Change in FY 2011	FY 2011 Control Deficiencies As Reported
Material Weaknesses:		
A – Financial Management and Reporting (USCG, FEMA, TSA)	• Department-wide Entity level conditions were substantially corrected. • FEMA made progress in correcting financial reporting deficiencies. • New financial reporting control weaknesses were identified at USCIS, related to a change in accounting for user fees. • The Department filled key accounting positions in FY 2011. The word "Management" was dropped from the title. • TSA made progress by hiring accounting personnel, and substantially completing the reconciliation of its balance sheet accounts, but some significant financial reporting control weaknesses remain. • USCG corrected some deficiencies and asserted to the accuracy of additional financial statement balances, but some significant financial reporting control weaknesses remain.	**Repeated** (Exhibits I-A and II-A) (USCG, TSA, USCIS)
B – Information Technology Controls and Financial Systems Functionality (USCG, CBP, FEMA, USCIS, FLETC, ICE)	• DHS Civilian Components and USCG made progress in remediation of IT findings we reported in FY 2010. The total number of IT findings reported dropped from 157 in FY 2010 to 135 in FY 2011. • Approximately 70 percent of the IT findings reported in FY 2011 are repeated from last year. Approximately 30 percent of our FY 2010 IT findings have been closed. • FEMA, USCG, ICE, and FLETC made the most progress in closing IT findings reported in FY 2010. • We identified fewer new findings in FY 2011 compared to the number of new findings identified in FY 2010. The majority of these new deficiencies were noted at CBP. • Financial systems functionality continues to be a significant contributor to the IT material weakness.	**Repeated** (Exhibits I-B and II-B) (USCG, CBP, FEMA, USCIS, ICE)
C – Fund Balance with Treasury (USCG)	• The Coast Guard corrected several significant FBWT control deficiencies. Consequently, we consider the remaining control deficiencies, all of which were reported in our FY 2010 report, to be less severe, but important enough to warrant management's attention.	**Partially Repeated** (Exhibit III-G) (USCG)
D – Property, Plant, and Equipment (USCG, TSA, CPB)	• The Coast Guard continued to execute remediation efforts to address PP&E process and control deficiencies, however, remediation efforts are scheduled to occur over a multi-year timeframe beyond FY 2011. Consequently, many of the control weaknesses reported in FY 2010 have been repeated in our FY 2011 report. • TSA and CBP continue to have control weaknesses in PP&E, however, control deficiencies at TSA are more severe. • New PP&E control weaknesses were identified at MGMT, related to assets that had been inappropriately expensed in prior fiscal years.	**Repeated** (Exhibits I-C and II-C) (USCG, TSA, CBP, MGMT)
E – Actuarial and Other Liabilities (USCG, FEMA)	• The USCG corrected control deficiencies related to actuarial liabilities. • Environmental liability control deficiencies at USCG have been repeated in FY 2011.	**Partial Repeat** (Exhibits I-D and III-H) (USCG, FEMA)

	• Grants management control deficiencies at FEMA are substantially repeated as a separate significant deficiency in FY 2011.	
F – Budgetary Accounting (USCG, CBP, FEMA)	• Budgetary accounting control deficiencies at USCG were repeated in FY 2011. • FEMA continued to improve its processes and internal controls over the obligation and monitoring process; however, some control deficiencies remain. • CBP implemented corrective actions in budgetary accounting processes in FY 2011, and substantially remediated the conditions we reported in FY 2010.	**Partially Repeated** (Exhibits I-E and II-E) (USCG, FEMA)
Significant Deficiencies:		
G – Other Entity Level Controls (USCG, CBP, FEMA)	• The Coast Guard continued to follow the Financial Strategy for Transformation and Audit Readiness (FSTAR) adopted in FY 2009, and has substantially remediated its entity level control deficiencies. • CBP substantially corrected its entity level control deficiencies reported in FY 2010. • FEMA continued to improve its entity level internal controls however, some control deficiencies reported in FY 2010 remain. • New entity level weaknesses were identified at TSA, primarily related to financial reporting infrastructure in operational and program areas.	**Partially Repeated** (Exhibit III-F) (FEMA, TSA)
H – Custodial Revenue and Drawback (CBP)	• Weaknesses reported in FY 2010, and previous years, have been repeated in FY 2011. Financial systems functionally issues reported in Exhibit II-B that require a multi-year effort to address, continue to be a significant cause of these deficiencies.	**Repeated** (Exhibit III-I) (CBP)
Compliance and Other Matters:		
I – Federal Managers' Financial Integrity Act of 1982 and Laws and Regulations Supporting OMB Circular No. A-50, Audit Follow-up	• The Department overall has taken positive steps toward full compliance with FMFIA, OMB Circular No. A-123, and the DHS Financial Accountability Act of 2004, the Department has not fully established effective systems, processes, policies, and procedures to ensure that internal controls are operating effectively throughout the Department. • The Department is substantially compliant with OMB Circular No. 50, Audit Follow-up, in FY 2011.	**Partially Repeated** (Exhibit IV – J)
J – Federal Financial Management Improvement Act of 1996	• The Department overall has taken positive steps toward full compliance with FFMIA, the USCG, CBP, FEMA, ICE, and TSA did not fully comply with at least one of the requirements of FFMIA. The reasons for noncompliance are reported in Exhibits I, II, and III.	**Repeated** (Exhibit IV – K)
K – Single Audit Act Amendments of 1996	• FEMA has adopted procedures to monitor grantees and their audit findings, FEMA did not fully comply with provisions in OMB Circular No. A-133 in FY 2011.	**Repeated** (Exhibit IV – L)
L – Chief Financial Officers Act of 1990	• DHS is required to submit to the Congress and OMB audited financial statements annually, however all required financial statements were not auditable in FY 2011.	**Repeated** (Exhibit IV – M)

M – Anti-deficiency Act	• Various management reviews and OIG investigations are on-going within the Department and its components that may identify ADA violations.	**Repeated** (Exhibit IV – N)
N – Government Performance and Results Act of 1993	• DHS completed the Quadrennial Homeland Security Review (QHSR) for the purpose of developing an updated strategic plan around priorities established by the Secretary. However the Department has not approved a new strategic plan based on the QHSR.	**Repeated** (Exhibit IV – O)

Department of Homeland Security
Index of Financial Reporting and Internal Control Criteria
(Listed Alphabetically by Criteria Source)

Criteria	Reference	Report Exhibit
CBP Office of Field Operations, Cargo and Conveyance Security's *Updated Guidance for Bonded Facilities and Oversight of In-Bond Procedures*, dated November 15, 2010		III-I
CBP Personal Property Management Handbook	HB 5200-13B, Chapter 8	II-C
CBP's FY 2011 Personal Property Inventory/Quality Assurance Review		II-C
CBP's Real Property Inventory Procedures		II-C
Coast Guard Financial Accounting and Reporting of Personal Property	Procedures No: 5.3.8.29 and 5.3.8.31	I-C
Coast Guard's "Open Obligation Validation User's Guide"		I-E
Coast Guard PPC's Standard Operating Procedures		I-D
Code of Federal Regulations Title 5	Sections 2634, 2638	III-F
Code of Federal Regulations, Title 19	Sections 18.2(d), 18.6(b), 18.8(b), 19.4, 146.3, and 191.51(b)(1)	III-I
Code of Federal Regulations, Title 44	Part 206	II-E
Compliance Review Handbook for Bonded Warehouses (HB 3500-09, December 2007)		III-I
Compliance Review Handbook for Foreign Trade Zones (HB 3500-10, July 2008)		III-I
DHS Management Directive 0480.1	Section 5	III-F
DHS 4300A Sensitive Systems Handbook	1.0 Introduction	I-B, II-B
DHS Component Requirements Guide for Financial Reporting	Section 42	I-C
DHS Sensitive Systems Policy Directive, 4300A	1.0, 4.0	I-B, II-B, III-F
Disaster Assistance Directorate, Individual Assistance program guidance on CCP		II-E
Disaster Assistance Directorate, Individual Assistance program guidance on DUA		II-E
Ethics Guide to FEMA Employees (July 2010)		III-F
Ethics in Government Act of 1978	Title I, sections 101-104, 106, 107, 109, and 111	III-F
Federal Financial Accounting And Auditing Technical Release 2: Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government		I-D
Federal Financial Management Improvement Act of 1996	Section 803, (a)	I-A, I-C, I-F, II-A, II-C, III-G
	Section 802	I-B, II-B
Federal Information Security Management Act		I-B, II-B
Federal Managers' Financial Integrity Act of 1982	Section 2	II-A, II-C, III-F
FEMA Budget Procedures Memorandum 10-02		II-E
FEMA Directive Number 112-1, Directives Management System		III-F
FEMA Form 90-129		II-E

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FEMA Instruction 1100.1		III-F
FEMA's SOP for Financial Processing of Mission Assignments, March 17, 2011		II-E
Financial Resource Management Manual, SOP for Recording and Reporting Contingent Legal Liabilities (CG-0945), and the CG-842 Desk Procedures		I-D
Fund Balance with Treasury Reconciliation Procedures, a Supplement to the Treasury Financial Manual, I TFM 2-5100	Section V, C Transmittal Letter 588	III-G
GAO's Standards for Internal Control in the Federal Government	Purpose and Anticipated Users of the Manual	I-B
	Control Activities	I-A, I-C, I-D, II-E, III-F, III-H, III-I
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GAO's Principles of Federal Appropriations Law	Section 7	I-E
Grants Programs Directorate, Grants Management Division, Grants Policy and Procedures 09-12, Grants Monitoring Policy	Section VII, B, 5	III-H
I TFM, 2-5100, *Reconciling Fund Balance with Treasury Accounts*	Appendix 2	III-G
Interpretation of Federal Financial Accounting Standards Interpretation No. 7, Items Held for Remanufacture	Paragraphs 7, 8, 13	I-C
Joint Financial Management Improvement Program (JFMIP), *Property Management Systems Requirements*	Acquiring / Receiving Property	I-C
Memorandum: In-Bond Guidance, dated April 7, 2010		III-I
Office of Federal Financial Management, Core Financial System Requirements	Accounting Period Maintenance and Closing Process / Audit Trails Process	I-A
Office of Field Operations, *Guide for In-Bond Cargo, Version 1.0*, March 31, 2006		III-I
OFM *Component Requirements Guide for Financial Reporting*	Section 18	I-C
Oil Pollution Act of 1990	Section 1002 (a)	I-A
OMB Bulletin No. 07-04, Audit Requirements for Federal Financial Statements	Compliance with FFMIA (Footnote 16)	II-A
OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*	Section 20	I-E
	Section 15.4	II-E
OMB Circular No. A-123, *Management's Responsibility for Internal Control*	I. Introduction	I-F, II-A, II-C, II-E, III-F, III-I
	II. Establishing Management Controls	II-E

Criteria	Reference	Report Exhibit
	(Recording and Documentation)	
	II. Standards, Subsection A A. Control Environment	II-A, II-C, II-E, III-F
	II. Standards, Subsection C	I-C, I-D, I-E
	II. Standards, Subsection D	III-F
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OMB Circular No. A-127, *Financial Management Systems*	Section 6 (Subsection N); Section 8 (Subpart C)	I-A, I-C
OMB Circular No. A-130, Management of Federal Information Resources	Memorandum (1. Purpose)	I-B, II-B
OMB Circular No. A-133, Audits of States, Local Governments, and Non-Profit Organizations, Revised to show changes published in the Federal Register of June 27, 2003 and June 26, 2007	Subparts B, D	III-H
OMB Circular No. A-136, *Financial Reporting Requirements*	Section V, Subsection V.1	I-A, II-A
OMB Circular No. A-50, Audit Follow-up	Memorandum	III-H
OMB memorandum M-07-03, *Business Rules for Intragovernmental Transactions*, dated November 13, 2006		II-A
Single Audit Act Amendments of 1996	Subsections 7502, 7504	III-H
Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*	Paragraph 77	I-E
	Paragraph 41	II-C
	Paragraph 39	III-G
Statement of Federal Financial Accounting Standards (SFFAS) No. 10, *Accounting for Internal Use Software*	Executive Summary (Paragraph 5); Paragraphs 16, 20	II-C
Statement of Federal Financial Accounting Standards (SFFAS) No. 14, *Amendments to Deferred Maintenance Reporting*	Executive Summary , Paragraph 1	I-C
Statement of Federal Financial Accounting Standards (SFFAS) No. 29, *Heritage Assets and Stewardship Land*	Paragraph 4	I-C
Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*	Paragraphs 70, 71 [FN 24]	I-A
Statement of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*	Executive Summary, Paragraphs 30, 31, 38 [FN 27]	II-E
Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*	Paragraphs 26, 34, 35, 38, 39	I-C, II-C
	Paragraphs 6, 13, 20, 29, 77	I-C

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	Paragraph 36	II-A
Treasury Financial Manual, Bulletin 2011-04, *Intragovernmental Business Rules*	III. Guidance	I-A, II-A
Treasury Financial Manual, Volume 1 *T/L 663 Revised by Bulletin No. 2011-08*	Part 2, Chapter 4700	I-A, II-A
TSA Personal Property Management Manual	Section 4.3	II-C
U.S. Government Standard General Ledger Fiscal Year 2010 Fiscal Year 2010 Reporting	Supplement Section III. Account Transactions	I-A
US Code Title 31, Chapter 13	Section 1341	I-E
US Code Title 31, Chapter 15	Section 1501, Section 1554,	I-E
US Code Title 44, Chapter 31	Subsection 3101	I-C, I-D

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

Homeland Security

November 11, 2011

MEMORANDUM FOR: Charles K. Edwards
Acting Inspector General

FROM: P. Sherry
Peggy Sherry
Deputy Chief Financial Officer

SUBJECT: Fiscal Year (FY) 2011 Financial and Internal Controls Audit

Thank you for the opportunity to comment on the Independent Public Accountant's audit of our balance sheets, the related statement of custodial activities and internal controls as of September 30, 2011 and 2010. We agree with the Independent Public Accountant's conclusions.

Although the report indicates that DHS still faces financial management challenges, the auditor noted the Department's progress in improving the quality and reliability of our financial reporting. During FY 2011, our Components implemented corrective actions that significantly improved key financial management and internal control areas. This year's qualified audit opinion on the Consolidated Balance Sheet and Statement of Custodial Activity demonstrates that the Department is committed to being a responsible steward of taxpayer dollars.

The FY 2011 audit results show that our corrective actions are working, and we are already focusing our efforts on remediating the remaining issues as we prepare for a full-scope audit in FY 2012. I want to thank you for your efforts and the continued dedication by your staff to work collaboratively in addressing our challenges. As we continue our steadfast progress, I look forward to working with the Office of Inspector General and the Independent Public Accountant.

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Appendix B
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