

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

National Protection and Programs Directorate's Management Letter for FY 2011 DHS Consolidated Financial Statements Audit





Homeland
Security

MAR 14 2012

Preface

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

This report presents the National Protection and Programs Directorate's Management Letter for FY 2011 DHS Consolidated Financial Statements Audit. It contains observations related to internal controls that were not required to be reported in the financial statements audit report. The independent public accounting firm KPMG LLP (KPMG) performed the integrated audit of DHS' FY 2011 financial statements and internal control over financial reporting and prepared this management letter. KPMG is responsible for the attached management letter dated February 3, 2012 and the conclusions expressed in it. We do not express opinions on DHS' financial statements or internal control or provide conclusions on compliance with laws and regulations.

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

A handwritten signature in cursive script that reads "Anne L. Richards".

Anne L. Richards
Assistant Inspector General for Audits



KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

February 3, 2012

Office of Inspector General
U.S. Department of Homeland Security, and
Chief Financial Officer
U.S. Department of Homeland Security National Protection and Programs Directorate
Washington, DC

Ladies and Gentlemen:

We have audited the 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, based on the criteria established in Office of Management and Budget, Circular No. A-123, *Management’s Responsibility for Internal Control*, Appendix A.

Our *Independent Auditors’ Report* issued on November 11, 2011, describes a limitation on the scope of our audit that prevented us from performing all procedures necessary to express an unqualified opinion on DHS’ FY 2011 financial statements and internal control over financial reporting. In addition, 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. We have not considered internal control since the date of our *Independent Auditors’ Report*.

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. 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. In accordance with *Government Auditing Standards*, our *Independent Auditors’ Report*, referred to in the paragraph above, included internal control deficiencies identified during our audit, that individually, or in aggregate, represented a material weakness or a significant deficiency.

The National Protection and Programs Directorate (NPPD) is a component of DHS. We noted certain matters, related to NPPD that are summarized in the Table of Financial Management Comments on the following pages, involving internal control and other operational matters that are less severe than a material weakness or a significant deficiency, and consequently are reported separately to the Office of Inspector General (OIG) and NPPD management in this letter. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies. The disposition of each internal control deficiency identified during our FY 2011 audit – as either reported in our *Independent Auditors’ Report*, or herein – is presented in Appendix A. The



status of internal control deficiencies identified during our FY 2010 audit is presented in Appendix B.

We would be pleased to discuss these comments and recommendations with you at any time. This report is intended for the information and use of DHS' and NPPD's management, the DHS Office of Inspector General, the U.S. Office of Management and Budget, the U.S. Congress, and the Government Accountability Office, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

National Protection and Programs Directorate
Table of Financial Management Comments
September 30, 2011

TABLE OF FINANCIAL MANAGEMENT COMMENTS (FMC)

Comment Reference	Subject	Page(s)
FMC 11-01	Inadequate Internal Controls over Reporting of Government Furnished Equipment Asset Disposals	2
FMC 11-02	Subject to Availability of Funding Agreements Not Obligated in Federal Financial Management System at Outset of Agreement	2
FMC 11-03	Inadequate Internal Controls over Reporting of Internal Use Software Projects	2-3
FMC 11-04	Inadequate Internal Controls over Reporting of Equipment	3
FMC 11-05	Untimely Reporting of Leasehold Improvements	3

APPENDIX

Appendix	Subject	Page
A	Crosswalk – Financial Management Comments to Active Notices of Finding and Recommendation (NFRs)	4
B	Status of Prior Year NFRs	5

FMC 11-01 – Inadequate Internal Controls over Reporting of Government Furnished Equipment Asset Disposals (NFR No. NPPD 11-01)

During testwork over a sample of five items from the capitalized asset disposal population at June 30, 2011, we noted that one asset was disposed of in fiscal year (FY) 2010, but was not recorded as a disposal in Federal Financial Management System (FFMS) until FY 2011.

Recommendation:

We recommend that National Protection and Programs Directorate (NPPD) follow existing policies and procedures related to the reporting of fixed assets and fixed asset disposals. We also recommend that NPPD continue to increase communications in this regard with its financial reporting provider, Immigration and Customs Enforcement.

FMC 11-02 – Subject to Availability of Funding Agreements Not Obligated in Federal Financial Management System at Outset of Agreement (NFR No. NPPD 11-02)

We noted that the Federal Protective Services (FPS) did not record a dollar value for obligations in FFMS for Subject to Availability Funding (SAF) agreements prior to incurring costs on the agreements.

We also noted that it is FPS's policy to obligate \$0 in FFMS for an agreement while costs are incurred. Additional funding is added to the obligation after the receipt of an invoice if the funding in FFMS is not sufficient to pay the invoice.

Recommendations:

We recommend that NPPD:

- Obtain specific, written representations from internal legal sources and external regulatory sources to support the practice if NPPD continues to utilize this practice.
- Consider implementing procedures to record obligations as they occur while minimizing the potential impact (e.g., potential Anti-deficiency Act violations) to customer organizations.

FMC 11-03 – Inadequate Internal Controls over Reporting of Internal Use Software Projects (NFR No. NPPD 11-04)

We noted that NPPD performed a review of internal use software (IUS) and identified two programs that create IUS but did not report any costs as capitalized as of September 30, 2011. NPPD reviewed expenses on all contracts on the two programs and noted that the capitalized costs and non-capitalized costs could not be separated and identified based on the supporting documentation available at the time of the review and therefore developed a methodology for determining the effect on the balance sheet. We noted that NPPD asset management failed to report capitalized costs for IUS projects in a timely manner for inclusion in the general ledger.

Recommendations:

We recommend that NPPD:

- Work with sub-components and programs to ensure proper tracking and reporting for all IUS.
- Work with the Office of Acquisitions and Office of Procurement Operations to ensure each contract includes the proper property reporting clause and to add/modify contract line item numbers/appropriate accounting strings specifically for property.

FMC 11-04 – Inadequate Internal Controls over Reporting of Equipment (NFR No. NPPD 11-05)

When performing testwork over property, plant, and equipment (PP&E) additions for the fourth quarter of FY 2011, we noted one instance where NPPD recorded capitalized costs related to government furnished equipment (GFE) in an untimely manner and one instance where NPPD recorded capitalized costs related to GFE at the incorrect amount.

Recommendations:

We recommend that NPPD – US-Visitor and Immigrant Status Indicator Technology’s Asset Management Team:

- Review its GFE and personal property to ensure all assets are properly accounted for in the asset management system.
- Revise management policies and procedures for both GFE and government held personal property to ensure internal controls are established and implemented to properly account for property.

FMC 11-05 – Untimely Reporting of Leasehold Improvements (NFR No. NPPD 11-06)

When performing testwork over PP&E additions for the fourth quarter of FY 2011, we noted that two items that were classified as leasehold improvements were not capitalized in a timely manner as the invoices included expenses incurred in prior years.

Recommendation:

We recommend that NPPD continue to work with ICE Office of Financial Management to improve policies and procedures to ensure that capital projects are identified at the time of obligation, including leasehold improvements.

National Protection and Programs Directorate
 Crosswalk - Financial Management Comments to Active NFRs
 September 30, 2011

NFR No.	Description	Disposition ¹			
		IAR			FMC
		MW	SD	NC	No.
11-01	Inadequate Internal Controls over Reporting of Government Furnished Equipment Asset Disposals				11-01
11-02	Subject to Availability of Funding Agreements Not Obligated in Federal Financial Management System (FFMS) at Outset of Agreement				11-02
11-03	Potential ADA Violation			N	
11-04	Inadequate Internal Controls over Reporting of Internal Use Software (IUS) Projects				11-03
11-05	Inadequate Internal Controls over Reporting of Equipment				11-04
11-06	Untimely Reporting of Leasehold Improvements				11-05

¹Disposition Legend:

IAR	Independent Auditors' Report dated November 11, 2011
FMC	Financial Management Comment
MW	Contributed to a Material Weakness at the Department level when combined with the results of all other components
SD	Contributed to a Significant Deficiency at the Department level when combined with the results of all other components
NC	Contributed to Non-Compliance with laws, regulations, contracts, and grant agreements at the Department level when combined with the results of all other components
NFR	Notice of Finding and Recommendation

Cross-reference to the applicable sections of the IAR:

A	Financial Reporting
B	Information Technology Controls and System Functionality
C	Property, Plant, and Equipment
D	Environmental and Other Liabilities
E	Budgetary Accounting
F	Entity-Level Controls
G	Fund Balance with Treasury
H	Grants Management
I	Custodial Revenue and Drawback
J	<i>Federal Managers' Financial Integrity Act of 1982 (FMFIA)</i>
K	<i>Federal Financial Management Improvement Act of 1996 (FFMIA)</i>
L	<i>Single Audit Act Amendments of 1996</i>
M	<i>Chief Financial Officers Act of 1990 (CFO Act)</i>
N	<i>Antideficiency Act, as amended (ADA)</i>
O	<i>Government Performance and Results Act of 1993 (GPRA)</i>

National Protection and Programs Directorate
Status of Prior Year NFRs
 September 30, 2011

NFR No.	Description	Disposition ¹	
		Closed ²	Repeat (2011 NFR No.)
10-01	Inadequate Internal Controls over Reporting of IUS Projects		NPPD-11-04
10-02	Inconsistent Application of Property Capitalization Thresholds at NPPD	X	
10-03	Untimely De-Obligation of Undelivered Orders	X	
10-04	Potential ADA Violation		NPPD-11-03
10-05	Subject to Availability of Funding Agreements Not Obligated in FFMS at Outset of Agreement		NPPD-11-02
10-06	Obligations Are Not Recorded in FFMS in a Timely Manner	X	
10-07	Payment Processed Without Contracting Officer Certification	X	

¹ KPMG was engaged to perform an audit over the DHS balance sheet and statement of custodial activity as of and for the year ended September 30, 2011, and was not engaged to perform an audit over the statement of net cost, statement of changes in net position, and statement of budgetary resources for the year ended September 30, 2011. In addition, we were engaged to follow-up on the status of all active NFRs that supported significant deficiencies reported in our FY 2010 *Independent Auditors' Report*.

² The scope of our audit was limited to follow-up on NFRs that supported a material weakness or significant deficiency as reported in our *Independent Auditors' Report*. All other NFRs, e.g., that described insignificant findings, and therefore presented to DHS management as observations for consideration, were considered closed.

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