

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

The Office of Financial Management'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 Office of Financial Management'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 03, 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  
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 Office of Financial Management (OFM) is part of DHS. We noted certain matters, related to OFM 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 OFM 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' 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**

Department of Homeland Security  
*Table of Financial Management Comments*  
September 30, 2011

**TABLE OF FINANCIAL MANAGEMENT COMMENTS (FMC)**

<b>Comment Reference</b>	<b>Subject</b>	<b>Page(s)</b>
FMC 11-01	Departmental Standards of Conduct and Procedural Guidance for Financial Disclosure Report Filing	2
FMC 11-02	Untimely Filing and Review of SF-278 Financial Disclosure Reports	2
FMC 11-03	Preparation and Review of the Special-Purpose Financial Statements and Notes	3
FMC 11-04	Findings Related to the Disbursement Process	3-4

**APPENDIX**

<b>Appendix</b>	<b>Subject</b>	<b>Page</b>
A	Crosswalk – Financial Management Comments to Active Notices of Finding and Recommendation (NFRs)	5
B	Status of Prior Year NFRs	6

**FMC 11-01 – Departmental Standards of Conduct and Procedural Guidance for Financial Disclosure Report Filing (NFR No. CONS 11-01)**

During our test work over entity-level controls, we noted that the U.S. Department of Homeland Security (DHS or Department):

- Had not issued DHS's Supplemental Standards of Conduct. Supplemental Standards of Conduct have been developed and approved by the Department. Prior to final issuance of the Supplemental Standards, a notice will be published in the Federal Register for public comment period. The Designated Agency Ethics Official (DAEO) cannot predict when the final approval and issuance in the Federal register will occur.
- Had drafted a revised Secretarial Directive on the Standards of Conduct (Directive Number 123-03). The final version was under internal review and required signature by the Under Secretary for Management.
- Had not issued common department-wide procedural guidance for filing financial disclosure reports. This guidance had been drafted, but issuance was pending approval of the revised Management Directive on the Standards of Conduct.

*Recommendation:*

We recommend that the DAEO continue to work to issue procedural guidance for financial disclosure reporting, the Secretary's statement on Standards of Conduct, and the Department's supplemental ethics directive.

**FMC 11-02 – Untimely Filing and Review of SF-278 Financial Disclosure Reports (NFR No. CONS 11-03)**

Out of a sample of 15 SF-278 financial disclosures filed by Senior Executive Service (SES) personnel at National Protection and Programs Directorate, Science and Technology Directorate, and the Management Directorate, one report had not been reviewed within 60 days of receipt by Office of General Counsel (OGC) Ethics Division as required by CFR 5 § 2634.605(a). OGC Ethics Division confirmed that additional information was not being sought in this case at that time.

Additionally, one employee out of the sample of 15 had, as of October 11, 2011, not filed the required SF-278. OGC Ethics Division reported that the individual was a new promotion to SES and that he had been contacted several times to remind him to file.

*Recommendation:*

We recommend that DHS collaborate with the Chief Human Capital Officer to develop a procedure to ensure the Ethics Office is notified when new filers come on board and are promoted, temporarily assigned to, or leave a covered position.

**FMC 11-03 – Preparation and Review of the Special-Purpose Financial Statements and Notes (NFR No. CONS 11-05)**

During testwork over the closing package submission, we identified the following errors, resulting in DHS reopening Governmentwide Financial Report System (GFRS) to update the initial closing package submission.

- GF004F – Trading Partner Summary Note Report – Statement of Changes in Net Position – Other Non-Budgetary Financing Sources – the September 2011 amount for Trading Partner 16, Department of Labor, was misstated resulting in a \$90 million overstatement error. Trading Partner 19, Department of State, was misstated resulting in a \$46 million overstatement error. Trading Partner 49, National Science Fund, was misstated resulting in a \$33 million overstatement error. Trading Partner 95, Independent and Other Agencies, was misstated resulting in a \$169 million understatement error.
- GF006 - Note 3 – Accounts and Taxes Receivable: in Section A – Taxes – the amounts recorded in Line 1 – Interest on uncollectible accounts were reported with the incorrect sign for fiscal year (FY) 2011 and FY 2010, \$405 million and \$315 million, respectively.
- GF006 – Note 04A – Direct Loans Receivable and Mortgage Backed Securities
  - In Section C – Components of Loans Receivable, Net – Current Year – Loans were incorrectly entered into the Federal Direct Student Loans category instead of Other, resulting in a \$10 million error.
  - In Section D – Components of Loans Receivable, Net – Current Year – Loans were incorrectly entered into the Federal Direct Student Loans category instead of Other, resulting in a \$85 million error.
- GF006 – Note 06 – Property, Plant and Equipment (PP&E)
  - In Line 3 – Capitalized acquisitions from the public, the current year PP&E amount was misstated resulting in a \$42 million understatement error.
  - In Line 4 – Capitalized acquisitions from Government agencies, the current year PP&E amount was misstated resulting in a \$42 million overstatement error.

*Recommendations:*

We recommend that DHS:

- Conduct a comprehensive review of the current GFRS Financial Reporting Note preparation and review process and identify additional areas for automation and streamlining and document each Financial Reporting Note’s process in detail to show source data.
- Enhance the quality control process of Component-provided data (manual notes and other text explanations) prior to consolidation and input into GFRS.

**FMC 11-04 – Findings Related to the Disbursement Process (NFR No. CONS 11-06)**

In performing enhanced procedures over the disbursement control process at DHS, we noted the following:

- A lack of policies and procedures to ensure a consistent, detailed review of invoices and related supporting documentation is completed prior to payment
- A lack of policies and procedures on how to define a proper invoice within a contract.

Department of Homeland Security  
*Financial Management Comments*  
September 30, 2011

---

- A lack in consistency regarding requirements contained within subcontractor agreements relating to the procedures to be performed when reviewing the invoices for the contracting officer (CO).
- A lack of policies and procedures for the CO to follow to perform appropriate oversight over procedures performed by the subcontractor in relation to invoice verification.
- Current policies and procedures over contract requirements do not address requirements for invoice submission to ensure adequate supporting documentation is received for personnel to perform an effective review prior to payment.
- Policies and procedures related to invoice review requirements are disaggregated into numerous documents.

*Recommendations:*

We recommend that DHS:

- Review Component policies and procedures and work with the DHS Office of the Chief Procurement Officer to develop Department-wide guidance to improve disbursement processes for contractual requirements and risks.
- Integrate internal control examination, reperformance, or other substantive test with improper payment testing to provide greater assurance that improper payment risks are mitigated.



Department of Homeland Security  
 Crosswalk - Financial Management Comments to Active NFRs  
 September 30, 2011

NFR No.	Description	Disposition <sup>1</sup>			
		IAR			FMC
		MW	SD	NC	No.
11-01	Departmental Standards of Conduct and Procedural Guidance for Financial Disclosure Report Filing				11-01
11-02	Audited Financial Statements			K, M	
11-03	Untimely Filing and Review of SF-278 Financial Disclosure Reports				11-02
11-04	Non-Compliance with Office of Management and Budget Circular A-136 & <i>Government Performance and Results Act</i>			O	
11-05	Preparation and Review of the Special-Purpose Financial Statements and Notes				11-03
11-06	Findings Related to the Disbursement Process				11-04

<sup>1</sup>Disposition 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>

Department of Homeland Security  
*Status of Prior Year NFRs*  
 September 30, 2011

NFR No.	Description	Disposition <sup>1</sup>	
		Closed <sup>2</sup>	Repeat (2011 NFR No.)
10-01	Tracking System for Ethics Training, Public Financial Disclosures, and Confidential Reports		CONS 11-01
10-02	Preparation of the Departmental Interim Legal Letter	X	
10-03	Audited Financial Statements		CONS 11-02
10-04	<i>Number not used</i>	Not applicable	
10-05	Lack of SAS 70 Roll-forward Guidance	X	
10-06	Compliance with OMB Circular A-136		CONS 11-04
10-07	Statement of Net Cost (SNC) Methodologies and IT Systems Functionality		CONS 11-04
10-08	Discrepancies Exist Between DHS Guidance and the Treasury Information Executive Repository Analytical Report	X	
10-09	<i>Number not used</i>	Not applicable	
10-10	Non-Compliance with OMB Circular A-50, <i>Audit Followup</i>	X	
10-11	Preparation and Review of the Special-Purpose Financial Statements and Notes		CONS-11-05

<sup>1</sup> 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*.

<sup>2</sup> 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.

## **Report Distribution**

---

### **Department of Homeland Security**

Secretary  
Deputy Secretary  
Chief of Staff  
Deputy Chief of Staff  
General Counsel  
Executive Secretary  
Director, GAO/OIG Liaison Office  
Assistant Secretary for Office of Policy  
Assistant Secretary for Office of Public Affairs  
Assistant Secretary for Office of Legislative Affairs  
Chief Financial Officer  
Chief Information Officer

### **Office of Financial Management**

Chief Financial Officer  
Audit Liaison

### **Office of Management and Budget**

Chief, Homeland Security Branch  
DHS OIG Budget Examiner

### **Congress**

Congressional Oversight and Appropriations Committees, as appropriate

## ADDITIONAL INFORMATION AND COPIES

To obtain additional copies of this report, please call the Office of Inspector General (OIG) at (202)254-4100, fax your request to (202)254-4305, or e-mail your request to our OIG Office of Public Affairs at [DHS-OIG.OfficePublicAffairs@dhs.gov](mailto:DHS-OIG.OfficePublicAffairs@dhs.gov). For additional information, visit our OIG website at [www.oig.dhs.gov](http://www.oig.dhs.gov) or follow us on Twitter @dhsoig.

## OIG HOTLINE

To report alleged fraud, waste, abuse or mismanagement, or any other kind of criminal or noncriminal misconduct relative to Department of Homeland Security programs and operations:

- Call our Hotline at 1-800-323-8603
- Fax the complaint directly to us at (202)254-4292
- E-mail us at [DHSOIGHOTLINE@dhs.gov](mailto:DHSOIGHOTLINE@dhs.gov); or
- Write to us at:  
DHS Office of Inspector General/MAIL STOP 2600,  
Attention: Office of Investigation - Hotline,  
245 Murray Drive SW, Building 410  
Washington, DC 20528

The OIG seeks to protect the identity of each writer and caller.