

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

## Science and Technology Directorate's Management Letter for FY 2011 DHS Consolidated Financial Statement 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 Science and Technology 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  
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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 Science and Technology 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 Science and Technology Directorate (S&T) is a component of DHS. We noted certain matters, related to S&T 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 S&T 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 S&T'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**

Science and Technology Directorate  
*Table of Financial Management Comments*  
September 30, 2011

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

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FMC 11-04	Insufficient Internal Controls to Ensure Timely Reporting of Internal Use Software in Development and Personal Property	3

**APPENDIX**

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B	Status of Prior Year NFRs	5

**FMC 11-01 – Inadequate Controls over Reporting of Construction in Progress and Buildings (NFR No. S&T 11-01)**

During testwork over a sample of five property additions as of June 30, 2011, we noted that two sample items were for construction services received prior to fiscal year (FY) 2011. We noted that construction in progress (CIP) costs for the National Bio and Agro Defense Facility in FY 2007 – 2009 were not capitalized until FY 2011 and CIP costs incurred in FY 2010 were not capitalized until receipt of invoices in FY 2011.

*Recommendations:*

We recommend that Science and Technology Directorate (S&T):

- Implement policies and procedures to accurately and timely capture and record capitalized CIP costs.
- Develop policies and procedures for the accrual of capitalized CIP costs.

**FMC 11-02 – Untimely De-obligation of Undelivered Orders (NFR No. S&T 11-02)**

We selected a statistical sample of 25 items from the population of aged undelivered orders (UDOs) as of June 30, 2011, and noted that eight items were invalid, and should have been de-obligated. We noted that these obligations were approved for de-obligation in prior fiscal years but S&T had not yet completed the review or de-obligation process.

*Recommendations:*

We recommend that S&T:

- Perform a targeted review for “stale” obligations.
- Continue to utilize quarterly verification and validation procedures for UDOs.

**FMC 11-03 – Inadequate Controls over New Hire Ethics Briefings (NFR No. S&T 11-03)**

We selected a sample of ten new hires from S&T from October 1, 2010 through June 30, 2011, and noted that a sign-in sheet for attendance at a new hire ethics orientation could not be produced for one individual. We noted that the individual was employed at an out of town location, but noted that employees at remote locations are subject to the training requirements, but can fulfill the training electronically or by reviewing printed materials. We noted that the employee did not fulfill any of the requirements.

*Recommendation:*

We recommend that S&T continue to utilize and enforce policies related to ethics briefings for newly hired employees.

**FMC 11-04 – Insufficient Internal Controls to Ensure Timely Reporting of Internal Use Software in Development and Personal Property (NFR No. S&T 11-04)**

During testwork over capitalized property additions for the fourth quarter of FY 2011, we noted that S&T capitalized \$355,142 of costs related to services received in the third quarter of FY 2011 for the First Responders Communities of Practice Beta version project and Biodefense Knowledge Management System.

*Recommendations:*

We recommend that S&T:

- Implement policies and procedures to accurately and timely capture and record capitalized software costs.
- Develop policies and procedures for the accrual of capitalized software costs.

Science and Technology Directorate  
 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	Inadequate Internal Controls over Reporting of Construction-In-Progress (CIP) and Buildings				11-01
11-02	Untimely De-obligation of Undelivered Orders				11-02
11-03	Inadequate Controls over New Hire Ethics Briefings				11-03
11-04	Insufficient Internal Controls to Ensure Timely Reporting of Internal Use Software (IUS) in Development and Personal Property				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>



Science and Technology Directorate  
*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	Inadequate Internal Controls over Reporting of CIP and Buildings		S&T 11-01
10-02	Insufficient Internal Controls to Ensure Timely Reporting of IUS in Development and Personal Property		S&T 11-04

<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.

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