

DEPARTMENT OF HOMELAND SECURITY
Office of Inspector General

**FY 2006 Audit of DHS' Internal Control
Over Financial Reporting**



Office of Inspector General

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



**Homeland
Security**


November 15, 2006

Preface

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

This report addresses the effectiveness of DHS' internal control over financial reporting. It is based on a review of applicable documents. We performed our review during the course of DHS' FY 2006 financial statement audit in conjunction with the independent public accountant, KPMG LLP. KPMG was engaged to audit the Department's balance sheet as of September 30, 2006 and 2005, and the related statement of custodial activity for the year ended September 30, 2006 (referred to herein as "financial statements"). KPMG was unable to provide an opinion on DHS' financial statements as of September 30, 2006 and 2005.

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

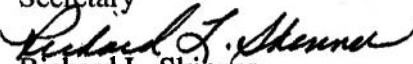

Richard L. Skinner
Inspector General



Homeland Security

November 15, 2006

MEMORANDUM FOR: The Honorable Michael Chertoff
Secretary

FROM: 
Richard L. Skinner
Inspector General

SUBJECT: Independent Auditors' Report on DHS' FY 2006 Internal Controls
over Financial Reporting

The attached report presents our independent auditors' opinion on internal controls over financial reporting as of September 30, 2006, based on the criteria established under the Federal Managers' Financial Integrity Act (FMFIA). DHS management is responsible for establishing and maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of DHS' internal control based on our examination.

The Department of Homeland Security Financial Accountability Act (The Act) (P.L. 108-330) was established to **amend** title 31 of the United States Code, to improve the financial accountability requirements applicable to the Department of Homeland Security (DHS). The Act also amended the Chief Financial Officers Act (CFO Act) of 1990 to include DHS as one of the federal agencies where the Chief Financial Officer is a Presidential appointee and reports directly to the Secretary.

Section 4 of The Act requires that the Secretary of Homeland Security include an audit opinion of the Department's internal controls over its financial reporting in each performance and accountability report beginning after fiscal year 2005.

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

Attachment



**Homeland
Security**

November 15, 2006

We have examined the effectiveness of **DHS'** internal control over financial reporting as of September **30**, 2006 based on the criteria established under the Federal Managers' Financial Integrity Act (FMFIA). **DHS** management is responsible for establishing and maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on the effectiveness of **DHS'** internal control based on our examination.

Our examination was conducted in accordance with U.S. generally accepted government auditing standards. It included obtaining an understanding of the internal control over financial reporting and performing such other procedures as we considered necessary to render our opinion. We believe that our examination and the report of the independent auditor provide a reasonable basis for our opinion.

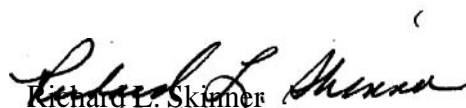
Because of inherent limitations in any internal control, misstatements due to error or fraud **may** occur and not be detected. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to the risk that the internal control may change, or that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

During fiscal year 2006, the following reportable conditions were identified by an independent auditor, which are considered material weaknesses.

- Financial Management Oversight (Entity Level Controls);
- Financial Reporting;
- Financial Systems Security;
- Fund Balance with Treasury;
- Property, Plant and Equipment;
- Operating Materials and Supplies;
- Legal and Other Liabilities;
- Actuarial Liabilities;
- Budgetary Accounting; and
- Intragovernmental and Intradepartmental Balances.

A material weakness is a condition that precludes the entity's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis. Due to the issues noted above, additional material **weaknesses** may exist that have not been reported.

Because of the effects of the above mentioned material weaknesses, in our opinion, DHS did not maintain effective internal control as of September 30,2006, to meet the following objectives: (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements and stewardship information in conformity with GAAP, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition; and (2) transactions are executed in accordance with laws governing the use of budget authority and with other significant laws and regulations that could have a direct and material effect on the financial statements and stewardship information. Consequently, DHS' internal control did not provide reasonable assurance that misstatements, losses, or noncompliance material in relation to the financial statements or to stewardship information would be prevented or detected on a timely basis.



Richard L. Skinner


Inspector General



Homeland Security

November 15, 2006

MEMORANDUM FOR: Richard L. Skinner, Inspector General

FROM: David L. Norquist, Chief Financial Officer 

SUBJECT: Audit Opinion of the Department's Internal Controls over
Financial Reporting

Thank you for the opportunity to review your draft audit opinion of the Department's internal controls over financial reporting. I agree with your **draft** audit report's conclusions and I am pleased that we have implemented the audit opinion requirement of the Department of Homeland Security Financial Accountability Act. I want to emphasize that I will continue to work with your office to ensure that inherited material weaknesses do not become ingrained into our operations. As we conclude the second year of implementing the Act, I appreciate our professional relationship and your office's efforts to establish an appropriate level of ongoing performance reporting that assesses and compliments management's corrective action efforts. The utility of your performance audits continues to develop through our combined efforts. I look forward to continuing this productive and successful relationship in FY 2007.

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