

OFFICE OF INSPECTOR GENERAL

**Independent Auditors’
Report on DHS’ FY 2020
Financial Statements and
Internal Control over
Financial Reporting**



**Homeland
Security**

November 13, 2020

OIG-21-08




OFFICE OF INSPECTOR GENERAL

Department of Homeland Security

Washington, DC 20528 / www.oig.dhs.gov

November 13, 2020

MEMORANDUM FOR: The Honorable Chad F. Wolf
Acting Secretary
Department of Homeland Security

FROM: Sondra F. McCauley 
Assistant Inspector General for Audits

SUBJECT: *Independent Auditors' Report on DHS' FY 2020
Financial Statements and Internal Control over
Financial Reporting*

The attached report presents the results of an integrated audit of the Department of Homeland Security's (DHS) consolidated financial statements for fiscal years (FY) 2020 and 2019 and internal control over financial reporting as of September 30, 2020. This audit is required by the *Chief Financial Officers Act of 1990*, as amended by the *Department of Homeland Security Financial Accountability Act of 2004*. We contracted with the independent public accounting firm KPMG LLP (KPMG) to conduct the audit. The contract required that the audit be performed in accordance with U.S. generally accepted government auditing standards, Office of Management and Budget audit guidance, and the GAO/CIGIE *Financial Audit Manual*. This report is incorporated into the Department's FY 2020 *Agency Financial Report*.

The Department continued to improve financial management in FY 2020 and achieved an unmodified (clean) opinion on all financial statements. However, KPMG issued an adverse opinion on DHS' internal control over financial reporting because of material weaknesses in internal control.

Summary

KPMG identified material weaknesses in internal control in two areas and other significant deficiencies in three areas. KPMG also reported instances of noncompliance with three laws and regulations.

Below are the material weaknesses, other significant deficiencies, and noncompliance with laws and regulations:



OFFICE OF INSPECTOR GENERAL
Department of Homeland Security

Material Weaknesses

- Information Technology Controls and Information Systems
- Financial Reporting

Other Significant Deficiencies

- Custodial Activities: Entry Processing, Refunds and Drawbacks, and Seized and Forfeited Property
- Grants Management
- Insurance Liabilities

Noncompliance with Laws and Regulations

- *Presidential Memorandum on Authorizing the Other Needs Assistance Program for Major Disaster Declarations Related to Coronavirus Disease 2019*
- *Federal Managers' Financial Integrity Act of 1982*
- *Federal Financial Management Improvement Act of 1996*

Moving DHS' Financial Management Forward

The Department continued its commitment to identifying areas for improvement, developing and monitoring corrective actions, and establishing and maintaining effective internal control over financial reporting this past fiscal year. Looking forward, the Department must continue remediation efforts and stay focused in order to sustain a clean opinion on its financial statements and obtain a clean opinion on its internal control over financial reporting.

KPMG is responsible for the attached Independent Auditors' Report dated November 13, 2020, and the conclusions expressed in the report.

To ensure the quality of the audit work performed, we evaluated KPMG's qualifications and independence, reviewed the approach and planning of the audit, monitored the progress of the audit at key points, reviewed and accepted KPMG's audit report, and performed other procedures that we deemed necessary. Our review, as differentiated from an audit in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on DHS's financial statements or internal control over financial reporting or provide conclusions



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Department of Homeland Security

on compliance with laws and regulations. Our review disclosed no instances where KPMG did not comply, in all material respects, with U.S. generally accepted government auditing standards.

Consistent with our responsibility under the *Inspector General Act*, we will provide copies of our report to congressional committees with oversight and appropriation responsibility over the Department of Homeland Security. We will post the report on our website for public dissemination.

Please call me with any questions at (202) 981-6000, or your staff may contact Maureen Duddy, Deputy Assistant Inspector General for Audits at (617) 565-8723.

Attachment



DHS OIG HIGHLIGHTS

Independent Auditors' Report on DHS' FY 2020 Financial Statements and Internal Control over Financial Reporting

November 13, 2020

Why We Did This Audit

The *Chief Financial Officers Act of 1990* (Public Law 101-576) and the *Department Of Homeland Security Financial Accountability Act* (Public Law 108-330) require us to conduct an annual audit of the Department of Homeland Security's (DHS) consolidated financial statements and internal control over financial reporting.

What We Recommend

KPMG LLP made 29 recommendations that, when implemented, may help improve the Department's internal control.

For Further Information:

Contact our Office of Public Affairs at (202) 981-6000, or email us at DHS-OIG.OfficePublicAffairs@oig.dhs.gov

What We Found

The independent public accounting firm KPMG LLP (KPMG) has issued an unmodified (clean) opinion on DHS' consolidated financial statements for fiscal years 2020 and 2019. KPMG noted that the financial statements present fairly, in all material respects, DHS' financial position as of September 30, 2020 and 2019.

KPMG issued an adverse opinion on DHS' internal control over financial reporting as of September 30, 2020. KPMG identified material weaknesses in internal control in two areas and other significant deficiencies in three areas. KPMG also reported instances of noncompliance with three laws and regulations.

Material Weaknesses

- Information Technology Controls and Information Systems
- Financial Reporting

Other Significant Deficiencies

- Custodial Activities: Entry Processing, Refunds and Drawbacks, and Seized and Forfeited Property
- Grants Management
- Insurance Liabilities

Noncompliance with Laws and Regulations

- *Presidential Memorandum on Authorizing the Other Needs Assistance Program for Major Disaster Declarations Related to Coronavirus Disease 2019*
- *Federal Managers' Financial Integrity Act of 1982*
- *Federal Financial Management Improvement Act of 1996*

Management's Response

DHS concurred with all of the recommendations.



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Department of Homeland Security

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KPMG LLP
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Washington, DC 20006

Independent Auditors' Report

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

Report on the Financial Statements and Internal Control

We have audited the accompanying consolidated financial statements of the U.S. Department of Homeland Security (DHS), which comprise the consolidated balance sheets as of September 30, 2020 and 2019, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements. We also have audited DHS's internal control over financial reporting as of September 30, 2020, based on criteria established in the *Standards for Internal Control in the Federal Government*, issued by the Comptroller General of the United States.

Management's Responsibility for the Financial Statements and Internal Control over Financial Reporting

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles. This includes the design, implementation, and maintenance of effective internal control over financial reporting relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Control over Financial Reporting*.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements and an opinion on DHS's internal control over financial reporting based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, in accordance with the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and in accordance with Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 19-03 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement and whether effective internal control over financial reporting was maintained in all material respects.

An audit of financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of financial statements also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.



An audit of internal control over financial reporting involves performing procedures to obtain audit evidence about whether a material weakness exists. The procedures selected depend on the auditors' judgment, including the assessment of the risks that a material weakness exists. An audit of internal control over financial reporting also involves obtaining an understanding of internal control over financial reporting and testing and evaluating the design and operating effectiveness of internal control over financial reporting based on the assessed risk. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Definition and Inherent Limitations of Internal Control over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with U.S. generally accepted accounting principles. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment 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.

We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

Opinion on Financial Statements

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of Homeland Security as of September 30, 2020 and 2019, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in Note 15 to the consolidated financial statements, DHS had intragovernmental debt used to finance the *National Flood Insurance Program* (NFIP) of approximately \$21 billion as of September 30, 2020 and 2019. The principal and interest payments are financed by the flood premiums from policyholders. Given the current rate structure, DHS will not be able to pay its debt from the premium revenue alone; therefore, DHS does not anticipate repaying the debt. Our opinion is not modified with respect to this matter.

Basis for Adverse Opinion on Internal Control over Financial Reporting

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, 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 have been identified in the following areas as described in the accompanying Exhibit I and included in the accompanying *Management's Report on Internal Control over Financial Reporting*.

- A. Information Technology Controls and Information Systems
- B. Financial Reporting



We considered the material weaknesses identified above in determining the nature, timing, and extent of audit procedures applied in our audit of the fiscal year 2020 consolidated financial statements, and these material weaknesses do not affect our opinion on the financial statements.

Adverse Opinion on Internal Control over Financial Reporting

In our opinion, because of the effect of the material weaknesses described in the Basis for Adverse Opinion paragraph above on the achievement of the objectives of the control criteria, DHS has not maintained effective internal control over financial reporting as of September 30, 2020, based on criteria established in *Standards for Internal Control in the Federal Government*, issued by the Comptroller General of the United States.

Other Matters

Interactive Data

Management has elected to reference to information on websites or other forms of interactive data outside the *Agency Financial Report* to provide additional information for the users of its financial statements. Such information is not a required part of the basic consolidated financial statements or supplementary information required by the Federal Accounting Standards Advisory Board. The information on these websites or the other interactive data has not been subjected to any of our auditing procedures, and accordingly we do not express an opinion or provide any assurance on it.

Required Supplementary Information

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis and Required Supplementary Information sections be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Federal Accounting Standards Advisory Board, which considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audits of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The information in the About this Report, Message from the Secretary, Message from the Chief Financial Officer, Introduction, Other Information, and Acronym List sections, as listed in the Table of Contents of the *Agency Financial Report*, is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.



Other Reporting Required by Government Auditing Standards

Internal Control over Financial Reporting

In accordance with *Government Auditing Standards*, we are required to report findings of significant deficiencies. 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. We consider the deficiencies in the following areas, as described in Exhibit II, to be significant deficiencies.

- C. Custodial Activities: Entry Processing, Refunds and Drawbacks, and Seized and Forfeited Property
- D. Grants Management
- E. Insurance Liabilities

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the DHS's consolidated financial statements as of and for the year ended September 30, 2020 are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the consolidated financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed the following instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 19-03 and are described in Exhibit III.

- F. *Presidential Memorandum on Authorizing the Other Needs Assistance Program for Major Disaster Declarations Related to Coronavirus Disease 2019 (COVID-19)*
- G. *Federal Managers' Financial Integrity Act of 1982 (FMFIA)*

We also performed tests of its compliance with certain provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996 (FFMIA)*. Providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances, described in Exhibit III, in which the DHS's 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.

DHS's Responses to Findings

DHS's responses to the findings identified in our audit are described in Appendix A. DHS's responses were not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the responses.

Purpose of the Other Reporting Required by Government Auditing Standards

The purpose of the communication described in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the deficiencies we consider to be significant deficiencies, and the scope of our testing of compliance and the results of that testing, and not to provide an opinion on compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Washington, D.C.
November 13, 2020

Independent Auditors' Report

Exhibit I – Material Weaknesses

The weaknesses in internal control existed as of September 30, 2020 and the instances of noncompliance with certain provisions of laws, regulations, contracts, and grant agreements were identified during the year ended September 30, 2020. The determination of which control deficiencies rise to the level of a material weakness or a significant deficiency is based on an evaluation of the impact of control deficiencies identified in all components, considered individually and in the aggregate, on the DHS consolidated financial statements as of September 30, 2020. Component-level deficiencies vary in severity. The associated entity level controls, as defined by the *Standards for Internal Control in the Federal Government* issued by the Comptroller General of the United States (Green Book), are also identified in relation to the control activities in the corresponding areas of the following Exhibits.

The findings are presented in three Exhibits:

- Exhibit I** Material Weaknesses. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, 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. DHS has material weaknesses within the following areas:
- A. Information Technology Controls and Information Systems
 - B. Financial Reporting
- Exhibit II** Significant Deficiencies. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by DHS management and others in positions of DHS oversight. DHS has significant deficiencies within the following areas:
- C. Custodial Activities: Entry Processing, Refunds and Drawbacks, and Seized and Forfeited Property
 - D. Grants Management
 - E. Insurance Liabilities
- Exhibit III** Compliance and Other Matters. The compliance and other matters identified included instances of noncompliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters that are required to be reported under *Government Auditing Standards* or Office of Management and Budget (OMB) Bulletin No. 19-03, *Audit Requirements for Federal Financial Statements*. DHS has instances of noncompliance as follows:
- F. Presidential Memorandum on Authorizing the Other Needs Assistance Program for Major Disaster Declarations Related to Coronavirus Disease 2019 (COVID-19)
 - G. Federal Managers' Financial Integrity Act of 1982
 - H. Federal Financial Management Improvement Act of 1996
- Criteria** DHS's internal control over financial reporting is based on the criteria established by the Green Book.

I-A Information Technology Controls and Information Systems

Background:

Information technology (IT) controls are a critical subset of an entity's internal control. There are two main types of IT controls: IT general controls (ITGCs) and application controls. ITGCs operate over entire or large portions of systems and represent the foundation of an IT control structure. They are applied at the entity-wide, operating system, database, or application level, and include controls over access control, configuration management, segregation of duties, and contingency planning. Effective ITGCs are necessary to create the foundation for the operation of application controls. Application controls are those controls that directly relate to specific IT applications and ensure completeness, accuracy, validity, confidentiality, and availability of data. The deficiencies indicated in this Exhibit are representative of ITGC and application control deficiencies at headquarters and various components across DHS including U.S. Customs and Border Protection (CBP), Federal Emergency Management Agency (FEMA), U.S. Immigration and Customs Enforcement (ICE), Management Directorate (MGMT), Transportation Security Agency (TSA), U.S. Coast Guard (USCG), U.S. Citizenship and Immigration Services (USCIS), and U.S. Secret Service (USSS).

Conditions:

DHS did not design and implement the entity's information systems and related control activities to achieve objectives and respond to risks as required by Green Book principles 11, *Design Activities for Information Systems*, and 12, *Implement Control Activities*. Specifically, DHS had:

- Ineffective design, implementation, or operating effectiveness of ITGCs over IT operating systems, databases, and applications supporting financial reporting processes across DHS in the following areas:

Access control and segregation of duties

- User, service, privileged, and generic (including emergency, temporary, developer, and migrator) accounts not properly authorized, recertified, and revoked timely;
- The principles of least privilege and segregation of duties not applied;
- Password security not properly configured for data protection and inactivity;
- Audit logging activity requirements not defined;
- Audit logs not generated, reviewed, or analyzed;

Configuration management

- Systems not properly configured;
- System changes not authorized or monitored;

Security management

- Assessments and documentation required for a new system Authority to Operate (ATO) not completed or approved; and
 - Periodic reviews of the results of vulnerability scans not performed.
- Ineffective design, implementation, or operating effectiveness of ITGCs at service organizations.
 - Ineffective application controls and manual controls that are dependent upon the information derived from DHS information systems.

Independent Auditors' Report

Exhibit I – Material Weaknesses

DHS continued to have deficiencies in its design and implementation of controls over IT Controls and Information Systems. These deficiencies have persisted since the inception of DHS. As a result, DHS did not remediate identified internal control deficiencies on a timely basis as required by Green Book principle 17, *Evaluate Issues and Remediate Deficiencies*. Specifically, DHS had:

- Ineffective design and implementation of controls to remediate IT findings, including insufficient corrective actions to address deficiencies that have existed for several years in multiple information systems.

Causes:

These deficiencies are a result of the failure of entity level controls, as follows:

Green Book principle 7 requires that “Management should identify, analyze, and respond to risks related to achieving the defined objectives.” DHS did not effectively implement and operate Green Book principle 7. Specifically:

- DHS did not fully implement a robust risk assessment of ITGCs that is necessary to identify weaknesses, nor did it assess the resulting risks created by IT deficiencies.
- DHS did not resolve the risks created by historic limitations in the functionality of its information systems.
- DHS did not successfully mitigate the risk created by implementing manual controls to compensate for risks resulting from decentralized systems and records management processes or utilities with limited automated capabilities.

Green Book principle 16 requires that “Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.” DHS did not effectively implement and operate Green Book principle 16. Specifically:

- DHS did not effectively implement a formalized process to monitor the third-party service organizations responsible for maintaining the infrastructure support for various IT systems.
- DHS established corrective action plans but had not monitored them to ensure they were tracking the progress toward remediation of deficiencies timely.

Effects:

Deficiencies in access controls and segregation of duties increase the risk that current employees, separated employees, or contractors may obtain unauthorized or inappropriate access to information systems or data. Such access could lead to unauthorized activities or inappropriate disclosures of sensitive data. Deficiencies in configuration management increase the risk that unauthorized or inappropriate changes to systems will be applied and go undetected by management, resulting in lower assurance that information systems will operate as intended and that data is reliable, valid, and complete. Deficiencies in security management increase the risk that system vulnerabilities will not be identified and remediated, compromising the reliability and integrity of data and increasing the risk of data loss.

In addition, system limitations contribute to deficiencies in multiple financial process areas across DHS. Many key DHS information systems are not compliant with Federal financial management system requirements as defined by FFMA, as noted in Exhibit III. These system limitations cause a greater risk of error and result in inconsistent, incomplete, or inaccurate control execution.

Collectively, DHS not performing an appropriate risk assessment to identify and mitigate the ITGC and application control deficiencies limits DHS's ability to process, store, and report financial data in a manner that ensures accuracy, confidentiality, integrity, and availability. In response to these deficiencies, DHS intended to utilize manual controls; however, these manual controls often were not properly designed or implemented, or did not operate effectively, as reported in Exhibits I and II.

Independent Auditors' Report
Exhibit I – Material Weaknesses

Recommendations:

We recommend that DHS:

1. Office of the Chief Financial Officer (OCFO), in coordination with the Office of the Chief Information Officer (OCIO), the Office of the Chief Information Security Officer (OCISO), and component IT and financial management, complete a comprehensive risk analysis and develop a mitigation plan to reduce risks related to ITGC and application control deficiencies timely;
2. OCFO, in coordination with the OCIO, the OCISO, and component IT and financial management, design and implement an effective internal control process to address the risk of errors due to IT system functionality issues, the inability to rely on information derived from systems, and the inability to rely on application controls until system deficiencies are remediated;
3. OCFO, in coordination with the OCIO, the OCISO, and component IT and financial management, design and implement an effective internal control process to review service organization risks to ensure that ineffective ITGCs performed by service organizations are evaluated and appropriate compensating controls are designed and implemented by DHS and component management;
4. OCFO, in coordination with the OCIO, the OCISO, and component IT and financial management, make the necessary improvements to DHS's ITGC and application controls timely, as detailed in limited distribution Notices of Findings and Recommendations to DHS and component management, and monitor corrective action plans; and
5. OCISO, the OCIO, and component IT management sufficiently monitor IT vulnerabilities and limitations, and coordinate with the OCFO and component financial management to implement manual controls to mitigate risk.

Independent Auditors' Report

Exhibit I – Material Weaknesses

I-B Financial Reporting

Background:

Internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, and is designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with U.S. generally accepted accounting principles.

Conditions:

DHS did not design control activities to achieve objectives and respond to risks as required by Green Book principle 10, *Design Control Activities*, or implement the entity's information systems and related control activities through policies as required by Green Book principles 11, *Design Activities for Information Systems*, and 12, *Implement Control Activities*. Specifically, DHS had:

- Ineffective design, implementation, or operating effectiveness of controls supporting financial reporting processes across DHS in the following areas:

Beginning balances

- Beginning balances not reviewed for completeness and accuracy at the transaction level at USCG;

Journal entries

- Manual journal entries not properly reviewed and approved at CBP, MGMT, and TSA;
- Manual journal entry amounts not validated with appropriate supporting documentation at CBP and USCG;
- Manual journal entries not properly reviewed for correct U.S. Government Standard General Ledger (USSGL) accounts at FEMA and USCG;
- Manual journal entry descriptions of the business events not aligned to the supporting documentation provided for the entry at USCG;

Service organization control (SOC) reports

- Service provider risks not addressed by obtaining and effectively reviewing SOC reports, or by assessing the risks when a SOC report does not exist at multiple components across DHS;

Application controls and information derived from systems

- Manual controls to compensate for application control deficiencies not designed and implemented at multiple components across DHS;
- Baseline assessments of application controls and information derived from systems with effective ITGCs not reviewed for completeness and accuracy at CBP and headquarters; and

Aggregation and reporting of financial information

- Financial information, including the preparation of the Agency Financial Report, not completely and accurately prepared across DHS.

DHS continued to have deficiencies in its design and implementation of controls over Financial Reporting. DHS did not remediate identified internal control deficiencies on a timely basis as required by Green Book principle 17, *Evaluate Issues and Remediate Deficiencies*. Some of these deficiencies have persisted since the inception of DHS.

Independent Auditors' Report

Exhibit I – Material Weaknesses

Causes:

These deficiencies are a result of the failure of entity level controls as follows:

Green Book principle 4 requires that “Management should demonstrate a commitment to recruit, develop, and retain competent individuals.” DHS did not effectively implement and operate Green Book principle 4. Specifically:

- DHS did not provide timely training on requirements for supporting documentation to individuals with responsibilities to review journal entries.

Green Book principle 5 requires that “Management should evaluate performance and hold individuals accountable for their internal control responsibilities.” DHS did not effectively implement and operate Green Book principle 5. Specifically:

- DHS did not enforce accountability of personnel responsible for the review of journal entries and SOC reports.

Green Book principle 7 requires that “Management should identify, analyze, and respond to risks related to achieving the defined objectives.” DHS did not effectively implement and operate Green Book principle 7. Specifically:

- DHS did not fully implement a robust risk assessment of ITGCs that is necessary to identify weaknesses, nor did it assess the resulting risks created by IT deficiencies.
- DHS did not assess the resulting risks created by IT deficiencies and their impact on other controls.

Green Book principle 9 requires that “Management should identify, analyze, and respond to significant changes that could impact the internal control system.” DHS did not effectively implement and operate Green Book principle 9. Specifically:

- DHS did not identify the need to evaluate the proper USSGL accounts for a journal entry related to the new lost wages assistance program.

Green Book principle 13 requires that “Management should use quality information to achieve the entity’s objectives.” DHS did not effectively implement and operate Green Book principle 13. Specifically:

- DHS did not process data into quality information that was useable for operating controls effectively.
- DHS did not perform baseline testing of information generated by applications prior to relying on that information as part of a control.
- DHS did not identify the appropriate information requirements to support proposed journal entries.

Green Book principle 14 requires that “Management should internally communicate the necessary quality information to achieve the entity’s objectives.” DHS did not effectively implement and operate Green Book principle 14. Specifically:

- DHS did not communicate effectively between headquarters and components to report complete and accurate financial information.

Independent Auditors' Report

Exhibit I – Material Weaknesses

Green Book principle 16 requires that “Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.” DHS did not effectively implement and operate Green Book principle 16. Specifically:

- DHS did not perform continuous monitoring and testing of IT and financial controls for all significant areas.
- DHS did not sufficiently monitor the status of corrective action plans.
- DHS did not monitor the assigned processes and controls performed by service organizations.
- DHS did not monitor the service organization’s controls surrounding the compilation of the National Flood Insurance Program (NFIP) financial statements and the related IT systems used to process insurance policies.
- DHS did not design and implement sufficient procedures to review SOC reports, including identification and assessment of complementary user entity controls.

Effects:

The failure to perform continuous monitoring and testing of IT and financial controls results in lack of timely remediation of existing deficiencies and noncompliance with FMFIA, as reported in Exhibit III.

The failure to adequately design, implement, and operate internal controls over beginning balances increases the risk that beginning balances could contain undetected misstatements.

The failure to adequately design, implement, and operate internal controls over journal entries increases the risk that misstatements can occur without being prevented, or detected and corrected timely.

The failure to provide timely training increases the risk that unsupported or incorrect journal entries will be recorded.

The failure to adequately design, implement, and operate internal controls related to oversight of service organizations increases the risk that misstatements can occur without being prevented, or detected and corrected timely.

The failure to adequately design, implement, and operate internal controls related to the baseline assessment of application controls and information derived from systems prevents management from relying on application controls. It also prevents management from relying on the information derived from systems used to record journal entries and perform control activities.

The lack of compensating controls for IT deficiencies also results in noncompliance with Federal financial management system requirements, as defined by FFMA and reported in Exhibit III.

The failure to adequately design, implement, and operate internal controls over the reporting of financial information increases the risk that financial information in the Agency Financial Report is misstated.

Independent Auditors' Report
Exhibit I – Material Weaknesses

Recommendations:

We recommend that DHS:

6. develop new policies, or improve and reinforce existing policies, procedures, and related internal controls, that:
 - a. beginning balances are recorded at the transaction level in the correct underlying general ledger systems in order to improve the quality of information in each system;
 - b. journal entries are adequately researched, supported, and reviewed before and after recording in the general ledger;
7. provide training and enforce accountability for adherence to policies and procedures and provide the necessary financial reporting oversight;
8. improve the process for identification, analysis, and response to risks related to financial reporting;
9. align knowledgeable individuals to monitor and evaluate the roles of service organizations, assess controls at those service organizations, and identify and assess complementary user entity controls within the components relying on those service organizations;
10. improve monitoring controls over assessing internal controls and remediating known internal control deficiencies timely; and
11. improve or reinforce existing policies, procedures, and related internal controls over financial information, including preparation of the Agency Financial Report.

Independent Auditors' Report
Exhibit II – Significant Deficiencies

II-C Custodial Activities: Entry Processing, Refunds and Drawbacks, and Seized and Forfeited Property

Background:

The majority of DHS's custodial collections are from merchandise entering the United States from foreign ports of origin, against which DHS assesses import duties, taxes, and fees. Refunds are a remittance, in whole or in part, due to the overpayment of duties, taxes, or fees previously paid by an importer.

Drawback claims typically occur when imported goods on which duties, taxes, or fees have been previously paid are subsequently exported from the United States or destroyed. The *Trade Facilitation and Trade Enforcement Act of 2015* (TFTEA), implemented in February 2019, contained provisions for drawback modernization that simplified the rules for determining if exports are eligible for drawback refunds, expanded the timeframe for drawback claims, and eliminated some of the documentation requirements. All drawback claims filed after the implementation date are filed under the regulations in Code of Federal Regulations (CFR) 190. Drawback claims filed prior to the TFTEA implementation date were filed under the regulations in CFR 191.

DHS is also responsible for reporting seized and forfeited property that is in its custody. DHS seizes various items, including prohibited drugs and counterfeit goods. DHS relies on several of its components to enter case information, including weights and measures, into the seized and forfeited property system.

Conditions:

DHS did not design and implement control activities to achieve objectives and respond to risks as required by Green Book principles 10, *Design Control Activities*, or implement control activities through policies as required by Green Book principle 12, *Implement Control Activities*. Specifically, at CBP, DHS had:

- Ineffective design, implementation, or operating effectiveness of controls supporting custodial activities in the following areas:

Entry processing:

- Canceled entry transactions not properly reviewed;

Refunds:

- Refund approvals or refund liquidations not properly reviewed;
- Interest rates for refund payments not properly reviewed;

Drawbacks:

- Policies and procedures over TFTEA drawback claims not finalized;
- Accelerated payments not properly reviewed;
- Drawback liquidations not properly reviewed;
- Excessive pre-TFTEA drawback claims not prevented or detected and corrected;
- Supporting documentation for pre-TFTEA drawback claims not maintained; and

Seized and forfeited property:

- Seized and forfeited asset transactions not recorded properly and timely in the seized and forfeited assets tracking system by CBP and ICE personnel.

Independent Auditors' Report

Exhibit II – Significant Deficiencies

Causes:

These deficiencies are a result of the failure of entity level controls as follows:

Green Book principle 4 requires that “Management should demonstrate a commitment to recruit, develop, and retain competent individuals.” DHS did not effectively implement and operate Green Book principle 4. Specifically:

- DHS did not sufficiently train individuals to develop competencies for key roles in executing the internal control objectives related to the seized and forfeited property note to the financial statements, including use of the new destruction module in the system of record.

Green Book principle 5 requires that, “Management holds entity personnel accountable for performing their assigned internal control responsibilities.” DHS did not effectively implement and operate Green Book principle 5. Specifically:

- DHS did not enforce compliance with existing policies over the review of cancelled entries, drawback and refund liquidations, administrative refunds, and accelerated drawback payments.

Green Book principle 6 requires that “Management defines objectives in specific terms so they are understood at all levels of the entity. This involves clearly defining what is to be achieved, who is to achieve it, how it will be achieved, and the time frames for achievement.” DHS did not effectively implement and operate Green Book principle 6. Specifically:

- DHS did not clearly define how the review of drawback and refund liquidations, administrative refunds, and accelerated drawback payments would be achieved.

Green Book principle 7 requires that “Management should identify, analyze, and respond to risks related to achieving the defined objectives.” DHS did not effectively implement and operate Green Book principle 7. Specifically:

- DHS did not analyze and respond to identified risks related to drawback claims submitted prior to the implementation of TFTEA.

Green Book principle 9 requires that “Management should identify, analyze, and respond to significant changes that could impact the internal control system.” DHS did not effectively implement and operate Green Book principle 9. Specifically:

- DHS did not identify whether existing drawback controls addressed the identified risks.

Green Book principle 14 requires that “Management should internally communicate the necessary quality information to achieve the entity’s objectives.” DHS did not effectively implement and operate Green Book principle 14. Specifically:

- DHS did not communicate quality information down and across reporting lines to enable personnel to perform key roles related to interest rates for refund payments and seized and forfeited property.

Green Book principle 15 requires that “Management should externally communicate the necessary quality information to achieve the entity’s objectives.” DHS did not effectively implement and operate Green Book principle 15. Specifically:

- DHS did not communicate quality information to claimants and brokers related to the document retention period for drawback claims.

Effects:

The failure to fully establish and define control activities related to the entry process could lead to potential misstatements of net taxes, duties, and trade receivables on the Balance Sheet and total cash collections on the Statement of Custodial Activity.

Independent Auditors' Report

Exhibit II – Significant Deficiencies

Until all CFR 191 drawback claims are processed, DHS's failure to implement effective controls over the drawback process may subject DHS to financial loss due to excessive drawback claims. In addition, drawback claims are governed by the laws and regulations in effect at the time of filing. As the length of the drawback lifecycle can last for years, it will take several years for claims filed under CFR 191 to be completed.

The failure to fully establish and define control activities related to the refund and drawback processes could lead to potential misstatements of payables on the Balance Sheet and refund and drawback disbursements on the Statement of Custodial Activity.

Failure to fully establish and define control activities related to seized and forfeited property may result in misstatements of the Seized and Forfeited Property note to the financial statements.

Recommendations:

We recommend that DHS:

Entry processing:

12. update guidance to ensure consistent performance of control activities across all DHS locations and distribute to appropriate personnel;
13. provide training to all personnel on new policies to ensure consistent implementation at all DHS locations;

Refunds:

14. update policies and procedures to clearly define how the review of refund liquidations and administrative refunds is achieved;
15. update guidance over the review of interest rates;

Drawbacks:

16. finalize the Drawback Handbook to document designed control activities over TFTEA drawback claims;
17. complete a robust risk assessment related to TFTEA drawback claims;
18. update policies and procedures to clearly define how the review of accelerated payments and drawback liquidations is achieved;
19. track and monitor the progress made in liquidating legacy drawback claims to support timely liquidation in accordance with the requirements of CFR 191;

Seized and forfeited property:

20. train individuals to develop competencies for key seized and forfeited property accounting roles, including timely and accurately recording and reviewing transactions in the system of record;
21. enhance the destruction module in the system of record; and
22. design and implement a control to mitigate the risk of inaccurate updates to property records after initial seizure.

Independent Auditors' Report

Exhibit II – Significant Deficiencies

II-D Grants Management

Background:

DHS manages multiple Federal disaster and non-disaster grant programs. In fiscal year 2018, DHS began implementation of the process to standardize all grant management activities, which continued into FY 2020. This included coordination among the grant regional offices and central management as well as among the various grant programs. In order to monitor the spending of the disaster and non-disaster grant funding, DHS performs site visits and monitors Federal Financial Reports submitted by grant recipients. The internal control deficiencies related to grants management were reported in prior years and persisted in FY 2020.

In FY 2020, DHS implemented a new grant program to provide lost wages assistance to state entities to supplement unemployment benefits related to the coronavirus pandemic. The internal control deficiencies related to the lost wages assistance program are new in FY 2020.

Conditions:

DHS did not design control activities to achieve objectives and respond to risks as required by Green Book principle 10, *Design Control Activities*, or implement control activities through policies as required by Green Book principle 12, *Implement Control Activities*. Specifically, at FEMA, DHS had:

- Ineffective controls over monitoring of grant recipients, including the completeness and accuracy of the Master Repository Listing used to monitor grant recipients' Federal Financial Reports;
- Ineffective implementation of monitoring controls over corrective action plans identified in the grant recipients' audit reports;
- Inconsistent delegation of authority documentation for controls over the review of disaster and non-disaster grant obligations and deobligations; and
- Insufficient controls over grant obligations related to the lost wages assistance program.

Causes:

These deficiencies are a result of the failure of entity level controls as follows:

Green Book principle 3 requires that "Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives." DHS did not effectively implement and operate Green Book principle 3. Specifically:

- DHS failed to obtain sufficient written documentation to continue operating the lost wages assistance program after reaching the limit imposed by the Presidential *Memorandum on Authorizing the Other Needs Assistance Program for Major Disaster Declarations Related to Coronavirus Disease 2019*.

Green Book principle 4 requires that "Management should demonstrate a commitment to recruit, develop, and retain competent individuals." DHS did not effectively implement and operate Green Book principle 4. Specifically:

- DHS personnel lack a sufficient level of understanding of control requirements to delegate the authority to review disaster and non-disaster obligations and deobligations.

Green Book principle 5 requires that "Management should evaluate performance and hold individuals accountable for their internal control responsibilities." DHS did not effectively implement and operate Green Book principle 5. Specifically:

- DHS did not enforce accountability of personnel responsible for monitoring corrective action plans.

Independent Auditors' Report

Exhibit II – Significant Deficiencies

Green Book principle 13 requires that “Management should use quality information to achieve the entity’s objectives.” DHS did not effectively implement and operate Green Book principle 13. Specifically:

- DHS failed to maintain reliable data used in the monitoring of the Federal Financial Reports and site visits.

Effects:

The failure to use quality information to implement standardized internal controls within DHS during FY 2020 caused ineffective monitoring of open and closed grants. Ineffective monitoring may result in inaccurate or unauthorized expense reporting by grant recipients and increases the risk that DHS may not identify corrective actions for grant recipients timely. In addition, DHS’s failure to use quality information elevates the risk of invalid obligations due to untimely closure of grants. The failure to obtain sufficient written documentation to continue operating the lost wages program leads to unauthorized grant obligations and non-compliance with the Presidential Memorandum, as reported in Exhibit III.

Recommendations:

We recommend that DHS:

23. develop policies and procedures to monitor grant recipients, including validating and documenting the completeness and accuracy of the Master Repository Listing, and monitoring corrective action plans;
24. provide training and enforce accountability for adherence to policies and procedures; and
25. design and implement controls over grant obligations for the lost wages assistance program to ensure compliance with the Presidential Memorandum.

II-E Insurance Liabilities

Background:

DHS manages the NFIP, a program to provide flood insurance to policyholders through a network of write-your-own (WYO) insurance companies. These insurance companies provide services on behalf of DHS, including underwriting premium policies and processing claims. In FY 2020, DHS implemented a new information system to aggregate the WYO financial information. DHS used the WYO data, along with NFIP loss and loss adjustment expense factors, to estimate the actuarially derived flood insurance liability for claims incurred but not yet reported as of September 30, 2020.

Conditions:

DHS did not design control activities to achieve objectives and respond to risks as required by Green Book principle 10, *Design Control Activities*, or implement the related control activities through policies as required by Green Book principle 12, *Implement Control Activities*. Specifically, at FEMA, DHS had:

- Insufficient design of the controls over the validation of the underlying data used in the valuation of the flood insurance liability; and
- Insufficient design and implementation of the controls over the assumptions, methods, and models used in the valuation of the flood insurance liability.

Independent Auditors' Report
Exhibit II – Significant Deficiencies

Causes:

These deficiencies are a result of the failure of entity level controls as follows:

Green Book principle 9 requires that “Management should identify, analyze, and respond to significant changes that could impact the internal control system.” DHS did not effectively implement and operate Green Book principle 9. Specifically:

- DHS did not appropriately anticipate and plan for the implementation of a new information system that contains the underlying data used in the actuarial insurance liability estimate.
- DHS did not properly assess and document the appropriateness of changes to the methods, models, and assumptions for the actuarial insurance liability estimate.

Effects:

The failure to adequately design, implement, and operate internal controls over the actuarially derived estimate increases the risk that misstatements to insurance liabilities on the Balance Sheet can occur without being prevented, or detected and corrected, timely.

Recommendations:

We recommend that DHS:

26. develop new policies, or improve and reinforce existing policies, procedures, and related internal controls, that:
 - a. the underlying data to actuarially derived estimates is reviewed timely;
 - b. information derived from the systems used in the operations of controls is determined to be complete and accurate;
 - c. risks related to the methods, models, assumptions, and data elements are assessed each year to identify, plan, and respond to changes; and
 - d. changes to the methods, models, assumptions, and data elements are sufficiently documented.

Independent Auditors' Report
Exhibit III – Compliance and Other Matters

III-F Presidential Memorandum on Authorizing the Other Needs Assistance Program for Major Disaster Declarations Related to Coronavirus Disease 2019 (COVID-19)

On August 8, 2020, the President signed a Presidential Memorandum directing FEMA to use up to \$44 billion of the Disaster Relief Fund (DRF) to provide lost wages assistance to state entities (i.e., states, territories, and the District of Columbia) to supplement state expenditures for unemployment benefits.

The grant program was available to eligible claimants until the balance of the DRF reached \$25 billion or December 6, 2020, whichever occurred first. Despite reaching a DRF balance of \$25 billion, FEMA continued to operate the lost wages assistance program.

Recommendation:

We recommend that DHS:

27. design and implement controls to ensure compliance with the Presidential Memorandum.

III-G Federal Managers' Financial Integrity Act of 1982

FMFIA requires agencies to establish effective internal control and information systems, and to continuously evaluate and assess the effectiveness of their internal control. DHS's implementation of OMB Circular No. A-123 facilitates compliance with FMFIA. DHS has implemented a multi-year plan to achieve full assurance on internal control. However, the DHS *Secretary's Assurance Statement*, dated November 13, 2020, as presented in *Management's Discussion and Analysis* of DHS's FY 2020 *Agency Financial Report*, acknowledged the existence of control activities demonstrating material weaknesses, and therefore provided qualified assurance that internal control over financial reporting was operating effectively as of September 30, 2020. Management's findings were similar to the control deficiencies described in Exhibits I and II. DHS did not perform continuous monitoring and testing of both IT and financial controls for all significant areas.

While DHS progressed toward compliance with FMFIA, DHS did not fully establish effective systems, processes, policies, and testing procedures to ensure that internal controls were operating effectively throughout DHS. Deficiencies related to monitoring the internal control system are discussed in Exhibit I, Comments **I-A**, *Information Technology Controls and Information Systems*, and **I-B**, *Financial Reporting*.

Recommendation:

We recommend that DHS:

28. continue its corrective actions to address internal control deficiencies in order to ensure compliance with FMFIA, and implement the recommendations provided in Exhibits I and II.

III-H Federal Financial Management Improvement Act of 1996

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 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.

Independent Auditors' Report
Exhibit III – Compliance and Other Matters

As of September 30, 2020, DHS's financial management systems did not comply substantially with Federal financial management system requirements, as described in Exhibit I, Comment **I-A**, *Information Technology Controls and Information Systems*, and application of the USSGL at the transaction level, as described in Exhibit I, Comment **I-B**, *Financial Reporting*. The DHS Secretary stated in the *Secretary's Assurance Statement*, dated November 13, 2020, that DHS's financial management systems did not substantially conform to government-wide requirements mandated by FFMA. DHS's remedial actions and related timeframes are also presented in Table 3 of *Management's Discussion and Analysis* in the FY 2020 AFR.

Recommendation:

We recommend that DHS:

29. improve its financial management systems to ensure compliance with FFMA, and implement the recommendations provided in Exhibit I.



OFFICE OF INSPECTOR GENERAL
Department of Homeland Security

Appendix A
Management Comments to the Draft Report


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



**Homeland
Security**

November 13, 2020

MEMORANDUM FOR: The Honorable Joseph V. Cuffari
Inspector General

FROM: Troy D. Edgar 
Chief Financial Officer

SUBJECT: Fiscal Year 2020 Financial and Internal Control Audit

Thank you for your audit report on the Department's financial statement and internal control over financial reporting for fiscal years (FY) 2020 and 2019. We agree with the Independent Public Accountant's conclusions. We are pleased to have earned an unmodified financial statement audit opinion for the eighth consecutive year.

In FY 2020, the Department faced unprecedented challenges due to the COVID-19 pandemic. DHS was a key part of the whole of government response and received and executed significant additional funding to support the national recovery effort. Despite these challenges, we continue to make progress on financial reporting and internal control to ensure that we carry on the Department's mission while safeguarding our resources.

As noted in the report, the Department made progress by eliminating a significant deficiency in Property, Plant, and Equipment and resolving a control weakness associated with actuarial pension liabilities. We are focused on improving information technology controls and have put in place an aggressive strategy to modernize our financial systems. At the start of FY 2021, the Department successfully migrated the Transportation Security Administration (TSA) to a modern integrated financial and procurement system, and other components are scheduled for modernization in the years ahead. This speaks to the Department's progress and commitment to strengthening information technology controls.

I look forward to working collaboratively with the Office of Inspector General and the Independent Public Accountant in the years ahead to further strengthen DHS financial management and internal control.



OFFICE OF INSPECTOR GENERAL
Department of Homeland Security

Appendix B
Report Distribution

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