

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

## Independent Auditors' Report on DHS' FY 2013 Financial Statements and Internal Control over Financial Reporting

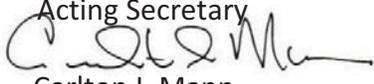




**OFFICE OF INSPECTOR GENERAL**  
Department of Homeland Security

Washington, DC 20528 / [www.oig.dhs.gov](http://www.oig.dhs.gov)

DEC 19 2013

MEMORANDUM FOR: The Honorable Rand Beers  
Acting Secretary  
  
FROM: Carlton I. Mann  
Chief Operating Officer

SUBJECT: *Independent Auditors' Report on DHS' FY 2013 Financial Statements and Internal Control over Financial Reporting*

Attached for your information is our revised report, *Independent Auditors' Report on DHS' FY 2013 Financial Statements and Internal Control over Financial Reporting*, for inclusion in the Department of Homeland Security 2013 *Agency Financial Report*. Language in the original *Independent Auditors' Report* was modified to be in conformance with the American Institute of Certified Public Accountants' clarified audit standard AU-C 705, *Modifications to the Opinion in the Independent Auditor's Report*. Modifications included language changes to the last sentence of *Auditors' Responsibility* section, third sentence in the *Basis for Qualified Opinion on the FY 2012 Financial Statements* section, first sentence of *Qualified Opinion on the FY 2012 Financial Statements* section, and last paragraph of *Emphasis of Matters* section.

The attached report presents the results of the U.S. Department of Homeland Security's (DHS) financial statements audit for fiscal year (FY) 2013 and the results of an examination of internal control over financial reporting of those financial statements. These are mandatory audits required by the *Chief Financial Officers Act of 1990*, as amended by the *Department of Homeland Security Financial Accountability Act of 2004*. This report is incorporated in the Department's FY 2013 *Agency Financial Report*. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the integrated audit.

The Department continued to improve financial management in FY 2013 and has achieved a significant milestone. This is the first year the Department has received an unmodified (clean) opinion on all financial statements. However, KPMG issued an adverse opinion on DHS' internal control over financial reporting of the FY 2013 financial statements. Further, as stated in the Secretary's Assurance Statement, the Department has material weaknesses in internal control over financial reporting. In order to sustain the unmodified opinion, the Department must continue remediating the remaining control deficiencies.



## Summary

KPMG expressed an unmodified opinion on the Department's balance sheet as of September 30, 2013, and the related statements of net cost, changes in net position, and custodial activity, and combined statement of budgetary resources for the year then ended (referred to as the "FY 2013 financial statements"). However, KPMG identified eight significant deficiencies in internal control, of which four are considered material weaknesses. Consequently, KPMG issued an adverse opinion on DHS' internal control over financial reporting as of September 30, 2013.

The report discusses eight significant deficiencies in internal control, four of which are considered material weaknesses, and four instances of noncompliance with laws and regulations, as follows:

### **Significant Deficiencies That Are Considered To Be Material Weaknesses**

- Financial Reporting
- Information Technology Controls and Financial System Functionality
- Property, Plant, and Equipment
- Budgetary Accounting

### **Other Significant Deficiencies**

- Entity-Level Controls
- Liabilities
- Grants Management
- Custodial Revenue and Drawback

### **Non-compliance with Laws and Regulations**

- *Federal Managers' Financial Integrity Act of 1982 (FMFIA)*,
- *Federal Financial Management Improvement Act of 1996 (FFMIA)*
- *Single Audit Act Amendments of 1996*
- *Anti-deficiency Act (ADA)*

### **Moving DHS' Financial Management Forward**

The Department continued to remediate conditions contributing to material weaknesses and was able to reduce the number of material weaknesses from five in FY 2012 to four in FY 2013. As a result of improvements made by USCG in FY 2012



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regarding environmental liability balances, liabilities were downgraded to a significant deficiency in FY 2013. Additionally, USCG completed several phases of a multi-year remediation plan to address process and control deficiencies related to the property, plant and equipment process. However, certain remediation efforts were not fully completed until late in FY 2013, and additional remediation activities are scheduled for FY 2014. Further, other components experienced challenges in financial reporting resulting in deficiencies in multiple processes.

In FY 2012 the Department provided qualified assurance that internal control over financial reporting was operating effectively at September 30, 2012, and acknowledged that material weaknesses existed in key financial processes. In FY 2013, the Department again issued a statement of qualified assurance and reported that material weaknesses in internal control over financial reporting continued to exist. The material weaknesses reported by the Department in the FY 2013 *Secretary's Assurance Statement* are all repeated from FY 2012. The independent auditors identified and reported the same findings as the Department, and consequently, has issued an adverse opinion on internal controls over financial reporting in FY 2013.

In FY 2014 and beyond, DHS' continuing challenge will be to sustain its progress in achieving an unmodified opinion on its financial statements, and avoid slipping backwards. The Department must continue remediation efforts, and stay focused, in order to sustain its clean opinion on the financial statements and achieve an unqualified opinion on its internal control over financial reporting.

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KPMG is responsible for the attached Independent Auditors' Report dated December 11, 2013, and the conclusions expressed in the report. We do not express opinions on financial statements or internal control or conclusions on compliance with laws and regulations.

Consistent with our responsibility under the *Inspector General Act*, we are providing copies of this report to appropriate congressional committees with oversight and appropriation responsibilities over the Department. In addition, we will post a copy of the report on our public website.

We request that the Office of the Chief Financial Officer provide us with a corrective action plan that demonstrates progress in addressing the report's recommendations.

Please call me with any questions, or your staff may contact Mark Bell, Acting Assistant Inspector General for Audits, at 202-254-4100.

Attachment



## Excerpts from the DHS Annual Financial Report

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## Independent Auditors' Report

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

### Report on the Financial Statements

We have audited the accompanying financial statements of the U.S. Department of Homeland Security (DHS or Department), which comprise the balance sheets as of September 30, 2013 and 2012, and the related 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 financial statements (referred to herein as the fiscal year (FY) 2013 and FY 2012 financial statements).

#### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### *Auditors' Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 14-02 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Department's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. An audit 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 financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the balance sheet as of September 30, 2013, and the statements of net cost, changes in net position, and custodial activity and combined statement of budgetary resources for the year ended September 30, 2013. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion on the FY 2012 financial statements.

#### *Basis for Qualified Opinion on the FY 2012 Financial Statements*

In FY 2012, U.S. Coast Guard (Coast Guard) continued an extensive project to reconcile its financial statement accounts, obtain sufficient evidence to support historical transactions, and prepare auditable financial statements. Coast Guard was unable to complete certain reconciliations or provide evidence supporting certain components of general property, plant, and equipment (PP&E), and heritage and stewardship assets, as presented in the accompanying FY 2012 financial statements and notes. Accordingly,



we were unable to obtain sufficient appropriate audit evidence about the PP&E and heritage and stewardship balance as of September 30, 2012. Consequently, we were unable to determine whether any adjustment to this amount was necessary. The unaudited PP&E balances, as reported in the accompanying balance sheet are \$7.6 billion or approximately 38 percent of total PP&E net book value at September 30, 2012.

#### ***Qualified Opinion on the FY 2012 Financial Statements***

In our opinion, except for the possible effects of the matter described in the Basis for Qualified Opinion on the FY 2012 Financial Statements, the FY 2012 financial statements referred to above present fairly, in all material respects, the financial position of DHS as of September 30, 2012, and its net costs, changes in net position, budgetary resources, and custodial activity for the year ended September 30, 2012, in accordance with U.S. generally accepted accounting principles.

#### ***Opinion on the FY 2013 Financial Statements***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of DHS as of September 30, 2013, and its net costs, changes in net position, budgetary resources, and custodial activity for the year ended September 30, 2013, in accordance with U.S. generally accepted accounting principles.

#### ***Emphasis of Matters***

As discussed in Notes 1T and 15 of the financial statements, the Department has intragovernmental debt of approximately \$24 billion used to finance the *National Flood Insurance Program* (NFIP) as of September 30, 2013. Due to the subsidized nature of the NFIP, the Department has determined that future insurance premiums, and other anticipated sources of revenue, may not be sufficient to repay this debt. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

As discussed in Note 34 to the financial statements, the FY 2012 financial statements have been restated to correct a misstatement in certain property, plant, and equipment, and related balances. Our opinion is not modified with respect to this matter.

#### ***Other Matters***

##### ***Required Supplementary Information***

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis (MD&A), Required Supplementary Information (RSI), and Required Supplementary Stewardship Information (RSSI) sections be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We were unable to complete limited procedures over MD&A as prescribed by professional standards because of the limitations on the scope of our FY 2012 audit described above in the *Basis for Qualified Opinion on the FY 2012 Financial Statements* section of our report. We have applied certain limited procedures to the required RSI (except for the section entitled Deferred Maintenance) and RSSI 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 financial statements, and other knowledge we obtained during our audits of the basic 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 financial statements as a whole. The information in the Message from Acting Secretary, Message from the Acting Chief Financial Officer, and Other Information section, as listed in the Table of Contents of the DHS *Agency Financial Report* is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

### **Report on Internal Control over Financial Reporting**

We have audited DHS' internal control over financial reporting as of September 30, 2013, based on the criteria established in OMB Circular No. A-123, *Management's Responsibility for Internal Control* (OMB Circular A-123), Appendix A. DHS management is responsible for maintaining effective internal control over financial reporting, and for its assertion of the effectiveness of internal control over financial reporting, included in the accompanying *Secretary's Assurance Statement* in the Department's *Agency Financial Report*. Our responsibility is to express an opinion on DHS' internal control over financial reporting based on our audit.

We conducted our audit in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

An entity's internal control over financial reporting is a process affected 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 financial statements.

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

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. The material weaknesses described below and in the accompanying Exhibit I have been identified and included in the *Secretary's Assurance Statement*.

- A. Financial Reporting
- B. Information Technology Controls and Financial Systems Functionality
- C. Property, Plant, and Equipment



#### D. Budgetary Accounting

In our opinion, because of the effect of the material weaknesses described 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, 2013, based on the criteria established in OMB Circular No. A-123, *Management's Responsibility for Internal Control* (OMB Circular A-123), Appendix A. We do not express an opinion or any other form of assurance on management's evaluation and assurances made in the *Secretary's Assurance Statement*.

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 described below and in the accompanying Exhibit II to be significant deficiencies.

- E. Entity-Level Controls
- F. Liabilities
- G. Grants Management
- H. Custodial Revenue and Drawback

The report on internal control over financial reporting is intended solely for the information and use of the DHS management, the DHS Office of the Inspector General, the U.S. Government Accountability Office, and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

#### **Other Reporting Required by *Government Auditing Standards***

##### ***Compliance and Other Matters***

As part of obtaining reasonable assurance about whether DHS' financial statements 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 determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 14-02. 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 14-02, and which are described below and in the accompanying Exhibit III.

- I. *Federal Managers' Financial Integrity Act of 1982*
- J. *Federal Financial Management Improvement Act of 1996*
- K. *Single Audit Act Amendments of 1996*
- L. *Anti-deficiency Act*

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 of FFMIA disclosed instances, as described in Exhibits I, II, and III, where DHS' financial management systems did not substantially comply with the (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.

We also reported other matters related to compliance with the *Anti-deficiency Act* at Coast Guard and Intelligence & Analysis in Exhibit III.



***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 scope of our testing of compliance and the result of that testing, and not to provide an opinion on compliance. Accordingly, this communication is not suitable for any other purpose.

**DHS' Responses to Findings**

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

**KPMG LLP**

December 11, 2013

## **Independent Auditors' Report**

### **Introduction to Exhibits on Internal Control and Compliance and Other Matters**

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Our report on internal control over financial reporting and compliance and other matters is presented in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. The internal control weaknesses in financial reporting, and findings related to compliance with certain laws, regulations, contracts, and grant agreements presented herein were identified during our audit of the U.S. Department of Homeland Security (Department or DHS)'s financial statements as of, and for the year ended, September 30, 2013, and our engagement to audit internal control over financial reporting of those financial statements. Our findings are presented in three exhibits:

- Exhibit I** Findings that individually or in aggregate that are considered material weaknesses in internal control over financial reporting affecting the DHS consolidated financial statements.
- Exhibit II** Findings that individually or in aggregate are considered significant deficiencies that are not material weaknesses, however, should be brought to the attention of DHS management and others in positions of DHS oversight.
- Exhibit III** Instances of noncompliance with certain laws, regulations, contracts, and grant agreements that are required to be reported under *Government Auditing Standards* or Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*.
- Criteria** *Index of Financial Reporting and Internal Control Criteria*
- Attachment** Management's response to our findings

The determination of which findings rise to the level of a material weakness is based on an evaluation of how deficiencies identified in all components, considered in aggregate, may affect the DHS financial statements as of September 30, 2013, and for the year then ended.

We have also performed follow-up procedures on findings identified in previous audits of the financial statements and internal control over financial reporting. To provide trend information for the DHS components, Exhibits I and II contain trend tables next to the heading of each finding. The trend tables in Exhibits I and II depict the severity by color (red boxes where component findings are more severe, and yellow boxes where component findings are less severe), and current status of findings, by component that has contributed to that finding from FY 2011 through FY 2013. Listed in the title of each material weakness and significant deficiency included in Exhibits I and II, are the DHS components that contributed to the finding in FY 2013.

The criteria supporting our findings, such as references from technical accounting standards, various rules and regulations, including requirements issued by the OMB and the U.S. Treasury, and internal Departmental and component directives, are presented in the *Index of Financial Reporting and Internal Control Criteria* behind Exhibit III.

A summary of our findings in FY 2013 and FY 2012 are presented in the Tables below:

- Table 1** Presents a summary of our internal control findings, by component, for FY 2013.  
**Table 2** Presents a summary of our internal control findings, by component, for FY 2012.

We have reported four material weaknesses and four significant deficiencies at the Department level in FY 2013, shown in Table 1.

**Independent Auditors' Report**  
**Introduction to Exhibits on Internal Control and Compliance and Other Matters**

**TABLE 1 – SUMMARIZED DHS FY 2013 INTERNAL CONTROL FINDINGS**  
**(Full-Scope Financial Statement Audit)**

| Comments / Financial Statement Area |   | DHS Consol. | CG                | CBP | USCIS | FEMA | ICE | MGMT | NPPD | USSS | OFM |
|-------------------------------------|---|-------------|-------------------|-----|-------|------|-----|------|------|------|-----|
| <b>Material Weaknesses:</b>         |   |             | <b>Exhibit I</b>  |     |       |      |     |      |      |      |     |
| A                                   | Financial Reporting                     | MW          |                   |     |       |      |     |      |      |      |     |
| B                                   | IT Controls and System Functionality    | MW          |                   |     |       |      |     |      |      |      |     |
| C                                   | Property, Plant, and Equipment          | MW          |                   |     |       |      |     |      |      |      |     |
| D                                   | Budgetary Accounting                    | MW          |                   |     |       |      |     |      |      |      |     |
| <b>Significant Deficiencies:</b>    |   |             | <b>Exhibit II</b> |     |       |      |     |      |      |      |     |
| E                                   | Entity-Level Controls – Department-wide | SD          |                   |     |       |      |     |      |      |      |     |
| F                                   | Liabilities                             | SD          |                   |     |       |      |     |      |      |      |     |
| G                                   | Grants Management                       | SD          |                   |     |       |      |     |      |      |      |     |
| H                                   | Custodial Revenue and Drawback          | SD          |                   |     |       |      |     |      |      |      |     |

**TABLE 2 – SUMMARIZED DHS FY 2012 INTERNAL CONTROL FINDINGS**  
**(Full-Scope Financial Statement Audit)**

| Comments / Financial Statement Area |                                      | DHS Consol. | CG                | CBP | USCIS | FEMA | FLETC | ICE | MGMT | NPPD | TSA |
|-------------------------------------|--------------------------------------|-------------|-------------------|-----|-------|------|-------|-----|------|------|-----|
| <b>Material Weaknesses:</b>         |                                      |             | <b>Exhibit I</b>  |     |       |      |       |     |      |      |     |
| A                                   | Financial Reporting                  | MW          |                   |     |       |      |       |     |      |      |     |
| B                                   | IT Controls and System Functionality | MW          |                   |     |       |      |       |     |      |      |     |
| C                                   | Property, Plant, and Equipment       | MW          |                   |     |       |      |       |     |      |      |     |
| D                                   | Environmental and Other Liabilities  | MW          |                   |     |       |      |       |     |      |      |     |
| E                                   | Budgetary Accounting                 | MW          |                   |     |       |      |       |     |      |      |     |
| <b>Significant Deficiencies:</b>    |                                      |             | <b>Exhibit II</b> |     |       |      |       |     |      |      |     |
| F                                   | Entity-Level Controls                | SD          |                   |     |       |      |       |     |      |      |     |
| G                                   | Grants Management                    | SD          |                   |     |       |      |       |     |      |      |     |
| H                                   | Custodial Revenue and Drawback       | SD          |                   |     |       |      |       |     |      |      |     |

All components of DHS, as defined in Note 1A – *Reporting Entity*, to the financial statements, were included in the scope of our audit of the DHS financial statements as of September 30, 2013, and our engagement to audit internal control over financial reporting of those financial statements. Accordingly, our financial statement audit and engagement to audit internal control considered significant account balances, transactions, and accounting processes of other DHS components not listed above. Control deficiencies identified in other DHS components that are not identified in the table above did not individually, or when combined with other component findings, contribute to a material weakness or significant deficiency at the DHS consolidated financial statement level.

**Independent Auditors' Report**  
**Exhibit I – Material Weaknesses**

**I-A Financial Reporting (USCG, MGMT, NPPD, ICE, USSS, OFM)**

*Background:* During fiscal year (FY) 2013, the U.S. Coast Guard (Coast Guard or USCG) continued to implement corrective action plans designed to remediate long-standing internal control deficiencies and strengthen financial reporting controls. These remediation efforts allowed management to make new assertions in FY 2013 related to the auditability of its financial statement balances, including approximately \$7.6 billion of personal property. However, we noted that deficiencies remain in some financial reporting areas and additional remediation efforts associated with the reconciliation of certain personal and real property balances are scheduled to continue in FY 2014.

Other DHS components, including The Management Directorate (MGMT), National Protection and Programs Directorate (NPPD), U.S. Immigration and Customs Enforcement (ICE), and U.S. Secret Service (USSS) experienced challenges in financial reporting, resulting in deficiencies in multiple processes.

The Office of Financial Management (OFM) is primarily responsible for issuing Departmental accounting policy and guidance, and performs a critical role in the Department's annual risk assessment, and monitoring of financial reporting throughout the year.

Transportation Security Administration (TSA) has made progress in strengthening internal controls over financial reporting in FY 2013.

*Conditions:* We noted the following internal control weaknesses related to financial reporting at Coast Guard, MGMT, NPPD, ICE, USSS, and OFM.

1. Coast Guard:

- Lacked adequate processes to ensure that all non-standard adjustments (i.e., journal entries, top side adjustments, and scripts) impacting the general ledger were adequately researched, supported, and reviewed prior to their recording in the general ledger.
- Has not fully compared existing policies to applicable generally accepted accounting principles (GAAP) and periodically monitored the financial statement impact of “non-GAAP” policies (e.g., imputed financing costs) that were inconsequential.
- Was not able to completely support beginning balance and year-end close-out related activity in its three general ledgers.
- Was not able to identify and reconcile intra-governmental activities and balances and ensure that transactions were coded to the correct trading partner. Additionally, internal controls associated with the periodic confirmation and reconciliation of intergovernmental activity were not fully implemented to ensure identified differences, especially with agencies outside DHS, were resolved in a timely manner.
- Had difficulty sustaining various financial reporting internal control activities, including those designed to ensure the accurate and timely completion of technical accounting research papers. Gaps in the design or operating effectiveness of internal controls were identified in transactional and management reviews associated with various processes including, but not limited to, fund balance with Treasury, accounts receivable, contingent liabilities, property, plant, and equipment,

| <b>Trend Table</b> |             |             |             |
|--------------------|-------------|-------------|-------------|
|                    | <b>2013</b> | <b>2012</b> | <b>2011</b> |
| <b>USCG</b>        |             |             |             |
| <b>MGMT</b>        |             | N/A         | N/A         |
| <b>NPPD</b>        |             | N/A         | N/A         |
| <b>ICE</b>         |             |             | N/A         |
| <b>USSS</b>        |             | N/A         | N/A         |
| <b>OFM</b>         |             | N/A         | N/A         |
| <b>TSA</b>         | C           |             |             |
| <b>USCIS</b>       | C           | C           |             |

| <b>Key – Trend Table</b> |                               |
|--------------------------|-------------------------------|
| C                        | Deficiencies are corrected    |
| N/A                      | No deficiencies reported      |
|                          | Deficiencies are less severe* |
|                          | Deficiencies are more severe* |
| * See Introduction       |                               |

**Independent Auditors' Report**  
**Exhibit I – Material Weaknesses**

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operating materials and supplies, and budgetary accounts. Some of the above weaknesses resulted in adjustments to the current or prior period financial statements.

- Did not always maintain general ledger activity in compliance with the United States Standard General Ledger (USSGL) at the transaction level.

2. MGMT:

- Had not fully designed internal controls to ensure effective monitoring of decentralized operations, and adequate communication with its service provider.
- Had not fully established a financial management infrastructure, including defined roles and responsibilities, and policies and procedures, that ensure consistently reliable, accurate, and timely financial reporting for all significant processes. For example, we noted:
  - Controls were not operating effectively to ensure that capital projects and leases were properly monitored, reviewed, and costs were appropriately recorded and disclosed;
  - Controls were not fully effective over expenses, payroll, including timesheet review, and review of invoices prior to disbursement, and timely adjustment of suspense balances at year end; and
  - Lack of documented policies and procedures to ensure the working capital funds are identified for proper recording by components.
- Was not fully compliant with the USSGL requirements at the transaction level.
- Internal controls over financial reporting were not operating effectively, which impaired MGMT's ability to respond to audit inquiries and provide auditable transaction populations with accurate information without reliance on the general ledger service provider.

3. NPPD:

- Had not fully designed internal controls to ensure effective monitoring of its decentralized operations, and ensure adequate communication with its service provider, and consistently reliable, accurate, and timely financial reporting for all significant processes. For example we noted:
  - Controls were not operating effectively to ensure that capital assets were timely and accurately recorded in the asset sub-ledger and general ledger; and
  - A lack of adequate policies and procedures over accruals of revenue where services were performed but not recorded, as well as policies to ensure timely research and resolution of reconciling items to fund balance with Treasury.
- Was not fully compliant with the USSGL requirements at the transaction level.
- Controls were not fully effective to provide readily auditable populations with accurate information without reliance on the general ledger service provider.

4. ICE:

- Supervisory review controls over journal vouchers, account reconciliations, and analysis were not operating effectively. Some of these deficiencies resulted in adjustments to the current or prior period financial statements.
- Did not always adhere to or reinforce compliance with existing policies and procedures.
- Lacked policies and procedures and associated controls to ensure that all key input data was valid (complete, accurate) and recorded timely.
- Lacked controls over monitoring and tracking capital assets including timely capitalization and appropriate depreciation of capital assets, internal use software, and leasehold improvements.

## Independent Auditors' Report

### Exhibit I – Material Weaknesses

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- Controls were not fully effective to provide readily auditable transaction populations with accurate supporting information.
  - Was not fully compliant with the USSGL requirements at the transaction level.
5. USSS:
- Internal controls over recording the actuarially derived pension expense and loss were not operating effectively, resulting in an incorrect journal entry and a financial statement error in the presentation of changes in long-term assumptions.
6. OFM:
- Controls over the preparation and review of consolidated financial information were not always operating effectively. For example, management review controls over contingent legal liabilities, lease disclosures, elimination analysis, and non-GAAP analysis were not fully effective in identifying errors or analyzing information.
  - Controls did not always operate at the designed level of precision to perform an effective quality review of information submitted by components. Consequently, deficiencies in component level reviews and analysis of financial information, sent to OFM, may not be identified.
  - Controls were not fully effective to ensure the consistent understanding and application of guidance issued by OFM to the components.

*Cause/Effect:* The Coast Guard's three legacy general ledger systems, developed over a decade ago, were not effective, and had severe functional limitations contributing to the Coast Guard's inability to address pervasive internal control weaknesses in financial reporting, strengthen the control environment, and comply with relevant Federal financial system requirements and guidelines, notably Comment **III-J**, *Federal Financial Management Improvement Act of 1996* (FFMIA). Also see information technology (IT) system functionality issues described at Comment **I-B**, *Information Technology Controls and Financial Systems Functionality*. The Coast Guard utilized a redundant general ledger system with duplicate transaction postings as a compensating control to mitigate identified financial reporting deficiencies, resulting in highly inefficient financial reporting processes. The conditions supporting our findings collectively limited the Coast Guard's ability to consistently process, store, and report financial data in a manner that ensured accuracy, confidentiality, integrity, and availability of data without substantial manual intervention.

NPPD and MGMT used ICE as a general ledger service provider, and for several years relied on ICE to ensure financial statement integrity. In recent years, NPPD and MGMT have assumed more responsibility for financial management functions to help manage their operations and budgets. An intra-agency agreement between ICE and NPPD and MGMT defines the roles and responsibilities of each component, however there was a control gap between the services provided by ICE (in accordance with an intra-agency agreement), and the procedures and processes performed by NPPD and MGMT, leading to a number of control deficiencies in financial reporting at those components. Additionally, NPPD and MGMT's financial management resources were limited and some operations were unique and decentralized. Additionally, MGMT's overall operational functions, including the Working Capital Fund, were complex and diverse.

ICE faced challenges in developing and maintaining communications that affect financial reporting throughout decentralized program offices.

The USSS did not properly interpret the annual report provided by the pension actuary, resulting in an erroneous journal entry to record the effects of assumption changes on pension expense.

The DHS OFM restructured staffing and quality control positions in the current year. Roles and responsibilities within OFM were not always clearly understood, and as a result, the quality of analysis of financial statement information was sometimes lacking. This resulted in control gaps allowing a number of errors to occur.

## **Independent Auditors' Report**

### **Exhibit I – Material Weaknesses**

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Because of the conditions noted above, and described throughout Exhibits I and II, the Department was unable to provide full assurance that internal controls over financial reporting were operating effectively at September 30, 2013. Management has acknowledged in the *Secretary's Assurance Statement* presented in *Management's Discussion and Analysis* section of the FY 2013 *Agency Financial Report* that material weaknesses and other internal control deficiencies continue to exist in some key financial processes. Also see Comment **III-I**, *Federal Managers' Financial Integrity Act of 1982*.

*Criteria:* Presented in *Index of Financial Reporting and Internal Control Criteria*, after Exhibit III.

*Recommendations:* We recommend that:

1. Coast Guard:
  - a. Establish new or improve existing policies, procedures, and related internal controls to ensure that:
    - i) All non-standard adjustments (i.e., journal entries, top side adjustments, and scripts) impacting the general ledger are adequately researched, supported, and reviewed prior to their recording in the general ledger;
    - ii) All “non-GAAP” policies are identified and their quantitative and qualitative financial statement impacts have been documented;
    - iii) The year-end close-out process, reconciliations, and financial data and account analysis procedures are supported by documentation, including evidence of effective management review and approval, and beginning balances in the following year are determined to be reliable and auditable; and
    - iv) All intra-governmental activities and balances are reconciled on a timely basis, accurately reflected in the financial statements, and differences are resolved in a timely manner.
  - b. Implement financial reporting policies and procedures that support process level internal controls to ensure that existing transactional and management review internal control activities are operating effectively; and
  - c. Implement accounting and financial reporting processes including an integrated general ledger system that is FFMIA compliant.
2. MGMT:
  - a. Improve communications with its general ledger service provider to ensure that general ledger activity is accounted for timely, completely and accurately;
  - b. Consider changes to the financial accounting and reporting structure to ensure effective internal control including supervisory reviews in all financial reporting processes;
  - c. Examine existing policies and procedures and consider updates and new policies to accommodate different operating environments such as the Working Capital Fund;
  - d. Establish processes and internal controls to ensure compliance with the USSGL requirements at the transaction level; and
  - e. Improve the accessibility of reliable and complete financial data for use by management and to support the annual audit.
3. NPPD:
  - a. Design and implement internal controls that ensure effective monitoring and communication of financial policies and procedures throughout the NPPD organization;
  - b. Examine key financial reporting processes for critical deficiencies in financial policies, establish procedures, and internal controls, and develop and implement corrective action plans, to ensure the accuracy and completeness of NPPD financial statements;

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**Exhibit I – Material Weaknesses**

- c. Establish processes and internal controls to ensure compliance with the USSGL requirements at the transaction level;
  - d. Consider changes to the financial reporting structure, or the service level agreement with ICE, to ensure effective control in all financial reporting processes at NPPD; and
  - e. Continue to analyze alternatives, including evaluation of systems, to enable FFMIA compliance.
4. ICE:
- a. Emphasize and train employees on the critical aspects of key transactional and supervisory review controls including the precision of the review, the need for supporting documentation, and impact to the financial statements;
  - b. Assess resource needs and assign sufficient staff to respond to audit inquiries with accurate and complete information in a timely manner;
  - c. Continue to analyze alternatives, including evaluation of systems, to enable FFMIA compliance; and
  - d. Establish processes and internal controls to ensure compliance with the USSGL requirements at the transaction level.
5. U.S. Secret Service evaluate the effectiveness of its review and understanding over the actuarial pension estimate, to ensure the appropriate review and recording of pension expense, gains, and losses.
6. The DHS OFM:
- a. Perform a review of its personnel structure in FY 2014, considering the turn-over in management and restructuring of responsibilities in FY 2013, to ensure that resources are committed to areas of greatest financial statement risk, and to improve the organization, facilitation, and controls over processes that involve multiple components; and
  - b. Strengthen management review controls that involve analysis of component data to provide effective quality reviews of component data. Consider separating the gathering and consolidation of data, from the analysis function to improve the effectiveness of review controls.
  - c. Implement procedures to ensure application of policies is consistently performed throughout the Department. For example, computation and reporting of minimum future lease disclosures.

**I-B Information Technology Controls and Financial System Functionality (USCG, CBP, USCIS, FEMA, ICE)**

*Background:* During our FY 2013 assessment of IT general and application controls, we noted that the DHS components made progress in the remediation of IT findings we reported in FY 2012. We closed approximately 45 percent of our prior year IT findings. However, new findings were noted at all DHS components in FY 2013.

We also considered the effects of financial system functionality when testing internal controls and evaluating findings. Many key DHS financial systems were not compliant with Federal financial management system requirements as defined by FFMIA and OMB Circular Number A-127, *Financial Management Systems*, as revised. DHS financial system functionality limitations add substantially to the Department’s challenges of addressing systemic internal control weaknesses, and limited the Department’s ability to leverage IT systems to effectively and efficiently process and report financial data.

|                                    | 2013  | 2012  | 2011  |
|------------------------------------|-------|-------|-------|
| USCG                               | Green | Green | Red   |
| CBP                                | Green | Green | Green |
| USCIS                              | Green | Green | Green |
| FEMA                               | Green | Red   | Red   |
| ICE                                | Green | Green | Green |
| See page I.1 for table explanation |       |       |       |

## **Independent Auditors' Report**

### **Exhibit I – Material Weaknesses**

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As noted in the chart on the right, the IT findings in each of the component listed are “less severe” (as defined in the Introduction to the Exhibits); however, the combination of IT findings from all components is considered a material weakness. In FY 2013, and recent years, the components have made good progress in remediating IT general control deficiencies, and in general, the severity of remaining deficiencies has diminished. However, when IT general control deficiencies that continued to exist in FY 2013 are combined with the risks of financial statement error caused by limitations in IT functionality (see below), the over all IT risk to the Department is elevated.

*Conditions:* Our findings, which were a cross-representation of general IT control deficiencies identified throughout the Department’s components and financial systems functionality, follow:

*Related to IT General Controls:*

1. *Access Controls:*

- Policies and procedures for key financial applications had not been developed to identify elevated access at the application level.
- Management of application, database, network, and remote user accounts was inadequate or inconsistent.
- Safeguards over logical and physical access to sensitive facilities and resources were not always effective.
- Generation, review, and analysis of system audit logs were not always adequate or consistent.
- Access of authorized personnel to sensitive areas containing key financial systems was sometimes more than needed, and data center access controls were not properly enforced.
- Transferred and/or terminated employees were not always timely removed from financial systems, and policies related to revocation of system access were not always implemented or finalized.
- Some interconnection security agreements (ISA) were expired and not updated.

2. *Configuration Management*

- Configuration management policies and procedures were not always documented.
- Security patch management and configuration deficiencies were identified during the vulnerability assessment on the platforms supporting the key financial applications and general support systems.
- Evidence to support authorized modifications to key financial systems was not always maintained.
- Monitoring controls were not always implemented for key financial systems to ensure the completeness and integrity of records of implemented system changes.
- Management of administrator access to move code within and between environments was sometimes inadequate or inconsistent.

3. *Security Management:*

- Required security authorization activities and supporting artifacts for key financial systems were not always completed and documented.
- Controls to monitor compliance with requirements for role-based training for personnel with significant information security responsibilities were not always consistently implemented, and documentation of individuals subject to role-based training requirements was sometimes incomplete.

## Independent Auditors' Report

### Exhibit I – Material Weaknesses

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- Federal employees and contractors did not consistently adhere to DHS and component policies, guidance, and security awareness training concerning the protection of sensitive assets and information from unauthorized access or disclosure.

#### 4. *Contingency Planning:*

- Service continuity plans were not always tested, and an alternate processing site has not been established for high risk systems.
- Backup policies and procedures were inconsistently documented.
- Backup parameters were not always properly implemented or managed.

#### 5. *Segregation of Duties:*

- Implementation of segregation of duties for IT and financial management personnel with access to financial systems across several platforms was inadequate or incomplete.

#### *Related to financial system functionality:*

We noted many cases where financial system functionality was inhibiting DHS' ability to implement and maintain internal controls, notably IT application controls supporting financial data processing and reporting. Financial system functionality limitations also contribute to other control deficiencies reported in Exhibits I and II, and compliance findings presented in Exhibit III. We noted persistent and pervasive financial system functionality conditions at all of the significant DHS components in the following general areas:

- At one component, IT systems have unique functionality issues due to numerous variables, most of which were not within the control of the component. Production versions of financial systems were outdated and did not provide the necessary core functional capabilities. The component had installed extensive workarounds, redundant and overlapping systems, and numerous manual reconciliation processes, as necessary to produce auditable financial statements. Some of these workarounds and systems were installed as the only means to validate actual data in the various general ledgers, and support the financial statements. In many cases, the IT systems were not designed to allow the component to install and use routine automated controls to assist with efficient, reliable, financial processing.
- At another component, multiple financial IT systems continued to be impaired by functionality limitations which prevent implementation of effective security controls. These limitations, which principally impact audit logging controls intended to monitor logical access and configuration management activities, were being addressed through enterprise-wide solutions which were not fully implemented at the time of our audit procedures. Additionally, certain feeder systems were operating with outdated and unsupported system software components which exposed them to vulnerabilities that cannot be mitigated.
- Several financial systems have limited capacity to process, store, and report financial and performance data to facilitate decision making, safeguarding and management of assets, and prepare financial statements that comply with GAAP.
- One financial system lacked the controls necessary to prevent or detect and correct excessive drawback claims. Specifically, the programming logic for the system did not link drawback claims to imports at a detailed, line item level.
- Technical configuration limitations, such as outdated systems that were no longer fully supported by the software vendors, impaired DHS' ability to fully comply with policy in areas such as IT security controls, notably password management, audit logging, user profile changes, and the restricting of access for off-boarding employees and contractors.

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**Exhibit I – Material Weaknesses**

- System capability limitations prevent or restrict the use of applications controls to replace less reliable, more costly manual controls; or in some cases, required additional manual controls to compensate for IT security or control weaknesses.
- Some IT subsidiary modules that could improve controls and reliability were not active due to various system design and integrity reasons.
- Some IT system controls were not designed to prevent the receipt of goods and services in excess of available funding.

*Cause/Effect:* DHS management recognized the need to upgrade its financial systems. Until serious legacy IT issues are addressed and updated IT solutions implemented, compensating controls and other complex manual workarounds must support its IT environment and financial reporting. As a result, DHS' difficulty attesting to a strong control environment, to include effective general IT controls and reliance on key financial systems, will likely continue.

The conditions supporting our findings collectively limit DHS' ability to process, store, and report financial data in a manner to ensure accuracy, confidentiality, integrity, and availability. Some of the weaknesses may result in material errors in DHS' financial data that were not detected in a timely manner through the normal course of business. In addition, because of the presence of IT control and financial system functionality weaknesses; there is added pressure on mitigating controls to operate effectively. Because mitigating controls were often more manually focused, there is an increased risk of human error that could materially affect the financial statements.

*Recommendation:* We recommend that the DHS Office of the Chief Financial Officer (OCFO) in coordination with the Office of the Chief Information Officer (OCIO), continue the *Financial Systems Modernization* initiative, and make necessary improvements to the Department's financial management systems and supporting IT security controls. Specific recommendations were provided in separate letters provided to DHS management.

**I-C Property, Plant, and Equipment (USCG, CBP)**

*Background:* The Coast Guard maintained approximately 50 percent of all DHS general property, plant, and equipment (PP&E). Many of the Coast Guard's assets were constructed over a multi-year period, have long useful lives, and undergo extensive routine servicing that may increase their value or extend their useful lives.

In FY 2013, the Coast Guard completed several phases of a multi-year remediation plan to address process and control deficiencies related to the PP&E process. However, certain remediation efforts were not fully completed until late in FY 2013, and additional remediation activities are scheduled for FY 2014. Consequently, most of the conditions cited below have been repeated from our FY 2012 report.

CBP continued to perform remediation to address deficiencies in the timely recording of capitalized costs and in the classification of PP&E between construction in progress (CIP) and "in-use." As a result, several of the conditions were repeated from our FY 2012 report. CBP's deficiencies were mostly concentrated in construction at its various facilities.

MGMT acquired a substantial amount of assets in recent years through the construction and development of its headquarters campus and leasehold improvements. Control deficiencies affecting PP&E were financial reporting in nature and have been grouped with conditions cited at Comment I-A, *Financial Reporting*.

|   | 2013 | 2012 | 2011 |
|---|------|------|------|
| USCG  |      |      |      |
| CBP   |      |      |      |
| MGMT  | **   | C    |      |
| ICE   | **   |      | N/A  |
| TSA   | C    | C    |      |
| ** See Comment I-A <i>Financial Reporting</i> |      |      |      |
| See page I.1 for table explanation            |      |      |      |

## Independent Auditors' Report

### Exhibit I – Material Weaknesses

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ICE made progress in remediation of PP&E control deficiencies in FY 2013. The conditions that remain were related to financial reporting. See Comment **I-A**, *Financial Reporting*.

*Conditions:* We noted the following internal control weaknesses related to PP&E at Coast Guard, and CBP:

1. USCG did not:

- Fully implement existing policies and procedures for personal property and CIP balances. For example, Coast Guard did not:
  - Implement sufficient internal controls and related processes to support interim PP&E balances and activity, including the identification and timely recording of leasehold improvements, asset impairments, and CIP activity;
  - Transfer completed assets from CIP to in-use assets in a timely manner;
  - Adhere to established inventory policies and procedures. For example, those regarding asset identification, system mapping, and tagging processes, to clearly differentiate and accurately track personal property assets to the fixed assets system; and
  - Sufficiently support all assumptions, underlying data, and adjustments associated with direct and indirect costs for CIP projects.
- Fully implement policies, procedures, and effective controls to ensure the accuracy of all underlying data elements and assumptions used to record certain estimated personal and real property balances, including electronic, internal-use software, land, buildings and other structure assets, including leasehold improvements, particularly when applying Statement of Federal Financial Accounting Standard (SFFAS) No. 35, *Estimating the Historical Cost of General Property, Plant, and Equipment* to estimate PP&E balances.
- Identify and evaluate all lease agreements to ensure that they were appropriately categorized as operating or capital, and properly reported in the financial statements and related disclosures.
- Fully design and implement policies and procedures to support the completeness, accuracy, and existence of all data utilized (e.g., real property multi-use assets) in developing required financial statement disclosures, and related supplementary information, for stewardship PP&E.

2. CBP:

- Did not consistently adhere to policies and procedures to properly account for asset purchases, construction, depreciation, or disposal of assets in a timely manner. For example, CBP did not:
  - Ensure all asset additions are recorded accurately and timely in the financial statements;
  - Reclassify certain assets from CIP to in-use assets in a timely manner; and
  - Record some asset disposals timely and in accordance with policy.

*Cause/Effect:* The Coast Guard has had difficulty establishing its opening PP&E balances and accounting for leases, primarily because of poorly designed policies, procedures, and processes implemented more than a decade ago, combined with ineffective internal controls, and IT system functionality difficulties. See Comment **I-B**, *Information Technology Controls and Financial System Functionality*. The Coast Guard was required to apply SFFAS No. 35 to estimate and present auditable PP&E balances. While applying SFFAS No. 35, the Coast Guard used various assumptions to project balances that required procedures outside the normal business processes, financial reporting controls, and presented unique documentation challenges for the Coast Guard.

Personnel within CBP's highly dispersed operations did not consistently adhere to established policies and procedures for recording PP&E costs, and did not have sufficient oversight, including monitoring controls

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**Exhibit I – Material Weaknesses**

over ongoing CIP projects, to ensure that all PP&E transactions were recorded timely and accurately in the general ledger.

*Criteria:* Presented in *Index of Financial Reporting and Internal Control Criteria*, after Exhibit III.

*Recommendations:* We recommend that:

1. Coast Guard:
  - a. Continue with planned remediation efforts, and adhere to existing policies and procedures associated with PP&E balances in FY 2014. Specifically, continue to implement controls over the transfer of completed CIP assets to in-use, accurately recording leasehold improvements, asset impairments, and CIP activity;
  - b. Fully adhere to established inventory policies and procedures;
  - c. Establish new or improve existing policies, procedures, and related internal controls to sufficiently support all assumptions, and underlying data for estimated personal and real property balances, including electronic, internal-use software, land, buildings and other structure assets;
  - d. Establish new or improve existing processes to identify and evaluate lease agreements to ensure that they are appropriately classified as operating or capital, and are properly reported in the financial statements and related disclosures; and
  - e. Develop and implement procedures to support the completeness, accuracy, and existence of all data utilized (e.g., real property multi-use assets) in developing required financial statement disclosures, and related supplementary information, for stewardship PP&E.
2. CBP:
  - a. Reinforce existing policies and procedures for recording asset additions, reclassifications, and retirements; and
  - b. Continue to enhance supervisory review and monitoring controls to review PP&E transactions in a timely manner.

**I-D Budgetary Accounting (USCG, FEMA, ICE, NPPD, MGMT)**

*Background:* The Coast Guard, Federal Emergency Management Agency (FEMA), and ICE continued to improve policies and procedures associated with budgetary accounting processes in FY 2013; however, some control deficiencies reported in FY 2012 remain, and new deficiencies were identified.

NPPD had deficiencies in budgetary accounting and related revenue accounting. The root cause of the deficiencies noted were similar to those noted at Comment **I-A**, *Financial Reporting*.

MGMT was responsible for the operations and financial oversight of several programs including the DHS Working Capital Fund. The Working Capital Fund provided shared services to DHS agencies. Control deficiencies affecting budgetary accounting were similar to the deficiencies noted in the overall financial reporting process cited at Comment **I-A**, *Financial Reporting*.

|                                    | 2013 | 2012 | 2011 |
|------------------------------------|------|------|------|
| USCG                               |      |      |      |
| FEMA                               |      |      |      |
| ICE                                |      |      | N/A  |
| NPPD                               |      | N/A  | N/A  |
| MGMT                               |      |      | N/A  |
| FLETC                              | C    |      | N/A  |
| See page I.1 for table explanation |      |      |      |

The Federal Law Enforcement Training Centers (FLETC) had made progress in correcting the budgetary control deficiencies we reported in FY 2012.

*Conditions:* We noted the following internal control weaknesses related to budgetary accounting at Coast Guard, FEMA, ICE, NPPD and MGMT:

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**Exhibit I – Material Weaknesses**

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1. Coast Guard:

- Lacked adequate processes to ensure the timely de-obligation of undelivered orders and recordation of new obligations during the fiscal year-end.
- Did not effectively complete management reviews over the monthly reconciliations of the SF-132, *Apportionment and Reapportionment Schedule*, to the SF-133, *Report on Budget Execution and Budgetary Resources*.

2. FEMA:

- Does not have effective controls over obligations, timely deobligations, and payments, and could not readily provide all supporting documentation.
- Did not properly review budgetary funding transactions recorded in the general ledger.
- Did not effectively complete management reviews over the monthly reconciliations of the SF-132, *Apportionment and Reapportionment Schedule*, to the SF-133, *Report on Budget Execution and Budgetary Resources*.

3. ICE:

- Controls were not operating effectively to ensure obligation and expense transactions were timely recorded in the general ledger.
- Policies and procedures were not fully documented to ensure that budgetary subsidiary accounts were reconciled to the general ledger and adjustments, if needed, were recorded timely.
- Lacks IT system controls to ensure expenditures were within budgetary limits, that also impact internal controls of other IT system users such as NPPD and MGMT.

4. NPPD:

- Lacked processes to ensure that recoveries of prior year expired funds were recorded timely.
- Lacked documented and effective policies and procedures to ensure that unfilled customer orders were timely adjusted when matching UDO balances were deobligated or adjusted.
- Controls were not operating effectively over reconciliations of budgetary accounts, timely recording of obligations, and over periodic adjustments to obligations.

5. MGMT:

- Had ineffective controls over budgetary accounting including timely recording of obligations, timely deobligations, and reconciliation of balances.

*Cause/Effect:* The Coast Guard's decentralized structure enabled obligations to be made throughout the country by various authorized personnel, contributed to the challenge of enforcing existing policies, procedures, and internal controls surrounding budgetary accounting and had caused various control gaps in the internal control environment. Additionally, financial system functionality issues prohibited the Coast Guard from implementing and maintaining automated internal controls to supplement their existing manual controls. For example, the Coast Guard relied on manual workarounds to identify undelivered orders since the budgetary module of the financial system was not active. Also see Comment **I-B**, *Information Technology Controls and Financial System Functionality*. Weak controls in budgetary accounting increase the risk that the Coast Guard will misstate budgetary balances, and may lead to unintentional violation of the *Anti-deficiency Act* by overspending its budget authority.

FEMA's administrative functions were geographically separated from programmatic operations, which present a challenge for consistent enforcement of policy. Certain offices within FEMA did not have effective document maintenance policies and procedures, making the retrieval of certain supporting

## Independent Auditors' Report

### Exhibit I – Material Weaknesses

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documentation difficult. FEMA's existing IT systems were not effective in facilitating a network of strong internal controls over administrative functions that were highly decentralized. See Comment **I-B**, *Information Technology Controls and Financial System Functionality*. We noted that for certain undelivered order balances, significant effort was required to coordinate and identify the responsible parties, to access certain files, locate files, or to provide information in a form that clearly supported the balances reported in the financial statements. Without adequate documentation, FEMA was unable to support the validity of obligation status. In addition, FEMA personnel have not fully adhered to the existing procedures for the recording of funding transactions because of lack of oversight by management. As a result, FEMA's financial information submitted to DHS for financial statement purposes may contain budgetary account errors. Currently, FEMA does not have effective monitoring controls to ensure that the monthly review of the SF-132 to SF-133 reconciliation identifies and properly remediates all variances within established timeframes. These deficiencies could cause the current status of FEMA funds to be incorrectly reported.

ICE's budget processes, including obligation and funds management, were significantly impacted by the continuing resolutions and sequestration that occurred in FY 2013, making it difficult for ICE to ensure that funding exists, and is maintained through the entire period of performance, before receipt of goods and services. Without adequate funds management, ICE may unintentionally violate the *Anti-deficiency Act* by overspending its budget authority. Also see Comment **I-B**, *Information Technology Controls and Financial System Functionality*.

NPPD and MGMT use the same IT systems as ICE, and therefore similar IT systems functionality issues also affect NPPD and MGMT. In addition, NPPD and MGMT have not fully implemented policies and procedures over obligations and funds management processes.

*Criteria:* Presented in *Index of Financial Reporting and Internal Control Criteria*, after Exhibit III.

*Recommendations:* We recommend that:

1. Coast Guard:
  - a. Adhere to existing policies and procedures related to processing obligation transactions and the periodic review and validation of undelivered orders. In particular, emphasize the importance of performing effective reviews of open obligations, obtaining proper approvals, and retaining supporting documentation;
  - b. Continue with current remediation efforts to develop and implement policies, procedures, and internal controls over the monitoring of reimbursable agreements and unfilled customer orders to ensure activity, including close-out and de-obligation, is recorded timely and accurately;
  - c. Implement sufficient policies and procedures for timely recording the appropriate budgetary entries upon receipt of goods, and prior to payment; and
  - d. Develop and implement monitoring controls to ensure that management reviews of the monthly SF-132 to SF-133 reconciliations are completed timely and effectively.
2. FEMA:
  - a. Enforce existing policies that require timely review and de-obligation of undelivered orders. Continue to improve procedures for storing and locating documentation supporting undelivered order information, including points of contact, so that supporting information is readily available for management review and audit purposes. Implement procedures to ensure that obligations recorded in the general ledger agreed to the approved obligation amounts;
  - b. Implement improved review procedures for budgetary funding transactions recorded in the general ledger; and
  - c. Develop and implement monitoring controls to ensure that management reviews of the monthly SF-132 to SF-133 reconciliations are completed timely and effectively.
3. ICE:

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**Exhibit I – Material Weaknesses**

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- a. Improve controls over the verification and validation of undelivered orders to identify outstanding obligations that need to be closed out and/or adjusted for financial statement presentation;
  - b. Implement policies and procedures to ensure that financial managers work with field office personnel to perform a rigorous review of the open obligations and maintain appropriate documentation of these reviews;
  - c. Improve the process of recording recoveries and upward adjustments of prior year obligations, including identification and adjustment for offsetting transactions; and
  - d. Implement an effective process to match advances to obligations at the transaction level.
4. NPPD:
- a. Develop and implement processes to ensure that recoveries of prior year expired funds and adjustments to unfilled customer orders are recorded timely;
  - b. Improve controls over the verification and validation of undelivered orders to identify outstanding obligations that need to be closed out and/or adjusted for financial statement presentation; and
  - c. Improve controls over reconciliations of budgetary accounts, and accurate recording of apportionments and obligations, and over periodic adjustments to obligations.
5. MGMT:
- a. Develop and implement improved controls over budgetary accounting to ensure timely recording of apportionments and obligations, timely deobligations of invalid obligations, and reconciliation of balances.

## Independent Auditors' Report

### Exhibit II – Significant Deficiencies

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#### II-E Entity-Level Controls (Department-wide)

*Background:* Entity-level controls encompass the over-all control environment throughout the entity. This includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance, and management concerning the entity's internal control and its importance in the entity. Entity-level controls are often categorized as environmental controls, risk assessment, monitoring and information and communications, as defined by the *Committee of Sponsoring Organizations* of the Treadway Commission (COSO) (1992 version), and the Government Accountability Office (GAO). These controls must be effective, to create and sustain an organizational structure that is conducive to reliable financial reporting.

The Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, (OMB Circular No. A-123) assessment is also designed to assist with management's evaluation of control effectiveness and the remediation of control deficiencies, in accordance with an OMB approved plan.

The conditions below should be read in conjunction with Comment **I-B**, *Information Technology Controls and Financial System Functionality*, which describes entity-level control weaknesses related to Department and component IT systems, and Comment **I-A**, *Financial Reporting*.

#### *Conditions and Recommendations:*

During our audit we noted certain control deficiencies, and underlying causes that were similar and pervasive throughout the Department. The resulting recommendations, to correct the deficiencies, are based on improvements in management's risk assessments, monitoring activities, and communications throughout the Department and components; including – control categories beyond process-level controls. Accordingly, the entity-level control deficiencies described below apply to the Department as a whole.

*Risk Assessments:* The Department and its components have not fully developed their risk assessment processes. As a result, events and transactions that have a greater likelihood of error are not always receiving an appropriate level of attention. Risk assessments should be improved at both the Department level by OCFO, and individual components annually, and updated during the year as needed. Examples of areas that should be addressed annually and updated periodically in the risk assessment are:

- Needs for policy, guidance, new processes, or implementation of standardized processes around new or significant financial transactions or events (e.g., accounting and disclosure implications around major disaster events, or new activities such as the construction of the DHS headquarters facility).
- Needs for technical and resource support to remediate severe control deficiencies and other areas where material financial statement errors could occur and not be identified and corrected timely.
- Training needs assessments for personnel to match skills with roles and responsibilities, and identify gaps that could lead to financial statement error.
- Smaller components that do not have the resources to fully support a separate financial management infrastructure should work with the Department to identify financial accounting and reporting risks, and close control gaps.
- Identification of financial accounts and transactions that are susceptible to error due to weaknesses in IT general controls and IT systems functionality (e.g., limitations in budgetary subsidiary IT systems). See Comment **I-B**, *Information Technology Controls and Financial System Functionality*.

**Independent Auditors' Report**  
**Exhibit II – Significant Deficiencies**

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*Communications and Information:* Communications between the Department and components should be improved to ensure:

- Consistency in application of guidance and accounting policy (e.g., such as disclosures for future minimum lease payments in the financial statements, coordination of year-end close and recording top-side journal entries, and review of the effects of non-GAAP policies).
- Understanding of roles and responsibilities between components and shared services providers (e.g., between ICE and NPPD and MGMT).
- Roles and responsibilities of program and field personnel that provide key financial information are fully defined and that those personnel understand and comply with policies.

*Monitoring Controls:* The Department and each component should design monitoring controls around its annual risk assessment to ensure transactions with higher risk of error are adequately monitored. Components with effective detective monitoring controls should look for opportunities to implement more reliable controls earlier in the process to prevent errors at the transaction source. In addition, detective controls intended to compensate or mitigate weak preventive or process-level controls (e.g., management review controls of the financial statements), are not always designed at a level of precision to identify a significant error. Consequently, errors or a combination of errors in the financial statements could go undetected.

The Department’s control environment, including executive level support for strong internal controls, continued progress in remediation of control deficiencies, and progress in resolving financial IT systems weaknesses will be critical to sustaining auditable financial statements in the future. These conditions were further evidenced through control deficiencies cited at Comment **I-A**, *Financial Reporting*.

*Cause/Effect:* Is described within the *Conditions and Recommendations* above.

*Criteria:* Presented in *Index of Financial Reporting and Internal Control Criteria*, after Exhibit III.

**II-F Liabilities (USCG)**

*Background:* The USCG made progress in correcting the control deficiencies around liabilities reported in FY 2012.

*Conditions:* We noted the following internal control weaknesses related to liabilities at USCG:

USCG:

- Did not adhere to its policies and procedures adopted in FY 2012 to update, maintain, and review schedules tracking environmental liabilities where Coast Guard was not the primary responsible party (e.g., Formerly Used Defense Sites).
- Process for validation of the prior year accounts payable estimates was not properly designed and implemented in FY 2013 as planned.
- Controls over the calculation and recording of contingent legal liabilities did not operate effectively, resulting in errors in calculation of the payout rates for various claim categories, and one claim category was not accurately recorded.

*Cause/Effect:* In addition to the effects described in the conditions above:

The Coast Guard devoted considerable attention and resources to fulfilling its commitment to complete remediation of PP&E balances and produce auditable financial statements in FY 2013, causing procedures over some other financial statement accounts to be deferred or not performed in FY 2013.

*Criteria:* Presented in *Index of Financial Reporting and Internal Control Criteria*, after Exhibit III.

|                                    |             |             |             |
|------------------------------------|-------------|-------------|-------------|
|                                    | <u>2013</u> | <u>2012</u> | <u>2011</u> |
| USCG                               |             |             |             |
| See page I.1 for table explanation |             |             |             |

**Independent Auditors' Report**  
**Exhibit II – Significant Deficiencies**

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*Recommendation:* We recommend that:

1. The Coast Guard complete a risk assessment at the beginning of FY 2014 to identify financial statement and control risk exposure in financial statement account balances. With the completion of PP&E remediation in FY 2013, the Coast Guard should reconsider resource needs, and direct appropriate management attention to address financial statement and control risks.

**II-G Grants Management (FEMA only)**

*Background:* FEMA was the primary grant-making component of DHS, managing multiple Federal disaster and non-disaster grant programs.

*Conditions:* Although FEMA remediated the prior year site visit monitoring findings, the following previously reported internal control weaknesses related to grants management remain in the current year.

|                                    |      |      |      |
|------------------------------------|------|------|------|
|                                    | 2013 | 2012 | 2011 |
| FEMA                               |      |      |      |
| See page I.1 for table explanation |      |      |      |

FEMA:

- Did not compile a complete list of grantees requiring single audits to fully comply with the *Single Audit Act Amendments of 1996 (Single Audit Act)* and related OMB Circular No. A-133, *Audits of States, Local Governments, and Nonprofit Organizations* (OMB Circular A-133). See Comment **IV-K**, *Single Audit Act Amendments of 1996*.
- Did not issue Management Decision Letters timely for OMB Circular A-133 audit reports available in the Federal Audit Clearinghouse.
- Did not maintain accurate and timely documentation related to reviews performed of grantees' OMB Circular A-133 audit reports.
- Did not consistently follow-up with grantees who have failed to submit quarterly financial reports timely.
- Did not consistently maintain documentation necessary to support grant-related activities.
- Did not consistently and effectively reconcile grantee quarterly financial reports to FEMA systems.
- Did not have a process in place to create and track comprehensive lists of FEMA grants that were eligible for close-out.

*Cause/Effect:* FEMA had not fully implemented policies and procedures over its grant program in order to ensure compliance with the *Single Audit Act* and OMB Circular A-133. In addition, FEMA did not have a grants IT system in place to efficiently and comprehensively track grants to help ensure that all programmatic events were accurately and timely completed. Manual processes that were not always effective were used to track grants that were eligible for close-out. See Comment **I-B**, *Information Technology Controls and Financial System Functionality*. FEMA had not implemented effective monitoring procedures over certain grant activities and the maintenance of related documentation. As a result, misreported grantee expenses may not be detected, which may impact the fair presentation of FEMA's grant accrual balances, undelivered orders, and expenses. Further, the diversity of grant programs and systems within FEMA caused difficulty in assembling a comprehensive status of grants eligible for close-out, which could result in untimely closure of grants and an overstatement of undelivered orders.

*Criteria:* Presented in *Index of Financial Reporting and Internal Control Criteria*, after Exhibit III.

*Recommendations:* We recommend that FEMA:

1. Complete the implementation of policies and procedures to ensure full compliance with the *Single Audit Act* and the related OMB Circular No. A-133 related to receipt and review of grantees' single audit reports;

**Independent Auditors' Report**  
**Exhibit II – Significant Deficiencies**

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2. Implement monitoring procedures over obtaining, timely reviewing and reconciling required quarterly grantee reports, and maintaining related documentation;
3. Develop and implement procedures to create and track comprehensive lists of FEMA grants that are eligible for close-out; and
4. Implement a continuous quality assurance and grants monitoring process to include review of corrective actions resulting from implementation of the recommendations in 1 – 3 above.

**II-H Custodial Revenue and Drawback (CBP Only)**

*Background:* CBP collected approximately \$36.6 billion in annual import duties, taxes, and fees on merchandise arriving in the United States from foreign countries (identified below as the Entry Process). Receipts of import duties and related refunds were presented in the statement of custodial activity in the DHS financial statements.

|                                    |             |             |             |
|------------------------------------|-------------|-------------|-------------|
|                                    | <b>2013</b> | <b>2012</b> | <b>2011</b> |
| <b>CBP</b>                         |             |             |             |
| See page I.1 for table explanation |             |             |             |

Drawback is a remittance, in whole or in part, of duties, taxes, or fees previously paid by an importer. Drawback typically occurs when the imported goods on which duties, taxes, or fees have been previously paid, are subsequently exported from the United States or destroyed prior to entering the commerce of the United States.

Our findings over the Entry Process include conditions identified in In-bond, Bonded Warehouse and Foreign Trade Zones. In-bond entries occur when merchandise is transported through one port; however, the merchandise does not officially enter U.S. commerce until it reaches the intended port of destination. Bonded Warehouses (BW) are facilities, under the joint supervision of CBP and the Bonded Warehouse Proprietor, used to store merchandise that has not made entry into the United States commerce. Foreign Trade Zones (FTZ) are secured areas under CBP supervision that are used to manufacture goods that are considered outside of the United States commerce for duty collection.

The conditions cited below have existed for several years. Management has stated that the timeframe for remediation of these conditions is dependent on funding for IT system upgrades and new system implementation.

In September of FY 2012, CBP deployed the In-Bond Compliance Module, which was intended to create a more effective in-bond monitoring system. However, during the FY 2013 audit, we identified deficiencies in the design of new controls, limitations in the functionality of the new module, and inconsistencies in the ports' implementation of new processes. These deficiencies continued to limit CBP's ability to monitor the in-bond process, both at the Headquarters and port levels.

*Conditions:* We noted the following internal control weaknesses related to custodial activities at CBP:

*Related to Drawback:*

- CBP's current entry/collections system lacked the controls necessary to prevent, or detect and correct excessive drawback claims. The programming logic did not link drawback claims to imports at a detailed level. In addition, the system did not have the capability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries and export documentation upon which the drawback claim is based. Further, the system had not been configured to restrict drawback claims to 99 percent of each entry summary.
- Drawback review policies did not require drawback specialists to review all, or a statistically valid sample, of prior drawback claims against a selected import entry to determine whether, in the aggregate, an excessive amount was claimed against import entries.
- Documentation retention periods were not appropriate to ensure that support for drawback transactions were maintained for the full claim time-period.

## Independent Auditors' Report

### Exhibit II – Significant Deficiencies

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*Related to the Entry Process:*

- During the audit period, CBP was unable to determine the status of the in-bond shipments and lacked policies and procedures for monitoring the results of in-bond audits and review of overdue in-bonds. Specifically, the system for tracking compliance exams and audits lacked sufficient reporting capability to support the in-bond compliance function at the port level. Port personnel did not have sufficient training or a clear understanding of the new compliance module which resulted in inconsistent implementation at the ports. CBP did not formally analyze the rate and types of violations found, to determine the effectiveness of the in-bond program, and did not identify a projected total amount of uncollected duties and fees on in-bond merchandise that has physically entered U.S. commerce without formal entry to ensure there was not a potentially significant loss of revenue. In addition, CBP did not have sufficient monitoring controls in place to evaluate the sufficiency of bonds.
- CBP headquarters had developed national databases which contain an inventory of all BWs and FTZs; however, these databases were not designed to document the assessed risk of each BW or FTZ, scheduled compliance review, or the results of compliance reviews. CBP was unable to verify the results of all compliance reviews in order to determine overall program effectiveness. In addition, we noted deficiencies in the operating effectiveness of monitoring controls at the port level.

*Cause/Effect:* IT system functionality and outdated IT systems contribute to the weaknesses identified above. See Comment **I-B**, *Information Technology Controls and Financial System Functionality*. For example, CBP could not perform a comprehensive analysis to determine the overall compliance rate of the in-bond program. For drawback, much of the process is manual until IT system functionality improvements are made, placing an added burden on limited resources.

The length of the drawback claim lifecycle often extends beyond the documentation retention period, which is set by statute.

The inability to effectively and fully monitor the in-bond process and to verify the arrival of in-bond merchandise at the ports could lead to loss of revenue due to uncollected duties and fees on in-bond merchandise that has physically entered U.S. commerce without formal entry.

The current entry/collection system is unable to provide management with clear and actionable information related to bond sufficiency. Additionally, port personnel do not consistently follow policies and procedures related to the evaluation of bond sufficiency.

CBP did not have the ability to perform a complete analysis over the effectiveness of the BW and FTZ programs. CBP headquarters cannot effectively monitor the BW and FTZ programs if it cannot identify a complete population of all BWs and FTZs.

*Criteria:* Presented in *Index of Financial Reporting and Internal Control Criteria*, after Exhibit III.

*Recommendations:* We recommend that CBP:

1. *Related to Drawback:*
  - a. Continue to pursue compensating controls and measures that may ultimately identify the potential revenue loss exposure to CBP. These compensating controls over drawback claims may lead to the ability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries and export documentation for which the drawback claim is based, and identify duplicate or excessive drawback claims;
  - b. Develop and implement automated controls, where feasible, to prevent overpayment of a drawback claim; and
  - c. Continue to analyze current policies and procedures performed at the Drawback Centers. Determine the benefit of current procedures and revise as necessary.

**Independent Auditors' Report**  
**Exhibit II – Significant Deficiencies**

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2. *Related to the Entry Process:*

- a. Develop policies and procedures, and provide training to port-level personnel related to the In-Bond Compliance Module;
- b. Address limitations in reporting capabilities within the In-Bond Compliance Module;
- c. Provide oversight and assistance at the headquarters-level to ensure that port personnel are following procedures, and monitor and review the in-bond process to ensure a high in-bond compliance rate;
- d. Develop procedures to evaluate the completeness of the compliance review results submitted to CBP headquarters;
- e. Continue to strengthen monitoring efforts related to bond sufficiency; and
- f. Increase monitoring over the BW and FTZ compliance review program by developing a method to determine the program's overall effectiveness.

## **Independent Auditors' Report**

### **Exhibit III – Compliance and Other Matters**

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All of the compliance and other matters described below are repeat conditions from FY 2012.

#### **III-I Federal Managers' Financial Integrity Act of 1982 (FMFIA)**

DHS' implementation of OMB Circular No. A-123 facilitates compliance with the FMFIA. The *DHS Financial Accountability Act* of 2004 requires DHS to obtain an annual audit opinion of internal control over financial reporting. DHS has implemented a Multi-Year Plan to achieve full assurance on internal controls. However, in some instances, DHS does not perform tests of design or tests of operating effectiveness until the fiscal year after the process area under remediation is corrected instead of during the fiscal year remediation occurs. The *DHS Secretary's Assurance Statement* dated December 11, 2013, as presented in *Management's Discussion and Analysis* of the Department's 2013 *Agency Financial Report* (AFR), acknowledges the existence of material weaknesses, and therefore provided qualified assurance that internal control over financial reporting was operating effectively as of September 30, 2013. Management's findings were similar to the control deficiencies we have described in Exhibits I and II.

While we noted the Department had taken positive steps toward full compliance with FMFIA, OMB Circular No. A-123, and the *DHS Financial Accountability Act* of 2004, the Department had not fully established effective systems, processes, policies, and procedures to ensure and test that internal controls are operating effectively throughout the Department.

*Recommendation:* We recommend that the Department continue its corrective actions to address internal control deficiencies, in order to ensure full compliance with FMFIA and its OMB Circular No. A-123 approved plan in FY 2014.

#### **III-J Federal Financial Management Improvement Act of 1996 (FFMIA)**

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 United States Government Standard General Ledger (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.

While we noted that the Department overall has taken positive steps toward full compliance with FFMIA, the Coast Guard, U.S. Customs and Border Protection, FEMA, U.S. Immigration and Customs Enforcement, U.S. Citizenship and Immigration Services, U.S. Secret Service, and Transportation Security Administration did not fully comply with at least one of the requirements of FFMIA. The reasons for noncompliance are reported in Exhibits I and II. The Secretary of DHS has stated in the Secretary's Assurance Statement dated December 11, 2013, that the Department's financial management systems do not substantially conform to government wide requirements mandated by FFMIA. The Department's remedial actions and related timeframes are also presented in the FY 2013 AFR.

An element within FFMIA, Federal system requirements is ensuring security over financial management information. This element is addressed further in the *Federal Information Security Management Act of 2002* (FISMA), which was enacted as part of the *E-Government Act of 2002*. FISMA requires the head of each agency to be responsible for (1) providing information security protections commensurate with the risk and magnitude of the harm resulting from unauthorized access, use, disclosure, disruption, modification, or destruction of (i) information collected or maintained and (ii) information systems used or operated; (2) complying with the requirements of the Act and related policies, procedures, standards, and guidelines, including (i) information security standards under the United States Code, Title 40, Section 11331, and (ii) information security standards and guidelines for national security systems; and (3) ensuring that information security management processes are integrated with agency strategic and operational planning processes.

## **Independent Auditors' Report**

### **Exhibit III – Compliance and Other Matters**

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We also noted weaknesses in financial systems security, reported by us in Comment **I-B**, *Information Technology Controls and Financial System Functionality*, which impact the Department's ability to fully comply with FISMA.

*Recommendation:* We recommend that DHS improve its financial management systems to ensure compliance with the FFMIA, and implement the recommendations provided in Exhibits I and II in FY 2014.

#### **III-K Single Audit Act Amendments of 1996 (Single Audit)**

FEMA is the only DHS component that has a significant grant making operation. The *Single Audit Act Amendments of 1996*, as implemented by OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires agencies awarding grants to monitor their grantees, ensure they receive grantee reports timely, and follow-up on Single Audit findings to ensure that grantees take appropriate and timely action. Although FEMA had implemented a system to monitor grantees and their audit findings, FEMA did not fully comply with provisions in OMB Circular No. A-133 in FY 2013. We noted that FEMA's monitoring efforts were inconsistent, and FEMA did not obtain and review all grantee *Single Audit* reports in a timely manner.

*Recommendation:* We recommend that FEMA implement the recommendations in Comment **II-G**, *Grants Management*.

#### **III-L Anti-deficiency Act (ADA)**

Various management reviews and OIG investigations are on-going within the Department and its components that may identify ADA violations, as follows:

- Coast Guard is currently in the process of reporting two separate ADA violations; one relating to funds that may have been used in advance of an approved apportionment from OMB, and one relating to the improper execution of the obligation and disbursement of funds for the lease of passenger vehicles. Coast Guard submitted notification packages, related to these two violations, to the President in FY 2013. Coast Guard is also in the process of investigating a third potential violation, related to partial termination of a firm fixed price contract modification funded through an appropriation other than the original appropriation used to obligate the delivery order.
- In response to a FY 2007 U.S. Government Accountability Office report, the DHS OIG conducted a review of National Protection and Programs Directorate's (NPPD) legacy organization for FY 2006 and found that it violated the ADA with respect to the use of shared services. NPPD has developed the package to notify the President, Congress, and GAO of the violation and it is currently in clearance.
- The Management Directorate completed its investigation of whether rental charges at the Office of the Federal Coordinator for Gulf Coast Rebuilding (OFCGCR) incurred in FY 2009 were not properly committed or obligated and determined that the OFCGCR committed a violation in FY 2009 and submitted the notification package to the President in FY 2013.
- Intelligence and Analysis (I&A) is investigating a potential ADA violation due to a difference in calculation of apportionments while under continuing resolution in FY 2012.

*Recommendation:* We recommend that the Department and the other components complete the internal reviews currently planned or being performed, and properly report the results in compliance with the ADA, where necessary.

**Independent Auditors' Report**  
**Index of Financial Reporting and Internal Control Criteria**  
*(Listed Alphabetically by Criteria Source)*

| Criteria  | Reference  | Report Exhibit      |
|---|--|---------------------|
| Automated Targeting System (ATS-N) Version 4.41 In-bond Compliance  |  | II-H                |
| <i>Bonded Warehouse Manual for Customs and Border Protection Officers and Bonded Warehouse Proprietors</i> (HB 3500-11, January 2012)                   |  | II-H                |
| CBP Directive 3510-004, <i>Monetary Guidelines for Setting Bond Amounts</i>   | Introduction, Activity 1.a   | II-H                |
| CBP Directive 3510-005, <i>Bond Sufficiency</i>   | Paragraph 2  | II-H                |
| CBP Directive 5320-028D, <i>Commitment, Obligation, Expenditure, and Payment Procedures for Goods and Services</i>                                      | Section 7.5.1  | I-C                 |
| Code of Federal Regulations, Title 19   | §18.2, §18.6, §18.8, §19.4, §111.23, §111.25, §113.13, §146.3, § 163.4, §191.15, §191.38, §191.51  | II-H                |
| Code of Federal Regulations, Title 31   | §205.33  | II-G                |
| <i>Compliance Review Handbook for Bonded Warehouses</i> (HB 3500-09, December 2007)   | Section A, Part 2-4  | II-H                |
| <i>Compliance Review Handbook for Foreign Trade Zones</i> (HB 3500-10, July 2008)   |  | II-H                |
| <i>DHS Component Requirements Guide for Financial Reporting</i> , Version 6.0, February 2013  | - Analysis of Leases<br>- Component Level Financial Statements and Disclosures<br>- Documentation Maintenance<br>- Non-GAAP Requirements<br>- Obligation Balance Analysis<br>- Property, Plant & Equipment (PP&E) Reporting<br>- SF-132 to SF-133 Reconciliation | I-A                 |
|   | - Analysis of Leases<br>- Property, Plant & Equipment (PP&E) Reporting   | I-C                 |
|   | - Obligation Balance Analysis<br>- SF-132 to SF-133 Reconciliation   | I-D                 |
| <i>DHS Financial Accountability Act</i> , October 16, 2004  | Section 4  | I-A                 |
| Federal Accounting Standards Advisory Board (FASAB) Interpretation of Federal Financial Accounting Standards No. 7, <i>Items Held for Remanufacture</i> | Paragraphs 7, 8  | I-A                 |
| Federal Acquisition Regulation (FAR)  | § 4.8 Government Contract Files<br>§ 4.801 General<br>§ 4.802 Contract Files   | I-D                 |
| <i>Federal Financial Management Improvement Act of 1996</i>   | Section 803  | I-A, I-C            |
| Federal Financial Management System Requirements, <i>Core Financial System Requirements</i> (OFFM No. 0106), January 2006                               | - General Ledger Management Function<br>- General Ledger Account Definition Process<br>- Mandatory Requirements  | I-A                 |
| <i>Federal Managers' Financial Integrity Act of 1982</i>  | Section 2  | I-A, I-C, I-D, II-H |
| <i>FEMA Budget Procedures Memorandum 10-02</i> , Version 3.2, January 2013  | Section 4<br>Subsections B.2, C, D, E, F   | I-D                 |
| <i>FEMA OCFO Standard Operating Procedures For SF-132/133 Reconciliation Process</i> , June 2013 V4   | VI. Responsibilities   | I-D                 |

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*(Listed Alphabetically by Criteria Source)*

| Criteria   | Reference  | Report Exhibit            |
|--|--|---------------------------|
| <i>Financial Resource Management Manual (FRMM COMDTINST M7100.3E), September 2013</i>  | Section 7.9<br>Section 10.2<br>Section 10.3  | I-A, I-C                  |
| <i>FY 2011 Financial Management Codes, January 27, 2011</i>  | Chapter 4, BOC 2589  | I-D                       |
| <i>GAO FINANCIAL MANAGEMENT FFMIA Implementation Critical for Federal Accountability (GAO-02-29)</i>   | Page 1, Paragraph 2  | I-A, I-C                  |
| <i>GAO Framework for Federal Financial Management System Checklist Systems Reviewed Under the Federal Financial Management Improvement Act of 1996 (AIMD-98-21.2.1)</i>                    | Requirements Checklist Item Number 39  | I-A                       |
| <i>GAO's Standards for Internal Control in the Federal Government</i>  | Control Activities   | I-A, I-D, II-G            |
|  | Examples of Control Activities (Accurate and Timely Recording of Transactions and Events)      | I-A, I-D, II-G            |
|  | Examples of Control Activities (Appropriate Documentation of Transaction and Internal Control) | I-A, I-D, II-G            |
|  | Examples of Control Activities (Proper Execution of Transactions and Events)                   | I-D                       |
|  | Monitoring   | II-E                      |
|  | Presentation of the Standards  | I-A                       |
|  | Risk Assessment  | II-E                      |
| <i>ICE OFM Standard Operating Procedures for Statement of Differences T0051, v1.1, January 2013</i>  | Section (J.5)  | I-A                       |
| <i>OMB Bulletin No. 07-04, Audit Requirements for Federal Financial Statements</i>   | Compliance with FFMIA (footnote 16)  | I-A                       |
| <i>OMB Circular No. A-11, Preparation, Submission, and Execution of the Budget, July 2013</i>  | Section 20.3, 20.5<br>Appendix B<br>Appendix F   | I-A, I-D                  |
|  | Section 130.9<br>Appendix G  | I-D                       |
| <i>OMB Circular No. A-123, Management's Responsibility for Internal Control, Revised</i>   | 1. Purpose   | I-A                       |
|  | 3. Policy  | I-C, II-H                 |
|  | I. Introduction  | I-A, I-C, I-D, II-E, II-H |
|  | II. Standards  | I-A, I-D                  |
|  | III. Integrated Internal Control Framework   | I-D                       |
|  | IV. Assessing Internal Control   | II-H                      |
|  | Appendix A, Section I. Introduction  | I-C                       |
| <i>OMB Circular No. A-127, Financial Management Systems, Revised</i>   | Section 5<br>Section 6 (subpart K)<br>Section 8 (subpart C)                                    | I-A, I-C                  |
| <i>OMB Circular No. A-133, Revised to show changes published in the Federal Register June 27, 2003 and June 26, 2007 Audits of States, Local Governments, and Non-Profit Organizations</i> | Subparts B, D  | II-G                      |

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| Criteria  | Reference  | Report Exhibit |
|---|--|----------------|
| OMB Circular No. A-136, <i>Financial Reporting Requirements</i> , Revised   | Section V.2 and V.3  | I-A            |
| <i>Personal Property Handbook, HB 5200-13B</i>  | Chapter 8  | I-C            |
| <i>Single Audit Act Amendments of 1996</i>  | §7502  | II-G           |
| Statement of Federal Financial Accounting Standards (SFFAS) No. 1, <i>Accounting for Selected Assets and Liabilities</i>  | Paragraphs 12, 13, 39, 77  | I-A            |
| Statement of Federal Financial Accounting Standards (SFFAS) No. 6, <i>Accounting for Property, Plant, and Equipment</i>   | Paragraphs 17, 18, 26, 34, 35, 39, 40  | I-A            |
|   | Paragraphs 17, 18, 26, 34, 35, 38, 39, 40, 77  | I-C            |
| Statement of Federal Financial Accounting Standards (SFFAS) No. 7, <i>Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting</i>                                | Paragraph 36   | I-A            |
|   | Paragraph 78   | I-A, I-D       |
| Statement of Federal Financial Accounting Standards (SFFAS) No. 10, <i>Accounting For Internal Use Software</i>   | Paragraphs, 15, 16   | I-A            |
|   | Paragraphs, 16, 18, 20   | I-A, I-C       |
| Statement of Federal Financial Accounting Standards (SFFAS) No. 14, <i>Amendments to Deferred Maintenance Reporting</i>   | Paragraph 1  | I-C            |
| Statement of Federal Financial Accounting Standards (SFFAS) No. 23, <i>Eliminating the Category National Defense PPE</i>  | Paragraph 12   | I-A, I-C       |
| Statement of Federal Financial Accounting Standards (SFFAS) No. 29, <i>Heritage Assets and Stewardship Land</i>   | Summary paragraph<br>Paragraph 26  | I-C            |
| Statement of Federal Financial Accounting Standards (SFFAS) No. 35, <i>Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23</i> | SFFAS 6 - Paragraph 40<br>SFFAS 23 - Paragraph 16  | I-A, I-C       |
| Treasury Financial Manual, Volume I, Bulletin 2011-06   | Section 5, Subsection B  | I-A            |
| Treasury Financial Manual, Volume I   | - Part 2, Chapter 4700, Section 4706.20<br>- Part 2, Chapter 4700, Appendix 10<br>- Part 2, Chapter 5100, Appendix 2<br>- Fund Balance with Treasury Reconciliation Procedures: A Supplement to I TFM 2-5100, Section IV | I-A            |
| United States Coast Guard <i>Procedures for Physical Inventory and Year End Certification of Capitalized Personal Property</i>  | Section 1.3<br>Section 5.9 through 5.17  | I-A, I-C       |
| US Code Title 31, Chapter 15  | §1501  | I-A            |
|   | §1501, §1554   | I-D            |
| <i>US Customs Service (USCS), Records Control, CIS HB 2100-05A</i>  | Page 2, Paragraph 1  | II-H           |
| US Government Standard General Ledger <i>Chart of Accounts, Treasury Financial Manual, 2013 Reporting Supplement</i>  | Part 1, Section 1  | I-A            |



**Homeland  
Security**

December 11, 2013

MEMORANDUM FOR: Charles K. Edwards  
Deputy Inspector General

FROM: Chip Fulghum   
Acting Chief Financial Officer

SUBJECT: Fiscal Year 2013 Financial and Internal Controls Audit

I am pleased to accept your audit report on the Department's financial statements and internal controls over financial reporting for fiscal years (FY) 2012 and 2013. We agree with the Independent Public Accountant's conclusions.

Although the report indicates that DHS still faces financial management challenges, the auditor noted the Department's continuing progress in improving the quality and reliability of our financial reporting. During FY 2013, our Components continued to implement corrective actions to significantly improve key financial management and internal control areas, while sustaining prior-year progress. This year's unmodified audit opinion on all financial statements demonstrates that the Department is committed to being a responsible steward of taxpayer dollars.

The FY 2013 audit results show that our corrective actions are working, and we are already focusing our efforts on remediating the remaining issues as we pursue our goals of obtaining an unqualified audit opinion on our internal controls over financial reporting. As we continue our steadfast progress, I look forward to working with the Office of Inspector General and the Independent Public Accountant.



## **Appendix A**

### **Report Distribution**

#### **Department of Homeland Security**

Acting 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  
Under Secretary for Management  
Chief Financial Officer  
Chief Information Officer  
Chief Information Security Officer  
Acting Chief Privacy Officer

#### **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

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