

OFFICE OF INSPECTOR GENERAL

**Independent Auditors'
Report on DHS' FY 2014
Financial Statements and
Internal Control over
Financial Reporting**



Homeland
Security

**November 14, 2014
OIG-15-10**



HIGHLIGHTS

Independent Auditors' Report on DHS' FY 2014 Financial Statements and Internal Control over Financial Reporting

November 14, 2014

Why We Did This

Sound financial practices and related management operations, reliable financial systems, and effective internal control are essential for reliable, timely financial information that supports management decision making needed to achieve the DHS mission.

What We Recommend

KPMG LLP made 68 recommendations to help improve internal control over financial reporting and increase the reliability of financial systems and operations. These recommendations address significant deficiencies, including issues related to financial reporting; information technology controls and financial systems functionality; property, plant, and equipment; and budgetary accounting.

For Further Information:

Contact our Office of Public Affairs at (202) 254-4100, or email us at DHS-IG.OfficePublicAffairs@oig.dhs.gov

What We Found

The independent public accounting firm, KPMG LLP, has issued an unmodified (clean) opinion on the Department of Homeland Security's (DHS) consolidated financial statements. In the independent auditors' opinion, the financial statements present fairly, in all material respects, the financial position of DHS as of September 30, 2014.

KPMG LLP also issued an adverse opinion on the Department's internal control over financial reporting of its financial statements as of September 30, 2014. The report identifies seven significant deficiencies in internal control, four of which are material weaknesses. The material weaknesses are in financial reporting; information technology controls and financial systems functionality; property, plant, and equipment; and budgetary accounting. The report also identifies instances of noncompliance with four laws and regulations.

Management's Response

The Department concurred with the independent auditors' conclusions and indicated that management will continue to implement corrective actions to improve financial management and internal control.



OFFICE OF INSPECTOR GENERAL

Department of Homeland Security

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

NOV 14 2014

TO: The Honorable Jeh Johnson
Secretary

FROM: John Roth 
Inspector General

SUBJECT: Independent Auditors' Report on DHS' FY 2014 Financial Statements and Internal Control over Financial Reporting

The attached report presents the results of an integrated audit of the Department of Homeland Security's (DHS) fiscal year (FY) 2014 financial statements and internal control over financial reporting. This is a mandatory audit required by the *Chief Financial Officers Act of 1990*, as amended by the *Department of Homeland Security Financial Accountability Act of 2004*. The report is incorporated in the Department's FY 2014 *Agency Financial Report*. We contracted with the independent public accounting firm KPMG LLP (KPMG) to conduct the audit.

The Department continued to improve financial management in FY 2014 and achieved an unmodified (clean) opinion on all financial statements. However, KPMG issued an adverse opinion on DHS' internal control over financial reporting because of material weaknesses in internal control.

Summary

KPMG identified seven significant deficiencies in internal control, of which four are considered material weaknesses. DHS identified the same material weaknesses in the *Secretary's Assurance Statement*.

The following are the four significant deficiencies in internal control considered to be material weaknesses, the three other significant deficiencies in internal control, and the four laws and regulations with which KPMG identified instances of DHS' noncompliance.

Significant Deficiencies 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
- Grants Management
- Custodial Revenue and Drawback

Laws and Regulations with Identified Instances of Noncompliance

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

Moving DHS' Financial Management Forward

The Department continued to remediate conditions contributing to the material weaknesses identified by the auditors in FY 2013. In FY 2013, the independent auditors identified four material weaknesses in financial reporting; information technology controls; property, plant, and equipment; and budgetary accounting. All these material weaknesses were also identified in FY 2014.

In an effort to remediate a material weakness in property, plant, and equipment (PP&E) the U.S. Coast Guard completed several phases of a multi-year remediation plan to address deficiencies in the PP&E process and control. However, certain efforts were not completed until late FY 2014 and additional remediation activities are scheduled for FY 2015.

In FY 2015 and beyond, DHS' continuing challenge will be to sustain its progress in achieving an unmodified opinion on its financial statements and avoid slipping backward. To sustain its clean opinion on financial statements and obtain an unqualified (clean) opinion on its internal control over financial reporting, the Department must continue remediation efforts and stay focused.

KPMG is responsible for the attached *Independent Auditors' Report* dated November 13, 2014, and the conclusions expressed in the report. To ensure the quality of the audit work, we evaluated KPMG's qualifications and independence, reviewed the audit approach and planning, monitored



OFFICE OF INSPECTOR GENERAL
Department of Homeland Security

the audit's progress at key points, reviewed and accepted KPMG's report, and performed other procedures we deemed necessary. Additionally, we provided oversight of the audit of financial statements and certain accounts and activities conducted at key components in the Department. Our review, as differentiated from an audit conducted in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on the financial statements or internal control or provide conclusions on compliance with laws and regulations. Our review disclosed no instances in which KPMG did not comply, in all material respects, with generally accepted government auditing standards.

Consistent with our responsibility under the *Inspector General Act of 1978*, as amended, 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 Anne L. Richards, Assistant Inspector General for Audits, at 202-254-4100.

Attachment



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KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the U.S. Department of Homeland Security (DHS or Department), which comprise the consolidated balance sheets as of September 30, 2014 and 2013, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion on the Financial Statements

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of Homeland Security as of September 30, 2014 and 2013, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in Notes 1T and 15 of the consolidated financial statements, the Department has intragovernmental debt of approximately \$24 billion used to finance the *National Flood Insurance Program* (NFIP) as of September 30, 2014. 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. Legislation will need to be enacted to provide funding to repay or forgive the debt. 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, Required Supplementary Information, and Required Supplementary Stewardship Information sections be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audits of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The information in the Message from the Secretary, Message from the 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 consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic consolidated 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, 2014, based on 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 on 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 effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with U.S. generally accepted accounting principles. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the 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 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 following material weaknesses described 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, 2014, 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 following deficiencies described in the accompanying Exhibit II to be significant deficiencies.

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

The Report on Internal Control Over Financial Reporting is intended solely for the information and use of DHS management, the DHS Office of 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 the DHS' consolidated 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 the following 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 in the accompanying Exhibit III.

- H. *Federal Managers' Financial Integrity Act of 1982*
- I. *Single Audit Act Amendments of 1996*
- J. *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 finding K of Exhibit 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.

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 consolidated financial statements and, accordingly, we express no opinion on the responses.

KPMG LLP

November 13, 2014

Independent Auditors' Report

Introduction to Exhibits on Internal Control and Compliance and Other Matters

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 September 30, 2014, 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, 2014.

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 2012 through FY 2014. The DHS components that contributed to the finding in FY 2014 are listed in the title of each material weakness and significant deficiency included in Exhibits I and II.

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 2014 and FY 2013 are presented in the Tables below:

- Table 1** Presents a summary of our internal control findings, by component, for FY 2014.
Table 2 Presents a summary of our internal control findings, by component, for FY 2013.

We have reported four material weaknesses and three significant deficiencies at the Department level in FY 2014, shown in Table 1.

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

TABLE 1 – SUMMARIZED DHS FY 2014 INTERNAL CONTROL FINDINGS
(Full-Scope Financial Statement Audit)

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

TABLE 2 – 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
Material Weaknesses:			Exhibit I								
A	Financial Reporting	MW									
B	IT Controls and System Functionality	MW									
C	Property, Plant, and Equipment	MW									
D	Budgetary Accounting	MW									
Significant Deficiencies:			Exhibit II								
E	Entity-Level Controls – Department-wide	SD									
F	Liabilities	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, 2014, 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, ICE, MGMT, NPPD, USSS)

Background: During fiscal year (FY) 2014 the Department of Homeland Security (DHS/Department) components continued to implement corrective action plans to address internal control weaknesses and strengthen internal control. Although the Department made progress, deficiencies remain. Specifically, during FY 2014, the U.S. Coast Guard (Coast Guard or USCG) continued efforts to remediate long-standing internal control deficiencies and strengthen financial reporting controls. However, we noted that deficiencies remain in some financial reporting areas and additional remediation, associated with real property balances, is scheduled to continue in FY 2015.

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

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

1. Coast Guard:

- Lacked adequate processes to ensure that non-standard adjustments (i.e., journal entries and top side adjustments) impacting the general ledger were adequately researched, supported, and reviewed prior to their recording in the general ledger. Continued property, plant, and equipment remediation efforts required the recordation of multiple adjustments. Many of these adjustments required corrections as the level of precision of review was not adequate.
- Did not adhere to existing policies and procedures to update, maintain, and review schedules tracking environmental liabilities. Policies and procedures were not designed and implemented to ensure the completeness and accuracy of all underlying data elements used to record environmental liabilities.
- Lacked effective controls over the review of accrual decisions and/or calculations as well as prior year accrual validation related to accounts payable.
- Was not able to completely support certain 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 or 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 properly designed or fully implemented to ensure identified differences, especially with agencies outside DHS, were resolved in a timely manner.
- Controls over the preparation and review of periodic financial information were not designed and implemented and/or operating effectively at an appropriate level of precision in various processes. These processes included, but were not limited to, fund balance with Treasury, operating expenses, accounts receivable, contingent liabilities, property, plant, and equipment, operating materials and supplies, accounts payable, and budgetary accounts.

Trend Table			
	2014	2013	2012
USCG			
ICE			
MGMT			N/A
NPPD			N/A
USSS			N/A
OFM	C		N/A
TSA	C	C	

Key – Trend Table	
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

- Did not always maintain general ledger activity in compliance with the United States Standard General Ledger (USSGL) at the transaction level.
2. ICE:
- Controls over preparation and review of journal entries were not designed and fully implemented to ensure proper posting. Further, supporting documentation for certain journal entries did not clearly and fully explain the purpose of the entry; this also impacts journal entries posted on behalf of the serviced components NPPD and MGMT.
 - Did not always adhere to or reinforce compliance with existing expense and fund balance with Treasury policies and procedures including review of invoices prior to disbursement and clearing of suspense balances.
 - Controls over the calculation of imputed costs for pension and health benefits were not fully effective to ensure the proper factors were used in the calculation to properly report the balance in the financial statements.
 - Internal controls over the presentation of the statement of net cost and property, plant, and equipment footnote disclosures were not fully effective to ensure gross costs and revenues were properly aligned to the correct major program and construction in progress costs were appropriately disclosed.
3. MGMT:
- Did not fully establish a financial management infrastructure, including defined roles and responsibilities 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 were properly monitored, reviewed, and costs were appropriately recorded and disclosed in the proper period; construction in process costs were recorded to the proper standard general ledger account and appropriate supporting documentation was available to evidence dates assets were placed into service; and
 - Controls were not fully effective over expenses, including review of employee set-up and certain payroll transactions, review of invoices prior to disbursement, coding of expenses to the proper trading partner and timely recording of expense.
 - Internal control over financial reporting was 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.
4. NPPD:
- Did not fully design internal controls to ensure accurate execution of processes and recording of transactions by the service provider. For example we noted:
 - Controls were not operating effectively to ensure that capital assets were recorded timely and accurately in the asset sub-ledger and general ledger in the proper period;
 - Controls were not designed appropriately to ensure gross costs and revenues were properly presented in the statement of net cost; and
 - Controls were not fully effective to ensure processes performed by the service provider related to recording of closing entries, timely liquidation of advances and revenue accruals were in accordance with existing policies and procedures.
 - Controls were not fully effective to ensure transactions were appropriately recorded to the proper vendor and trading partner.

Independent Auditors' Report
Exhibit I – Material Weaknesses

5. USSS:

- Internal controls over the review of assumptions used in the actuarially derived pension liability were not operating effectively, resulting in a change in the calculation of the discount rate in order to comply with Federal accounting standards.

Cause/Effect: The Coast Guard devoted considerable attention to substantially completing remediation over property, plant, and equipment. These remediation efforts, coupled with an inadequate number of skilled resources, have hindered progress over the development and implementation of robust internal control over financial reporting. Coast Guard also lacks specific standard operating procedures detailing internal controls in certain process areas. Additionally, the Coast Guard's three legacy general ledger systems, developed over a decade ago, have 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*.

ICE faced challenges in maintaining communications that affect financial reporting functions performed at different program offices and finance centers.

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 continued to define and enhance their roles and responsibilities as they assumed more financial management functions. The intra-agency agreement between ICE and NPPD and MGMT defines these roles and responsibilities, however a control gap continued to exist between the services provided by ICE and the procedures and processes established by NPPD and MGT. NPPD enhanced its financial management structure; however, NPPD has not established or implemented all necessary procedures to perform service provider oversight. MGMT's resources are limited and some operational functions, including the Working Capital Fund, were complex and diverse.

The USSS did not properly review key assumptions used by the actuary in the calculation of the pension liability, resulting in a change to the discount rate in order to comply with Federal accounting standards.

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, 2014. Management has acknowledged in the *Secretary's Assurance Statement*, presented in *Management's Discussion and Analysis* section of the FY 2014 *Agency Financial Report*, that material weaknesses and other internal control deficiencies continue to exist in some key financial processes. Also see Comment **III-H**, *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:
 - i) All non-standard adjustments (i.e., journal entries and top side adjustments) impacting the general ledger are adequately researched, supported, and reviewed prior to their recording in the general ledger;
 - ii) Environmental liability schedules are updated, maintained, and reviewed;
 - iii) Underlying data used in the estimation of environmental liabilities is complete and accurate;
 - iv) Accrual decisions and/or calculations as well as the validation of prior year accrual amounts are properly reviewed;

Independent Auditors' Report
Exhibit I – Material Weaknesses

- v) 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 supported; and
 - vi) 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. Adopt policies, procedures, and accounting treatments documented in ad hoc technical accounting research papers into official financial reporting guidance that is distributed agency wide; and refine financial reporting policies and procedures to prescribe process level internal controls at a sufficient level of detail to ensure consistent application to mitigate related financial statement risks;
 - c. Identify and employ additional skilled resources; and
 - d. Implement accounting and financial reporting processes and an integrated general ledger system that is FFMI compliant.
2. 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. Reinforce compliance with existing expense and fund balance with Treasury policies and procedures including review of invoices prior to disbursement and clearing of suspense transactions;
 - c. Improve existing policies and procedures over the recording of imputed costs to ensure the appropriate cost factors are used; and
 - d. Implement additional controls over the preparation and review of financial statements and footnotes to ensure information is reported properly.
3. 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 improve internal control and supervisory review in key financial reporting processes; and
 - c. Improve the accessibility of reliable and complete financial data for use by management and to support the annual audit.
4. NPPD:
- a. Continue to implement changes and enhancements to the financial reporting structure, or the service level agreement with ICE, to ensure effective control in all financial reporting processes at NPPD; and
 - b. Improve controls to ensure transactions are recorded to the proper vendor and trading partner.
5. USSS:
- a. Evaluate the effectiveness of its review and understanding over the actuarial pension estimate, to ensure key assumptions are in compliance with the applicable standards.

Independent Auditors' Report
Exhibit I – Material Weaknesses

I-B Information Technology Controls (USCG, CBP, FEMA) and Financial System Functionality (Department-wide)

Background: During our FY 2014 assessment of general information technology (IT) controls and process-level IT application controls, we noted that the DHS Components made progress in the remediation of IT findings we reported in FY 2013. We closed approximately 35 percent of our prior year IT findings. However, new findings were noted in many DHS Components in FY 2014, many of which were either (1) related to controls that were effective in prior years, or (2) control deficiencies noted over new systems which were similar to deficiencies previously reported.

As indicated in the chart to the right, we noted improvements in the general IT control environments at USCIS and ICE. In FY 2014, as in recent years, the Components have made progress in remediating general IT control deficiencies. However, the general IT control deficiencies that continued to exist across all Components in FY 2014 represent an overall elevated IT risk to the Department, and certain deficiencies at Coast Guard, CBP, and FEMA, collectively, are considered a material weakness.

	2014	2013	2012
USCG			
CBP			
USCIS	C		
FEMA			
ICE	C		
See page I.1 for table explanation			

During our IT audit procedures, we also evaluated and considered the impact of financial system functionality on financial reporting. In recent years, we have noted that limitations in DHS Components' financial systems' functionality may be inhibiting the Department's ability to implement and maintain effective internal control and to effectively and efficiently process and report financial data. At many Components, key financial and feeder systems have not been substantially updated since being inherited from legacy agencies several years ago. Many key DHS financial systems were not compliant with Federal financial management system requirements as defined by FFMIA and OMB Circular Number A-123, Appendix D, *Compliance with FFMIA*. Our observations related to functionality issues noted across all DHS systems, including at Components which did not necessarily directly contribute to the IT material weakness but are associated with deficiencies reported elsewhere in this report, are described below.

Conditions Related to General IT Controls: We noted the following internal control weaknesses related to general IT controls at Coast Guard, CBP, and FEMA. Weaknesses indicated in this exhibit represent a cross-representation of deficiencies identified at these components. In addition, other observations noted during our audit procedures, which did not contribute to the IT material weakness at these and other Components, are described in greater detail in separate letters provided to DHS and Component management.

1. *Access Controls:*

- Did not consistently or completely develop and formally document policies and procedures for managing and monitoring access to key financial applications and underlying system software components, including those owned and operated on behalf of DHS and Components by third-party service organizations.
- Initial authorization and periodic recertification of application, database, and operating system user, service, and generic accounts (including emergency and temporary access) was inadequate, inconsistent, or in violation of the principles of least privilege and segregation of duties.
- Technical controls over logical access to key financial applications and underlying system software components, including password requirements and account security configurations, were not consistently implemented in accordance with DHS requirements.
- Controls over the generation, review, analysis, and protection of application, database, and operating system audit logs were not fully implemented or were inconsistently performed.

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- Transferred and/or terminated employees' and contractors' access privileges were not always consistently or timely removed from financial systems and general support systems, and controls related to review and revocation of system access were not always implemented or finalized.

2. Configuration Management

- Security patch management and configuration deficiencies were identified during the vulnerability assessments on the servers, system software, and databases supporting key financial applications and general support systems.
- Vulnerability management activities, including performing internal scans of financial applications and system software and implementing vendor-recommended patches to address known vulnerabilities, were not consistently performed.
- Monitoring controls to ensure the completeness and integrity of records of implemented system changes for key financial systems were not always implemented.
- Controls to ensure that application functionality was appropriately mirrored between the test and production environments for one financial system were not effective.
- Configuration changes to financial systems were not consistently tested before deployment to production.

3. Segregation of Duties:

- Implementation of segregation of duties for IT and financial management personnel with access to financial systems across several platforms and environments (including development and production) was inadequate or incomplete.

Conditions Related to Financial System Functionality:

In addition to the general IT control deficiencies noted above at Coast Guard, CBP, and FEMA, we identified many instances across all DHS components where financial system functionality limitations were inhibiting DHS' ability to implement and maintain internal control, including process-level IT application controls supporting financial data processing and reporting. Financial system functionality limitations also contributed 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 in the following general areas at multiple components:

- System software supporting key financial applications, feeder systems, and general support systems either lacked the required functionality to implement effective controls or was outdated and no longer supported by the respective vendors, resulting in unmitigated vulnerabilities that exposed underlying data to potential unauthorized and undetected access and exploitation.
- General IT controls and financial process areas were implemented or supported by highly-manual processes, outdated or decentralized systems and records management processes, or utilities with limited automated capabilities. These limitations introduced a high risk of error and resulted in inconsistent, incomplete, or inaccurate control execution and supporting documentation.
- Multiple Components' financial system controls were not fully effective to efficiently provide readily auditable transaction populations without substantial manual intervention and additional supporting information.

In addition to these general areas, system limitations contributed to deficiencies noted in multiple financial process areas across the DHS Components. For example, system configurations and posting logic deficiencies limited the effectiveness of controls to properly calculate the value of certain transactions, identify funding variances, or prevent or detect and correct excessive refund claims. In some cases, while Components implemented manual processes to compensate for these limitations, these manual processes

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were prone to error and increased the risk that financial data and transactions were improperly posted to the respective systems.

Cause: The control deficiencies described in this exhibit stem from a number of systemic root causes across the affected DHS Components. In many cases, resource limitations, ineffective or inadequate management oversight, the complex, highly interrelated yet decentralized nature of systems and system components, or error-prone manual processes resulted in inadequately designed and implemented or ineffectively operating controls. In some cases, cost-prohibitive options for vendor support has limited system development activity to “break/fix” and sustainment activities.

Effect: DHS management continued to recognize the need to upgrade its financial systems. Until serious legacy IT issues are addressed and updated IT solutions are implemented, compensating controls and other complex manual workarounds must support the DHS and Components’ IT environment and financial reporting processes. 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 are 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 was 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) and Component management, continue the *Financial Systems Modernization* initiative, and make necessary improvements to the Department’s and Components’ financial management systems and supporting IT security controls. Specific, more detailed recommendations were provided in individual limited distribution (For Official Use Only) Notices of Findings and Recommendations (NFRs) and separate letters provided to DHS and Component management.

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

Background: DHS property, plant, and equipment is primarily concentrated in several large components. The Coast Guard maintained approximately 50 percent of all DHS general property, plant, and equipment.

In FY 2014, the Coast Guard substantially completed remaining remediation activities that were not completed in prior years. However, due to the continued remediation in FY 2014, most of the conditions cited below have been repeated from our FY 2013 report.

CBP continued to enhance controls and to perform remediation to address deficiencies in the timely recording of capitalized costs and in the classification of property, plant, and equipment between construction in progress and “in-use.” However, several of the conditions were repeated from our FY 2013 report.

	2014	2013	2012
USCG			
CBP			
ICE	C	**	
MGMT	**	**	C
** See Comment I-A <i>Financial Reporting</i>			
See page I.1 for table explanation			

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Exhibit I – Material Weaknesses

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 property, plant, and equipment were financial reporting in nature and have been grouped with conditions cited at Comment **I-A**, *Financial Reporting*.

ICE remediated their property, plant, and equipment control deficiencies in FY 2014.

Conditions: We noted the following internal control weaknesses related to property, plant, and equipment at Coast Guard and CBP:

1. Coast Guard did not:

- Design and implement controls to appropriately track asset activity at a transaction level and ensure the timely recording of asset additions, deletions, or other adjustments.
- Implement sufficient internal controls and related processes to support interim property, plant, and equipment balances and activity, including the identification and timely recording of leasehold improvements, asset impairments, and construction in progress activity.
- Transfer completed assets from construction in progress to in-use assets in a timely manner.
- Adhere to established inventory policies and procedures, such as those regarding asset identification, system mapping, and tagging processes, to clearly differentiate and accurately track personal property assets in the fixed assets system.
- 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 property.

2. CBP did not:

- Consistently adhere to policies and procedures to timely account for asset purchases, construction, depreciation, or disposal of assets in a timely manner. For example, CBP did not:
 - Ensure all asset additions were recorded completely, accurately, and timely in the financial statements;
 - Transfer certain completed assets from construction in progress to in-use assets in a timely manner; and
 - Record some asset disposals timely and in accordance with policy.

Cause/Effect: The Coast Guard continued remediation over property, plant, and equipment balances in FY 2014. These remediation efforts, coupled with a deficient number of skilled resources, have hindered progress over development and implementation of robust internal control over property, plant, and equipment. Additionally, the Coast Guard did not properly assess the risk related to current year impacts of remediation when designing and executing their remediation plan. This resulted in difficulties in distinguishing remediation activity from FY 2014 activity inhibiting adequate reviews of activity for reasonableness and alignment with current year business events.

Personnel within CBP's highly dispersed operations did not consistently adhere to established policies and procedures for recording property, plant, and equipment costs. In addition, CBP did not have sufficient oversight, including monitoring controls over ongoing construction in progress projects, to ensure that all property, plant, and equipment transactions were recorded timely and accurately in the general ledger.

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

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Recommendations: We recommend that:

1. Coast Guard:
 - a. Design and implement controls to appropriately track asset activity at a transaction level and ensure the timely recording of asset additions, deletions, or other adjustments;
 - b. Continue to implement controls over the transfer of completed construction in progress assets to in-use and accurately recording leasehold improvements, asset impairments, and construction in progress activity;
 - c. Fully adhere to established inventory policies and procedures;
 - d. Establish new or improve existing policies, procedures, and related internal controls to sufficiently support personal and real property balances, including electronics, internal-use software, land, buildings and other structures;
 - e. Establish new, or improve existing, processes to identify and evaluate lease agreements to ensure they are appropriately classified as operating or capital, and are properly reported in the financial statements and related disclosures;
 - f. Identify and employ additional skilled resources; and
 - g. 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 property.
2. CBP:
 - a. Reinforce existing policies and procedures for recording asset additions and reclassifications;
 - b. Modify existing policies and procedures to require formal authorization and documentation of all real property retirements; and
 - c. Continue to enhance supervisory review and monitoring controls to review property, plant, and equipment transactions in a timely manner.

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

Background: The Department continued to implement corrective action plans during FY 2014; however deficiencies still remain. The Coast Guard, Federal Emergency Management Agency (FEMA), and ICE continued to implement and improve policies and procedures associated with budgetary accounting processes in FY 2014; however, some control deficiencies reported in FY 2013 remain.

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*.

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

Conditions: We noted the following internal control weaknesses related to budgetary accounting at Coast Guard, FEMA, ICE, MGMT, and NPPD. In addition, we noted weaknesses related to budgetary accounting at other components such as untimely de-obligation of undelivered orders, and inaccurate recording of unfilled customer orders; however, these deficiencies did not warrant individual reporting.

	2014	2013	2012
USCG			
FEMA			
ICE			
MGMT			
NPPD			N/A
FLETC	C	C	
See page I.1 for table explanation			

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1. Coast Guard:

- Controls to ensure the timely de-obligation of undelivered orders were not operating effectively.
- Controls over contract management were not operating effectively to ensure modifications to extend contract period of performance were processed timely and appropriate documentation was maintained to support activity recorded against undelivered orders.

2. FEMA:

- Controls were not operating effectively over obligations, de-obligations, and payments.
- Controls over the review of budgetary funding transactions recorded in the general ledger were not operating effectively.
- Control over the monthly reconciliations of the SF-132, *Apportionment and Reapportionment Schedule*, to the SF-133, *Report on Budget Execution and Budgetary Resources* were not operating effectively.

3. ICE:

- Controls were not operating effectively to ensure obligations, recoveries and expense transactions were timely and appropriately recorded in the general ledger.
- Controls were not operating effectively to ensure obligation activity was supported by appropriate supporting documentation.
- Lacked IT system controls to ensure expenditures were within budgetary limits, which also impacted internal controls of other IT system users such as NPPD and MGMT.
- Controls over the review of open obligations were not fully effective to ensure all contracts were appropriately assessed for validity prior to period end.

4. MGMT:

- Controls over budgetary accounting including timely recording of obligations, de-obligations and expenses were ineffective.
- Controls were not fully effective to ensure funds were appropriately presented as either available or unavailable in the financial statements.
- Lacked controls to properly identify and report all possible instances of non-compliance with laws and regulations.

5. NPPD:

- Lacked controls to ensure apportionments transactions were timely and accurately recorded in the general ledger and to ensure the accurate reporting of funds as either available or unavailable in the financial statements.
- Controls were not operating effectively to ensure budgetary transactions were supported by appropriate documentation.
- Controls over budgetary accounting were not operating effectively, including timely recording of obligations, de-obligations, recoveries, and expenses.

Cause/Effect: The Coast Guard's decentralized structure enabled obligations to be made throughout the country by various authorized personnel and contributed to the challenge of enforcing existing policies, procedures, and internal controls surrounding budgetary accounting. Additionally, financial system functionality issues prohibited the Coast Guard from implementing and maintaining automated internal controls to supplement their existing manual controls. Also see Comment **I-B**, *Information Technology*

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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 existing IT systems were not effective in facilitating a network of strong internal controls. 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. In addition, FEMA personnel have not fully adhered to the existing procedures for the recording of funding transactions due to 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 impacted by the government shutdown and continuing resolution which occurred during the first quarter of FY 2014, which made it difficult for ICE to ensure that funding existed, and was 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 affected NPPD and MGMT. In addition, NPPD and MGMT did not fully implement 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.
2. FEMA:
 - a. Implement proper monitoring controls to ensure the enforcement of existing policies that require timely review and approval for all undelivered order activities;
 - b. Implement improved review procedures for budgetary funding transactions recorded in the general ledger including properly training personnel, conducting regular quality control reviews, and performing reconciliations between the budgetary and general ledger systems; 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:
 - a. Improve processes with program offices to ensure the timely recording of obligations, expenses and recoveries;
 - b. Improve the process of recording recoveries and upward adjustments of prior year obligations, including identification and adjustment for offsetting transactions;
 - c. Improve processes over non-contract obligations to ensure sufficient supporting documentation is maintained to support transactions recorded in the general ledger; and

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- d. Improve process over the validation of obligations to ensure sufficient time is available for all contracts to be reviewed prior to period-end.
4. MGMT:
- a. Develop and implement improved controls over budgetary accounting to ensure timely recording of obligations and timely de-obligations of invalid obligations;
 - b. Improve processes over recording of apportionment transactions to ensure funding is properly presented as available or unavailable in the financial statements; and
 - c. Develop and implement controls to ensure all possible instances of non-compliance with laws and regulations are reported to the appropriate individuals and investigated timely.
5. NPPD:
- a. Improve the processes of recording apportionments to ensure amounts recorded in the general ledger do not exceed the approved SF-132;
 - b. Improve processes over non-contract obligations to ensure sufficient supporting documentation is maintained to support transactions recorded in the general ledger;
 - c. Improve processes with program offices to ensure the timely recording of obligations; and
 - d. Improve controls over identification and processing of contracts for close-out to ensure outstanding obligations that need to be closed out are processed timely and the funds de-obligated.

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Exhibit II – Significant Deficiencies

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

Background: Entity-level controls encompass the overall 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 and 2013 versions), 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-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.

The Department made some progress in this area in FY 2014 with the issuance of new and updated financial management policies and procedures, in addition to conducting monthly leadership meetings to address audit risks and ensure resources were committed to critical control deficiency remediation efforts. However, opportunities for improvement still exist. Examples of areas that should be addressed annually and updated periodically in the risk assessment are:

- 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 deficiencies.
- 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*.

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

- 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.

Related to IT, controls to monitor compliance with requirements for security awareness training and 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. Additionally, required background investigations were not consistently completed prior to granting access to key financial systems.

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 Grants Management (FEMA only)

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

Conditions: The following previously reported internal control weaknesses related to grants management remain in the current year.

	2014	2013	2012
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-I**, *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.

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Exhibit II – Significant Deficiencies

- Did not consistently follow-up with grantees who failed to submit quarterly financial reports timely.
- Did not consistently and effectively reconcile grantee quarterly financial reports to FEMA systems.
- Did not have a consistent, entity wide, process in place to effectively monitor the amount of cash on hand at FEMA grantees.
- 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. 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 the cash on hand at grantees and the status of grants eligible for close-out, which could result in excessive cash on hand at grantees, 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;
2. Implement monitoring procedures over obtaining, timely reviewing, and reconciling required quarterly grantee reports;
3. Improve existing procedures to ensure cash on hand analyses are completed consistently and correctly for all FEMA grantees;
4. Develop and implement procedures to create and track comprehensive lists of FEMA grants that are eligible for close-out; and
5. Implement a continuous quality assurance and grants monitoring process to include review of corrective actions resulting from implementation of the recommendations in 1 – 4 above.

II-G Custodial Revenue and Drawback (CBP Only)

Background: The Department collected approximately \$39 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. CBP is the primary collector of these revenues within the Department.

	2014	2013	2012
CBP			
See page I.1 for table explanation			

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Exhibit II – Significant Deficiencies

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 Warehouses (BWs) and Foreign Trade Zones (FTZs). 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 are facilities, under the joint supervision of CBP and the BW Proprietor, used to store merchandise that has not made entry into the U.S. commerce. FTZs are secured areas under CBP supervision that are used to manufacture goods that are considered outside of the U.S. 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 and 2014 audit, we identified deficiencies in the design of controls, limitations in the functionality of the module, and inconsistencies in the ports' implementation of the 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.
- The automated control designed to prevent a claimant from exceeding the continuous bond amount on file does not operate effectively and no manual procedures exist to ensure the sufficiency of continuous bonds.
- Controls over the review of refunds prior to disbursement, were not operating effectively.

Related to the Entry Process:

- During the audit period, CBP modified its controls and revised policies and procedures over the In-Bond process. These modified controls did not operate effectively. Specifically, the system for tracking compliance exams and audits lacks sufficient reporting capabilities. Furthermore, personnel were unable to generate complete and accurate listings of completed in-bond compliance exams and audits. Additionally, port personnel did not have sufficient training or a clear understanding of the system, which resulted in inconsistent implementation.

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Exhibit II – Significant Deficiencies

- CBP did not formally analyze the rate and types of violations found to determine the effectiveness of the in-bond program. In addition, CBP 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.
- 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 and deficiencies in the operating effectiveness of monitoring controls at the port level were noted.
- CBP did not have sufficient monitoring controls in place to evaluate the sufficiency of entry bonds. CBP had not developed revised policies and procedures over the monitoring of single transaction bonds. As a result, single transaction bonds were not subject to review.
- CBP did not consistently adhere to existing policies and procedures for review, and verification of Entry Edit/Exception reports.

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. In addition CBP is pursuing changes to statutes, which govern the drawback process, to further reduce the need for manual controls.

The length of the drawback claim lifecycle often extends beyond the documentation retention period, which is set by statute. The system used to support the in-bond compliance exam and audit function lacks sufficient retention capabilities, resulting in discrepancies between reports. Further, CBP did not effectively communicate the modified control processes and did not provide sufficient training to port personnel. 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 and increases the risk of non-compliance with Title 19, Section 18 of the Code of Federal Regulation.

Policies and procedures over the review of single transaction bonds, review of various reports, and completion of Compliance Reviews were not consistently followed.

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. Further, improper monitoring of BWs or FTZs creates a risk that imported goods awaiting entry into commerce may not be secure, and could result in a loss of revenue, error to the balance taxes, duties and trade receivables, and increases the risk of non-compliance with Title 19, Section 18 of the Code of Federal Regulation.

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;

Independent Auditors' Report
Exhibit II – Significant Deficiencies

- 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.
2. *Related to the Entry Process:*
- a. Redistribute guidance to necessary personnel regarding the appropriate CBP Directives that communicated the steps required for completing control procedures;
 - b. Develop policies and procedures, and provide training to port-level personnel related to the In-Bond Compliance Module;
 - c. Address limitations in reporting capabilities within the In-Bond Compliance Module;
 - d. 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;
 - e. Develop procedures to evaluate the completeness of the compliance review results submitted to CBP headquarters;
 - f. Continue to strengthen monitoring efforts related to bond sufficiency; and
 - g. 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

All of the compliance and other matters described below are repeat conditions from FY 2013.

III-H 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 November 13, 2014, as presented in *Management's Discussion and Analysis* of the Department's 2014 *Agency Financial Report* (AFR), acknowledged the existence of material weaknesses, and therefore provided qualified assurance that internal control over financial reporting was operating effectively as of September 30, 2014. 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 2015. We also recommend that the Department conduct timely validation and verification procedures to demonstrate remediation in the fiscal year in which remediation occurred.

III-I 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 2014. 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-J Anti-deficiency Act (ADA)

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

- In response to a FY 2007 GAO report, the DHS OIG conducted a review of the NPPD legacy organization for FY 2006, and found that it violated the ADA with respect to the use of shared services. DHS formally notified the President, Congress, and GAO of the 2006 violation in FY 2014.
- Per the DHS OIG report and recommendations for the FY 2006 shared services violation, NPPD completed a review of FY 2007, FY 2008, FY 2009, and FY 2010 Management and Administration appropriation obligations for any potential shared service appropriation violations.

Independent Auditors' Report

Exhibit III – Compliance and Other Matters

NPPD is in the process of investigating a potential violation for one transaction related to shared services in FY 2007.

- The independent investigation, at Intelligence and Analysis, related to the obligation of funds in excess of its continuing resolution apportionment in FY 2012 has been completed. The package to notify the President, Congress, and GAO of the violation is under review.
- In FY 2014, investigations related to two potential ADA violations at Coast Guard were completed. One potential violation is related to the partial termination of a contract modification funded through an appropriation other than the original appropriation used to obligate the delivery order and the other potential violation is related to the potential use of an incorrect appropriation to pay for an in-scope contract modification.
- The Department is investigating a potential ADA violation related to incorrect use of funds received from components for services.
- ICE is investigating a potential ADA violation related to payments for the room, board, treatment, and medication of aliens with mental health conditions following their release from ICE custody.
- The Management Directorate is researching a potential violation related to an overobligation of funds that occurred in FY 2013.
- In FY 2013, the Department submitted notification packages related to two separate violations, at the Coast Guard, to the President. One violation related to funds that may have been used in advance of an approved apportionment from OMB, and one related to improper execution of the obligation and disbursement of funds for the lease of passenger vehicles.
- In FY 2013, the Department submitted a notification package related to an ADA violation at the Management Directorate; the violation related to rental charges at the Office of the Federal Coordinator for Gulf Coast Rebuilding incurred in FY 2009 that were not properly committed or obligated.

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.

III-K 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.

We noted that the Department overall has taken positive steps toward compliance with FFMIA and remediated some of the conditions identified in the prior year. However, the following components did not fully comply with at least one of the requirements of FFMIA: the Coast Guard, U.S. Customs and Border Protection, FEMA, U.S. Immigration and Customs Enforcement, and U.S. Secret Service. The reasons for noncompliance are reported in Exhibits I and II. The Secretary of DHS has stated in the Secretary's Assurance Statement dated November 13, 2014, 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 2014 AFR.

Independent Auditors' Report
Exhibit III – Compliance and Other Matters

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.

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.

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Index of Financial Reporting and Internal Control Criteria
(Listed Alphabetically by Criteria Source)

Criteria	Reference	Report Exhibit
AU Section 342, <i>Auditing Accounting Estimates</i>	Section 342.03 Section 340.05 through 340.06	I-A
AU Section 350, <i>Audit Sampling</i>	Sections 350.23	I-A
<i>Bonded Warehouse Manual for Customs and Border Protection Officers and Bonded Warehouse Proprietors</i> (HB 3500-11, January 2012)	Part 1.1	II-G
CBP 2013 <i>Drawback Handbook</i> , Issued (HB 3700-01B, February 2013)	5.2 <i>Accelerated Payment</i>	II-G
CBP <i>Business Rules and Process Documents (Internal) Version 3.3</i>	6.1 <i>Single Transaction Bonds</i>	II-G
CBP <i>Compliance Review Handbook for Bonded Warehouses</i> (HB 3500-09, December 2007)		II-G
CBP <i>Compliance Review Handbook for Foreign Trade Zones</i> (HB 3500-10, July 2008)	<i>Risk Assessments</i> (1)(2)(3)	II-G
CBP Directive 3710-004B, <i>Refund of Miscellaneous Collections</i>	Section 2.2, Section 5.7.1 Section 6.1	II-G
CBP Directive 5320-028D, <i>Commitment, Obligation, Expenditure, and Payment Procedures for Goods and Services</i>	Section 7.5.1	I-C
CBP Directive 5610-004B, <i>Resolving Certain ACS Exception and Error Reports</i>	Section 5.4.2 Section 5.5.2 Section 5.6.2 Section 5.11.2	II-G
CBP Directive 5610-006A, <i>Entry Deletion and Entry or Entry Summary Cancellation</i>	Section 1	II-G
CBP <i>Information Systems Security Policies and Procedures Handbook 1400-05D</i> , Version 4.0	Section 4.1.5.c	II-E
CBP <i>Office of Field Operations' Guide for In-Bond Cargo</i> , Version 1.0, March 31, 2006	<i>In-Bond Exams and Audits</i>	II-G
CBP's <i>Personal Property Handbook, HB 5200-13B</i>	Chapter 8	I-C
CIS HB 2100-05A, <i>Records Control Handbook</i>	Section B	II-G
Code of Federal Regulations, Title 19	§18.2, §18.6, §18.8, §19.4, §111.23, §111.25, §113.13, §113.15, §113.26, §113.65, §146.3, §163.4, §191.15, §191.38, §191.51, §191.92	II-G
Code of Federal Regulations, Title 31	§205.33	II-F
<i>Component Requirements Guide for Financial Reporting in FY 2014</i> , Version 2.0, June 2014	Section 3.1 Section 8.12 Section 8.16 Section 9.9 Section 9.10 Section 10.1	I-A
	Section 9.9	I-C
	Section 8.12 Section 8.16	I-D
<i>Debt Collection Improvement Act of 1996</i>	Section 3B	I-A
DHS Instruction 121-01-007, <i>Personnel Suitability and Security Program</i> , June 2009	- Chapter 2, Section 3.E - Appendix B	II-E

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Criteria	Reference	Report Exhibit
DHS Sensitive Systems Policy Directive 4300A, Version 11.0	Section 4.1	II-E
<i>Exemption of Classes of Debts from Mandatory Referral To Treasury, Procedures and Standards, January 2001</i>	Section II	I-A
FASAB Technical Release 14: <i>Implementation Guidance on the Accounting for the Disposal of General Property, Plant, & Equipment</i>	Paragraph 10 Paragraph A7	I-C
Federal Acquisition Regulation (FAR)	§4.801, §4.802	I-B
Federal Emergency Management Agency Directives Management System, <i>SF 132/SF 133 Reconciliation Standard Operating Procedures, July 2014</i>	VIII. Responsibilities IX. Standard Operating Procedures	I-D
<i>Federal Financial Management Improvement Act of 1996</i>	Section 803	I-A, I-B, I-C
<i>Federal Managers Financial Integrity Act of 1982</i>	Section 2	I-A, I-B, I-C, I-D, II-G
Federal Travel Regulation (FTR)	§301-2.1	I-A
FEMA Budget Planning Analysis Division's <i>Funds Loading Standard Operating Procedures</i>	Section B Section D	I-D
FEMA Corrective Actions SOP, January 2014	Section 3	I-B
FEMA Directive 112-12: <i>Policy, Directive and Doctrine Process Guidance</i>	Section III.B.3 Section IV.A.6	I-B
<i>Financial Resource Management Manual (FRMM COMDTINST M7100.3E), September 2013</i>	Section 7.9 Section 10.2 Section 10.3	I-A, I-C
<i>FY 2011 Financial Management Codes, January 27, 2011</i>	Chapter 4, BOC 2589	I-D
GAO / President's Council on Integrity & Efficiency <i>Financial Audit Manual (GAO-08-585G)</i>	Section 480.07 Section 480.11 Section 480.16	I-A
GAO <i>FINANCIAL MANAGEMENT FFMIA Implementation Critical for Federal Accountability (GAO-02-29)</i>	Page 1, Paragraph 2	I-A, I-B, I-C
GAO <i>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
GAO's <i>Standards for Internal Control in the Federal Government</i>	Control Activities	I-A, I-B, I-D, II-F
	Definition and Objectives	I-A
	Examples of Control Activities (Accurate and Timely Recording of Transactions and Events)	I-A, I-D, II-F
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	Examples of Control Activities (Proper Execution of Transactions and Events)	I-D
	Presentation of the Standards	I-A
Grants Programs Directorate, <i>FY 2014 FEMA Monitoring Plan, Updated December 3, 2013</i>	Section 4.3	I-B

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Criteria	Reference	Report Exhibit
Interpretation of Federal Financial Accounting Standards 7: <i>Items Held for Remanufacture</i>	Paragraphs 7 and 8	I-A, I-B
Memorandum: <i>In-Bond Compliance Module Deployment</i>		II-G
National Institute of Standards and Technology Special Publication 800-53 Revision 4, <i>Security and Privacy Controls for Federal Information Systems and Organizations</i>	Appendix F: AT-2, AT-3, AT-4, SA-3	II-E
Office of Personnel Management, Benefits Administration Letter, Number: 14-304	14-304 - Fiscal Year 2014 Cost Factors for Calculating Imputed Costs	I-A
OMB Circular No. A-11, <i>Preparation, Submission, and Execution of the Budget</i> , July 2014	Section 1	I-A
	Section 20.5 Appendix F	I-A, I-D
	Appendix G	I-B, I-D
	Section 120.50	I-D
OMB Circular No. A-123, <i>Management's Responsibility for Internal Control</i> , Revised	I. Purpose	I-G
	3. Policy	I-A, I-C, II-G
	I. Introduction	I-A, I-B, I-C, I-D, II-G
	II. Standards	I-B, I-D, II-G
	III. Integrated Internal Control Framework	I-D
	IV. Assessing Internal Control	II-G
	Appendix D	I-A, I-B, I-C
OMB Circular No. A-130, <i>Management of Federal Information Resources</i> , Revised	Appendix III, Section 3	II-E
OMB Circular No. A-133, <i>Revised to show changes published in the Federal Registers of June 27, 2003 and June 26, 2007 Audits of States, Local Governments, and Non-Profit Organizations</i>	Subparts B, D	II-F
OMB Circular No. A-136, <i>Financial Reporting Requirements</i> , Revised	Section V.2 and V.3	I-A
<i>Single Audit Act Amendments of 1996</i>	Section 7502	II-F
Statement of Federal Financial Accounting Standards 1: <i>Accounting for Selected Assets and Liabilities</i>	Paragraphs 39, 41, 45, 77	I-A
Statement of Federal Financial Accounting Standards 5: <i>Accounting for Liabilities of The Federal Government</i>	Paragraph 19	I-A
Statement of Federal Financial Accounting Standards 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	I-C
Statement of Federal Financial Accounting Standards 7: <i>Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting</i>	Paragraph 78	I-A
Statement of Federal Financial Accounting Standards 10: <i>Accounting for Internal Use Software</i>	Paragraphs 16, 18, 20	I-A

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Criteria	Reference	Report Exhibit
Statement of Federal Financial Accounting Standards 29: <i>Heritage Assets and Stewardship Land</i>	Summary	I-A, I-C
Statement of Federal Financial Accounting Standards 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 SFFAS 23 - Paragraph 16 SFFAS 23 - Paragraph 12	I-A, I-C
Statement of Federal Financial Accounting Standards 42: <i>Deferred Maintenance and Repairs: Amending Statements of Federal Financial Accounting Standards 6, 14, 29 and 32</i>	Paragraph 7	I-A, I-C
Treasury Financial Manual, Volume I	- Part 2, Chapter 4700, Section 4706.25 - Part 2, Chapter 4700, Appendix 10 - Part 2, Chapter 5100, Appendix 2 - Fund Balance With Treasury Reconciliation Procedures: A Supplement to TFM Volume I, Part 2, Chapter 5100, Section V	I-A
U.S. Department of Homeland Security Federal Emergency Management Agency Grant Programs Directorate Regional Coordination and Oversight Branch, <i>Cash Analysis Reporting SOP</i> , February 2014	Appendix C	II-F
United States Coast Guard <i>Environmental Liabilities Process Guide</i>	Section 2.5.2	I-A
United States Coast Guard <i>Finance Center Standard Operating Procedures</i>	Chapter 12, Section A	I-A
United States Coast Guard, NPFC, <i>Case Management Division Standard Operating Procedures, CM SOP Appendix</i> , NPFCINST M16451.23A	Chapter 7, Section I	I-A
United States Coast Guard <i>Procedures for Physical Inventory and Year End Certification of Capitalized Personal Property</i>	Section 1.3 Section 5.5 through 5.7	I-A, I-C
US Code Title 31, Chapter 15	§1501, §1554	I-A, I-D
US Government Standard General Ledger <i>Chart of Accounts, Treasury Financial Manual</i> , Fiscal Year 2014 Reporting Supplement	Part 1, Section 1	I-A



OFFICE OF INSPECTOR GENERAL
Department of Homeland Security

Appendix A

Management Comments to the Report

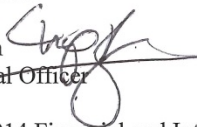
U.S. Department of Homeland Security
Washington, DC 20528



**Homeland
Security**

November 13, 2014

MEMORANDUM FOR: John Roth
Inspector General

FROM: Chip Fulghum 
Chief Financial Officer

SUBJECT: Fiscal Year 2014 Financial and Internal Controls Audit

Thank you for your audit report on the Department's financial statements and internal controls over financial reporting for fiscal years (FY) 2013 and 2014. 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 2014, our Components continued to implement corrective actions to significantly improve key financial management and internal control areas, while sustaining our unmodified audit opinion on all financial statements.

We are already focusing our efforts on remediating the remaining issues in FY 2015 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 B

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