

# Department of Homeland Security Office of Inspector General

**U.S. Coast Guard's Management Letter for FY 2011  
DHS Consolidated Financial Statements Audit**



*Office of Inspector General*

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



# Homeland Security

**MAR 14 2012**

## Preface

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

This report presents the U.S. Coast Guard's Management Letter for FY 2011 DHS Consolidated Financial Statements Audit. It contains observations related to internal controls that were not required to be reported in the financial statements audit report. The independent public accounting firm KPMG LLP (KPMG) performed the integrated audit of DHS' FY 2011 financial statements and internal control over financial reporting and prepared this management letter. KPMG is responsible for the attached management letter dated February 03, 2012 and the conclusions expressed in it. We do not express opinions on DHS' financial statements or internal control or provide conclusions on compliance with laws and regulations.

The recommendations herein have been discussed in draft with those responsible for implementation. We trust this report will result in more effective, efficient, and economical operations. We express our appreciation to all of those who contributed to the preparation of this report.

A handwritten signature in black ink, appearing to read "Anne L. Richards".

Anne L. Richards  
Assistant Inspector General for Audits



**KPMG LLP**  
Suite 12000  
1801 K Street, NW  
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February 3, 2012

Office of Inspector General  
U.S. Department of Homeland Security, and  
Chief Financial Officer  
U.S. Department of Homeland Security U.S. Coast Guard  
Washington, DC

Ladies and Gentlemen:

We have audited the balance sheet of the U.S. Department of Homeland Security (DHS or Department) as of September 30, 2011 and the related statement of custodial activity for the year then ended (referred to herein as the “fiscal year (FY) 2011 financial statements”). The objective of our audit was to express an opinion on the fair presentation of these financial statements. We were also engaged to examine the Department’s internal control over financial reporting of the balance sheet as of September 30, 2011, and statement of custodial activity for the year then ended, based on the criteria established in Office of Management and Budget, Circular No. A-123, *Management’s Responsibility for Internal Control*, Appendix A.

Our *Independent Auditors’ Report* issued on November 11, 2011, describes a limitation on the scope of our audit that prevented us from performing all procedures necessary to express an unqualified opinion on DHS’ FY 2011 financial statements and internal control over financial reporting. In addition, the FY 2011 DHS *Secretary’s Assurance Statement* states that the Department was unable to provide assurance that internal control over financial reporting was operating effectively at September 30, 2011. We have not considered internal control since the date of our *Independent Auditors’ Report*.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. In accordance with *Government Auditing Standards*, our *Independent Auditors’ Report*, referred to in the paragraph above, included internal control deficiencies identified during our audit, that individually, or in aggregate, represented a material weakness or a significant deficiency.

The U.S. Coast Guard (Coast Guard) is a component of DHS. We noted certain matters, related to the Coast Guard that are summarized in the Table of Financial Management Comments on the following pages, involving internal control and other operational matters that are less severe than a material weakness or a significant deficiency, and consequently are reported separately to the Office of Inspector General (OIG) and the Coast Guard management in this letter. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies. The disposition of each internal control deficiency identified during our FY 2011 audit – as either reported in our *Independent Auditors’ Report*, or herein – is presented in Appendix A. The



status of internal control deficiencies identified during our FY 2010 audit is presented in Appendix B. Our findings related to information technology systems security have been presented in a separate letter to the OIG and the Coast Guard Chief Financial Officer and Chief Information Officer.

We would be pleased to discuss these comments and recommendations with you at any time. This report is intended for the information and use of DHS' and the Coast Guard's management, the DHS Office of Inspector General, the U.S. Office of Management and Budget, the U.S. Congress, and the Government Accountability Office, and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

*KPMG LLP*

U.S. Coast Guard  
*Table of Financial Management Comments*  
September 30, 2011

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U.S. Coast Guard  
*Financial Management Comments*  
September 30, 2011

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**FMC 11-01 – Financial Management Oversight (NFR No. USCG 11-03)**

While U.S. Coast Guard (Coast Guard or USCG) financial management oversight exists and remediation efforts related to entity-level controls continue, weaknesses in the entity-level control structure continue to affect Coast Guard financial management as follows:

Based on our September 30, 2011 testwork, we noted that the Coast Guard has not fully implemented an internal control environment that supports the philosophy and operating style, commitment to competence, organizational structure, human resources policies and practices, and integrity and ethical values. Specifically:

- The Coast Guard has not developed adequate controls to track and monitor whether the training and continued education courses have been completed by civilian employees to ensure maintenance and improvement of their competencies for their jobs.
- The Coast Guard has not developed adequate controls to track whether all employees receive the Standards of Ethical Conduct upon entry into the USCG. Specifically, USCG was unable to provide evidence to support that Standards of Ethical Conduct was received and reviewed within the first 90 days of duty for eight out of eight civilian employees hired during October 1, 2010 through December 31, 2010.
- The Coast Guard has not developed adequate controls to support employee's awareness of the existence of the DHS Office of Inspector General (OIG) Hotline for reporting information on waste, fraud, abuse, and corruption in the workplace to the OIG. Specifically, three out of 10 employees were not aware of the existence of the DHS OIG Hotline through inquiries performed.

*Recommendations:*

We recommend that the Coast Guard:

- Develop a new system to track and monitor whether training and continued education courses have been completed by civilian employees to ensure maintenance and improvement of their competencies for their jobs.
- Develop a new system to track and document whether new civilian employees complete initial ethics training.
- Develop a new system to raise awareness of the DHS OIG Hotline for reporting information on waste, fraud, abuse, and corruption in the workplace to the OIG.

**FMC 11-02 – Accrued Payroll and Unfunded Leave Accrual (NFR No. USCG 11-10)**

We noted that the Coast Guard does not perform a timely reconciliation of annual leave discrepancies identified between payroll related systems.

*Recommendations:*

We recommend that the Coast Guard:

- Accelerate the rollout of electronic timekeeping to encompass all employees.
- Re-direct staff as available to reconcile differences in civilian employee leave balances between payroll related systems.
- Establish a more robust procedure for comparing civilian employee leave balances in payroll related systems each pay period and reconciling the differences in a timely manner.

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#### **FMC 11-03 – Financial Disclosure Reports (*NFR No. USCG 11-13*)**

We noted that the Coast Guard had not developed adequate controls to track and monitor the filing and review of the Confidential Financial Disclosure Report (CFDRs), including document retention for the investigation of any violation and corrective actions taken to ensure compliance.

We selected a sample of 15 CFDRs from the 2011 filed CFDRs and noted the following exceptions where the CFDR filing process was not properly followed. Specifically:

- One CFDR was reviewed after the 60 day reviewing period.
- One CFDR was signed by the employee after the date CG-0944 received the form.
- Two CFDR filers did not properly complete all sections required for reporting transactions which could represent a potential conflict of interest.

We noted the Coast Guard has not developed adequate controls to track and monitor compliance with the Coast Guard code of conduct – *Standards of Ethical Conduct*, including evidence of compliance with ethics training requirements.

While the Coast Guard maintained a centralized list of positions required to file a CFDR, we noted the Coast Guard does not maintain a centralized list of employees required to file a CFDR and attend ethical training to monitor compliance with CFDR filing and training requirements. Further, we noted the Coast Guard does not have procedures in place to ensure the completeness or accuracy of the list of individuals required to file CFDRs or Public Financial Disclosure Report (PFDRs).

*Recommendation:*

We recommend that Coast Guard evaluate and strengthen its internal controls related to CFDR and PFDR filings before December to ensure full compliance with all CFDR and PFDR program rules.

#### **FMC 11-04 – Operating Materials and Supplies (*NFR No. USCG 11-16*)**

We noted gaps in policies and procedures that prevent consistent implemented control procedures between Aviation Logistics Center (ALC) and Coast Guard Air Stations. Inconsistent document retention requirements, and non-standardized forms, can increase the risk of control deficiencies. More specifically,

- ALC could not provide source documentation for eight out of the 15 selected issuances between October 1, 2010 to June 30, 2011.
- Source documentation for two out of 15 receipts could not be provided because the information was not properly retained by Coast Guard Air Stations.

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During our substantive testing procedures, we noted the following:

*As of June 30, 2011:*

- The ALC inventory system calculates the weighted average pricing for intragovernmental related purchases using the price at which the asset is ordered and not the amount actually paid. As a result, we noted two known errors of approximately \$30 and a projected error of \$341,312.

*September 30, 2011:*

- Similar to June 30, 2011 findings, we noted that for one sample, the incorrect purchase price was used to calculate the weighted average pricing. As a result, we noted a known overstatement of \$123 and a projected overstatement of \$58,248.
- We noted that the quantity on hand for one sample was incorrect as of September 30, 2011, causing a \$12,607 known understatement and a projected understatement of \$198,599.

*Recommendations:*

We recommend that Coast Guard:

- Closely monitor the implementation of existing Coast Guard requirements to insure compliance at Coast Guard Air Stations.
- Conduct an analysis of the impact and materiality of using ordered price instead of actual price paid in the calculation of weighted average pricing.

**USCG – FMC 11-05 – Human Resources Compliance with Laws and Regulations (NFR No. USCG 11-20)**

While performing compliance testwork related to Thrift Savings Plan (TSP) elections, we noted the Coast Guard was unable to provide the TSP-1 (TSP election form) for one employee. Additionally, we noted the information provided to evidence the employee's most current TSP election indicated a contribution amount of \$200 per pay period while the employee's TSP contribution made in pay period 12 was \$449. As such, we were unable to verify that the appropriate deduction for the employee was taken in pay period 12.

*Recommendation:*

We recommend that Coast Guard implement a review process to compare employee TSP elections to the documented TSP deduction being used by the payroll service provider and reported on the employees' leave and earnings statements.

**USCG – FMC 11-06 – Actuarial Medical Liabilities (NFR No. USCG 11-24)**

During FY 2011, the Coast Guard continued to implement internal control and substantive procedures over medical payment information associated with direct care medical claims. While reviewing the sampling plan implemented to test direct care data, we noted the following related to its design and implementation:

- Selecting only one line per invoice page and only two pages from each invoice may be insufficient for large volume invoices (i.e., invoices with many pages and pages with many lines).

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- The single stage projection methodology applied by the Coast Guard to project errors does not match the sample design. It may be more appropriate for errors to be projected through each stage of the sample, eliminating the need to artificially cap error rates.

*Recommendations:*

We recommend that Coast Guard:

- Consider the direct care test results from FY 2010 and FY 2011 as well as the conditions above to update the sampling plan for FY 2012.
- Consider eliminating the state of sampling requiring a page number to be randomly selected from a paper invoice patient category and then a line item to be randomly selected from the page.
- Consider the use of electronic reconciliations of the paper invoice patient categories to directly sample line items.

**U.S. Coast Guard**  
**Crosswalk - Financial Management Comments to Active NFRs**  
September 30, 2011

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<b>NFR No.</b>	<b>Description</b>	<b>Disposition<sup>1</sup></b>			<b>FMC</b>
		<b>IAR</b>	<b>MW</b>	<b>SD</b>	
11-01	Environmental Liabilities		D		
11-02	Heritage Assets		C		
11-03	Financial Management Oversight				11-01
11-04	Statement of Net Cost		A		
11-05	Fund Balance with Treasury (FBWT) Reconciliations			G	
11-06	Cumulative Results of Operations		A		
11-07	UDOs		E		
11-08	Legal Liability Reporting		D		
11-09	Accrued Payroll and Unfunded Leave Accrual (Military)		D		
11-10	Accrued Payroll and Unfunded Leave Accrual				11-02
11-11	Financial Reporting Process		A		
11-12	Accounts Payable Accrual		D		
11-13	Financial Disclosure Reports				11-03
11-14	Purchase Requests/Commitments		E		
11-15	Accounts Receivable		A		
11-16	Operating Materials and Supplies				11-04
11-17	PP&E Non-CIP Assets		C		
11-18	<i>Federal Managers' Financial Integrity Act of 1982</i>				J
11-19	PP&E Asset Records		C		
11-20	Human Resources Compliance with Laws and Regulations				11-05
11-21	Intragovernmental Transactions and Balances		A		
11-22	PP&E: Repairables		C		
11-23	PP&E: CIP		C		
11-24	Actuarial Medical Liabilities				11-06
11-25	Federal Managers' Financial Integrity Act of 1996				K
11-26	PP&E: 4 <sup>th</sup> Quarter Site Visit Observations		C		

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**1Disposition Legend:**

IAR	Independent Auditors' Report dated November 11, 2011
FMC	Financial Management Comment
MW	Contributed to a Material Weakness at the Department level when combined with the results of all other components
SD	Contributed to a Significant Deficiency at the Department level when combined with the results of all other components
NC	Contributed to Non-Compliance with laws, regulations, contracts, and grant agreements at the Department level when combined with the results of all other components
NFR	Notice of Finding and Recommendation

**Cross-reference to the applicable sections of the IAR:**

A	Financial Reporting
B	Information Technology Controls and System Functionality
C	Property, Plant, and Equipment
D	Environmental and Other Liabilities
E	Budgetary Accounting
F	Entity-Level Controls
G	Fund Balance with Treasury
H	Grants Management
I	Custodial Revenue and Drawback
J	<i>Federal Managers' Financial Integrity Act of 1982 (FMFIA)</i>
K	<i>Federal Financial Management Improvement Act of 1996 (FFMIA)</i>
L	<i>Single Audit Act Amendments of 1996</i>
M	<i>Chief Financial Officers Act of 1990 (CFO Act)</i>
N	<i>Antideficiency Act, as amended (ADA)</i>
O	<i>Government Performance and Results Act of 1993 (GPRA)</i>

**U.S. Coast Guard**  
*Status of Prior Year NFRs*  
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<b>NFR No.</b>	<b>Description</b>	<b>Disposition<sup>1</sup></b>	
		<b>Closed<sup>2</sup></b>	<b>Repeat (2011 NFR No.)</b>
10-01	Heritage Assets		USCG 11-02
10-02	Purchase Requests/Commitments		USCG 11-14
10-03	Statement of Net Cost		USCG 11-04
10-04	Contracting Officer Warrant Authority	X	
10-05	Environmental Liabilities		USCG 11-01
10-06	PP&E Non-CIP Assets		USCG 11-17
10-07	Vessels and Small Boats Useful Lives	X	
10-08	FFMIA		USCG 11-25
10-09	Cumulative Results of Operations		USCG 11-06
10-10	Financial Disclosure Reports		USCG 11-13
10-11	PP&E Asset Records		USCG 11-19
10-12	Legal Liability Reporting		USCG 11-08
10-13	Actuarial Post Employment Travel Liability	X	
10-14	PP&E: Repairables		USCG 11-22
10-15	Intragovernmental Transactions and Balances		USCG 11-21
10-16	PP&E: Fourth Quarter Site Visit Observations		USCG 11-26
10-17	PP&E Construction in Progress		USCG 11-23
10-18	Financial Management Oversight		USCG 11-03
10-19	Permanent Change of Station – Separation/Retirement Presentation	X	
10-20	FBWT – Reconciliations		USCG 11-05
10-21	Suspense Accounts	X	
10-22	Accrued Payroll and Unfunded Leave Accrual (Military)		USCG 11-09
10-23	Operating Materials and Supplies		USCG 11-16
10-24	Accrued Payroll and Unfunded Leave Accrual		USCG 11-10
10-25	FY 2010 Actuarial Liabilities Restatement	X	
10-26	Accounts Payable Accrual		USCG 11-12
10-27	Undelivered Orders		USCG 11-07
10-28	Financial Reporting Process		USCG 11-11
10-29	Federal Managers' Financial Integrity Act		USCG 11-18
10-30	Actuarial Medical Liabilities		USCG 11-24
10-31	Accounts Receivable		USCG 11-15
10-32	FBWT and Unexpended Appropriations	X	

U.S. Coast Guard  
*Status of Prior Year NFRs*  
September 30, 2011

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<sup>1</sup> KPMG was engaged to perform an audit over the DHS balance sheet and statement of custodial activity as of and for the year ended September 30, 2011, and was not engaged to perform an audit over the statement of net cost, statement of changes in net position, and statement of budgetary resources for the year ended September 30, 2011. In addition, we were engaged to follow-up on the status of all active NFRs that supported significant deficiencies reported in our FY 2010 *Independent Auditors' Report*.

<sup>2</sup> The scope of our audit was limited to follow-up on NFRs that supported a material weakness or significant deficiency as reported in our *Independent Auditors' Report*. All other NFRs, e.g., that described insignificant findings, and therefore presented to DHS management as observations for consideration, were considered closed.

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