Department of Homeland Security
Office of Inspector General

Independent Auditors' Report on U.S. Customs and Border Protection's FY 2012 Financial Statements

OIG-13-53

March 2013

OFFICE OF INSPECTOR GENERAL
Department of Homeland Security

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

MAR 22 2013

MEMORANDUM FOR: Deborah J. Schilling
Chief Financial Officer
U.S. Customs and Border Protection

FROM: Anne L. Richards
Assistant Inspector General for Audits

SUBJECT: *Independent Auditors' Report on U.S. Customs and Border Protection's FY 2012 Financial Statements*

Attached for your action is our final report, *Independent Auditors' Report on U.S. Customs and Border Protection's FY 2012 Financial Statements*. We have incorporated the formal comments from U.S. Customs and Border Protection (CBP) in the final report.

The report presents the results of CBP's consolidated financial statement audits for fiscal years (FY) 2012 and 2011. We contracted with the independent public accounting firm KPMG LLP to perform the audits. KPMG LLP concluded that CBP's consolidated financial statements as of and for the years ended September 30, 2012, and September 30, 2011, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

The FY 2012 independent auditors' report also contains observations and 18 recommendations related to internal control weaknesses that were considered significant deficiencies and were required to be reported in the financial statement audit report. The four significant deficiencies in internal controls are presented below; the first significant deficiency is considered to be a material weakness. Your office concurred with the one material weakness and three other significant deficiencies presented below:

Significant Deficiencies in Internal Control

A. Drawback of Duties, Taxes, and Fees
B. Property, Plant, and Equipment
C. Entry Process
    1. In-Bond Program
    2. Bonded Warehouse and Foreign Trade Zones
    3. Entry Reports
D. Information Technology

KPMG LLP is responsible for the attached independent auditors' report dated January 25, 2012, and the conclusions expressed in the report. We do not express opinions on financial statements or internal control or conclusions on compliance with laws and regulations.

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

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

Attachment

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

Independent Auditors' Report

Inspector General
U.S. Department of Homeland Security:

Deputy Commissioner
U.S. Customs and Border Protection:

We have audited the accompanying consolidated balance sheets of the U.S. Customs and Border Protection (CBP), a Component of the U.S. Department of Homeland Security (DHS), as of September 30, 2012 and 2011, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources (hereinafter referred to as "consolidated financial statements") for the years then ended. The objective of our audits was to express an opinion on the fair presentation of these consolidated financial statements. In connection with our fiscal year 2012 audit, we also considered CBP's internal control over financial reporting and tested CBP's compliance with certain provisions of applicable laws, regulations, and contracts that could have a direct and material effect on these consolidated financial statements.

Summary

As stated in our opinion on the consolidated financial statements, we concluded that CBP's consolidated financial statements as of and for the years ended September 30, 2012 and 2011, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

As discussed in our Opinion on the Financial Statements, CBP changed its presentation for reporting the Statement of Budgetary Resources and changed its method of accounting for certain user fees in fiscal year 2012.

Our consideration of internal control over financial reporting resulted in identifying certain deficiencies that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies, as defined in the Internal Control Over Financial Reporting section of this report, as follows:

Material Weakness:

A. Drawback of Duties, Taxes, and Fees

Significant Deficiencies:

B. Property, Plant, and Equipment
C. Entry Process
    1. In-Bond Program
    2. Bonded Warehouse and Foreign Trade Zones
    3. Entry Reports
D. Information Technology

The results of our tests of compliance with certain provisions of laws, regulations, and contracts disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards*, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

The following sections discuss our opinion on CBP's consolidated financial statements; our consideration of CBP's internal control over financial reporting; our tests of CBP's compliance with certain provisions of applicable laws, regulations, and contracts; and management's and our responsibilities.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of the U.S. Customs and Border Protection, a component of the U.S. Department of Homeland Security, as of September 30, 2012 and 2011, and the related consolidated statements of net cost, changes in net position, and custodial activity, and the combined statements of budgetary resources for the years then ended.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CBP as of September 30, 2012 and 2011, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, CBP changed its presentation for reporting the combined statement of budgetary resources in fiscal year 2012, based on new reporting requirements under OMB Circular No. A-136, *Financial Reporting Requirements*. As a result, CBP's combined statement of budgetary resources for fiscal year 2011 has been reclassified to conform to the current year presentation.

As discussed in Note 22, CBP changed its method of accounting for certain user fees. These accounting changes were reflected in the fiscal year 2012 financial statements.

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis and Required Supplementary Information sections be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We 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 financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The information in the Commissioner's Message, Performance Section, Message from the Chief Financial Officer, Other Accompanying Information, and Acronyms as reflected in CBP's *Fiscal Year 2012 Performance and Accountability Report* is presented for the purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

Internal Control Over Financial Reporting

Our consideration of the internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, in our fiscal year 2012 audit, we identified certain deficiencies in internal control over financial reporting that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

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. We consider the deficiencies described in Exhibit I to be a material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in Exhibit II to be significant deficiencies.

Exhibit III presents the status of prior year significant deficiencies and the material weakness.

We noted certain additional matters that we will report to the management of CBP in a separate letter.

Compliance and Other Matters

The results of our tests of compliance as described in the Responsibilities section of this report disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

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Responsibilities

Management's Responsibilities. Management is responsible for the consolidated financial statements; establishing and maintaining effective internal control over financial reporting; and complying with laws, regulations, and contracts applicable to CBP.

Auditors' Responsibilities. Our responsibility is to express an opinion on the fiscal year 2012 and 2011 consolidated financial statements of CBP 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 OMB Bulletin No. 07-04. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CBP's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements;

- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall consolidated financial statement presentation.

We believe that our audits provide a reasonable basis for our opinion.

In planning and performing our fiscal year 2012 audit, we considered CBP's internal control over financial reporting by obtaining an understanding of CBP's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of CBP's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of CBP's internal control over financial reporting. We did not test all controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

As part of obtaining reasonable assurance about whether CBP's fiscal year 2012 consolidated financial statements are free of material misstatement, we performed tests of CBP's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to CBP. However, providing an opinion on compliance with laws, regulations, and contracts was not an objective of our audit and, accordingly, we do not express such an opinion.

CBP's written response to the findings identified in our audit is presented in Management's Response to the Independent Auditors' Report. Management's response was not subjected to the auditing procedures applied in the audit of CBP's consolidated financial statements and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of CBP's management, DHS' management, the DHS Office of Inspector General, OMB, 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.

KPMG LLP

January 25, 2013

EXHIBIT I

Material Weakness

A. Drawback of Duties, Taxes, and Fees

Background:

U.S. Customs and Border Protection (CBP) performs an important revenue collection function for the U.S. Department of the Treasury. CBP collected approximately $35.5 billion in import duties, taxes, and fees in fiscal year (FY) 2012 on merchandise arriving in the U.S. from foreign countries.

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. Depending on the type of drawback claim, the claimant has up to eight years from the date of importation to file for drawback.

The conditions cited below have existed for several years; however, since FY 2009 CBP's planned remediation for many of these conditions was tied to systems modernization through the Automated Commercial Environment (ACE). In recent years, funding for the implementation of ACE has been reduced, and a systems solution is currently unfunded. In FY 2012, CBP continued its efforts to review and reassess the drawback process as a whole.

Condition:

The following weaknesses related to internal control over drawback of duties, taxes, and fees paid by the importer were identified:

- CBP is unable to prevent, or detect and correct excessive drawback claims against an entry summary due to the inherent limitations of the Automated Commercial System (ACS) and the lack of controls therein. An entry summary can comprise numerous line items; however, ACS does not have the capability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries (UCEs), their individual line items, or export documentation upon which the drawback claim is based.
- Currently, the drawback module within ACS provides information to ensure that the total amount of all drawback claims against a given import entry does not exceed 100% of the total amount of duties, taxes, and fees collected, at the entry summary level. By law, the amount paid for drawback claims against a given import entry are not to exceed 99% of the duties, taxes, and fees collected at the individual line item level and the entry summary level. In addition, export information is not linked to the drawback module and therefore, electronic comparisons of export data cannot be performed within ACS to ensure that overpayments of drawback claims are not made.
- Drawback review policies do 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 has been claimed against import entries. CBP utilizes a "validity tree" approach when selecting prior drawback claims for review. The validity tree approach requires CBP to review the largest prior drawback claims; however, this approach is not statistical. In addition, for certain claims drawback review policy and procedures allow Drawback Specialists, with supervisory approval, to judgmentally decrease the number of UCEs reviewed to 30 if the number of UCEs exceeds 30 entries, which decreases the review's effectiveness. Further, CBP's sampling methodology for selecting UCEs is not considered to be statistically valid and CBP's Drawback Handbook does not include procedures for statistically projecting errors identified in the sample.

- The statutory period for document retention of a drawback claim is only three years from the date of payment. However, there are several situations that could extend the life of the drawback claim well beyond three years.

Cause/Effect:

Due to system functionality limitations, much of the drawback process is manual, placing an added burden on limited resources. CBP uses a sampling approach to compare, verify, and match consumption entry and export documentation to drawback claims submitted by importers. However, system and procedural limitations significantly decrease the effectiveness of this approach.

The inherent risk of fraudulent claims or claims made in error is high, which increases the risk of erroneous payments. Since all, or a statistically valid sample, of the related drawback claims are not reviewed for a selected import entry, the possibility exists that the related drawback claims, in aggregate, will exceed the amount of duty and tax collected on the UCEs at the line item level. In addition, the length of the drawback claim lifecycle often extends beyond the document retention period, which is set by statute at three years after payment of the claim.

Criteria:

Presented in *Index of Financial Reporting and Internal Control Criteria* behind Exhibit III.

Recommendations:

We recommend that CBP:

1. Continue to pursue alternative compensating controls and measures that may ultimately identify the potential revenue loss exposure to CBP, as the incorporation of drawback processing is not in the near-term schedule for ACE production. These alternative internal controls over drawback claims may result in the capability to compare, verify, and track essential information on drawback claims to the related UCEs and export documentation for which the drawback claim is based, and identify duplicate or excessive drawback claims;
2. Develop and implement automated controls to prevent overpayment of a drawback claim; and
3. Analyze current policies and procedures performed at the Drawback Centers, determine the cost/benefit of current procedures, and revise as necessary.

CBP Response:

See management's response included in the attached letter.

Other Significant Deficiencies

B. Property, Plant, and Equipment

Background:

U.S. Customs and Border Protection (CBP) acquired substantial new technology, facilities, and other assets in recent years through purchase and construction. The increased assets primarily include construction of border fencing (both physical and virtual), purchase of inspection equipment at Ports of Entry (POEs), and new facility construction at POEs.

Condition:

Improvements over CBP's accounting for Property, Plant, and Equipment (PP&E) were observed in FY 2012; however, several weaknesses remained throughout the fiscal year. Specifically, CBP:

- Did not properly and timely record certain construction-in-progress (CIP) settlement transactions, resulting in the misclassification of assets in the general ledger. The settlement recording delays spanned from one to seventeen months. As a result of these late settlements, depreciation for the assets was understated from the time the assets were placed in service to when the assets were settled. CBP performs a manual journal entry to correct total accumulated depreciation and depreciation expense in the general ledger. In addition, certain assets were identified in which CBP understated the value of its assets that were placed in service. CBP did not recognize the full value of the assets until further invoices were received. Furthermore, CBP incorrectly allocated overhead related to some American Recovery and Reinvestment Act Land Port of Entry construction projects that were incorrectly settled. Subsequent adjustments were made to the assets which caused over and understatements throughout the year.
- Did not detect assets incorrectly recorded, misclassified, or not recorded in the general ledger. Additionally, certain assets were recorded in the general ledger that no longer existed.
- Recorded certain asset additions for an amount other than the amount paid prior to the completion of a construction project, without proper supporting documentation, or in an untimely manner.
- Improperly recorded certain asset retirements. Specifically, some assets that were retired did not have proper approval and/or supporting documentation.
- Did not timely record certain asset retirements and did not properly write-down the value of some assets that were no longer providing their expected services. For the retirement transactions not timely recorded, one month to twelve months lapsed between when an asset was physically removed from service and when it was retired from service in the system.

Criteria:

Presented in *Index of Financial Reporting and Internal Control Criteria* behind Exhibit III.

Cause/Effect:

CBP did not fully implement policies and procedures and does not have sufficient oversight of its policies and procedures, to ensure that all PP&E transactions are recorded timely and accurately. As a result, CBP's CIP, PP&E, depreciation expense, and accumulated depreciation may be misstated at any point during the fiscal year by the recording of transactions that are incorrect, unsupported, or untimely.

Recommendations:

We recommend that CBP:

1. Ensure that existing policies and procedures for the proper recordation of asset additions, transfers and retirements with regard to asset valuations and depreciation are followed, and properly communicated throughout CBP;
2. Determine whether existing policies and procedures regarding purchase orders and goods receipt are sufficient, revise policies where necessary, and communicate policies and procedures to receivers of goods throughout CBP;
3. Establish procedures and training materials to ensure that program offices understand and implement internal controls to transfer completed assets timely and accurately from CIP to final assets; and
4. Request system changes, where possible, to require the submission of detailed supporting documentation and to ensure the proper authorization for retirement has been obtained prior to the completion of asset retirement transactions.

C. Entry Process

1. In-Bond Program

Background:

In FY 2012, CBP deployed a new system to replace the existing in-bond oversight functions, called the In-Bond Compliance Module. This module was implemented in early September 2012 and is intended to create a more effective in-bond monitoring system. However, for the majority of the period under audit, CBP was following policies and procedures that led to ineffective and inefficient in-bond processes and was using a system with limitations that restricted CBP's ability to accurately monitor the in-bond process, both at the Headquarters and port levels. The following discussion and conditions relate to processes and procedures that were in place during FY 2012.

General In-Bond Process

An in-bond entry allows the movement of cargo through the United States without payment of duty or appraisement prior to entry into domestic or foreign commerce. The cargo may enter commerce after it arrives at the destination port and an entry is filed. An in-bond also allows foreign merchandise arriving at one U.S. port to be transported through the U.S. for exportation from another U.S. port without the payment of duty.

Compliance Audit and In-Bond

In 1998, CBP implemented an audit system within the Automated Commercial System (ACS) to serve as a compliance measurement system. This audit system, known as Tin-Man, utilizes random physical examinations and post audit reviews to ensure bonded carrier compliance with bond obligations. Tin-Man is used to select ports to perform physical examinations at the time of arrival and departure and to perform post audit reviews of carrier activity. Once each week, ports throughout the U.S. are to be assigned post audits and physical examinations to perform based on a GAO-approved algorithm.

In-Bond Shipments Overdue for Export (M02) Report

In-bond shipments overdue for export are included on the M02 report. Items on this report are in-bond movements transmitted by importers or brokers via the Automated Manifest System (AMS), Automated Broker Interface (ABI), or paper that have not exported within the required time limit. Review of the M02 report is designed to identify, but is not limited to, cargo that has not been exported and therefore may have physically, but not formally entered into U.S. commerce, administrative or clerical errors with paperwork, or system processing errors.

Monthly List of In-Bond Shipments Overdue (M07) Report:

In-bond shipments overdue are included on the monthly M07 report. Data on paperless and conventional in-bond movements transmitted by AMS participants, as well as in-bond information input via the Process Departures function in ACS appear on this report. Review of the M07 report is designed to identify cargo that has not arrived at the original destination POE communicated to CBP.

Condition:

The following weaknesses were identified over the in-bond program:

- Ports were required to submit a summary of post audits conducted and the associated results to Headquarters. However, due to a system limitation in ACS, Headquarters was unable to generate an oversight report to determine if ports had completed all required audits. The In-Bond Exam/Audit Selection report in ACS was designed to provide this function, but did not accurately list the history of all in-bonds selected for audit and was not consistent with the listing of incomplete Tin-Man audits on the In-Bond Exam Audit Table report. With the implementation of the ATS In-Bond Compliance module, Headquarters will be able to generate an oversight report to determine if ports have completed all required audits.
- Headquarters completed a monthly analysis of the post audits and results submitted from the ports to determine the overall compliance rate of the in-bond program. However, documentation of this analysis was not maintained.
- The M02 report was designed to track overdue in-bonds for all modes of export; however, the M02 report was unable to track air in-bonds.
- The design of the M02 and M07 reports led to outdated information being reported on the monitoring reports. Therefore, the ports were instructed to focus on the most recent issues. As a result, there was no requirement for ports to completely resolve all open items on the M02 and M07 reports each time they were reviewed and open items on the reports remained unresolved. Additionally, certain ports were not maintaining the M02 and M07 reports in accordance with documentation retention requirements outlined in policy.
- Certain ports were not performing physical examinations as designated by Tin-Man, were not generating the Tin-Man report at the frequency prescribed in policy, and were not maintaining the Tin-Man reports in accordance with documentation retention requirements outlined in policy.

Criteria:

Presented in *Index of Financial Reporting and Internal Control Criteria* behind Exhibit III.

Cause/Effect:

CBP memorandums and guidelines that outlined field personnel requirements to generate, review, and reconcile items on the Tin-Man, M02, and M07 reports and to retain supporting documentation were not always followed. Due to a flaw in the design of the M02 and M07 reports, there was no requirement for ports to completely resolve all items on the reports each time the reports were reviewed. Furthermore, ACS system limitations restricted the ability of CBP personnel to accurately monitor the in-bond process, both at the Headquarters and port levels.

The inability to monitor the in-bond process and verify the arrival of in-bond merchandise at the port level effectively could result in the loss of custodial fines and penalties revenue.

The lack of an automated compilation and analysis of audit results at the national level makes it difficult for CBP to ensure complete information is received from the ports in order to determine the effectiveness of in-bond audits and common in-bond errors.

Recommendations:

We recommend that CBP perform the following:

1. Monitor the newly implemented In-bond Compliance Module to ensure that the system is functioning correctly;
2. Correct any systemic issues that may develop and ensure corrections are fully implemented at the port level;
3. Provide additional policy and direction, if necessary, after a periodic review of the In-bond Compliance Module; and
4. Provide Headquarters oversight and assistance to the field to ensure that ports are following policies and procedures.

2. Bonded Warehouse and Foreign Trade Zones

Background:

Bonded Warehouses (BWs) are facilities under CBP's supervision used to store merchandise that has not made entry into the U.S. Commerce. The merchandise stored in such warehouses is secured by the bond on the warehouse. Merchandise is entered into the BW by the submission of the Entry Summary, CBP Form 7501, and can be stored in the bonded facility for up to five years.

Foreign Trade Zones (FTZs) are secure areas under CBP supervision considered to be outside of the CBP territory. Authority for establishing these facilities is granted by the Foreign Trade Zones Board under the Foreign Trade Zones Act of 1934, as amended (19 U.S.C. 81a-81u). Foreign and domestic merchandise may be admitted into zones for operations not otherwise prohibited by law, including storage, exhibition, assembly, manufacturing, and processing. Merchandise is admitted into a FTZ by completing CBP Form 214.

The monitoring of BW and FTZ operations is based on the performance of risk assessments and compliance reviews by CBP officers in the field. CBP conducts an annual survey of ports that have BWs and FTZs, the results of which are submitted to Headquarters for compilation and analysis. Headquarters uses the survey results to assist in CBP's determination on the effectiveness of the BW and FTZ programs. CBP developed national databases within ACE to maintain a centralized repository of profiles of bonded facilities and FTZ sites.

Condition:

The following weaknesses were identified related to the BW and FTZ programs:

- The national databases within ACE were not designed to document the assessed risk of each BW or FTZ, scheduled compliance review, or the results of compliance reviews. CBP uses Sharepoint to document the assessed risk of each BW or FTZ, scheduled compliance review, and the results of compliance reviews. ACE is the system of record for Facilities Information Resource Management (FIRMS) codes, which are assigned upon approval of a BW and FTZ; however, CBP has not conducted a reconciliation of the FIRMS codes in ACE with the information in Sharepoint. Furthermore, requirements do not exist for Headquarters or the field offices to compare the FIRMS codes in the ACE databases to the compliance review schedules submitted by the ports to ensure that all compliance reviews are being performed.
- CBP performed a year-end analysis over the FY 2012 survey; however, management cannot determine if the information in the analysis is complete and therefore could not determine overall program effectiveness.
- For several FTZs and BWs, CBP was unable to provide evidence that risk assessments were performed at the time of the FY 2012 compliance reviews of the facilities. Additionally, CBP was unable to provide supporting documentation to evidence a compliance review and associated risk assessment was performed during the fiscal year.

Criteria:

Presented in *Index of Financial Reporting and Internal Control Criteria* behind Exhibit III.

Cause/Effect:

Ports do not always follow the required guidelines stated in the *Compliance Review Handbook for Bonded Warehouses* and the *Compliance Review Handbook for Foreign Trade Zones*. CBP does not have updated formal guidance related to Headquarters' monitoring of the BW and FTZ programs, including procedures to ensure all necessary compliance reviews are scheduled and completed.

There is a risk that a BW or FTZ may not be properly monitored by the ports if risk assessments and compliance reviews are not conducted. Additionally, there is a risk that the BW and FTZ programs may not be properly monitored as there is no formal requirement for Headquarters to reconcile the database with the compliance reviews conducted.

Recommendations:

We recommend that CBP perform the following:

1. Continue to monitor and review the compliance review results to ensure that the high compliance rate continues;
2. Continue to review facility profiles in ACE to ensure that profiles are constantly updated;
3. Work within the constraint of the current fiscal parameters to develop additional training and information sharing processes for the ports;
4. Continue to provide outreach and guidance to the field as necessary; and
5. Create a Headquarters process to monitor compliance reviews for accuracy and consistency, on a quarterly basis.

3. Entry Reports

Background:

Per CBP Directives No. 5610-004B, *Resolving Certain ACE Exception and Error Reports*, and No. 5610-006A, *Entry Deletion and Entry or Entry Summary Cancellation*, all ports are required to process specific entry edit/exception reports, including the following:

- The B06, Weekly ACS List of Rejected/Cancelled Entries Report, lists all entries that were either cancelled or placed in rejected status by the end of the previous week.
- The B07, Weekly ACS List of Unpaid/Rejected Entries, provides a cumulative listing of entries in rejected status and entries for which duty, taxes, and fees have not been collected, or if collected, not properly posted to the entry.
- The B08, Weekly Late Report: Entry Releases with No Follow-Up Summaries, is a cumulative listing of entry releases with no processing errors or follow-up entry summary on file in ACS/ACE.
- The B84, Weekly Budget Clearing Account (BCA) and Suspense Item Report, is a cumulative listing of collections that are an intentional posting to a suspense account or collections in an error condition.
- The S21, Cargo Selectivity Weekly Selectivity Delete Report, lists all entries that have been deleted by port personnel during the previous week.
- The Q07, Monthly Unreported Quota Report, is a cumulative listing of quota entries that have not been processed through the quota module or remain in quota rejected status where processing was attempted.

Condition:

Several instances of non-compliance with CBP Directives No. 5610-004B and No. 5610-006A were identified at the POEs. Specifically, a lack of segregation of duties was identified over the review process for certain reports, some reports were untimely generated and reviewed, and certain reports were not reviewed.

Criteria:

Presented in *Index of Financial Reporting and Internal Control Criteria* behind Exhibit III.

Cause/Effect:

CBP ports did not follow the policies in place to ensure entry edit/exception reports are generated and reviewed in a timely manner. CBP does not have adequate controls in place to ensure the segregation of duties related to the processing, review, and verification of entry edit/exception reports at the ports. CBP did not properly enforce and communicate directives over entry edit/exception reports to the ports.

Non-performance or inadequate processing, review and verification of entry edit/exception reports may cause CBP to fail to collect all revenue to which it is entitled. Specifically, entries improperly cancelled or deleted, unpaid duties, late entry summaries, duties held in suspense accounts, and unreported quotas could result in a loss of revenue from uncollected duties and fees.

Recommendation:

We recommend that CBP reinforce the importance of CBP Directives No. 5610-004B and No. 5610-006A by issuing a reminder memorandum to ensure that entry monitoring reports are generated and regularly reviewed, as specified in the directives.

D. Information Technology

Background:

Controls over information technology (IT) and related financial systems are essential elements of financial reporting integrity. Effective controls in an IT and financial systems environment are typically defined in five key general control areas (security management, access control, configuration management, segregation of duties, and contingency planning) and four key application control areas (application level general controls, business process controls, interface controls, and data management system controls). In addition to reliable general and application controls, financial management system functionality is important to program monitoring, increasing accountability of financial and program managers, providing better information for decision-making, and increasing the efficiency and effectiveness of services provided by the Federal Government.

Condition:

During FY 2012, CBP took corrective action to address prior year IT control deficiencies. For example, CBP made improvements to various system accreditation documentation, reviews of security event logs, and privileged user access management processes. However, during FY 2012 new and continuing general IT control weaknesses were identified that could potentially impact CBP's financial data. The most significant weaknesses from a financial statement audit perspective related to controls over access control, segregation of duties, and configuration management. Collectively, the general IT control weaknesses limit CBP's ability to support assertions that critical financial and operational data confidentiality, integrity, and availability are maintained. Additionally, CBP's current system of record used to process entries imported into the U.S. cannot support all of CBP's operations, which limits CBP's ability to manage and monitor the custodial revenue and drawback processes effectively. Due to the sensitive nature of the issues identified, we will issue a separate restricted distribution report that discusses the general IT control and functionality control deficiencies in greater detail.

Criteria:

Presented in *Index of Financial Reporting and Internal Control Criteria* behind Exhibit III.

Cause/Effect:

Funding for IT development and implementation, as well as for IT support staff has been reduced in recent years, resulting in delays of systems that would replace or enhance current systems and insufficient system management resources. In addition, because of the presence of IT control and financial system functionality weaknesses, there is added pressure on mitigating controls to operate effectively.

Recommendation:

We recommend that CBP improve the general and application controls over its financial systems to ensure adequate security, protection, and functionality of the information systems.

CBP Response:

See management's response included in the attached letter.

EXHIBIT III

Status of Prior Year Material Weakness and Significant Deficiencies

Prior Year Condition	As Reported at September 30, 2011	Status as of September 30, 2012
Drawback of Duties, Taxes, and Fees	**Material weakness:** The Automated Commercial System (ACS) lacked controls to detect and prevent excessive drawback claims and payments, requiring inefficient compensating manual processes. The drawback review policies did not require Drawback Specialists to review all related drawback claims.	**Continue as a material weakness:** Weaknesses continue to exist related to the drawback process in fiscal year (FY) 2012. See control finding letter A.
Property, Plant, and Equipment (PP&E)	**Significant deficiency:** Weaknesses existed related to the untimely transfer of construction-in-progress (CIP) to fixed assets and recording PP&E additions, reclassifications, and retirements. Additionally, weaknesses existed with recording the percentage of completion for certain construction projects. Furthermore, weaknesses existed related to oversight of PP&E, such as not properly performing inventory counts.	**Continue as a significant deficiency:** Weaknesses continue to exist related to untimely transfer of CIP to fixed assets and recording PP&E additions and retirements. Additionally, weaknesses continue to exist with oversight of PP&E. Several instances were noted regarding incomplete and nonexistent PP&E. See control finding B.
Entry Process – In-Bond	**Significant deficiency:** Several weaknesses existed related to in-bond, such as lack of official guidance related to monitoring in-bond shipments at the port level, lack of CBP Headquarters review of the in-bond program, and the overall inability to determine the effectiveness of the in-bond program for CBP in its entirety.	**Continue as a significant deficiency:** Weaknesses continued to exist related to in-bond, such as ACS system issues preventing appropriate Headquarters oversight, inadequate documentation of the monthly in-bond analysis, ineffective monitoring of management reports, and Tin-Man system limitations. See control finding letter C, section 1.
Entry Process –Trade Compliance Measurement (TCM)	**Significant deficiency:** Weaknesses existed related to TCM, such as inconsistent use of data queries and reports by TCM Coordinators, Automated Commercial Environment (ACE) reporting functionality limitations, inadequate training on ACE capabilities, inadequate monitoring and insufficient review guidance.	**Significant deficiency was remediated in FY 2012.**
Entry Process – Bonded Warehouse (BW) and Foreign Trade Zones (FTZ)	**Significant deficiency:** Several weaknesses existed related to the BW and FTZ processes, such as inadequate	**Continue as a significant deficiency:** Weaknesses continue to exist related to the BW and

Prior Year Condition	As Reported at September 30, 2011	Status as of September 30, 2012
	monitoring and documentation.	FTZ programs, such as inadequate monitoring and documentation. See control finding letter C, section 2.
Information Technology (IT)	**Significant deficiency:** Weaknesses existed related to general IT and application controls and IT functionality. Specifically, these included findings in the area of general IT security planning and management, logical and physical access to programs and data, segregation of duties, software change management, business continuity, and the ability of systems to track financial transactions accurately and completely.	**Continue as a significant deficiency:** Weaknesses continue to exist related to general IT and application controls and IT functionality. In FY 2012, the majority of prior year findings were unresolved and several new findings were identified. See control finding letter D.

Index of Financial Reporting and Internal Control Criteria

(Listed Alphabetically by Criteria Source)

Criteria	Reference	Report Exhibit
Code of Federal Regulations, Title 19	Sections 111.23, 111.25, 163.4(a), 163.4(b), 191.15, 191.38, 191.51(b)(1)	I-A
	Sections 18.2(d), 18.6(b), 18.8(b)	II-C-1
	Sections 19.4(a), 146.3	II-C-2
Federal Information Security Management Act		II-D
Federal Manager's Financial Integrity Act		II-B
National Institute of Standards and Technology (NIST) Special Publication (SP) 800-30, *Risk Management Guide for Information Technology Systems*		II-D
NIST SP 800-37, revision 1, *Guide for Applying the Risk Management Framework to Federal Information Systems*		II-D
NIST SP 800-53, revision 3, *Recommended Security Controls for Federal Information Systems and Organizations*		II-D
Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*		I-A, II-B, II-C-1, II-C-2
OMB Circular No. A-127, *Financial Management Systems*		II-D
OMB Circular No. A-130, *Management of Federal Information Resources*		II-D
Standards for Internal Control in the Federal Government issued by the Government Accountability Office (GAO)		II-C-3
Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*		II-B

1300 Pennsylvania Avenue NW
Washington, DC 20229

U.S. Customs and
Border Protection

JAN 2 3 2013

MEMORANDUM FOR: Anne L. Richards
Assistant Inspector General for Audits
U.S. Department of Homeland Security

FROM: Deborah J. Schilling
Chief Financial Officer
U.S. Customs and Border Protection

SUBJECT: Management Response – Draft Independent Auditor's Report on CBP's FY 2012 Financial Statements

Thank you for the opportunity to review and comment on this report. U.S. Customs and Border Protection (CBP) agrees with the Independent Public Accountant, which concluded that CBP's consolidated financial statements are fairly presented in all material respects and conformity with accounting principles.

CBP has reviewed and concurs with the one material weakness and the three significant deficiencies. Mission Action Plans outlining CBP's strategy to correct these conditions were completed and provided to the office of the Department of Homeland Security Chief Financial Officer. CBP will continue to work to resolve the auditor identified weaknesses.

I want to thank you for your efforts and look forward to continuing our professional auditing relationship. If you have any questions or would like additional information, please contact me at (202) 344-2300, or have a member of your staff contact Ms. Jaye M. Williams, Executive Director, Financial Operations Directorate, at (202) 344-2364.

Deborah J. Schilling

Deborah J. Schilling

Appendix A
Report Distribution

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