

DEPARTMENT OF HOMELAND SECURITY

Office of Inspector General

Audit of DHS' Corrective Action Plan Process for Financial Reporting – Report No. 4



Office of Inspector General

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



**Homeland
Security**

February 16, 2007

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 published by our office as part of our DHS oversight responsibility to promote economy, effectiveness, and efficiency within the department.

This report is the fourth of a series of OIG performance audit reports on planned DHS corrective actions to improve internal control. Improving internal control is a critical objective of the DHS Financial Accountability Act (*Public Law 108-330*). The report is based on interviews with employees and officials of relevant agencies and institutions, direct observations, and a review of applicable documents. We contracted with the independent public accounting firm KPMG LLP to perform the audit. KPMG is responsible for the attached auditor's report and the conclusions expressed in it.

The recommendations herein have been discussed in draft with those responsible for implementation. It is our hope that 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 "R. Skinner".

Richard L. Skinner
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January 17, 2007

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KPMG LLP is pleased to submit this performance audit report related to several of the United States Coast Guard's financial improvement activities. The activities were designed to address material weaknesses reported in the Department of Homeland Security's (the Department) independent auditors' report included in the fiscal year 2005 *Performance and Accountability Report*. Our audit included an evaluation of:

- The integrity of four Corrective Action Plans (CAPs) – Entity-Level Controls, Financial Reporting, Fund Balance with Treasury, and Actuarial Liabilities updated as of September 30, 2006.
- How well five contractor support plans align to address material weaknesses related to financial system improvement, project management, internal control policy development and testing, and financial reporting review and generally accepted accounting principles (GAAP) compliance.
- The status of the Financial Management Transformation and CFO Audit Remediation Plans defined in the memorandum dated July 3, 2006, from Commandant Thad Allen to CG-8.

This performance audit is the fourth of a series of performance audits that the Department's Office of Inspector General has engaged us to perform for fiscal year 2006. This performance audit is designed to meet the objectives identified in the *Background, Objectives, and Scope* section of this report.

We conducted this performance audit from October 10, 2006 to November 3, 2006, in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. The purpose of this report is to communicate the results of our performance audit and the related findings and recommendations.



Since November 3, 2006, we have not performed any additional procedures with respect to this performance audit and have no obligation to update this report or to revise the information contained herein to reflect events occurring subsequent to November 3, 2006.

The Department's Office of Inspector General has authorized this report to be sent electronically for the convenience of the Department. However, only the final hard copy of our report should be deemed our work product.

KPMG LLP

Executive Summary

Objective

The Department's Office of Inspector General (OIG) requested a performance audit to evaluate the United States Coast Guard's (Coast Guard) development of four CAPs, the alignment of contractor support activities to the resolution of material weaknesses in financial reporting, and the status of the development of a strategic plan for financial management transformation, as directed by the Commandant's Intent Action Order #5 (the Order) dated July 3, 2006.

Overview

The Coast Guard undertook a number of activities, including the development of CAPs, engagement of contractors, and issuance of internal directives, in an effort to resolve material weaknesses in financial reporting.

The Coast Guard has drafted four CAPs to address material weaknesses in financial reporting related to Entity-Level Controls, Financial Reporting, Fund Balance with Treasury, and Actuarial Liabilities. The Department deems these CAPs to be critical steps towards its objective of obtaining an unqualified audit opinion on its consolidated financial statements, as well as on its internal controls over financial reporting. The CAPs were developed in the final months of fiscal year 2006 by the respective process owners and were to include the identification of root causes of the material weakness, key success factors, key performance measures, verification and validation, risks, and resources requirements.

Additionally, to assist in the implementation of the CAPs and the resolution of the material weaknesses, the Coast Guard awarded five contracts in August 2006 and September 2006, as follows:

- Deloitte Consulting, LLP (Deloitte) for project management and financial management support services.
- Okoye & Associates, LLC (Okoye) for internal control policy development and test plan development for compliance with internal control over financial reporting.
- PricewaterhouseCoopers, LLP (PwC) for financial reporting assistance, assistance in policy development, and compliance with guidance and regulations such as generally accepted accounting principles (GAAP), Federal Managers Financial Integrity Act (FMFIA), and Federal Financial Management Improvement Act (FFMIA).
- Global Computer Enterprises, Inc. (GCEI) for financial system audit remediation support focused on financial system security [two contracts].

Finally, Commandant Allen issued the Commandant's Order, which directed the establishment of a team to plan for transformation of the Coast Guard's financial management organization into a model of excellence. Accordingly, in July 2006, the Coast Guard chartered the Financial Management Transformation Task Force (FMTTF) with providing short-term win plans and a long(er)-term strategic plan of action and milestones (POAM) to advance the goal of earning sustainable, clean audit opinions.

Approach

Our assessment of the integrity of the Coast Guard CAPs (as of September 30, 2006) focused on an evaluation of the following CAP elements:

- Identification of the underlying root cause(s)
- Development of an effective remediation plan
- Accountability for establishing and successfully implementing the CAP
- Validation of the successful implementation of the CAP.

The CAPs were the subject of three previous performance audits. Accordingly, we considered the revisions made to them since the last performance audit.

Our assessment of the contracts focused on how well they aligned with efforts necessary to resolve the Coast Guard's material weaknesses. Specifically, we reviewed the methods used in developing the performance work statement (PWS) and their relationship to the material weaknesses.

With respect to the Commandant's Order, our assessment focused on the identification of activities taken in response to the Order (six actions). However, the timing of our review coincided with the commencement of activities resulting from that order, and therefore, the intended outcomes of the execution of the Order have not yet been fully achieved.

Our performance audit did not assess whether the CAPs, contracting actions, or actions taken in response to the Commandant's Order will resolve the respective material weaknesses.

Summary of Key Observations

During the course of the performance audit, we observed some underlying elements that were common among all objectives. Those elements are described below. Additional observations specific to a particular area of the performance audit are included within the *Background*, *Findings*, and *Recommendations* sections of this report.

Coordination of Efforts

The Coast Guard did not effectively coordinate its various remediation activities. It appears that the development and update of the CAPs, the development of the PWSs for the contracts, and the POAM were done concurrently and independent of each other. The activities were not adequately coordinated to form a single cohesive/comprehensive plan. In addition, there does not appear to be a single point of authority to coordinate the integration of remediation efforts and provide strategic oversight of each of these endeavors to help ensure that plans are coordinated and efforts are not duplicated.

For example, both the CAP process owners and the FMTTF performed a root cause analysis. However, the work products of the FMTTF have not been integrated into the revised CAPs. In another example, the FMTTF has created/will create short-term plans to resolve select material weaknesses. These plans were described as supplements to the CAPs; however, these plans have not been included in the revised CAPs.

Coast Guard management believes that the remediation of the material weaknesses will require completion of the action steps contained in the short-term plans, the milestones included in the CAPs, and the steps outlined in the long-term plan (the POAM). To reduce the likelihood that efforts are duplicated or that gaps do not exist in the plans, efforts will need to be coordinated and integrated.

Root Cause Analysis, Plan Development, and Verification/Validation

The CAPs and the FMTTF POAM would benefit from detailed definitions and process-level analysis (e.g., A-123 analysis) of the underlying root causes of the material weaknesses. While these plans identified high-level "causes", they have not fully contemplated an assessment of the business processes and information systems that drive the transactions/activities giving rise to the material weaknesses. Implementing corrective actions without first determining whether all significant deficiencies affecting management's ability to support their financial reporting have been identified may risk missing some of the deficiencies and their underlying cause(s) and result in potential wasted time. For example, the Coast Guard has planned to adopt the "TSA general ledger platform" as part of the resolution to the Financial Reporting material weakness. Without a thorough analysis to determine all of the deficiencies and limitations of the current general ledger, the Coast Guard risks implementing a "solution" that may not resolve all deficiencies and thus the related material weaknesses.

In addition, the Coast Guard has not defined procedures to assess the effectiveness of its remediation activities. The CAPs, contracts, and POAM did not contain activities for validating the effectiveness of the plans. While the plans did include goals, tasks, and milestones, they did not include an evaluation process to determine whether the material weaknesses have been resolved. However, the Coast Guard did indicate that such a process would be developed by their contractors.

Contract Oversight

The Coast Guard requires human resources to effectively execute and provide oversight for the execution of remediation activities. The Coast Guard is constrained both by low head count and by the lack of personnel with deep financial management and project management experience and capabilities. For example, although the Coast Guard has established overall accountability for the CAPs at a senior level, they have not assigned accountability for specific tasks at a detailed level. Coast Guard management stated that the resources to perform/oversee these tasks are currently not available. Furthermore, the shortage of qualified staff, including a designated leader, is impairing the Coast Guard's ability to continue the transformation efforts of the FMTTF. As a result, the Financial Reengineering team is not fully fielded to assist with carrying out FMTTF activities/actions.

In response to these resource constraints, the Coast Guard has turned to contractors to assist in the remediation efforts. While the use of contractors helps alleviate the resource constraints, there appears to be an inadequate number of experienced and trained government staff to oversee the work. For example, the oversight of the estimated 150 contractors in the Financial Systems Division is shared among six Coast Guard staff. In addition, the government personnel providing oversight for the contracts do not have the credentials or experience in financial management oversight of complex organizations to direct or evaluate the quality of the work provided by the contractors.

Summary of Key Recommendations

During the course of the performance audit, we formed several recommendations related to our observations above. Additional recommendations specific to a particular area of the performance audit are included within the *Background*, *Findings*, and *Recommendations* sections of this report. Specifically, the Coast Guard should:

Coordination of Efforts

- 1) Develop a consolidated and comprehensive plan for all remediation activities and/or integrate the plan with other internal control assessment and remediation initiatives (e.g., OMB Circular A-123). The remediation plan should include:
 - The incorporation of the POAM, the CAPs, and all subsequent actions performed to assist with remediation planning to form a single unified plan for all efforts and determine whether any current efforts, to include Lean Six Sigma implementation, should be continued, curtailed, or stopped.
 - Work breakdown structures for each root cause once they are identified and validated. The work breakdown structures should include a detailed set of activities that include the process-level activities that must be addressed to resolve the issue, the individuals responsible for implementing the activities, the level of effort required by each individual to implement the activities, and detailed timelines with intermediate milestones for monitoring and reporting on work completed.
- 2) Identify a designated Coast Guard "owner" or senior-level executive (e.g., DCFO) responsible for integrating and coordinating all financial management and reporting improvement initiatives. The owner should implement a process for integrating the contractor support efforts, FMTTF activities, and CAP updates. Such coordination and integration is needed to avoid duplicating remediation efforts and for reducing the likelihood of costly contract modifications.

Root Cause Analysis, Plan Development, and Verification/Validation

- 3) Utilize existing contract support to review the identification of root causes for the CAPs and the analysis prepared to support the development of the remediation plans. The Coast Guard should develop detailed crosswalks for mapping root causes, related audit findings, and recommendations to address each material weakness. Further, the Coast Guard should undertake an independent validation and verification to determine whether the root causes listed in the CAPs are complete and adequately aligned to address the material weaknesses.
- 4) Develop a risk-based approach for prioritizing activities and establishing the critical paths for resolving identified weaknesses. The Coast Guard should use materiality or business-risk analysis methodologies to identify high-value areas and prioritize efforts (e.g., use materiality to determine financial statement line items to take action in the near term).

Contract Oversight

- 5) Implement the navigational dashboard being developed by the PMO to standardize the reporting and tracking functions and define the criteria for evaluating percentage to completion of CAP activities.

- 6) Ensure that resource requirements are identified, aligned, and in place to implement the CAPs. This will require the Coast Guard to ensure that all resource requirements are either in the budget for hiring or provided to the appropriate human resources personnel for rotations or reassignments within the Department. Alternative staffing models should be used in the near term until resources have been secured. Example alternative staffing models could include the use of detailees and/or long-term rotational assignments of Coast Guard or Department personnel.
- 7) Provide Coast Guard personnel to oversee contracting efforts, evaluate work products, and monitor compliance with the SOWs. The Coast Guard must assemble an adequately trained and credentialed government staff that is sufficient in size to supervise all contractor performance. The staff should have the requisite knowledge and experience to direct and evaluate the quality of contractor work products.

Background, Objectives, and Scope

Background

Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*, states "Federal agencies are subject to numerous legislative and regulatory requirements that promote and support effective internal control. Effective internal control is a key factor in achieving agency missions and program results through improved accountability. Identifying internal control weaknesses and taking related corrective actions are critically important to creating and maintaining a strong internal control infrastructure that supports the achievement of agency objectives."

OMB Circular A-123 builds upon the internal control framework within the *Standards for Internal Control in the Federal Government* (Green Book), issued by the U.S. Government Accountability Office (GAO), which defines internal control as "an integral component of an organization's management that provides reasonable assurance that the following objectives, effectiveness and efficiency of operations; reliability of financial reporting; and compliance with applicable laws and regulations are being achieved."

Ten material weaknesses associated with internal controls were reported in the Department's independent auditors' report included in the fiscal year 2005 *Performance and Accountability Report*. The Department has undertaken an initiative to develop and implement a formal CAP process. Under this initiative, the Department has issued guidance and has deployed a Web-based software application, Electronic Program Management Office (ePMO), to manage the collection and reporting of CAP information for the Department and its components. Under this initiative, the Department's intent is to develop effective CAPs and position itself to move forward in its objective of obtaining an unqualified audit opinion on its consolidated financial statements, as well as on its internal controls over financial reporting.

The first key milestone in the Department's CAP process required all components to develop CAPs for each material weakness and to submit them for input into ePMO by the Department's Office of the Chief Financial Officer (OCFO) by May 31, 2006. The second key milestone was to submit revisions of the revised June 30, 2006, CAPs by July 12, 2006. Additionally, beginning in July 2006, each CAP was required to be updated within ePMO by the last day of each month.

The September 30,2006, CAPs were used as the basis of our performance audit.

Objectives

This performance audit has three main objectives: (1) assess the integrity of the CAPs, updated as of September 30, 2006, related to 4 of the 10 material weaknesses that were cited in the independent auditors' report; (2) evaluate the alignment of 5 contracts awarded to support actions to correct specific material weaknesses; and (3) evaluate the Financial Management Transformation and CFO Audit Remediation task force activities taken in response to the Commandant's Order issued July 3,2006.

Our performance audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States, specifically, the standards for performance audits.

Scope

The scope of our work included evaluating the integrity of the following CAPs updated as of September 30,2006:

- Entity-Level Controls
- Financial Reporting
- Fund Balance with Treasury
- Actuarial Liabilities

Additionally, the scope included an assessment of how well the following contractor support plans aligned with efforts necessary to resolve the Coast Guard's material weaknesses:

- Deloitte, for project management and financial management support services
- Okoye, for internal control policy development and test plan development
- PwC, for financial reporting review and GAAP compliance review
- GCEI, for financial system audit remediation support [two contracts]

Finally, our scope included a review of the FMTTF activities to assess if milestones had been met as outlined in the Commandant's Order.

Our scope did not include procedures on any of the CAPs associated with any of the other material weaknesses cited in the Department's fiscal year 2005 independent auditors' report. Furthermore, our performance audit did not address the outcomes achieved as a result of the execution of the CAPs, contracting actions, or Commandant's Order, or the status of the material weaknesses.

The **timeline** for this performance audit was as follows:

- Field Work – October 10,2006 through November 3,2006
- Draft Report – November 17,2006
- Final Report – January 17,2007

Performance Audit Approach

Our methodology consisted of the following four-phased approach:

Phase I – Project Initiation and Planning

We met with personnel from the Department's OIG to discuss the scope, timeline, and deliverable associated with the performance audit. After the OIG meeting, we held a kick-off meeting with various Coast Guard personnel and contractor representatives to review the objectives, scope, and timeline of the performance audit.

Meetings were scheduled with the CAP process owners, Coast Guard representatives supporting the contractor support plans, and the FMTTF.

Phase II – Assessment of Process and Related Guidance

Interviews:

- We interviewed personnel from the Coast Guard on their understanding and implementation of the CAPs as of September 30, 2006, including, but not limited to, the root cause analysis performed, the critical milestones chosen for measurement, and the mechanisms used to monitor progress in meeting the milestones.
- We also interviewed Coast Guard personnel about their understanding and implementation of the contractor support plans, including, but not limited to, the development process and the alignment of the contracts to the material weaknesses.
- Additionally, we interviewed Coast Guard personnel about their understanding and implementation of the Financial Management Transformation and CFO Audit Remediation Plans outlined in the Commandant's Order, including, but not limited to, their approach for identifying short-term and long-term remediation activities/plans. Finally, we interviewed the independent auditors regarding NFRs issued in connection with the fiscal year 2005 and 2006 independent auditors' report.

Documentation Reviews:

- We reviewed the CAPs, including both the detail and summary report, contained within ePMO and supporting documentation underlying the CAPs.
- We also reviewed the contractor support plans and supporting documentation (i.e., PWSs, project plans).
- Additionally, we reviewed the Commandant's Order dated July 3, 2006, and supporting documentation from the FMTTF.
- Finally, we reviewed the NFRs issued in connection with the fiscal year 2005 and 2006 independent auditors' report.

Phase III – Analysis

We reviewed the *Department's Corrective Action Plan Process Guide* (CAP guide), relevant NFRs, work group charters, Department CAP workshop memorandum, and existing internal control monitoring guidance (e.g., OMB Circular No. A-123 and CAP guides published by other Federal agencies) for practices that would serve as our evaluation criteria. We then compared our

understanding of the Department's existing CAPs to these practices to identify potential areas for improvement. These findings reflect situations that could negatively impact the Department's remediation of the material weaknesses if additional corrective action is not taken.

We categorized the areas for improvement into one of the four broad phases generally found in an effective CAP analysis:

- Identification of the underlying root cause is an important action step in the CAP process. Accurate identification of the root cause mitigates the chances of recurrence. Often, merely the symptoms of the deficiency are identified rather than the root cause. By identifying only the symptoms, it is difficult to develop an effective CAP that will successfully resolve the deficiency.
- Development of an effective remediation plan is an appropriate way to cure an internal control deficiency. A key component of an effective plan is the inclusion of both attainable and measurable milestones to allow both the Department and the component to monitor the remediation process effectively.
- Accountability is vital to the CAP process because it necessitates the establishment of an individual CAP owner who is responsible for its successful implementation. The owner's responsibilities include helping to ensure that milestones are achieved and that the validation phase is completed.
- Validation is important in order to verify that the CAP has been successfully completed. The CAP should include activities that will provide evidence to support the closure of the CAP. These activities should include documentation reviews, work observations, and performance testing.

For the contractor support plans, we reviewed the statements of work for each of the five contracts and compared them to the material weaknesses to determine if the contracts were structured in a way that promotes CAP development and/or refinement. We also reviewed the manner in which the contracts were developed and the oversight responsibilities for the contractors. We categorized the areas for improvement into three categories:

- Development of an effective PWS for the contracts. This is essential to the success of the project plan. Defining objectives, tasks, deliverables, and milestones are key for effectively outlining the work and monitoring progress.
- Accountability over contractor work efforts. Accountability is central to the contract process, as it establishes an individual who is responsible for overseeing the work of the contractors.
- Validation of the quality of the work performed by the contractors.

With respect to the Commandant's Order, we reviewed the subsequent charter of the FMTTF and compared it to the actual activities of the task force to determine that a team was identified and tasked with leading the process being developed for resolving the material weaknesses. The review also included determining the degree of oversight established to oversee the implementation of short-term solutions identified in the plan. We also considered the timeliness of the deliverables outlined in the charter.

Phase IV – Reporting

After conducting our analysis in Phase III, we formulated our findings and recommendations for each potential area of improvement identified.

Background, Findings, and Recommendations

Background information and our findings and recommendations related to the four CAPs, five contracts, and activities performed by the FMTTF are provided below.

Corrective Action Plans

The Coast Guard has drafted four CAPs to address material weaknesses related to Entity-Level Controls, Financial Reporting, Fund Balance with Treasury, and Actuarial Liabilities. The September 30, 2006, CAPs were used for this review.

Background

In response to the fiscal year 2005 independent auditors' report, the Coast Guard developed CAPs to assist with implementing process and systems improvements covering Entity-Level Controls, Financial Reporting, Fund Balance with Treasury, and Actuarial Liabilities.

KPMG met with senior Coast Guard management concerning the CAP development process. In each case, with respect to root cause identification, the process included internal workshops and management-level discussions to identify the root causes of the material weaknesses. The Coast Guard relied heavily on first-hand organizational knowledge to identify root causes and develop the CAPs. During the root cause identification process, the NFRs relating to material weaknesses of the respective CAPs were considered; however, they were not the primary drivers for root cause identification.

In the area of remediation plan development, the CAP process owners developed plans that were based primarily on intra-office collaboration and Department-sponsored workshops. The CAPs have been updated several times based on input received from the GAO tool (a summary of internal control activities) and internal review meetings.

In the area of accountability, long-term success of the four CAPs is dependent on obtaining the necessary resources. Although the CAP process owners have identified initial resource estimates required for implementing the CAPs, the necessary government resources are not secured. This is impairing the Coast Guard's ability to assign accountability at the milestone/operational level of the CAPs.

With respect to validation, formal plans to test and validate the activities of the four CAPs have not been established or developed. Coast Guard management indicated that validation plans would be developed for the four CAPs with the assistance of contractors.

Findings

To evaluate the integrity of the CAP, we reviewed the root cause identification process, the development process for the remediation plans, assessed whether accountability had been

established, and whether a validation assessment (evaluation process) was included. During the course of the performance audit, we made the following observations and findings.

Root Cause Identification

Ongoing root cause identification continues to reveal weaknesses in the initial root cause exercise that was performed to draft the CAPs. There was no evidence provided that a formal analysis to include walkthroughs of business processes and related systems was performed to identify all deficiencies or validate known or perceived deficiencies. This type of analysis would be necessary to evaluate the integrity or completeness of the root cause identification exercise used to create the CAPs. The principal determinant of root causes has been first-hand organizational knowledge by respective Coast Guard personnel, including CG-8 and FINCEN personnel.

We could not determine whether the fiscal year 2006 NFRs have been considered in the CAP update process. Supporting system reviews, interviews, or surveys were not used in the root cause identification process, which could have assisted the CAP owners with understanding the process-level issues that are leading up to the root cause.

For the CAPs we reviewed, it remains difficult to determine if all conditions of the material Weaknesses have been identified and whether the root causes that have been identified are adequate to assist management with developing effective remediation plans.

Financial Reporting CAP – Multiple root causes directly contribute to weaknesses in financial reporting. While the CAP has identified some of the issues that resulted in NFRs, they need to go much deeper to address system coding flaws and other contributing causes. For example, the transition from the DAFIS System to the Oracle System was not identified as an overarching issue (the processes used to migrate data and the transitioning of systems was not identified as a contributing factor), but appeared to be a significant root cause.

Fund Balance with Treasury CAP – Similarly, the Coast Guard should continue to explore the drivers underlying the issues with the Fund Balance with Treasury. For example, understanding "why" Coast Guard business processes and accounting are resulting in transactions posted to suspense accounts that cannot be supported will assist the Coast Guard with targeting the root causes of the problem and developing comprehensive remediation to clear suspense transactions timely and properly.

Actuarial Liabilities CAP – The root causes do not appear to address the process-level issues that are contributing to systemic data problems and reconciliations. For example, the Coast Guard is not effectively executing a process to validate personnel and medical expenditure data prior to providing it to the actuary, thus negatively impacting the resulting actuarial calculations. Without a thorough analysis of business processes and related systems, the Coast Guard risks not identifying all of the problems and causes and, consequently, efficient resolution of the material weaknesses.

Entity-Level Controls – While the Coast Guard has identified the need for qualified and trained personnel to establish a culture in which financial management is a priority, it has not fully identified the corresponding organizational structure or financial management oversight responsibilities or processes.

Development of the Remediation Plans

Coast Guard management did not consider business risks, materiality, or cost versus benefit analysis when developing the remediation plans. This level of analysis could assist management with targeting higher-risk areas and prioritizing activities. The plans include high-level work breakdown structures but not resource estimates for each subtask of the milestones or a formal process for reporting progress against each CAP's milestones. The Coast Guard did not have detailed work breakdown structures below the major milestone level available for our review. Critical milestones appear to have been identified for each CAP; however, specific implementation steps/activities have not been assigned to each milestone. We were informed that this level of detail related to milestone development is in the planning stage. Without formal work breakdown structures for its CAPs, the Coast Guard does not have visibility into the assignment of process holders to the level of effort required to monitor, implement, and report progress.

The availability of qualified government resources continues to be a factor for the Coast Guard's inability to develop detailed plans and implement CAP activities. With respect to the Entity-Level Controls (Financial Management) CAP, senior CG-8 management indicated that the Department has no "bench strength" or available personnel to assist with overseeing and implementing the CAP, including policy efforts in the office. Likewise, the Financial Reporting CAP is currently being enhanced using contractor support, with particular emphasis placed on remediation plan development. For the Fund Balance with Treasury CAP, resource requirements for executing the CAP at the top level have been identified (resources required but not on hand), but not at the task level.

Accountability

For the four CAPs, accountability for all areas, including accountability below the process owner level, has not been fully determined. Coast Guard management indicated that resources remain deficient for CAP implementation, and we could not determine whether any of the full-time government personnel positions included in the CAPs have been placed in the budget or have been identified within the Department. Long-term success of the four CAPs is dependent on obtaining the necessary resources for oversight and implementation. We were informed that if the human resources identified in the CAPs are not in place, the plans are at risk and the timelines will require re-baselining.

Validation

The Coast Guard has not defined procedures to assess the effectiveness of its remediation activities. The four CAPs do not contain plans for validation or verification that the respective work is effective. While goals, tasks, and top-level milestones were outlined, the evaluation process to measure progress was not evident.

Recommendations

With respect to all four CAPs, the Coast Guard should:

Root Cause Identification

- 1) Validate the existing CAP root cause analyses. The Coast Guard should utilize existing contract support to review the identification of root causes for the CAPs and the analysis prepared to support the development of the remediation plans in coordination with A-123 implementation efforts. This effort should assist in determining whether additional root causes exist, and in validating that the current CAPs are adequately aligned to address the material weakness and include the necessary steps to implement the CAPs. To develop remediation plans effectively, the Coast Guard must understand and identify the process and system-level factors that are contributing to the material weakness. Understanding the problem at the process/system level should assist with developing remediation plans and with establishing evaluation criteria for determining whether the plans are addressing the root causes and are properly aligned to correct the material weakness.
- 2) Develop crosswalks to ensure all conditions leading to identified material weaknesses are tracked to the root causes.

Development of the Remediation Plans

- 3) Update the current work breakdown structures for the remediation plans after the root cause analysis and validation efforts are completed. Future updates to the work breakdown structures should be coordinated with the PMO to ensure all remediation efforts are integrated. The updated work breakdown structures should include the individuals responsible for implementing the activities, a detailed set of process and system-level activities that must be addressed to resolve the issues, the level of effort required by each individual to implement the detailed activities, detailed timelines with intermediate milestones, and methodologies for monitoring and reporting on work completed.
- 4) Develop a risk-based plan for each of the four CAPs to prioritize tasks and assist with aligning resources to high-value tasks. The materiality of the financial statement line items to which the CAPs relate should be used as the basis for assessing risk.
- 5) The CAPs should address alternatives for addressing resource constraints, such as: a) the transfer of other resources from departments within the Coast Guard; b) the use of contractors specified in terms of hours and period of performance for specific defined tasks, and c) the hiring of resources, including a plan to mitigate the risks of the hired individuals not completing sufficient training and not having sufficient logistical support to complete their assignments. Each of these plans should include a matrix to identify and prevent the duplication of contracting effort and to help ensure that such effort is aligned to assist the Coast Guard in addressing specific weaknesses and issues.

Accountability

- 6) Designate a Coast Guard owner or senior-level executive (e.g., DCFO) responsible for the coordination of all financial management and reporting improvement initiatives. The owner's duties would include the integration of contractor support effort, FMTTF activities, and updates to CAPs. The coordination of the various CAP efforts should help reduce the duplication of remediation efforts and potentially eliminate costly contract modifications.

Validation

- 7) Undertake an independent validation and verification to determine whether the root causes listed in the CAPs have been adequately implemented and whether the CAPs have resolved the material weaknesses.
- 8) Implement the navigational dashboard currently under development by the PMO to standardize the reporting and tracking functions and define the criteria for evaluating percentage to completion.

Contractor Support Plans

The Coast Guard has issued five contracts to assist with addressing the material weaknesses identified in the fiscal year 2005 independent auditors' report. The contracts covered system improvement (two contracts), project management, internal control policy development and testing, and financial reporting review and GAAP compliance. We assessed the PWS to validate whether the contracts considered the material weaknesses. We also reviewed the development process of the contract support plans for assigning accountability and providing government oversight.

Financial System Contracts

Background

The CAS Financial System touches many of the 10 material weaknesses, and through the use of a Systems Audit Remediation Master Cost Sheet, the Coast Guard determined that the cost to remediate all the issues would total over \$25 million. In order to prioritize the work, the Financial System Division consulted with other divisions in the Coast Guard and with the external auditors. From these discussions, management determined that the Financial System Security material weaknesses should be addressed first, reasoning that if the system lacked adequate security, the other functions would be irrelevant.

To create the PWS, the Financial System Division developed a list of tasks they believed would address the specific deficiencies that were identified by the external auditors and recorded these tasks on the Systems Audit Remediation Schedule. The items were prioritized as described above, and prices for each task were determined with the help of the developer. Based on the funding allowed, the tasks at the top of the list were selected to be included in the PWS. Once the tasks were selected, the PWS was circulated to CG-8 leadership and to members of the Finance Center. Once consensus was reached, which took close to six months, the contracts were signed in August 2006.

Findings

To evaluate the development of the PWS and the relationship of the PWS activities to the material weaknesses, we reviewed the development process of the contracts, determined whether accountability had been established for the oversight of the contractor support, and verified that a validation assessment was included. During the course of the performance audit, we made the following observations and findings:

Identification of Material Weaknesses to the Performance Work Statements (PWSs)

While the individual deficiencies (NFRs) were prioritized and the contract was designed to resolve each independently, the identification of the root cause of the financial systems material weakness was not specifically addressed in the process of contract development. This condition supports the need for the root cause analysis and crosswalk described previously. Therefore, it is difficult to determine whether the contracts are properly aligned to address all deficiencies resulting in material weaknesses.

Development of Contract Support Plans

--- The contracts PWS and list of priority tasks are under dispute by members of management, which has caused delay in the performance of the contract and may result in costly modifications to the contract. It was disclosed that the dispute, made by management members who reviewed the PWS before the contract was signed, has caused some of the tasks listed in the contract to be put on hold until a consensus of the task priorities can be reached.

In addition, a project plan was not provided for the contract work. It could not be determined if a plan existed or if the contractor is using the list of tasks provided by the Coast Guard as the basis of the project plan.

Accountability and Government Oversight

Government oversight of contract performance does not appear to be adequate. The Division Chief and her five staff members must provide oversight of the estimated 150 contractors in the Financial Systems Division. In addition, no formal review or approval process was evident in the development of the contracts. Regarding communications, e-mail concerning the contract content is the only documentation of management involvement and the only evidence of accountability to the contents of the contracts.

Validation of the Contracts to Address Material Weaknesses

Due to resource constraints, the Coast Guard relies on additional contractor support to validate the success of the contractor's remediation activities. No formal process for validation was evident.

Recommendations

The Coast Guard should:

- 1) Define specific expectations for the contracts, considering the root cause of the material weakness and NFRs (link conditions and consider recommendations). In addition, the Coast Guard should review the existing PWSs and consider modifications, if necessary, to align them with necessary remediation efforts. This effort should assist in confirming that the cause of the problem is being addressed and not just the symptoms, and should provide clear definitions for what needs to be done under the contract to assist with remediation efforts.
- 2) Help ensure that project plans exist and are approved by the appropriate Coast Guard personnel for each contract. The plans should include detailed tasks and timelines for accomplishments.
- 3) Enhance the contract development process to ensure management consensus is reached to preclude disputes about contract content after the contract is signed, thereby avoiding potentially costly contract modifications (longer periods can lead to more costly solutions).
- 4) Provide adequate government human resources for the oversight and validation of contract Fork. Even though the contracts are fixed-price, the work must be reviewed for adequacy and timelines must be met according to Coast Guard standards.

Project Management/Internal Control Development/Financial Reporting Review Contracts

Background

A contract for project management and financial management support services was issued by the Coast Guard to assist with overall project management support and for the Entity-Level Controls (Financial Management) material weakness. This contract was intended to provide oversight of the other contracts that were in development to help ensure that no overlaps or gaps existed between the contracts and to assist the Coast Guard with FMTTF activities. This contract was awarded to Deloitte on September 15, 2006.

An issue that was fundamental to many of the material weaknesses was the lack of internal control. A second contract was developed that addressed internal control development, testing, and training. In review of the PWS, it appears that the tasks were designed to address compliance with OMB Circular A-123, Appendix A, *Internal Controls Over Financial Reporting*. This contract was awarded to Okoye on September 26, 2006. For this project, a subcontractor to Okoye is PwC.

To address the financial reporting material weakness, a contract was developed to assist the preparation of many aspects of the financial reporting process; help ensure compliance with laws and regulations, such as FMFIA and FFMIA; adhere to GAAP; and assist in the development of a financial management policy. This contract was awarded to PwC on September 30, 2006.

To develop the contracts, the Coast Guard reviewed the deficiencies identified in the current and previous fiscal year audit reports and consulted with the external auditors. Members of

the CG-84 group determined that the Coast Guard required additional staff, organization, and competencies to effect the necessary changes. Members of the CG-84 group developed the vision and worked with the contracting office to develop the specific PWSs for each of the contracts listed above. The contents of the PWS were reviewed by other members of the CG-84 group. In addition, Resource Management (CG-83) was consulted to determine the resources available for the coming year.

The oversight of the Deloitte and Okoye contracts is the responsibility of a member of the CG-8T organization. The oversight of the PwC contract is the responsibility of a member of the CG-84 organization. Moreover, Deloitte will be assisting in the oversight responsibilities as project manager. This oversight assistance includes reviewing the work of the other contractors to verify that the work complies with the strategic plans and that there are no overlaps or gaps in the work process. As one of the methods of observing the work of the other contractors, Deloitte will be attending the status meetings of the other contractors.

Findings

To evaluate the development of the PWS and the relationship of the PWS activities to the material weaknesses, we reviewed the development process of the contracts, and determined whether accountability had been established for the oversight of the contractor support and whether a validation assessment was included. During the course of the performance audit, we made the following observations and findings:

Identification of the Material Weaknesses to the PWS

While the Coast Guard has taken considerable steps to engage contractors to improve financial management and financial reporting business processes, the contracts lack specificity and direction, which increases the risks of wasting resources and failing to achieve intended results. In addition, since it remains difficult to determine whether all conditions of the material weakness have been identified through the CAP development process, it also remains difficult to determine if the contracts are properly aligned to ensure that the material weaknesses are addressed.

Development of Contract Support Plans

The contracts were put into effect prior to the delivery of the POAM developed by the FMTTF, and as a result, the contracts may need future modifications to align with the strategic direction of the POAM. Delaying the commencement of contract work may have delayed remediation of the material weaknesses; however, it may have been more economically prudent to align the contracts with the FMTTF strategic plan to avoid costly modifications to the contracts.

Due to human resource constraints, the Coast Guard is relying heavily on contractor support to accomplish audit remediation tasks, including providing oversight of the contract work itself. Deloitte is assisting in the oversight of the other contractors to help ensure that goals are realistic, milestones are reached, and that industry leading practices are followed. Coast Guard management group personnel should be assisting Deloitte with these efforts.

There is no formal approval process and no documentation to support the approval of the PWS content. Documentation was limited to e-mails revealing discussion of the contents among its reviewers. Therefore, there was no evidence of management approval of the contract content.

Modifications to contracts are not being adequately documented and approved. The contract for PwC has been modified through verbal agreement. The only written documentation of contract changes is e-mail confirmation from the contractor. The revisions included deleting seven of the nine original tasks in the PWS. Because the change was not considered to be outside the scope of the contract, it was decided not to incur the expense of a formal contract modification.

Accountability and Government Oversight

As noted for the Financial System contracts, Government oversight of contract performance does not appear to be adequate. The Contracting Officer's Technical Representative (COTR) for these contracts is assigned more oversight than is normally expected. Additional trained COTRs should be identified and placed in oversight roles to distribute the work requirements for these contracts. Inadequate oversight increases the risk of wasted contract resources and not achieving the intended corrective action results.

Validation of Contracts to Address Material Weaknesses

It does not appear that validation of the contracted work has been addressed. It is evident that the Coast Guard relies on contractor support to assist in the improvements to business processes and systems to resolve the material weaknesses. It is not evident how the Coast Guard will assess the success of these efforts.

Recommendations

The Coast Guard should:

- 1) Continue efforts to validate the root causes of the material weaknesses as a prerequisite to developing the contract PWSs for remediation activities. This validation should help provide confidence that the causes, and not the symptoms, of the material weaknesses are being addressed by the contracts.
- 2) Coordinate and align the contract support plans with the POAM developed by the FMTTF and the CAPs developed by the process owners. This should confirm that all staff and contractors are working toward a cohesive plan for the remediation of the material weaknesses.
- 3) Assess the need for human capital, both in number and competency, and provide sufficient human resources to ease reliance on contractor support.
- 4) Similar to the CAPs recommendation discussed previously, enhance the contract development process to ensure management consensus is reached to preclude disputes about contract content after the contract is signed and thereby avoiding potentially costly contract modifications (longer periods can lead to more costly solutions).

- 5) Obtain additional contract technical managers and ensure they have obtained the appropriate COTR training and certification.
- 6) Validate the success of the contract work. The validation should be documented in writing by the Coast Guard to determine whether performance measurements are established and reviewed to determine the adequacy and completeness of the contract work.

Commandant's Intent Action Order #5 (the Order): Financial Management Transformation and CFO Audit Remediation Plans

The Commandant's Order directed the establishment of a team to develop a plan to transform the Coast Guard's financial management organization into a model of excellence, capable of earning sustainable clean audit opinions.

Background

With the assistance of consultants, the team was directed to create a plan for resolving long-standing material weaknesses to include short-term corrective actions and longer-term systemic and organizational solutions. Short-term solutions were to be implemented immediately, where possible. This directive was followed by a charter for its implementation. The charter specifically outlined the FMTTF, including its structure, mission, guiding principles, deliverables, and corresponding due dates. The deliverables included a short-term win plan, an analysis of the status quo, and an initial plan of action and milestones that includes a comprehensive review of the status quo and the recommended visionary end-state for the organization.

The FMTTF began on July 17, 2006, and promptly created a list of short-term or "quick hitter" actions that could be readily implemented. For long-term strategies, the FMTTF researched external and internal financial requirements through the use of surveys, internal and external interviews, and review of the NFRs, material weaknesses, and current CAPs. Three different plans of action were developed and brought to an off-site meeting among process owners for discussion and feedback. Participants were divided into four focus groups, and each provided feedback on the same three strategy plans. From this, the FMTTF identified a primary plan option (A) and an alternative plan (B). These plans were sent to the participants for additional feedback. The result was the FMTTF final report, or plan of action and milestones (POAM).

The FMTTF was led by a senior Coast Guard representative with leadership skills and financial expertise who was identified and approved by the Chief of Staff. The task force was composed of members from various communities of interest throughout the Coast Guard and contractors.

To assess the progress of the POAM on an ongoing basis and allow adjustments to the plan as necessary, the Coast Guard will rely on the program management contractor, Deloitte. The POAM states that the contractor will utilize a "portfolio" management approach that includes identification of the Coast Guard's portfolio of projects and people that will execute financial transformation work, and development of strategies that will optimize resources and performance. The FMTTF developed an initial draft set of performance measures, which should be revised and/or expanded as the plan progresses.

Findings

To evaluate the activities taken in response to the Order (six actions), we reviewed the schedule and deliverables listed in the charter for implementing the financial management transformation and CFO audit remediation, and compared them to actual activities of the FMTTF. During the course of the performance audit, we made the following observations and findings:

Action I – Group Formation

The FMTTF was substantially staffed and functioning by July 15, 2006, with remaining members reporting no later than August 1, 2006. However, the duration of their assignments was limited and the group is now standing down.

Action II – Contractor Support

Though later than originally planned, the Coast Guard engaged contractor support. The "Big 4" consulting firm was to be in place by August 15, 2006. However, the contract was not executed until September 15, 2006. The support did not commence until September 22, 2006.

Action III – Short-Term Win Plan

The short-term win plan was completed by the July 31, 2006, due date. However, initial due dates for some of the items listed on the short-term win plan were not realistic. When asked about the past-due items, the Coast Guard explained that the initial due dates, which were estimated completion times, were not reasonable and needed to change.

Action IV – Status Quo Analysis and Approach

The FMTTF completed the project approach and status quo analysis in a reasonably timely fashion. The project approach and the analysis of the status quo were to be submitted by August 15, 2006. While the project approach was submitted by this date, the status quo analysis was submitted in two sections—external requirements and internal requirements on August 24, 2006 and August 31, 2006, respectively.

Action V – Plan of Action with Milestones

The POAM was to be submitted by October 1, 2006. However, it appears that this deadline was established before the level of effort to accomplish this task was determined. The completion date for the POAM was revised to November 9, 2006, by Coast Guard management. The resources required to execute the POAM are not assigned. After the delivery of the final report (the POAM is included within the final report) on November 9, 2006, the FMTTF will stand down. The POAM proposes that, in its place, the Financial Management Transformation organization (CG-8T) be chartered and tasked with completing the planning, implementing the actions identified in the POAM, and identifying the actions necessary to achieve and sustain clean audit opinions. The CG-8T organization would be made up of three teams: Financial Reengineering, Internal

Control, and Audit Remediation. Currently, there is only a skeleton staff in place. In addition, although it was suggested by the FMTTF that the Coast Guard Deputy Chief Financial Officer should lead the new CG-8T organization, this position is currently vacant. Therefore, there is neither a leader nor sufficient staff to carry the POAM implementation forward.

Action VI – Leadership and Stakeholder Awareness

Coast Guard Leadership Team/FMTTF briefings were held regularly and the FMTTF activities and progress were noted in Coast Guard-wide e-mails. The POAM was developed with the assistance of stakeholder surveys and focus groups. The Coast Guard took actions to increase leadership and stakeholder awareness through these briefings and meetings.

Recommendations

The Coast Guard should:

- 1) Secure adequate human resources to complete the planning and to implement the actions identified in the POAM, as well as to identify actions necessary to achieve and sustain clean audit opinions. Further, the CG-8 team should be led by an individual with sufficient leadership skills, financial expertise, and the authority to implement changes.
- 2) Document in writing any changes to directives, whether in tasks or due dates, and include the written approval by the appropriate authority or authorities. Although documentation in briefings and dashboards indicate that Coast Guard leadership may have been aware of the delays, it does not indicate their approval.
- 3) Ensure that the POAM is integrated with the CAPs. To ensure that efforts are not duplicated or that gaps do not exist in the plans, all activities, timelines, and schedules need to be coordinated and integrated.



7000
8 Jan 2007

MEMORANDUM

From: RDML R. S. Branham
COMDT (CG-8)

Reply to: CG-84
Attn of: CAPT D. L. Hill
202-372-3610

To: Mr. David Zavada
Assistant Inspector General for Audit
Department of Homeland Security

Subj: FEEDBACK ON DRAFT PERFORMANCE AUDIT NR. 4 REPORT

1. Thank you for the opportunity to comment on your draft performance audit report related to several of the Coast Guard's financial improvement activities. In general, we concur with the 21 recommendations contained in the report. In fact, as a result of our efforts ongoing at the time of the audit and since completed in several areas, we have already taken aggressive action on many of the recommendations. We've conducted several briefs to the DHS CFO, DHS IG staff and the DHS IG during the last month, all of which reflected some of the corrective action accomplished:

- a. Integration of our corrective action plans and Financial Management Transformation Task Force (FMTTF) plan of action and milestones;
- b. Development of additional milestones to expand root cause analysis;
- c. Development of risk-based, prioritized milestones and associated tasks to aid in sequencing and funding initiatives; and
- d. Assignment of initial resources to begin executing the FMTTF plan of action and milestones – now an integrated set of initiatives and related milestones.

2. I have three comments on the findings outlined in the report that I recommend you consider before going final with the report:

- a. Page 3, under Coordination of Efforts: I do not agree with the statement that "the Coast Guard did not effectively coordinate its various remediation activities." While it is true that our FMTTF efforts began after we initiated our CAP activities earlier in the spring of 2006, we realized at the outset that our CAP process needed to be an integral part of developing the FMTTF's plan of action and milestones. As such, CAP owners participated extensively during the entire FMTTF process and the resulting POAM includes their input. Due to the timing differences of the two efforts, we then followed up with an extensive integration of the two efforts to eliminate conflicts and redundancies. As indicated in paragraph 1 above, we now have

a single, integrated set of milestones in place. In addition, our efforts with the contracts reviewed under this performance audit were an integral part of our FMTTF and CAP process. For example, the Deloitte performance work statement was written specifically to obtain support for the FMTTF and CAP efforts, and the performance requirements include specific tasks necessary to successfully carry out the efforts of our project management office. We have found their support to be invaluable, and we expect that same level of support to continue as we pursue execution of our integrated and comprehensive project plan. Furthermore, the Okoye and PwC performance work statements were written specifically to provide support for existing CAP-related work (i.e., internal controls and financial reporting), and we in fact have found these contractors' support to be especially crucial to our overall efforts now that we have integrated milestones in place for both of these initiatives.

b. Page 11, under Root Cause Identification: While the Coast Guard recognizes that the root cause analysis is not yet complete in all areas, your report as written does not adequately reflect the extensive level of root cause analysis we've already undertaken. More specifically, it should be noted that at the time of this performance audit, an extensive business process and controls analysis had already been completed by PwC for Financial Reporting, Funds Management (Fund Balance with Treasury) and Entity Level Controls as part of our efforts to implement the DHS multi-year internal control initiative. In fact, some of the identified gaps were included in our 30 Sep 2006 version of the Coast Guard's CAPs. In addition, a very detailed gap analysis was completed by the FMTTF as part of developing the strategic plan of action and milestones. As indicated above, we have since integrated our CAPs and FMTTF efforts and have developed additional milestones to expand our root cause analysis even further.

c. Page 17, under Accountability and Government Oversight: the statement that "The contract technical managers for the Deloitte, Okoye, and PwC contracts do not have Contracting Officer's Technical Representative (COTR) certifications and, therefore, may not be trained in the duties and responsibilities of this position" is not correct. The current COTR for these contracts is certified as such, and she is backed up with a Coast Guard subject matter expert to support her in carrying out her duties. Nevertheless, we acknowledge that this same COTR is assigned more oversight responsibilities than is normally expected. We are in the process of training additional COTRs and exploring other options to provide the COTR oversight resources.

2. While we recognize the importance of root cause analysis, we also recognize the urgency of beginning the process of fixing known problems. The audit feedback provided in this report will allow us to make necessary course corrections along the way, and we're committed to working hard to incorporate your recommendations, especially as they relate to strategic coordination and contract coordination and oversight. In this vein, and with the assistance of our newly formed Project Management Office (PMO), we are establishing formal processes for tracking, monitoring and reporting the status of remediation efforts, and for providing quality control monitoring of completed tasks. I will provide you with more details on the PMO and quality monitoring procedures when I provide the more detailed narratives to back up the Comprehensive Project Plan milestones I forwarded to you last month.

Subj: FEEDBACK ON DRAFT PERFORMANCE AUDIT NR.
4 REPORT

7000
8 Jan 2006

3. I would be happy to meet with you to discuss our feedback. I would appreciate an opportunity to review the report one more time before it goes to print. In the meantime, we look forward to a continued strong relationship with the DHS IG and KPMG as we implement our multi-year financial management improvement plan.

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