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U.S. HOUSE OF REPRESENTATIVES

CONCERNING

DHS FINANCIAL MANAGEMENT: INVESTIGATING DHS'

STEWARDSHIP OF TAXPAYER DOLLARS

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Good morning Chairman Duncan, Ranking Member Barber, and Members of the Subcommittee:

Thank you for inviting me here today to testify about financial management at the Department of Homeland Security (DHS). Today, I will address financial management within the Department by focusing on the *Independent Auditors' Report on DHS' FY 2012 Financial Statements and Internal Control over Financial Reporting* and on our fiscal year (FY) 2012 Major Management Challenges report, both of which were issued in November 2012. KPMG, LLP prepared the independent auditors' report. Both FY 2013 reports will be issued in mid-December of this year.

The Federal Government has a fundamental responsibility to be an effective steward of taxpayer dollars. Sound financial practices and related management operations are critical for DHS to achieve its mission and to provide reliable, timely financial information to support management decision-making throughout DHS. Congress and the public must be confident that the Department is properly managing its finances to minimize inefficient and wasteful spending, and to make informed decisions to manage its programs and implement its policies.

Although DHS produced an auditable balance sheet and statement of custodial activity in FY 2011 and obtained a qualified opinion on those statements, challenges remained for the Department's financial management. Achieving a qualified opinion in FY 2011 resulted from considerable effort by DHS employees, rather than through complete implementation of a reliable system of control over financial reporting. As a result of DHS obtaining a qualified opinion on its balance sheet and statement of custodial activity in FY 2011, the scope of the FY 2012 audit was increased to include statements of net cost, changes in net position, and combined statement of budgetary resources.

The Department continued to improve financial management in FY 2012 and achieved a significant milestone. FY 2012 was the first year the Department completed a full scope audit on all financial statements. The independent auditors issued a qualified opinion on the financial statements. Nevertheless, the Department still had work to do in FY 2013. In FY 2012, KPMG was unable to perform the necessary procedures to form an opinion on DHS' internal control over financial reporting of that fiscal year's financial statements. In addition, the Department had material weaknesses in internal control over financial reporting. To sustain or improve upon the FY 2012 qualified opinion, DHS needed to continue remediating the remaining control deficiencies.

Managerial Cost Accounting

As we noted in our FY 2012 report on DHS' major management challenges, the Department does not have the ability to provide timely cost information by major program, and by strategic and performance goals. Its financial management systems do not allow for the accumulation of costs at the consolidated level by major program, nor do they allow for the accumulation of costs by responsibility segments that directly align with the major goals and outputs described in each entity's strategic and performance plan. The Department also needs to develop a plan to implement managerial cost accounting, including necessary information systems functionality. As of FY 2012, the Department was using manual data calls to collect cost information from the various components and compile consolidated data. During audits that we issued in FY 2013, we identified a number of components that did not have the ability to provide various cost data when requested.

For example:

- During the audit of the Transportation Security Administration's (TSA) Aviation Channeling Service Provider project (*Transportation Security Administration's Aviation Channeling Services Provider Project*, OIG-13-42, February 2013), we learned that TSA did not track and report all project costs. According to TSA officials, it was impossible to provide exact costs because the expenditures were not tracked in detail.

- During the audit examining U.S. Custom's and Border Protection's (CBP) acquisition and conversion of H-60 helicopters (*DHS' H-60 Helicopter Programs*, OIG 13-89 Revised, May 2013), CBP officials received high-level cost information from the U.S. Army, but it did not include the detail necessary for adequate oversight of the component's H-60 programs. For example, the Army conducted approximately 15,000 tests on CBP H-60 components, but CBP could not identify which tests were completed or the specific costs. In addition, for each CBP H-60 helicopter, financial data from three sources listed a different total cost.

- During the audit of CBP's use of radiation portal monitors at seaports (*United States Customs and Border Protection's Radiation Portal Monitors at Seaports*, OIG-13-26, January 2013), we identified instances in which the acquisition values for the monitors were incorrect and could not be supported.

Anti-Deficiency Act Violations

As of September 30, 2012, the Department and its components reported five potential *Anti-Deficiency Act* (ADA) violations in various stages of review, including one potential ADA violation identified in FY 2012, which the Department was investigating. The four other ADA violations involved: (1) expenses incurred before funds were committed or obligated, (2) pooled appropriations to fund shared services, (3) a contract awarded before funds had been re-apportioned, and (4) improper execution of the obligation and disbursement of funds to lease passenger vehicles. No new ADA violations were identified in FY 2013.

FY 2012 Financial Statement Audit

The *Independent Auditors' Report on DHS' FY 2012 Financial Statements and Internal Control over Financial Reporting* contained five items that showed the status of DHS' efforts to address internal control weaknesses in financial reporting. These were identified as material weaknesses in the FY 2011 independent audit of DHS' consolidated balance sheet and statement of custodial activity. All five material weaknesses remained in FY 2012. Table 1, which appeared in independent auditors' report, summarizes the auditors' FY 2012 findings. The auditors identified significant deficiencies considered to be material weaknesses in financial reporting; information technology (IT) controls and financial system functionality; property, plant, and equipment (PP&E); environmental and other liabilities; and budgetary accounting. DHS made progress in remediating two material weaknesses. Specifically, the United States Coast Guard (USCG) properly stated environmental liability balances, which resulted in the auditors retroactively removing the FY 2011 qualification in this area. The USCG was also able to remediate a number of internal control weaknesses related to IT scripting, and it continued to make progress in PP&E, with the goal of being able to assert to the entire PP&E balance by January 2013. They did not, however, meet that goal. Other significant deficiencies were identified in entity-level controls, grants management, and custodial revenue and drawback.

TABLE 1 – SUMMARIZED DHS FY 2012 INTERNAL CONTROL FINDINGS
(Full-Scope Financial Statement Audit)

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

	Control deficiency findings are ***more significant*** to the evaluation of effectiveness of controls at the Department-Level
	Control deficiency findings are ***less significant*** to the evaluation of effectiveness of controls at the Department-Level
MW	Material weakness at the Department level exists when all findings are aggregated
SD	Significant deficiency at the Department level exists when all findings are aggregated

In FY 2012, the Department provided qualified assurance that internal control over financial reporting was operating effectively at September 30, 2012, and it acknowledged that material weaknesses continued to exist in key financial processes. Consequently, the independent auditors were unable to render an opinion on DHS' internal controls over financial reporting in FY 2012.

Financial Reporting

Financial reporting presents financial data on an agency's financial position, its operating performance, and its flow of funds for an accounting period. In FY 2011, the USCG, U.S. Citizenship and Immigration Services (USCIS), and TSA contributed to the material weakness in this area. Although some findings reported in FY 2011 were corrected, other findings at the USCG and TSA remained in FY 2012. Also, in FY 2012, new financial reporting findings were identified at U.S. Immigration and Customs Enforcement (ICE).

As in the previous year, the auditors reported in FY 2012 that the USCG did not have properly designed, implemented, and effective policies, procedures, processes, and controls related to its financial reporting process. The USCG used three general ledgers, developed more than a decade ago. This legacy system had severe functional limitations that affected its ability to address systemic internal control weaknesses in financial reporting, strengthen the control environment, and comply with relevant Federal financial system requirements and guidelines.

The auditors also identified deficiencies that remained in some financial reporting processes at TSA. For example, there were weak or ineffective controls in some key financial reporting processes, in management's quarterly review of the financial statements, and in supervisory reviews over journal vouchers. In addition, TSA was not fully compliant with the United States Government Standard General Ledger requirements at the transaction level. In recent years, TSA implemented several new procedures and internal controls to correct known deficiencies, but some procedures still required modest improvements to fully consider all circumstances or potential errors. The control deficiencies contributed to substantive and classification errors reported in the financial statements and discovered during the audit.

During FY 2012, the auditors noted financial reporting control weaknesses at ICE, primarily resulting from expanded audit procedures for the full-scope financial statement audit. ICE had not fully developed sufficient policies, procedures, and internal controls for financial reporting. It also needed adequate resources to respond to audit inquiries promptly and accurately, and to be able to identify potential technical accounting issues. ICE faced challenges in developing and maintaining adequate lines of communication within its Office of Financial Management and among its program offices. Communication between financial managers and personnel responsible for contributing to financial reports was not sufficient to consistently generate clear and usable information. In addition, ICE did not have sufficient coordination with IT personnel, including contractors who were generating certain financial reports.

The independent auditors made several recommendations to the USCG, TSA, and ICE to address these challenges.

Information Technology Controls and Financial Systems Functionality

IT general and application controls are essential to effective and reliable reports of financial and performance data.

During the FY 2011 financial statement audit, the independent auditors noted that the Department remediated 31 percent of the prior year IT findings. The most significant FY 2011 weaknesses included: (1) excessive unauthorized access to key DHS financial applications, resources, and facilities; (2) configuration management controls that were not fully defined, followed, or effective; (3) security management deficiencies in the certification and accreditation process and an ineffective program to enforce role-based security training and compliance; (4) contingency planning that lacked current, tested contingency plans developed to protect DHS resources and financial applications; and (5) improperly segregated duties for roles and responsibilities in financial systems. These deficiencies negatively affected internal control over DHS' financial reporting and its operation and contributed to the FY 2011 financial management and reporting material weakness.

In FY 2012, DHS made some progress in correcting the IT general and application control weaknesses identified in FY 2011. DHS and its components remediated 46 percent of the prior year IT control weaknesses, with CBP, the Federal Emergency Management Agency (FEMA), and

TSA making the most progress in remediation. Although CBP and FEMA made progress in correcting their prior year issues, in FY 2012, the most new issues were noted at these two components. New findings resulted primarily from new IT systems and business processes that were within the scope of the broadened FY 2012 financial statement audit and were noted at all DHS components.

The auditors noted many cases in which financial system functionality limitations inhibited DHS' ability to implement and maintain internal controls, notably IT application controls supporting financial data processing and reporting. As a result, ongoing financial system functionality limitations contributed to the Department's challenge to address systemic internal control weaknesses and strengthen the overall control environment. In FY 2012, five IT control weaknesses remained and presented risks to the confidentiality, integrity, and availability of DHS' financial data: (1) access controls; (2) configuration management; (3) security management; (4) contingency planning; and (5) segregation of duties. Several findings were related to the USCG's financial system functionality, including limitations that were preventing the USCG from establishing automated processes and application controls that would improve accuracy, reliability, as well as facilitate efficient processing of certain financial data. Financial system functionality limitations also contributed to other reported control deficiencies.

The independent auditors recommended that the DHS Office of the Chief Information Officer, in coordination with the Office of the Chief Financial Officer, continue the *Financial Systems Modernization* initiative, and make necessary improvements to the Department's financial management systems and supporting IT security controls.

Property, Plant, and Equipment

DHS capital assets and supplies consist of items such as PP&E operating materials, as well as supplies, including boats and vessels at the USCG, passenger and baggage screening equipment at TSA, and stockpiles of inventory to be used for disaster relief at FEMA. The USCG maintains approximately 50 percent of all DHS PP&E.

During FY 2011, TSA, the USCG, CBP, and the Management Directorate (MGMT) contributed to a departmental material weakness in PP&E. During FY 2012, TSA and MGMT substantially completed corrective actions in PP&E accounting processes.

In FY 2012, the USCG continued to remediate PP&E process and control deficiencies, specifically those associated with land, buildings and other structures, vessels, small boats, aircraft, and construction in process. However, remediation efforts were not fully completed in FY 2012. The USCG had difficulty establishing its opening PP&E balances and accounting for leases, primarily because of poorly designed policies, procedures, and processes implemented more than a decade ago, combined with ineffective internal controls and IT system functionality difficulties.

As in prior years, CBP had either not fully implemented policies and procedures, or it did not have sufficient oversight of its adherence to policies and procedures, to ensure that all PP&E transactions were recorded promptly and accurately, or to ensure that all assets were recorded and properly valued in the general ledger.

In FY 2012, ICE did not have adequate processes and controls in place to identify internal-use software projects that should be considered for capitalization. It also did not have adequate policies and procedures to ensure that assets acquired were recorded in the general ledger in a timely manner.

The independent auditors made several recommendations to the USCG, CBP, and ICE to address these challenges.

Environmental and Other Liabilities

Liabilities are the probable and measurable future outflow or other sacrifice of resources resulting from past transactions or events. Internal control weaknesses reported in this area relate to various liabilities, including environmental, accounts payable, legal, and accrued payroll and benefits.

In FY 2012, the USCG's environmental liabilities represented approximately $500 million or 75 percent of total DHS environmental liabilities. Later in FY 2012, the USCG completed the final phases of a multiyear remediation plan to address process and control deficiencies related to environmental liabilities. However, the USCG did not implement effective controls to ensure the completeness and accuracy of all underlying data components used to calculate environmental liability balances. The USCG also did not have documented policies and procedures to update, maintain, and review schedules to track environmental liabilities (e.g., Formerly Used Defense Sites) for which it was not primarily responsible at the Headquarters level. Additionally, the USCG did not effectively implement existing policies and procedures to validate the prior year accounts payable estimate.

The independent auditors made recommendations related to environmental and other liabilities to the USCG.

Budgetary Accounting

Budgetary accounts are general ledger accounts for recording transactions related to the receipt, obligation, and disbursement of appropriations and other authorities to obligate and spend agency resources. DHS has numerous sources and types of budget authority, including annual, multiyear, no-year, and permanent and indefinite appropriations, as well as several revolving, special, and trust funds. Timely and accurate accounting for budgetary transactions is essential to managing Department funds and preventing overspending.

In FY 2012, the USCG implemented corrective actions plans over various budgetary accounting processes; however, some control deficiencies reported in FY 2011 remained, and new deficiencies were identified. The USCG had not fully implemented existing policies, procedures, and internal controls to ensure that obligations were reviewed and that approved and undelivered order balances were monitored to ensure their timely deobligation when appropriate. It also did not have fully implemented policies, procedures, and internal controls over the monitoring of reimbursable agreements, and related budgetary unfilled customer orders, to ensure activity, including closeout and deobligation, as appropriate, was recorded timely and accurately. The component did not have sufficient policies and procedures for recording the appropriate budgetary entries upon receipt of goods, and prior to payment.

Although FEMA also continued to improve its processes and internal controls over the obligation and monitoring process, some control deficiencies remained. The component did not effectively certify the status of its obligations to ensure validity prior to fiscal year end. It could not readily provide all supporting documentation for obligations and deobligations made during the year and for undelivered orders audited at June 30, 2012 and September 30, 2012. FEMA also did not properly review budgetary funding transactions recorded in the general ledger. It did not timely and effectively complete management reviews over the monthly reconciliations of the SF-132, *Apportionment and Reapportionment Schedule,* to the SF-133, *Report on Budget Execution and Budgetary Resources.*

As the financial service provider, ICE is responsible for recording budgetary transactions, and it administers budgetary processes across different types of funds at the National Protection and Programs Directorate, the Science and Technology Directorate, MGMT, and the Office of Health Affairs. In FY 2011, ICE identified and began remediating deficiencies in the financial management system that impacted accounting transactions, such as posting logic related to adjustments of prior year unpaid, undelivered orders. In FY 2012, ICE continued to address these issues with certain types of obligations.

MGMT is responsible for the operations and financial oversight of several programs including the DHS Working Capital Fund, which provides shared services to DHS agencies. In FY 2012, MGMT recorded several corrective adjustments that were indicative of deficiencies in internal controls over financial reporting at the process level. MGMT lacked effective controls to monitor undelivered order balances to deobligate or adjust undelivered order balances on a timely basis. Internal controls were not properly designed to adequately monitor unfilled customer order balances, related to both the Working Capital Fund and non-Working Capital Fund activity.

The Federal Law Enforcement Training Center budgetary reporting process was within the scope of the FY 2012 audit, and, as a result, new control deficiencies were identified. Management did not have controls in place to perform a thorough review of the FY 2012 unfilled customer order beginning balances related to reimbursable construction, to ensure that beginning balances were properly recorded.

The auditors made recommendations to address deficiencies at the three DHS Components, as well as at MGMT and the training center.

Conclusion

In FY 2012, DHS received a qualified opinion on its financial statements. Improvements were seen at various components. For example, USCIS corrected control deficiencies in financial reporting that contributed to the overall material weakness. Likewise, TSA made significant progress in addressing PP&E, removing its contribution to the Department’s material weakness. The USCG also continued to make financial reporting improvements in FY 2012, by completing its planned corrective actions over selected internal control deficiencies. These remediation efforts allowed management to make new assertions in FY 2012 related to the auditability of its financial statement balances. In addition, management was able to provide a qualified assurance of internal control over financial reporting in FY 2012.

According to DHS' Office of Financial Management, in FY 2012, there was improved access to and better quality of financial management information. The Department implemented business intelligence tools to help organize, store, and analyze data more efficiently. According to the Office of Financial Management, the Department was able to take information from individual budgets and display it for the enterprise, allowing views of DHS' budget allocation by mission area. Additionally, the Department reported it was developing the Decision Support Tool to help compile department-wide program cost information and to provide a central dashboard with key indicators, such as cost, funding, and schedule, to assess and track the health of acquisitions.

Sound financial practices and related management operations are critical to achieving the Department's mission and to providing reliable, timely financial information to support management decision-making throughout DHS. The Department has demonstrated its commitment to improving its practices and operations. It continued to make progress in FY 2012, but needed to address some concerns to avoid losing momentum and to achieve the reachable goal of a clean opinion in FY 2013. OIG, in turn, will continue to conduct financial statement audits and make recommendations to help DHS meet its challenges and ensure proper stewardship of taxpayer dollars.

Mr. Chairman, this concludes my prepared statement. I welcome any questions you or other Members of the Subcommittee may have.