U.S. Department of Homeland Security Annual Financial Report

Fiscal Year 2010

Homeland Security

About this Report

The *U.S. Department of Homeland Security Annual Financial Report for Fiscal Year (FY) 2010* presents the Department's detailed financial information relative to our mission and the stewardship of those resources entrusted to us. It also provides readers with a sense of the Department's priorities, strengths, and challenges in implementing programs to enhance the safety of our Nation.

For FY 2010, the Department is using the alternative approach as identified in the Office of Management and Budget's Circular A-136 to produce its Performance and Accountability Reports consisting of the following three reports:

- ***DHS Annual Financial Report***: Publication Date – November 15, 2010
- ***DHS Annual Performance Report***: Publication Date – February 7, 2011
- ***DHS Summary of Performance and Financial Information:*** Publication Date – February 15, 2011

When published, all three reports will be located at our public website at: http://www.dhs.gov/xabout/budget/editorial_0430.shtm.

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Message from the Secretary

November 15, 2010

I am pleased to submit the Department of Homeland Security's (DHS) Annual Financial Report for Fiscal Year (FY) 2010. This report provides an assessment of the Department's detailed financial information and our stewardship of taxpayer resources in support of our mission of securing the United States. In 2010, DHS completed the first-ever Quadrennial Homeland Security Review (QHSR), which established a unified, strategic framework for homeland security missions and goals. Subsequently, DHS conducted a Bottom-Up Review (BUR) to align our programmatic activities and organizational structure to better serve those missions and goals.

The QHSR reflects the most comprehensive assessment and analysis of homeland security to date. DHS worked closely with the White House, National Security Staff, other federal departments and agencies, and our state, local, tribal and territorial partners to represent the whole-of-government approach to national security envisioned by the Administration.

This report outlines the Department's major goals and priorities, consistent with the QHSR and the BUR, as we work to build a more ready and resilient Nation.

Priority Areas

To build a safe, secure, and resilient homeland, DHS is focused on six Departmental missions: preventing terrorism and enhancing security; securing and managing our borders; enforcing and administering our immigration laws; safeguarding and securing cyberspace; ensuring resilience to disasters; and complementary Department responsibilities. Additionally, DHS is constantly striving to mature and strengthen the homeland security enterprise.

Preventing Terrorism and Enhancing Security

Protecting the United States from terrorism is the cornerstone of homeland security. DHS's counterterrorism responsibilities focus on three goals: preventing terrorist attacks; preventing the unauthorized acquisition, importation, movement, or use of chemical, biological, radiological, and nuclear materials and capabilities within the United States; and reducing the vulnerability of critical infrastructure and key resources, essential leadership, and major events to terrorist attacks and other hazards.

Securing and Managing Our Borders

DHS secures the Nation's air, land, and sea borders to prevent illegal activity while facilitating lawful travel and trade. The Department's border security and management efforts focus on three interrelated goals: effectively securing U.S. air, land, and sea borders; safeguarding and streamlining lawful trade and travel; and disrupting and dismantling transnational criminal and terrorist organizations.

Enforcing and Administering Our Immigration Laws

DHS is focused on smart and effective enforcement of U.S. immigration laws while streamlining and facilitating the legal immigration process. The Department has fundamentally reformed immigration enforcement, focusing on identifying and removing criminal aliens who pose a threat to public safety and targeting employers who knowingly and repeatedly break the law.

Safeguarding and Securing Cyberspace

By statute and Presidential directive, DHS has the lead for the Federal Government to secure civilian government computer systems and works with industry and state, local, tribal and territorial governments to secure critical infrastructure and information systems. DHS analyzes and reduces cyber threats and vulnerabilities; distributes threat warnings; and coordinates the response to cyber incidents to ensure that our computers, networks, and cyber systems remain safe.

Ensuring Resilience to Disasters

DHS provides the coordinated, comprehensive federal response in the event of a terrorist attack, natural disaster or other large-scale emergency while working with federal, state, local, and private sector partners to ensure a swift and effective recovery effort. The Department's efforts to build a ready and resilient Nation include fostering a community-oriented approach; bolstering information sharing; providing grants, plans and training to our homeland security and law enforcement partners; and facilitating rebuilding and recovery along the Gulf Coast.

Complementary Department Responsibilities

DHS leads and supports many activities that provide essential support to national and economic security including, but not limited to: maximizing collection of customs revenue; protecting the financial services sector; maintaining the safety and security of the marine transportation system; preventing the exploitation of children; providing law enforcement training; and coordinating the Federal Government's response to global intellectual property theft. DHS contributes in many ways to these elements of broader U.S. national and economic security while fulfilling its other five homeland security missions.

This report highlights the Department's activities and accomplishments in each of these mission areas in FY 2010 and discusses upcoming initiatives that will build on these efforts to achieve a safer and more secure Nation.

Maturing and Strengthening the Homeland Security Enterprise

The integration of all or part of 22 different federal departments and agencies into a unified, integrated DHS has historically presented both public policy and management challenges. The QHSR, BUR, and ongoing initiatives under the Secretary's Efficiency Review highlight the Department's recent steps taken towards greater unification and integration. Since its launch in March 2009, the DHS Efficiency Review program has implemented over 30 separate initiatives to achieve these aims while also promoting greater accountability, transparency, and customer satisfaction. The Efficiency Review has led to improvements in how the Department manages its resources in several areas, including its physical assets and support of its workforce, as well as the day-to-day expenditures required to do business. Additionally, we are continuing our investment and commitment to the Acquisition Workforce—investing in our employees through workforce training and integrated professional and leadership development—and are making significant investments in data center consolidation. Further, while DHS currently operates in 50 disparate locations throughout the National Capital Region, we are making significant progress on construction of a unified headquarters at the St. Elizabeths campus.

Management Assurances and Performance Measurement

Pursuant to the *Department of Homeland Security Financial Accountability Act*, in FY 2010, the Department focused its efforts on eliminating audit qualifications and executing corrective actions to strengthen Department-wide internal controls over financial reporting. The Department is addressing the remaining material weaknesses and making progress toward a clean audit opinion. Most significantly, the U.S. Coast Guard's Financial Strategy for Transformation and Audit Readiness has increased the value of auditable balance sheet amounts from $3 to $53 billion between FY 2008 and FY 2010. The Department is proud of these accomplishments and will continue to partner with the U.S. Coast Guard to obtain an audit opinion in the near term.

The Department is committed to improving performance measurement and accountability by increasing the quality of the Department's performance measures and linking those measures to the mission outcomes articulated in the QHSR and the BUR. DHS is currently in the process of assessing all of its performance measures to align them with the QHSR and the BUR and create a comprehensive performance plan that will provide the basis for strategic planning and management controls.

The men and women of the Department of Homeland Security remain focused on achieving our objectives in the coming year while continuing to be responsible stewards of taxpayer resources. The scope of our mission is broad, challenging, and vital to the security of the Nation. We will continue to meet these and other challenges head-on, with a sense of urgency and purpose that the American people expect and that our mission requires. Thank you for your partnership and collaboration.

Yours very truly,

Janet Napolitano

Management's Discussion and Analysis

The ***Management's Discussion and Analysis*** **(MD&A)** section explains the Department's mission, goals, and organization, and summarizes program and financial performance.

See *inside front cover* for a description of the DHS approach to performance and accountability reporting.

Mission and Organization

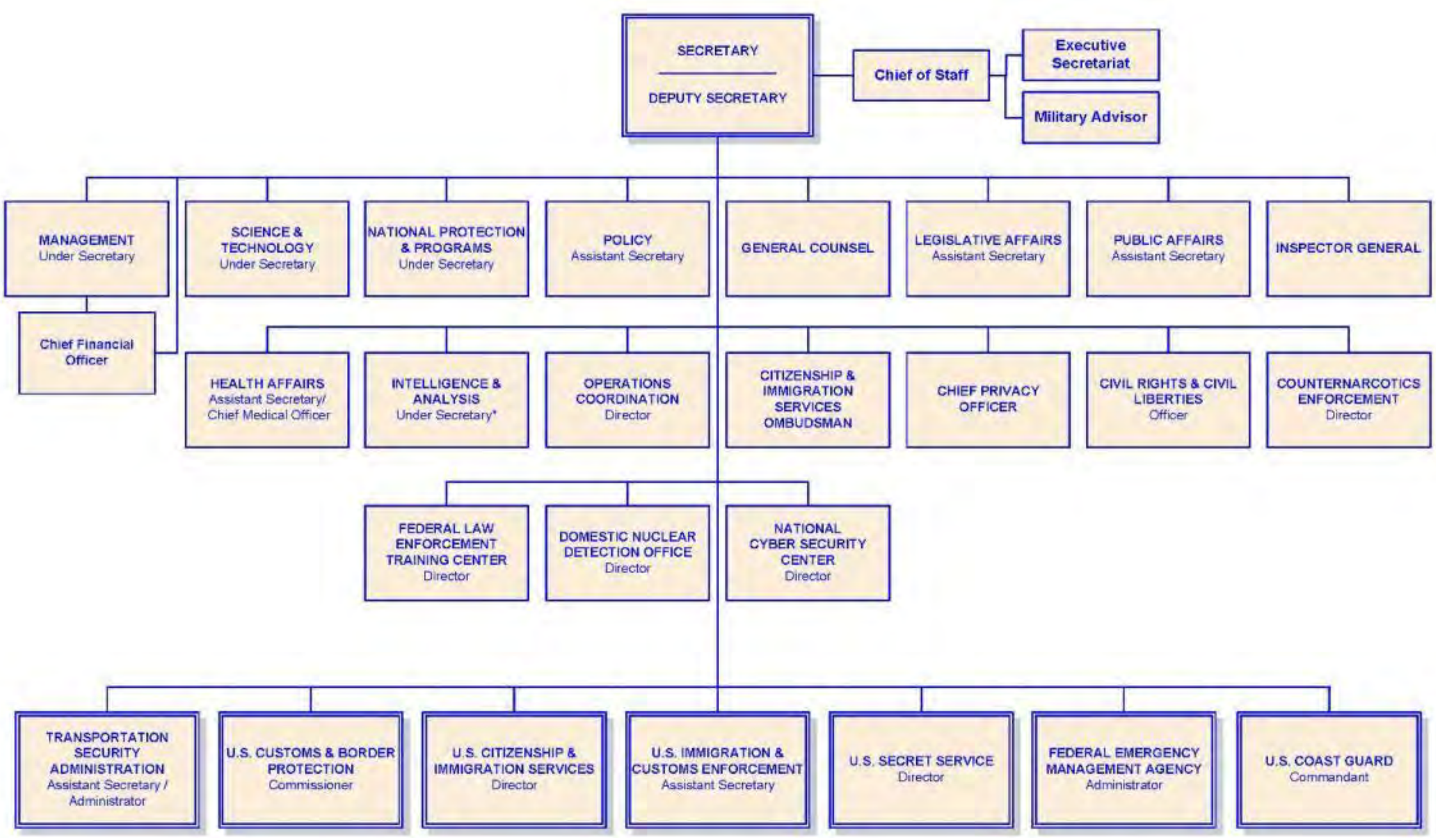
Our Mission

We will lead efforts to achieve a safe, secure, and resilient homeland. We will counter terrorism and enhance our security; secure and administer our borders; enforce and administer our immigration laws; protect cyber networks and critical infrastructure; and ensure resilience from disasters.

Our Organization

The Department of Homeland Security leverages resources within Federal, state, local, territorial, and tribal governments, coordinating multiple agencies and programs into a single, integrated effort focused on protecting the American people and their homeland. The seven Operational Components, listed along the bottom of the chart below, lead the Department's operational activities to protect our Nation. The remaining Components of the Department provide resources, analysis, equipment, research, policy development, and support to ensure the front-line organizations have the tools and resources to accomplish the DHS mission. For more information, visit our website at http://www.dhs.gov/xabout/structure.

Figure 1. DHS Organization Chart



Quadrennial Homeland Security Review

In February 2010, DHS published our Nation's first-ever comprehensive review of America's homeland security strategy—*the Quadrennial Homeland Security Review (QHSR)*. The QHSR was the first step in setting forth the strategic foundation to guide the activities of the homeland security enterprise toward a common end—a homeland that is safe, secure, and resilient against terrorism and other hazards. The QHSR accomplished this by laying out a vision for a secure homeland, key mission priorities, and specific goals for each of those mission areas.

The QHSR identified five mission areas for the homeland security enterprise:

Mission 1: Preventing Terrorism and Enhancing Security – Preventing a terrorist attack in the United States remains the cornerstone of homeland security. Our vision is a secure and resilient Nation that effectively prevents terrorism in ways that preserve our freedom and prosperity. Achieving this vision requires us to focus on the core goal of preventing terrorist attacks, highlighting the challenges of preventing attacks using chemical, biological, radiological, and nuclear (CBRN) weapons and managing risks to critical infrastructure.

Mission 2: Securing and Managing Our Borders – A safe and secure homeland requires that we secure our air, land, and sea borders and disrupt and dismantle transnational criminal and terrorist organizations while facilitating lawful travel and trade.

Mission 3: Enforcing and Administering Our Immigration Laws – Virtually all Americans are affected by our immigration system. A fair and effective immigration system enriches American society, unifies families, and promotes our security. The success of our Nation's immigration policy plays a critical role in advancing homeland security.

Mission 4: Safeguarding and Securing Cyberspace – Our economic vitality and national security depend today on a vast array of interdependent and critical cyber networks, systems, services, and resources. If these cyber tools and networks cannot function properly, we will not be able to effectively communicate, travel, power our homes, run our economy, or obtain government services.

Mission 5: Ensuring Resilience to Disasters – Despite ongoing vigilance and efforts to protect this country and its citizens, major accidents and disasters, as well as terrorist attacks, will occur. The challenge is to build the capacity of American society to be resilient in the face of attacks, disasters, and other crises. Our vision is a Nation that understands the hazards and risks we face; is prepared for disasters; can withstand the disruptions that attacks and disasters may cause; can manage itself effectively during a crisis; can recover quickly and effectively; and can adapt to conditions that have changed as a result of the event.

Bottom-up Review

A bottom-up review (BUR) of DHS was initiated in November 2009 as an immediate follow-on and complement to the QHSR. The BUR included an assessment of the organizational alignment of the Department with the homeland security missions set forth in the QHSR, including the Department's organizational structure, management systems, procurement systems, and physical and technical infrastructure. The BUR also included a review and assessment of the effectiveness of the mechanisms of the Department for utilizing the requirements developed in the QHSR in the development of the Department's acquisition strategies and expenditure plan.

The BUR Report describes the alignment of the Department with the homeland security missions, and sets forth the Department's priority initiatives and enhancements to increase mission performance, improve Department management, and increase accountability over the next four years. The BUR Report includes recommendations for improving the organizational alignment of the Department and enhancing its business processes.

The BUR is the second step of a three-step process. The Department's FY 2012 budget request will begin the process of implementing the BUR initiatives and enhancements, and the corresponding FY 2012–2016 Future Years Homeland Security Report will set forth the budget plan required to provide sufficient resources to successfully execute the full range of homeland security missions as described in the QHSR and the priority initiatives and enhancements set forth in the BUR Report over the FY 2012–2016 period, in order to set a foundation for future success.

As a result of the BUR and discussions of the Department's FY 2012 budget request and FY 2012–2016 Future Years Homeland Security Report, the Department articulated a sixth mission, designed to address the many activities DHS leads and supports that provide essential support to national and economic security, referred to throughout as *Complementary Department Responsibilities.* These activities include, but are not limited to: maximizing collection of customs revenue; protecting the financial services sector; maintaining the safety and security of the marine transportation system; preventing the exploitation of children; providing Federal law enforcement training; and coordinating the Federal Government's response to global intellectual property theft. DHS contributes in many ways to these elements of broader U.S. national and economic security while fulfilling its other five homeland security missions.

Performance Overview

The performance overview provides an analysis of each homeland security mission area, selected accomplishments for FY 2010, and key future initiatives to strengthen the Department's efforts in achieving a safer and more secure Nation.

Preventing Terrorism and Enhancing Security

Preventing a terrorist attack in the United States remains the cornerstone of homeland security. Our vision is a secure and resilient Nation that effectively prevents terrorism in ways that preserve our freedom and prosperity. Achieving this vision requires us to focus on the core goal of preventing terrorist attacks, highlighting the challenges of preventing attacks using chemical, biological, radiological, and nuclear (CBRN) weapons and managing risks to critical infrastructure.

We will achieve this mission through the following goals:

- **Prevent Terrorist Attacks:** Prevent malicious actors from conducting terrorist attacks within or against the United States.
- **Prevent the Unauthorized Acquisition or Use of CBRN Materials and Capabilities:** Prevent malicious actors from acquiring or moving dangerous chemical, biological, radiological, and nuclear materials or capabilities within the United States.
- **Manage Risks to Critical Infrastructure, Key Leadership, and Events:** Reduce the vulnerability of key sectors to attack or disruption.

DHS Performs 100 Percent Watchlist Matching for U.S. Airlines

In June 2010, Secretary Janet Napolitano announced that 100 percent of passengers flying domestically and internationally on U.S. airlines are now being checked against the U.S. Government's consolidated terrorist watchlist through the Transportation Security Administration's (TSA) Secure Flight program—a major step in fulfilling a key 9/11 Commission recommendation.

"Secure Flight fulfills a key recommendation of the of the *9/11 Commission Report*, enabling TSA to screen passengers directly against the U.S. Government's consolidated watchlist using passenger name, date of birth, and gender before a boarding pass is issued," said Secretary Napolitano. "This program is one of our many layers of security—coordinated with our partners in the airline industry and governments around the world—that we leverage to protect the traveling public against threats of terrorism."

In addition to facilitating secure travel for all passengers, the program helps prevent the misidentification of passengers who have names similar to individuals on the U.S. Government's consolidated terrorist watchlist.

Successful Test of Maritime Radiation Detection Technology

The Department's Domestic Nuclear Detection Office (DNDO) has established the U.S. Government's premier radiological and nuclear detection system test and evaluation organization. Since 2005, DNDO has conducted 48 separate test and evaluation campaigns at more than 20 experimental and operational venues. In FY 2010, DNDO completed the *Dolphin* test campaign to evaluate the performance of currently available radiological and nuclear detection systems mounted on small vessels and designed for operation in the maritime environment. These systems were tested in the San Diego, California harbor under operational conditions with U.S. Coast Guard and local law enforcement participation. This test successfully demonstrated the feasibility of boat-mounted systems, and will be instructive to Federal, state, local and tribal entities developing capabilities throughout U.S. port regions, seeking to counter the threat of nuclear terrorism in our coastal waters and harbors.

Future Initiatives

Strengthening Aviation Security:
The attempted terrorist attack on December 25, 2009, illustrated the continuing and evolving nature of the threat to the aviation transportation system. DHS implements a layered security system to address evolving threats and, over the past year, has embarked upon a major global initiative, in conjunction with the International Civil Aviation Organization (ICAO), to improve aviation security technology and processes around the world. Over the past nine months, Secretary Napolitano has participated in regional aviation security summits around the world, forging historic agreements with her international colleagues to strengthen the civil aviation system through enhanced information collection and sharing, cooperation on technological development, and modernized aviation security standards. On October 8, 2010, the ICAO General Assembly passed an unprecedented joint Declaration on Aviation Security, which calls on member states to address new and emerging threats by developing and deploying new security technologies that better detect dangerous materials; strengthening security measures and standards for airport inspections and cargo screening around the globe; and promoting innovative, effective, and efficient security approaches and information-sharing strategies among member states to raise awareness of threats and trends. DHS is also partnering with the Department of Energy—including the National Laboratories—and private industry to develop new and more effective technologies to deter and disrupt known threats and anticipate and protect against new threats. DHS will also continue to collaborate with the aviation industry to use a risk-based approach to inform decisions about changes to operations, business processes, and aircraft development.

Standardizing and Institutionalizing the National Fusion Center Network: Since 2003, a national network of fusion centers has been developed at the state, local, tribal, and territorial level, supported by DHS and the Department of Justice with funding, training, exercises, and technical assistance. As part of a systematic effort to fully integrate these centers into national intelligence efforts, DHS will assess and raise the current level of capability of fusion centers in conjunction with Federal, state, local, tribal, and territorial partners and the private sector.

Securing and Managing Our Borders

A safe and secure homeland requires that we secure our air, land, and sea borders and disrupt and dismantle transnational criminal and terrorist organizations while facilitating lawful travel and trade.

We will achieve this mission through the following goals:

- **Secure U.S. Air, Land, and Sea Borders:** Prevent the illegal flow of people and goods across U.S. air, land, and sea borders.
- **Safeguard Lawful Trade and Travel:** Facilitate and secure lawful trade and travel.
- **Disrupt and Dismantle Transnational Criminal Organizations:** Disrupt and dismantle transnational organizations that engage in smuggling and trafficking across the U.S. border.

Western Hemisphere Travel Initiative

The Western Hemisphere Travel Initiative (WHTI) requires U.S. citizens and nonimmigrant aliens from Canada, Bermuda, and Mexico departing from or entering the United States from within the Western Hemisphere by air, land or sea ports-of-entry to have WHTI-compliant documents—passports or other approved documents that denote identity and citizenship.

U.S. Customs and Border Protection's (CBP) comprehensive local, national, and international outreach campaign has lead to a high rate of WHTI document compliance, averaging more than 95 percent nationally throughout FY 2010. CBP now conducts queries against law enforcement databases on more than 95 percent of the traveling public, up from just 5 percent in FY 2005.

In FY 2010, CBP enhanced a new software capability deployed to all land border ports to provide highly accurate traveler counts and targeted intelligence alerts, which has contributed to a 30 percent increase in drug seizures on the southern border. In addition, apprehensions due to false claims of U.S. citizenship increased 25 percent, while the rate of fraudulent documents intercepted increased by 12 percent throughout FY 2010.

Border Enforcement Security Task Forces and Operation In Plain Sight

DHS's Immigration and Customs Enforcement (ICE) partnered with Federal, state, local and foreign law enforcement counterparts to create the Border Enforcement Security Task Force (BEST) initiative—a series of multi-agency teams that work to identify, disrupt, and dismantle criminal organizations posing significant threats to our border security.

Operation In Plain Sight, which was initiated by the Tucson BEST and carried out in coordination with the Phoenix BEST and Mexican law enforcement, was an Arizona-wide investigation of alien smuggling in the transportation infrastructure from Mexico to the United States. This investigation culminated in FY 2010 and uncovered major smuggling organizations using private and commercial transportation to move aliens across the Arizona border, through Tucson, and into Phoenix, from which they dispersed to locations throughout the United States.

Operation In Plain Sight resulted in nearly 50 criminal arrests and more than 40 administrative arrests; seizures of illicit weapons, cash, and vehicles; and the initiation of promising investigations of criminal organizations in Mexico—effectively dismantling an entire criminal enterprise engaged in smuggling through Arizona.

Future Initiatives

Expanding Joint Operations and Intelligence Capabilities:
DHS will unify the use of technology, surveillance capabilities, and related resources across air, land, and maritime domains, with an emphasis on data collection, data processing, and data integration across domains. DHS will also create and lead new Joint Interagency Task Forces (JIATF) to harmonize operations and intelligence for the geographical approaches not currently covered by JIATF–South, as well as for the arrival of people and goods into the United States.

Additional Southwest Border Security Capabilities:
The recent passage and signing of Southwest border security supplemental legislation will provide additional capabilities to secure the Southwest border at and between our ports of entry and reduce the illicit trafficking of people, drugs, currency, and weapons. Specifically, this bill provides $14 million for improved tactical communications systems along the Southwest border; $32 million for two additional CBP unmanned aircraft systems; $176 million for an additional 1,000 Border Patrol agents to be deployed between ports of entry; $68 million to hire 250 new CBP officers at ports of entry and to maintain 270 officers currently deployed to ports of entry; $80 million for 250 new ICE agents; and $6 million to construct two forward operating bases along the Southwest border to improve coordination of border security activities.

Enforcing and Administering Our Immigration Laws

Virtually all Americans are affected by our immigration system. A fair and effective immigration system enriches American society, unifies families, and promotes our security. Our Nation's immigration policy plays a critical role in advancing homeland security.

We will achieve this mission through the following goals:

- **Strengthen and Effectively Administer the Immigration System:** Promote lawful immigration, facilitate administration of immigration services, and promote the integration of lawful immigrants into American society while guarding against fraud and abuse of the immigration system.
- **Prevent Unlawful Immigration:** Reduce conditions that encourage foreign nationals to illegally enter and remain in the United States, while identifying and removing those who violate our laws.

U.S. Citizenship and Immigration Services Redesigns "Green Card"

In FY 2010, U.S. Citizenship and Immigration Services (USCIS) redesigned the Permanent Resident Card, commonly known as the "Green Card," to incorporate several major new security features. The Green Card redesign is the latest advance in USCIS's ongoing efforts to deter immigration fraud. State-of-the-art technology incorporated into the new card prevents counterfeiting, obstructs tampering, and facilitates quick and accurate authentication. USCIS will issue all Green Cards in the new, more secure format and will replace Green Cards already in circulation as individuals apply for renewal or replacement.

"Redesigning the Green Card is a major achievement for USCIS," said USCIS Director Alejandro Mayorkas. "The new security technology makes a critical contribution to the integrity of the immigration system."

The enhanced features will better serve law enforcement, employers, and immigrants, all of whom look to the Green Card as definitive proof of authorization to live and work in the United States.

National Fugitive Operations Program – Operation Cross Check

The National Fugitive Operations Program is one facet of DHS's strategy to identify and remove dangerous criminal aliens from the United States. ICE Fugitive Operations Teams prioritize aliens who pose a threat to national security and public safety, including members of transnational street gangs, child sex offenders, and aliens with prior convictions for violent crimes. The Fugitive Operations Teams use intelligence-based information and leads to locate and arrest aliens who have been ordered to leave the country, but have failed to comply. Today ICE has 104 Fugitive Operations Teams deployed nationwide. This targeted enforcement strategy is yielding impressive results, as the Nation's fugitive alien population continues to decline.

ICE launched Operation Cross Check, an ICE operation targeting fugitive or criminal aliens who pose a threat to national security and community safety, in December 2009. ICE has conducted Cross Check operations in 37 states, including in California, Texas, Virginia and Arizona, as well as regional operations in the Southeast, Northeast and Midwest. In FY 2010, through Operation Cross Check, ICE arrested 2,064 convicted criminals, fugitives, and aliens who have illegally re-entered the United States after removal.

Future Initiatives

Improving the Detention and Removal Process:
DHS administers the detention and removal process in partnership with the Department of Justice. To expedite the removal of criminal and other dangerous foreign nationals, DHS will continue to increase non-investigatory law enforcement staffing for detention and removal operations in order to focus law enforcement on criminal investigations. DHS will continue to expand the Secure Communities program and the Criminal Alien Program nationwide. These programs ensure that criminal aliens are identified within Federal, state, and local jails and prisons and have removal orders by the time they complete their criminal sentence, removing the burden of detaining these aliens beyond their criminal sentences while they are awaiting removal orders. DHS is also working to revise national standards for detainee care and treatment, including those needing continuing medical treatment, ensuring that detention facilities housing immigration detainees meet or exceed these standards and canceling the contracts at facilities that receive deficient ratings.

Targeting Egregious Employers Who Knowingly Exploit Illegal Workers:
Preventing unlawful immigration depends on reducing the demand for illegal labor. DHS has improved and expanded the E-Verify system, adding new features to monitor for fraud and redesigning the system to ensure compliance and ease of use. The Administration also announced the "I E-Verify" initiative to let consumers know which businesses are working to maintain legal workforces by using E-Verify. While implementing E-Verify improvements and enhancing efforts to promote voluntary employer compliance, DHS is also focusing on worksite enforcement, targeting egregious employers who knowingly exploit illegal labor. Since January 2009, DHS has

audited more than 3,200 employers suspected of hiring illegal labor, debarred more than 225 companies and individuals, and issued more than $50 million in financial sanctions—more than the total amount of penalties issued in the entire previous administration.

Safeguarding and Securing Cyberspace

Our economic vitality and national security depend on a vast array of interdependent and critical cyber networks, systems, services, and resources. If these cyber tools and networks cannot function properly, we will not be able to effectively communicate, travel, power our homes, run our economy, or obtain Government services.

We will achieve this mission through the following goals:

- **Create a Safe, Secure, and Resilient Cyber Environment:** Ensure malicious actors are unable to effectively exploit cyberspace, impair its safe and secure use, or attack the Nation's information infrastructure.
- **Promote Cybersecurity Knowledge and Innovation:** Ensure that the Nation is prepared for the cyber threats and challenges of tomorrow.

Cybersecurity Investigations – Credit Card Trafficking

Agents with the U.S. Secret Service initiated an undercover cyber-based investigation involving a suspect operating under the nickname "BadB," which they identified as Vladislav Anatolievich Horohorin, an international credit card trafficker thought to be one of the most prolific sellers of stolen data.

U.S. Secret Service agents determined Horohorin, who is a citizen of Israel and the Ukraine, allegedly used online criminal forums such as "CarderPlanet" and "carder.su" to sell stolen credit card information, known as "dumps," to online purchasers around the world. Using an online undercover identity, U.S. Secret Service agents negotiated the sale of numerous stolen credit card dumps. In FY 2010, Horohorin was indicted by a Federal grand jury on charges of access device fraud and aggravated identity theft. He is currently being detained in France pending extradition to the United States.

Cyber Storm III

In FY 2010, DHS hosted Cyber Storm III—a three-day exercise that brings together a diverse cross-section of the Nation's cyber incident responders to assess U.S. cyber response capabilities.

"Securing America's cyber infrastructure requires close coordination with our Federal, state, international and private sector partners," said Secretary Napolitano. "Exercises like Cyber Storm III allow us build upon the significant progress we've made in responding to evolving cyber threats."

Cyber Storm III is an exercise scenario that simulates a large-scale cyber attack on critical infrastructure across the Nation. The goal of the exercise is to examine and strengthen collective cyber preparedness and response capabilities, involving thousands of participants across government and industry. Seven Cabinet-level departments, 11 states, 12 international partners, and 60 private-sector companies participated. As part of Cyber Storm III, DHS exercised elements of the newly-developed National Cyber Incident Response Plan—a blueprint for the Nation's cybersecurity incident response.

Cyber Storm III also represented the first major exercise testing the new National Cybersecurity and Communications Integration Center which serves as the hub of national cybersecurity coordination and was established at the beginning of FY 2010.

Future Initiatives

Increasing DHS's Predictive and Forensic Capabilities for Cyber Intrusions and Attacks:
The ability to predict the emergence of new cyber threats will help mitigate the effects of such threats. Likewise, the ability to determine the source of a cyber attack, intrusion, or disruption both increases the likelihood of a successful prosecution of the attacker and creates a powerful deterrent effect against both state and non-state actors. To that end, DHS will build a new predictive analytic capability that will work closely with the law enforcement and intelligence communities and the private sector to improve the identification of cyber adversaries, establish and advance deterrence strategies, and promote a more accurate understanding of emerging cyber threats. To meet these goals, DHS is currently enhancing its efforts to recruit and develop an expanded cyber intelligence and analysis team.

Increase the Focus and Integration of DHS's Operational Cybersecurity and Infrastructure Resilience Activities:
DHS has substantial operational cyber security responsibilities, which are inextricably intertwined with its responsibilities to manage all hazards risk to critical infrastructure. DHS typically manages its operational responsibilities through Operating Components. However, the majority of DHS's operational activities relating to cyber security and infrastructure protection and resilience are

currently administered by the National Protection and Programs Directorate (NPPD), which is designated as a DHS headquarters element. DHS will focus NPPD's activities on operations and more closely align cyber and critical infrastructure protection and resilience efforts, in cooperation with the private sector, to secure cyber networks and make critical infrastructure resilient. DHS will examine ways to clarify NPPD's increasingly operational role as opposed to other elements of the DHS headquarters, as well as NPPD's functions not related to cybersecurity or infrastructure protection and resilience.

Ensuring Resilience to Disasters

Despite ongoing vigilance and efforts to protect this country and its citizens, major accidents and disasters, as well as terrorist attacks, may occur. The challenge is to build the capacity of American society to be resilient in the face of attacks, disasters, and other crises. Our vision is a Nation that understands the hazards and risks we face; is prepared for disasters; can withstand the disruptions that terrorist attacks and disasters may cause; can manage itself effectively during a crisis; can recover quickly and effectively; and can adapt to conditions that have changed as a result of the event.

We will achieve this mission through the following goals:

- **Mitigate Hazards:** Strengthen capacity at all levels of society to withstand threats and hazards.
- **Enhance Preparedness:** Engage all levels and segments of society in improving preparedness.
- **Ensure Effective Emergency Response:** Strengthen response capacity nationwide.
- **Rapidly Recover:** Improve the Nation's ability to adapt and rapidly recover.

Preparedness Grants – Improving Federal, State, Local, and Tribal Government Preparedness Capabilities

In FY 2010, DHS provided more than $3.8 billion in Federal Emergency Management Agency (FEMA) preparedness grants designed to help states, urban areas, tribal governments and nonprofit organizations enhance their protection, prevention, response, and recovery capabilities for risks associated with potential terrorist attacks and other hazards.

DHS uses a risk-based methodology to identify areas eligible for homeland security grants, accounting for threats, population, and prevalence of critical infrastructure. To support our Nation's first responders, DHS has eliminated red tape by streamlining the grant process and expanding what grants can be used for, such as maintenance and sustainability, enabling local jurisdictions to continue to support previous investments rather than buying new equipment or technology each year. DHS has also made it easier to put fire grants to work quickly to rehire laid-off firefighters and retain current forces by waiving the local match requirement, salary cap, and retention requirements to give fire departments more flexibility in protecting the jobs of veteran firefighters.

FEMA Responds to Tennessee Floods

On May 1 and 2, 2010, Tennessee experienced one of the worst rain storms in its history. The Cumberland River crested at nearly 52 feet in Nashville, a level not seen since 1937.

FEMA was on the scene from the very beginning, supporting the immediate needs of water, food, generators, and shelter.

More than $136 million in FEMA assistance has been provided to individuals and households for rental assistance and home repair to help residents continue the recovery process. An additional $18 million has been provided to the state and local governments to reimburse them for the repairs to infrastructure such as damaged roads and flooded utilities. In addition, FEMA opened 67 Disaster Recovery Centers across the affected area to provide assistance to people affected by the severe storms and flooding. With FEMA's support, Tennessee and its residents are on the road to recovery.

Future Initiatives

Improving DHS's Ability to Lead in Emergency Management:
To improve overall effectiveness in emergency management, FEMA will create a new strategic approach to developing the agency's current workforce. This approach will involve recruiting and hiring the best talent available and strengthening skill sets across the workforce in support of FEMA's core responsibilities. DHS will create a career path for employees with emergency management responsibilities, including headquarters positions, field deployments, and mobility assignments, and implement both paid and unpaid internship programs to develop future emergency managers.

Engaging Private Sector to "Design-In" Greater Resilience for Critical Infrastructure:
DHS efforts to reduce vulnerabilities to critical infrastructure and key resources must incorporate resilience. It is more efficient and more effective to build in resilience by design than to retrofit for resilience once facilities and networks are developed. To that end, DHS will work with nongovernmental organizations that set infrastructure design standards to establish commonly agreed upon standards for critical infrastructure resilience. DHS will build upon the standards provided under Title IX of the *Implementing the 9/11 Recommendations Act of 2007*, and will seek to incorporate design standards for critical infrastructure resilience into federally administered insurance and re-insurance programs.

Complementary Department Responsibilities

DHS leads and supports many activities that provide essential support to national and economic security including, but not limited to: maximizing collection of customs revenue; protecting the financial services sector; maintaining the safety and security of the marine transportation system; preventing the exploitation of children; providing Federal law enforcement training; and coordinating the Federal Government's response to global intellectual property theft. DHS contributes in many ways to these elements of broader U.S. national and economic security while fulfilling its other five homeland security missions.

U.S. Trade Laws – Revenue Collection

CBP enforces U.S. trade laws and collects customs revenue, making it the third largest revenue generator for the U.S. Government after the Internal Revenue Service and the Social Security Administration. From September 2009 through August 2010, approximately $29.1 billion in revenue was collected. In order to ensure that accurate revenue is collected from imports, CBP has a robust revenue targeting program in order to ensure compliance. This work is coordinated by CBP's National Targeting and Analysis Group.

Blue Campaign – Helping Stop Human Trafficking

The Blue Campaign was officially launched in July 2010 by U.S. Immigration and Customs Enforcement, U.S. Customs and Border Protection, U.S. Citizenship and Immigration Services, and the Federal Law Enforcement Training Center—underscoring the Department's unified effort to prevent human trafficking, assist victims, and hold traffickers accountable by bringing together the Department's diverse resources and expertise under one initiative.

To help citizens learn to identify and properly report indicators of human trafficking, the Department is launching public outreach tools that include social media, multilingual public awareness campaigns, and a comprehensive one-stop website for the Department's efforts to combat human trafficking at http://www.dhs.gov/humantrafficking.

The Blue Campaign also features new training initiatives for law enforcement and DHS personnel, enhanced victim assistance efforts, and the creation of new partnerships and interagency collaboration—including the deployment of additional victim assistance specialists and specialized training for law enforcement personnel.

Priority Goals

In the FY 2010 Budget, the Obama Administration defined Priority Goals, which represent areas in which the Administration has identified opportunities to significantly improve near-term performance. These goals are only a subset of each agency's critical efforts, which also include long-term strategic goals and goals dependent on new legislation or additional funding.

The DHS Priority Goals are:

- **Preventing Terrorism and Enhancing Security through Aviation Security:** *Improve commercial aviation security screening through layered security measures including the utilization of Transportation Security Officers, Secure Flight and Advanced Imaging Technology.* TSA is working to deploy the most effective layered screening technologies at all airports to detect threats on passengers and in baggage and cargo, and to improve the vetting process for air passengers against Government watchlists by implementing Secure Flight.

- **Preventing Terrorism and Enhancing Security through Surface Transportation Security:** *Improve security in the surface modes of transportation by performing risk assessments, closing vulnerability gaps, vetting key workers, providing training and deploying highly skilled prevention and response teams.* Millions of passengers and millions of tons of commodities move through our Nation's surface transportation network each year. DHS recognizes that the risk from terrorism and other hazards demands a coordinated approach to security involving all sector partners and stakeholders, including Federal, state, and local governments as well as the private sector. TSA is leveraging these partnerships to increase surface transportation security in mass transit, highways, freight rail, and pipelines.

- **Securing and Managing Our Borders through the Western Hemisphere Travel Initiative (WHTI):** *Prevent terrorist and criminal movement at land ports of entry through secure travel documents and enhanced technology that will effectively integrate vehicle and passenger data.* The initial success of WHTI improved vehicle processing at the land border by requiring travelers to present secure, technically enhanced travel documents. WHTI also strengthened CBP's ability to target violators by integrating vehicle and passenger data. WHTI continues to expand the use of technology to additional land locations and other key mission processing areas, including pedestrian, outbound, and the Border Patrol checkpoints.

- **Enforcing and Administering Our Immigration Laws through Detention and Removal Efficiency:** *Improve the efficiency of the process to detain and remove illegal immigrants from the United States.* ICE is prioritizing the arrest and removal of convicted criminals, fugitives, illegal re-entrants, recent border violators, and visa overstays, focusing enforcement resources on aliens who pose a public safety threat to the United States. In particular, the Secure Communities program uses biometric identification technology to better identify aliens arrested and booked for a crime in state and local jurisdictions.

- **Enforcing and Administering Our Immigration Laws through U.S. Citizenship and Immigration Services Business Transformation:** *Implement an enterprise-wide transformation to move from a form-driven, paper-based system into a centralized, electronic adjudication system in order to improve the speed, ease of use, and quality of immigration services.* In its current state, the USCIS relies largely on the movement of paper to deliver immigration benefits and services. In the future, USCIS will use a paperless, electronic system that will transform nearly all of the agency's processes. Through web-based technology, customers will maintain individual accounts with USCIS and be able to obtain more detailed and current information on their cases. By organizing and sharing information digitally, USCIS will increase the efficiency of its adjudications, while also facilitating the rapid and collaborative exchange of information with partner agencies.

- **Ensuring Resilience to Disasters by Strengthening Disaster Preparedness and Response Capabilities:** *Strengthen disaster preparedness and response by improving FEMA's operational capabilities and strengthening state, local, and private citizen preparedness.* FEMA is improving its operational capabilities; strengthening state, local, individual and private-sector preparedness through Emergency Management Institute training and preparedness grants; putting in place resources and strategies for temporary housing; and ensuring the availability of life-sustaining/life-saving commodities during disasters.

- **Maturing and Strengthening the Homeland Security Enterprise through Effective Information Sharing:** *Effectively deliver information in a timely manner that is responsive to state, local, tribal, and territorial information needs.* DHS is working to improve and enhance secure information-sharing capabilities for state and local partners; the timeliness and sufficiency of responses to stakeholders' requests; and internal information sharing. In addition to addressing these specific issues, DHS is developing a Department-wide information-sharing roadmap based on the strategic framework set forth in the QHSR.

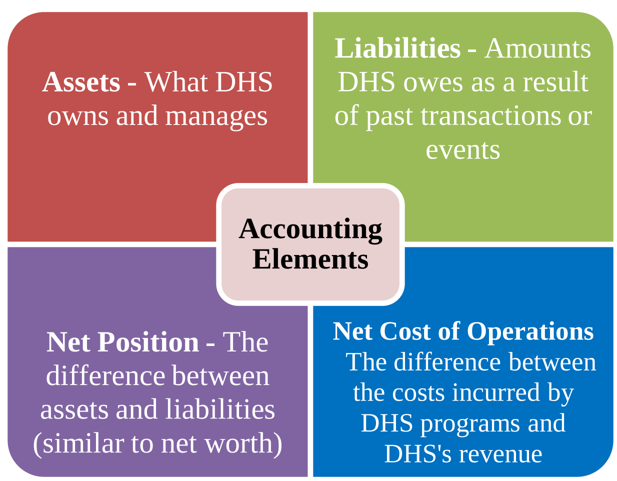
- **Maturing and Strengthening the Homeland Security Enterprise by Improving Acquisition Execution:** *Improve acquisition execution across the DHS acquisition portfolio, by ensuring key acquisition expertise resides in major program office and acquisition oversight staffs throughout the Department.* This goal includes having disciplined oversight processes and robust acquisition program management teams in place. Oversight processes begin with having a well-defined acquisition requirement and a cost, schedule, and performance plan against which program managers are held accountable for results.

Financial Overview

DHS's appropriated budgetary resources were approximately $83 billion for FY 2010. The budget represents our plan for achieving the strategic objectives set forth by the Secretary to carry out our mission and to ensure that DHS manages its operations within the appropriated amounts using budgetary controls. DHS prepares its annual financial statements on an accrual basis, in accordance with generally accepted accounting principles, meaning that economic events are recorded as they occur, regardless of when cash is received or disbursed. DHS primarily uses the cash basis for its budgetary accounting. The cash basis is an accounting method in which income is recorded when cash is received and expenses are recorded when cash is paid out. These financial statements provide the results of our operations and financial position, including long-term commitments and obligations. The independent accounting firm KPMG LLP was engaged to audit the Balance Sheet and Statement of Custodial Activity.

On October 28, 2009, the President of the United States signed the *FY 2010 Homeland Security Appropriations Act* (Pub. L. 111-83), which included a provision transferring the Federal Protective Service (FPS) from ICE to NPPD. The realignment allows FPS to focus on its primary mission—securing Federal buildings by performing building security assessments and deploying appropriate countermeasures—while enabling ICE to focus on the enforcement of immigration and customs laws. As a result of the transfer, certain reclassifications were made to the FY 2009 financial statements and related footnotes to conform to FY 2010 presentation.

The Department received $2.8 billion in supplemental appropriations during FY 2009 as a result of *The American Recovery and Reinvestment Act of 2009* (Recovery Act) (Pub. L. 111-5). This funding included $200 million for the consolidation of the DHS headquarters; $420 million for modernization of CBP-owned land ports of entry; $260 million for CBP border security technology, including non-intrusive inspection technology, Southwest border technology, and tactical communications equipment and radios; $20 million for ICE automation modernization and tactical communications; $1 billion for explosives detection systems and checkpoint screening equipment at airports nationwide; $142 million for bridge alteration construction; $98 million for U.S. Coast Guard shore and vessel preservation; $100 million for the Emergency Food and Shelter Program; $150 million for transit and rail security grants; $150 million for port security grants; and $210 million for Fire Station Construction grants. Additional Recovery Act information can be found at www.recovery.gov.



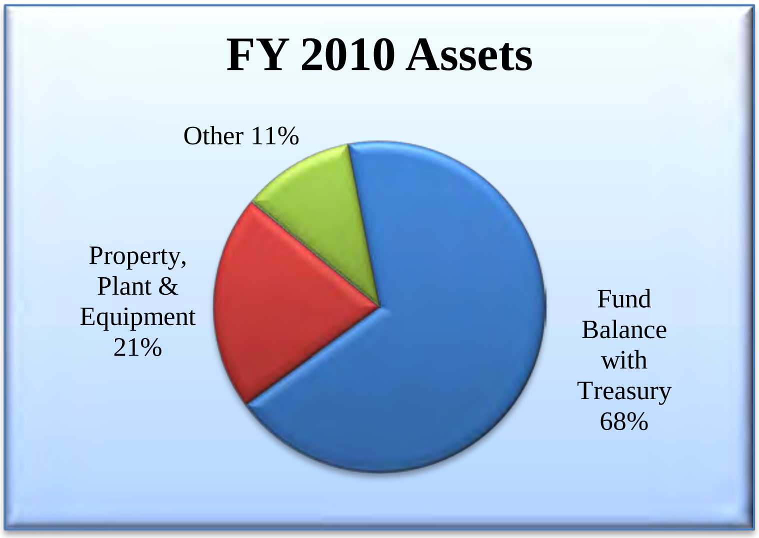
The Department restated FY 2009 balances primarily because of actions completed to correct financial management weaknesses reported in prior financial statement audit reports. The Department is taking corrective actions related to the causes of the restatements.

Balance Sheet

The Balance Sheet presents the resources owned or managed by DHS that have future economic benefits (assets) and the amounts owed by DHS that will require future payments (liabilities). The difference between DHS's assets and liabilities is the residual amount retained by DHS (net position) that is available for future programs and capital investments.

Assets – What We Own and Manage
Assets represent amounts owned or managed by DHS that can be used to accomplish its mission. At September 30, 2010, DHS had $90 billion in assets, representing a $5 billion increase from FY 2009 restated assets of $85 billion.

As of September 30 (in Millions)	FY 2010	FY 2009 (Restated)
Fund Balance with Treasury	$60,822	$57,172
General Property, Plant, and Equipment, Net	19,074	17,697
Other	10,201	9,935
Total Assets	$90,097	$84,804



Fund Balance with Treasury (FBwT), the Department's largest asset, comprises 68 percent ($61 billion) of the total assets. Included in FBwT is the remaining balance of DHS unspent prior-year budgets plus miscellaneous receipts. FBwT increased approximately $4 billion from FY 2009 in part due to additional funding for the Deepwater Horizon oil spill recovery efforts in the Gulf (as referenced in Note 22) and an increase in funds received for TSA's Explosive Detection technology.

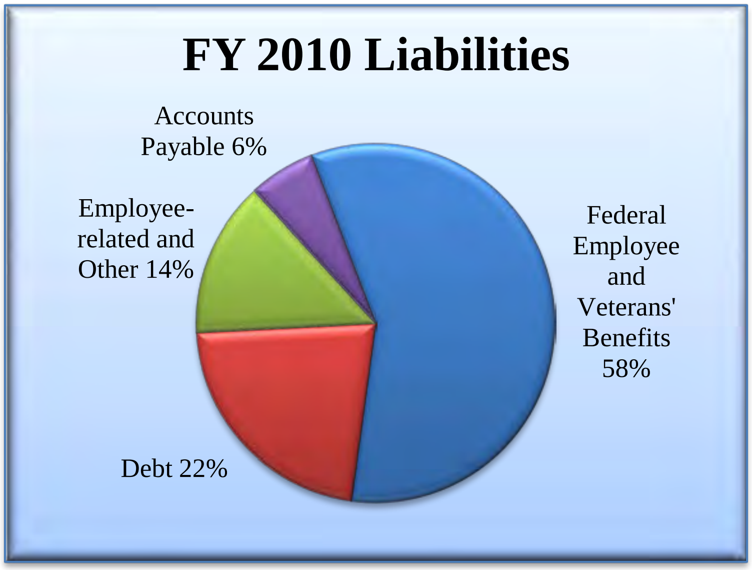

U.S. Coast Guard assets account for more than 50 percent of the property, plant, and equipment assets of DHS.

Property, Plant, and Equipment (PP&E) is the second largest asset, comprising 21 percent of total assets. The major items in this category include construction in progress, buildings and facilities, vessels, aircraft, and other equipment. In acquiring these assets, DHS either spent cash or incurred a liability to make payment at a future date; however, because these assets should provide future benefits to help accomplish the DHS mission, DHS reports these items as assets rather than expenses. PP&E is recorded net of accumulated depreciation. Recording the net value of the PP&E items is intended to approximate its remaining useful life. During FY 2010, PP&E increased by $1 billion. A large part of this was due to the U.S. Coast Guard's increases in equipment related to the National Security Cutter and Rescue 21 efforts. Also contributing to this increase was SBI*net* Virtual Fence Construction, software development and modernization, and aircraft upgrades at CBP.

Liabilities – What We Owe

At September 30, 2010, DHS reported approximately $84 billion in total liabilities. Liabilities are the amounts owed to the public or other Federal agencies for goods and services provided but not yet paid for; to DHS employees for wages and future benefits; and for other liabilities. Eighty-seven percent of these liabilities will need to be paid from funds received in future appropriations. DHS's largest liability not covered by budgetary resources is for Federal Employee and Veterans' Benefits, arising primarily from U.S. Coast Guard personnel benefits. The National Flood Insurance Program (NFIP) administered by FEMA is the second largest such liability. Liabilities increased approximately $9 billion from FY 2009 restated liabilities which totaled $75 billion.

As of September 30 (in Millions)	FY 2010	FY 2009 (Restated)
Federal Employee and Veterans' Benefits	$48,317	$39,425
Debt	18,505	19,004
Employee-related and Other	12,029	11,101
Accounts Payable	4,745	4,972
Total Liabilities	$83,596	$74,502



DHS's largest liability is for Federal Employee and Veterans' Benefits, representing 58 percent of total liabilities. This liability increased approximately $9 billion from FY 2009. This increase primarily relates to U.S. Coast Guard changing its assumptions used to calculate Retired Pay and Military Care Actuarial liability. DHS owes these amounts to current and past civilian and military personnel for pension and other post-employment benefits. The liability also includes medical costs for approved workers compensation cases and an estimate for incurred but not yet reported workers' compensation costs. This liability is not covered by current budgetary resources, and DHS will use future appropriations to cover these liabilities.

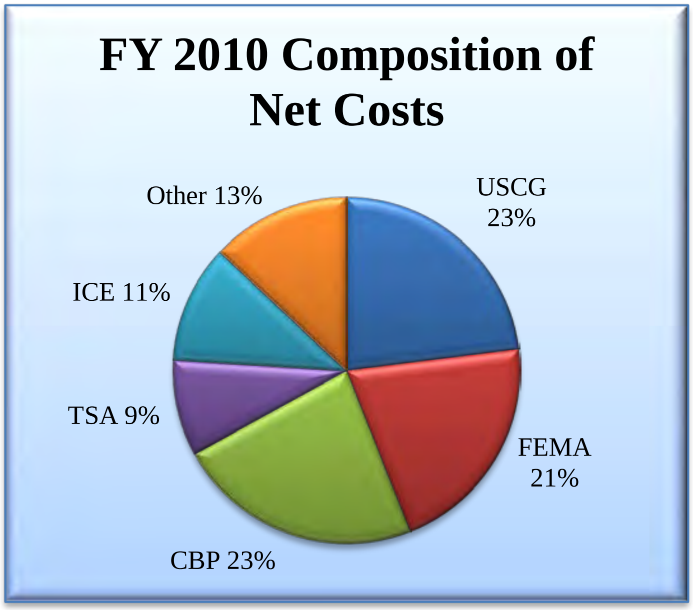

The National Flood Insurance Program and the Disaster Assistance Direct Loan Program operations of FEMA account for 100 percent of the overall debt of DHS.

Debt is DHS's second-largest liability, representing 22 percent of total liabilities. This debt results from Department of Treasury loans and related interest payable to fund the NFIP and Disaster Assistance Direct Loan Program operations of FEMA. Total debt decreased approximately $500 million from FY 2009 due to the NFIP. Most of this debt is not covered by current budgetary resources. The premiums collected by FEMA for disaster assistance do not cover the cash outlays. This is discussed further in Note 15 in the financial section.

Employee-related and other liabilities, comprising 14 percent of the Department's liabilities, increased approximately $1 billion from FY 2009. The difference primarily relates to an increase in importing taxes due to Treasury, an increase in accrued payroll due to workforce expansion, and an increase in contingent liabilities. Also included in these liabilities are unpaid wages and benefits for current DHS employees. Six percent of total liabilities results from accounts payable, which are actual or estimated amounts DHS owes to vendors for goods and services provided for which we have not yet paid. These liabilities are covered by current budgetary resources.

Statement of Net Cost

Net Cost of Operations represents the difference between the costs incurred by DHS programs less revenues. The U.S. Coast Guard incurred 23 percent of total net costs, in ensuring maritime safety, security, and stewardship. The five percent decrease in the U.S. Coast Guard's net cost is primarily due to current and future funded expenses for Retirement Pay, Actuarial Pension and Health Care, and Environmental Compliance and Restoration. CBP, which represents 23 percent of total net cost, saw a net cost increase of approximately ten percent from FY 2009 primarily due to workforce growth and increases in property, plant, and equipment depreciation and contingent liabilities. FEMA represents 21 percent of the Department's net cost, a nine percent decrease from FY 2009 resulting from additional NFIP earned revenue and reduced costs associated with disasters. TSA net costs represents nine percent of the Department total and went to ensuring the security and stewardship of the U.S. transportation network, primarily aviation security. Net costs for ICE, which represent eleven percent of the total, increased ten percent from FY 2009. This was primarily due to funding changes at the Detention and Removal Office and Southwest border initiatives.



In March 2010, TSA began deploying advanced imaging technology units purchased with *American Recovery and Reinvestment Act* funds.

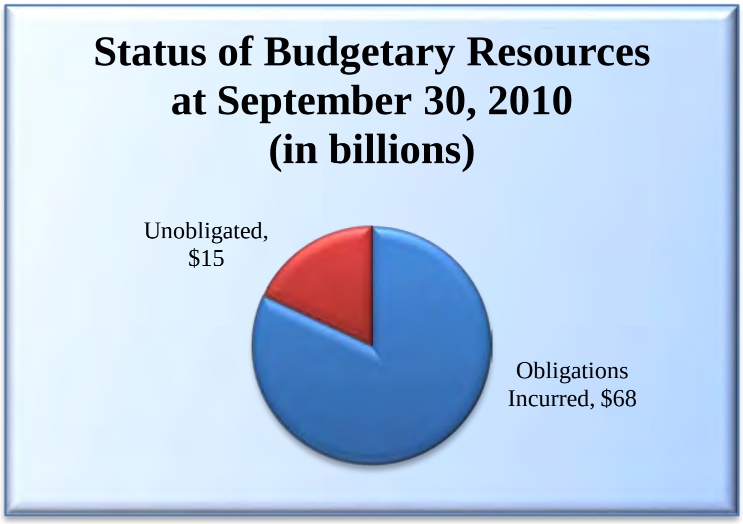
During FY 2010, the Department earned approximately $10.4 billion in revenues; this is a marginal increase of about $600 million from the restated amount of $9.8 billion on September 30, 2009. The Department classifies revenues as either exchange ("earned") or non-exchange revenue. Exchange revenues arise from transactions in which DHS and the other party receive value and that are directly related to departmental operations. DHS also collects non-exchange duties, taxes, and fee revenues on behalf of the Federal Government. These non-exchange revenues are presented in the Statement of Custodial Activity rather than the Statement of Net Cost. An example of non-exchange revenue is user fees that CBP collects on behalf of the Federal Government as a result of its sovereign powers rather than as a result of providing goods or services for a fee. Non-exchange revenues are either retained by the Department to further its mission or returned to Treasury's General Fund.

Statement of Changes in Net Position

Net position represents the accumulation of revenue, expenses, budgetary and other financing sources since inception, as represented by an agency's balances in unexpended appropriations and cumulative results of operations on the Statement of Changes in Net Position. Financing sources increase net position and include, but are not limited to, appropriations, user fees, and excise taxes. The net costs discussed above and transfers to other agencies decrease net position. In FY 2010, the U.S. Coast Guard had higher costs due to a change in the assumptions used to calculate employee-related benefits.

Statement of Budgetary Resources

This statement provides information on the status of the approximately $83 billion in budgetary resources available to DHS during FY 2010. This authority was derived from appropriations of $56 billion, $13 billion in authority carried forward from FY 2009, $10 billion in collections, and $4 billion of miscellaneous authority.



The total amount of resources available decreased by approximately $2 billion from FY 2009 levels. This is primarily due to a decrease in FEMA's prior year supplemental disaster funding, which reduced the availability of carry-forward amounts.

Of the total budget authority available, DHS incurred a total of $68 billion in obligations from purchase orders placed, contracts awarded, salaries and benefits, or similar transactions. These obligations will require payments during the same or future period. As of September 30, 2010, $15 billion of the $83 billion available was not yet obligated. The $15 billion represents $5 billion in unavailable funding and $10 billion in apportioned funds available for future use.

Statement of Custodial Activities

This statement presents the disposition of revenues collected and disbursed by DHS on behalf of other recipient entities. CBP collects revenue from a variety of duties, excise taxes, and various other fees, and USCIS collects user fees that are subsequently remitted to the Treasury's General Fund or to other entities. Note 31 in the financial section provides additional information on these activities. Total cash collections increased by more than $3 billion in FY 2010. This is primarily due to increased importing into the U.S. during FY 2010, which resulted in additional cash collections for customs duties.

Stewardship Assets and Investments

DHS's stewardship assets primarily consist of U.S. Coast Guard heritage assets, which include ship equipment, lighthouses and other aids to navigation, communication items, military uniforms, ordnance, artwork, and display models. A heritage asset is any personal property that is retained by DHS because of its historic, cultural, educational, or artistic value as opposed to its current usefulness to carrying out the mission of the Department. Of the U.S. Coast Guard buildings and structures designated as heritage assets—including memorials, recreational areas, and other historical areas—more than two-thirds are multi-use heritage assets. CBP has four multi-use heritage assets located in Puerto Rico, and FEMA has one multi-use heritage asset that is used by the United States Fire Administration for training in Emmitsburg, Maryland. In addition, CBP, USCIS, and TSA have collection-type assets that consist of documents, artifacts, immigration and naturalization files, as well as architectural and building artifacts used for education.

Stewardship investments are substantial investments made by the Federal Government for the benefit of the Nation. When incurred, stewardship investments are treated as expenses in calculating net cost, but they are separately reported as Required Supplementary Stewardship Information (RSSI) to highlight the extent of investments that are made for long-term benefits. Included are investments in research and development, human capital, and non-Federal physical property.

Other Key Regulatory Requirements

See the Other Accompanying Information section for *Prompt Payment Act, Debt Collection Improvement Act*, and Biennial User Charges Review information.

Management Assurances

The Federal Managers' Financial Integrity Act, Federal Financial Management Improvement Act, and Department of Homeland Security Financial Accountability Act

DHS is responsible for establishing, maintaining, and assessing internal control to provide reasonable assurance that the internal control objectives of the *Federal Managers' Financial Integrity Act*, 31 U.S. Code 3512 Sections 2 and 4, and the *Federal Financial Management Improvement Act*, Pub. L. 104-208, are met. To identify material weaknesses and nonconformance conditions, management used the following criteria:

- Merits the attention of the Executive Office of the President and the relevant Congressional oversight committees;
- Impairs fulfillment of essential operations or mission;
- Deprives the public of needed services;
- Significantly weakens established safeguards against waste, loss, unauthorized use or misappropriation of funds, property, other assets, or conflicts of interest;
- Substantial noncompliance with laws and regulations; and
- Financial management systems conformance to Government-wide systems requirements.

In addition, the *Department of Homeland Security Financial Accountability Act*, Pub. L. 108-330, requires a separate assertion and an audit opinion of the Department's internal controls over its financial reporting. A material weakness within internal control over financial reporting is defined as a reportable condition or combination of reportable conditions, that results in more than a remote likelihood that a material misstatement of the financial statements or other significant financial reports, will not be prevented or detected.

The DHS Accountability Structure includes a Senior Management Council (SMC), an Internal Control Coordination Board (ICCB), and a Senior Assessment Team (SAT). The SMC approves the level of assurances for the Secretary's consideration and is comprised of the Department's Under Secretary for Management, Chief Financial Officer, Chief Administrative Services Officer, Chief Human Capital Officer, Chief Information Officer, Chief Information Security Officer, Chief Security Officer, and Chief Procurement Officer. The ICCB seeks to integrate and coordinate internal control assessments with other internal control related activities and includes representatives from all DHS lines of business to address crosscutting internal control issues. Finally, the SAT led by the Chief Financial Officer, is comprised of senior-level financial managers assigned to carry out and direct Component-level internal control over financial reporting assessments.

Individual Component assurance statements serve as the primary basis for the Secretary's assurance statements. The assurance statements are also based on information gathered from various sources including management initiated internal control assessments, program reviews, and evaluations. In addition, the DHS Office of Inspector General (OIG) and the Government Accountability Office (GAO) conduct reviews, audits, inspections, and investigations.

Secretary's Assurance Statement

November 12, 2010

The Department of Homeland Security is committed to a culture of integrity, accountability, fiscal responsibility and transparency. The Department's management team is responsible for establishing and maintaining effective internal control over the three internal control objectives: effectiveness and efficiency of operations; reliability of financial reporting; and compliance with applicable laws and regulations.

In accordance with the *Federal Managers' Financial Integrity Act* (FMFIA) and the *Department of Homeland Security Financial Accountability Act* (DHS FAA), I have directed an evaluation of internal control at the Department of Homeland Security in effect during the fiscal year (FY) ending September 30, 2010. This evaluation was conducted in accordance with OMB Circular No. A-123, *Management's Responsibility for Internal Control*. The Department's approach for implementing Appendix A of OMB Circular No A-123, which focused on remediation of existing control deficiencies, was also approved by OMB.

The Department is unable to provide assurance that internal controls over financial reporting were operating effectively as of September 30, 2010, due to five material weaknesses listed in the Other Accompanying Information Section of this report. In addition, DHS does not currently have a consolidated financial management system, and most legacy systems do not comply with Federal Financial Management System Requirements, Accounting Standards, and the U.S. General Ledger at the transaction level. The Department can provide qualified assurance that the objectives of the FMFIA over nonfinancial operations have been achieved.

As a result of our strong commitment to improving internal controls, for the fifth consecutive year, the annual financial statement audit shows the Department continues to make progress. Audit qualifications have been reduced from ten to one, and the number of management-identified financial reporting material weaknesses have been reduced by more than half since FY 2005 (See Exhibits I and II). Specific improvements made by the Department and its Components include new policies, processes, and corrective actions that increased the auditable balance sheet balances to approximately ninety percent in FY 2010. Looking forward, to demonstrate continued stewardship and accountability, we are concentrating our efforts on obtaining an audit opinion on the Consolidated Balance Sheet and Statement of Custodial Activity by FY 2011.

I remain fully committed to an effective program of internal controls that accomplishes our mission while safeguarding the resources entrusted to us, and installing IT systems and processes used for all aspects of financial management that will demonstrate the highest levels of accountability and transparency.

Janet Napolitano
Secretary of Homeland Security

Progress in Strengthening Department-wide Financial Management

Due to our strong commitment to strengthening Department-wide financial management, the results of the annual audit continue to improve. The Department now has only one remaining audit qualification that prevents us from getting an audit opinion and has reduced our material weaknesses in internal controls over financial reporting by half since Fiscal Year (FY) 2005. The Department has also reduced its control deficiency findings by over twenty percent.

Our approach to improving internal control over financial reporting in FY 2010 focused on eliminating audit qualifications and executing corrective actions to strengthen Department-wide internal controls and significantly improved key financial areas. Most notably, improvements made by the U.S. Coast Guard and other Components include new policies, processes, and corrective actions that increased the auditable balance sheet balances to approximately ninety percent.

The Transportation Security Administration no longer contributes to an audit qualification and made tremendous progress this year by reducing control deficiency findings in the Financial Reporting and Information Technology Controls areas. U.S. Customs and Border Protection, U.S. Immigration and Customs Enforcement, and the National Protection and Programs Directorate also improved internal controls in Property, Plant and Equipment. In addition, the Federal Emergency Management Agency contributed to this year's audit success with reductions in Financial Reporting control deficiency findings.

To demonstrate our continued commitment, the Department is focused on obtaining an audit opinion next year on its Consolidated Balance Sheet and Statement of Custodial Activity. DHS also plans to begin implementing an integrated financial, procurement, and asset management system that will comply with Federal Financial Management Systems Requirements.

This year's successes demonstrate the quality, dedication, and professionalism of those who continue to improve financial management at the Department of Homeland Security. Our teams work tirelessly to ensure taxpayer dollars are managed with integrity, diligence, and accuracy, and that the systems and processes used for all aspects of financial management demonstrate the highest levels of accountability and transparency.

Exhibit I. Internal Control over Financial Reporting Assessment Results FY 2010

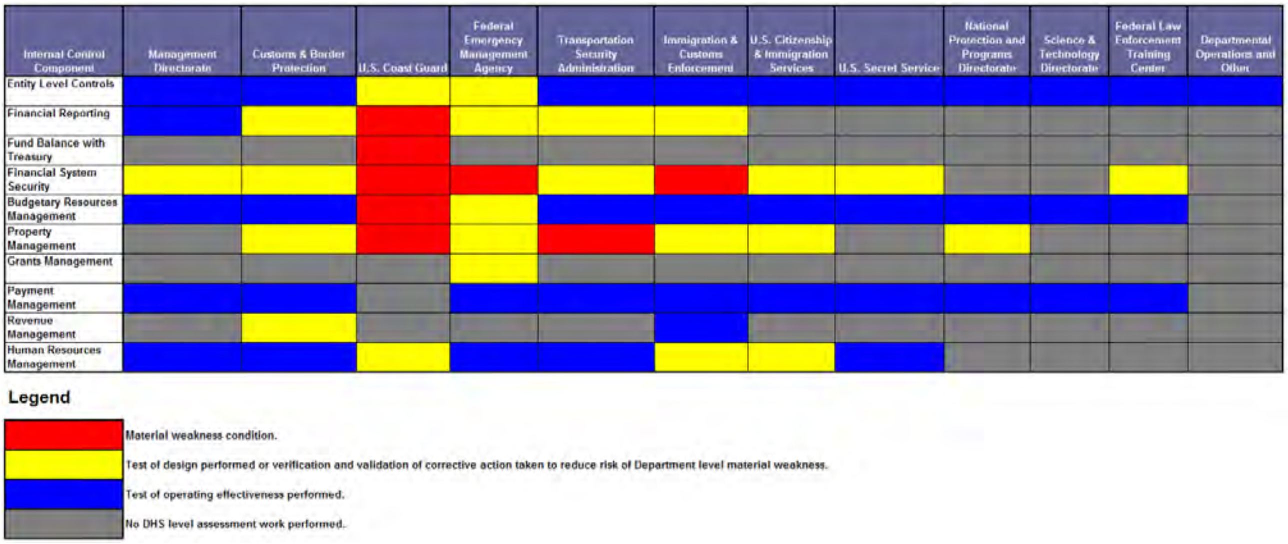
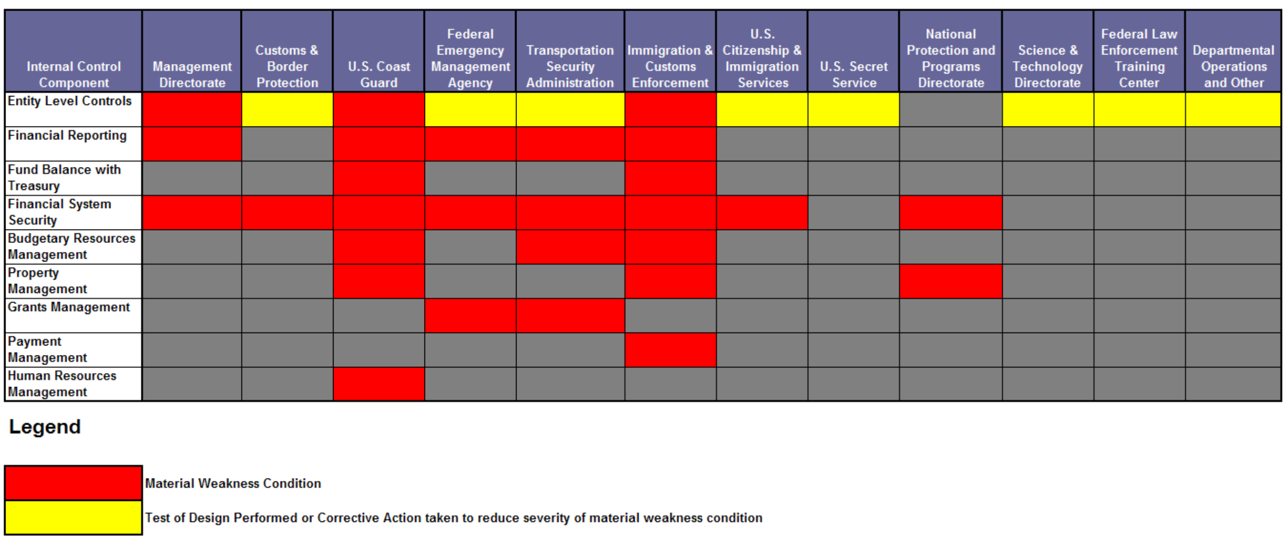


Exhibit II. Internal Control over Financial Reporting Assessment Results FY 2005



Federal Financial Management Improvement Act

The *Federal Financial Management Improvement Act* (FFMIA) of 1996 was designed to improve Federal financial management and reporting by requiring that financial management systems comply substantially with three requirements: (1) Federal financial management system requirements; (2) applicable Federal accounting standards; and (3) the United States Government Standard General Ledger at the transaction level. Furthermore, the Act requires independent auditors to report on agency compliance with the three stated requirements as part of financial statement audit reports. The Department's financial management systems do not comply with the FFMIA, and the Other Accompanying Information section of this report discusses planned remediation activities for bringing systems into substantial compliance with FFMIA.

Financial Information

The ***Financial Information*** section demonstrates our commitment to effective stewardship over the funds DHS receives to carry out its mission, including compliance with relevant financial management legislation. It includes the ***Independent Auditors' Report—*** an independent auditors' report on the Balance Sheet and Statement of Custodial Activity—as well as the Department's ***Annual Financial Statements*** and accompanying ***Notes to the Financial Statements***. The audit report is provided by the Department's Office of Inspector General.

Message from the Chief Financial Officer

November 15, 2010

This Annual Financial Report (AFR) is our principal financial statement of accountability to the President, Congress and the American public. The AFR gives a comprehensive view of the Department's financial activities and demonstrates the Department's stewardship of taxpayer dollars.

For the fifth consecutive year, the annual audit shows the Department continues to make progress. Most significantly, disclaimer conditions have been reduced from ten to one and material weaknesses in internal controls over financial reporting have been reduced by more than half.

To demonstrate strong stewardship and accountability, the Department ended the practice of conducting stand-alone audits at our Components in FY 2010, except at U.S. Customs and Border Protection, which is one of the largest collectors of tax revenue for the U.S. Government. This strategy allowed our Components to direct staff resources to developing and implementing corrective actions for pervasive material weaknesses, increasing risk management processes, and building standard Department-wide business processes.

Over the past year the Department worked to be responsive to the transitioning landscape of financial management throughout the federal government while continuing to improve the completeness, timeliness and accuracy of all our financial information and make it available to the public. Consistent with the Administration and Secretary's objectives for the American Recovery and Reinvestment Act we created jobs while making America safer by obligating $2.7 billion dollars.

The financial management community throughout DHS has consistently shown a commitment to accountability, accuracy, and stewardship. I am extremely proud of the Department's accomplishments over the past year. Looking forward, we will continue to build upon our successes and strive toward the highest levels of transparency and accountability.

Sincerely,

Peggy Sherry

Peggy Sherry
Deputy Chief Financial Officer

Introduction

The principal financial statements included in this report are prepared pursuant to the requirements of the *Government Management Reform Act of 1994* (Pub. L. 103-356) and the *Chief Financial Officers Act of 1990* (Pub. L. 101-576), as amended by the *Reports Consolidation Act of 2000* (Pub. L. 106-531). Other requirements include the Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*. The responsibility for the integrity of the financial information included in these statements rests with the management of DHS. The Department's Inspector General selected an independent certified public accounting firm to audit the Balance Sheet and the Statement of Custodial Activity. The independent auditors' report accompanies the principal financial statements. These financial statements include the following:

- The **Balance Sheets** present, as of September 30, 2010 and 2009, those resources owned or managed by DHS that represent future economic benefits (assets), amounts owed by DHS that will require payments from those resources or future resources (liabilities), and residual amounts retained by DHS comprising the difference (net position).

- The **Statements of Net Cost** present the net cost of DHS operations for the fiscal years ended September 30, 2010 and 2009. DHS net cost of operations is the gross cost incurred by DHS less any exchange revenue earned from DHS activities.

- The **Statements of Changes in Net Position** present the change in DHS's net position resulting from the net cost of DHS operations, budgetary financing sources, and other financing sources for the fiscal years ended September 30, 2010 and 2009.

- The **Statements of Budgetary Resources** present how and in what amounts budgetary resources were made available to DHS during FY 2010 and FY 2009, the status of these resources at September 30, 2010 and 2009, the changes in the obligated balance, and outlays of budgetary resources for the fiscal years ended September 30, 2010 and 2009.

- The **Statements of Custodial Activity** present the disposition of custodial revenue collected and disbursed by DHS on behalf of other recipient entities for the fiscal years ended September 30, 2010 and 2009.

- The **Notes to the Financial Statements** provide detail and clarification for amounts on the face of the financial statements for the fiscal years ended September 30, 2010 and 2009.

Limitations of Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Department, pursuant to the requirements of Title 31, United States Code, Section 3515(b) relating to financial statements of Federal agencies. While the statements have been prepared from the books and records of the entity in accordance with generally accepted accounting principles (GAAP) for Federal agencies and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Financial Statements

Department of Homeland Security
Balance Sheets
As of September 30, 2010 and 2009
(In Millions)

	2010 (Unaudited)	2009 (Unaudited) (Restated)
ASSETS		
Intragovernmental		
Fund Balance with Treasury (Notes 2 and 3)	$60,822	$57,172
Investments, Net (Note 5)	3,482	3,417
Accounts Receivable (Note 6)	326	369
Other (Note 13)		
Advances and Prepayments	2,225	2,688
Total Intragovernmental	**$66,855**	**$63,646**
Cash and Other Monetary Assets (Notes 2 and 4)	61	57
Accounts Receivable, Net (Notes 2 and 6)	491	449
Taxes, Duties, and Trade Receivables, Net (Notes 2 and 7)	2,459	1,874
Direct Loans, Net (Note 8)	85	55
Inventory and Related Property, Net (Note 9)	499	435
General Property, Plant, and Equipment, Net (Note 11)	19,074	17,697
Other (Note 13)		
Advances and Prepayments	573	591
TOTAL ASSETS	**$90,097**	**$84,804**
Stewardship Property, Plant, and Equipment (Note 12)		
LIABILITIES		
Intragovernmental		
Accounts Payable	$2,174	$2,179
Debt (Note 15)	18,505	19,004
Other (Note 18)		
Due to the General Fund	2,475	1,969
Accrued FECA Liability	374	370
Other	501	720
Total Intragovernmental	**$24,029**	**$24,242**
Accounts Payable	2,571	2,793
Federal Employee and Veterans' Benefits (Note 16)	48,317	39,425
Environmental and Disposal Liabilities (Note 17)	1,061	1,012
Other (Notes 18, 19, 20, and 21)		
Accrued Payroll and Benefits	2,217	1,936
Deferred Revenue and Advances from Others	2,650	2,629
Unliquidated Antidumping and Countervailing Duties	127	106
Insurance Liabilities	482	508

Department of Homeland Security
Balance Sheets
As of September 30, 2010 and 2009
(In Millions)

	2010 (Unaudited)	2009 (Unaudited) (Restated)
Refunds and Drawbacks	129	126
Other	2,013	1,725
Total Liabilities	**$83,596**	**$74,502**
Commitments and Contingencies (Notes 18, 19, 20, and 21)		
NET POSITION		
Unexpended Appropriations		
Unexpended Appropriations-Other Funds	$51,612	$49,283
Cumulative Results of Operations		
Cumulative Results of Operations-Earmarked Funds (Note 22)	(13,816)	(15,410)
Cumulative Results of Operations-Other Funds	(31,295)	(23,571)
Total Net Position	**$6,501**	**$10,302**
TOTAL LIABILITIES AND NET POSITION	**$90,097**	**$84,804**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Net Cost
For the Years Ended September 30, 2010 and 2009
(In Millions)

Directorates and Other Components (Notes 23 and 24)	2010 (Unaudited)	2009 (Unaudited) (Restated)
U.S. Customs and Border Protection		
Gross Cost	$11,775	$10,672
Less Earned Revenue	(152)	(166)
Net Cost	**11,623**	**10,506**
U.S. Coast Guard		
Gross Cost	12,975	12,274
Less Earned Revenue	(897)	(432)
Net Cost	**12,078**	**11,842**
U.S. Citizenship and Immigration Services		
Gross Cost	2,531	2,329
Less Earned Revenue	(2,418)	(2,696)
Net Cost	**113**	**(367)**
Federal Emergency Management Agency		
Gross Cost	14,207	14,748
Less Earned Revenue	(3,681)	(3,193)
Net Cost	**10,526**	**11,555**
Federal Law Enforcement Training Center		
Gross Cost	410	450
Less Earned Revenue	(36)	(36)
Net Cost	**374**	**414**
National Protection and Programs Directorate		
Gross Cost	2,061	2,032
Less Earned Revenue	(828)	(822)
Net Cost	**1,233**	**1,210**
U.S. Immigration and Customs Enforcement		
Gross Cost	5,750	5,173
Less Earned Revenue	(229)	(166)
Net Cost	**5,521**	**5,007**

Department of Homeland Security
Statements of Net Cost
For the Years Ended September 30, 2010 and 2009
(In Millions)

Directorates and Other Components (Notes 23 and 24)	2010 (Unaudited)	2009 (Unaudited) (Restated)
Office of Health Affairs		
Gross Cost	231	414
Less Earned Revenue	-	-
Net Cost	**231**	**414**
Departmental Operations and Other		
Gross Cost	1,880	1,776
Less Earned Revenue	(6)	(2)
Net Cost	**1,874**	**1,774**
U.S. Secret Service		
Gross Cost	1,782	1,818
Less Earned Revenue	(15)	(16)
Net Cost	**1,767**	**1,802**
Science and Technology Directorate		
Gross Cost	887	968
Less Earned Revenue	(5)	(4)
Net Cost	**882**	**964**
Transportation Security Administration		
Gross Cost	6,631	6,991
Less Earned Revenue	(2,145)	(2,243)
Net Cost	**4,486**	**4,748**
Total Department of Homeland Security		
Gross Cost	61,120	59,645
Less Earned Revenue	(10,412)	(9,776)
Net Cost Before Loss on Pension, ORB, or OPEB Assumption Changes	50,708	49,869
Loss on Pension, ORB, or OPEB Assumption Changes (Note 16)	5,675	-
NET COST OF OPERATIONS	**$56,383**	**$49,869**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statement of Changes in Net Position
For the Year Ended September 30, 2010
(In Millions)

	2010 (Unaudited)			
	Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
Cumulative Results of Operations				
Beginning Balances	$(15,410)	$(23,571)	$ -	$(38,981)
Budgetary Financing Sources				
Appropriations Used	-	45,757	-	45,757
Non-exchange Revenue	3,611	5	-	3,616
Donations and Forfeitures of Cash and Cash Equivalents	2	-	-	2
Transfers In/Out Without Reimbursement	(1,964)	1,738	-	(226)
Other	(5)	-	-	(5)
Other Financing Sources				
Donations and Forfeitures of Property	-	3	-	3
Transfers In/Out Without Reimbursement	(13)	133	-	120
Imputed Financing	76	1,179	191	1,064
Other	-	(78)	-	(78)
Total Financing Sources	1,707	48,737	191	50,253
Net Cost of Operations	(113)	(56,461)	(191)	(56,383)
Net Change	1,594	(7,724)	-	(6,130)
Cumulative Results of Operations	**(13,816)**	**(31,295)**	**-**	**(45,111)**
Unexpended Appropriations				
Beginning Balance	-	49,283	-	49,283
Budgetary Financing Sources				
Appropriations Received (Note 28)	-	48,824	-	48,824
Appropriations Transferred In/Out	-	47	-	47
Other Adjustments	-	(785)	-	(785)
Appropriations Used	-	(45,757)	-	(45,757)
Total Budgetary Financing Sources	-	2,329	-	2,329
Total Unexpended Appropriations	**-**	**51,612**	**-**	**51,612**
NET POSITION	**$(13,816)**	**$20,317**	**$ -**	**$6,501**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statement of Changes in Net Position
For the Year Ended September 30, 2009
(In Millions)

	2009 (Unaudited) (Restated) Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
Cumulative Results of Operations				
Beginning Balances	$(19,359)	$(23,056)	$ -	$(42,415)
Adjustments:				
Correction of Errors (Note 32)	-	(43)	-	(43)
Beginning Balance, as Adjusted	(19,359)	(23,099)	-	(42,458)
Budgetary Financing Sources				
Appropriations Used	-	49,300	-	49,300
Non-exchange Revenue	3,526	4	-	3,530
Donations and Forfeitures of Cash and Cash Equivalents	3	-	-	3
Transfers In/Out Without Reimbursement	(1,835)	1,640	-	(195)
Other	-	(62)	-	(62)
Other Financing Sources				
Donations and Forfeitures of Property	-	4	-	4
Transfers In/Out Without Reimbursement	12	(1)	-	11
Imputed Financing	54	932	226	760
Other	-	(5)	-	(5)
Total Financing Sources	1,760	51,812	226	53,346
Net Cost of Operations	2,189	(52,284)	(226)	(49,869)
Net Change	3,949	(472)	-	3,477
Cumulative Results of Operations	**(15,410)**	**(23,571)**	**-**	**(38,981)**
Unexpended Appropriations				
Beginning Balances	-	55,239	-	55,239
Budgetary Financing Sources				
Appropriations Received (Note 28)	-	46,067	-	46,067
Appropriations Transferred In/Out	-	(2,064)	-	(2,064)
Other Adjustments	-	(659)	-	(659)
Appropriations Used	-	(49,300)	-	(49,300)
Total Budgetary Financing Sources	-	(5,956)	-	(5,956)
Total Unexpended Appropriations	**-**	**49,283**	**-**	**49,283**
NET POSITION	**$(15,410)**	**$25,712**	**$ -**	**$10,302**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Budgetary Resources
For the Years Ended September 30, 2010 and 2009
(In Millions)

	2010 (Unaudited)		2009 (Unaudited) (Restated)	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
BUDGETARY RESOURCES				
Unobligated Balance, Brought Forward, October 1	$13,383	$ -	$21,431	$4
Recoveries of Prior Year Unpaid Obligations	4,463	-	4,280	-
Budget Authority:				
Appropriations (Note 28)	55,852	-	52,839	-
Borrowing Authority (Note 26)	-	-	-	51
Spending Authority from Offsetting Collections:				
Earned:				
Collected	9,913	33	9,542	88
Change in Receivables from Federal Sources	(79)	-	124	-
Change in Unfilled Customer Orders:				
Advances Received	(230)	-	280	-
Without Advance From Federal Sources	418	(33)	(506)	(30)
Previously Unavailable	30	-	-	-
Expenditure Transfers from Trust Funds	48	-	48	-
Subtotal	65,952	-	62,327	109
Nonexpenditure Transfers, Net; Anticipated and Actual	1,105	-	(1,576)	-
Temporarily Not Available Pursuant to Public Law	(32)	-	(4)	-
Permanently Not Available	(1,671)	-	(1,212)	(47)
TOTAL BUDGETARY RESOURCES	**$83,200**	**$ -**	**$85,246**	**$66**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred (Note 25):				
Direct	$63,344	$ -	$67,636	$66
Reimbursable	4,668	-	4,227	-
Subtotal	68,012	-	71,863	66
Unobligated Balance:				
Apportioned	10,190	-	7,706	-
Exempt from Apportionment	5	-	5	-
Subtotal (Note 3)	10,195	-	7,711	-
Unobligated Balance Not Available (Note 3)	4,993	-	5,672	-
TOTAL STATUS OF BUDGETARY RESOURCES	**$83,200**	**$ -**	**$85,246**	**$66**

Department of Homeland Security
Statements of Budgetary Resources
For the Years Ended September 30, 2010 and 2009
(In Millions)

	2010 (Unaudited)		2009 (Unaudited) (Restated)	
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts
CHANGE IN OBLIGATED BALANCE				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, October 1	$46,764	$294	$47,103	$323
Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(2,044)	(293)	(2,427)	(323)
Total Unpaid Obligated Balance, Net	44,720	1	44,676	-
Obligations Incurred, Net	68,012	-	71,863	66
Gross Outlays	(61,646)	(34)	(67,897)	(95)
Obligated Balance Transferred, Net				
Actual Transfers, Unpaid Obligations	(26)	-	(25)	-
Total Unpaid Obligated Balance Transferred, Net	(26)	-	(25)	-
Recoveries of Prior Year Unpaid Obligations, Actual	(4,463)	-	(4,280)	-
Change in Uncollected Customer Payments from Federal Sources	(340)	34	383	30
Obligated Balance, Net, End of Period				
Unpaid Obligations	48,641	261	46,764	294
Uncollected Customer Payments from Federal Sources	(2,384)	(260)	(2,044)	(293)
Total, Unpaid Obligated Balance, Net, End of Period	**$46,257**	**$1**	**$44,720**	**$1**
NET OUTLAYS				
Gross Outlays	$61,646	$34	$67,897	$95
Offsetting Collections	(9,731)	(33)	(9,870)	(88)
Distributed Offsetting Receipts	(6,328)	-	(5,213)	-
NET OUTLAYS	**$45,587**	**$1**	**$52,814**	**$7**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Custodial Activity
For the Years Ended September 30, 2010 and 2009
(In Millions)

	2010 (Unaudited)	**2009 (Unaudited)**
Revenue Activity (Note 31)		
Sources of Cash Collections:		
Duties	$25,284	$22,633
User Fees	1,508	1,405
Excise Taxes	2,880	2,555
Fines and Penalties	64	63
Interest	6	25
Miscellaneous	179	127
Total Cash Collections	29,921	26,808
Accrual Adjustments	636	(392)
Total Custodial Revenue	**30,557**	**26,416**
Disposition of Collections		
Transferred to Others:		
Federal Entities:		
U.S. Department of Agriculture	8,490	7,698
U.S. Department of Labor	146	94
U.S. Department of State	70	70
National Science Foundation	91	89
Treasury General Fund Accounts	19,749	17,373
Other Federal Agencies	27	30
Non-Federal Entities:		
Government of Puerto Rico	-	2
Other Non-Federal Entities	26	13
(Increase)/Decrease in Amounts Yet to be Transferred	597	(433)
Refunds and Drawbacks (Notes 18 and 31)	1,279	1,367
Retained by the Department	82	113
Total Disposition of Custodial Revenue	**30,557**	**26,416**
Net Custodial Activity	**$ -**	**$ -**

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements (Unaudited)

Table of Contents for Notes to the Financial Statements (Unaudited)

Notes to the Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

A. Reporting Entity

The Department of Homeland Security (DHS or the Department) was established by the *Homeland Security Act of 2002* (HSA), *Pub. L. 107-296*, dated November 25, 2002, as an executive department of the U.S. Federal Government. DHS leads efforts to achieve a safe, secure, and resilient homeland by countering terrorism and enhancing our security; securing and administering our borders; enforcing and administering our immigration laws; protecting our cyber networks and critical infrastructure; and ensuring resilience from disasters. Additionally, DHS contributes in many ways to elements of broader U.S. national and economic security while fulfilling its other five homeland security missions and is constantly striving to mature and strengthen the homeland security enterprise. The Department includes the following financial reporting Components[1]:

- **U.S. Customs and Border Protection (CBP)**
- **U.S. Coast Guard (USCG)**
- **U.S. Citizenship and Immigration Services (USCIS)**
- **Federal Emergency Management Agency (FEMA)**
- **Federal Law Enforcement Training Center (FLETC)**
- **National Protection and Programs Directorate (NPPD),** including the Federal Protective Service (FPS)
- **U.S. Immigration and Customs Enforcement (ICE)**
- **Office of Health Affairs (OHA)**
- **Departmental Operations and Other**, including the Management Directorate (MGMT), the Office of the Secretary, the Office of the Inspector General (OIG), the Domestic Nuclear Detection Office (DNDO), the Office of Intelligence and Analysis, and the Office of Operations Coordination and Planning
- **U.S. Secret Service (USSS)**
- **Science and Technology Directorate (S&T)**
- **Transportation Security Administration (TSA)**

On October 28, 2009, the President of the United States signed the *FY 2010 Homeland Security Appropriations Act* (Pub. L. 111-83), which included a provision transferring FPS from ICE to NPPD. The realignment allows FPS to focus on its primary mission—securing Federal buildings by performing building security assessments and deploying appropriate countermeasures—while enabling ICE to focus on the enforcement of immigration and customs laws. As a result of the transfer, we made certain reclassifications to the FY 2009 financial statements and related footnotes to conform to FY 2010 presentation.

The Department received supplemental appropriations during FY 2009 as a result of *The American Recovery and Reinvestment Act of 2009* (Recovery Act) (Pub. L. 111-5). Seven DHS Components received funding to carry out Recovery Act programs in support of the Department's mission.

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[1] Financial reporting Components are to be distinguished from direct report Components presented in the Department's organization chart.

MGMT received funding for the consolidation of DHS headquarters; CBP received funding to modernize infrastructure and enhance border security technology; ICE received funding for tactical communications upgrades; TSA received funding for enhanced security technology; the U.S. Coast Guard received funding for bridge alteration construction and shore, facility and vessel modernization; FEMA received funding for port, transit, and fire station construction grants and additional funding for the Emergency Food and Shelter program; and OIG received funding for oversight and audit of programs, grants, and projects funded under the Recovery Act. Additional Recovery Act information can be found at www.recovery.gov.

B. Basis of Presentation

These financial statements are prepared to report the consolidated financial position, net cost of operations, changes in net position, custodial activity, and combined budgetary resources of the Department pursuant to the *Government Management Reform Act of 1994* and the *Chief Financial Officers Act of 1990*, as amended by the *Reports Consolidation Act of 2000*.

The Department's financial statements have been prepared from the accounting records of the Department based on guidance in United States generally accepted accounting principles (GAAP) and OMB Circular A-136, *Financial Reporting Requirements*. GAAP for Federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board, the official accounting standards-setting body of the Federal Government.

The Department's financial statements reflect the reporting of Departmental activities, including appropriations received to conduct operations and revenue generated from operations. The financial statements also reflect the reporting of certain non-entity (custodial) functions performed by the Department on behalf of the Federal Government.

Intragovernmental assets and liabilities result from activity with other Federal entities. All other assets and liabilities result from activity with parties outside the Federal Government, such as domestic and foreign persons, organizations, or governments. Intragovernmental earned revenues are collections or accruals of revenue from other Federal entities, and intragovernmental costs are payments or accruals to other Federal entities. Transactions and balances among the Department's Components have been eliminated in the consolidated presentation of the Balance Sheets, Statements of Net Cost, Statements of Changes in Net Position, and the Statements of Custodial Activity. The Statements of Budgetary Resources are reported on a combined basis; therefore, intradepartmental balances have not been eliminated.

While these financial statements have been prepared from the books and records of the Department in accordance with the formats prescribed by OMB, these financial statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.

These financial statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity, whose liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the U.S. Government acting in its capacity as a sovereign entity.

C. Basis of Accounting

Transactions are recorded on an accrual and a budgetary basis of accounting. Under the accrual basis, revenues are recorded when earned, and expenses are recognized when a liability is incurred, regardless of when cash is exchanged. Budgetary accounting facilitates compliance with legal constraints and the controls over the use of Federal funds. The balances and activity of budgetary accounts are used to prepare the Statements of Budgetary Resources. The Statements of Custodial Activity are reported using the modified cash basis. With this method, revenue from cash collections is reported separately from receivable accruals, and cash disbursements are reported separately from payable accruals.

D. Use of Estimates

Preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of consolidated financial statements, and the reported amounts of revenues and claims and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include: the year-end accruals of accounts and grants payable; contingent legal and environmental liabilities; accrued workers' compensation; allowance for doubtful accounts receivable; allowances for obsolete inventory and operating materials and supplies (OM&S) balances; allocations of indirect common costs to construction-in-progress; capitalized property, plant, and equipment; depreciation; subsidy re-estimates; deferred revenues; National Flood Insurance Program (NFIP) insurance liability; actuarial assumptions related to workers' compensation; military and other pension, retirement and post-retirement benefit assumptions; allowances for doubtful duties, fines, penalties, and certain non-entity receivables; and payables related to custodial activities and undeposited collections.

E. Entity and Non-Entity Assets

Entity assets are assets the Department has the authority to use in its operations. The authority to use funds in an entity's operations means either Department management has the authority to decide how funds are used or management is legally obligated to use funds to meet entity obligations (e.g., salaries and benefits).

Non-entity assets are assets held by the Department but not available for use by the Department. An example of a non-entity asset is the portion of Fund Balance with Treasury that consists of special and deposit funds, permanent appropriations, and miscellaneous receipts that are available to pay non-entity liabilities.

For additional information, see Note 2, Non-Entity Assets.

F. Fund Balance with Treasury

Fund Balance with Treasury represents the aggregate amount of the Department's accounts with the U.S. Department of the Treasury (Treasury) available to pay current liabilities and finance authorized purchases, except as restricted by law. The Department's Fund Balance with Treasury balances are primarily appropriated, revolving, trust, deposit, receipt, and special fund amounts remaining as of the end of the fiscal year. Fund Balance with Treasury does not include fiduciary amounts (see Note 1.Y., Fiduciary Activities).

For additional information, see Note 3, Fund Balance with Treasury.

G. Cash and Other Monetary Assets

The Department's cash and other monetary assets primarily consist of undeposited collections, imprest funds, cash used in undercover operations, cash held as evidence, cash held by insurance companies, and seized cash and monetary instruments.

The Department does maintain cash in commercial bank accounts. Insurance companies receive and process certain receipts and disbursements for FEMA. Treasury processes the remainder of the receipts and disbursements.

For additional information, see Note 4, Cash and Other Monetary Assets.

H. Investments, Net

Investments consist of U.S. Government nonmarketable par value and market-based Treasury securities and are reported at cost or amortized cost net of premiums or discounts. Premiums or discounts are amortized into interest income over the terms of the investment using the effective interest method or the straight-line method, which approximates the interest method. No provision is made for unrealized gains or losses on these securities because it is the Department's intent to hold these investments to maturity.

For additional information, see Note 5, Investments, Net.

I. Accounts Receivable, Net

Accounts receivable represents amounts due to the Department from other Federal agencies and the public. In general, intragovernmental accounts receivable arise from the provision of goods and services to other Federal agencies and are expected to be fully collected.

Accounts receivable due from the public typically results from various immigration and user fees, premiums and restitution from insurance companies and policyholders, breached bonds, reimbursable services, and security fees. Public accounts receivable are presented net of an allowance for doubtful accounts, which is based on analyses of debtors' ability to pay, specific identification of probable losses, aging analysis of past-due receivables, or historical collection experience.

For additional information, see Note 6, Accounts Receivable, Net.

J. Advances and Prepayments

Intragovernmental advances, presented as a component of other assets in the accompanying Balance Sheets, consist primarily of disaster recovery and assistance advances to other Federal agencies.

Advances and prepayments to the public, presented as a component of other assets in the accompanying Balance Sheets, consist primarily of disaster recovery and assistance grants to States and other grant activity. Advances are expensed as they are used by the recipients.

For additional information, see Note 13, Other Assets.

K. Direct Loans, Net

Direct loans are loans issued by the Department to local governments. FEMA, the only DHS Component with loan activity, operates the Community Disaster Loan Program to support local governments that have suffered a substantial loss of tax and other revenue as a result of a major disaster and demonstrate a need for Federal financial assistance in order to perform governmental functions. Under the program, FEMA transacts direct loans to local governments that meet statutorily set eligibility criteria. Loans are accounted for as receivables as funds are disbursed.

All of the Department's loans are post-1991 obligated direct loans, and the resulting receivables are governed by the *Federal Credit Reform Act of 1990 (FCRA)* (Pub. L. 101-508). Under FCRA, for direct loans disbursed during a fiscal year, the corresponding receivable is adjusted for subsidy costs. Subsidy costs are estimated long-term costs to the U.S. Government for its loan programs. The subsidy cost is equal to the present value of the estimated cash outflows over the life of the loans minus the present value of the estimated cash inflows, discounted at the applicable Treasury interest rate. Administrative costs such as salaries and contractual fees are not included. Subsidy costs can arise from interest rate differentials, interest subsidies, delinquencies and defaults, and other cash flows. The Department calculates the subsidy costs based on a subsidy calculator model created by OMB.

Loans receivable are recorded at the present value of the estimated net cash flows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recorded in the allowance for subsidy, which is estimated and adjusted annually, as of year-end. Interest receivable is the total interest that has accrued on each of the outstanding loans, less any cancellations that may have been recorded due to the FEMA cancellation policy as described in 44 Code of Federal Regulations (CFR) Section 206.366.

For additional information, see Note 8, Direct Loans, Net.

L. Inventory and Related Property, Net

Operating materials and supplies are tangible personal property consumed during normal operations. Department OM&S consist primarily of goods consumed during the service of vessels and aircraft. OM&S at the U.S. Coast Guard aircraft warehouses in Elizabeth City, North Carolina, and vessel warehouses in Baltimore, Maryland are accounted for using the consumption method. OM&S held at the U.S. Coast Guard field units is accounted for using the purchase method. Excess, obsolete, and unserviceable OM&S are stated at net realizable value net of an allowance, which is based on the condition of various asset categories as well as historical experience with using and disposing of such assets. OM&S held at CBP consist of aircraft, marine, and secure border initiative (SBI) operating materials and supplies to be used in CBP's operations. CBP's OM&S are accounted for using the consumption method.

Repairable spares are classified as property, plant, and equipment (PP&E). Repairable spares consist of repairable components that are repeatedly repaired and put back into service. Repairable spares are valued based on a moving average cost flow assumption. The cost is depreciated along with the major PP&E asset (e.g., aircraft, vessel, boat) they support. Normal repair costs are expensed in the period incurred.

Inventory is tangible personal property held for sale or used in the process of production for sale. Inventories on hand at year-end are stated at cost using standard price/specific identification, first-in/first-out, or moving average cost methods, which approximates historical cost. Revenue on inventory sales and associated cost of goods sold are recorded when merchandise is sold to the end user. Department inventories consist primarily of the U.S. Coast Guard Supply Fund—which provides uniform clothing, subsistence provisions, retail stores, technical material, and fuel—and the U.S. Coast Guard Industrial Fund, which provides inventory for the repair of U.S. Coast Guard and other Government agency ships and vessels.

Stockpile materials are critical materials held due to statutory requirements for use in national emergencies. The Department's stockpile materials held by FEMA include goods that would be used to respond to national disasters (e.g., water, meals, cots, blankets, tarps, and blue roof sheeting). Inventory at year-end is stated at historical cost using the weighted average method.

For additional information, see Note 9, Inventory and Related Property, Net.

M. Seized and Forfeited Property

Seized property falls into two categories: prohibited and nonprohibited. Prohibited seized property includes illegal drugs, contraband, and counterfeit items that cannot legally enter into the commerce of the United States. Prohibited seized property results primarily from criminal investigations and passenger/cargo processing. Nonprohibited seized property includes items that are not inherently illegal to possess or own, such as monetary instruments, real property, and tangible personal property of others.

Seized property is not considered an asset of the Department and is not reported as such in the Department's financial statements. However, the Department has a stewardship responsibility until the disposition of the seized items is determined (i.e., judicially or administratively forfeited or returned to the entity from which it was seized).

Forfeited property is seized property for which the title has passed to the U.S. Government. Prohibited forfeited items such as counterfeit goods, narcotics, or firearms are held by the Department until disposed of or destroyed. Nonprohibited forfeited property is transferred to the Treasury Forfeiture Fund.

An analysis of changes in seized and forfeited property of prohibited items is presented in Note 10, Seized and Forfeited Property.

N. General Property, Plant, and Equipment, Net

The Department's PP&E consists of aircraft, vessels, vehicles, land, structures, facilities, leasehold improvements, software, information technology, and other equipment. PP&E is recorded at cost. The Department capitalizes PP&E acquisitions when the cost equals or exceeds an established threshold and has a useful life of two years or more.

Costs for construction projects are recorded as construction-in-progress until completed and are valued at actual (direct) costs plus applied overhead and other indirect costs. In cases where historical cost information was not maintained, PP&E is capitalized using an estimated cost methodology consistent with Statement of Federal Financial Accounting Standards (SFFAS) No. 35, *Estimating the Historical Cost of General Property, Plant, and Equipment*. Estimated cost may be based on the cost of similar assets at the time of acquisition or the current cost of similar assets discounted for inflation since the time of acquisition. The U.S. Coast Guard uses market analysis as a reasonable alternative valuation method to record PP&E assets when the historical cost is unknown. For unique or uncommon assets, formal appraisals are conducted to determine acquisition cost. The Department owns some of the buildings in which Components operate. Other buildings are provided by the General Services Administration (GSA), which charges rent equivalent to the commercial rental rates for similar properties.

Internal-use software includes purchased commercial off-the-shelf software (COTS), contractor-developed software, and internally developed software. For COTS software, the capitalized costs include the amount paid to the vendor for the software. For contractor-developed software, the capitalized costs include the amount paid to a contractor to design, program, install, and implement the software. For internally developed software, capitalized costs include the full costs (direct and indirect) incurred during the software development phase. Costs incurred during the preliminary design and post-implementation/operational phases are expensed in the period incurred. In addition, CBP applies capital lease accounting concepts to software license fee agreements that give CBP the "right to use" internal-use software.

The schedule of capitalization thresholds shown below is a summary of the range of capitalization rules used by the Components. DHS policy allows Components to continue using legacy thresholds and capitalization rules for assets acquired prior to October 1, 2007. For assets acquired on or after October 1, 2007, Components use the DHS capitalization policy unless: 1) adopting it would cause a material misstatement of the standalone financial statements, 2) it would cause the Component to not be in compliance with GAAP, or 3) certain assets, such as repairable spares held by the U.S. Coast Guard, do not reasonably conform to DHS policy.

The ranges of capitalization thresholds and service life used by Components, by primary asset category, are as follows (unaudited):

Asset Description	Capitalization Threshold	Service Life
Land	Zero to $200,000	Not Applicable
Improvements to land	Zero to $200,000	2 years to 40 years
Buildings	$50,000 to $200,000	6 years to 40 years
Equipment	$25,000 to $200,000	2 years to 74 years
Capital leases and leasehold improvements	$50,000 to $200,000	2 years to 40 years
Software	$50,000 to $750,000	2 years to 7 years

The Department begins to recognize depreciation expense once the asset has been placed in service. Depreciation is calculated on a straight-line method for all asset classes over their estimated useful lives. Land is not depreciated. Leasehold improvements are depreciated over the shorter of the term of the remaining portion of the lease or the useful life of the improvement. Buildings and equipment acquired under capital leases are amortized over the lease term. Amortization of capitalized software is calculated using the straight-line method and begins on the date of acquisition if purchased, or when the module or component has been placed in use (i.e., successfully installed and tested) if contractor or internally developed. There are no restrictions on the use or convertibility of general PP&E.

For additional information, see Note 11, General Property, Plant, and Equipment, Net.

O. Stewardship Property, Plant, and Equipment

Stewardship PP&E includes heritage assets that generally are not included in general PP&E presented on the Balance Sheet. Heritage assets are unique due to their historical or natural significance; cultural, educational, or artistic importance; or significant architectural characteristics. In general, heritage assets are expected to be preserved indefinitely. The Department's heritage assets consist primarily of historical artifacts, artwork, buildings, and structures owned by the U.S. Coast Guard. The cost of improving, reconstructing, or renovating heritage assets is recognized as an expense in the period incurred. Similarly, the cost to acquire or construct a heritage asset is recognized as an expense in the period incurred. Due to their nature, heritage assets are not depreciated because matching costs with specific periods would not be meaningful.

Heritage assets can serve two purposes: a heritage function and a general government operational function. If a heritage asset serves both purposes, but is predominantly used for general government operations, the heritage asset is considered a multi-use heritage asset, which is included in general PP&E on the Balance Sheet. DHS depreciates its multi-use heritage assets over their useful life. The Department's multi-use heritage assets consist of buildings and structures owned by CBP, U.S. Coast Guard, and FEMA.

For additional information, see Note 12, Stewardship Property, Plant, and Equipment.

P. Liabilities

Liabilities represent the probable and measurable future outflow or other use of resources as a result of past transactions or events. Liabilities covered by budgetary resources are those liabilities for which Congress has appropriated funds or for which funding is otherwise available to pay amounts due. Liabilities not covered by budgetary or other resources represent amounts owed in excess of available congressionally appropriated funds or other amounts, where there is no certainty that the appropriations will be enacted. The U.S. Government, acting in its sovereign capacity, can annul liabilities of the Department arising from any transaction or event other than contracts.

Q. Contingent Liabilities

The Department has disclosed contingent liabilities where the conditions for liability recognition have not been met and the likelihood of unfavorable outcome is more than remote. The Department has accrued contingent liabilities where a loss is determined probable and the amount can be reasonably estimated. The Department does not accrue for possible losses related to cases where the potential loss cannot be estimated or the likelihood of an unfavorable outcome is less than probable. Other contingencies exist where losses are reasonably possible and an estimate can be determined or an estimate of the range of possible liability can be determined. Contingent liabilities considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee is disclosed.

For additional information, see Note 21, Commitments and Contingent Liabilities.

Environmental Cleanup Costs. Environmental liabilities consist of environmental remediation, cleanup, and decommissioning. The liability for environmental remediation is an estimate of costs necessary to bring a known contaminated asset into compliance with applicable environmental standards. Accruals for environmental cleanup costs are the costs of removing, containing, and/or disposing of hazardous wastes or materials that, because of quantity, concentration, or physical or chemical characteristics, may pose a substantial present or potential hazard to human health or the environment.

For all PP&E in service as of October 1, 1997, DHS recognizes the estimated total cleanup costs associated with the PP&E when the cleanup costs are probable and reasonably estimable. The estimate may be subsequently adjusted for material changes due to inflation/deflation or changes in regulations, clean-up plans, or technology. The applicable costs of decommissioning DHS's existing and future vessels are considered cleanup costs.

For additional information, see Note 17, Environmental and Disposal Liabilities.

R. Grants Liabilities and Cooperative Agreements

The Department awards grants and cooperative agreements to state and local governments, universities, nonprofit organizations, and private-sector companies to build their capacity to respond to disasters and emergencies; conduct research into preparedness; enhance and ensure the security of passenger and cargo transportation by air, land, or sea; and support other Department-related activities. The Department estimates the year-end grant and cooperative agreement accrual for unreported recipient expenditures using historical disbursement data. Grants and cooperative agreement liabilities are combined with accounts payable to the public in the accompanying Balance Sheets.

S. Insurance Liabilities

Insurance liabilities are the result of the Department's sale or continuation-in-force of NFIP, which is managed by FEMA. The NFIP insurance liability represents an estimate based on the loss and loss adjustment expense factors inherent to the NFIP Insurance Underwriting Operations. Actual incurred losses and loss adjustment expenses may not conform to the assumptions inherent in the estimation of the liability. Accordingly, the ultimate settlement of losses and the related loss adjustment expenses may vary from the estimate reported in the financial statements.

NFIP premium rates are generally established for actuarially rated policies with the intent of generating sufficient premiums to cover losses and loss adjustment expenses of a historical average loss year and to provide a surplus to compensate Insurance Underwriting Operations for the loss potential of an unusually severe loss year due to catastrophic flooding.

Notwithstanding the foregoing, subsidized rates have historically been charged on a countrywide basis for certain classifications of the insured. These subsidized rates produce a premium less than the loss and loss adjustment expenses expected to be incurred in a historical average loss year. The subsidized rates do not include a provision for losses from catastrophic flooding. Subsidized rates are used to provide affordable insurance on construction or substantial improvements started on or before December 31, 1974, or before the effective date of the initial Flood Insurance Rate Map (i.e., an official map of a community on which NFIP has delineated both the special hazard areas and the nonsubsidized premium zones applicable to the community).

For additional information, see Note 18, Other Liabilities, and Note 20, Insurance Liabilities.

T. Debt and Borrowing Authority

Debt is reported within Intragovernmental Liabilities and results from Treasury loans and related interest payable to fund NFIP and Disaster Assistance Direct Loan Program (DADLP) operations of FEMA. Most of this debt is not covered by current budgetary resources. The premiums collected by FEMA for the NFIP are not sufficient to cover the debt repayments. Congress will need to enact legislation to provide funding to repay the Treasury Department or to forgive the debt.

Borrowing authority is in budgetary status for use by FEMA for NFIP purposes, and community disaster loans and transfers have been made to the Fund Balance with Treasury for these purposes.

For more information, see Note 15, Debt and Note 26, Available Borrowing Authority.

U. Accrued Payroll and Benefits

Accrued Payroll. Accrued payroll consists of salaries, wages, and other compensation earned by the employees but not disbursed as of September 30. The liability is estimated for reporting purposes based on historical pay information.

Leave Program. Earned annual and other vested compensatory leave is accrued as it is earned and reported on the Balance Sheet. The liability is reduced as leave is taken. Each year, the balances in the accrued leave accounts are adjusted to reflect the liability at current pay rates and leave balances. Sick leave and other types of nonvested leave are not earned benefits. Accordingly, nonvested leave is expensed when used.

Federal Employees Compensation Act. The *Federal Employees Compensation Act (FECA)* (Pub. L. 103-3) provides income and medical cost protection to covered Federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA program is administered by the U.S. Department of Labor (DOL), which pays valid claims and subsequently seeks reimbursement from the Department for these paid claims.

The FECA liability consists of two elements. The first element, accrued FECA liability, is based on actual claims paid by DOL but not yet reimbursed by the Department. The Department reimburses DOL for the amount of actual claims as funds are appropriated for this purpose. In general, there is a two- to three-year time period between payment by DOL and reimbursement to DOL by the Department. As a result, the Department recognizes an intragovernmental liability for the actual claims paid by DOL and to be reimbursed by the Department.

The second element, actuarial FECA liability, is the estimated liability for future benefit payments and is recorded as a component of Federal Employee and Veterans' Benefits. This liability includes death, disability, medical, and miscellaneous costs. DOL determines the actuarial FECA liability annually, as of September 30, using an actuarial method that considers historical benefit payment patterns, wage inflation factors, medical inflation factors, and other variables. The projected annual benefit payments are discounted to present value using the OMB economic assumptions for 10-year Treasury notes and bonds. The actuarial FECA liability is not covered by budgetary resources and will require future funding.

For more information on the actuarial FECA liability, see Note 16, Federal Employee and Veterans' Benefits. For additional information on the accrued FECA liability, accrued payroll, and accrued leave, see Note 18, Other Liabilities.

V. Federal Employee and Veterans' Benefits

The Department's Federal employee and veterans' benefits consist of civilian employees' pension programs, other retirement benefits (ORB), and other post-employment benefits (OPEB), as well as the Military Retirement System (MRS), post-employment military travel benefits, and Uniformed Division and Special Agent Pension. Civilian employees' pension programs, ORB and OPEB are administered by the Office of Personnel Management (OPM) and do not represent a liability for the Department.

The Department recognizes liabilities and expenses for MRS, post-employment military travel benefits, and Uniformed Division and Special Agent Pension. SFFAS No. 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*, effective for FY 2010, requires display of gains and losses from changes in long-term assumptions used to measure these liabilities as a separate line item on the Statement of Net Cost. SFFAS No. 33 also requires additional disclosure of the reconciliation of beginning and ending liability balances.

Civilian Pension and Other Post-Employment Benefits. The Department recognizes the full annual cost of its civilian employees' pension benefits; however, the assets of the plan and liability associated with pension costs are recognized by OPM rather than the Department. Accordingly, DHS does not display gains and losses from changes in long-term assumptions used to measure these liabilities on the Statement of Net Cost.

Most Federal employees of DHS hired prior to January 1, 1984, participate in the Civil Service Retirement System (CSRS), to which the Department contributes 7 percent of base pay for regular CSRS employees and 7.5 percent of base pay for law enforcement agents. The majority of employees hired after December 31, 1983, are covered by the Federal Employees Retirement System (FERS) and Social Security. For the FERS basic annuity benefit, the Department contributes 11.2 percent of base pay for regular FERS employees and 24.9 percent for law enforcement agents. A primary feature of FERS is that it also offers a defined contribution plan (Federal Thrift Savings Plan) to which the Department automatically contributes 1 percent of base pay and matches employee contributions up to an additional 4 percent of base pay. The Department also contributes the employer's Social Security matching share for FERS participants.

Similar to CSRS and FERS, OPM reports the liability for future payments to retired employees who participate in the Federal Employees Health Benefits Program and Federal Employees Group Life Insurance Program. The Department reports both the full annual cost of providing these ORB for its retired employees and reporting contributions made for active employees. In addition, the Department recognizes the cost for OPEB, including all types of benefits provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents.

The difference between the full annual cost of CSRS and FERS retirement, ORB, and OPEB and the amount paid by the Department is recorded as an imputed cost and offsetting imputed financing source in the accompanying financial statements.

Military Retirement System Liability. The U.S. Coast Guard MRS is a defined benefit plan that includes pension benefits, disability benefits, and survivor benefits and covers all retired active duty and reserve military members of the U.S. Coast Guard. The plan is a pay-as-you-go system funded through annual appropriations. The actuarial unfunded accrued liability reported on the accompanying Balance Sheet is determined by subtracting the sum of the present value of future employer normal costs and any plan assets from the present value of the future benefits expected to be paid. The normal cost (current period expense) is computed using the individual entry age normal actuarial cost method.

Military Health System for Retirees and Beneficiaries Liability. There are two categories of the Military Healthcare liability for the U.S. Coast Guard retirees and beneficiaries. The first is the Military Healthcare liability for the Medicare-eligible U.S. Coast Guard military retirees and beneficiaries. The U.S. Department of Defense (DOD) is the administrative entity for the Medicare-Eligible Retiree Health Care Fund (MERHCF) and, in accordance with SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, is required to recognize the liability on the MERHCF's financial statements. The U.S. Coast Guard makes annual payments to fund benefits for the current active duty members and their spouses who will receive benefits when they reach

Medicare-eligibility. The future cost and liability of the MERHCF is determined using claim factors and claims cost data developed by DOD, adjusted for U.S. Coast Guard retiree and actual claims experience. The DOD Board of Actuaries calculates all MERHCF assumptions, and the Defense Finance and Accounting Service provides accounting and investment services for the fund. The U.S. Coast Guard receives per-member amounts (reserve and active duty member amounts separately) to be contributed to the MERHCF from the DOD Board of Actuaries office and pays its share, depending on its demography.

The second category is the Military Healthcare liability for the pre-Medicare-eligible retirees and beneficiaries. The benefits are funded on a pay-as-you-go basis. There are no assets in this plan as benefits are paid in full as they become due from the current year appropriations.

Post-Employment Military Travel Benefit. U.S. Coast Guard uniformed service members and their family or survivors are authorized a one-time transfer benefit to the members' home of address upon separation or retirement to include permanent disability and preretirement death in service. The allowances are provided whether or not the member is on active duty at the time of travel and without regard to the comparative costs of the various modes of transportation.

The U.S. Coast Guard treats this entitlement as an ORB. The U.S. Coast Guard recognizes an expense and a liability for this benefit when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the reporting date. The liability for this benefit is determined in the same manner as the liability for the MRS by subtracting the sum of the present value of future normal costs from the present value of the future entitlements expected to be paid. The normal cost is computed using the individual entry age normal actuarial cost method.

Uniformed Division and Special Agent Pension Liability. The District of Columbia Police and Fireman's Retirement System (the DC Pension Plan) is a defined benefit plan that covers USSS Uniformed Division and Special Agents. The DC Pension Plan makes benefit payments to retirees and/or their beneficiaries. USSS receives permanent, indefinite appropriations each year to pay the excess of benefit payments over salary deductions. The DC Pension Plan is a pay-as-you-go system funded through annual appropriations. The unfunded accrued liability reported on the accompanying Balance Sheet is actuarially determined by subtracting the present value of future employer/employee contributions, as well as any plan assets, from the present value of future cost of benefits. Current period expense is computed using the aggregate cost method.

For more information on civilian pension and OPEB, MRS liability, post-employment military travel benefits, and Uniformed Division and Special Agent Pension liability, see Note 16, Federal Employee and Veterans' Benefits.

W. Earmarked Funds

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources that remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes and must be accounted for separately from the Federal Government's general revenues.

Earmarked non-exchange revenue and other financing sources, including appropriations and net cost of operations, are shown separately on the Statements of Changes in Net Position. The portion of cumulative results of operations attributable to earmarked funds is shown separately on both the Statements of Changes in Net Position and the Balance Sheets.

For additional information, see Note 22, Earmarked Funds, and Note 5, Investments, Net.

X. Revenue and Financing Sources

Appropriations. The Department receives the majority of funding to support its programs through Congressional appropriations. The Department receives annual, multi-year, and no-year appropriations that may be used, within statutory limits, for operating and capital expenditures. Additional funding is obtained through exchange revenues, non-exchange revenues, and transfers-in.

Appropriations are recognized as financing sources when related expenses are incurred or assets are purchased. Revenue from reimbursable agreements is recognized when the goods or services are provided by the Department. Prices for goods and services sold to the public are based on recovery of full cost or are set at a market price. Reimbursable work between Federal agencies is subject to the *Economy Act* (31 United States Code (U.S.C.) 1535). Prices for goods and services sold to other Federal Government agencies are generally limited to the recovery of direct cost.

Allocation Transfers. The Department is a party to allocation transfers with other Federal agencies as both a transferring (parent) entity and a receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. In general, all financial activity related to these allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations, and budget apportionments are derived. The Department allocates funds, as the parent, to the Department of Health and Human Services. During FY 2008, OMB granted an exemption from reporting this fund as a parent for FY 2008 and future periods. Therefore, financial activity related to these funds is not reported in the DHS financial statements and related footnotes. DHS receives allocation transfers, as the child, from GSA, the U.S. Department of Transportation, and the Environmental Protection Agency.

Exchange and Non-exchange Revenue. Exchange revenues are recognized when earned and are derived from transactions where both the Government and the other party receive value (i.e., goods have been delivered or services have been rendered). Non-exchange revenues from user fees are recognized as earned in accordance with the *Consolidated Omnibus Budget Reconciliation Act of 1985* (COBRA) (Pub. L. 99-272), as amended. Non-exchange revenues also arise from transfers-in with and without financing sources and donations from the public. Other financing sources, such as donations and transfers of assets without reimbursements, are recognized on the Statements of Changes in Net Position during the period in which the donations and transfers occurred.

Deferred revenue is recorded when the Department receives payment for goods or services which have not been fully rendered. Deferred revenue is reported as a liability on the Balance Sheets until earned. Fees for flood mitigation products and services, such as insurance provided through FEMA's NFIP, are established at rates with the intent of generating sufficient premiums to cover losses and loss adjustment expenses of a historical average loss year and to provide a surplus to compensate Insurance Underwriting Operations for the loss potential of an unusually severe loss year due to catastrophic flooding. NFIP premium revenues are recognized ratably over the life of the policies. Deferred revenue relates to unearned premiums reserved to provide for the remaining period of insurance coverage. USCIS requires advance payments of the fees for adjudication of applications or petitions for immigration and naturalization benefits.

Imputed Financing Sources. In certain instances, operating costs of DHS are paid out of funds appropriated to other Federal agencies. For example, OPM, by law, pays certain costs of retirement programs, and certain legal judgments against DHS are paid from a judgment fund maintained by the Treasury. When costs that are identifiable to DHS and directly attributable to DHS operations are paid by other agencies, DHS recognizes these amounts as operating expenses. DHS also recognizes an imputed financing source on the Statements of Changes in Net Position to indicate the funding of DHS operations by other Federal agencies.

Custodial Activity. Non-entity revenue, disbursements, and refunds are reported on the Statement of Custodial Activity using a modified cash basis. Non-entity revenue reported on the Department's Statement of Custodial Activity include duties, excise taxes, and various non-exchange fees collected by CBP that are subsequently remitted to the Treasury General Fund or to other Federal agencies. Duties, user fees, fines, and penalties are assessed pursuant to the provisions of 19 U.S.C.; nonimmigrant petition fees and interest under 8 U.S.C.; and excise taxes under 26 U.S.C.

CBP assesses duties, taxes, and fees on goods and merchandise brought into the United States from foreign countries. The custodial revenue is recorded at the time of collection. These revenue collections primarily result from current fiscal year activities. CBP records an equal and offsetting liability due to the Treasury General Fund for amounts recognized as non-entity tax and trade receivables. Non-entity tax and trade accounts receivables are recognized when CBP is entitled to collect duties, user fees, fines and penalties, refunds and drawback overpayments, and interest associated with import/export activity on behalf of the Federal Government that have been established as a specifically identifiable, legally enforceable claim and remain uncollected as of year-end. CBP accrues an estimate of duties, taxes, and fees related to commerce released prior to year-end where receipt of payment is anticipated subsequent to year-end. The portions of the fees that are subsequently remitted to other Federal agencies are recorded as custodial revenue at the time of collection.

Non-entity receivables are presented net of amounts deemed uncollectible. CBP tracks and enforces payment of estimated duties, taxes, and fees receivable by establishing a liquidated damage case that generally results in fines and penalties receivable. A fine or penalty, including interest on past-due balances, is established when a violation of import/export law is discovered. An allowance for doubtful collections is established for substantially all accrued fines and penalties and related interest. The amount is based on past experience in resolving disputed assessments, the debtor's payment record and willingness to pay, the probable recovery of amounts from secondary sources (such as sureties), and an analysis of aged receivable activity. CBP regulations allow importers to dispute the assessment of duties, taxes, and fees. Receivables related to disputed assessments are not recorded until the protest period expires or a protest decision is rendered in CBP's favor.

Refunds and drawback of duties, taxes, and fees are recognized when payment is made. A permanent, indefinite appropriation is used to fund the disbursement of refunds and drawbacks.

Disbursements are recorded as a decrease in the amount transferred to Federal entities as reported on the Statements of Custodial Activity.

An accrual adjustment is recorded on the Statements of Custodial Activity to adjust cash collections and refund disbursements with the net increase or decrease of accrued non-entity accounts receivables, net of uncollectible amounts, and refunds payable at year-end.

For additional information, see Note 7, Taxes, Duties, and Trade Receivables, Net, and Note 31, Custodial Revenues.

Y. Fiduciary Activities

Fiduciary activities are Federal Government activities that relate to the collection or receipt—and the subsequent management, protection, accounting, investment and disposition—of cash or other assets in which non-Federal individuals or entities have an ownership. Federal accounting standards require the Department to distinguish the information relating to its fiduciary activities from all other activities. Fiduciary activities are not recognized on the accompanying financial statements. The Department's fiduciary activities are currently immaterial, and therefore, no additional disclosure is necessary.

Z. Taxes

The Department, as a Federal agency, is not subject to Federal, state, or local income taxes. Therefore, no provision for income taxes has been recorded in the accompanying financial statements.

AA. Restatements and Reclassifications

In FY 2010, the Department restated certain FY 2009 balances and made certain reclassifications to FY 2009 balances to conform to FY 2010 presentation. For additional information, see Note 32, Restatements and Note 1. A., Reporting Entity.

2. Non-Entity Assets

Non-entity assets at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited) (Restated)
Intragovernmental:		
Fund Balance with Treasury	$1,327	$1,415
Total Intragovernmental	1,327	1,415
Cash and Other Monetary Assets	8	10
Accounts Receivable, Net	23	17
Taxes, Duties, and Trade Receivables, Net	2,459	1,874
Total Public	2,490	1,901
Total Non-Entity Assets	3,817	3,316
Total Entity Assets	86,280	81,488
Total Assets	**$90,097**	**$84,804**

Non-entity Fund Balance with Treasury consists of certain special and deposit funds, permanent and indefinite appropriations, and miscellaneous receipts that are available to pay non-entity liabilities. Non-entity assets (also discussed in Notes 3, 4, 6, and 7) are offset by non-entity accrued liabilities at September 30, 2010 and 2009. Taxes, duties and trade receivables from the public represent amounts due from importers for goods and merchandise imported to the United States.

3. *Fund Balance with Treasury*

A. Fund Balance with Treasury

Fund Balance with Treasury at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Appropriated Funds	$54,407	$51,844
Trust Funds	573	28
Revolving, Public Enterprise, and Working Capital Funds	851	428
Special Funds	4,264	4,223
Deposit Funds	727	649
Total Fund Balance with Treasury	**$60,822**	**$57,172**

Appropriated funds consist of amounts appropriated annually by Congress to fund the operations of the Department. Appropriated funds include clearing funds totaling $151 million and $(32) million at September 30, 2010 and 2009, respectively (unaudited), which represent reconciling differences with Treasury balances.

Trust funds include both receipt accounts and expenditure accounts that are designated by law as a trust fund. Trust fund receipts are used for specific purposes, in general to offset the cost of expanding border and port enforcement activities and oil spill related claims and activities. For additional information, see Note 22, Earmarked Funds.

Revolving funds are used for continuing cycles of business-like activity, in which the fund charges for the sale of products or services and uses the proceeds to finance its spending, usually without requirement for annual appropriations. A public enterprise revolving fund is an account that is authorized by law to be credited with offsetting collections from the public and those monies are used to finance operations. The Working Capital Fund is a fee-for-service fund established to support operations of Department Components. Also included are the financing funds for credit reform and the National Flood Insurance Fund.

Special funds are funds designated for specific purposes including the disbursement of non-entity monies received in connection with antidumping and countervailing duty orders due to qualifying Injured Domestic Industries (IDI). The Department also has special funds for immigration and naturalization user fees and CBP user fees, as well as inspection fees, flood map modernization subsidy, and off-set and refund transfers. For additional information, see Note 22, Earmarked Funds.

Deposit funds represent amounts received as an advance that are not accompanied by an order and include non-entity collections that do not belong to the Federal Government.

B. Status of Fund Balance with Treasury

The status of Fund Balance with Treasury at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Budgetary Status		
Unobligated Balances:		
Available	$10,195	$7,711
Unavailable	4,993	5,672
Obligated Balance Not Yet Disbursed	46,258	44,721
Total Budgetary Status	61,446	58,104
Reconciling Adjustments:		
Receipt, Clearing, and Deposit Funds	929	712
Borrowing Authority	(1,427)	(1,427)
Investments	(3,436)	(3,375)
Receivable Transfers and Imprest Fund	(317)	(270)
Receipts Unavailable for Obligation	2,117	1,960
Authority Temporarily Precluded from Obligation	46	43
SFRBTF; Oil Spill Liability Trust Fund	1,464	1,425
Total Fund Balance with Treasury	**$60,822**	**$57,172**

Portions of the Unobligated Balances Available, Unavailable, and Obligated Balance Not Yet Disbursed contain CBP's user fees of $715 million and $732 million at September 30, 2010 and 2009, respectively (unaudited), which are restricted by law in its use to offset costs incurred by CBP.

Portions of the Unobligated Balance Unavailable include amounts appropriated in prior fiscal years that are not available to fund new obligations, including expired funds. However, the amounts can be used for upward and downward adjustments for existing obligations in future years. The Obligated Balance Not Yet Disbursed represents amounts designated for payment of goods and services ordered but not received or goods and services received but for which payment has not yet been made.

Since the following line items do not post to budgetary status accounts, certain adjustments are required to reconcile the budgetary status to nonbudgetary Fund Balance with Treasury as reported in the accompanying Balance Sheets:

- Receipt, clearing, and deposit funds represent amounts on deposit with Treasury that have no budget status at September 30, 2010 and 2009.

- Borrowing authority is in budgetary status for use by FEMA for NFIP purposes and community disaster loans, but transfers have not yet been made to the Fund Balance with Treasury account for these purposes.
- Budgetary resources have investments included; however, the money has been moved from the Fund Balance with Treasury asset account to Investments.
- Receivable transfers of currently invested balances increase the budget authority at the time the transfer is realized; however, obligations may be incurred before the actual transfer of funds.
- Imprest funds represent funds moved from Fund Balance with Treasury to Cash and Other Monetary Assets with no change in the budgetary status.
- For receipts unavailable for obligations, authorizing legislation may specify that obligations are not available until a specified time in the future or until specific legal requirements are met.
- Authority temporarily precluded from obligation is offsetting collections that become unavailable for obligation until specific legal requirements are met.
- Sport Fish Restoration Boating Trust Fund (SFRBTF) is a Treasury-managed fund. This fund receives revenues transferred from custodial activities of the Treasury, which are deposited in a Treasury account (see Note 22).

4. Cash and Other Monetary Assets

Cash and Other Monetary Assets at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Cash	$60	$56
Seized Monetary Instruments	1	1
Total Cash and Other Monetary Assets	**$61**	**$57**

DHS cash includes cash held by others, imprest funds, undeposited collections, seized cash deposited, and the net balance maintained by insurance companies for flood insurance premiums received from policyholders. Seized Monetary Instruments are held until disposition. As of September 30, 2010 and 2009, restricted non-entity cash and other monetary assets were $8 million and $10 million, respectively (unaudited).

5. *Investments, Net*

Investments at September 30, 2010, consisted of the following (in millions) (unaudited):

Type of Investment:	Amortization Method	Cost	Amortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value Disclosure
Intragovernmental Securities:						
Oil Spill Liability Trust Fund	Effective interest method	$1,500	$34	$8	$1,542	N/A
Sport Fish Restoration Boating Trust Fund	Effective interest method	1,938	1	1	1,940	N/A
Total Nonmarketable		3,438	35	9	3,482	N/A
Total Investments, Net		**$3,438**	**$35**	**$9**	**$3,482**	**N/A**

Investments at September 30, 2009, consisted of the following (in millions) (unaudited):

Type of Investment:	Amortization Method	Cost	Amortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value Disclosure
Intragovernmental Securities:						
Oil Spill Liability Trust Fund	Effective interest method	$1,396	$36	$ -	$1,432	N/A
Sport Fish Restoration Boating Trust Fund	Effective interest method	1,984	1	-	1,985	N/A
Total Nonmarketable		3,380	37	-	3,417	N/A
Total Investments, Net		**$3,380**	**$37**	**$ -**	**$3,417**	**N/A**

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds (Oil Spill Liability Trust Fund, SFRBTF, and General Gift Fund) for the U.S. Coast Guard. The cash receipts collected from the public for an earmarked fund are deposited in the Treasury, which uses the cash for general Federal Government purposes. Treasury securities are issued to the U.S. Coast Guard as evidence of its receipts. Treasury securities associated with earmarked funds are an asset to the U.S. Coast Guard and a liability to the Treasury.

Treasury securities provide the U.S. Coast Guard with authority to draw upon the Treasury to make future benefit payments or other expenditures. For additional information, see Note 22, Earmarked Funds.

6. Accounts Receivable, Net

Accounts Receivable, Net, at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited) (Restated)
Intragovernmental	**$326**	**$369**
With the Public:		
Accounts Receivable	682	664
Allowance for Doubtful Accounts	(191)	(215)
	491	**449**
Accounts Receivable, Net	**$817**	**$818**

Intragovernmental accounts receivable results from reimbursable work performed by the Department. Accounts receivable with the public consist of amounts due for reimbursable services, aviation security fees due to TSA, receivables related to the Deepwater Horizon oil spill, and other user fees.

7. Taxes, Duties, and Trade Receivables, Net

Taxes, Duties, and Trade Receivables consisted of the following (in millions):

As of September 30, 2010 (Unaudited):

Receivables Category	Gross Receivables	Allowance	Total Net Receivables
Duties	$2,162	$(139)	$2,023
Excise Taxes	121	(6)	115
User Fees	133	4	137
Fines/Penalties	716	(607)	109
Antidumping and Countervailing Duties	641	(566)	75
Refunds and Drawbacks	1	(1)	-
Total Taxes, Duties, and Trade Receivables, Net	**$3,774**	**$(1,315)**	**$2,459**

As of September 30, 2009 (Unaudited):

Receivables Category	Gross Receivables	Allowance	Total Net Receivables
Duties	$1,650	$(146)	$1,504
Excise Taxes	106	(6)	100
User Fees	117	(7)	110
Fines/Penalties	736	(660)	76
Antidumping and Countervailing Duties	497	(413)	84
Total Taxes, Duties, and Trade Receivables, Net	**$3,106**	**$(1,232)**	**$1,874**

When a violation of import/export law is discovered, a fine or penalty is established. CBP assesses a liquidated damage or penalty for these cases to the maximum extent of the law. After receiving the notice of assessment, the importer or surety has a period of time to either file a petition requesting a review of the assessment or pay the assessed amount. Once a petition is received, CBP investigates the circumstances as required by its mitigation guidelines and directives. Until this process has been completed, CBP records an allowance, net of interest, on fines and penalties of approximately 85 percent and 90 percent at September 30, 2010 and 2009, respectively (unaudited) of the total assessment based on historical experience of fines and penalties mitigation and collection. Duties and taxes receivables are non-entity assets for which there is an offsetting liability Due to the General Fund (see Note 18). The increase is primarily due to an escalation in import activity into the United States during FY 2010, which resulted in an increase in receivables related to entry.

8. Direct Loans, Net

DHS's loan program consists of Community Disaster Loans (CDLs) administered by FEMA. CDLs may be authorized to local governments that have suffered a substantial loss of tax and other revenues as a result of a major disaster and have demonstrated a need for financial assistance in order to perform their municipal operating functions.

The loans are made at the current Treasury rate for a term of five years and cannot exceed 25 percent of the annual operating budget of the local government for the fiscal year in which the major disaster occurred. The exception is the Special CDL for Hurricanes Katrina and Rita, where the interest rate on the loan is less than the Treasury rate, and the amount of the loan cannot exceed 50 percent of the annual operating budget of the local government for the fiscal year in which the major disaster occurred. In addition, CDLs may exceed $5 million and may not be cancelled in accordance with the following *Stafford Act* amendments: the *Community Disaster Loan Act of 2005* (Pub. L. 109-88) and the *U.S. Troop Readiness, Veteran's Care, Katrina Recovery, and Iraq Accountability Appropriations Act* (Pub. L. 110-28). Since the 2006 Cohort is still disbursing, the balance remains in the program account to cover costs of undisbursed loans. Disbursements are tracked by cohort as determined by the date of obligation rather than disbursement

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A. Summary of Direct Loans to Non-Federal Borrowers at September 30 (in millions):

	2010 (Unaudited) Loans Receivable, Net	2009 (Unaudited) Loans Receivable, Net
Community Disaster Loans	**$85**	**$55**

An analysis of loans receivable and the nature and amounts of the subsidy and administrative costs associated with the direct loans is provided in the following sections.

B. Direct Loans Obligated After FY 1991 (in millions):

As of September 30, 2010 (Unaudited):	Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
Community Disaster Loans	**$1,074**	**$113**	**$(1,102)**	**$85**

As of September 30, 2009 (Unaudited):	Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
Community Disaster Loans	**$1,041**	**$83**	**$(1,069)**	**$55**

C. Total Amount of Direct Loans Disbursed, Post-1991 (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Community Disaster Loans	**$34**	**$89**

D. Subsidy Expense for Direct Loans by Program and Component (in millions):

Subsidy Expense for New Direct Loans Disbursed as of September 30 (in millions):

Community Disaster Loans	Interest Differential	Defaults and Other	Total
2010 (Unaudited)	$6	$27	**$33**
2009 (Unaudited)	$14	$73	**$87**

Total Direct Loan Subsidy Expense

	2010 (Unaudited)	2009 (Unaudited)
Community Disaster Loans	**$33**	**$87**

E. Direct Loan Subsidy Rates at September 30 (in millions):

The direct loan subsidy rates, by program, are as follows:

	2010 (Unaudited)	2009 (Unaudited)
	Community Disaster Loans	Community Disaster Loans
Interest Subsidy Cost	2.84%	5.04%
Default Costs	- %	- %
Other	90.98%	88.90%

F. Schedule for Reconciling Subsidy Cost Allowance Balances at September 30 (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Beginning balance of the subsidy cost allowance	$1,069	$987
Add subsidy expense for direct loans disbursed during the reporting years by component:		
Interest rate differential costs	6	14
Other subsidy costs	27	73
Adjustments:		
Subsidy allowance amortization	-	-
Ending balance of the subsidy cost allowance before reestimates	1,102	1,074
Add subsidy reestimate by component		
Technical/default reestimate	-	(5)
Ending balance of the subsidy cost allowance	**$1,102**	**$1,069**

G. Administrative Expenses at September 30 (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Community Disaster Loans	**$0.7**	**$0.8**

9. *Inventory and Related Property, Net*

Inventory and Related Property, Net at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited) (Restated)
Operating Materials and Supplies (OM&S)		
Items Held for Use	$315	$253
Items Held for Future Use	31	39
Excess, Obsolete and Unserviceable Items	42	37
Less: Allowance for Losses	(18)	(36)
Total OM&S, Net	**370**	**293**
Inventory		
Inventory Purchased for Resale	71	79
Less: Allowance for Losses	(3)	(2)
Total Inventory, Net	**68**	**77**
Stockpile Materials Held in Reserve	**61**	**65**
Total Inventory and Related Property, Net	**$499**	**$435**

10. Seized and Forfeited Property

Prohibited seized property item counts as of September 30 and seizure and forfeiture activity for FY 2010 and 2009 are as follows:

Seizure Activity						
Fiscal Year Ended September 30, 2010 (Unaudited)						
Seized Property Category:	Beginning Balance	New Seizures	Remissions	New Forfeitures	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	1,163	1,203,104	-	(1,203,504)	1,094	1,857
Cocaine	174	23,955	-	(23,968)	8	169
Heroin	5	4,674	-	(4,673)	2	8
Ecstasy	34	787	-	(786)	(26)	9
Steroids	97	1,331	(812)	(280)	242	578
Firearms and Explosives (in number of items)	1,379	2,259	(1,267)	(763)	(126)	1,482
Counterfeit Currency (US/Foreign, in number of items)	4,198,926	1,631,500	-	-	(1,256,271)	4,574,155

Forfeiture Activity						
Fiscal Year Ended September 30, 2010 (Unaudited)						
Forfeited Property Category:	Beginning Balance	New Forfeitures	Transfers	Destroyed	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	126,052	1,203,504	(543)	(471,500)	(741,488)	116,025
Cocaine	19,037	23,968	(123)	(66,259)	47,978	24,601
Heroin	2,270	4,673	(36)	(1,118)	296	6,085
Ecstasy	1,417	786	(46)	(1,140)	90	1,107
Steroids	39	280	-	(300)	(2)	17
Firearms and Explosives (in number of items)	412	763	(576)	(1)	49	647

Seizure Activity						
Fiscal Year Ended September 30, 2009 (Unaudited)						
Seized Property Category:	Beginning Balance	New Seizures	Remissions	New Forfeitures	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	1,037	1,062,594	-	(1,065,252)	2,784	1,163
Cocaine	215	26,012	-	(26,428)	375	174
Heroin	8	1,556	-	(1,558)	(1)	5
Ecstasy	33	1,147	-	(1,146)	-	34
Steroids	145	326	-	(364)	(10)	97
Firearms and Explosives (in number of items)	873	1,651	(303)	(784)	(58)	1,379
Counterfeit Currency (US/Foreign, in number of items)	3,676,346	1,574,547	-	-	(1,051,967)	4,198,926

Forfeiture Activity						
Fiscal Year Ended September 30, 2009 (Unaudited)						
Forfeited Property Category:	Beginning Balance	New Forfeitures	Transfers	Destroyed	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	116,600	1,065,252	(1,833)	(525,453)	(528,514)	126,052
Cocaine	35,374	26,428	(212)	(24,057)	(18,496)	19,037
Heroin	7,066	1,558	(48)	(1,374)	(4,932)	2,270
Ecstasy	1,575	1,146	-	(1,145)	(159)	1,417
Steroids	42	364	-	(368)	1	39
Firearms and Explosives (in number of items)	408	784	(773)	(7)	-	412

This schedule is presented only for material prohibited (nonvalued) seized and forfeited property. These items are retained and ultimately destroyed by CBP and USSS and are not transferred to the U.S. Departments of Treasury or Justice Asset Forfeiture Funds or other Federal agencies. The ending balance for firearms includes only those seized items that can actually be used as firearms. Illegal drugs are presented in kilograms, and a portion of the weight includes packaging, which often cannot be reasonably separated from the weight of the drugs since the packaging must be maintained for evidentiary purposes. The adjustments are caused by changes during the year to the beginning balances of cases. Also, a prior year case can change legal status or property type. For example, a case considered forfeited could be re-opened and changed to seized status or a drug property type may change on a case.

The U.S. Coast Guard and ICE also seize and take temporary possession of small boats, equipment, firearms, contraband, and other illegal drugs. The U.S. Coast Guard and ICE usually dispose of these properties within three days by destroying it or by transfer to CBP (who transfers the proceeds from the sale of nonprohibited seized property to the Treasury Forfeiture Fund); the Drug Enforcement Administration; other Federal, state and local law enforcement agencies; or foreign governments. Seized property in U.S. Coast Guard and ICE possession at year-end is not considered material and therefore is not itemized and is not reported in the financial statements of the Department.

11. General Property, Plant, and Equipment, Net

General Property, Plant, and Equipment (PP&E) consisted of the following (in millions):

As of September 30, 2010 (Unaudited):	Service Life	Gross Cost	Accumulated Depreciation/ Amortization	Total Net Book Value
Land and Land Rights	N/A	$191	N/A	$191
Improvements to Land	2-40 yrs	1,800	177	1,623
Construction in Progress	N/A	4,782	N/A	4,782
Buildings, Other Structures and Facilities	6-40 yrs	5,279	2,499	2,780
Equipment:				
Automated Data Processing Equipment	5 yrs	453	322	131
Aircraft	12-35 yrs	5,373	2,697	2,676
Vessels	5-74 yrs	6,052	2,963	3,089
Vehicles	3-8 yrs	862	573	289
Other Equipment	2-30 yrs	5,688	3,627	2,061
Assets Under Capital Lease	2-40 yrs	69	26	43
Leasehold Improvements	2-40 yrs	761	297	464
Internal Use Software	2-7 yrs	2,077	1,606	471
Internal Use Software - in Development	N/A	474	N/A	474
Total General Property, Plant, and Equipment, Net		**$33,861**	**$14,787**	**$19,074**

As of September 30, 2009 (Unaudited) (Restated):	Service Life	Gross Cost	Accumulated Depreciation/ Amortization	Total Net Book Value
Land and Land Rights	N/A	$177	N/A	$177
Improvements to Land	2-40 yrs	1,256	90	1,166
Construction in Progress	N/A	5,964	N/A	5,964
Buildings, Other Structures and Facilities	6-40 yrs	4,817	2,341	2,476
Equipment:				
Automated Data Processing Equipment	5 yrs	419	272	147
Aircraft	12-35 yrs	3,478	1,828	1,650
Vessels	5-74 yrs	5,255	2,643	2,612
Vehicles	3-8 yrs	826	538	288
Other Equipment	2-30 yrs	5,275	3,346	1,929
Assets Under Capital Lease	2-40 yrs	79	32	47
Leasehold Improvements	2-40 yrs	620	182	438
Internal Use Software	2-7 yrs	1,671	1,380	291
Internal Use Software - in Development	N/A	512	N/A	512
Total General Property, Plant, and Equipment, Net		**$30,349**	**$12,652**	**$17,697**

12. Stewardship Property, Plant, and Equipment

DHS's Stewardship PP&E is comprised of U.S. Coast Guard, CBP, USCIS, TSA, and FEMA heritage assets located in the United States, including the Commonwealth of Puerto Rico. Physical unit information related to heritage assets as of September 30 consisted of the following (in number of units):

2010 (Unaudited)	Beginning Balance	Additions	Withdrawals	Total
Collection-type Assets				
USCG	19,768	207	(423)	19,552
CBP	2	-	-	2
USCIS	5	-	-	5
TSA	3	-	-	3
Non-collection-type Assets				
USCG	60	-	-	60
Multi-use Heritage Assets				
USCG	784	-	(20)	764
CBP	4	-	-	4
FEMA	1	-	-	1
Total Stewardship Property, Plant and Equipment	**20,627**	**207**	**(443)**	**20,391**

2009 (Unaudited) (Restated)	Beginning Balance	Additions	Withdrawals	Total
Collection-type Assets				
USCG	19,607	281	(120)	19,768
CBP	2	-	-	2
USCIS	5	-	-	5
TSA	3	-	-	3
Non-collection-type Assets				
USCG	60	-	-	60
Multi-use Heritage Assets				
USCG	796	-	(12)	784
CBP	4	-	-	4
FEMA	1	-	-	1
Total Stewardship Property, Plant and Equipment	**20,478**	**281**	**(132)**	**20,627**

The Department's Stewardship PP&E primarily consists of U.S. Coast Guard's heritage assets, which are unique due to historical, cultural, artistic, or architectural significance. These assets are used to preserve and to provide education on U.S. Coast Guard history and tradition.

The U.S. Coast Guard possesses a wide range of heritage assets, such as ship's equipment, lighthouse and other aids-to-navigation/communication items, military uniforms, ordnance, artwork, and display models. Historical artifacts are also gifted to the U.S. Coast Guard. Withdrawals occur when items have deteriorated through damage due to moving and transportation, storage or display, or environmental degradation. Withdrawals are also made when the U.S. Coast Guard curatorial staff, in conjunction with the U.S. Coast Guard historian, determines that an artifact does not meet the needs of the collection. U.S. Coast Guard collectible heritage assets can be categorized as follows:

- Artifacts include ship's equipment (sextants, bells, binnacles, etc.); decommissioned aids-to-navigation and communication equipment (buoy bells, lighthouse lenses, lanterns, etc.); personal-use items (uniforms and related accessories); and ordnance (cannons, rifles, and Lyle guns).
- Artwork consists of the U.S. Coast Guard's collection of World War II combat art as well as modern art depicting both historical and modern U.S. Coast Guard activities.
- Display models are mostly of U.S. Coast Guard vessels and aircraft. These are often builders' models acquired by the U.S. Coast Guard as part of the contracts with the ship or aircraft builders.

U.S. Coast Guard non-collection type heritage assets include sunken vessels and aircraft, as stipulated in the property clause of the U.S. Constitution, Articles 95 and 96 of the *International Law of the Sea Convention, Sunken Military Craft Act*, and the sovereign immunity provisions of Admiralty law. Despite the passage of time or the physical condition of these assets, they remain Government-owned until the Congress of the United States formally declares them abandoned. The U.S. Coast Guard desires to retain custody of these assets to safeguard the remains of crew members lost at sea, to prevent the unauthorized handling of explosives or ordnance that may be aboard, and to preserve culturally valuable artifacts of the U.S. Coast Guard.

U.S. Coast Guard's real property heritage assets are used in operations. Some examples are historic lighthouses and buildings still in use.

CBP possesses a wide range of documents and artifacts that are unique due to historical, cultural, artistic, or architectural significance. CBP aggregates its personal property heritage assets as documents and artifacts and reflects its real property as a number of physical units. These assets are used to preserve and to educate about CBP's history and tradition. Documents consist of dated tariff classifications, CBP regulations, ledgers of Collectors of Customs, and Customs pamphlets. Artifacts include antique scales, dated pictures of Customs inspectors, aged tools used to sample imported commodities such as wood bales and bulk grain, and dated Customs uniforms, badges, and stamps. In addition, CBP has four multi-use heritage assets located in Puerto Rico, which consist of customs houses that facilitate the collection of revenue for the Department.

USCIS stewardship assets consist of an archive of five different types of immigration and naturalization files that can be used to trace family lineages. USCIS has established a Genealogy Program to allow the public access to the records on a fee-for-service basis. Archived records available through the Genealogy Program include: naturalization certificate files, alien registration forms, visa files, registry files, alien files numbered below eight million, and documents dated prior to May 1951.

TSA possesses architectural or building artifacts that include concrete pieces that belonged to western wall of the Pentagon, subway rails from the Port Authority Trans-Hudson subway station located below the World Trade Center, and the steel facade from the exterior of one of the World Trade Center Towers that were destroyed by the terrorist attacks of September 11, 2001. As the lead agency protecting the Nation's transportation systems to ensure freedom of movement for people and commerce, TSA uses this property for the purpose of educating individuals about its history, mission, values, and culture.

FEMA has one multi-use heritage asset, the National Fire Academy, which is used by the U.S. Fire Administration for training in Emmitsburg, Maryland. The National Fire Academy develops, delivers, and manages educational and training programs to support the DHS and FEMA goals to help state and local response agencies prevent, mitigate, prepare for, and respond to local, regional, and national emergencies.

When heritage assets are functioning in operational status, the U.S. Coast Guard classifies these as multi-use heritage assets in accordance with SFFAS No. 6, *Accounting for Property, Plant and Equipment*. All multi-use heritage assets are reflected on the Balance Sheet as general PP&E and are depreciated over their useful life. Deferred maintenance and condition information for heritage assets and general PP&E are presented in the required supplementary information. When multi-use heritage assets are no longer needed for operational purposes, they are reclassified as heritage assets, where most are transferred to other Government agencies or public entities.

13. Other Assets

Other Assets at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Intragovernmental:		
Advances and Prepayments	$2,225	$2,688
Total Intragovernmental	**2,225**	**2,688**
Public:		
Advances and Prepayments	573	591
Total Public	**573**	**591**
Total Other Assets	**$2,798**	**$3,279**

Intragovernmental Advances and Prepayments primarily consist of FEMA's Disaster Relief Fund disaster assistance advances to other Federal agencies (principally the U.S. Department of Transportation) responsible for restoration efforts of the New York City region transportation system.

The Department provides advance funds to public grant recipients to incur expenses related to the approved grant. Advances are made within the amount of the total grant obligation.

14. Liabilities Not Covered by Budgetary Resources

Liabilities Not Covered by Budgetary Resources at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited) (Restated)
Intragovernmental:		
Debt (Note 15)	$18,276	$18,525
Due to the General Fund (Note 18)	2,475	1,969
Accrued FECA Liability (Note 18)	374	370
Other	34	73
Total Intragovernmental	21,159	20,937
Public:		
Federal Employee and Veterans' Benefits:		
Actuarial FECA Liability (Note 16)	1,938	1,826
Military Service and Other Retirement Benefits (Note 16)	46,379	37,599
Environmental and Disposal Liabilities (Note 17)	1,018	987
Other:		
Accrued Payroll and Benefits (Note 18)	1,168	1,065
Insurance Liabilities (Note 20)	482	508
Contingent Legal Liabilities (Note 21)	540	242
Capital Lease Liability (Note 19)	51	71
Other	91	7
Total Public	51,667	42,305
Total Liabilities Not Covered by Budgetary Resources	72,826	63,242
Liabilities Covered by Budgetary Resources	10,770	11,260
Total Liabilities	**$83,596**	**$74,502**

The Department anticipates that the liabilities listed above will be funded from future budgetary resources when required, except for Due to the General Fund, which is funded by future custodial collections. Effective with FY 2010 reporting, Due to the Treasury General Fund is reported as a liability not covered by budgetary resources. FY 2009 information was reclassified to also report Due to the Treasury General Fund as a liability not covered by budgetary resources.

15. Debt

Debt at September 30 consisted of the following (in millions):

As of September 30, 2010 (Unaudited)	Beginning Balance	Net Borrowing	Ending Balance
Debt to the Treasury General Fund:			
Debt for the NFIP	$19,000	$(499)	$18,501
Debt for Credit Reform	4	-	4
Total Debt to the Treasury General Fund	$19,004	$(499)	$18,505
Total Debt	**$19,004**	**$(499)**	**$18,505**

As of September 30, 2009 (Unaudited)	Beginning Balance	Net Borrowing	Ending Balance
Debt to the Treasury General Fund:			
Debt for the NFIP	$17,719	$1,281	$19,000
Debt for Credit Reform	-	4	4
Total Debt to the Treasury General Fund	$17,719	$1,285	$19,004
Total Debt	**$17,719**	**$1,285**	**$19,004**

DHS's intragovernmental debt is owed to Treasury's Bureau of Public Debt (BPD) and consists of borrowings to finance claims under NFIP and borrowings to finance FEMA's credit reform programs (Disaster Assistance Direct Loan Program). The decrease in debt is attributable to FEMA repayments of their NFIP loan during FY 2010.

NFIP loans from Treasury are typically for a three-year term. Interest rates are obtained from the BPD and range by cohort year from 0.38 percent to 4.75 percent (unaudited) as of September 30, 2010, and from 0.13 percent to 4.75 percent (unaudited) as of September 30, 2009. Interest is paid semi-annually on October 1 and April 1. Interest is accrued based on the loan balances reported by BPD. Principal repayments are required only at maturity but are permitted any time during the term of the loan. Flood premiums from policy holders and map collection fees are intended to repay loan principal and interest payments due to Treasury; however, due to the size of the debt incurred for damages sustained for Hurricanes Katrina and Rita, premiums received are only sufficient to cover the interest payments. Congress will need to enact legislation to provide funding to repay the Treasury Department or to forgive the debt.

Under Credit Reform, the unsubsidized portion of direct loans is borrowed from the Treasury. The repayment terms of FEMA's borrowing from Treasury are based on the life of each cohort of direct loans. Proceeds from collections of principal and interest from the borrowers are used to repay the Treasury. In addition, an annual reestimate is performed to determine any change from the original subsidy rate. If an upward reestimate is determined to be necessary, these funds are available through permanent indefinite authority, which is to be approved by OMB. Once these funds are appropriated, the original borrowings are repaid to Treasury. The weighted average interest rates for FY 2010 and FY 2009 were 2.76 percent and 4.75 percent (unaudited), respectively.

16. Federal Employee and Veterans' Benefits

Accrued liability for military service and other retirement and employment benefits at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited) (Restated)
U.S. Coast Guard Military Retirement and Healthcare Benefits	$42,476	$33,761
USSS DC Pension Plan Benefits	3,833	3,769
U.S. Coast Guard Post-Employment Military Travel Benefits and Other	70	69
Actuarial FECA Liability	1,938	1,826
Total Federal Employee and Veterans' Benefits	**$48,317**	**$39,425**

A. Reconciliation of Beginning and Ending Liability Balances for Pensions, ORB, and OPEB

The reconciliation of beginning and ending liability balances for pensions, ORB, and OPEB for the year ended September 30, 2010 consisted of the following (in millions) (unaudited):

	USCG Defined Benefit Plan	USCG Post-Retirement Healthcare	USSS Defined Benefit Plan	Total
Beginning Liability Balance:	$26,801	$6,960	$3,770	$37,531
Expenses:				
Normal Cost	1,189	528	244	1,961
Interest on the Liability Balance	1,555	392	-	1,947
Actuarial Losses/(Gains):				
From Experience	626	(80)	63	609
From Assumption Changes	4,557	1,118	-	5,675
Other	113	-	(1)	112
Total Expense	8,040	1,958	306	10,304
Less Amounts Paid	1,080	203	243	1,526
Ending Liability Balance	**$33,761**	**$8,715**	**$3,833**	**$46,309**

B. U.S. Coast Guard Military Retirement and Healthcare Benefits

The components of the MRS expense for the year ended September 30, 2009 consisted of the following (in millions):

Defined Benefit Plan:	2009 (Unaudited) (Restated)
Normal Cost	$731
Interest on the Liability	1,584
Actuarial Losses/(Gains)	642
Actuarial Assumption Change	(264)
Total Defined Benefit Plan Expense	**$2,693**
Post-retirement Healthcare:	
Normal Cost	$333
Interest on the Liability	395
Other Actuarial (Gains)/Losses	1,507
Actuarial Assumption Change	(232)
Total Post-retirement Healthcare Expense	**2,003**
Total MRS Expense	**$4,696**

U.S. Coast Guard. The U.S. Coast Guard's military service members (both current active duty and reserve duty) participate in the MRS. The U.S. Coast Guard receives an annual "Retired Pay" appropriation to fund MRS benefits. The retirement system allows voluntary retirement for active members upon credit of at least 20 years of active service at any age. Reserve members may retire after 20 years of creditable service with benefits beginning at age 60. Reserve members may retire earlier if they perform certain active service after January 1, 2008. The U.S. Coast Guard's Military Health Services System (Health Services Plan) is a post-retirement medical benefit plan that covers all current active duty and reserve members of the U.S. Coast Guard.

The accrued Military Health Services System liability is for the health care of non-Medicare eligible retirees and beneficiaries. Effective October 1, 2002, the U.S. Coast Guard transferred its liability for the health care of Medicare eligible retirees/beneficiaries to the DOD MERHCF, which was established to finance the health care benefits for the Medicare-eligible beneficiaries of all DOD and non-DOD uniformed services.

The unfunded accrued liability, presented as a component of the liability for military service and other retirement benefits in the accompanying Balance Sheet, represents both retired pay and health care benefits for non-Medicare eligible retirees/survivors. The present value of future benefits is the actuarial present value of the future payments that are expected to be paid under the retirement plan's provisions. Credited service is the years of service from active duty base date (or constructive date in the case of active duty reservists) to date of retirement measured in years and completed months. The present value of future benefits is then converted to an accrued liability by subtracting the present value of future employer/employee normal contributions. U.S. Coast Guard plan participants may retire after 20 years of active service at any age with annual benefits equal to 2.5 percent of retired base pay for each year of credited service. Personnel who became members after August 1, 1986, may elect to receive a $30,000 lump sum bonus after 15 years of service and reduced benefits prior to age 62. Annual disability is equal to the retired pay base multiplied by the larger of 2.5 percent times years of service or the percentage of member disability. If a U.S. Coast Guard member is disabled, the member is entitled to disability benefits, assuming the disability is at least 30 percent (under a standard schedule of rating disabilities by Veterans Affairs) and either the member has one month and one day of service; the disability results from active duty; or the disability occurred in the line of duty during a time of war or national emergency or certain other time periods.

The significant actuarial assumptions used to compute the accrued pension and healthcare liability are as follows:

- life expectancy and expected future service are based upon the DOD decrement (mortality, disability, withdrawal, and retirement) tables, as adjusted to reflect actual U.S. Coast Guard experience;
- DOD decrement tables are only used for mortality. Disability, withdrawal, and retirement tables were developed based on actual U.S. Coast Guard experience study of 9/30/2009;
- cost of living increases are 3.0 percent annually (only for the retirement plan);
- healthcare cost increase assumptions are based on the annual liability report provided by DOD and vary, depending on the year and type of care;
- annual rate of investment return is 5.75 percent; and
- the discount rate of 5.75 percent (not the same as an annual rate of return, a concept that only applies to the funded plan) was in effect prior to the current valuation; however, the current valuations determined in accordance with SFFAS No. 33 are slightly different for each plan, with the retirement plan being 4.75 percent and the health care plan being 4.65 percent.

The increase in Federal employee and veteran's benefit liability is due to the U.S. Coast Guard changing the assumptions used to calculate the Retired Pay and Military Care Actuarial liability.

U.S. Secret Service. Special agents and other USSS personnel in certain job series hired as civilians before January 1, 1984, are eligible to transfer to the District of Columbia Police and Fireman's Retirement System (DC Pension Plan) after completion of ten years of Secret Service employment and ten years of protection-related experience. All uniformed USSS officers who were hired before January 1, 1984, are automatically covered under this retirement system. Participants in the DC Pension Plan make contributions of 7 percent of base pay with no matching contribution made by USSS. Annuitants of this plan receive benefit payments directly from the DC Pension Plan. USSS reimburses the District of Columbia for the difference between benefits provided to the annuitants and payroll contributions received from current employees. This liability is presented as a component of the liability for military service and other retirement benefits in the accompanying Balance Sheet. SFFAS No. 5 requires the administrative entity (administrator) to report the actuarial liability. However, USSS records a liability because the administrator (the DC Pension Plan) is not a Federal entity and as such the liability for future funding would not otherwise be recorded in the Government-wide consolidated financial statements.

The primary actuarial assumptions used to determine the liability at September 30, 2010, are:

- life expectancy is based upon the RP 2000 Combined Healthy Mortality Table;
- cost of living increases are 3.5 percent annually;
- rates of salary increases are 3.5 percent annually;
- annual rate of investment return is 7.25 percent; and
- rates of withdrawal for active service by gender and age.

Total expenses related to the DC Pension Plan for the fiscal years ended September 30, 2010 and 2009, were $244 million and $237 million, respectively (unaudited).

C. Actuarial FECA Liability

The actuarial FECA liability represents the estimated liability for future workers' compensation and includes the expected liability for death, disability, medical, and miscellaneous costs for approved cases. Future workers' compensation estimates for the future cost of approved compensation cases, which are generated from an application of actuarial procedures developed by DOL, were approximately $1,938 million and $1,826 million at September 30, 2010 and 2009, respectively (unaudited).

17. Environmental and Disposal Liabilities

Environmental and disposal liabilities at September 30, 2010 and 2009, are $1,061 million and $1,012 million, respectively (unaudited and restated). The Department is responsible for remediating its sites with environmental contamination and is party to various administrative proceedings, legal actions, and tort claims that may result in settlements or decisions adverse to the Federal Government. The source of remediation requirements to determine the environmental liability is based on compliance with Federal, state, or local environmental laws and regulations. The major Federal laws covering environmental response, cleanup, and monitoring are the *Comprehensive Environmental Response, Compensation and Liability Act* (Pub. L. 96-510) and the *Resource Conservation and Recovery Act* (Pub. L. 94-580).

The U.S. Coast Guard completed a study of its lighthouses in FY 2009, identifying from various historical lists of lighthouses with potential liability. Based on this study, the U.S. Coast Guard created a cost methodology for estimating cleanup cost for various categories of lighthouse environmental liability. A total of 1,539 lighthouses were confirmed and recorded as a probable environmental and disposal liability of $794 million (unaudited) for FY 2010.

In accordance with the *Consolidated Security, Disaster Assistance, and Continuing Appropriations Act, 2009* (Pub. L. 110-329), the Secretary of Homeland Security has directed the administrator of GSA to sell through public sale all real and related personal property and transportation assets that support the Plum Island Animal Disease Center operations. The probable environmental remediation cost of the center is recognized as $8 million (unaudited) for S&T. In addition, the

Facility Closure and Transition Study indicates a reasonably possible range of liability of approximately $8 million to $30 million (unaudited).

The Department's remaining environmental liabilities are due to light stations, fuel storage tanks, underground storage tanks, buildings containing asbestos and/or lead-based paint, firing ranges, fuels, solvents, industrial chemicals, and other environmental cleanup associated with normal operations of CBP, FLETC, TSA, the U.S. Coast Guard, FEMA and S&T.

The Department has an unrecognized environmental liability of $98 million (unaudited) as of September 30, 2010, and $93 million (unaudited) for September 30, 2009, for U.S. Coast Guard vessels that have a reasonable possibility of being converted into marine artificial reefs; however, decisions on these conversions have not occurred. The preparation process includes the removal of all grease and buoyant material that might be harmful to the marine environment.

Cost estimates for environmental and disposal liabilities are subject to revision as a result of changes in inflation, technology, environmental laws and regulations, and plans for disposal.

18. Other Liabilities

Other Liabilities at September 30 consisted of the following (in millions):

As of September 30, 2010 (Unaudited)	Current	Non-Current	Total
Intragovernmental:			
Due to the General Fund (Note 2)	$2,475	$ -	$2,475
Accrued FECA Liability	165	209	374
Advances from Others	216	-	216
Employer Benefits Contributions and Payroll Taxes	237	-	237
Other Intragovernmental Liabilities	46	2	48
Total Intragovernmental Other Liabilities	**$3,139**	**$211**	**$3,350**
Public:			
Accrued Payroll and Benefits (See B. below)	$2,217	$ -	$2,217
Deferred Revenue and Advances from Others (See B. below)	1,941	709	2,650
Unliquidated Antidumping and Countervailing Duties (Notes 3, and 7)	127	-	127
Insurance Liabilities (Note 20)	401	81	482
Refunds and Drawbacks	129	-	129
Contingent Legal Liabilities (Note 21)	693	34	727
Capital Lease Liability (Note 19)	6	45	51
Other	1,225	10	1,235
Total Other Liabilities with the Public	**6,739**	**879**	**7,618**
Total Other Liabilities	**$9,878**	**$1,090**	**$10,968**

As of September 30, 2009 (Unaudited) (Restated)	Current	Non-Current	Total
Intragovernmental:			
Due to the General Fund (Note 2)	$1,969	$ -	$1,969
Accrued FECA Liability	76	294	370
Advances from Others	447	-	447
Employer Benefits Contributions and Payroll Taxes	190	1	191
Other Intragovernmental Liabilities	17	65	82
Total Intragovernmental Other Liabilities	**$2,699**	**$360**	**$3,059**

Public:			
Accrued Payroll and Benefits (See B. below)	$1,936	$ -	$1,936
Deferred Revenue and Advances from Others (See B. below)	1,405	1,224	2,629
Unliquidated Antidumping and Countervailing Duties (Notes 3 and 7)	106	-	106
Insurance Liabilities (Note 20)	175	333	508
Refunds and Drawbacks	126	-	126
Contingent Legal Liabilities (Note 21)	469	20	489
Capital Lease Liability (Note 19)	23	48	71
Other	1,158	7	1,165
Total Other Liabilities with the Public	**$5,398**	**$1,632**	**$7,030**
Total Other Liabilities	**$8,097**	**$1,992**	**$10,089**

A. Intragovernmental Other Liabilities

Due to the General Fund. Amounts due to the Treasury General Fund represent duty, tax, and fees collected by CBP to be remitted to various General Fund accounts maintained by Treasury.

Workers' Compensation. Claims incurred for the benefit of Department employees under FECA are administered by DOL and are ultimately paid by the Department. The accrued FECA liability represents money owed for current claims. Reimbursement to DOL for payments made occurs approximately two years subsequent to the actual disbursement. Budgetary resources for this intragovernmental liability are made available to the Department as part of its annual appropriation from Congress in the year in which the reimbursement takes place. Workers' compensation expense was $165 million and $161 million, respectively (unaudited), for the fiscal years ended September 30, 2010 and 2009.

B. Other Liabilities with the Public

Accrued Payroll and Benefits. Accrued Payroll and Benefits at September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Accrued Funded Payroll and Benefits	$967	$841
Accrued Unfunded Leave	1,155	1,047
Unfunded Employment Related Liabilities	13	18
Other	82	30
Total Accrued Payroll and Benefits	**$2,217**	**$1,936**

Deferred Revenue and Advances from Others. Deferred Revenue and Advances From Others for the periods ended September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
USCIS Application Fees	$711	$781
FEMA Unearned NFIP Premium	1,911	1,837
Advances from Others	28	11
Total Deferred Revenue	**$2,650**	**$2,629**

USCIS requires payments of fees for applications or petitions for immigration and naturalization benefits at the time of filing. FEMA's deferred revenue relates to unearned NFIP premiums recognized over the term of the period of insurance coverage.

Unliquidated Antidumping and Countervailing Duties and Injured Domestic Industries. The *Continued Dumping and Subsidy Offset Act (CDSOA) of 2000* (Pub. L. 106-387, Title X), enacted in FY 2001, calls for CBP to collect and disburse monies received in connection with antidumping and countervailing duty orders and findings to qualifying IDI. Antidumping duties are collected when it is determined that a class or kind of foreign merchandise is being released into the U.S. economy at less than its fair value to the detriment of a U.S. industry. Countervailing duties are collected when it is determined that a foreign government is providing a subsidy to its local industries to manufacture, produce, or export a class or kind of merchandise for import into the U.S. commerce to the detriment of a U.S. industry. Due to the repeal of CDSOA in the Deficit Reduction Omnibus Reconciliation Act of 2005, only duties collected prior to October 1, 2007, will eventually be distributed to affected U.S. companies, pursuant to rulings by the U.S. Department of Commerce (DOC).

Other Liabilities. Other public liabilities consist primarily of deposit and suspense fund liability.

19. Leases

A. Operating Leases

The Department leases various facilities and equipment under leases accounted for as operating leases. Leased items consist of offices, warehouses, vehicles, and other equipment. The majority of office space occupied by the Department is either owned by the Federal Government or is leased by GSA from commercial sources. The Department is not committed to continue paying rent to GSA beyond the period occupied, providing that proper advance notice to GSA is made and unless the space occupied is designated as unique to Department operations. However, it is expected the Department will continue to occupy and lease office space from GSA in future years, and lease charges will be adjusted annually to reflect operating costs incurred by GSA.

As of September 30, 2010, estimated future minimum lease commitments under operating leases, which are non-cancelable, for equipment and GSA controlled leases were as follows (in millions) (unaudited):

	Land and Buildings	Vehicles and Equipment	Total
FY 2011	$207	$1	$208
FY 2012	201	1	202
FY 2013	190	1	191
FY 2014	166	1	167
FY 2015	147	-	147
After FY 2015	421	-	421
Total Future Minimum Lease Payments	**$1,332**	**$4**	**$1,336**

The estimated future lease payments for operating leases are based on lease contract terms considering payments made during the year ended September 30, 2010.

B. Capital Leases

The Department maintains capital leases for buildings and commercial software license agreements. The liabilities associated with capital leases and software license agreements are presented as other liabilities in the accompanying financial statements based upon the present value of the future minimum lease payments.

Certain license agreements are cancelable depending on future funding. Substantially all of the net present value of capital lease obligations and software license agreements will be funded from future sources. As of September 30, the summary of assets under capital lease was as follows (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Land and Buildings	$69	$69
Vehicles and Equipment	-	10
Software	116	152
Accumulated Amortization	(142)	(160)
Assets under Capital Lease, Net	**$43**	**$71**

As of September 30, 2010, estimated future minimum lease payments under capital leases, which were all non-GSA, were as follows (in millions) (unaudited):

	Land and Buildings
FY 2011	$6
FY 2012	6
FY 2013	6
FY 2014	6
FY 2015	6
After FY 2015	46
Total Future Minimum Lease Payments	76
Less: Imputed Interest and Executory Costs	25
Total Capital Lease Liability	**$51**

20. Insurance Liabilities

Insurance liabilities for the periods ended September 30, 2010 and 2009, were $482 million and $508 million, respectively (unaudited), and consist primarily of NFIP insurance liabilities.

The insurance liability for unpaid losses and related loss adjustment expenses and amounts paid for the year ended September 30 consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Beginning Balance	$508	$5,531
Change in Incurred Losses	1,132	(1,825)
Less: Amounts Paid During Current Period	(1,158)	(3,198)
Total Insurance Liability	**$482**	**$508**

The NFIP insurance liability, the majority of the insurance liability reported, represents an estimate of NFIP based on the loss and loss adjustment expense factors inherent in the NFIP insurance underwriting operations experience and expectations. Estimation factors used by the insurance underwriting operations reflect current case basis estimates and give effect to estimates of trends in claim severity and frequency. These estimates are periodically reviewed, and adjustments, reflected in current operations, are made as deemed necessary.

21. *Commitments and Contingent Liabilities*

A. Legal Contingent Liabilities

The Department is a party in various administrative proceedings, legal actions, and tort claims that may ultimately result in settlements or decisions adverse to the Federal Government. These contingent liabilities arise in the normal course of operations, and their ultimate disposition is unknown.

In the opinion of the Department's management and legal counsel, based on information currently available, the expected outcome of legal actions, individually or in the aggregate, will not have a materially adverse effect on the Department's financial statements, except for the legal actions described below (in millions).

		Estimated Range of Loss	
	Accrued Liabilities	Lower End	Upper End
FY 2010			
Probable	$727	$727	$1,140
Reasonably Possible		$100,431	$101,424

The claims above relate to the *Federal Tort Claims Act* (Pub. L. 79-601), Oil Spill Liability Trust Fund, and various customs laws and regulations. The estimated contingent liability recorded in the accompanying financial statements included with other liabilities for all probable and reasonably estimable litigation-related claims at September 30, 2010, was $727 million (unaudited), of which $187 million (unaudited) was funded.

Asserted and pending legal claims for which loss was reasonably possible is estimated to range from $100 billion (unaudited) to $101 billion (unaudited) at September 30, 2010. This is mainly due to the claim related to FEMA formaldehyde contamination in trailers where the plaintiffs seek to recover damages for personal injuries allegedly resulting from exposure to formaldehyde while residing in temporary emergency housing units.

As of September 30, 2010, legal claims exist for which the potential range of loss could not be determined; however, the total amount claimed is not material to the financial statements. In addition, other claims exist for which the amount claimed and the potential range of loss could not be determined.

B. Duty and Trade Refunds

There are various trade-related matters that fall under the jurisdiction of other Federal agencies, such as the DOC, which may result in refunds of duties, taxes, and fees collected by CBP. Until a decision is reached by the other Federal agencies, CBP does not have sufficient information to estimate a contingent liability amount, if any, for trade-related refunds under jurisdiction of other Federal agencies in addition to the amount accrued on the accompanying financial statements. All known duty and trade refunds as of September 30, 2010 and 2009, have been recorded.

C. Loaned Aircraft and Equipment

The Department is generally liable to DOD for damage or loss to aircraft on loan to CBP and vessels on loan to the U.S. Coast Guard. As of September 30, 2010 and 2009, CBP had 17 aircraft loaned from DOD with a replacement value of up to $25 million (unaudited) per aircraft. As of September 30, 2010, the U.S. Coast Guard had seven vessels on loan from DOD with a replacement value of $84 million (unaudited).

D. Other Contractual Arrangements

In addition to future lease commitments disclosed in Note 19, the Department is committed under contractual agreements for goods and services that have been ordered but not yet received (undelivered orders) at fiscal year-end. Aggregate undelivered orders for all Department activities are disclosed in Note 30. In accordance with the *National Defense Authorization Act for Fiscal Year 1991* (Pub. L. 101-510), the Department is required to automatically cancel obligated and unobligated balances of appropriated funds five years after a fund expires. Obligations that have not been paid at the time an appropriation is cancelled may be paid from an unexpired appropriation that is available for the same general purpose. As of September 30, 2010, DHS estimates total payments related to cancelled appropriations to be $146 million (unaudited), of which $72 million (unaudited) for contractual arrangements may require future funding.

TSA entered into a number of *Letters of Intent for Modifications to Airport Facilities* with 11 major airports in which TSA may reimburse the airports for 90 percent (estimated total of $1.5 billion (unaudited)) of the costs to modify the facilities for security purposes. These letters of intent would not obligate TSA until funds have been appropriated and obligated. TSA received $200 million in both FY 2010 and FY 2009 (unaudited) under this program. These funds are available for payment to the airports upon approval by TSA of an invoice for the modification costs incurred. As of September 30, 2010, TSA has received invoices or documentation for costs incurred totaling $13 million (unaudited) for the invoices that have not yet been paid.

22. Earmarked Funds

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources that remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities or purposes. SFFAS No. 27, *Identifying and Reporting Earmarked Funds*, defines the following three critieria for determining an earmarked fund: 1) a statute committing the Federal Government to use specifically identifed revenues and other financing sources only for designated activities, benefits, or purposes; 2) explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and 3) a requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguished the earmarked fund from the Federal Government's general revenues.

There are no transactions between earmarked funds that require elimination in consolidation. Earmarked funds consisted of the following (in millions) (unaudited):

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	Oil Spill Liability Trust Fund	All Other Earmarked Funds	Total Earmarked Funds
Balance Sheet as of September 30, 2010							
ASSETS							
Fund Balance with Treasury	$715	$(3)	$1,533	$714	$566	$1,536	$5,061
Investments, Net	-	1,940	-	-	1,542	-	3,482
Accounts Receivable	93	140	4	4	195	60	496
Taxes Receivable	81	-	-	-	-	1	82
Other	-	-	139	559	7	74	779
Total Assets	**$889**	**$2,077**	**$1,676**	**$1,277**	**$2,310**	**$1,671**	**$9,900**
LIABILITIES							
Other Liabilities	$100	$1,283	$1,036	$20,840	$305	$152	$23,716
Total Liabilities	**$100**	**$1,283**	**$1,036**	**$20,840**	**$305**	**$152**	**$23,716**

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	Oil Spill Liability Trust Fund	All Other Earmarked Funds	Total Earmarked Funds
NET POSITION							
Cumulative Results of Operations	$789	$794	$640	$(19,563)	$2,005	$1,519	$(13,816)
Total Liabilities and Net Position	**$889**	**$2,077**	**$1,676**	**$1,277**	**$2,310**	**$1,671**	**$9,900**

Statement of Net Cost for the Year Ended September 30, 2010

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	Oil Spill Liability Trust Fund	All Other Earmarked Funds	Total Earmarked Funds
Gross Program Costs	$398	$133	$2,368	$2,457	$405	$1,035	$6,796
Less: Earned Revenues	-	-	(2,433)	(3,285)	(516)	(449)	(6,683)
Net Cost of Operations	**$398**	**$133**	**$(65)**	**$(828)**	**$(111)**	**$586**	**$113**

Statement of Changes in Net Position for the Year Ended September 30, 2010

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	Oil Spill Liability Trust Fund	All Other Earmarked Funds	Total Earmarked Funds
Net Position Beginning of Period	$811	$850	$506	$(20,388)	$1,441	$1,370	$(15,410)
Net Cost of Operations	(398)	(133)	65	828	111	(586)	(113)
Non-exchange Revenue	1,759	638	-	-	550	664	3,611
Other	(1,383)	(561)	69	(3)	(97)	71	(1,904)
Change in Net Position	(22)	(56)	134	825	564	149	1,594
Net Position, End of Period	**$789**	**$794**	**$640**	**$(19,563)**	**$2,005**	**$1,519**	**$(13,816)**

Balance Sheet as of September 30, 2009 (restated)

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	Oil Spill Liability Trust Fund	All Other Earmarked Funds	Total Earmarked Funds
ASSETS							
Fund Balance with Treasury	$732	$5	$1,479	$362	$10	$1,439	$4,027
Investments, Net	-	1,985	-	-	1,432	-	3,417
Accounts Receivable	99	151	7	7	141	116	521
Taxes Receivables	65	-	-	-	-	-	65
Other	-	-	117	556	-	62	735
Total Assets	**$896**	**$2,141**	**$1,603**	**$925**	**$1,583**	**$1,617**	**$8,765**
LIABILITIES							
Other Liabilities	$85	$1,291	$1,097	$21,313	$142	$247	$24,175
Total Liabilities	**$85**	**$1,291**	**$1,097**	**$21,313**	**$142**	**$247**	**$24,175**

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	Oil Spill Liability Trust Fund	All Other Earmarked Funds	Total Earmarked Funds
NET POSITION							
Cumulative Results of Operations	$811	$850	$506	$(20,388)	$1,441	$1,370	$(15,410)
Total Liabilities and Net Position	**$896**	**$2,141**	**$1,603**	**$925**	**$1,583**	**$1,617**	**$8,765**
Statement of Net Cost for the Year Ended September 30, 2009 (restated)							
Gross Program Costs	$399	$124	$2,278	$(224)	$153	$1,160	$3,890
Less: Earned Revenues	-	-	(2,707)	(2,900)	(27)	(445)	(6,079)
Net Cost of Operations	**$399**	**$124**	**$(429)**	**$(3,124)**	**$126**	**$715**	**$(2,189)**
Statement of Changes in Net Position for the Year Ended September 30, 2009 (restated)							
Net Position Beginning of Period	$847	$903	$17	$(23,648)	$1,171	$1,351	$(19,359)
Net Cost of Operations	(399)	(124)	429	3,124	(126)	(715)	2,189
Non-exchange Revenue	1,619	658	-	134	491	624	3,526
Other	(1,256)	(587)	60	2	(95)	110	(1,766)
Change in Net Position	(36)	(53)	489	3,260	270	19	3,949
Net Position, End of Period	**$811**	**$850**	**$506**	**$(20,388)**	**$1,441**	**$1,370**	**$(15,410)**

Customs User Fees

When signed in April 1986, COBRA (Pub. L. 99-272) authorized CBP to collect user fees for certain services. The law initially established processing fees for air and sea passengers, commercial trucks, rail cars, private vessels and aircraft, commercial vessels, dutiable mail packages, and CBP broker permits. An additional fee category for processing barges and bulk carriers for Canada and Mexico, contained in tax reform legislation, was added later that year.

In addition to the collection of user fees, other changes in CBP procedures were enacted due to the COBRA statute. Most importantly, provisions were included for providing nonreimbursable inspectional overtime services and paying for excess pre-clearance costs from COBRA user fee collections.

The *Customs and Trade Act of 1990* amended the COBRA legislation to provide for the hiring of inspectional personnel, the purchasing of equipment, and the covering of related expenses with any surplus monies available after overtime and excess pre-clearance costs are satisfied. Expenditures from the surplus can only be used to enhance the service provided to those functions for which fees are collected. The fees for certain customs services are provided by 19 USC § 58c. The authority to use these funds is contained in the annual DHS Appropriations Act.

Sport Fish Restoration and Boating Trust Fund (SFRBTF)

The SFRBTF, previously known as the Aquatic Resources Trust Fund, was created by Section 1016 of the *Deficit Reduction Act of 1984* (Pub. L. 98-369). Two funds were created under this act, the Boating Safety Account and the Sport Fish Restoration Account. The SFRBTF has been the source of budget authority for the boat safety program for many years through the transfer of appropriated funds. The SFRBTF is a Treasury-managed fund and provides funding to states and other entities to promote boating safety and conservation of U.S. recreational waters.

This fund receives revenues transferred from custodial activities of the Treasury, which are deposited in a Treasury account. The revenues are derived from a number of sources, including motor boat fuel tax, excise taxes on sport fishing equipment, and import duties on fishing tackle and yachts. Three agencies share in the available portion of the revenue: Fish and Wildlife Service in the U.S. Department of Interior (Treasury Account Fund Symbol (TAFS) 14X8151); the U.S. Army Corps of Engineers (TAFS 96X8333); and the U.S. Coast Guard (TAFS 70X8149 and TAFS 70X8147).

The most recent reauthorization of SFRBTF and expenditure of Boating Safety funds for the National Recreational Boating Safety Program was enacted in 2005 in the *Safe, Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users* (Pub. L. 109-59) and the *Sportfishing and Recreational Boating Safety Amendments Act of 2005* (Pub. L. 109-74).

Immigration Examination Fees

In 1988, Congress established the Immigration Examination Fee Account (IEFA), and the fees deposited into the IEFA have been the primary source of funding for providing immigration and naturalization benefits and other benefits as directed by Congress. The *Immigration and Nationality Act* (INA) (Pub. L. 82-414, Section 286(m)) provides for the collection of fees at a level that will ensure recovery of the costs of providing adjudication and naturalization services, including the costs of providing similar services without charge to asylum applicants and other immigrants. The INA also states that the fees may recover administrative costs. This revenue remains available to provide immigration and naturalization benefits and allows the collection, safeguarding, and accounting for fees.

The primary sources of revenue are the application and petition fees that are collected during the course of the fiscal year and deposited into the Immigration Examinations Fee Account (TAFS 70X5088). In addition, USCIS provides specific services to other Federal agencies, such as production of border crossing cards for the U.S. Department of State, that result in the collection of other revenues arising from intragovernmental activities.

National Flood Insurance Program

The NFIP was established by the *National Flood Insurance Act of 1968* (Pub. L. 90-448). The purpose of NFIP is to better indemnify individuals for flood losses through insurance, reduce future flood damages through state and community floodplain management regulations, and reduce Federal expenditures for disaster assistance and flood control.

The NFIP requires all partners (Write Your Own (WYO) companies) in the program to submit financial statements and statistical data to the NFIP Legacy Systems Services on a monthly basis. This information is reconciled, and the WYO companies are required to correct any variances.

The NFIP is an insurance program for which the Department pays claims to policyholders that experience flood damage due to flooding within the rules and regulations. The WYO companies that participate in the program have authority to use Departmental funds (revenue and other financing sources) to respond to the obligations of the policyholders. Congress has mandated that the NFIP funds are used only to pay claims and claims-related loss adjustment expenses caused by flooding.

The NFIP sources of revenue and other financing comes from premiums collected to insure policyholder’s homes and the borrowing authority provided to the program from Congress. The resources are inflows to the Government and are not the result of intragovernmental flows.

The *Flood Disaster Protection Act of 1973* (Pub. L. 93-234) expanded the authority of FEMA and its use of the NFIP to grant premium subsidies as an additional incentive to encourage widespread state, community, and property owner acceptance of the program requirements.

The *National Flood Insurance Reform Act of 1994* (Pub. L. 103-325) reinforced the objective of using insurance as the preferred mechanism for disaster assistance by expanding mandatory flood insurance purchase requirements and by effecting a prohibition on further flood disaster assistance for any property where flood insurance, after having been mandated as a condition for receiving disaster assistance, is not mandated.

The *Bunning-Bereuter-Blumenauer Flood Insurance Reform Act of 2004* (Pub. L. 108-264) provides additional tools for addressing the impact of repetitive loss properties on the National Flood Insurance Fund. It introduced a pilot project though FY 2009 that defines severe repetitive loss properties, authorizes additional funds for mitigation projects, and mandates a 50 percent increase of premiums for property owners who decline a mitigation offer, along with an appeal process. Since the inception of the program in 2008, FEMA has awarded more than $97 million for the mitigation of severe repetitive loss properties. For FY 2008, approximately $35 million was awarded, with the remaining $62 million awarded in FY 2009. It also modifies the Flood Mitigation Assistance program by doubling the annual authorized funding level and directing it to give priority to those properties that are in the best interest of the National Flood Insurance Fund.

Oil Spill Liability Trust Fund

The Oil Spill Liability Trust Fund (OSLTF) was originally established under § 9509 of the Internal Revenue Code of 1986. The *Oil Pollution Act of 1990 (OPA)* (Pub. L. 101-380) authorized the use of the money or the collection of revenue necessary for its maintenance.

Fund uses defined by the OPA include removal costs incurred by the U.S. Coast Guard and the Environmental Protection Agency; state access for removal activities; payments to Federal, state, and Indian tribe trustees to conduct natural resource damage assessments and restorations; payment of claims for uncompensated removal costs and damages; research and development (subject to congressional appropriations); and other specific appropriations by the Congress.

The OSLTF has three major funds: the Principal Fund (TAFS 70X8185), Emergency Fund (TAFS 70X8349), and Claims Fund (TAFS 70X8312). All revenue is deposited directly into the Principal Fund. The recurring and nonrecurring revenue are derived from a number of sources, including barrel tax, interest from U.S. Treasury investments, cost recoveries, and fines and penalties. The Emergency Fund is available for Federal on-scene coordinators (FOSCs) to respond to discharges and for Federal trustees to initiate natural resource damage assessments. The Emergency Fund is a recurring $50 million available to the President annually. The fund remains available until expended. Claimants may file oil spill related claims against the Claims Fund if the responsible party is not identified or denies the claims. The maximum amount that can be paid from the Claims Fund with respect to any single incident shall not exceed $1 billion. Once the maximum payout has been reached for the incident, no additional funds can be disbursed from the OSLTF for that specific incident.

Deepwater Horizon Oil Spill. On April 20, 2010, the offshore drilling platform, Deepwater Horizon, exploded and sank 52 miles southeast of Venice, Louisiana. An estimated 4.9 million barrels of oil leaked from the sunken platform's undersea ruptured pipe. The states of Louisiana, Mississippi, Alabama, Florida, and Texas were affected by the spill. The cost of clean-up and damages is unprecedented.

There are currently five identified responsible parties and two guarantors for the Deepwater Horizon oil spill. Liability is joint and severable under the OPA (33 USC 2701 et.seq). The OPA and the *Clean Water Act* (33 U.S.C. 1321 et.seq) direct the responsible parties to conduct clean-up operations, and to advertise and pay claims for damages specified by the OPA. Under the OPA, the responsible party is liable for costs associated with the containment or clean-up of the spill, property damage, loss of government revenue, loss of profits or earning capacity, loss of subsistence use of natural resources, increased state and local public service costs, and damages to natural resources resulting from the spill. In addition, the OPA and applicable Federal legislation and regulations provide the U.S. Coast Guard with broad responsibilities and authorities regarding oil spill response oversight on the navigable waters of the United States. The U.S. Coast Guard has been designated as the FOSC to respond to this disaster. As FOSC, the U.S. Coast Guard directs and coordinates the response activities of all Federal agencies. The U.S. Coast Guard has entered into various reimbursable agreements with other Federal agencies.

In responding to the Deepwater Horizon oil spill, British Petroleum (BP), a responsible party, established a process designed to pay individual, business, and governmental claims for compensable costs under OPA. BP transferred responsibility for administration and payment of individual and business claims to the Gulf Coast Claims Facility (GCCF) in August 2010. BP has agreed to establish a $20 billion escrow account to be funded over the next three years to pay spill related costs, including claims paid by the GCCF, however, establishment of this account does not represent a cap or floor on any amount that may ultimately be paid by BP.

The OSLTF provides emergency funding resources to the FOSC for oil removal, and to Federal trustees for initial natural resource damage assessment activities, up to amounts specified under OPA section 6002(b) (33 U.S.C. 2752(b)). In June 2010, the President of the United States signed into law an amendment to section 6002(b) allowing multiple budgetary authority advances from the OSLTF for the Deepwater Horizon oil spill response and Federal natural resource damage assessment activities limited only by the statutory per-incident cap at 26 U.S.C. 9509(c)(2). Through September 30, 2010, the OSLTF has advanced $600 million to the FOSC to fund the

FOSC oil removal activities in response to the Deepwater Horizon oil spill. In addition, the U.S. Coast Guard has obligated $22 million out of the advance amounts to the Federal Lead Administrative Trustee to initiate the assessment of natural resource damages, as provided by OPA section 6002(b).

The status of OSLTF available funds, costs incurred by the Federal Government, and billings to the responsible parties as of September 30, 2010, is described below.

Status of OSLTF Funds and Costs Incurred and Billed. The FOSC has obligated $589 million of the funding advanced by the OSLTF, of which $554 million has been expended through September 30, 2010. Of the amounts expended, $518 million has been billed to the responsible parties as of September 30, 2010. The billed amounts encompass actual FOSC expenditures; including costs of all U.S. Coast Guard personnel, ships, aircraft, and cutters directly supporting the FOSC; and funds obligated by the FOSC to other Federal, state, and local government agencies. All the obligations and expenditures to date are considered billable and fully collectible from the responsible parties. Funds are obligated by the FOSC to other Federal, state, and local government agencies via FOSC approved Pollution Removal Funding Authorizations or Military Interdepartmental Purchase Requests that provide reimbursable funding authority.

Contingent Liabilities. The OSLTF, which is administered by the U.S. Coast Guard National Pollution Funds Center (NPFC), may be available to pay claims for OPA specified costs and damages, not paid by BP, or another responsible party. Under OPA, claimants are required to present their claims first to the responsible parties (or the GCCF for Deepwater Horizon costs); and if not compensated, they may then file an action in court or file a claim against the OSLTF through the NPFC. NPFC anticipates recovery, from the responsible party, of all costs ultimately paid, if any, including costs incurred in adjudicating paid claims.

All Other Earmarked Funds

The balances and activity reported for all other earmarked funds result from the funds listed below. Information related to these earmarked funds can be located in the Department's appropriations legislation or the statutes referenced.

- 70X0715: Radiological Emergency Preparedness Program, Federal Emergency Management Agency, Department of Homeland Security
- 70X5089: U.S. Customs and Border Protection, Land Border Inspection Fees, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70_5087: U.S. Customs and Border Protection, Immigration User Fees, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5126: Breach Bond/Detention Fund, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5378: Student and Exchange Visitor Program, Border and Transportation Security, Department of Homeland Security; 110 Stat. 3009-706, Sec. (e)(4)(B)
- 70X5382: Immigration User Fee Account, BICE, Department of Homeland Security; 116 Stat. 2135
- 70X5385: Aviation Security Capital Fund, Transportation Security Administration, Department of Homeland Security; 117 Stat. 2567(h)(1)

- 70_5389: H-1B and L Fraud Prevention and Detection Account, U.S. Citizenship and Immigration Service, Department of Homeland Security; 8 U.S.C. § 1356(s)
- 70X5390: Unclaimed Checkpoint Money, Transportation Security Administration, Department of Homeland Security; 118 Stat. 1317-1318, Sec.515(a)
- 70X5398: H-1B and L Fraud Prevention and Detection, U.S. Immigration and Customs Enforcement, Department of Homeland Security; Pub. L. 108-447, 118 Stat. 3357, Sec. 426(b)(1)
- 70X5451: Immigration Enforcement Account, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5542: Detention and Removal Operations, U.S. Immigration and Customs Enforcement, Department of Homeland Security; 8 USC 1356(m)-(n); Pub. L. 107-296, Sec. 476c
- 70X5545: Airport Checkpoint Screening Fund, Transportation Security Administration, Department of Homeland Security; Pub. L. 110-161
- 70X5595: Electronic System for Travel Authorization (ESTA) Fees, U.S. Customs and Border Protection, Department of Homeland Security; Pub. L. 110-53, 121 Stat. 344; Pub. L. 111-145, 124 Stat. 56
- 70_5694: User Fees, Small Airports, U.S. Customs Service, Department of Homeland Security; 116 Stat. 2135
- 70X8244: Gifts and Donations, Department Management, Department of Homeland Security; 116 Stat. 2135
- 70_8314: Trust Fund Share of Expenses, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8533: General Gift Fund, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8870: Harbor Maintenance Fee Collection, U.S. Customs Service, Department of Homeland Security; 116 Stat. 2135
- 70_5106: H-1 B Nonimmigrant Petitioner Account, U.S. Citizenship and Immigration Service, Department of Homeland Security; 116 Stat. 2135
- 70X8360: Gifts and Bequests, Federal Law Enforcement Training Center, Department of Homeland Security; 116 Stat. 2135
- 70X8420: Surcharge Collections, Sales of Commissary Stores, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8428: Coast Guard Cadet Fund, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X5543: International Registered Traveler Program Fund, U.S. Customs and Border Protection, Department of Homeland Security; 121 Stat. 2091-2092

23. Intragovernmental Costs and Exchange Revenue

For the year ended September 30, 2010 (in millions) (Unaudited)

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
U.S. Customs and Border Protection			
Gross Cost	$3,247	$8,528	$11,775
Less Earned Revenue	(40)	(112)	(152)
Net Cost	**3,207**	**8,416**	**11,623**
U.S. Coast Guard			
Gross Cost	1,150	11,825	12,975
Less Earned Revenue	(137)	(760)	(897)
Net Cost	**1,013**	**11,065**	**12,078**
U.S. Citizenship and Immigration Services			
Gross Cost	722	1,809	2,531
Less Earned Revenue	(3)	(2,415)	(2,418)
Net Cost	**719**	**(606)**	**113**
Federal Emergency Management Agency			
Gross Cost	1,207	13,000	14,207
Less Earned Revenue	(364)	(3,317)	(3,681)
Net Cost	**843**	**9,683**	**10,526**
Federal Law Enforcement Training Center			
Gross Cost	61	349	410
Less Earned Revenue	(34)	(2)	(36)
Net Cost	**27**	**347**	**374**
National Protection and Programs Directorate			
Gross Cost	414	1,647	2,061
Less Earned Revenue	(828)	-	(828)
Net Cost	**(414)**	**1,647**	**1,233**
U.S. Immigration and Customs Enforcement			
Gross Cost	1,477	4,273	5,750
Less Earned Revenue	(73)	(156)	(229)
Net Cost	**1,404**	**4,117**	**5,521**
Office of Health Affairs			
Gross Cost	150	81	231
Less Earned Revenue	-	-	-
Net Cost	**150**	**81**	**231**

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
Departmental Operations and Other			
Gross Cost	$680	$1,200	$1,880
Less Earned Revenue	(6)	-	(6)
Net Cost	**674**	**1,200**	**1,874**
U.S. Secret Service			
Gross Cost	442	1,340	1,782
Less Earned Revenue	(15)	-	(15)
Net Cost	**427**	**1,340**	**1,767**
Science and Technology Directorate			
Gross Cost	408	479	887
Less Earned Revenue	(3)	(2)	(5)
Net Cost	**405**	**477**	**882**
Transportation Security Administration			
Gross Cost	1,386	5,245	6,631
Less Earned Revenue	-	(2,145)	(2,145)
Net Cost	**1,386**	**3,100**	**4,486**
Total Department of Homeland Security			
Gross Cost	11,344	49,776	61,120
Less Earned Revenue	(1,503)	(8,909)	(10,412)
Net Cost Before Loss on Pension, ORB, or OPEB Assumption Changes	9,841	40,867	50,708
Loss on Pension, ORB, or OPEB Assumption Changes	-	5,675	5,675
Net Cost	**$9,841**	**$46,542**	**$56,383**

For the year ended September 30, 2009 (in millions) (Unaudited) (Restated)

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
U.S. Customs and Border Protection			
Gross Cost	$2,876	$7,796	$10,672
Less Earned Revenue	(45)	(121)	(166)
Net Cost	**2,831**	**7,675**	**10,506**
U.S. Coast Guard			
Gross Cost	907	11,367	12,274
Less Earned Revenue	(187)	(245)	(432)
Net Cost	**720**	**11,122**	**11,842**
U.S. Citizenship and Immigration Services			
Gross Cost	640	1,689	2,329
Less Earned Revenue	(8)	(2,688)	(2,696)
Net Cost	**632**	**(999)**	**(367)**
Federal Emergency Management Agency			
Gross Cost	1,866	12,882	14,748
Less Earned Revenue	(259)	(2,934)	(3,193)
Net Cost	**1,607**	**9,948**	**11,555**
Federal Law Enforcement Training Center			
Gross Cost	49	401	450
Less Earned Revenue	(35)	(1)	(36)
Net Cost	**14**	**400**	**414**
National Protection and Programs Directorate			
Gross Cost	422	1,610	2,032
Less Earned Revenue	(779)	(43)	(822)
Net Cost	**(357)**	**1,567**	**1,210**
U.S. Immigration and Customs Enforcement			
Gross Cost	1,298	3,875	5,173
Less Earned Revenue	(55)	(111)	(166)
Net Cost	**1,243**	**3,764**	**5,007**
Office of Health Affairs			
Gross Cost	355	59	414
Less Earned Revenue	-	-	-
Net Cost	**355**	**59**	**414**

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
Departmental Operations and Other			
Gross Cost	$570	$1,206	$1,776
Less Earned Revenue	(2)	-	(2)
Net Cost	**568**	**1,206**	**1,774**
U.S. Secret Service			
Gross Cost	450	1,368	1,818
Less Earned Revenue	(16)	-	(16)
Net Cost	**434**	**1,368**	**1,802**
Science and Technology Directorate			
Gross Cost	528	440	968
Less Earned Revenue	(3)	(1)	(4)
Net Cost	**525**	**439**	**964**
Transportation Security Administration			
Gross Cost	1,157	5,834	6,991
Less Earned Revenue	(1)	(2,242)	(2,243)
Net Cost	**1,156**	**3,592**	**4,748**
Total Department of Homeland Security			
Gross Cost	11,118	48,527	59,645
Less Earned Revenue	(1,390)	(8,386)	(9,776)
Net Cost	**$9,728**	**$40,141**	**$49,869**

Intragovernmental costs represent exchange transactions made between two reporting entities within the Federal Government and are presented separately from costs with the public (exchange transactions made between the reporting entity and a non-Federal entity). Intragovernmental exchange revenue is disclosed separately from exchange revenue with the public. The criteria used for this classification requires that the intragovernmental expenses relate to the source of goods and services purchased by the reporting entity and not to the classification of related revenue. For example, with "exchange revenue with the public," the buyer of the goods or services is a non-federal entity. With "intragovernmental costs," the buyer and seller are both Federal entities. If a Federal entity purchases goods or services from another Federal entity and sells them to the public, the exchange revenue would be classified as "with the public," but the related costs would be classified as "intragovernmental." The purpose of this classification is to enable the Federal Government to provide consolidated financial statements, and not to match public and intragovernmental revenue with costs that are incurred to produce public and intragovernmental revenue.

24. Suborganization Costs by DHS Missions and Goals

Operating costs are summarized in the Statement of Net Cost by responsibility segment, as applicable to the reporting period. A responsibility segment is the Component that carries out a mission or major line of activity, and whose managers report directly to Departmental management.

In FY 2010, net cost of operations is the gross (i.e., total) cost incurred by the Department, excluding any gains and losses from changes in long-term assumptions used to measure Federal civilian and military employee pensions, other retirement benefits (ORB), and other postemployment benefits (OPEB), including veterans' compensation, less any exchange (i.e., earned) revenue. Gains and losses from changes in long-term assumptions used to measure Federal civilian and military employee pensions, ORB, and OPEB are reported on a separate line item in accordance with SFFAS No. 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*.

In FY 2010, the Department completed the Quadrennial Homeland Security Review (QHSR), which established a unified, strategic framework for homeland security missions and goals, and also conducted a Bottom-Up Review (BUR) to align programmatic activities and organizational structure to those missions and goals. Since the QHSR and the BUR reflect the most comprehensive assessment and analysis of Homeland Security to date, the Department has elected to use them as basis for integrating FY 2010 net cost to performance information. The Department is currently developing an appropriate cost model within the QHSR framework that will be used to present DHS suborganization costs by mission and goals in future disclosures.

25. Apportionment Categories of Obligations Incurred: Direct versus Reimbursable Obligations

Apportionment categories are determined in accordance with the guidance provided in OMB Circular No. A-11, *Preparation, Submission and Execution of the Budget*. Category A represents resources apportioned for calendar quarters. Category B represents resources apportioned for other time periods; for activities, projects, or objectives; or for any combination thereof (in millions).

Year Ended September 30, 2010 (Unaudited):	**Apportionment Category A**	**Apportionment Category B**	**Exempt from Apportionment**	**Total**
Obligations Incurred - Direct	$34,501	$27,823	$1,020	$63,344
Obligations Incurred - Reimbursable	4,003	654	11	4,668
Total Obligations Incurred	**$38,504**	**$28,477**	**$1,031**	**$68,012**

Year Ended September 30, 2009 (Unaudited) (Restated):	**Apportionment Category A**	**Apportionment Category B**	**Exempt from Apportionment**	**Total**
Obligations Incurred - Direct	$32,668	$33,740	$1,294	$67,702
Obligations Incurred - Reimbursable	3,303	914	10	4,227
Total Obligations Incurred	**$35,971**	**$34,654**	**$1,304**	**$71,929**

The increase in reimbursable obligations incurred was the result of data center consolidation and information technology improvements at MGMT and FEMA's international aid efforts in response to the Haiti earthquake.

26. Available Borrowing Authority

At the beginning of FY 2010, the Department, through FEMA's NFIP, had available borrowing authority of $1,427 million (unaudited). During FY 2010, FEMA did not use any borrowing authority, which leaves a balance of $1,427 million (unaudited). For FY 2009, FEMA had a beginning balance of $3,415 million (unaudited) in borrowing authority. During FY 2009, FEMA received $51 million (unaudited) in new borrowing authority, used $1,992 million (unaudited) in borrowing authority, and had a decrease of $47 million (unaudited) in indefinite borrowing authority, leaving a balance of $1,427 million (unaudited). FEMA annually requests borrowing authority to cover the principal amount of direct loans not to exceed $25 million less the subsidy due from the program account.

27. Permanent Indefinite Appropriations

Permanent indefinite appropriations refer to the appropriations that result from permanent public laws, which authorize the Department to retain certain receipts. The amount appropriated depends upon the amount of the receipts rather than on a specific amount. The Department has three permanent indefinite appropriations, which are not subject to budgetary ceilings established by Congress:

- CBP has a permanent and indefinite appropriation that is used to disburse tax and duty refunds and duty drawbacks. Although funded through appropriations, refund and drawback activity is, in most instances, reported as custodial activity of the Department. Refunds are custodial revenue-related activity in that refunds are a direct result of overpayments of taxes, duties, and fees. CBP's refunds payable at year-end are not subject to funding restrictions. Federal tax revenue received from taxpayers is not available for use in the operation of the Department and is not reported on the Statement of Net Cost. Likewise, the refunds of overpayments are not available for use by the Department in its operations.

- USSS has a permanent and indefinite appropriation that is used to reimburse the DC Pension Plan for the difference between benefits to participants in the DC Pension Plan (see Note 16) and payroll contributions received from current employees.

- USCIS has permanent authority to use immigration and naturalization application fees to pay costs of providing adjudication and naturalization services, including the costs of providing services without charge to asylum applicants and other immigrants and costs associated with the collection, safeguarding, and accounting for fees. USCIS also has the authority to transfer certain fees to other Federal agencies, including the Department of Labor, the Department of State, and the National Science Foundation. The transferred funds are earmarked for immigration fraud prevention and domestic training programs intended to reduce the need for foreign workers under the H-1B visa program.

28. Legal Arrangements Affecting the Use of Unobligated Balances

Unobligated balances whose period of availability has expired are not available to fund new obligations. Expired unobligated balances are available to pay for current period adjustments to obligations incurred prior to expiration. For a fixed appropriation account, the balance can be carried forward for five fiscal years after the period of availability ends. At the end of the fifth fiscal year, the account is closed and any remaining balance is canceled and returned to Treasury. For a no-year account, the unobligated balance is carried forward indefinitely until specifically rescinded by law or the head of the agency concerned or the President determines that the purposes for which the appropriation was made have been carried out and disbursements have not been made against the appropriation for two consecutive years.

Included in the cumulative results of operations for special funds is $924 million (unaudited) and $1 billion (unaudited) at September 30, 2010 and September 30, 2009, respectively, that represents the Department's authority to assess and collect user fees relating to merchandise and passenger processing; to assess and collect fees associated with services performed at certain small airports or other facilities; to retain amounts needed to offset costs associated with collecting duties; and taxes and fees for the Government of Puerto Rico. These special fund balances are restricted by law in their use to offset specific costs incurred by the Department. Part of the passenger fees in the User Fees Account, totaling approximately $743 million (unaudited) and $784 million (unaudited) at September 30, 2010 and 2009, respectively, is restricted by law in its use to offset specific costs incurred by the Department and are available to the extent provided in Department appropriation acts.

The entity trust fund balances result from the Department's authority to use the proceeds from general order items sold at auction to offset specific costs incurred by the Department relating to their sale, to use available funds in the Salaries and Expense Trust Fund to offset specific costs for expanding border and port enforcement activities, and to use available funds from the Harbor Maintenance Fee Trust Fund to offset administrative expenses related to the collection of the Harbor Maintenance Fee.

The table below provides a reconciliation for the difference between Appropriations Received on the Statement of Budgetary Resources and the Statement of Changes in Net Position for the year ended September 30 (in millions).

	2010 (Unaudited)	2009 (Unaudited)
Statement of Budgetary Resources – Appropriations Received	$55,852	$52,839
Permanent and Indefinite Appropriations	(1,350)	(1,409)
User Fees, Immigration Fees, and Trust Funds, Net	(5,835)	(5,632)
Other	157	269
Statement of Changes in Net Position – Appropriations Received	**$48,824**	**$46,067**

29. Explanation of Differences between the Statement of Budgetary Resources and the Budget of the U.S. Government

The table below documents the material differences between the FY 2009 Statement of Budgetary Resources (SBR) and the actual amounts reported for FY 2009 in the Budget of the U.S. Government. Since the FY 2010 financial statements will be reported prior to the release of the Budget of the U.S. Government, DHS is reporting for FY 2009 only. Typically, the Budget of the U.S. Government with the FY 2010 actual data is published in February of the subsequent year. Once published, the FY 2010 actual data will be available on the OMB web site at: www.whitehouse.gov/omb.

	Budgetary Resources	**Obligations Incurred**	**Distributed Offsetting Receipts**	**Net Outlays**
FY 2009 Actual Balances per the FY 2011 President's Budget (in millions) (Unaudited)	**$84,768**	**$70,471**	**$5,213**	**$56,945**
Reconciling Items:				
Accounts that are expired that are not included in Budget of the United States.	1,590	174	-	-
Distributed Offsetting Receipts not included in the Budget of the United States.	-	-	-	(5,213)
Refunds and drawbacks not included in the Budget of the United States.	922	226	-	226
Byrd Program (Continued Dumping and Subsidy Offset) not included in the Budget of the United States.	1,217	1,217	-	1,092
Biodefense Countermeasure Program included in the Budget of the United States.	(3,194)	(161)	-	(224)
Miscellaneous Differences	9	2	-	(5)
Per the 2009 SBR (Unaudited)	**$85,312**	**$71,929**	**$5,213**	**$52,821**

30. Undelivered Orders, Unpaid, End of Period

An unpaid undelivered order exists when a valid obligation has occurred and funds have been reserved but the goods or services have not been delivered. Undelivered orders for the periods ended September 30, 2010 and 2009, were $43,445 million (unaudited) and $41,566 million (unaudited and restated), respectively.

31. Custodial Revenues

The Department collects revenue from a variety of duties, excise taxes, and various other fees. Collection activity primarily relates to current-year activity. Non-entity revenue reported on the Department's Statement of Custodial Activity include duties, excise taxes, and various non-exchange fees collected by CBP and user fees collected by USCIS that are subsequently remitted to the Treasury General Fund or to other Federal agencies. CBP assesses duties, taxes, and fees on goods and merchandise brought into the United States from foreign countries.

The significant types of non-entity accounts receivable (custodial revenues as presented in the Statement of Custodial Activity) are described below.

- **Duties:** amounts collected on imported goods collected on behalf of the Federal Government.
- **User fees:** amounts designed to maintain U.S. harbors and to defray the cost of other miscellaneous service programs. User fees include application fees collected from employers sponsoring nonimmigrant petitions.
- **Excise taxes:** amounts collected on imported distilled spirits, wines, and tobacco products.
- **Fines and penalties:** amounts collected for violations of laws and regulations.

Refunds are amounts due to the importer/exports as a result of overpayments of duties, taxes, fees, and interest. Refunds include drawback remittance paid when imported merchandise, for which duty was previously paid, is exported from the United States.

Tax disbursements from the refunds and drawbacks account, broken out by revenue type and by tax year, were as follows for the fiscal years ended September 30, 2010 and 2009 (in millions) (unaudited):

	2010 Tax Disbursements			
	Tax Year			
	2010	2009	2008	Prior Years
Customs duties	$767	$154	$74	$284
Total non-exchange revenue refunded	767	154	74	284
Exchange revenue refunded	-	-	-	-
Total tax refunds and drawbacks disbursed	**$767**	**$154**	**$74**	**$284**

	2009 Tax Disbursements			
	Tax Year			
	2009	2008	2007	Prior Years
Customs duties	$755	$176	$71	$365
Total non-exchange revenue refunded	755	176	71	365
Exchange revenue refunded	-	-	-	-
Total tax refunds and drawbacks disbursed	**$755**	**$176**	**$71**	**$365**

The disbursements include interest payments of $35 million and $85 million for the fiscal years ended September 30, 2010 and 2009, respectively (unaudited).

The disbursement totals for refunds include antidumping and countervailing duties collected that are refunded pursuant to rulings by DOC. These duties are refunded when the DOC issues a decision in favor of the foreign industry. See Note 18, Other Liabilities, for more information.

The total amounts of antidumping and countervailing duties vary from year to year depending on decisions from DOC. Antidumping and countervailing duty refunds (included in total refunds presented above) and associated interest refunded for the fiscal years ended September 30, 2010 and 2009, consisted of the following (in millions):

	2010 (Unaudited)	2009 (Unaudited)
Antidumping and Countervailing Duty Refunds	$43	$29
Interest	-	1
Total Antidumping and Countervailing Duty Refunds	**$43**	**$30**

32. *Restatements*

A. USCIS Restatement (Unaudited)

Contingent Liabilities. The Department restated the FY 2009 financial statements to correct the contingent liabilities balance due to a change in status. The status of the contingent liability changed due to a clause included in the *FY 2010 Appropriations Act*. This correction was recorded in the USCIS financial statements but was not received in time to be recorded in the Department FY 2009 *Annual Financial Report (AFR)*, thus requiring adjustments to each of the principal financial statements and related footnotes, except for the Statement of Budgetary Resources and Statement of Custodial Activity, as follows:

A.1 – Decrease other non-governmental liabilities by $100 million;
A.2 – Decrease operating expense by $100 million; and
A.3 – Increase cumulative results of operations – earmarked funds and net position by $100 million.

B. U.S. Coast Guard Restatement (Unaudited)

Accounts Payable. The Department restated the FY 2009 financial statements to correct the accounts payable balances. The FY 2009 medical accrual to DOD facilities was corrected to be reported as a Federal accounts payable. This restatement required adjustments to the Balance Sheet, as follows:

B.1 – Increase intragovernmental accounts payable by $72 million; and
B.2 – Decrease non-governmental accounts payable by $72 million.

Inventory. The Department restated the FY 2009 financial statements to correct errors in the reporting of the Coast Guard Field Units operating materials and supplies. Correction of these errors required adjustments to the Balance Sheet and Statement of Changes in Net Position and related footnotes as follows:

B.3 – Decrease inventory and related property, net by $127 million;
B.4 – Decrease cumulative results of operations – other funds and net position by $127 million;
B.5 – Increase operating expense by $30 million; and
B.6 – Decrease beginning balance FY 2009 cumulative results of operations by $97 million.

Actuarial Liability. The Department restated the FY 2009 financial statements to correct errors in the actuarial liabilities for the U.S. Coast Guard's Military Retirement, Military Health, and Post-Employment benefit balances. The overstatements of actuarial liabilities were caused by data importation and database construction errors. Correction of these estimates required adjustments to each of the principal financial statements and related footnotes, except for the Statement of Budgetary Resources and Statement of Custodial Activity, as follows:

B.7 – Decrease Federal employee and veteran benefits by $1,588 million;
B.8 – Decrease operating expense by $1,588 million; and
B.9 – Increase cumulative results of operations – other funds and net position by $1,588 million.

C. FLETC Restatement (Unaudited)

Environmental Disposal Liabilities. The Department restated the FY 2009 financial statements to correct errors in the environmental and disposal liabilities. The understatement of environmental and disposal liabilities was caused by additional cleanup costs that were recorded in the FLETC financial statements but were not received in time to be recorded in the published Department FY 2009 AFR, thus requiring adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Budgetary Resources and the Statement of Custodial Activity, as follows:

C.1 – Increase environmental disposal liabilities by $1 million;
C.2 – Increase operating expense by $1 million; and
C.3 – Decrease cumulative results of operations – other funds and net position by $1 million.

***Retirement Costs*.** The Department restated the FY 2009 financial statements to correct errors in retirement costs. A correction in OPM retirement costs was recorded in the FLETC financial statements but was not received in time to be recorded in the published Department FY 2009 AFR, thus requiring adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Budgetary Resources and the Statement of Custodial Activity, as follows:

C.4 – Decrease imputed financing by $6 million; and
C.5 – Decrease operating expense by $6 million.

***Unexpended Appropriations*.** The Department restated the FY 2009 financial statements to correct errors in unexpended appropriations due to invalid appropriations posted in reimbursable funds. A correction to unexpended appropriations was recorded in the FLETC financial statements but was not received in time to be recorded in the published Department FY 2009 AFR, thus requiring adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Budgetary Resources and the Statement of Custodial Activity, as follows:

C.6 – Increase unexpended appropriations – other funds by $6 million;
C.7 – Increase operating expense by $6 million;
C.8 – Decrease cumulative results of operations – other funds and net position by $6 million; and
C.9 – Increase other adjustments by $6 million.

D. TSA Restatement (Unaudited)

Accounts Payable. The Department restated the FY 2009 financial statements to correct errors in the Accounts Payable balance due to under-accruing for TSA's Other Transaction Agreements and purchase card disbursements. The correction was recorded in the TSA financial statements but was not received in time to be recorded in the published Department FY 2009 AFR. This error required correcting adjustments to each of the principal financial statements and related footnotes, except for the Statement of Budgetary Resources and Statement of Custodial Activity, as follows:

D.1 – Increase non-governmental accounts payable by $55 million;
D.2 – Decrease unexpended appropriations - other funds by $47 million;
D.3 – Increase appropriations used by $47 million;
D.4 – Increase operating expense by $55 million;
D.5 – Decrease cumulative results of operations – earmarked funds and net position by $3 million; and
D.6 – Decrease cumulative results of operations – other funds and net position by $5 million.

Personal Property and Equipment. The Department restated the FY 2009 financial statements to correct errors in property, plant, and equipment balances and transactions, as described below:

- Property-related goods and services were received but not accrued/paid at the end of the fiscal year; and
- TSA erroneously applied the incorrect useful life for certain equipment.

Correction of these errors required adjustments to each of the principal financial statements and related footnotes, except for the Statement of Budgetary Resources and Statement of Custodial Activity, as follows:

D.7 – Decrease general property, plant, and equipment, net by $4 million;
D.8 – Decrease operating expense by $38 million;
D.9 – Decrease cumulative results of operations – other funds and net position by $4 million; and
D.10 – Decrease beginning balance FY 2009 cumulative results of operations by $42 million.

Transportation Security Equipment (TSE). During FY 2009, TSA performed a subsequent analysis of the other direct costs associated with TSE to determine if they were capitalized. This analysis revealed that TSA had understated its TSE balance. The correction of this error required adjustments to each of the principal financial statements and related footnotes, except the Statement of Budgetary Resources and Statement of Custodial Activity, as follows:

D.11 – Increase general property, plant, and equipment, net by $155 million;
D.12 – Increase cumulative results of operations – other funds and net position by $155 million;
D.13 – Decrease operating expense by $58 million; and
D.14 – Increase beginning balance FY 2009 cumulative results of operations by $97 million.

Stewardship Property, Plant and Equipment. During FY 2010, TSA identified collection-type heritage assets that were not reported during FY 2009. This resulted in changes to FY 2009 balances in Note 12, Stewardship Property, Plant and Equipment.

E. Other Restatements (Unaudited)

The Department recorded miscellaneous restatements to correct various errors as follows:

E.1 – Increase unexpended appropriations – other funds by $5 million;
E.2 – Decrease cumulative results of operations – other funds and net position by $5 million;
E.3 – Increase appropriations used by $1 million;
E.4 – Decrease other financing sources by $6 million;
E.5 – Increase other adjustments by $6 million;
E.6 – Increase spending authority from offsetting collections-earned-collected by $1 million;
E.7 – Increase obligations incurred direct by $1 million;
E.8 – Increase obligations incurred, net by $1 million;
E.9 – Decrease gross outlays by $1 million;
E.10 – Increase net outlays-gross outlays by $1 million; and
E.11 – Decrease offsetting collections by $1 million.

The Department restated FY 2009 balances primarily as a result of actions completed to correct financial management weaknesses reported in prior financial statement audit reports. The Department is taking corrective actions related to the causes of the restatements.

BALANCE SHEET, in millions	Original 2009	Effects of Restatements	Restated 2009	Description Reference
ASSETS				
Intragovernmental				
Fund Balance with Treasury	$57,172	$ -	$57,172	
Investments, Net	3,417	-	3,417	
Accounts Receivable	369	-	369	
Other				
Advances and Prepayments	2,688	-	2,688	
Due from Treasury	-	-	-	
Total Intragovernmental	**$63,646**	**$ -**	**$63,646**	
Cash and Other Monetary Assets	57	-	57	
Accounts Receivable, Net	449	-	449	
Taxes, Duties, and Trade Receivables, Net	1,874	-	1,874	
Direct Loans, Net	55	-	55	
Inventory and Related Property, Net	562	(127)	435	B.3
General Property, Plant and Equipment, Net	17,546	151	17,697	D.7, D.11
Other				
Advances and Prepayments	591	-	591	
TOTAL ASSETS	**$84,780**	**$24**	**$84,804**	
LIABILITIES				
Intragovernmental				
Accounts Payable	$2,107	$72	$2,179	B.1
Debt	19,004	-	19,004	
Other				
Due to the General Fund	1,969	-	1,969	
Accrued FECA Liability	370	-	370	
Other	720	-	720	
Total Intragovernmental	**$24,170**	**$72**	**$24,242**	
Accounts Payable	2,810	(17)	2,793	B.2, D.1
Federal Employee and Veteran Benefits	41,013	(1,588)	39,425	B.7
Environmental and Disposal Liabilities	1,011	1	1,012	C.1
Other				
Accrued Payroll	1,936	-	1,936	
Deferred Revenue and Advances from Others	2,629	-	2,629	
Unliquidated Antidumping and Countervailing Duties	106	-	106	
Insurance Liabilities	508	-	508	
Refunds and Drawbacks	126	-	126	
Other	1,825	(100)	1,725	A.1
Total Liabilities	**$76,134**	**$(1,632)**	**$74,502**	

BALANCE SHEET, in millions	Original 2009	Effects of Restatements	Restated 2009	Description Reference
Net Position				
Unexpended Appropriations – Other Funds	$49,319	$(36)	$49,283	C.6, D.2, E.1
Cumulative Results of Operations – Earmarked Funds	(15,507)	97	(15,410)	A.3, D.5
Cumulative Results of Operations – Other Funds	(25,166)	1,595	(23,571)	B.4, B.9, C.3, C.8, D.6, D.9, D.12, E.2
Total Net Position	**$8,646**	**$1,656**	**$10,302**	
TOTAL LIABILITIES AND NET POSITION	**$84,780**	**$24**	**$84,804**	

STATEMENT OF NET COST, in millions	Original 2009	Effects of Restatements	Restated 2009	Description Reference
Directorates and Other Components				
U.S. Customs and Border Protection				
Gross Cost	$10,672	$ -	$10,672	
Less Earned Revenue	(166)	-	(166)	
Net Cost	**10,506**	**-**	**10,506**	
U.S. Coast Guard				
Gross Cost	13,832	(1,558)	12,274	B.5, B.8
Less Earned Revenue	(432)	-	(432)	
Net Cost	**13,400**	**(1,558)**	**11,842**	
U.S. Citizenship and Immigration Services				
Gross Cost	2,429	(100)	2,329	A.2
Less Earned Revenue	(2,696)	-	(2,696)	
Net Cost	**(267)**	**(100)**	**(367)**	
Federal Emergency Management Agency				
Gross Cost	14,748	-	14,748	
Less Earned Revenue	(3,193)	-	(3,193)	
Net Cost	**11,555**	**-**	**11,555**	
Federal Law Enforcement Training Center				
Gross Cost	449	1	450	C.2, C.5, C.7
Less Earned Revenue	(36)	-	(36)	
Net Cost	**413**	**1**	**414**	
National Protection and Preparedness Directorate *				
Gross Cost	2,032	-	2,032	
Less Earned Revenue	(822)	-	(822)	
Net Cost	**1,210**	**-**	**1,210**	
U.S. Immigration and Customs Enforcement *				
Gross Cost	5,173	-	5,173	
Less Earned Revenue	(166)	-	(166)	
Net Cost	**5,007**	**-**	**5,007**	

* As discussed in Note 1, Summary of Significant Accounting Policies, the FY 2009 financial statements have been reclassified to conform with the FY 2010 presentation.

STATEMENT OF NET COST, in millions	Original 2009	Effects of Restatements	Restated 2009	Description Reference
Office of Health Affairs				
Gross Cost	414	-	414	
Less Earned Revenue	-	-	-	
Net Cost	**414**	**-**	**414**	
Departmental Operations and Other				
Gross Cost	1,776	-	1,776	
Less Earned Revenue	(2)	-	(2)	
Net Cost	**1,774**	**-**	**1,774**	
U.S. Secret Service				
Gross Cost	1,818	-	1,818	
Less Earned Revenue	(16)	-	(16)	
Net Cost	**1,802**	**-**	**1,802**	
Science and Technology				
Gross Cost	968	-	968	
Less Earned Revenue	(4)	-	(4)	
Net Cost	**964**	**-**	**964**	
Transportation Security Administration				
Gross Cost	7,032	(41)	6,991	D.4, D.8, D.13
Less Earned Revenue	(2,243)	-	(2,243)	
Net Cost	**4,789**	**(41)**	**4,748**	
NET COST OF OPERATIONS	**$51,567**	**$(1,698)**	**$49,869**	

STATEMENT OF CHANGES IN NET POSITION, in millions	Original 2009	Effects of Restatements	Restated 2009	Description Reference
Cumulative Results of Operations				
Beginning Balances	$(42,415)	$ -	$(42,415)	
Adjustments:				
Correction of Errors	-	(43)	(43)	B.6, D.10, D.14
Beginning Balance, as adjusted	$(42,415)	$(43)	$(42,458)	
Budgetary Financing Sources:				
Appropriations Used	49,252	48	49,300	D.3, E.3
Non-Exchange Revenue	3,530	-	3,530	
Donations and Forfeitures of Cash and Cash Equivalents	3	-	3	
Transfers in/out without Reimbursement	(195)	-	(195)	
Other	(56)	(6)	(62)	E.4
Other Financing Sources (Non-Exchange):				
Donations and Forfeitures of Property	4	-	4	
Transfers in/out Reimbursement	11	-	11	
Imputed Financing	766	(6)	760	C.4
Other	(5)	-	(5)	
Total Financing Sources	53,309	36	53,346	
Net Cost of Operations	(51,567)	1,698	(49,869)	A.2, B.5, B.8, C.2, C.5, C.7, D.4, D.8, D.13
Net Change	1,742	1,735	3,477	
Cumulative Results of Operations	**(40,673)**	**1,692**	**(38,981)**	
Unexpended Appropriations:				
Beginning Balances	55,239	-	55,239	
Budgetary Financing Sources:				
Appropriations Received	46,067	-	46,067	
Appropriations transferred in/out	(2,064)	-	(2,064)	
Other Adjustments	(671)	12	(659)	C.9, E.5
Appropriations Used	(49,252)	(48)	(49,300)	D.3, E.3
Total Budgetary Financing Sources	(5,920)	(36)	(5,956)	
Total Unexpended Appropriations	**49,319**	**(36)**	**49,283**	
NET POSITION	**$8,646**	**$1,656**	**$10,302**	

STATEMENT OF BUDGETARY RESOURCES, in millions	Original 2009		Effects of Restatements		Restated 2009		
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Description Reference
BUDGETARY RESOURCES							
Unobligated Balance, Brought Forward, October 1	$21,431	$4	$ -	$ -	$21,431	$4	
Recoveries of Prior Year Unpaid Obligations	4,280	-	-	-	4,280	-	
Budget Authority:							
Appropriations	52,839	-	-	-	52,839	-	
Borrowing Authority	-	51	-	-	-	51	
Spending Authority from Offsetting Collections:							
Earned:							
Collected	9,541	88	1	-	9,542	88	E.6
Change in Receivable from Federal Sources	124	-	-	-	124	-	
Change in Unfilled Customer Orders:							
Advances Received	280	-	-	-	280	-	
Without Advance from Federal Sources	(506)	(30)	-	-	(506)	(30)	
Expenditure transfers from Trust Funds	48	-	-	-	48	-	
Subtotal	62,326	109	1	-	62,327	109	
Non-expenditure Transfers, Net; Anticipated and Actual	(1,576)	-	-	-	(1,576)	-	
Temporarily Not Available Pursuant to Public Law	(4)	-	-	-	(4)	-	
Permanently Not Available	(1,212)	(47)	-	-	(1,212)	(47)	
TOTAL BUDGETARY RESOURCES	**$85,245**	**$66**	**$1**	**$ -**	**$85,246**	**$66**	

STATEMENT OF BUDGETARY RESOURCES, in millions	Original 2009		Effects of Restatements		Restated 2009		
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Description Reference
STATUS OF BUDGETARY RESOURCES							
Obligations Incurred:							
Direct	$67,635	$66	$1	$ -	$67,636	$66	E.7
Reimbursable	4,227	-	-	-	4,227	-	
Subtotal	71,862	66	1	-	71,863	66	
Unobligated Balance:							
Apportioned	7,706	-	-	-	7,706	-	
Exempt from Apportionment	5	-	-	-	5	-	
Subtotal	7,711	-	-	-	7,711	-	
Unobligated Balance Not Available	5,672	-	-	-	5,672	-	
TOTAL STATUS OF BUDGETARY RESOURCES	**$85,245**	**$66**	**$1**	**$ -**	**$85,246**	**$66**	

STATEMENT OF BUDGETARY RESOURCES, in millions	Original 2009 Budgetary	Original 2009 Non-Budgetary Credit Reform Financing Accounts	Effects of Restatements Budgetary	Effects of Restatements Non-Budgetary Credit Reform Financing Accounts	Restated 2009 Budgetary	Restated 2009 Non-Budgetary Credit Reform Financing Accounts	Description Reference
CHANGE IN OBLIGATED BALANCE							
Obligated Balance, Net							
Unpaid Obligations Brought Forward, October 1	$47,103	$323	$ -	$ -	$47,103	$323	
Less: Uncollected Customer Payments from Federal Sources, brought forward, October 1	(2,427)	(323)	-	-	(2,427)	(323)	
Total Unpaid Obligated Balance, Net	44,676	-	-	-	44,676	-	
Obligations Incurred, Net	71,862	66	1	-	71,863	66	E.8
Less: Gross Outlays	(67,896)	(95)	(1)	-	(67,897)	(95)	E.9
Obligated Balance Transferred, Net							
Actual Transfers, Unpaid Obligations	(25)	-	-	-	(25)	-	
Total Unpaid Obligated Balance Transferred, Net	(25)	-	-	-	(25)	-	
Recoveries of Prior Year Unpaid Obligations, Actual	(4,280)	-	-	-	(4,280)	-	
Change in Uncollected Customer Payments from Federal Sources	383	30	-	-	383	30	
Obligated balance, Net End of Period							
Unpaid obligations	46,764	294	-	-	46,764	294	
Less: Uncollected customer payments from Federal Sources	(2,044)	(293)	-	-	(2,044)	(293)	
Total, unpaid obligated balance, net end of period	**$44,720**	**$1**	**$ -**	**$ -**	**$44,720**	**$1**	

STATEMENT OF BUDGETARY RESOURCES, in millions	Original 2009		Effects of Restatements		Restated 2009		
	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Budgetary	Non-Budgetary Credit Reform Financing Accounts	Description Reference
NET OUTLAYS							
Gross Outlays	$67,896	$95	$1	$ -	$67,897	$95	E.10
Less: Offsetting Collections	(9,869)	(88)	(1)	-	(9,870)	(88)	E.11
Less: Distributed Offsetting Collections	(5,213)	-	-	-	(5,213)	-	
NET OUTLAYS	**$52,814**	**$7**	**$ -**	**$ -**	**$52,814**	**$7**	

33. Reconciliation of Net Cost of Operations (Proprietary) to Budget

The Reconciliation of Net Cost of Operations to Budget reconciles the Department's Resources Used to Finance Activities (first section), which consists of the budgetary basis of accounting Net Obligations plus the proprietary basis of accounting Other Resources, to the proprietary basis of accounting Net Cost of Operations. The second section, Resources Used to Finance Items Not Part of the Net Cost of Operations, reverses out items included in the first section that are not included in Net Cost of Operations. The third section, Components of Net Cost of Operations that Will Not Require or Generate Resources in the Current Period, adds items included in the Net Cost of Operations that are not included in the first section.

The third section's subsection, Components Requiring or Generating Resources in Future Periods, includes costs reported in the current period that are included in the Liabilities Not Covered by Budgetary Resources reported in Note 14. This subsection does not include costs reported in prior fiscal years that are also included in Liabilities Not Covered by Budgetary Resources.

The reconciliations of net cost of operations to budget for FY 2010 and FY 2009 are as follows:

	2010 (Unaudited)	2009 (Unaudited) (Restated)
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred (Note 25)	$68,012	$71,929
Less: Spending Authority from Offsetting Collections and Recoveries	(14,533)	(13,826)
Obligations Net of Offsetting Collections and Recoveries	53,479	58,103
Less: Offsetting Receipts	(6,328)	(5,213)
Net Obligations	47,151	52,890
Other Resources		
Donations and Forfeiture of Property	3	4
Transfers In (Out) Without Reimbursement	120	11
Imputed Financing from Costs Absorbed by Others	1,064	760
Other	(78)	(5)
Net Other Resources Used to Finance Activities	1,109	770
Total Resources Used to Finance Activities	**$48,260**	**$53,660**

Resources Used to Finance Items Not Part of the Net Cost of Operations		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but Not Yet Provided	$1,192	$(491)
Resources that Fund Expenses Recognized in Prior Periods	27	6,090
Budgetary Offsetting Collections and Receipts that Do Not Affect Net Cost of Operations:		
Credit Program Collections that Increase Liabilities for Loan Guarantees or Allowances for Subsidy	33	88
Other	(3,504)	(2,172)
Resources that Finance the Acquisition of Assets	3,664	5,241
Other Resources or Adjustments to Net Obligated Resources that Do Not Affect Net Cost of Operations	1,229	1,436
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	2,641	10,192
TOTAL RESOURCES USED TO FINANCE THE NET COST OF OPERATIONS	**$45,619**	**$43,468**
Components of the Net Cost of Operations that Will Not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increase in Annual Leave Liability	$109	$100
Increase in Environmental and Disposal Liability	49	-
Increase in Exchange Revenue Receivable from the Public	(7)	1
Upward/Downward reestimates of credit subsidy expense	-	(5)
Other		
Increase in Actuarial Pension Liability	7,024	1,785
Increase in Actuarial Health Insurance Liability	1,754	2,051
Increase in USCG Military Post-Employment PCS Benefits and Other	1	-
Other	377	324
Total Components of Net Cost of Operations that Will Require or Generate Resources in Future Periods	9,307	4,256
Components not Requiring or Generating Resources		
Depreciation and Amortization	1,560	1,541
Revaluation of Assets or Liabilities	48	208
Other	(151)	396
Total Components of Net Cost of Operations that Will Not Require or Generate Resources	1,457	2,145
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	**10,764**	**6,401**
NET COST OF OPERATIONS	**$56,383**	**$49,869**

Required Supplementary Stewardship Information (Unaudited)

Stewardship Investments

Stewardship investments are substantial investments made by the Federal Government for the benefit of the Nation. When incurred, stewardship investments are treated as expenses in calculating net cost, but they are separately reported as Required Supplementary Stewardship Information to highlight the extent of investments that are made for long-term benefit. The Department's expenditures (including carryover funds expended in FY 2010) in Human Capital, Research and Development, and Non-Federal Physical Property are shown below:

Summary of Stewardship Investments (in millions) (unaudited)

	FY 2010	FY 2009	FY 2008	FY 2007	FY 2006
Research and Development	$980	$852	$880	$1,115	$1,144
Human Capital	93	104	96	82	36
Non-Federal Physical Property	286	420	204	394	(118)
Total	$1,359	$1,376	$1,180	$1,591	$1,062

1. Investments in Research and Development

Investments in research and development represent expenses incurred to support the search for new or refined knowledge and ideas. The intent of the investment is to apply or use such knowledge to develop new or improved products and processes with the expectation of maintaining or increasing national productive capacity or yielding other future benefits. TSA, U.S. Coast Guard, and S&T have made significant investments in research and development.

TSA

TSA has invested within three categories of applied research projects. These applied research projects include:

- Human factors research intended to enhance screener capabilities and increase human system effectiveness.
- Ongoing certification testing of screening technologies including Explosive Detection System and Explosives Trace Detection technology.
- Infrastructure protection research related to using biometrics for passenger access controls.

U.S. Coast Guard

The U.S. Coast Guard Research & Development Program invests in the application of research and development projects. The following are some of the major ongoing developmental projects:

- Develop a means to certify a shipboard system to insure aquatic nuisance species are eradicated before entering U.S. waters.

- Further develop the at-sea biometrics system that can identify individuals encountered at sea. Partner with and leverage the databases of other Government agencies.
- Adapt the U.S. Coast Guard Tactical Modeling (TME) for simulation-based analysis of operations in the Arctic. Develop and demonstrate the TME model's capabilities to provide decision support for analysts and researchers examining tactical alternatives for the Arctic theater of operations.
- Install prototypes and conduct a technology demonstration of a tidal generator as a source of electrical power for U.S. Coast Guard Station Eastport, Maine.
- Expand existing sensor modeling and simulation tools to incorporate multiple U.S. Coast Guard sensors against a wider range of targets from air, surface, and/or shore-based platforms to support analysis of multi-sensor searches in coordinated search and surveillance operations.

Significant accomplishments in development:

- Delivered a report, "Feasibility of Developing a Protocol for Automated Protist Analysis," that supported continued automated protest analysis work in ballast water treatment systems development.
- Explored capability for development of 10-print system that includes multi-modal biometrics (10-fingerprint, facial photo, and possibly an iris image) to be tested for potential fleet-wide deployment on cutter assets for multi-mission use. Work began on representation of full system data flow for current Biometrics at Sea System operations, maintenance, and support.
- Demonstrated the Arctic Tactical Modeling Environment, a prototype simulation model that measures the relative effectiveness of various force-deployment options in the Arctic Region. The proof-of concept analysis illustrated how the mode could be used to examine the U.S. Coast Guard's ability to achieve surface asset patrol area presence under changing scenarios and adding new resupply facilities.
- Baselined existing sensor modeling and simulation tool capabilities and documented target inventories (existing modes). This provided a listing of the gaps in Multi-Sensor Performance Prediction. Delivered high-level summary of the approach used and the results achieved, including a suggested meta-structure for integrating the software components that are currently used.

The following major new applications developments are ongoing:

- Develop and evaluate the most promising capabilities and techniques for recovering heavy viscous oil on the ocean floor and integrate those capabilities and techniques with heavy oil detection systems.
- Develop equipment and a detailed and accepted group of methodologies that can be used successfully to detect, track, and recover oil in ice-filled waters in all conditions in order to minimize the damage to the environment caused by spilled oil in extreme cold, either in the Arctic Region or the northern states in the United States.
- Explore the U.S. Coast Guard's needs with regard to alternative energy systems and the extent these systems are currently used throughout the U.S. Coast Guard. Baseline the carbon footprint of selected U.S. Coast Guard afloat assets. Investigate potential "green"

technology projects for powering U.S. Coast Guard afloat assets and the technologies that have the potential for providing renewable energy while lowering the carbon footprint.
- Investigate and develop modeling approaches that provide more efficacy in board-based decision support for current and future acquisition activities.
- Conduct a review of distress notification methods and determine the most effective methods and systems, or combinations, and propose carriage regulation changes that allow alternatives or a combination of alternatives to current requirements that are found to be less than effective.

Significant accomplishments in research:

- Evaluated test plans for adaptation of the existing dredge system technique for recovering heavy oil from the ocean floor. Prepared papers for Oil Spill Response conferences to communicate progress in heavy oil recovery technique research.
- Facilitated an Arctic Workshop that brought cold weather/Arctic and oil spill response subject matter experts and identified and prioritized issues with respect to preventing/mitigating oil-in-ice scenarios.
- Applied specific cost-estimating documents and material, such as the GAO guide and Work Breakdown Structure templates, to the development of the U.S. Coast Guard's *Cost Strategy and Cost Handbook*. This provided a high-level overview of U.S. Coast Guard and DHS requirements for cost estimating.

S&T

The S&T Directorate has a research portfolio investment integrated through its divisions. For example, the Directorate conducts research in many areas to support the Department's missions to defend against chemical and biological threats, including protecting infrastructure and transportation systems from explosives, preparing the nation to respond to large- and small-scale events, and protecting the critical systems that run our financial and electrical power systems, to name a few. The S&T Directorate also develops new standards, educates the next-generation workforce, and conducts testing and evaluation activities to further increase the security of the nation.

Significant accomplishments in development include:

The development of a levee breaching plug represents one of the S&T Directorate's successes in developing technology to improve homeland security. Rapid repair of breaching levees is one priority identified by the S&T Directorate's customers. In FY 2009, S&T demonstrated a scaled prototype solution for rapidly closing a levee breach using a water-filled tube. This levee plug was deployed from a floating platform and guided into place where, due to the rushing water, it conformed to the breach and reduced the flow of water by approximately 95 percent.

In FY 2010, the S&T Directorate Domain Name System Security Extensions (DNSSEC) Signer software became commercially available. The DNSSEC Signer appliance is a turnkey "DNSSEC-in-a-box" solution that eliminates most, if not all, of the concerns associated with DNSSEC deployment. These concerns include complexity, cost, correct configurations, and security, and they are all addressed by the DNSSEC Signer. The successful deployment of DNSSEC will offer assured Internet communications, thwarting a large number of current Internet attacks. The S&T Directorate also delivered secure wireless devices that will help secure wireless transmission for process control systems (PCSs). Improving security for PCSs is critical as they control water supply, electrical power, gas and oil pipelines, and other distributed processes.

2. Investments in Human Capital

Investments in human capital include expenses incurred for programs to educate and train first responders. These programs are intended to increase or maintain national productive capacity as evidenced by outputs and outcomes. Based on a review of the Department's programs, FEMA and TSA have made significant investments in human capital.

FEMA

FEMA has invested resources in educational, training, and professional development in the following areas:

- The National Fire Academy has been developed by FEMA to promote the professional development of the fire and emergency response community and its allied professionals. The National Fire Academy also develops and delivers educational and training courses with a national focus to supplement and support state and local fire service training programs.
- The Emergency Management Institute (EMI) serves as the national focal point for the development and delivery of emergency management training to enhance the capabilities of Federal, state, local, and tribal government officials, volunteer organizations, and the public and private sectors to minimize the impact of disasters on the American public. EMI curricula are structured to meet the needs of this diverse audience, with an emphasis on how the various elements work together in emergencies to save lives and protect property.
- The Center for Domestic Preparedness (CDP) is a Federal training center that specializes in providing advanced hands-on, all-hazards training for emergency responders. Its purpose is the "preparation of first responders by building, sustaining, and improving their capability to respond to all hazards." The CDP offers training to America's Federal, state, local, tribal, and private emergency responders—to include responders working in rural jurisdictions—in their missions to prevent, deter, respond to, and recover from terrorist acts, especially those involving weapons of mass destruction or hazardous materials. The CDP's training programs offer a selection of 43 courses and a fully certified, multi-disciplined instructional staff with an average of 19 years of experience in their respective emergency response fields. The CDP is the only congressionally chartered Weapons of Mass Destruction training center for civilians.

TSA

TSA's Highway Watch Cooperative Agreement with the American Trucking Association (ATA) expanded ATA's Highway Watch program, which taught highway professionals to identify and report safety and security situations on our Nation's roads. The program provided training and communications infrastructure to prepare 400,000 transportation professionals to respond in the event they or their cargo are the target of a terrorist attack and to share valuable intelligence with TSA if they witness potential threats. The intelligence allows Federal agencies and industry stakeholders to quickly move to prevent an attack or to immediately respond if an attack occurs.

3. Investments in Non-Federal Physical Property

Investments in non-Federal physical property are expenses included in the calculation of net cost incurred by the reporting entity for the purchase, construction, or major renovation of physical property owned by State and local governments. TSA has made significant investments in non-Federal physical property.

TSA

Airport Improvement Program. To help facilitate Explosive Detection System (EDS) installations, TSA purchases and installs in-line EDS equipment through a variety of funding mechanisms, including congressionally authorized Letters of Intent (LOI). Since the modifications tend to be costly, the LOI is used to offset the costs incurred by commercial service airports for the modifications. TSA has issued 12 LOIs for 12 agreements to provide for the facility modifications necessary to accommodate in-line EDS screening solutions.

Airport Renovation Program. Under this program, TSA employs other transaction agreements (OTAs) to fund the installation of integrated and non-integrated EDS and explosive trace detection equipment as well as improvements to be made to the existing systems in the baggage handling area. These OTAs establish the respective cost-sharing obligations and other responsibilities of TSA and the specific entity (board, port, or authority) conducting the installations or improvements. All work will be completed in order to achieve compliance with the *Aviation and Transportation Security Act* (ATSA), Pub. L. 107-71, November 19, 2001.

American Recovery and Reinvestment Act. TSA entered into OTAs with 36 airports. These agreements are funded by the *American Recovery and Reinvestment Act*. In FY 2009 and FY 2010, TSA obligated $629.9 million: $568 million for the electronic baggage screening program and $61.9 million for closed circuit television cameras.

Air Cargo. On August 3, 2007, President Bush signed into law the *Implementing Recommendations of the 9/11 Commission Act of 2007* (9/11 Act), Pub. L. 110-53. The 9/11 Act required TSA to establish a system for industry to screen 100 percent of cargo transported on passenger aircraft in the United States at the piece-level, commensurate with passenger baggage. TSA met this requirement in August 2010. To comply, TSA has entered into OTAs with 47 freight forwarders totaling $36.8 million.

Intercity Bus Security Program. This program provided funds to improve security for intercity bus operators and passengers. TSA awarded grants based on the following program categories:

- Vehicle-specific security enhancements to protect or isolate the driver, such as alarms and security mirrors.
- Monitoring, tracking, and communication technologies for over-the-road buses.
- Implementation and operation of passenger and baggage screening programs at terminals and over-the-road buses.
- Development of an effective security assessment/security plan that identifies critical security needs and vulnerabilities.

- Training for drivers, dispatchers, ticket agents, and other personnel in recognizing and responding to criminal attacks and terrorist threats, evacuation procedures, passenger screening procedures, and baggage inspection.

Required Supplementary Information (Unaudited)

1. Deferred Maintenance

The Department Components use condition assessment to determine the deferred maintenance for each class of asset. The procedure includes reviewing equipment, building, and other structure logistic reports. Component logistic personnel identify maintenance not performed as scheduled and establish future performance dates. Logistic personnel use a condition assessment survey to determine the status of referenced assets according to the range of conditions shown below.

Good. Facility/equipment condition meets established maintenance standards, operates efficiently, and has a normal life expectancy. Scheduled maintenance should be sufficient to maintain the current condition. There is no deferred maintenance on buildings or equipment in good condition.

Fair. Facility/equipment condition meets minimum standards but requires additional maintenance or repair to prevent further deterioration, to increase operating efficiency, and to achieve normal life expectancy.

Poor. Facility/equipment does not meet most maintenance standards and requires frequent repairs to prevent accelerated deterioration and to provide a minimal level of operating function. In some cases, this includes condemned or failed facilities.

Based on periodic condition assessments, an indicator of condition is the percentage of facilities and items of equipment in each of the good, fair, or poor categories.

Deferred maintenance as of September 30, 2010, on general property, plant, and equipment and heritage assets was estimated to range from $995 million (unaudited) to $1,222 million (unaudited), and the condition of these assets ranges from poor to good. These amounts represent maintenance on vehicles, vessels, and buildings and structures owned by the Department that was not performed when it should have been, or was scheduled to be performed but was delayed for a future period.

In FY 2009, the Department reported estimated deferred maintenance ranging from $1,065 million (unaudited) to $1,295 million (unaudited) on general property, plant, and equipment and heritage assets with a range of poor to good condition. These amounts represent maintenance on vehicles, vessels, and buildings and structures owned by the Department that was not performed when it should have been, or was scheduled to be performed but was delayed for a future period.

A summary of deferred maintenance, by asset class, at September 30, 2010, follows (in millions) (unaudited):

	Low estimate	High estimate	Asset Condition
Building & Structures	$828	$1,012	Good to Poor
Equipment (vehicles and vessels)	92	112	Good to Fair
Equipment (Other)	69	84	Good to Fair
Heritage assets	6	14	Good to Poor
Total	**$995**	**$1,222**	

2. Statement of Budgetary Resources

The principal Statement of Budgetary Resources combines the availability, status, and outlays of the Department's budgetary resources during FY 2010 and FY 2009. Presented on the following pages is the disaggregation of this combined information by DHS Components, which represent the responsibility segments that carry out the Department's missions. As discussed in Note 1, Summary of Significant Accounting Policies, the FY 2009 financial statements have been reclassified to conform with the FY 2010 presentation.

2. Statement of Budgetary Resources

Schedule of FY 2010 Budgetary Resources by Responsibility Segments (in millions) (unaudited) (page 1 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
BUDGETARY RESOURCES													
Unobligated Balance, Brought Forward, October 1	$3,067	$1,994	$886	$4,201	$155	$596	$40	$340	$443	$142	$171	$1,348	**$13,383**
Recoveries of Prior Year Obligations	458	211	135	2,783	11	359	6	114	115	9	97	165	**4,463**
Budget Authority:													
Appropriations	12,944	10,353	2,649	12,228	291	5,792	139	1,635	1,318	1,727	1,007	5,769	**55,852**
Borrowing Authority	-	-	-	-	-	-	-	-	-	-	-	-	-
Spending Authority from Offsetting Collections:													
Earned:													
Collected	1,586	419	32	3,819	134	174	38	652	1,087	15	90	1,900	**9,946**
Change in Receivable from Federal Sources	(21)	3	(34)	6	(15)	9	-	2	(29)	4	(3)	(1)	**(79)**
Change in Unfilled Customer Orders:													
Advance Received	1	(14)	1	(285)	-	(1)	-	49	1	-	17	1	**(230)**
Without Advance from Federal Sources	(7)	205	(3)	24	16	(35)	-	92	16	10	72	(5)	**385**
Previously Unavailable	-	-	-	30	-	-	-	-	-	-	-	-	**30**
Expenditure Transfers from Trust Funds	3	45	-	-	-	-	-	-	-	-	-	-	**48**
Subtotal	14,506	11,011	2,645	15,822	426	5,939	177	2,430	2,393	1,756	1,183	7,664	**65,952**
Nonexpenditure Transfers, Net; Anticipated and Actual	297	785	7	(15)	-	(1)	(2)	21	(3)	16	-	-	**1,105**
Temporarily Not Available Pursuant to Public Law	-	-	-	(32)	-	-	-	-	-	-	-	-	**(32)**
Permanently Not Available	(536)	(303)	(5)	(591)	(5)	(63)	-	(43)	(56)	(28)	(11)	(30)	**(1,671)**
TOTAL BUDGETARY RESOURCES	**$17,792**	**$13,698**	**$3,668**	**$22,168**	**$587**	**$6,830**	$221	**$2,862**	**$2,892**	**$1,895**	**$1,440**	**$9,147**	**$83,200**
STATUS OF BUDGETARY RESOURCES													
Obligations Incurred:													
Direct	13,554	10,871	2,637	16,368	354	5,922	161	1,786	1,283	1,729	1,112	7,567	**63,344**
Reimbursable	1,591	419	23	220	98	156	40	805	1,114	29	168	5	**4,668**
Subtotal	15,145	11,290	2,660	16,588	452	6,078	201	2,591	2,397	1,758	1,280	7,572	**68,012**
Unobligated Balance:													
Apportioned	64	2,198	372	5,079	108	201	15	199	367	76	154	1,357	**10,190**
Exempt from Apportionment	-	2	-	3	-	-	-	-	-	-	-	-	**5**
Subtotal	64	2,200	372	5,082	108	201	15	199	367	76	154	1,357	**10,195**
Unobligated Balance Not Available	2,583	208	636	498	27	551	5	72	128	61	6	218	**4,993**
TOTAL STATUS OF BUDGETARY RESOURCES	**$17,792**	**$13,698**	**$3,668**	**$22,168**	**$587**	**$6,830**	**$221**	**$2,862**	**$2,892**	**$1,895**	**$1,440**	**$9,147**	**$83,200**

Schedule of FY 2010 Budgetary Resources by Responsibility Segments (in millions) (unaudited) (page 2 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
CHANGE IN OBLIGATED BALANCES													
Obligated Balance, Net													
Unpaid Obligations Brought Forward, October 1	$4,568	$3,985	$971	$26,588	$178	$2,074	$491	$1,820	$1,542	$296	$1,036	$3,509	**$47,058**
Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(200)	(178)	(47)	(915)	(126)	(121)	(9)	(360)	(270)	(8)	(92)	(11)	**(2,337)**
Total Unpaid Obligated Balance, Net	4,368	3,807	924	25,673	52	1,953	482	1,460	1,272	288	944	3,498	**44,721**
Obligations Incurred, Net	15,145	11,290	2,660	16,588	452	6,078	201	2,591	2,397	1,758	1,280	7,572	**68,012**
Gross Outlays	(14,194)	(10,391)	(2,529)	(13,960)	(417)	(5,729)	(247)	(2,334)	(2,183)	(1,685)	(1,056)	(6,955)	**(61,680)**
Obligated Balance Transferred, Net	-	-	-	26	-	-	-	-	-	-	-	-	**26**
Recoveries of Prior Year Unpaid Obligations	(458)	(211)	(135)	(2,783)	(11)	(359)	(6)	(114)	(115)	(9)	(97)	(165)	**(4,463)**
Change in Uncollected Customer Payments from Federal Sources	28	(209)	37	(30)	(1)	26	-	(94)	13	(15)	(68)	7	**(306)**
Obligated Balance, Net End of Period													
Unpaid Obligations	5,061	4,672	966	26,407	202	2,064	440	1,963	1,641	360	1,164	3,962	**48,902**
Uncollected Customer Payments from Federal Sources	(172)	(386)	(9)	(945)	(127)	(95)	(10)	(454)	(257)	(23)	(161)	(5)	**(2,644)**
Total, Unpaid Obligated Balance, Net, End of Period	4,889	4,286	957	25,462	75	1,969	430	1,509	1,384	337	1,003	3,957	**46,258**
NET OUTLAYS													
Net Outlays													
Gross Outlays	14,194	10,391	2,529	13,960	417	5,729	247	2,334	2,183	1,685	1,056	6,955	**61,680**
Offsetting Collections	(1,591)	(450)	(33)	(3,533)	(134)	(174)	(38)	(701)	(1,088)	(15)	(107)	(1,900)	**(9,764)**
Distributed Offsetting Receipts	(2,467)	(488)	(2,777)	(175)	-	(168)	-	(2)	1	-	-	(252)	**(6,328)**
Net Outlays	**$10,136**	**$9,453**	**$(281)**	**$10,252**	**$283**	**$5,387**	**$209**	**$1,631**	**$1,096**	**$1,670**	**$949**	**$4,803**	**$45,588**

Schedule of FY 2009 Budgetary Resources by Responsibility Segments (in millions) (unaudited and restated) (page 1 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
BUDGETARY RESOURCES													
Unobligated Balance, Brought Forward, October 1	$2,549	$1,792	$971	$13,573	$140	$525	$10	$305	$543	$63	$174	$790	**$21,435**
Recoveries of Prior Year Obligations	371	167	77	3,055	12	183	6	91	112	-	55	151	**4,280**
Budget Authority:													
Appropriations	13,186	9,864	2,353	7,778	333	5,334	2,332	1,790	1,158	1,750	934	6,027	**52,839**
Borrowing Authority	-	-	-	51	-	-	-	-	-	-	-	-	**51**
Spending Authority from Offsetting Collections:													
Earned:													
Collected	1,598	486	29	3,569	141	158	33	542	991	23	40	2,020	**9,630**
Change in Receivable from Federal Sources	11	9	35	26	10	20	(1)	(8)	21	(1)	3	(1)	**124**
Change in Unfilled Customer Orders:													
Advance Received	-	3	-	282	-	(1)	-	(2)	-	(1)	(1)	-	**280**
Without Advance From Federal Sources	(92)	(24)	(4)	(467)	(12)	(30)	5	97	(40)	(4)	37	(2)	**(536)**
Previously Unavailable	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Expenditure Transfers from Trust Funds	3	45	-	-	-	-	-	-	-	-	-	-	**48**
Subtotal	14,706	10,383	2,413	11,239	472	5,481	2,369	2,419	2,130	1,767	1,013	8,044	**62,436**
Nonexpenditure Transfers, Net; Anticipated and Actual	321	246	(17)	(26)	-	11	(2,176)	35	30	-	-	-	**(1,576)**
Temporarily Not Available Pursuant to Public Law	-	-	-	(4)	-	-	-	-	-	-	-	-	**(4)**
Permanently Not Available	(279)	(249)	(9)	(594)	(4)	(13)	-	(47)	(7)	(11)	(14)	(32)	**(1,259)**
TOTAL BUDGETARY RESOURCES	**$17,668**	**$12,339**	**$3,435**	**$27,243**	**$620**	**$6,187**	**$209**	**$2,803**	**$2,808**	**$1,819**	**$1,228**	**$8,953**	**$85,312**
STATUS OF BUDGETARY RESOURCES													
Obligations Incurred:													
Direct	$13,075	$9,859	$2,528	$22,959	$289	$5,443	$131	$1,861	$1,323	$1,661	$971	$7,602	**$67,702**
Reimbursable	1,527	486	21	83	176	154	39	601	1,035	17	85	3	**4,227**
Subtotal	14,602	10,345	2,549	23,042	465	5,597	170	2,462	2,358	1,678	1,056	7,605	**71,929**
Unobligated Balance:													
Apportioned	64	1,565	422	3,251	134	287	36	238	326	53	166	1,164	**7,706**
Exempt from Apportionment	-	2	-	3	-	-	-	-	-	-	-	-	**5**
Subtotal	64	1,567	422	3,254	134	287	36	238	326	53	166	1,164	**7,711**
Unobligated Balance Not Available	3,002	427	464	947	21	303	3	103	124	88	6	184	**5,672**
TOTAL STATUS OF BUDGETARY RESOURCES	**$17,668**	**$12,339**	**$3,435**	**$27,243**	**$620**	**$6,187**	**$209**	**$2,803**	**$2,808**	**$1,819**	**$1,228**	**$8,953**	**$85,312**

Schedule of FY 2009 Budgetary Resources by Responsibility Segments (in millions) (unaudited and restated) (page 2 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
CHANGE IN OBLIGATED BALANCES													
Obligated Balance, Net													
Unpaid Obligations brought forward, Oct 1	$5,378	$3,887	$1,049	$26,796	$161	$2,070	$758	$1,612	$1,316	$346	$1,107	$2,946	**$47,426**
Uncollected customer payments from federal sources, brought forward, Oct 1	(280)	(193)	(16)	(1,357)	(128)	(131)	(5)	(272)	(288)	(14)	(52)	(14)	**(2,750)**
Total unpaid obligated balance, net	5,098	3,694	1,033	25,439	33	1,939	753	1,340	1,028	332	1,055	2,932	**44,676**
Obligations incurred, net	14,602	10,345	2,549	23,042	465	5,597	170	2,462	2,358	1,678	1,056	7,605	**71,929**
Gross Outlays	(15,041)	(10,081)	(2,550)	(20,169)	(435)	(5,423)	(430)	(2,163)	(2,008)	(1,729)	(1,072)	(6,891)	**(67,992)**
Obligated balance transferred, net	-	-	-	(25)	-	-	-	-	-	-	-	-	**(25)**
Recoveries of Prior Year Unpaid Obligations	(371)	(167)	(77)	(3,055)	(12)	(183)	(6)	(91)	(112)	-	(55)	(151)	**(4,280)**
Change in uncollected customer payments from Federal Sources	81	16	(31)	441	1	9	(5)	(88)	20	6	(40)	3	**413**
Obligated balance, net end of Period													
Unpaid Obligations	4,569	3,985	971	26,588	178	2,060	491	1,820	1,556	295	1,036	3,509	**47,058**
Uncollected customer payments from Federal Sources	(200)	(178)	(47)	(915)	(126)	(121)	(9)	(360)	(270)	(8)	(92)	(11)	**(2,337)**
Total, unpaid obligated balance, net, end of period	4,369	3,807	924	25,673	52	1,939	482	1,460	1,286	287	944	3,498	**44,721**
NET OUTLAYS													
Net Outlays													
Gross Outlays	15,041	10,081	2,550	20,169	435	5,423	430	2,163	2,008	1,729	1,072	6,891	**67,992**
Offsetting collections	(1,601)	(534)	(30)	(3,850)	(141)	(157)	(33)	(540)	(990)	(23)	(39)	(2,020)	**(9,958)**
Distributed offsetting receipts	(2,281)	(26)	(2,485)	(5)	-	(154)	-	(11)	-	-	-	(251)	**(5,213)**
Net Outlays	**$11,159**	**$9,521**	**$35**	**$16,314**	**$294**	**$5,112**	**$397**	**$1,612**	**$1,018**	**$1,706**	**$1,033**	**$4,620**	**$52,821**

3. Statement of Custodial Activity

Substantially all duty, tax, and fee revenues collected by CBP are remitted to various General Fund accounts maintained by Treasury and the U.S. Department of Agriculture. Treasury further distributes these revenues to other Federal agencies in accordance with various laws and regulations. CBP either transfers the remaining revenue (generally less than one percent of revenues collected) directly to other Federal agencies or the Governments of Puerto Rico and the U.S. Virgin Islands. Refunds of revenues collected from import/export activities are recorded in separate accounts established for this purpose and are funded through permanent indefinite appropriations. These activities reflect the non-entity, or custodial, responsibilities that CBP, as an agency of the Federal Government, has been authorized by law to enforce.

CBP reviews selected documents to ensure all duties, taxes, and fees owed to the Federal Government are paid and to ensure all regulations are followed. If CBP determines duties, taxes, fees, fines, or penalties are due in addition to estimated amounts previously paid by the importer/violator, the importer/violator is notified of the additional amount due. CBP regulations allow the importer/violator to file a protest on the additional amount due for review by the Port Director. A protest allows the importer/violator the opportunity to submit additional documentation supporting the claim of a lower amount due or to cancel the additional amount due in its entirety. During this protest period, CBP does not have a legal right to the importer/violator’s assets, and consequently CBP recognizes accounts receivable only when the protest period has expired or an agreement is reached. For FY 2010 and FY 2009, CBP had legal right to collect $2.5 billion and $1.9 billion of receivables, respectively (unaudited). In addition, there were $2.4 billion and $2.2 billion representing records still in the protest phase for FY 2010 and FY 2009, respectively (unaudited). CBP recognized as write-offs $43 million and $397 million, respectively (unaudited), of assessments that the Department had statutory authority to collect at September 30, 2010 and 2009, but have no future collection potential. Most of this amount represents fines, penalties, and interest.

4. Risk Assumed Information

The Department has performed an analysis of the contingencies associated with the unearned premium reserve for the NFIP. The underlying calculation estimates the amount of subsidy in the total rates, removes the expense load, and applies the results to the unearned premium reserve. The range is designed to straddle the resulting estimate of unpaid expected losses by $500 to $550 million (unaudited).

Actual flood losses are highly variable from year to year. For the majority of years, this unearned premium reserve is adequate to pay the losses and expenses associated with this unearned premium. In those years with catastrophic flooding, the reserve will prove inadequate, and the average across all years will be inadequate because of the subsidies in premium levels.

Independent Auditors' Report

Office of Inspector General

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

Homeland Security

NOV 1 2 2010

MEMORANDUM FOR: The Honorable Janet Napolitano
Secretary

FROM: Richard L. Skinner
Richard L. Skinner
Inspector General

SUBJECT: *Independent Auditor's Report on DHS' FY 2010 Financial Statements and Internal Control over Financial Reporting*

The attached report presents the results of the Department of Homeland Security's (DHS) financial statement audits for fiscal years (FY) 2010 and 2009 and the results of an examination of internal control over financial reporting of the balance sheet as of September 30, 2010, and the statement of custodial activity for FY 2010. These are mandatory audits required by the *Chief Financial Officers Act of 1990,* as amended by the *Department of Homeland Security Financial Accountability Act of 2004*. This report is incorporated in the department's FY 2010 *Annual Financial Report*. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the integrated audit.

Generally, the department continued to show modest improvement in financial reporting during FY 2010, but still has much work to do. Many of DHS' challenges in financial management and reporting can be attributed to the original stand-up of a complex executive branch agency without adequate organizational expertise in financial management and accounting. Consequently, for the sixth year, KPMG was unable to express an opinion on the department's balance sheet and statement of custodial activity. Additionally, KPMG was unable to perform procedures necessary to form an opinion on DHS' internal control over financial reporting of the FY 2010 balance sheet and statement of custodial activity.

Summary

KPMG was unable to express an opinion on the department's balance sheets as of September 30, 2010 and 2009, and the related statements of custodial activity for the years then ended. DHS was unable to represent that certain financial statement balances were correct and was unable to provide sufficient evidence to support its financial statements. Additionally, KPMG was unable to perform the examination procedures necessary to form an opinion on DHS' internal control over financial reporting of the balance sheet as of September 30, 2010, and the statement of custodial activity for the year then ended.

The FY 2010 Independent Auditor's Report discusses six significant deficiencies considered to be material weaknesses, two other significant deficiencies in internal control, and six instances of non-compliance with laws and regulations, as follows:

Significant Deficiencies That Are Considered To Be Material Weaknesses

- Financial Management and Reporting
- Information Technology Controls and System Functionality
- Fund Balance with Treasury
- Property, Plant, and Equipment
- Actuarial and Other Liabilities
- Budgetary Accounting

Other Significant Deficiencies

- Entity-Level Controls
- Custodial Revenue and Drawback

Non-compliance with Laws and Regulations

- *Federal Managers' Financial Integrity Act of 1982 (FMFIA), and laws and regulations supporting OMB Circular No. A-50, Audit Follow-up*, as revised
- *Federal Financial Management Improvement Act of 1996* (FFMIA)
- *Single Audit Act Amendments of 1996, and laws and regulations supporting OMB Circular No. A-50, Audit Follow-up*, as revised
- *Chief Financial Officers Act of 1990*
- *Anti-deficiency Act*
- *Government Performance and Results Act of 1993*

Moving DHS' Financial Management Forward

While the auditors noted improvement toward correction of internal control weaknesses, the increase in audit scope related to auditing internal control over financial reporting resulted in our independent auditors identifying significant departmental challenges that have a pervasive impact on the effectiveness of internal control over consolidated financial reporting. Specifically:

- Development and implementation of effective information and communication processes to help ensure that technical accounting issues are identified, analyzed and resolved in a timely manner. For example, development of an accounting position and/or responses to our questions at the U.S. Customs and Border Protection (CBP), Federal Emergency Management Agency (FEMA) and Transportation Security Administration (TSA), is often a time-consuming process, that spans several months, even for some less complex matters;

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- Generally, the components continue to be dependent on the external financial statement audit to discover and resolve technical accounting issues;

- Field and operational personnel do not always share responsibilities for, or are not held accountable for, financial management matters that affect the financial statements, including adhering to accounting policies and procedures and performing key internal control functions in support of financial reporting; and

- The Department's financial Information Technology (IT) system infrastructure is aging and has limited functionality, which is hindering the Department's ability to implement efficient corrective actions and produce reliable financial statements that can be audited. Weaknesses in the general control environment are interfering with more extensive use of IT application controls to improve efficiencies in operations and reliability of financial information.

In FY 2010, the department reduced the number of conditions leading to the independent auditors' disclaimer of opinion on DHS' financial statements from two to one. As a result, TSA no longer contributes to the disclaimer condition. However, the department was unable to represent that its financial statements as of, and for the year ended, September 30, 2010, were presented in conformity with U.S. generally accepted accounting principles due to conditions existing in FY 2009 that remained at the U.S. Coast Guard (Coast Guard) throughout FY 2010. The Coast Guard was unable to provide sufficient evidence to support any of the account balances presented in the balance sheet consequently the independent auditor was unable to render an opinion. All six material weakness conditions and five instances of noncompliance with laws and regulations from FY 2009 were repeated in FY 2010. During the FY 2010 the independent auditors identified an additional noncompliance with laws and regulations. The department did not comply with the *Government Performance and Results Act of 1993*.

In FY 2010, Coast Guard made limited progress with implementing aspects of its *Financial Strategy for Transformation and Audit Readiness* (FSTAR) in the areas necessary to assert to the completeness, existence, and accuracy of PP&E, actuarial liabilities, and fund balance with Treasury balances. In addition to its planned FSTAR initiatives for FY 2010, the Coast Guard performed additional remediation efforts over discrete elements of its balance sheet. This "balance sheet strategy" was designed to achieve additional account balance assertions. As a result, Coast Guard was able to assert to more than $43 billion of its balance sheet. However, Coast Guard was unable to accomplish all aspects of its planned remediation efforts. As a result the Coast Guard was unable to fully remediate prior year control weaknesses and the auditor again reported that the Coast Guard contributed to all six material weaknesses and the significant deficiency regarding entity-level controls.
During FY 2010, the DHS made modest progress in remediating weaknesses and remains committed to focusing on remediation efforts at the Coast Guard, (CBP), FEMA, U.S. Immigrations and Customs Enforcement (ICE), and TSA. However, FEMA Information Technology management may not have a complete understanding of its control deficiencies because FEMA reported that it had closed 28 information technology controls and system functionality weakness conditions but the independent auditors concurred with

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management's conclusion on only 5 of the conditions reported as closed. The remaining 23 weakness conditions were reissued to FEMA. The OIG also noted that, unlike in previous years, the department sustained progress made in FY 2009 throughout FY 2010.

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KPMG is responsible for the attached independent auditor's report dated November 13, 2010, 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 this report to appropriate congressional committees with oversight and appropriation responsibilities over the department. In addition, we will post a copy of the report on our public website.

We request that the Office of the Chief Financial Officer provide us with a corrective action plan that demonstrates progress in addressing the report's recommendations.

We appreciate the cooperation extended to the auditors by the department's financial offices. Should you have any questions, please call me, or your staff may contact Anne Richards, Assistant Inspector General for Audits, at 202-254-4100.

Attachment

Department of Homeland Security
Office of Inspector General

Independent Auditors' Report on DHS' FY 2010 Financial Statements and Internal Control over Financial Reporting

OIG-11-09

November 2010

Washington, DC 20528

Homeland Security

NOV 12 2010

Preface

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

The attached report presents the results of the DHS financial statements audits for fiscal years (FY) 2010 and 2009 and the results of an examination of internal control over financial reporting of the balance sheet as of September 30, 2010, and the statement of custodial activity for FY 2010. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the audits. The contract required that KPMG perform its audits according to generally accepted government auditing standards and guidance from the Office of Management and Budget and the Government Accountability Office. KPMG was unable to provide an opinion on DHS' balance sheets as of September 30, 2010 and 2009, or on DHS' internal control over financial reporting of the FY 2010 balance sheet and statement of custodial activity. The FY 2010 auditors' report discusses eight significant deficiencies in internal control, of which six are considered material weaknesses, and five instances of noncompliance with laws and regulations. KPMG is responsible for the attached draft auditors' report and the conclusions expressed in the report. We do not express opinions on DHS' financial statements or provide conclusions on compliance with laws and regulations.

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

Richard L. Skinner

Richard L. Skinner
Inspector General

U.S. DEPARTMENT OF HOMELAND SECURITY

Excerpts from the DHS Annual Financial Report

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KPMG LLP
2001 M Street, NW
Washington, DC 20036

INDEPENDENT AUDITORS' REPORT

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

We were engaged to audit the accompanying balance sheets of the U.S. Department of Homeland Security (DHS or Department) as of September 30, 2010 and 2009, and the related statements of custodial activity for the years then ended (referred to herein as "financial statements"). We were also engaged to examine the Department's internal control over financial reporting of the balance sheet as of September 30, 2010, and statement of custodial activity for the year then ended. In connection with our audit engagement, we also considered DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on the balance sheet as of September 30, 2010 and the related statement of custodial activity for the year ended. We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources, for the years ended September 30, 2010 and 2009 (referred to herein as "other fiscal year (FY) 2010 and 2009 financial statements"), or to examine internal control over financial reporting over the other FY 2010 financial statements.

Summary

As stated in our Report on the Financial Statements, the scope of our work was not sufficient to express an opinion on the DHS balance sheets as of September 30, 2010 and 2009, or the related statements of custodial activity for the years then ended.

As discussed in Notes 1V and 1N, DHS adopted Statement of Federal Financial Accounting Standard (SFFAS) No. 33, *Pensions, Other Retirement Benefits, and Other Post-employment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*, and SFFAS No. 35, *Estimating the Historical Cost of General Property, Plant, and Equipment* (SFFAS No. 35) as of October 1, 2009.

As stated in our Report on Internal Control over Financial Reporting, we were unable to perform procedures necessary to form an opinion on DHS' internal control over financial reporting of the FY 2010 balance sheet and statement of custodial activity.

Material weaknesses in internal control over financial reporting, as defined in the Report on Internal Control over Financial Reporting section of this report, have been identified in the following areas:

- Financial Management and Reporting
- Information Technology Controls and Financial System Functionality
- Fund Balance with Treasury
- Property, Plant, and Equipment
- Actuarial and Other Liabilities
- Budgetary Accounting.

Significant deficiencies, as defined in the Report on Internal Control over Financial Reporting section of this report, have been identified in the following areas:

- Certain Entity Level Controls
- Custodial Revenue and Drawback.

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed instances of noncompliance or other matters in the following areas that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended:

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- *Federal Managers' Financial Integrity Act of 1982* (FMFIA), and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-up*, as revised
- *Federal Financial Management Improvement Act of 1996* (FFMIA)
- *Single Audit Act Amendments of 1996*
- *Chief Financial Officers Act of 1990*
- *Anti-deficiency Act*
- *Government Performance and Results Act of 1993.*

We also reported other matters related to compliance with the *Anti-deficiency Act* at the National Protection and Programs Directorate (NPPD), U.S. Secret Service (USSS), U.S. Coast Guard (Coast Guard), and the Management Directorate.

Other deficiencies in internal control, potentially including additional material weaknesses and significant deficiencies, and other instances of non-compliance may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DHS' balance sheets as of September 30, 2010 and 2009, and the related statements of custodial activity for the years then ended, had we been able to perform all procedures necessary to express an opinion on DHS' internal control over financial reporting of the balance sheet as of September 30, 2010, and statement of custodial activity for the year then ended, and had we been engaged to audit the other FY 2010 and 2009 financial statements, and to examine internal control over financial reporting of the other FY 2010 financial statements.

The following sections discuss the reasons why we are unable to express an opinion on the accompanying DHS financial statements; why we were unable to express an opinion on internal control over financial reporting of the balance sheet as of September 30, 2010, and statement of custodial activity for the year then ended; our tests of DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements and other matters; and management's and our responsibilities.

Report on the Financial Statements

We were engaged to audit the accompanying balance sheets of the U.S. Department of Homeland Security as of September 30, 2010 and 2009, and the related statements of custodial activity for the years then ended. These financial statements are the responsibility of DHS management.

The Coast Guard was unable to provide sufficient evidential matter that support transactions and certain balance sheet accounts including fund balance with Treasury, accounts receivable, inventory and related property, general property, plant and equipment including heritage assets and stewardship land, certain actuarially-derived liabilities, environmental and other liabilities, and net position, as reported in the accompanying DHS balance sheets as of September 30, 2010 and 2009. The total assets and liabilities of the Coast Guard, as reported in the accompanying DHS balance sheets, were $20.3 billion and $18.7 billion, or 23 and 22 percent of total DHS consolidated assets, and were $46.4 billion and $37.8 billion, or 56 and 51 percent of total DHS consolidated liabilities as of September 30, 2010 and 2009, respectively.

The Transportation Security Administration (TSA) was unable to provide sufficient evidential matter that supports certain general property, plant, and equipment balances and related effects on net position, as reported in the accompanying DHS balance sheets as of September 30, 2009. The TSA general property, plant, and equipment balances reported in the accompanying DHS balance sheets were $997 million as of September 30, 2009, or 6 percent of DHS' consolidated general property, plant, and equipment as of September 30, 2009.

It was impractical to extend our procedures sufficiently to determine the extent, if any, to which the DHS balance sheets as of September 30, 2010 and 2009, and the related statements of custodial activity for the years then ended, may have been affected by the matters discussed in the two preceding paragraphs. Accordingly, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements and the related notes thereto.

We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the years ended September 30, 2010 and 2009, and accordingly, we do not express an opinion on these other FY 2010 and 2009 financial statements.

As discussed in Note 32, DHS restated its FY 2009 financial statements to correct multiple errors identified by U.S. Citizenship and Immigration Services, TSA, Coast Guard, Federal Law Enforcement Training Center, and Federal Emergency Management Agency that required adjustment of balances previously reported in DHS' FY 2009 financial statements. Because of the matters discussed in the second and third paragraphs of the Report on the Financial Statements regarding our audits at the Coast Guard and TSA, we were unable to audit the restatements identified by the Coast Guard and TSA, and accordingly, we have not concluded on the appropriateness of this accounting treatment or the restatement of the DHS balance sheet as of September 30, 2009. In addition, DHS did not present the Statements of Net Cost as of September 30, 2010 and 2009 by major program, goals and outputs as described in a strategic and performance plan, and also omitted certain related financial statement disclosures, required by OMB Circular No. A-136, *Financial Reporting Requirements*, as amended.

As discussed in Notes 1V and 1N, DHS adopted Statement of Federal Financial Accounting Standard (SFFAS) No. 33, *Pensions, Other Retirement Benefits, and Other Post-employment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*, and SFFAS No. 35, *Estimating the Historical Cost of General Property, Plant, and Equipment* (SFFAS No. 35) as of October 1, 2009.

The information in the Management's Discussion and Analysis (MD&A), Required Supplementary Stewardship Information (RSSI), and Required Supplementary Information (RSI) sections of the DHS FY 2010 AFR is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We were unable to complete limited procedures over MD&A, RSSI, and RSI as prescribed by professional standards because of the limitations on the scope of our audit described in the second and third paragraphs of this section of our report. Certain information presented in the MD&A, RSSI, and RSI is based on other FY 2010 and 2009 financial statements on which we have not expressed an opinion. We did not audit the MD&A, RSSI, and RSI, and accordingly, we express no opinion on it. However, we noted that DHS did not include summary performance information that is aligned with its FY 2010 strategic goals and other information, within the MD&A section of the FY 2010 AFR, as required by OMB Circular No. A-136, *Financial Reporting Requirements*, as amended. DHS recently completed a quadrennial review for the purpose of developing an updated strategic plan around new priorities established by the Secretary.

The information in the Other Accompanying Information section of DHS' FY 2010 AFR is presented for purposes of additional analysis, and are not a required part of the financial statements. This information has not been subjected to auditing procedures, and accordingly, we express no opinion on it.

Report on Internal Control over Financial Reporting

We were engaged to examine the Department's internal control over financial reporting of the balance sheet as of September 30, 2010, and statement of custodial activity for the year then ended, based on the criteria established in OMB Circular No. A-123, *Management's Responsibility for Internal Control* (OMB Circular No. A-123), Appendix A. DHS management is responsible for establishing and maintaining effective internal control over financial reporting, and for its assertion on the effectiveness of internal control over financial reporting, included in the FY 2010 DHS *Secretary's Assurance Statement*, included in MD&A on page 29 of the DHS FY 2010 AFR, as required by OMB Circular No. A-123. We were not engaged to examine and report on internal control over financial reporting at the DHS component level.

The FY 2010 DHS *Secretary's Assurance Statement*, states that the Department was unable to provide assurance that internal control over financial reporting was operating effectively at September 30, 2010. This conclusion is based on the Department's evaluation and analysis of control deficiencies in the Coast Guard, TSA, Federal Emergency Management Agency, U.S. Customs and Border Protection, and U.S. Immigration and Customs Enforcement that in combination represent Departmental material weaknesses. In addition, the Coast Guard was unable to provide documentation of key processes, risk assessments, or evidence supporting the existence of internal controls, and Management acknowledges that pervasive material weaknesses exist in key financial processes, and is therefore unable to make an assertion on the effectiveness of internal control over financial reporting in key financial statement processes.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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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. Material weaknesses in internal control over financial reporting have been identified in the following areas:

- Financial Management and Reporting
- Information Technology Controls and Financial Systems Functionality
- Fund Balance with Treasury
- Property, Plant, and Equipment
- Actuarial and Other Liabilities
- Budgetary Accounting

Deficiencies at the Coast Guard that are considered to be material weaknesses at the consolidated level, when aggregated with deficiencies existing at other components, are presented in Exhibit I. Deficiencies at other DHS components that contribute to material weaknesses at the consolidated level, when aggregated with deficiencies existing at the Coast Guard, are presented in Exhibit II.

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. Our consideration of internal control was for the purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in DHS' internal control that might be significant deficiencies. However, in accordance with *Government Auditing Standards*, we are required to report significant deficiencies in internal control identified during our examination. Significant deficiencies have been identified in the following areas:

- Other Entity Level Controls
- Custodial Revenue and Drawback.

Exhibit III presents significant deficiencies at the consolidated level.

Because of the limitation on the scope of our examination described in the second paragraph of the Report on the Financial Statements section, and the second paragraph of the Report on Internal Control over Financial Reporting section, the scope of our work was not sufficient to enable us to express, and we do not express an opinion on the effectiveness of DHS' internal control over financial reporting of the balance sheet as of September 30, 2010, and related statement of custodial activity for the year then ended. It was impractical to extend our procedures sufficiently to determine the extent, if any, to which the FY 2010 balance sheet and statement of custodial activity may have been affected by these circumstances. We were not engaged to examine internal controls over financial reporting of the accompanying statements of net cost, changes in net position, and budgetary resources, for the year ended September 30, 2010. Additional deficiencies in internal control over financial reporting, potentially including additional material weaknesses and significant deficiencies, may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DHS' internal control over financial reporting of the FY 2010 balance sheet and statement of custodial activity, and had we been engaged to audit the other FY 2010 and 2009 financial statements, and to examine internal control over financial reporting over the other FY 2010 financial statements.

The FY 2010 DHS *Secretary's Assurance Statement*, states that the Department identified five material weaknesses in internal control over financial reporting, which differs from the number of material weaknesses indentified by us during our FY 2010 audit. The reasons for this difference are provided in Exhibit IV, Comment I.

A summary of the status of FY 2009 material weaknesses and significant deficiencies is included as Exhibit V. We also noted certain additional deficiencies involving internal control over financial reporting and its operation that we will report to the management of DHS in a separate letter.

Report on Compliance and Other Matters

In connection with our engagement to audit of the balance sheet of DHS as of September 30, 2010, and statement of custodial activity for the year then ended, we performed tests of DHS' compliance with certain provisions of

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laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the balance sheet amounts as of September 30, 2010, and the related statement of custodial activity for the year then ended, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, as amended, including the provisions referred to in Section 803(a) of FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to DHS. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our engagement, and accordingly, we do not express such an opinion.

Management is responsible for complying with laws, regulations, contracts and grant agreements applicable to DHS.

The results of certain of our tests of compliance exclusive of those referred to in the FFMIA, disclosed the following six instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04, as amended, and are described in Exhibit IV:

- *Federal Managers' Financial Integrity Act of 1982* (FMFIA), and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-up*, as revised
- *Federal Financial Management Improvement Act of 1996* (FFMIA)
- *Single Audit Act Amendments of 1996*
- *Chief Financial Officers Act of 1990*
- *Anti-deficiency Act*
- *Government Performance and Results Act of 1993.*

The results of our other tests of compliance exclusive of those referred to in FFMIA, disclosed no other instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04, as amended.

The results of our tests of FFMIA disclosed instances described in Exhibits I, II, and III where DHS' financial management systems did not substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.

As discussed in our Reports on the Financial Statements and Internal Control over Financial Reporting, the scope of our work was not sufficient to express an opinion on the balance sheets as of September 30, 2010 and 2009, and the related statements of custodial activity for the years then ended, or to express an opinion on the effectiveness of internal control over financial reporting of the balance sheet as of September 30, 2010 and the related statement of custodial activity for the year then ended. Accordingly, other instances of noncompliance with laws, regulations, contracts, and grant agreements may have been identified and reported, had we been able to perform all procedures necessary to complete our audit of the financial statements and examination of internal control over financial reporting of the balance sheet as of September 30, 2010 and the related statements of custodial activity for the year then ended, and had we been engaged to audit the other FY 2010 and 2009 financial statements and to examine internal control over financial reporting over the other FY 2010 financial statements. In addition, because of the matters discussed in the second paragraph of our report on the financial statements, we were unable to complete tests of compliance over the Prompt Payment Act and Titles 10, 14, 31 (as related to the *Anti-deficiency Act*), and 37 of the United States Code at the Coast Guard.

Other Matters: Management of the NPPD, USSS, Coast Guard, and the Management Directorate have initiated reviews of certain collections, classification and use of funds, expenditures and/or obligations recorded that may identify a violation of the *Anti-deficiency Act*, or other violations of appropriation law in FY 2010 or in previous years.

Management's Response to Internal Control and Compliance Findings

DHS management has indicated in a separate letter immediately following this report that it concurs with the findings presented in Exhibits I, II, III, and IV of our report. We did not audit DHS' response, and accordingly, we express no opinion on it.

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KPMG

Restricted Use

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

November 12, 2010

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

Our report on internal control over financial reporting and compliance and other matters is presented in accordance with *Government Auditing Standards,* issued by the Comptroller General of the United States. The internal control weaknesses and findings related to compliance with certain laws, regulations, contracts, and grant agreements presented herein were identified during our engagement to audit the U.S. Department of Homeland Security (Department or DHS)'s the balance sheet as of September 30, 2010, and statement of custodial activity for the year then ended (financial statements), and to examine internal control over financial reporting of those financial statements. We were not engaged to audit the Department's fiscal year (FY) 2010 statements of net cost, changes in net position, and budgetary resources (referred to as other FY 2010 financial statements), or to examine internal controls over financial reporting of the other FY 2010 financial statements. Our findings and the status of prior year findings are presented in five exhibits:

Exhibit I Significant deficiencies in internal control identified at the United States Coast Guard (Coast Guard). All of the significant deficiencies reported in Exhibit I are considered material weaknesses at the DHS consolidated level when combined with other significant deficiencies reported in Exhibit II.

Exhibit II Significant deficiencies in internal control identified throughout the Department or at other DHS components (components other than Coast Guard are collectively referred to as DHS Civilian Components). All of the significant deficiencies reported in Exhibit II are considered material weaknesses at the DHS consolidated level when combined with other significant deficiencies reported in Exhibit I.

Exhibit III Significant deficiencies that are not considered a material weakness at the DHS consolidated financial statement level.

Exhibit IV Instances of noncompliance with certain laws, regulations, contracts, and grant agreements that are required to be reported under *Government Auditing Standards* or Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements,* as amended.

Exhibit V The status of our findings reported in FY 2009.

As stated in our Independent Auditors' Report, the scope of our work was not sufficient to enable us to express an opinion on the effectiveness of DHS' internal control over financial reporting of the balance sheet as of September 30, 2010, and related statement of custodial activity for the year then ended. In addition, the scope of our work was not sufficient to express an opinion on the financial statements that we were engaged to audit; consequently, additional deficiencies in internal control over financial reporting, potentially including additional material weaknesses and significant deficiencies, may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DHS' internal control over financial reporting of the financial statements, and had we been engaged to audit the other FY 2010 financial statements, and to examine internal control over financial reporting of the other FY 2010 financial statements.

The determination of which findings rise to the level of a material weakness is based on an evaluation of how deficiencies identified in all components, considered in aggregate, may affect the DHS balance sheet as of September 30, 2010, or the related statement of custodial activity for the year then ended.

We have also performed follow-up procedures on findings identified in previous engagements to audit the DHS financial statements. All of the significant deficiencies identified and reported in Exhibit I for the Coast Guard are repeated from our FY 2009 and FY 2008 report, and include updates for new findings resulting from our 2010 procedures. To provide trend information for the DHS Civilian Components, Exhibits II and III contain Trend Tables next to the heading of each finding. The Trend Tables in Exhibits II and III depict the severity and current status of findings by component that has contributed to that finding from FY 2008 through FY 2010.

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

A summary of our findings in FY 2010 and FY 2009 are presented in the Tables below:

Table 1 Presents a summary of our internal control findings, by component, for FY 2010.
Table 2 Presents a summary of our internal control findings, by component, for FY 2009.

We have reported six material weaknesses and two significant deficiencies at the Department level in FY 2010, shown in Table 1.

TABLE 1 – SUMMARIZED DHS FY 2010 INTERNAL CONTROL FINDINGS

Comments / Financial Statement Area		DHS Consol.	CG	CBP	USCIS	FEMA	FLETC	ICE	NPPD	TSA
			Military	Civilian						
Material Weakness:			Exhibit I	Exhibit II						
A	Financial Management and Reporting	MW								
B	IT Controls and System Functionality	MW								
C	Fund Balance with Treasury	MW								
D	Property, Plant and Equipment	MW								
E	Actuarial and Other Liabilities	MW								
F	Budgetary Accounting	MW								
Significant Deficiencies:			Exhibit III							
G	Other Entity-Level Controls	SD								
H	Custodial Revenue and Drawback	SD								

TABLE 2 – SUMMARIZED DHS FY 2009 INTERNAL CONTROL FINDINGS

Comments / Financial Statement Area		DHS Consol.	CG	CBP	USCIS	FEMA	FLETC	ICE	NPPD	TSA
			Military	Civilian						
Material Weakness:			Exhibit I	Exhibit II						
A	Financial Management and Reporting	MW								
B	IT Controls and System Functionality	MW								
C	Fund Balance with Treasury	MW								
D	PP&E and OMS	MW								
E	Actuarial and Other Liabilities	MW								
F	Budgetary Accounting	MW								
Significant Deficiencies:			Exhibit III							
G	Other Entity-Level Controls	SD								
H	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

All components of DHS, as defined in Note 1A – *Reporting Entity*, to the financial statements, were included in the scope of our engagement to audit the consolidated balance sheet of DHS as of September 30, 2010, and the related statement of custodial activity for the year then ended, and to examine internal control over financial reporting of those financial statements. Accordingly, our engagement to audit and examine internal control considered significant account balances, transactions, and accounting processes of other DHS components not listed above. Control deficiencies identified in other DHS components that are not identified in the table above did not individually, or when combined with other component findings, contribute to a significant deficiency at the DHS consolidated financial statement level.

i.2

I-A Financial Management and Reporting

Background: In fiscal year (FY) 2010, we were engaged to perform an examination of internal controls over financial reporting. The auditors' objective in an examination of internal control is to form an opinion on the effectiveness of internal control. When planning our examination, we gave appropriate emphasis to testing entity-level controls, such as management's risk assessment and monitoring processes, and other control environment elements that exist throughout the Department. Four Department-wide control environment conditions were identified through our examination procedures that have a pervasive influence on the control environment and effectiveness of control activities at the United States Coast Guard (Coast Guard). This Exhibit should be read in conjunction with the Department-wide conditions and recommendations described in Comment **II-A**, *Financial Management and Reporting*.

In previous years, we reported that the Coast Guard had several internal control deficiencies that led to a material weakness in financial reporting. In response, the Coast Guard developed its *Financial Strategy for Transformation and Audit Readiness* (FSTAR), which is a comprehensive plan to identify and correct conditions that are causing control deficiencies, and in some cases preventing the Coast Guard from preparing auditable financial statements.

The Coast Guard made progress in FY 2010, by completing its planned corrective actions over selected internal control deficiencies. Specifically, remediation efforts associated with accrued payroll, pension, and medical liabilities allowed management to make assertions on the completeness and accuracy of more than $43 billion of accrued liabilities, which represents more than 50 percent of DHS' total liabilities. The FSTAR calls for continued remediation of control deficiencies and reconciliation of balances in FY 2011.Consequently many of the financial reporting deficiencies we reported in the past remain uncorrected at September 30, 2010.

Conditions:

1. In FY 2010, certain entity-level control weaknesses, that may interfere with the timely completion of corrective actions planned for FY 2011 and beyond, continued to exist. While progress has been made, the Coast Guard has not completed the:
   - Development and implementation of effective policies, procedures, internal controls, and information and communication processes to ensure that data supporting financial statement assertions are complete and accurate, that transactions are accounted for consistent with generally accepted accounting principles (GAAP), and that technical accounting issues are identified, analyzed and resolved in a timely manner. For example, the development and implementation of an accounting position over post-employment travel benefits, totaling less than one percent of liabilities took several months to complete. This condition is a potentially serious impediment to the Coast Guard's objective of producing an auditable balance sheet next year;
   - Adoption of an on-going Coast Guard-wide risk assessment by financial, IT, and program personnel that addresses all significant financial statement line items; and
   - Implementation of adequate monitoring controls over headquarters, units, and areas/districts with significant financial activity, including those controls associated with management override.
2. The Coast Guard does not have properly designed, implemented, and effective policies, procedures, processes, and controls surrounding its financial reporting process, as necessary to:
   - Support beginning balances, year-end close-out, and the cumulative results of operations analysis in its general ledgers individually and/or in the aggregate;
   - Ensure that transactions and accounting events at Coast Guard headquarters, units, and areas/districts are appropriately supported and accounted for in its general ledgers;
   - Ensure that accounts receivable balances exist, are complete and accurate, and properly presented in the financial statements. For example, underlying data supporting accounts receivable balances is not maintained, reimbursable related activity is not identified timely, and accounts receivable activity is not properly recorded in the financial statements on a timely basis;

Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

- Ensure financial statement information and related disclosures submitted for incorporation in the DHS financial statements are accurate and complete; and
- Ascertain that intragovernmental activities and balances are identified and differences, especially with agencies outside DHS, are being resolved in a timely manner in coordination with the Department's Office of Financial Management (OFM).

Cause/Effect: The Coast Guard has thorough and highly procedural processes for identifying and resolving technical accounting issues, and/or responding to auditor inquiries. This process often results in exceptionally long time periods devoted to issue resolution, which can extend to several months or even years, to resolve a single matter. In some cases, the issues are not material to the financial statements, but still require long time periods to resolve. This approach interferes with the timely completion of financial reports, and the availability of auditable accounting positions. In addition, insufficient controls over financial reporting could create an environment where an *Anti-deficiency Act* violation could occur.

The Coast Guard has not developed and implemented an effective general ledger system. The Core Accounting System (CAS), Aircraft Logistics Management Information System (ALMIS), and Naval Engineering Supply Support System (NESSS) general ledgers do not comply with the requirements of the *Federal Financial Management Improvement Act* (FFMIA). The general ledgers do not allow for compliance with the United States Standard General Ledger (USSGL) at the transaction level, and period-end and opening balances are not supported by transactional detail in the three general ledgers. The conditions described below in Comment **I-B**, *Information Technology Controls and Financial Systems Functionality* contribute to the financial reporting control deficiencies, and make correction more difficult.

Because of the conditions noted above, the Coast Guard was unable to provide reasonable assurance that internal controls over all financial reporting processes are operating effectively, and has acknowledged that pervasive material weaknesses continue to exist in some key financial processes. Consequently, the Coast Guard cannot be reasonably certain that its financial statements are reliable, or assert to the completeness, existence, accuracy, valuation, rights and obligations, or presentation of their financial data related to their balances of fund balance with Treasury, accounts receivable, general property, plant, and equipment, including heritage assets and stewardship land, environmental and other liabilities, and net position as reported in the Department's balance sheets as of September 30, 2010 and 2009.

Criteria: FFMIA Section 803(a) requires that each agency shall implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. FFMIA is intended to ensure that agencies use financial management systems that provide reliable, timely, and consistent information.

The *Federal Managers' Financial Integrity Act of 1982* (FMFIA) requires that agencies establish internal controls according to standards prescribed by the Comptroller General. These standards are specified in the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government (Standards)*. These standards define internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

The GAO *Standards* require that internal controls be documented in management directives, administrative policies or operating manuals; transactions and other significant events be clearly documented; and information be recorded and communicated timely with those who need it within a timeframe that enables them to carry out their internal control and other responsibilities. The GAO *Standards* also identify the control environment as one of the five key elements of control, which emphasizes the importance of conscientiousness in management's operating philosophy and commitment to internal control. These standards cover controls such as human capital practices, supervisory reviews, policies, procedures, monitoring, and segregation of duties.

The Treasury *Federal Intragovernmental Transactions Accounting Policies Guide*, dated August 13, 2010, states that Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*, as revised, require Federal CFO Act and non-CFO Act entities identified in the Treasury

Financial Manual (TFM) 2010, Vol. I, Part 2, Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government*, to perform quarterly reconciliations of intragovernmental activity/balances. TFM, Section 4706, *Intragovernmental Requirements*, requires reporting agencies to reconcile and confirm intragovernmental activity and balances quarterly for specific reciprocal groupings. TFM Bulletin 2007-03, *Intragovernmental Business Rules*, also provides guidance to Federal agencies for recording and reconciling intragovernmental activities.

Recommendations: We recommend that the Coast Guard:

1. Continue the implementation of the FSTAR, as planned;
2. Develop and implement effective policies, procedures, and internal controls to ensure that technical accounting issues are identified, analyzed, and resolved in a timely manner. The Coast Guard should be able to discuss initial accounting positions with basic rationale and supporting facts within one week of issue identification. Final resolution, may take longer depending on the complexity of the issues and impact on the Department, however even difficult cases should be resolved in substantially less time;
3. Improve entity-level controls by fully implementing a formal risk assessment process, evaluating and updating processes used to communicate policies and ensure that all transactions are recorded completely and accurately, and improve monitoring controls over financial data supporting the general ledger and financial statements;
4. Implement accounting and financial reporting processes including an integrated general ledger system that is FFMIA compliant; and
5. Establish new or improve existing policies, procedures, and related internal controls to ensure that:
   a. The year-end close-out process, reconciliations, and financial data and account analysis procedures are supported by documentation, including evidence of effective management review and approval, and beginning balances in the following year are determined to be reliable and auditable;
   b. All accounting transactions and balances are properly reflected in the financial statements and consistent with GAAP;
   c. Accounts receivable balances exist, are complete and accurate, and properly presented in the financial statements;
   d. Financial statement disclosures submitted for incorporation in the DHS financial statements are accurate and complete; and
   e. All intragovernmental activity and balances are accurately reflected in the financial statements, and differences are being resolved in a timely manner in coordination with the Department's OFM.

I-B Information Technology Controls and Financial Systems Functionality

Background: Information Technology (IT) general and application controls are essential for achieving effective and reliable reporting of financial and performance data. IT general controls (ITGC) are tested using the objectives defined by the GAO's *Federal Information System Controls Audit Manual* (FISCAM), in five key control areas: security management, access control, configuration management, segregation of duties, and business continuity. Our procedures included a review of the Coast Guard's key ITGC environments.

We also considered the effects of financial systems functionality when testing internal controls, because key Coast Guard financial systems are not compliant with FFMIA and are no longer supported by the original software provider. Functionality limitations add to the challenge of addressing systemic internal control weaknesses, and strengthening the control environment at the Coast Guard.

Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

In FY 2010, our IT audit work identified 28 IT findings, of which 10 were repeat findings from the prior year and 18 were new findings. In addition, we determined that Coast Guard remediated eight IT findings identified in previous years. Specifically, the Coast Guard took actions to improve aspects of its user recertification process, data center physical security, and scanning for system vulnerabilities. The Coast Guard's remediation efforts have enabled us to expand our testwork into areas that previously were not practical to test, considering management's acknowledgment of the existence of control deficiencies. Most of the new findings relate to IT systems that were added to our examination scope this year.

Conditions: Our findings related to financial systems controls and functionality are as follows:

Related to IT controls:

Condition: We noted that Coast Guard's core financial system configuration management process controls are not operating effectively, and continue to present risks to DHS financial data confidentiality, integrity, and availability. Financial data in the general ledger may be compromised by automated and manual changes that are not adequately controlled. For example, the Coast Guard uses an IT scripting process to make updates to its core general ledger software, as necessary, to process financial data. During our FY 2010 testing, we noted that some previously identified control deficiencies were remediated (particularly with the implementation of a new script change management tool in the second half of FY 2010), while other deficiencies continued to exist. The remaining control deficiencies vary in significance. However, three key areas that impact the Coast Guard IT script control environment are:

- Script testing requirements – Limited testing requirements exist to guide Coast Guard staff in the development of test plans and guidance over the functional testing that should be performed;
- Script testing environment – Not all script changes were tested in the appropriate test environments, as required; and
- Script audit logging process – The Coast Guard's core system databases are logging changes to tables as well as successful and unsuccessful logins. However, no reconciliation between the scripts run and the changes made to the database tables is being performed to monitor the script activities and ensure that all scripts run have been approved.

In addition, we noted weaknesses in the script change management process as it relates to the Internal Control over Financial Reporting (ICOFR) process (e.g., the financial statement impact of the changes to FINCEN core accounting system through the script change management process). The Coast Guard has not fully developed and implemented procedures to ensure that a script, planned to be run in production, has been through an appropriate level of review by a group of individuals thoroughly assessing if the script would have a financial statement impact. Furthermore, the rationale documenting the impact of the script, whether deemed as having financial impact or not, is not documented and retained for internal assessment or audit purposes. Internal controls that ensure the reliability of the scripting process must be effective throughout the year, but most importantly during the year-end close-out and financial reporting process.

All of our ITGC findings are described in detail in a separate *Limited Official Use* (LOU) letter provided to the Coast Guard and DHS management.

Related to financial system functionality:

We noted that certain financial system functionality limitations are contributing to control deficiencies reported elsewhere in Exhibit I, are inhibiting progress on corrective actions for Coast Guard, and are preventing the Coast Guard from improving the efficiency and reliability of its financial reporting processes. Some of the financial system limitations lead to extensive manual and redundant procedures to process transactions, to verify the accuracy of data, and to prepare financial statements. Systemic conditions related to financial system functionality include:

- As noted above, Coast Guard's core financial system configuration management process is not operating effectively due to inadequate controls over IT scripts. The IT script process was instituted as a solution primarily to compensate for system functionality and data quality issues;

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- Financial system audit logs are not readily generated and reviewed, as some of the financial systems are lacking the capability to perform this task efficiently;
- Production versions of operational financial systems are outdated and do not provide the necessary core functional capabilities (e.g., general ledger capabilities); and
- Financial systems functionality limitations are preventing the Coast Guard from establishing automated processes and application controls that would improve accuracy, reliability, and facilitate efficient processing of certain financial data such as:
  - Ensuring proper segregation of duties and access rights such as automating the procurement process to ensure that only individuals who have proper contract authority can approve transactions or setting system access rights within the fixed asset subsidiary ledger;
  - Maintaining sufficient data to support Fund Balance with Treasury related transactions, including suspense activity;
  - Maintaining adequate posting logic transaction codes to ensure that transactions are recorded in accordance with GAAP; and
  - Tracking detailed transactions associated with intragovernmental business and eliminate the need for default codes such as Trading Partner Identification Number that cannot be easily researched.

Cause/Effect: The IT system development activities did not incorporate adequate security controls during the initial implementation more than seven years ago. The current IT configurations of many Coast Guard financial systems cannot be easily reconfigured to meet new DHS security requirements. The existence of these IT weaknesses leads to added dependency on the other mitigating manual controls to be operating effectively at all times. Because mitigating controls often require more human involvement, there is an increased risk that human error could materially affect the financial statements. In addition, the Coast Guard's core financial systems are not FFMIA compliant with the Federal Government's Financial System Integration Office (FSIO) requirements. See Comment **I-A**, *Financial Management and Reporting*, for a discussion of the related conditions causing significant noncompliance with the requirements of FFMIA. Configuration management weaknesses are also among the principle causes of the Coast Guard's inability to support its financial statement balances for audit purposes.

Criteria: The *Federal Information Security Management Act* (FISMA) passed as part of the *E-Government Act of 2002*, provides guidance that Federal entities maintain IT security programs in accordance with National Institute of Standards and Technology (NIST) guidance.

OMB Circular No. A-130, *Management of Federal Information Resources*, establishes policy for the management of Federal information resources.

FFMIA is intended to ensure that agencies use financial management systems that provide reliable, timely, and consistent information. The purpose of FFMIA is to (1) provide for consistency of accounting by an agency from one fiscal year to the next, and uniform accounting standards throughout the Federal Government, (2) require Federal financial management systems to support full disclosure of Federal financial data, including the full costs of Federal programs and activities, (3) increase the accountability and credibility of federal financial management, (4) improve performance, productivity, and efficiency of Federal Government financial management, and (5) establish financial management systems to support controlling the cost of Federal Government.

OMB Circular No. A-123, *Management's Responsibility for Internal Control*, states, "Agency managers should continuously monitor and improve the effectiveness of internal control associated with their programs. This continuous monitoring, and other periodic evaluations, should provide the basis for the agency head's annual assessment of and report on internal control, as required by FMFIA." This Circular indicates that "control weaknesses at a service organization could have a material impact on the controls of the customer organization. Therefore, management of cross-servicing agencies will need to provide an annual assurance statement to its customer agencies in advance to allow its customer agencies to rely upon that assurance statement. Management of cross-servicing agencies shall test the controls over the activities for which it performs for others on a yearly basis. These controls shall be highlighted in management's assurance statement that is provided to its customers. Cross-servicing and customer agencies will need to coordinate the timing of the assurance statements."

DHS *Sensitive Systems Policy Directive, 4300A*, as well as the DHS *4300A Sensitive Systems Handbook* documents policies and procedures adopted by DHS intended to improve the security and operation of all DHS IT systems including the Coast Guard IT systems.

The GAO's FISCAM provides a framework and recommended audit procedures that are used to conduct the IT general control test work.

Recommendations: We recommend that the DHS Office of Chief Information Officer, in coordination with the Office of the Chief Financial Officer (OCFO), implement the recommendations in our LOU letter provided to the Coast Guard and DHS management. In that letter, we provide more detailed recommendations to effectively address the deficiencies identified in the configuration management process.

Additionally, regarding IT controls, we recommend that the Coast Guard:

1. Develop and implement policies and procedures that address open aspects of script testing, including documentation of test documents;
2. Develop training that addresses all aspects of script testing (including documentation of test documents) and provide training to appropriate CM staff;
3. Develop a resource plan with associated supporting business case(s) to address the database audit logging requirements;
4. Develop procedures and perform regular account revalidation for the script management tool to ensure privileges remain appropriate; and
5. Conduct an assessment over the ICFOR process related to identifying and evaluating scripts that have a financial statement impact. This assessment can be included in the configuration management oversight process as part of USCG's annual A-123 efforts, or performed independent of the A-123 process. We recommend that this assessment (1) be performed early in the FY 2011, in time to remediate deficiencies before the end of the third quarter, and (2) involve process documentation and sufficient testing to fully assess both design and operating effectiveness of controls. The objective being to have a reliable process and internal controls in place that allow the auditor to test, and rely on those controls, during the fourth quarter of FY 2011.

I-C Fund Balance with Treasury

Background: Fund Balance with Treasury (FBWT) at the Coast Guard totaled approximately $6.5 billion, or approximately 10.7 percent of total DHS FBWT at September 30, 2010. The majority of these funds represented appropriated amounts that were obligated, but not yet disbursed, as of September 30, 2010. In FY 2009, we reported a material weakness in internal control over FBWT at the Coast Guard. In FY 2010, the Coast Guard corrected some FBWT control deficiencies; specifically issues associated with payroll related transactions, and revised its remediation plan to include additional corrective actions that are scheduled to occur after FY 2010. Consequently, most of the conditions stated below are repeated from our FY 2009 report.

Conditions: The Coast Guard has not developed a comprehensive process, to include effective internal controls, to ensure that all FBWT transactions are recorded in the general ledger timely, completely, and accurately. For example, the Coast Guard:

- Did not properly design and implement FBWT monthly activity reconciliations and/or could not provide detail transaction lists reconciled to the general ledger for amounts reported to Treasury for all Coast Guard Agency Location Codes;

- Has not been able to substantiate the completeness and accuracy of all inputs to the SF 224 process;
- Recorded adjustments to the general ledger FBWT accounts or activity reports submitted to Treasury, including adjustments to agree Coast Guard balances to Treasury amounts, that were unsupported;
- Does not have an effective process for clearing suspense account transactions related to FBWT due to over-reliance on vendor-provided data. The Coast Guard lacks documented and effective policies and procedures and internal controls necessary to support the completeness, existence, and accuracy of suspense account transactions. In addition, certain issues persist with industrial service orders (ISOs) and credit cards that preclude a complete and accurate population of suspense detail; and
- Does not have well established procedures to perform routine analytical comparisons between accounts, particularly budgetary accounts that should have a direct relationship with FBWT accounts.

Cause/Effect: The Coast Guard had not designed and implemented accounting processes, including a financial system that complies with federal financial system requirements, as defined in OMB Circular No. A-127, *Financial Management Systems*, as revised, and the requirements of the *Joint Financial Management Improvement Program* (JFMIP), now administered by the FSIO, to fully support the FY 2010 FBWT activity and balance as of September 30, 2010. Failure to implement timely and effective reconciliation processes could increase the risk of undetected errors and/or violations of appropriation laws, including instances of undiscovered *Anti-deficiency Act* violations or fraud, abuse, and mismanagement of funds, which could lead to inaccurate financial reporting and affect DHS' ability to effectively monitor its budget status.

Criteria: Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*, paragraph 39 states, "Federal entities should explain any discrepancies between fund balance with Treasury in their general ledger accounts and the balance in the Treasury's accounts and explain the causes of the discrepancies in footnotes to financial statements. (Discrepancies due to time lag should be reconciled and discrepancies due to error should be corrected when financial reports are prepared). Agencies also should provide information on unused funds in expired appropriations that are returned to Treasury at the end of a fiscal year."

Per *Fund Balance with Treasury Reconciliation Procedures, a Supplement to the Treasury Financial Manual, I TFM 2-5100*, Section V, "Federal agencies must reconcile their SGL 1010 account and any related subaccounts [...] on a monthly basis (at minimum) [...] Federal agencies must [...] resolve all differences between the balances reported on their G/L FBWT accounts and balances reported on the [*Government-wide Accounting* system (GWA)]." In addition, "An agency may not arbitrarily adjust its FBWT account. Only after clearly establishing the causes of errors and properly documenting those errors, should an agency adjust its FBWT account balance. If an agency must make material adjustments, the agency must maintain supporting documentation. This will allow correct interpretation of the error and its corresponding adjustment."

Section 803(a) of FFMIA requires that each agency shall implement and maintain financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. FFMIA is intended to ensure that agencies use financial management systems that provide reliable, timely, and consistent information.

The GAO *Standards* hold that transactions should be properly authorized, documented, and recorded completely and accurately.

Recommendations: We recommend that the Coast Guard continue to implement remediation efforts associated with establishing policies, procedures, and internal controls to ensure that FBWT transactions are recorded accurately completely, and in a timely manner, and that all supporting documentation is maintained for all recorded transactions. The Coast Guard remediation efforts should include procedures to:

1. Ensure that appropriate supporting documentation is maintained and readily available to support all aspects of appropriation activity (e.g., warrants, transfers, rescissions, etc.) and opening 2011 FBWT balances;
2. Perform complete and timely FBWT reconciliations using the Treasury Government-wide Accounting tools. Adequate documentation should be maintained and readily available for all data (e.g., receipts, disbursements, journal entries, etc.) used in the reconciliation process. Documentation should be sufficient to support items at the transactional level, and enable transactions and balances to be reconciled to the general ledger, as appropriate;
3. Better manage its suspense accounts to include researching and clearing items carried in suspense clearing accounts in a timely manner during the year, and maintaining proper supporting documentation in clearing suspense activity;
4. Perform analytical procedures over budgetary and proprietary activity related to the FBWT process; and
5. Review any IT related application (e.g., system generated reports) or general controls (e.g., change management) associated with the FBWT process.

I-D Property, Plant, and Equipment

Background: The Coast Guard maintains approximately 51 percent of all DHS property, plant, and equipment (PP&E), including a large fleet of boats and vessels. Many of the Coast Guard's assets are constructed over a multi-year period, have long useful lives, and undergo extensive routine servicing that may increase their value or extend their useful lives. In FY 2010, the Coast Guard continued to execute remediation efforts as documented in FSTAR to address the PP&E process and control deficiencies, specifically those associated with vessels, small boats, and aircraft. However, FSTAR procedures are scheduled to occur over a multi-year timeframe. Consequently, many of the conditions cited below have been repeated from our FY 2009 report.

DHS Stewardship PP&E primarily consists of Coast Guard heritage assets, which are PP&E that are unique due to historical or natural significance; cultural, educational, or artistic (e.g., aesthetic) importance; or architectural characteristics. Coast Guard heritage assets consist of both collection type heritage assets, such as artwork and display models, and non-collection type heritage assets, such as lighthouses, sunken vessels, and buildings.

Conditions: The Coast Guard has not:

Regarding PP&E:

- Established its opening PP&E balances necessary to prepare a balance sheet as of September 30, 2010. Inventory procedures were performed in 2010 to assist in the substantiation of existence and completeness of PP&E balances; however, they were not performed over all asset classes (e.g., real property). Furthermore, in cases where original acquisition documentation has not been maintained, the Coast Guard has not fully implemented methodologies and assumptions to support the value of all PP&E;
- Implemented appropriate controls and related processes to accurately, consistently, and timely record additions to PP&E and construction in process (CIP), (including all costs necessary to place the asset in service e.g., other direct costs), transfers from other agencies, disposals in its fixed asset system, and support the valuation and classification of repairable PP&E;
- Implemented accurate and complete asset identification, system mapping, and tagging processes that include sufficient detail (e.g., serial number) to clearly differentiate and accurately track physical assets to those recorded in the fixed asset system;

- Developed and implemented a process to identify and evaluate all lease agreements to ensure that they are appropriately categorized as operating or capital, and properly reported in the financial statements and related disclosures;
- Properly accounted for improvements and impairments to buildings and structures, capital leaseholds, selected useful lives for depreciation purposes, and appropriate capitalization thresholds, consistent with GAAP; and
- Identified and tracked all instances where accounting is not in compliance with GAAP (usually due to immateriality), and prepare a non-GAAP analysis that supports managements accounting policies. This analysis should be maintained and available for audit.

Regarding Stewardship PP&E:

- Fully designed and implemented policies, procedures, and internal controls to support the completeness, existence, accuracy, and presentation assertions over data utilized in developing required financial statement disclosures and related supplementary information for Stewardship PP&E.

Cause/Effect: The Coast Guard has had difficulty establishing its opening PP&E balances primarily because of poorly designed policies, procedures, and processes implemented more than a decade ago, combined with ineffective internal controls. PP&E was not properly tracked or accounted for many years preceding the Coast Guard's transfer to DHS in 2003, and now the Coast Guard is faced with a formidable challenge of performing retroactive analysis in order to properly establish the existence, completeness, and accuracy of PP&E. Furthermore, the fixed asset module of the Coast Guard's CAS is not updated timely for effective tracking and reporting of PP&E on an ongoing basis. As a result, the Coast Guard is unable to accurately account for its PP&E, and provide necessary information to DHS OFM for consolidated financial statement purposes.

The Coast Guard management deferred correction of the Stewardship PP&E weaknesses reported in previous years, and acknowledged that the conditions we reported in prior years remained throughout FY 2010. The lack of comprehensive and effective policies and controls over the identification and reporting of Stewardship PP&E could result in misstatements in the required financial statement disclosures and related supplementary information for Stewardship PP&E.

Criteria: SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, provides the general requirements for recording and depreciating property, plant, and equipment. SFFAS No. 6 was recently amended by SFFAS No. 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23*, which clarifies that "reasonable estimates of original transaction data historical cost may be used to value general PP&E... Reasonable estimates may be used upon initial capitalization as entities implement general PP&E accounting for the first time, as well as by those entities who previously implemented general PP&E accounting." Additionally, SFFAS No. 35 "allows the use of reasonable estimates when an entity determines it is necessary to revalue general PP&E assets previously reported."The Federal Accounting Standards Advisory Board (FASAB)'s Federal Financial Accounting Standards Interpretation No. 7, dated March 16, 2007, defines "items held for remanufacture" as items "in the process of (or awaiting) inspection, disassembly, evaluation, cleaning, rebuilding, refurbishing and/or restoration to serviceable or technologically updated/upgraded condition. Items held for remanufacture may consist of: Direct materials, (including repairable parts or subassemblies [...]) and Work-in-process (including labor costs) related to the process of major overhaul, where products are restored to 'good-as-new' condition and/or improved/upgraded condition. 'Items held for remanufacture' share characteristics with 'items held for repair' and items in the process of production and may be aggregated with either class. Management should use judgment to determine a reasonable, consistent, and cost-effective manner to classify processes as 'repair' or 'remanufacture'."

SFFAS No. 29, *Heritage Assets and Stewardship Land*, provides the requirements for the presentation and disclosure of heritage assets. In summary, this standard requires that heritage assets and stewardship land information be disclosed as basic information in the notes to the financial statements, except for condition information, which is reported as required supplementary information (RSI).

FFMIA Section 803(a) requires that each agency shall implement and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. OMB Circular No. A-127 prescribes the standards for federal agencies' financial management systems.

Recommendations: We recommend that the Coast Guard:

Regarding PP&E:

1. Continue to implement remediation efforts associated with establishing PP&E balances, including designing and implementing inventory procedures over all PP&E categories and implementing methodologies, including the use of SFFAS No. 35, to support the value of all PP&E;
2. Implement appropriate controls and related processes to accurately and timely record additions to PP&E and CIP, transfers from other agencies, improvements, impairments, capital leases, depreciable lives, disposals in its fixed asset system, and valuation and classification of repairable PP&E;
3. Implement processes and controls to record any identifying numbers in the fixed asset system at the time of asset purchase to facilitate identification and tracking; and to ensure that the status of assets is accurately tracked in the subsidiary ledger;
4. Develop and implement a process to identify and evaluate all lease agreements to ensure that they are appropriately categorized as operating or capital, and are properly reported in the financial statements and related disclosures;
5. Ensure that appropriate supporting documentation is maintained and readily available to support PP&E life-cycle events (e.g., improvements, in-service dates, disposals, etc.); and
6. Perform and document a non-GAAP analysis for all instances where accounting policies are not in compliance with GAAP.

Regarding stewardship PP&E:

7. Design and implement policies, procedures, and internal controls to support the completeness, existence, accuracy, and presentation and disclosure assertions related to the data utilized in developing disclosure and related supplementary information for Stewardship PP&E that is consistent with GAAP.

I-E Actuarial and Other Liabilities

Background: The Coast Guard maintains medical and post-employment travel benefit programs that require actuarial computations to record related liabilities for financial reporting purposes. The Military Retirement System (MRS) is a defined benefit plan that covers both retirement pay and health care benefits for all active duty and reserve military members of the Coast Guard. The medical plan covers active duty, reservists, retirees/survivors, and their dependents that are provided care at Department of Defense (DoD) medical facilities. The post-employment travel benefit program pays for the relocation (i.e., travel and shipment of household goods) of uniformed service members to their home station upon separation from the Coast Guard. Annually, participant and cost data is extracted by the Coast Guard from its records and provided to an actuarial firm as input for the liability calculations. The accuracy of the actuarial liability, as reported in the financial statements, is dependent on the accuracy and completeness of the underlying participant and cost data provided to the actuary, as well as the reasonableness of the assumptions used.

The Coast Guard estimates accounts payable by adjusting the prior year revised accounts payable accrual estimate by the percentage change in budgetary authority for the current fiscal year. The revised prior year estimate is the mid-point of the range in which the accrual should fall based on an analysis of actual payments made subsequent to September 30 of the prior year. The calculation is based on the results of a statistical sample for a portion of the subsequent disbursement population and a judgmental sample for the other portion.

The Coast Guard's environmental liabilities consist of environmental remediation, cleanup, and decommissioning. The environmental liabilities are categorized as relating to shore facilities or vessels. Shore facilities include any facilities or property other than ships (e.g., buildings, fuel tanks, lighthouses, small arms firing ranges, etc.).

Conditions: We noted the following internal control weaknesses related to actuarial and other liabilities.

Regarding actuarial liabilities:

The Coast Guard had not implemented sufficient internal controls to ensure that information used by the actuary to calculate the pension benefit liability was complete, accurate, and properly used in actuarial valuation calculations until later in FY 2010. In early FY 2010, adjustments to the prior year pension benefit liability were identified by both the actuarial service provider and the Coast Guard, which highlighted this control weakness. During FY 2010, management implemented new internal controls that they believe will address these deficiencies.

The Coast Guard has not:

- Developed and implemented sufficient ongoing internal controls to ensure that information used by the actuary to calculate the actuarial medical benefit liability is complete and accurate. During FY 2010, the Coast Guard implemented various mitigating internal control and substantive procedures to address these conditions, however did not design or implement a sufficient long-term internal control solution; and
- Implemented effective policies, procedures, and controls to ensure the completeness and accuracy of relocation claims provided to, and used by, the actuary for the calculation of the post-employment travel benefit liability.

Regarding accounts payable and payroll estimates:

- Designed a methodology used to estimate accounts payable that considers and uses all applicable current year data. As a result, current year data that may have a significant impact on the estimate could be overlooked;
- Fully implemented effective controls to ensure that services have been provided to qualified Coast Guard members prior or subsequent to the payment of medical related invoices. As a result, medical related year-end accounts payable amounts and data utilized in the calculation of medical incurred but not reported estimates may be misstated, and improper payments may be made to service providers. During FY 2010, the Coast Guard implemented detective procedures to review invoices paid in FY 2010, however they did not review historical invoices (i.e., invoices paid prior to FY 2010) used in the incurred but not reported calculation nor implement a sufficient long-term internal control solution to address these conditions; and
- Designed and implemented a process to properly calculate and record civilian related payroll liabilities until fiscal year-end.

Regarding environmental liabilities:

- Fully supported the completeness, existence, and accuracy assertions of the data utilized in developing the estimate for the FY 2010 environmental liability account balance; and
- Fully developed, documented, and implemented the policies and procedures in developing, preparing, and recording the environmental liability estimates related to shore facilities and vessels.

Cause/Effect: The Coast Guard did not perform a comprehensive review over information provided by actuarial service providers to ensure the completeness and accuracy of their calculation of pension benefit liabilities. Additionally, ineffective policies, procedures, and controls exist to ensure the completeness and accuracy of relocation claims provided to, and used by, the actuary for the calculation of post-employment benefit liabilities.

The Coast Guard's methodology used to estimate accounts payable is based on the prior year estimate, validated via a subsequent payment analysis, and does not consider or use all applicable current year data. Additionally, the information provided by medical service providers is not sufficient for the Coast Guard to perform detailed reviews prior to payment, and as such, modifications may be necessary to existing service agreements.

The Coast Guard has not fully developed, documented, and implemented policies and procedures to develop, prepare, and record environmental liability estimates in accordance with applicable accounting standards.

The process to record civilian related payroll accruals was not designed or operating effectively until fiscal year-end, leading to misstatements in quarterly financial statements.

Criteria: According to SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, paragraph 79, Other Retirement Benefits (ORB) include all retirement benefits other than pension plan benefits. Per paragraph 88, the ORB liability should be reported using the aggregate entry-age normal method. The liability is the actuarial present value of all future benefits less the actuarial future present value of future cost contributions that would be made for and by the employees under the plan.

According to SFFAS No. 5, paragraph 95, the employer entity should recognize an expense and a liability for other post-employment benefits (OPEB) when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the reporting date. Further, the long-term OPEB liability should be measured at the present value of future payments, which requires the employer entities to estimate the amount and timing of future payments, and to discount the future outflow over the period for which the payments are to be made.

The GAO *Standards* hold that transactions should be properly authorized, documented, and recorded completely and accurately. SFFAS No. 1, paragraph 77 states, "When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of the goods. If invoices for those goods are not available when financial statements are prepared, the amounts owed should be estimated."

FASAB Technical Release No. 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*, states that an agency is required to recognize a liability for environmental cleanup costs as a result of past transactions or events when a future outflow or other sacrifice of resources is probable and reasonably estimable. "Probable" is related to whether a future outflow will be required. "Reasonably estimable" relates to the ability to reliably quantify in monetary terms the outflow of resources that will be required.

Recommendations: We recommend that the Coast Guard:

Regarding actuarial liabilities:

1. Continue to assess the effectiveness of controls implemented during FY 2010 to ensure that information used by the actuary to calculate the pension benefit liability is complete, accurate, and properly used in actuarial valuation calculations;
2. Develop and implement sufficient internal controls to ensure that information used by the actuary to calculate the actuarial medical benefit liability is complete and accurate; and
3. Implement effective policies, procedures, and controls to ensure the completeness and accuracy of information provided to the actuary to develop the post-employment travel benefit liability.

Regarding accounts payable and payroll estimates:

4. Analyze and make appropriate improvements to the methodology used to estimate accounts payable and support all assumptions and criteria with appropriate documentation to develop and subsequently validate the estimate for financial reporting;
5. Implement effective internal controls to ensure that services have been provided to qualified Coast Guard members prior or subsequent to the payment of medical invoices; and

6. Continue to assess the effectiveness of internal controls implemented over payroll at fiscal year-end.

Regarding environmental liabilities:

7. Develop and implement policies, procedures, processes, and controls to ensure the identification and recording of all environmental liabilities, to define the technical approach, to establish cost estimation methodology, and to develop overall financial management oversight of its environmental remediation projects. Consider the "Due Care" requirements defined in FASAB Technical Release No. 2. The policies should include:
   a. Procedures to ensure the proper calculation and review of cost estimates for consistency and accuracy in financial reporting, including the use of tested modeling techniques, use of verified cost parameters, and assumptions;
   b. Periodically validate estimates against historical costs; and
   c. Ensure that detailed cost data is maintained and reconciled to the general ledger.

I-F Budgetary Accounting

Background: Budgetary accounts are a category of general ledger accounts where transactions related to the receipt, obligation, and disbursement of appropriations and other authorities to obligate and spend agency resources are recorded. Each Treasury Account Fund Symbol (TAFS) with separate budgetary accounts must be maintained in accordance with OMB and Treasury guidance. The Coast Guard has over 90 TAFS covering a broad spectrum of budget authority, including annual, multi-year, and no-year appropriations; and several revolving, special, and trust funds.

Conditions: We noted the following internal control weaknesses related to budgetary accounting, many of which were repeated from our FY 2009 report. The Coast Guard has not:

- Fully implemented policies, procedures, and internal controls over the Coast Guard's process for validation and verification of undelivered order (UDO) balances. Recorded obligations and UDO balances were not always complete, valid, or accurate, and proper approvals and supporting documentation are not always maintained;
- Finalized and implemented policies and procedures to monitor unobligated commitment activity in CAS throughout the fiscal year. Currently, the Coast Guard only performs a year-end review to reverse commitments that are no longer valid; and
- Designed and implemented effective procedures, processes, and internal controls to verify the completeness and accuracy of the year-end obligation "pipeline" which are obligations executed on or before September 30 but not recorded in the Coast Guard's CAS, and to record all executed obligations. These deficiencies affected the completeness, existence, and accuracy of the year-end "pipeline" adjustment that was made to record obligations executed before year end.

Cause/Effect: Several of the Coast Guard's budgetary control weaknesses can be corrected by modifications or improvements to the financial accounting system, process improvements, and strengthened policies and internal controls. Weak controls in budgetary accounting, and associated contracting practices increase the risk that the Coast Guard could violate the *Anti-deficiency Act* and overspend its budget authority. The financial statements are also at greater risk of misstatement. Reliable accounting processes surrounding obligations, UDOs, and disbursements are essential for the accurate reporting of accounts payable in the DHS consolidated financial statements. The untimely release of commitments may prevent funds from being used for other purposes.

Criteria: According to the Office of Federal Financial Management's *Core Financial System Requirements*, dated January 2006, an agency is responsible for establishing a system for ensuring that it does not obligate or disburse funds in excess of those appropriated or authorized, and "the Budgetary Resource Management function must support agency policies on internal funds allocation methods and controls." The *Federal Acquisition Regulation* (FAR) Section 1.602 addresses the authorities and responsibilities granted to contracting officers. Treasury's USSGL guidance at TFM S2 10-02 (dated August 2010) specifies the accounting entries related to budgetary transactions.

FFMIA Section 803(a) requires that each agency shall implement and maintain financial management systems that comply substantially with Federal financial management system requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. OMB Circular No. A-127, as revised, prescribes the standards for federal financial management systems.

Recommendations: We recommend that the Coast Guard:

1. Continue to improve policies, procedures, and the design and effectiveness of controls related to processing obligation transactions, including periodic review and validation of UDOs. Emphasize to all fund managers the need to perform effective reviews of open obligations, obtain proper approvals, and retain supporting documentation;
2. Finalize policies and procedures to periodically review commitments, and make appropriate adjustments in the financial system; and
3. Improve procedures, processes, and internal controls to verify the completeness and accuracy of the year-end obligation "pipeline" adjustment to record all executed obligations for financial reporting.

II-A Financial Management and Reporting

Department-wide Entity-Level Controls affecting Financial Reporting:

Background: We were engaged to perform an integrated audit in fiscal year (FY) 2010, which is an audit of the financial statements integrated with an examination of internal control over financial reporting. The auditors' objective in an examination of internal control is to form an opinion on the effectiveness of internal control. We used the criteria defined in the Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control,* to evaluate effectiveness of internal control. OMB Circular No. A-123, and other similar control criteria such as *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), emphasizes the importance of entity-level controls as well as control activities over key financial statement processes. Consequently, when planning our examination, we gave appropriate emphasis to testing entity-level controls, such as management's risk assessment and monitoring processes, and other control environment elements that exist throughout the Department of Homeland Security (DHS or the Department). In FY 2009, we noted that the Department lacked a sufficient number of management personnel with the requisite financial accounting knowledge and background to ensure that its financial statements are prepared accurately and in compliance with generally accepted accounting principles. Throughout FY 2010, the Department executed a staffing plan to fill gaps in Department-wide skill sets, increasing the number of accounting and financial management personnel with essential technical competencies. Four Department-wide control environment conditions were identified through our examination procedures that have a pervasive influence on the effectiveness of controls. Those common themes are described below; however, they also contribute to several of the conditions presented throughout Exhibits I – IV.

Conditions: We identified the following Department-wide control environment weaknesses that have a pervasive effect on the effectiveness of internal controls over consolidated financial reporting:

- Development and implementation of effective information and communication processes to help ensure that technical accounting issues are identified, analyzed and resolved in a timely manner. For example, development of an accounting position and/or responses to our questions at the U.S. Customs and Border Protection (CBP), Federal Emergency Management Agency (FEMA) and Transportation Security Administration (TSA) at various times throughout the audit, is often a time-consuming process, that spans several months, even for some less complex matters;
- Generally, the components continue to be dependent on the external financial statement audit to discover and resolve technical accounting issues;
- Field and operational personnel do not always share responsibilities for, or are not held accountable for, financial management matters that affect the financial statements, including adhering to accounting policies and procedures and performing key internal control functions in support of financial reporting; and
- The Department's financial Information Technology (IT) system infrastructure is aging and has limited functionality, which is hindering the Department's ability to implement efficient corrective actions and produce reliable financial statements that can be audited. Weaknesses in the general control environment are interfering with more extensive use of IT application controls to improve efficiencies in operations and reliability of financial information.

Recommendations: We recommend that the Department's Office of the Chief Financial Officer (OCFO), with the support of the Deputy Secretary and Under Secretary for Management, develop and implement actions to:

1. Design and implement strategies to ensure that technical accounting issues are identified, analyzed, and resolved in a timely manner. DHS components, working with Office of Financial Management (OFM) support, should be able to discuss initial accounting positions, with basic rationale and supporting facts, within one to two days of issue identification. Final resolution, may take longer depending on the complexity of the issues and impact on the Department, however, even difficult matters should be resolved in substantially less time;

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Exhibit II – Material Weaknesses – DHS Civilian Components

2. Consider realignment of some recently hired financial accounting and reporting personnel to devote more resources to technical accounting issue resolution, and reduce reliance on the external audit;

3. Expand the annual risk assessment process to involve field and operational personnel, to identify potential accounting and financial reporting issues, including accounting systems, processes, and infrastructure, where problems are likely to occur due to changing operations and programs; and

4. Continue the assessment of the Department's financial IT system infrastructure, with the objective of improving the effectiveness of IT controls, both general and application, and IT functionality in support of timely and accurate financial reporting. In the interim, consider opportunities to expand use of application controls to help ensure completeness, accuracy, authorization, and validity of financial transactions reported in the financial statements.

Financial Management and Reporting (TSA and FEMA):

Background: The TSA is in the final stages of establishing baseline accounting policies, procedures, and processes, with well-designed and effective internal controls. In FY 2010, TSA made progress by hiring accounting personnel, and completing the reconciliation of its balance sheet accounts. In addition, TSA addressed matters that have led to misstatements in the financial statements in previous years. Again in FY 2010, this progress was achieved through the exceptional efforts of a few people in the OFM, reliance on external contractor expertise, and reliance on the external audit to identify issues. Consequently, some entity-level and financial reporting control weaknesses reported in FY 2009 continued to exist, however measurable progress has been made FY 2010, allowing us to downgrade the severity of this control deficiency.

	2010	2009	2008
DHS-HQ	N/A	N/A	C
TSA	Deficiencies are less severe*	Deficiencies are more severe*	Deficiencies are more severe*
FEMA	Deficiencies are less severe*	Deficiencies are more severe*	Deficiencies are more severe*
CBP	C	Deficiencies are less severe*	N/A

Key – Trend Table	
C	Deficiencies are corrected
	Deficiencies are less severe*
	Deficiencies are more severe*
* See Introduction	

FEMA's accounting and financial reporting processes must support multi-faceted operations such as temporary assistance funds, disaster relief loans, national flood insurance programs, stockpiles of essential supplies, mission assignments to other federal agencies for restoration and reconstruction, and grants to state and local governments. While FEMA has taken positive steps in FY 2010 to correct control deficiencies that we have reported in the past, certain financial reporting control deficiencies continued to exist throughout the year.

CBP substantially corrected control deficiencies affecting financial reporting that we reported in FY 2009. However, some entity-level control deficiencies continue to exist, and have been reported in Comment **III-G**, *Other Entity-Level Controls*.

Conditions:

1. TSA:

- Has not fully developed its financial reporting process with sufficient policies, procedures, and internal controls to ensure the reliability of financial statements. For example, we noted that TSA:
  - Has not distributed the financial reporting workload to ensure that skill sets are aligned with tasks, make optimal use of newly hired resources, and improve the financial reporting internal control structure;
  - Lacks effective internal controls, including supervisory reviews and monitoring, at some significant process-level risk points, e.g., where there is a risk of material error within a process;
  - Does not perform sufficient procedures, or have established compensating controls, working in coordination with the Agency's OMB A-123 process, that would identify abnormalities in

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account balances and correct errors that may occur. Instead, Office of Financial Management (OFM) is dependent on receiving accurate data, from various sources within TSA, some of which may not have fully effective internal controls (see comment **II-D**, *Property, Plant, and Equipment*); and

- Remains dependent on the external financial statement audit process, or outside contractors, to identify risks of misstatement, account balance errors, and provide feedback on corrective action plans.

- Is not fully compliant with the United States Government Standard General Ledger (USSGL) requirements at the transaction level. For example, TSA did not record property-related adjustments into the applicable general ledger accounts at the appropriate fund account symbol to provide an audit trail to the transaction level; and

- Is unable to fully identify and present its intragovernmental balances and transactions by trading partner.

2. FEMA:

- Did not have adequate processes and controls throughout the year to ensure that all adjustments were fully researched, substantiated, documented, and/or appropriately reviewed prior to preparation and submission of financial data to the Department. For example, FEMA performs manual adjustments to correct attributes for certain financial activity, primarily related to the Grants Program Directorate (GPD). These adjustments are not fully substantiated;

- Did not have well designed controls throughout the year over financial reporting to the Department using the Treasury Information Repository System (TIER) system, and did not always maintain evidence of the control procedures performed. For example, we noted that FEMA:
  - Did not properly document its verification that TIER beginning balances were accurate and agreed to prior year TIER ending balances;
  - Did not perform the June TIER to Integrated Financial Management Information System (IFMIS) reconciliation at the Treasury Account Fund Symbol (TAFS) level in June, and investigate discrepancies that existed between the TIER balances on the reconciliation and the submitted TIER trial balance;
  - Did not maintain evidence of supervisory review of the TIER file in the TIER holding area before it was moved to the TIER repository prior to the third quarter of FY 2010; and
  - Did not prepare and review the initial and final TIER to the IFMIS reconciliations prior to submission of the TIER file to the DHS TIER repository prior to the fourth quarter of FY 2010.

- Did not properly complete the Government Accountability Office (GAO) Financial Audit Manual (FAM) 2010 – Checklist for Federal Accounting, and the supervisory review control was not effective in identifying errors in the checklist.

Cause/Effect: TSA continued to devote substantial resources to remediation of control deficiencies and reconciliation of balance sheet accounts in FY 2010, which placed greater than normal demands on the staff. Technical accounting staff were often committed to projects, and TSA was unable to make optimal use of its newly hired resources in a review and monitoring capacity. As a result, in some cases, adjustments to correct errors in accounts were recorded without appropriate supporting analysis, documentation, and reviews.

FEMA's IT systems are outdated and have limited capacity for modification. (See comment **II-B**, *Information Technology Controls and Financial System Functionality*.) Consequently, FEMA must rely more heavily on manual analyses and adjustments to accurately prepare financial statements. With accelerated time-frames for reporting, particularly at year-end, the likelihood that a material error will occur increases. Additionally, prior to the fourth quarter of FY 2010, FEMA had not devoted adequate resources to correct the errors related to GPD. Further, prior to the third quarter of FY 2010, FEMA did not have formal documented processes for various financial reporting activities, including the timely completion and documentation of all TIER-related control activities.

Criteria: OMB Circular No. A-123 defines internal control and provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal control. In particular, management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. The documentation for internal control, all transactions, and other significant events should be readily available for examination. Further, relevant, reliable, and timely information should be communicated to relevant personnel at all levels within an organization. It is also crucial that an agency communicate with outside organizations. In addition, the Circular states that management should identify both internal and external risks, and analyze those risks for their potential effect on the agency.

The *Federal Financial Managers Improvement Act of 1996* (FFMIA) Section 803(a) requires that each agency shall implement financial management systems that comply substantially with Federal financial management systems requirements, applicable Federal accounting standards, and the USSGL at the transaction level. FFMIA is intended to ensure that agencies use financial management systems that provide reliable, timely, and consistent information.

OMB Circular No. A-50, *Audit Follow-Up,* states that corrective action taken by management on resolved findings and recommendations is essential to improving the effectiveness and efficiency of Government operations. Each agency shall establish systems to assure the prompt and proper resolution and implementation of audit recommendations. These systems shall provide for a complete record of action taken on both monetary and nonmonetary findings and recommendations.

Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, paragraph 164, states that financial reporting "should help report users make relevant comparisons among similar federal reporting units, such as comparisons of the costs of specific functions or activities. Comparability implies that differences among financial reports should be caused by substantive differences in the underlying transactions or organizations rather than by the mere selection of different alternatives in accounting procedures or practices."

Per Section 18 of the DHS OFM *Component Requirements Guide for Financial Reporting*, each component must "report Component information in accordance with the OMB financial reporting requirements, including OMB Circular No. A-136, *Financial Reporting Requirements* (as updated)."

The Treasury *Federal Intragovernmental Transactions Accounting Policies Guide*, dated August 13, 2010, states that OMB Circular No. A-136, *Financial Reporting Requirements,* as revised, require Federal CFO Act and non-CFO Act entities identified in the Treasury Financial Manual (TFM) 2010, Vol. I, Part 2, Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government,* to perform quarterly reconciliations of intragovernmental activity/balances. TFM, Section 4706, *Intragovernmental Requirements,* requires reporting agencies to reconcile and confirm intragovernmental activity and balances quarterly for specific reciprocal groupings. TFM Bulletin 2007-03, *Intragovernmental Business Rules,* also provides guidance to Federal agencies for recording and reconciling intragovernmental activities.

Recommendations: We recommend that:

1. TSA:
   a. Consider redistribution of the workload to further integrate newly hired personnel with accounting skills into the financial reporting processes. As restructuring or realignment of staffing is considered, responsibilities can be better matched with technical skills;
   b. Ensure that the annual risk assessment process is fully utilized to identify risk-points where control weaknesses exist and update policies and procedures to mitigate risk of error in the financial statements. This may also involve added supervisory reviews and monitoring controls at significant process-level risk points, particularly where the risk of misstatement exists outside of the OFM;

c. Strengthen monitoring controls, such as account relationship or flux analysis, to help identify and investigate potential errors in financial statements;

d. Develop policies and procedures to ensure compliance with the USSGL requirements at the transaction level. Specifically, the procedures should ensure that adjustments to the general ledger system are recorded at the appropriate fund account symbol and include the correct budgetary and proprietary entries; and

e. Work with its accounting service provider to ensure that the proper trading partner code is recorded for each intragovernmental transaction. Until such time, TSA should continue to perform its manual process for the identification and reporting of intragovernmental activities and balances.

2. FEMA:

a. Fully implement new processes and controls to ensure that manual adjustments are fully researched, substantiated, documented, and/or appropriately reviewed prior to preparation and submission of financial data to the Department;

b. Complete the full implementation of the new TIER to IFMIS reconciliation processes and controls;

c. Formally document and implement policies and procedures for opening and closing funds, including requirements to maintain all supporting documents; and

d. Develop and implement procedures over the preparation and review of the GAO FAM 2010 – Checklist for Federal Accounting.

II-B Information Technology Controls and Financial System Functionality

	2010	2009	2008
CBP			
USCIS			
FEMA			
FLETC			
ICE			N/A
TSA	C		

See page II.2 for table explanation

Background: Effective IT general and application controls and financial systems functionality are essential for achieving accurate and reliable reporting of financial and performance data. As part of the DHS financial statement audit, we evaluated select IT general controls using the objectives defined by GAO's *Federal Information System Controls Audit Manual* (FISCAM), in five key control areas: security management, access control, configuration management, segregation of duties, and business continuity. In addition to IT general controls, we evaluated select application controls, which are controls supporting the structure, policies, and procedures that apply to the use, operability, interface, edit, and monitoring controls of a financial application. We also considered the effects of financial system functionality when testing internal controls. Many key DHS financial systems are not compliant with FFMIA and OMB Circular Number A-127, *Financial Management Systems* (as revised and effective on October 1, 2009). DHS financial system functionality limitations add to the Department's challenges of addressing systemic internal control weaknesses, and limit the Department's ability to effectively and efficiently process and report financial data.

During our FY 2010 assessment of IT general and application controls and financial system functionality, we noted that the DHS Civilian Components made some progress in remediation of IT findings we reported in FY 2009. We have closed approximately 30 percent of our prior year IT findings. In FY 2010, we indentified approximately 140 findings, of which more than 60 percent are repeated from last year. Further, nearly one-third of our repeat findings were for IT deficiencies that management represented were corrected during FY 2010. Disagreements with managements self assessment occurred almost entirely at FEMA, and only occasionally in other components.

The findings identified below are a cross-representation of the nature of IT general control deficiencies identified throughout the Department's components. Many represent a single instance of an indentified deficiency at one component, and may not be representative of the general control environment in other components.

Conditions: Our findings related to IT controls and financial systems functionality follow:

Related to IT controls:

1. *Access controls:*
   - Deficiencies in management of application and/or database accounts, network, and remote user accounts:
     - System administrator root access to financial applications was not properly restricted, logged, and monitored;
     - Strong password requirements were not enforced;
     - User account lists were not periodically reviewed for appropriateness, inappropriate authorizations and excessive user access privileges were allowed at some DHS components, and users were not disabled or removed promptly upon personnel termination;
     - Emergency and temporary access was not properly authorized, and contractor development personnel were granted conflicting access to implement database changes;
     - Initial and modified access granted to application and/or database, network, and remote users was not properly documented and authorized; and
     - The process for authorizing and managing remote virtual private network (VPN) access to external state emergency management agencies, and component contractors, did not comply with DHS and component requirements.
   - Ineffective safeguards over logical and physical access to sensitive facilities and resources:
     - While performing after-hours physical access testing, we identified the following unsecured items: Government credit cards; financial system user IDs and passwords; computer laptops; and server names and IP addresses; and
     - While performing social engineering testing, we identified instances where DHS employees provided their system user names and passwords to an auditor posing as a help desk employee.
   - Ineffective or insufficient use of available audit logs:
     - Logs of auditable events are not being reviewed to identify potential incidents, or were reviewed by those with conflicting roles;
     - Logging of application and/or database events required to be recorded was not enabled;
     - Documented procedures for audit log follow-up do not meet DHS requirements; and
     - Evidence of audit log reviews was not retained.
2. *Configuration management*
   - Lack of documented policies and procedures:
     - To prevent users from having concurrent access to the development, test, and production environments of the system at four DHS components; and
     - Configuration, vulnerability, and patch management plans have not been established and implemented, or did not comply with DHS policy;
   - Vulnerabilities were identified during periodic internal scans and related corrective actions were not reported and tracked in accordance with DHS policy; and

- Security patch management and configuration deficiencies were identified during the vulnerability assessment on hosts supporting the key financial applications and general support systems.

3. *Security management:*

- Systems certification and accreditation:
  - Several component financial and associated feeder systems as well as general support systems, were not properly certified and accredited, in compliance with DHS policy;
  - Compliance with the Federal Desktop Core Configuration (FDCC) security configurations is in progress, but has not been completed; and
  - An instance where Interconnection Security agreements was not documented.
- Roles and responsibilities have not been clearly defined:
  - Instances of security roles and responsibilities are not adequately defined for financial applications and general support systems; and
  - System boundaries have not been adequately and completely defined within the System Security Plan.
- Lack of policies and procedures:
  - One instance of incomplete or inadequate policies and procedures associated with computer incident response capabilities;
  - Procedures for exit processing of transferred/terminated personnel, including contractors, had not been established; and
  - Lack of component policies and procedures for IT-based specialized security training.
- Lack of compliance with existing policies:
  - Several instances where background investigations of federal employees and contractors employed to operate, manage and provide security over IT systems were not being properly conducted;
  - Lack of compliance with DHS computer security awareness training requirements;
  - Non-disclosure agreements were not completed at one DHS component; and
  - A complete and accurate listing of workstations could not be provided at one DHS component and as a result anti-virus protection is not installed on all workstations.

4. *Contingency Planning:*

- Instances where incomplete or outdated business continuity plans and systems with incomplete or outdated disaster recovery plans were noted at four DHS components. Some plans did not contain current system information, emergency processing priorities, procedures for backup and storage, or other critical information;
- Service continuity plans were not consistently and/or adequately tested, and individuals did not receive training on how to respond to emergency situations at four DHS components;
- An alternate processing site has not been established for high risk systems; and
- Appropriate authorization to access backup media was not made available.

5. *Segregation of Duties:*

- Financial system users had conflicting access rights as the Originator, Funds Certification Official, and an Approving Official profile;

- Lack of evidence to show that least privilege and segregation of duties controls exist; and
- Policy and procedures to define and implement segregation of duties were not properly developed and/or implemented.

These control findings, including other significant deficiencies are described in greater detail in a separate *Limited Official Use* letter provided to DHS management.

Related to financial system functionality:

We noted that in some cases, financial system functionality is inhibiting DHS' ability to implement and maintain internal controls, notably IT applications controls supporting financial data processing and reporting. Financial system functionality limitations also contributes to other control deficiencies reported in Exhibits I, II and III, and can make compliance with FFMIA and OMB Circular A-127 more difficult. Financial system functionality conditions include:

- Inability to modify IT system core software, and install controls to prevent duplicate payments. The component identified two instances where duplicate payments were made in FY 2009 and FY 2010, and the funds needed to be recovered;
- The financial systems in one component cannot be configured to:
  - Prevent, detect, and correct excessive refunds;
  - Provide summary information of the total unpaid assessments for duties, taxes, and fees by individual importer; and
  - Report information on outstanding receivables, the age of receivables, or other data necessary for management to fully monitor collection actions; and
- Two inventory tracking systems are not fully integrated with the financial system of record; and
- Several financial systems do not have the necessary functionality to enforce DHS-required system security requirements. For example, one system does not have the functionality to enforce policy requirements related to password complexity, account lockout, and profiles changes. In addition, a system does not have the functionality to track new users or user profile changes.

Cause/Effect: The IT control weaknesses have resulted from systemic challenges in complying with DHS security policies, which is complicated by many components' financial systems inability to offer the necessary functionality. One key Department financial system was migrated to a new operating platform during FY 2010, which will help alleviate some control weaknesses and functionality limitations. However, DHS broad and systemic IT weaknesses and financial system functionality limitations will not be fully addressed until the Department implements a stable centralized financial system platform. DHS is currently planning such a platform - the Transformation and Systems Consolidation (TASC) initiative, which is designed to consolidate and integrate mission-essential enterprise financial, acquisition, and asset management systems. However, the time and resources needed to implement TASC and address IT control weaknesses will take several years.

The conditions supporting our findings collectively limit DHS' ability to ensure that critical financial and operational data is kept secure and is maintained in a manner to ensure confidentiality, integrity, and availability. Many of these weaknesses, especially those in the area of access and configuration management controls, may result in material errors in DHS' financial data that are not detected in a timely manner and in the normal course of business. In addition, as a result of the presence of IT control weaknesses and financial system functionality weaknesses, there is added pressure on other mitigating controls to be operating effectively at all times. Because mitigating controls often require more manually performed procedures, there is an increased risk of human error that could materially affect the financial statements.

Criteria: The *Federal Information Security Management Act* (FISMA) passed as part of the *E-Government Act of 2002,* provides guidance that Federal entities maintain IT security programs in accordance with National Institute of Standards and Technology (NIST) guidance.

OMB Circular Number A-130, *Management of Federal Information Resources*, establishes policy for the management of Federal information resources.

FFMIA is intended to ensure that agencies use financial management systems that provide reliable, timely, and consistent information. The purpose of FFMIA is to: (1) provide for consistency of accounting by an agency from one fiscal year to the next, and uniform accounting standards throughout the Federal Government; (2) require Federal financial management systems to support full disclosure of Federal financial data, including the full costs of Federal programs and activities; (3) increase the accountability and credibility of federal financial management; (4) improve performance, productivity and efficiency of Federal Government financial management; and (5) establish financial management systems to support controlling the cost of Federal Government. FFMIA requirements are complemented by specific financial system polices and standards contained in OMB Circular Number A-127, as revised on October 1, 2009.

DHS *Sensitive Systems Policy Directive 4300A*, as well as the DHS *4300A Sensitive Systems Handbook*, documents policies and procedures adopted by DHS intended to improve the security and operation of all DHS IT systems.

Recommendations: We recommend that the DHS Office of the Chief Information Officer, in coordination with the OCFO, make necessary improvements to the Department's financial management systems. Specific recommendations are provided in a separate *Limited Official Use* letter provided to DHS management.

II-C Not Used

II-D Property, Plant, and Equipment (TSA and CBP)

	2010	2009	2008
CBP			
FEMA	N/A	C	
TSA			
USCIS	C		N/A
ICE	C		N/A
NPPD	C		N/A

See page II.2 for table explanation

Background: TSA manages passenger and baggage X-ray, explosives detection, and other equipment as part of its mission. This equipment, which is in every major U.S. airport, is owned and maintained by TSA. The costs required to procure, ship, temporarily store, install, operate, and maintain this equipment are substantial and consume a large portion of TSA's annual operating budget. Unique accounting processes and systems are necessary to track the status and accumulate costs, and to accurately value, account for, and depreciate the equipment. TSA completed the reconciliation of its property, plant and equipment (PP&E) accounts in FY 2010 and was able to assert to that its PP&E balances at September 30, 2010 are fairly stated in the DHS FY 2010 AFR. TSA made some progress remediating controls deficiencies however was not able to fully address all of the conditions that existed in FY 2009.

CBP has acquired substantial new technology, facilities, and other assets in recent years through purchase and construction. CBP's increased assets include construction of border fencing (both physical and virtual), purchase of inspection equipment at ports of entry, and new construction at port of entry facilities.

USCIS, ICE and NPPD corrected the PP&E conditions we reported in FY 2009.

Conditions: We noted the following internal control weaknesses related to PP&E:

1. TSA:

   - Has not implemented policies, procedures, and controls to properly identify risks and potential errors related to general property, equipment, and software balances, as necessary, to maintain the accuracy and completeness of those account balances. For example, we noted that TSA did not accurately and completely account for internal use software, other direct costs (ODC) incurred to transport, store, and install screening equipment at airports, and depreciation expense throughout

II. 9

FY 2010. Several adjustments totaling in excess of $100 million, some of which were auditor-identified adjustments, were required to fairly state PP&E accounts affected by these items;

- Has not fully adopted sufficient procedures to properly document, track, and value capital assets on an on-going basis. For example, we noted that TSA lacks sufficient policies and procedures to:
  - Perform a periodic analysis of idle assets stored in a warehouse and adjust the carrying value of those assets to net realizable value (NRV), if necessary, as required by GAAP;
  - Ensure that assets warehoused are inventoried and reported in the financial statements timely and accurately;
  - Identify and account for assets below the capitalization threshold (i.e., peripheral equipment);
  - Ensure asset additions, disposals, and transfers are recorded in the general ledger timely and accurately; and
- Continues to have weaknesses in coordination and communication (including training, oversight, and monitoring) with personnel outside of the OFM that contribute to control weaknesses in processes dependent on operations.

2. CBP:

- Does not have adequate accounting policies, procedures, processes, and controls to properly account for new equipment purchases and transfers, construction, or disposal of assets in a timely manner. For example, CBP did not:
  - Consistently record construction-in-process (CIP) to its construction projects per the observed percentage of completion (POC);
  - Transfer assets from CIP to "in-use" assets in a timely manner; and
  - Record some asset additions and disposals in accordance with its policy.
- Did not properly perform and/or document several physical annual inventories related to real and personal property.

Cause/Effect: TSA focused primarily on correcting the conditions that prevented management from asserting to the accuracy and completeness of certain PP&E balances as of September 30, 2009, and relatively less time was devoted to correcting related control deficiencies in FY 2010. Further, time constraints caused TSA to record some adjustments before a proper review was performed. These conditions led to a number of errors in the financial statements that were discovered during our audit. In some cases, TSA was dependent on input and feedback from outside contractors, and the auditor for interpretation and application of accounting standards to resolve difficult accounting issues related to the development of its opening balance sheet. This deficiency is also related to the conditions described in Comment **II-A**, *Financial Management and Reporting*.

CBP does not have documented and/or fully implemented policies and procedures, or 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 PP&E balance may be misstated by the recording of transactions, which are incorrect, unsupported, or untimely. Also, CBP IT systems lack functionality to track and account for assets in various stages of completion and deployment leading to increased manual involvement to accurately report assets. This deficiency is also related to the conditions described in Comment **II-A**, *Financial Management and Reporting*, and Comment **II-B**, *Information Technology Controls and Financial System Functionality*.

Criteria: SFFAS No. 10, *Accounting for Internal Use Software*, provides requirements for the capitalization and reporting of internal use software development costs. According to paragraph 16, the capitalizable cost should include "… the full cost (direct and indirect cost) incurred during the software development stage." Per SFFAS No. 10, paragraphs 18-20, "For COTS [Commercial off-the-shelf] software, capitalized cost should include the amount paid to the vendor for the software. For contractor-developed software, capitalized cost should include the amount paid to a contractor to design, program, install, and implement the software. Material internal cost incurred by the federal entity to implement the COTS or contractor-developed software and otherwise make it ready for use should be capitalized [...] Costs incurred after final acceptance testing has been successfully completed should be expensed."

SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, paragraph 17, states, "Property, plant, and equipment consists of tangible assets, including land, that meet the following criteria: they have estimated useful lives of 2 years or more; they are not intended for sale in the ordinary course of operations, and they have been acquired or constructed with the intention of being used, or being available for use by the entity." Per paragraph 26, "All general PP&E shall be recorded at cost. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use." Paragraph 34 requires, "In the case of constructed PP&E, the PP&E shall be recorded as construction work in progress until it is placed in service, at which time the balance shall be transferred to general PP&E." Per paragraph 35, "Depreciation expense is calculated through the systematic and rational allocation of the cost of general PP&E, less its estimated salvage/residual value, over the estimated useful life of the general PP&E. Depreciation expense shall be recognized on all general PP&E, except land and land rights of unlimited duration." Per paragraphs 38, "In the period of disposal, retirement, or removal from service, general PP&E shall be removed from the asset accounts along with associated accumulated depreciation/amortization. Any difference between the book value of the PP&E and amounts realized shall be recognized as a gain or a loss in the period that the general PP&E is disposed of, retired, or removed from service."

GAO's *Standards for Internal Control in the Federal Government (Standards)* requires that internal control and all transactions and other significant events be clearly documented and readily available for examination. The Joint Financial Management Improvement Program (JFMIP), *Property Management Systems Requirements,* states that the agency's property management system must create a skeletal property record or have another mechanism for capturing information on property in transit from the providing entity (e.g., vendor, donator, lender, grantor, etc.).

Recommendations: We recommend that:

1. TSA:
   a. Develop and implement policies and procedures to properly identify risks, potential errors, and account for, monitor, and report general property, equipment, and internal use software balances;
   b. Develop and implement sufficient procedures to properly document, track, and value assets on an on-going basis; and
   c. Improve coordination and communication with personnel outside of the Office of Financial Management to ensure that actions regarding updates to the capital asset subsidiary ledger are properly reflected in accordance with GAAP.
2. CBP:
   a. Develop, document, and communicate policies and procedures for classifying, recording, and reviewing all capital transactions, particularly for new construction, to ensure that the financial statements are materially correct and presented in accordance with GAAP. Consideration should be given to the adequacy of policies to account for CIP, including methodologies to apply overhead charges, and establishing an appropriate useful life for annual depreciation charges;
   b. Emphasize the need to record asset additions and disposals in accordance with established policy;
   c. Consider adding supervision and monitoring controls to ensure that all intended corrective actions are effective and functioning properly;
   d. Establish and implement a standardized process that is integrated with its financial system of record in order to facilitate the timely recording of new assets placed into service; and
   e. Improve guidance for the performance and documentation of PP&E inventories.

II-E Actuarial and Other Liabilities (FEMA)

	2010	2009	2008
FEMA			
FLETC	C	C	
ICE	C	C	
S&T	C	C	
TSA	C		C

See page II.2 for table explanation

Background: FEMA is recognized as the primary grant-making component of DHS, managing multiple Federal disaster and non-disaster grant programs.

Conditions: We noted the following internal control weaknesses related to other liabilities at FEMA:

- Does not have sufficient policies and procedures in place to fully comply with the *Single Audit Act Amendments of 1996* (*Single Audit Act*) and related OMB Circular No. A-133, *Audits of States, Local Governments, and Nonprofit Organizations* (OMB Circular A-133) (see Comment **IV-K**, *Single Audit Act Amendments of 1996*);
- Does not maintain accurate and timely documentation related to site visits/desk reviews performed for grantees. Specifically, our control testwork performed over a sample of 60 site visits/ desk reviews performed during the six-month period ended March 31, 2010, identified 35 exceptions related to documentation; and
- Does not consistently follow-up with grantees who have failed to submit quarterly financial and/or programmatic reports timely.

Cause/Effect: FEMA has not implemented policies and procedures over its grant program in order ensure compliance with the *Single Audit Act* and OMB Circular A-133. In addition, while GPD guidance and grant monitoring policies and procedures were disseminated in early FY 2009, all regions have not yet achieved the same level of control conscientiousness when it comes to documentation of grantee monitoring. As a result, misreported grantee expenses may not be detected, which would impact the fair presentation of FEMA's grant accrual balances, undelivered orders, and expenses.

Criteria: OMB Circular No. A-123 states, "Management is responsible for developing and maintaining effective internal control. Effective internal control provides assurance that significant weaknesses in the design or operation of internal control, that could adversely affect the agency's ability to meet its objectives, would be prevented or detected in a timely manner. [...] Management should identify internal and external risks that may prevent the organization from meeting its objectives. When identifying risks, management should take into account relevant interactions within the organization as well as with outside organizations."

The *Single Audit Act Amendments of 1996*, Section 7502 (f)(1)(B) states, "Each Federal agency which provides Federal awards to a recipient shall… review the audit of a recipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to Federal awards provided to the recipient by the Federal agency." Chapter 75, Section 7504 requires each federal awarding agency to "monitor non-Federal entity use of Federal awards."

OMB Circular No. A-133, Subpart D, provides for the responsibilities of federal agencies and pass-through entities for audits of states, local governments, and non-profit organizations.

Recommendations: We recommend that:

1. FEMA:
   a. Implement policies and procedures to ensure full compliance with the *Single Audit Act* and the related OMB Circular No. A-133; and
   b. Continue to provide comprehensive financial monitoring plans and expand guidance to regional staff responsible for conducting financial monitoring visits and obtaining and reviewing required quarterly grantee reports.

II-F Budgetary Accounting (FEMA and CBP)

	2010	2009	2008
CBP			
FEMA			
TSA	N/A	N/A	C

See page II.2 for table explanation

Background: Budgetary accounts are a category of general ledger accounts where transactions related to the receipt, obligation, and disbursement of appropriations and other authorities to obligate and spend agency resources are recorded. DHS has over 350 separate TAFS combined, each with separate budgetary accounts that must be maintained in accordance with OMB and Treasury guidance. The TAFS cover a broad spectrum of budget authority, including annual, multi-year, and no-year appropriations, and several revolving, special, and trust funds. Accounting for budgetary transactions in a timely and accurate manner is essential to managing the funds of the Department and preventing overspending of allotted budgets.

In FY 2010, FEMA improved its processes and internal controls over the obligation and monitoring process; however, some control deficiencies remain.

CBP has implemented policies and procedures requiring the timely review and deobligation of funds when the contracts have expired or are complete. However, CBP has not been effective in adhering to its policy or in monitoring compliance.

Conditions: We noted the following internal control weaknesses related to budgetary accounting at FEMA and CBP:

1. FEMA:

   - Did not effectively monitor the status of its obligations as part of its normal operations to ensure timely deobligation when appropriate;
   - Could not readily provide all supporting documentation for undelivered orders (UDO)s, other than mission assignments, interagency agreements, and non-disaster grants tested at June 30, 2010 and September 30, 2010. We noted that for certain portions of the population, significant effort was required to coordinate and identify the responsible parties, to access certain files, or to provide information in a form that clearly supported the balances reported in the financial statements; and
   - Was required to correct numerous erroneous entries recorded by the Budget Planning & Analysis Division (BPAD) or to record transactions that should have been recorded by the BPAD but were not.

2. CBP is not enforcing its policies and procedures (Directive 1220-011C) to monitor and deobligate or close-out its obligations in a timely manner. We noted that CBP did not properly deobligate inactive undelivered orders for several items we tested as of September 30, 2010. In addition, when completing its review and certification of UDOs as of December 31, 2009, CBP marked the majority of its UDOs as not yet reviewed.

Cause/Effect: FEMA's administrative functions are geographically separated from programmatic operations which make locating certain UDO documentation difficult. Additionally, FEMA's new UDO annual certification and quarterly validation processes are not fully effective. Without supporting documentation, FEMA is unable to support the validity of certain UDO balances. Certain personnel within the BPAD do not have the necessary skills or training to correctly record budgetary entries in FEMA's general ledger. As a result, FEMA's financial information submitted to DHS may contain significant budgetary account errors if they are not detected by the OCFO.

CBP did not properly monitor all open obligations, and consequently, government funds may be committed and not made available to CBP for other Federal expenditures for longer periods of time than necessary. In addition, CBP's financial statements will not properly reflect the status of obligations.

Criteria: According to GAO *Standards*, "transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records." Further, "control activities help to ensure that all transactions are completely and accurately recorded." In addition, "internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination [...] All documentation and records should be properly managed and maintained."

US Code Title 31 Section 1501 states that "an amount shall be recorded as an obligation of the United States Government only when supported by documentary evidence of (1) a binding agreement between an agency and another person (including an agency) that is (a) in writing, in a way and form, and (b) Executed before the end of the period of availability for obligation of the appropriation or fund used for specific goods to be delivered, real property to be bought or leased, or work or service to be provided." Section 1554, Audit, control and reporting states, "The head of each agency shall establish internal controls to assure that an adequate review of obligated balances is performed..."

CBP Directive 1220-011C states that all obligation records must be reconciled to supporting documentation at the close of each quarter and that additionally, a semi-annual review of specific populations of obligations must be performed and the status for each record identified to assure that only valid obligations remain open.

Recommendations: We recommend that:

1. FEMA:
   a. Modify and complete the implementation of the new UDO annual certification and quarterly validation processes to ensure that outstanding obligations are reviewed for validity quarterly;
   b. Continue to improve procedures for storing and locating documentation supporting UDO information, including points of contact, so that supporting information is readily available for management review and audit purposes; and
   c. Dedicate the appropriate resources to adequately staff, train, and supervise BPAD personnel to ensure that the BPAD is properly recording all necessary budgetary transactions.
2. CBP:
   a. Implement improved procedures to ensure full compliance with CBP Directive 1220-011C to ensure that obligations are reconciled to supporting documentation on a quarterly basis and are reviewed for validity on a semi-annual basis.

III-G Other Entity-Level Controls (USCG, FEMA and CBP)

	2010	2009	2008
USCG			
FEMA			
CBP		NA	NA
TSA	C		
See page II.2 for table explanation			

Background: In the past three years, the Department of Homeland Security (DHS or the Department) has undertaken and completed several steps designed to strengthen its entity and process level internal controls, and thereby improve the reliability of financial reporting. These steps are documented in the *Internal Control over Financial Reporting Playbook* and in component level Mission Action Plans (MAPs) prepared annually. The Department's Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control,* assessment is also designed to assist with the remediation of control deficiencies.

The comments below should be read in conjunction with Comments **I-B** and **II-B**, *Information Technology Controls and Financial System Functionality,* which describe other entity-level control weaknesses related to Department and Component IT systems. United States Coast Guard (Coast Guard) and Department-wide entity-level control deficiencies that contribute to the Department's material weakness in financial reporting are presented in Comments **I-A** and **II-A**, *Financial Management and Reporting,* respectively.

The Coast Guard continues to make progress in remediation of control deficiencies that are important to its objective of becoming auditable in FY 2011. Some of the conditions cited below are repeated from FY 2009 and remain important to the Coast Guard's continued success in reconciling opening balances, and installing policies and procedures to support sustainable accounting processes and reliable financial reporting. The Coast Guard continues to follow the *Financial Strategy for Transformation and Audit Readiness* (FSTAR) updated in FY 2009. The FSTAR is a comprehensive plan to identify and correct the root causes of control deficiencies.

FEMA made continued progress toward correction of its entity-level control deficiencies in FY 2010. While progress has been made, some entity-level control deficiencies identified at FEMA in previous years continued during FY 2010, and are repeated below.

CBP's investment in accounting and financial reporting infrastructure did not keep pace with its significant expansion in capital assets in prior years, creating an environment where financial statement errors are more likely to occur. In FY 2010, CBP management recognized that its operations continue to experience rapid and large scale growth and took action to bring the resources allocated to its financial management in line with this growth. However, our audit determined that some entity-level control deficiencies continued to exist, which impair CBP's ability to produce timely, reliable financial information throughout the fiscal year.

Conditions: We noted the following internal control weaknesses related to other entity-level controls:

1. Coast Guard:

   - Has not developed adequate policies, procedures, or controls associated with monitoring, training, and continual education courses associated with personnel with financial duties;
   - Does not have standardized job descriptions that include the identification and definition of tasks required, for particular assignments that have financial duties;
   - Does not have policies that are operating effectively for hiring and evaluating financial employees, as management does not maintain adequate documentation for certain hiring requirements and periodic performance evaluations; and
   - Has not developed adequate controls with the Standards of Ethical Conduct to a) ensure that recent changes in the Coast Guard environment are included, and b) track and monitor compliance, including document retention for the investigation of any violation and corrective actions taken to ensure proper filing and review of the Confidential Disclosure Reports and ethics training requirements.

Independent Auditors' Report
Exhibit III – Significant Deficiencies – All DHS Components

2. FEMA:

- Has not developed sufficiently effective methods of communication to ensure that significant financial-related system development and acquisition projects involve all relevant stakeholders, including the Office of the Chief Financial Officer (OCFO), to ensure the projects meet organizational mission needs and functional and technical requirements;
- Has not provided adequate monitoring and oversight of its National Flood Insurance Program (NFIP) contractor to ensure the implementation and maintenance of required security controls for NFIP information systems;
- Has not completed its documentation and/or update of formal policies and procedures (including desk manuals) for several of the roles, responsibilities, processes, and functions performed within FEMA;
- Has not committed sufficient resources to ensure that personnel attend required ethics training; and
- Has not developed sufficient policies and procedures to properly designate position sensitivity for positions that use, develop, or operate IT systems; track the status of background investigations; and maintain related documentation.

3. CBP:

- Does not timely resolve or have proper oversight of financial management issues, particularly, when the information resides with and/or is controlled and maintained by a contractor, to ensure that policies are followed and transactions are recorded accurately and timely in the general ledger. The lack of oversight contributed to the following conditions:
  - Operating materials and supply purchases were not properly recorded in a timely manner;
  - Financial information received from contractors was not always timely, reliable, and complete;
  - Inaccurate reporting of the percentage of completion of construction projects in the first half of FY 2010; and
  - Ultimate resolution of accounting issues related to SBInet were not finalized until the final weeks of the fiscal year.

Cause/Effect: Coast Guard management has acknowledged that longstanding procedural, control, personnel, IT and cultural issues have impeded progress toward installing an effective financial management structure. Coast Guard has developed, and is in the process of implementing, a multi-year MAP (FSTAR) that addresses entity-level controls, see comment **I-A**, *Financial Management and Reporting*.

In FY 2010, FEMA devoted substantial resources to developing certain policies and procedures, including those related to financial reporting. Consequently, FEMA devoted comparatively less attention to correcting other control deficiencies in FY 2010. Decentralized and informal background investigation processes present potential risks to FEMA's operations and IT systems.

In its FY 2010 representations made to the Secretary pursuant to the *DHS Financial Accountability Act*, the Coast Guard stated that they cannot provide reasonable assurance that internal control over financial reporting are operating effectively.

CBP does not have an effective process in place to timely review and analyze contractor information that could potentially impact the financial statements. As a result, CBP is unable to address changes in its operations that could potentially result in errors or omissions in the financial statements, or misapplication of GAAP may go undetected throughout the year.

Criteria: OMB Circular No. A-123, as revised, states that internal controls are the organization, policies, and procedures that agencies use to help program and financial managers achieve results and safeguard the integrity of their programs.

III.2

The *Federal Managers' Financial Integrity Act of 1982* (FMFIA) requires that agencies establish internal controls according to standards prescribed by the Comptroller General. These standards are established in the GAO's *Standards for Internal Control in the Federal Government (Standards).* The GAO defines internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

The GAO *Standards* identify the control environment as one of the five key elements of control, which emphasizes the importance of conscientiousness in management's operating philosophy and commitment to internal control. These standards cover controls such as human capital practices, supervisory reviews, policies, procedures, monitoring, and segregation of duties.

DHS 4300A *Sensitive Systems Handbook*, sets forth requirements related to background investigations for federal employees and contractors requiring access to DHS systems.

FEMA Directive Number 112-1, *Directives Management System,* sets forth the procedures for initiating, authorizing and updating FEMA directives. Page 5 of Directive states that the Directives Management System Point-of-Contact (DMS-POC) is responsible for "Establishing a biennial re-certification process for the review of their organization's functional area directives by using FEMA Form 112-1-1-1 Management Directives Review Report, and providing notification to the Directives Management Office."

Recommendations: We recommend that:

1. Coast Guard:
   a. Review and enhance, if necessary, the entity-level planned actions in its FSTAR to include steps to fully assess entity-level controls, develop effective corrective actions, and implement improved financial processes and systems.
2. FEMA:
   a. Develop and implement agency-wide communication protocols to ensure that significant financial-related system development and acquisition projects involve all relevant stakeholders, including the OCFO;
   b. Develop and implement monitoring procedures over the NFIP contractor to ensure the implementation and maintenance of required controls for NFIP information systems;
   c. Complete the efforts underway to ensure that formal policies and procedures (including desk manuals) are documented and current for all significant roles, responsibilities, processes, and functions performed within FEMA;
   d. Complete development and implementation of procedures and dedicate resources to provide, track compliance with, and monitor the annual and new hire ethics training requirements; and
   e. Develop and implement policies and procedures to properly designate position sensitivity for all positions that use, develop, or operate IT systems; track the status and completion of background investigations; and maintain related documentation.
3. CBP:
   a. Executive senior management needs to emphasize the importance of the financial statements to all program offices to ensure they provide the information necessary to identify and address risks and issues related to CBP's operations which could possibly lead to misstatements on CBP's financial statements; and
   b. CBP program offices should conduct an assessment relating to their financial reporting requirements to ensure they have the proper resources and processes to timely and accurately provide the information requested for the CBP Financial Statements.

III-H Custodial Revenue and Drawback (CBP Only)

Background: CBP collects approximately $29.5 billion in annual import duties, taxes, and fees on merchandise arriving in the United States from foreign countries (identified below as the Entry Process). Receipts of import duties and related refunds are presented in the statement of custodial activity in the DHS financial statements.

Drawback is a remittance, in whole or in part, of duties, taxes, or fees previously paid by an importer. Drawback typically occurs when the imported goods on which duties, taxes, or fees have been previously paid, are subsequently exported from the United States or destroyed prior to entering the commerce of the United States.

Our findings on the Entry Process include In-bond, Bonded Warehouse, Foreign Trade Zones, and the Trade Compliance Measurement Program (TCM). In-bond entries occur when merchandise is transported through one port; however, the merchandise does not officially enter U.S. commerce until it reaches the intended port of destination. Bonded Warehouses (BW) are facilities, under the joint supervision of CBP and the Bonded Warehouse Proprietor, used to store merchandise that has not made entry into the United States commerce. Foreign Trade Zones (FTZ) are secured areas under CBP supervision that are used to manufacture goods that are considered outside of the United States commerce for duty collection.

TCM is the primary method by which CBP measures risk in the areas of trade compliance and revenue collection. CBP utilizes the TCM program to measure the effectiveness of its control mechanisms deployed, and its execution in collecting revenues rightfully due to the U.S. Department of the Treasury.

Conditions: We noted the following internal control weaknesses related to custodial activities at CBP:

Related to drawback:

- The Automated Commercial System (ACS) lacks automated controls to detect and prevent excessive drawback claims and overpayments, necessitating inefficient manual processes that do not effectively compensate for these automated controls;
- ACS lacks controls to prevent the overpayment of drawback claims at the summary line level;
- 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 was claimed;
- Drawback review policy and procedures allow drawback specialists, with supervisory approval, to judgmentally decrease the number of underlying consumption entries (UCEs) randomly selected for review, which decreases the review's effectiveness. Further, CBP's sampling methodology for selecting UCEs is not considered to be statistically valid; and
- The period for document retention related to a drawback claim is only three years from the date of payment, based on statutory requirements set by Congress. However, there are several situations that could extend the life of the drawback claim well beyond three years.

Related to the Entry Process:

- CBP is unable to determine the status of the in-bond shipments and lacks policies and procedures that require monitoring the results of in-bond audits and require the review of overdue air in-bonds. Although port personnel are required to review some overdue in-bonds, there is no requirement to completely resolve overdue items;
- In-bond cargo examinations were not performed at the ports in FY 2010 because CBP failed to manually reset its system that selects in-bond cargo examinations at the beginning of fiscal year;
- CBP does not perform an analysis to determine the overall compliance rate of the in-bond program. CBP does not analyze the rate and types of violations found to determine the effectiveness of the in-bond program, and does not identify a projected total amount of uncollected

duties and fees on in-bond merchandise that has physically entered U.S. commerce without formal entry to ensure there is not a potentially significant loss of revenue;

- TCM oversight guidelines do not provide complete coverage over the TCM program. CBP implemented a consistent set of procedures for performing TCM reviews, during FY 2010, however, there are weaknesses in the oversight and monitoring of the TCM program at the port and CBP headquarter locations; and
- Current BW and FTZ Compliance Review Manuals lack specific guidance for ports to determine the appropriate risk assessment of a BW or FTZ. In addition, HQ review of the BWs and FTZs assessment results does not provide CBP with objective data related to the effectiveness of compliance reviews, common discrepancies found and the risks associated with those discrepancies, and techniques for mitigating risks.

Cause/Effect: IT system functionality and outdated IT systems contribute to the weaknesses identified above, also see Comment **II-B**, *Information Technology Controls and Financial System Functionality*. For example, CBP is unable to determine the status of the in-bond shipments with the information available within ACS, and CBP does not have the ability to run an oversight report to determine if ports have completed all required audits. For drawback, much of the process is manual until IT system functionality improvements are made, placing an added burden on limited resources.

The inability to effectively and fully monitor the in-bond process and verify the arrival of in-bond merchandise at the port could lead to loss of revenue due to uncollected duties and fees on in-bond merchandise that has physically entered U.S. commerce without formal entry.

The weaknesses in the CM program could result in CBP incorrectly evaluating the effectiveness of its control environment over the collections of duties, taxes, and fees.

It is possible that BWH/FTZ operators and users may be able to operate BWHs and FTZs that contain merchandise that CBP has no or limited knowledge about.

Criteria: Under FMFIA, management must implement cost-effective controls to safeguard assets and ensure reliable financial reporting. OMB's *Implementation Guidance for FFMIA*, dated January 9, 2009, states that financial systems should "routinely provide reliable financial information consistently, accurately, and uniformly."

OMB Circular No. A-127, *Financial Management Systems*, prescribes the standards for Federal agencies' financial management systems. The Office of Federal Financial Management's *Core Financial System Requirements*, dated January 2006, states that the core financial system must maintain detailed information sufficient to provide audit trails and to support reconciliation and research activities.

The *Improper Payments Information Act of 2002* requires agencies to annually review programs and activities and identify any that may be susceptible to significant improper payment. Whenever an agency estimates that improper payments may exceed $10 million, it must also provide a report on what actions are being taken to reduce such payments. In addition to the statutory requirements stated above, CBP's *Drawback Handbook*, dated July 2004, states that management reviews are necessary to maintain a uniform national policy of supervisory review.

OMB Circular No. A-50, *Audit Follow-Up*, states that corrective action taken by management on resolved findings and recommendations is essential to improving the effectiveness and efficiency of Government operations. Each agency shall establish systems to assure the prompt and proper resolution and implementation of audit recommendations. These systems shall provide for a complete record of action taken on both monetary and nonmonetary findings and recommendations.

CFR 19, Ch.1, Section 111.23, which addresses documents that support import entries, states that: (1) "…records must be retained by a broker in accordance with the provisions of this part and part 163 of this chapter within the broker district that covers the Customs port to which they relate unless the broker chooses to consolidate records at one or more other locations, and provides advance notice of that consolidation to Customs…" and (2) "…the records described in paragraph (a)(1) of this section, other than powers of attorney, must be retained for at least 5 years after the date of entry."

Recommendations: We recommend that CBP:

1. *Related to drawback:*
   - a. Implement effective internal controls over drawback claims as part of any new system initiatives, including the ability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries and export documentation for which the drawback claim is based, and identify duplicate or excessive drawback claims;
   - b. Develop and implement automated controls to prevent overpayment of a drawback claim; and
   - c. Pilot statistically valid drawback claim review programs at each Drawback Center. Analyze the results of the pilots and determine the benefit of full implementation of the programs.
2. *Related to the Entry Process:*
   - a. Increase headquarters oversight of the in-bond process by (a) analyzing the summary of post-audits conducted and associated results, (b) ensuring the system that selects in-bond cargo examinations is manually reset beginning of the fiscal year;
   - b. Develop or re-emphasize formal requirements for all ports to continue to run and completely resolve overdue in-bond items and maintain documentation of the resolution;
   - c. Resolve errors related to the universe of overdue air in-bonds. Issue guidance and require ports to and completely resolve overdue air in-bonds;
   - d. Analyze the in-bond program annually to determine an overall compliance rate of the in-bond program;
   - e. Provide additional detail in the TCM guidelines, specifying the use of the monitoring report, data queries, and any other tools to provide complete coverage over the TCM program;
   - f. Develop standard operating procedures for conducting risk assessments for all BWs and FTZs. In addition, develop standardized procedures for HQ or field office oversight to ensure compliance review schedules are being reviewed timely and provide effective training to ensure that all ports are aware of updates and changes to the program and can consistently execute all requirements presented in the compliance review manuals and handbooks; and
   - g. Continue the implementation of a national database of BWs and FTZs and develop procedures to ensure completeness.

All of the compliance and other matters described below are repeat conditions from FY 2009, except IV-N - *Government Performance and Results Act of 1993*, which is new in FY 2010.

IV-I *Federal Managers' Financial Integrity Act of 1982* (FMFIA) and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-Up*, as revised

Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, requires agencies and Federal managers to: (1) develop and implement internal controls; (2) assess the adequacy of internal controls; (3) separately assess and document internal control over financial reporting; (4) identify needed improvements; (5) take corresponding corrective action; and (6) report annually on internal controls. During fiscal year (FY) 2010 and 2009, the Department of Homeland Security (DHS or the Department) developed an annual *Internal Control Playbook* to implement corrective actions and support management assurances by performing tests of design and operating effectiveness of entity level controls and other financial accounting and reporting processes. DHS' implementation of OMB Circular No. A-123 facilitates compliance with the *Federal Managers' Financial Integrity Act of 1982* (FMFIA). The *DHS Financial Accountability Act of 2004* requires DHS to submit an annual audit opinion of internal control over financial reporting. The Secretary of DHS has stated in the Secretary's Assurance Statement dated November 12, 2010, as presented in Management's Discussion and Analysis (MD&A) of the Department's 2010 *Annual Financial Report* (AFR), that based on the material weaknesses identified from the OMB Circular A-123 assessment, the Department provides no assurance that internal control over financial reporting was operating effectively as of September 30, 2010.

The FY 2010 DHS *Secretary's Assurance Statement*, states that the Department identified five material weaknesses in internal control over financial reporting, which differs from the number of material weaknesses indentified by us during our FY 2010 audit. The reasons for this difference are related to the timing of management's assurance statement, which is as of September 30, 2010. Management believes that they have corrected the control deficiencies related to actuarial liabilities we reported in Exhibit I-E. Further, management has classified the remaining controls deficiencies we identify in Exhibit I-E together with Financial Reporting. Consequently, as reported in the FY 2010 AFR, Other Accompanying Information, management has reassessed, and thereby removed, the material weakness related to Human Resource Management at the U.S. Coast Guard.

In addition, OMB Circular No. A-50, as revised, provides guidance for use by executive agencies when considering reports issued by Inspectors General, other executive branch audit organizations, the Government Accountability Office (GAO), and non-Federal auditors, where follow up is necessary. Corrective action taken by management on findings and recommendations is essential to improve the effectiveness and efficiency of government operations, and to support the objectives of sound fiscal management. As described above, the DHS OCFO has developed an extensive corrective action plan that requires each component to develop and execute corrective actions to address all material weaknesses in internal controls. This strategy is documented in the *Internal Control Playbook*. Progress is monitored by the Under Secretary for Management (USM) and the CFO, and regularly reported to OMB and other outside stakeholders, such as Congressional Committees. We noted that each component has complied with the DHS directive to develop corrective actions, and they have been reviewed and approved by the USM and CFO. All DHS components have made progress toward remediation of material internal control weaknesses; however, as shown in Exhibits I, II and III, deficiencies identified in prior years have not been fully corrected in FY 2010.

While we noted the Department overall has taken positive steps toward full compliance with FMFIA, OMB Circular No. A-123, OMB Circular No. A-50, and the *DHS Financial Accountability Act*, the Department has not fully established effective systems, processes, policies, and procedures to ensure that internal controls are operating effectively throughout the Department.

Recommendation: We recommend that the Department continue its corrective actions to address internal control deficiencies, in order to ensure full compliance with FMFIA and its OMB-approved plan for implementation of Circular No. A-123, in future years. We also recommend that DHS continue to follow and complete the actions defined in the *Internal Control Playbook*, to ensure that audit recommendations are resolved timely and corrective action plans addressing all DHS audit findings are developed and implemented together with appropriate supervisory review in FY 2011.

IV-J *Federal Financial Management Improvement Act of 1996* (FFMIA)

FFMIA Section 803(a) requires that agency Federal financial management systems comply with (1) applicable Federal accounting standards; (2) Federal financial management system requirements; and (3) the United States Government Standard General Ledger (USSGL) at the transaction level. FFMIA emphasizes the need for agencies to have systems that can generate timely, reliable, and useful information with which to make informed decisions to ensure ongoing accountability.

While we noted the Department overall has taken positive steps toward full compliance with FFMIA, the Coast Guard, US Customs and Border Protection (CBP), the Federal Emergency Management Agency (FEMA), the Federal Law Enforcement Training Center (FLETC), U.S. Immigration and Customs Enforcement (ICE), and TSA did not fully comply with at least one of the requirements of FFMIA. The reasons for noncompliance are reported in Exhibits I, II, and III. The Secretary of DHS has stated in the Secretary's Assurance Statements dated November 12, 2010 that the Department's financial management systems do not substantially conform to government wide requirements mandated by FFMIA. The Department's remedial actions and related timeframes are also presented in that section of the FY 2010 AFR.

An element within FFMIA Federal system requirements is ensuring security over financial management information. This element is addressed further in the *Federal Information Security Management Act of 2002* (FISMA), which was enacted as part of the *E-Government Act of 2002*. FISMA requires the head of each agency to be responsible for (1) providing information security protections commensurate with the risk and magnitude of the harm resulting from unauthorized access, use, disclosure, disruption, modification, or destruction of (i) information collected or maintained and (ii) information systems used or operated; (2) complying with the requirements of the Act and related policies, procedures, standards, and guidelines, including (i) information security standards under the United States Code, Title 40, Section 11331 and (ii) information security standards and guidelines for national security systems; and (3) ensuring that information security management processes are integrated with agency strategic and operational planning processes.

We noted weaknesses in financial systems security, reported by us in Comments **I-B** and **II-B**, *Information Technology Controls and Financial System Functionality*, which impact the Department's ability to fully comply with FISMA.

Recommendation: We recommend that DHS improve its financial management systems to ensure compliance with the FFMIA, and implement the recommendations provided in Exhibits I, II, and III, in FY 2011.

IV-K *Single Audit Act Amendments of 1996* (*Single Audit*)

FEMA is the only DHS component that has a significant grant making operation. OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* requires agencies awarding grants to ensure they receive grantee reports timely and to follow-up on *Single Audit* findings to ensure that grantees take appropriate and timely action. Although FEMA has adopted procedures to monitor grantees and their audit findings, FEMA did not fully comply with provisions in OMB Circular No. A-133 in FY 2010. We noted that FEMA does not always obtain and review grantee *Single Audit* reports in a timely manner, or follow-up on questioned costs and other matters identified in these reports. Because Single Audits typically are performed by other entities outside of DHS, procedures related to these reports are not always entirely within the control of DHS and its components.

Recommendations: We recommend that:

1. FEMA further develop and implement procedures to ensure compliance with its policy to obtain and review grantee Single Audit reports in a timely manner, and follow-up on questioned costs and other matters identified in these reports. We also recommend that FEMA perform the following in FY 2011:
   a. Further develop and implement a tracking system to identify each grantee for which a *Single Audit* is required, and the date the audit report is due;
   b. Use the tracking system to ensure audit reports are received timely, and follow-up when reports are overdue; and

c. Perform reviews of grantee audit reports, issue-related management decisions, and ensure that the grantees take appropriate corrective action, on a timely basis.

IV-L *Chief Financial Officers Act of 1990*

The *DHS Financial Accountability Act of 2004* made DHS subject to the *Chief Financial Officers Act of 1990*, as amended, which requires DHS to submit to the Congress and OMB audited financial statements annually. DHS' Office of the Inspector General (OIG) has engaged an independent auditor to audit the September 30, 2010 balance sheet and related statement of custodial activity. Other financial statements, including the statements of net cost, changes in net position, and budgetary resources, are not currently auditable. DHS must be able to represent that its balance sheet is fairly stated, and obtain at least a qualified opinion before it is practical to extend the audit to other financial statements.

Recommendation: We recommend that DHS and its components continue to implement the Mission Action Plans described in DHS' *Internal Control Playbook* (see Comment **IV – I**, *Federal Managers' Financial Integrity Act of 1982*, above) to remediate the FY 2010 material weaknesses and significant deficiencies, and improve its policies, procedures, and processes, as necessary, to allow management to assert that all financial statements are fairly stated in compliance with accounting principles generally accepted in the United States, and are ready for an independent audit.

IV-M *Anti-deficiency Act* (ADA)

Various management reviews and OIG investigations are on-going within the Department and its components that may identify ADA violations. The Coast Guard management continues to work to resolve four potential ADA violations relating to funds used in advance of an approved apportionment from OMB, funds used for construction and improvement projects, funds that may be been inappropriately administered the funding for modifications to fixed price contracts, and the improper execution of the obligation and disbursement of funds for the lease of passenger vehicles. National Protection and Programs Directorate (NPPD) management is continuing their review, initiated in FY 2007, over the classification and use of certain funds that may identify an ADA violation. The GAO reported that the United States Secret Service (USSS) spending, in one fund, exceeded the amount budgeted in its fiscal year 2009 Presidential Candidate Nominee Protection PPA. The Management Directorate is currently investigating whether rental charges incurred in FY 2008 and FY 2009 were not properly committed or obligated.

Recommendations: We recommend that the Department, along with the OIG and the other components, complete the internal reviews currently planned or being performed, and properly report the results in compliance with the ADA, if necessary.

IV-N *Government Performance and Results Act of 1993*

The *Government Performance and Results Act of 1993* requires each agency to prepare performance plans that include a description of the operational processes, skills and technology, and the resources required to meet the goals, and a description of the means used to verify and validate the measured results. In addition, the AFR should include performance indicators established in the annual strategic and performance plan, the actual performance achieved compared with the prior year goals, and an evaluation of the current year performance plan with respect to success in achieving the performance goals. DHS recently completed a quadrennial review for the purpose of developing an updated strategic plan around new priorities established by the Secretary. However the Department has not formally revised and adopted a new strategic plan. Since DHS has not updated its strategic plan, the Statements of Net Cost as of September 30, 2010 and 2009 have not been presented by major program, goals and outputs, and certain related financial statement disclosures, required by OMB Circular No. A-136, *Financial Reporting Requirements*, as amended, are not included in the FY 2010 AFR. In addition, DHS is did not include summary performance information that is aligned with its strategic goals and other information, within the MD&A section of the FY 2010 AFR.

Recommendation: We recommend that DHS develop policies and procedures to ensure full compliance with the *Government Performance Results Act of 1993* in FY 2011.

Independent Auditors' Report
Exhibit V – Status of Prior Year Findings

Summary of Conditions As Reported in the 2009 DHS Annual Financial Report		Fiscal Year 2010 Status/ Disposition
Material Weaknesses:		
A.	**Financial Reporting**	
A.1	There are several Department of Homeland Security (DHS or Department) Department-wide control environment weaknesses affecting financial reporting. The Department lacks a sufficient number of accounting and financial management personnel with core technical competencies to ensure financial statements are prepared accurately and in compliance with generally accepted accounting principles. DHS's accounting and financial reporting infrastructure have not received investments in proportion to the Department's rapid growth. The Department's IT infrastructure is aging and has limited functionality.	**Partially Repeated** (Exhibit II-A)
A.2	The Coast Guard had not developed and implemented an effective general ledger system. The general ledgers are not compliant with the United States Government Standard General Ledger (USSGL). The Coast Guard had deficiencies in its policies, procedures, and controls surrounding its financial reporting process, and did not have adequate beginning balance or year-end close out procedures or cumulative results of operations analysis. The Coast Guard did not have adequate policies or procedures to ensure that transactions are appropriately supported and accounted for in its general ledgers. The Coast Guard did not have effective policies and procedures to identify the cause and resolve abnormal balances and account relationship discrepancies, e.g. budgetary to proprietary reconciliations. The Coast Guard did not have a process to reconcile and resolve differences between intragovernmental transactions with its Federal trading partners.	**Partially Repeated** (Exhibit I-A)
A.3	TSA did not have a sufficient number of accounting personnel with technical accounting proficiencies to perform essential accounting and financial reporting functions, ensure segregation of duties, and identify financial reporting issues on a timely basis. TSA had not developed and implemented procedures to fully analyze the effects of its accounting policies to ensure full compliance with GAAP. TSA is not compliant with the USSGL requirements at the transaction level. TSA did not fully reconcile its intragovernmental balances with trading partners.	**Partially Repeated** (Exhibit II-A)
A.4	FEMA did not have sufficient experienced financial managers and staff to ensure segregation of duties in financial reporting roles. FEMA's financial reporting process was complex and required numerous "on-top" adjustments. FEMA did not have effective policies and procedures to identify the cause and resolve abnormal balances and account relationship discrepancies, e.g. budgetary to proprietary reconciliations.	**Partially Repeated** (Exhibit II-A)
A.5	CBP did not have sufficient resources or infrastructure to ensure proper and timely accounting and reporting. CBP did not have effective policies to properly account for and timely report significant new activities. CBP did not have an annual risk assessment process to timely identify and address new accounting standards.	**Corrected**

V.1

Independent Auditors' Report
Exhibit V – Status of Prior Year Findings

	Summary of Conditions As Reported in the 2009 DHS Annual Financial Report	Fiscal Year 2010 Status/ Disposition
B.	**Information Technology General and Application Controls**	
	DHS and its components had IT and financial system security control weaknesses in access controls, change controls, and service continuity.	**Repeated** (Exhibits I-B and II-B)
C.	**Fund Balance with Treasury (FBWT)**	
	The Coast Guard had not developed a comprehensive process to ensure all FBWT are recorded in the general ledger timely, completely and accurately. The Coast Guard did not maintain adequate supporting documentation that validated the accuracy for at least three of the six Agency Location Codes FBWT reconciliations. The Coast Guard recorded unsupported adjustments to general ledger FBWT accounts. The Coast Guard did not have an effective process for clearing suspense account transactions. The Coast Guard was unable to provide military payroll data to support payroll transactions processed through the FBWT account and did not have policies for processing and documenting military and civilian payroll transactions.	**Repeated** (Exhibit I-C)
D.	**Property, Plant, and Equipment**	
D.1	The Coast Guard had not consistently applied policies and procedures to ensure appropriate documentation is maintained to support Property Plant & Equipment (PP&E) acquisitions and their existence, and the methodologies and assumptions, to support the value of PP&E where documentation has not been maintained, has not been developed. The Coast Guard has not implemented appropriate controls to accurately, consistently, and timely record additions to PP&E and construction in process, transfers, disposals, and valuation and classification of repairable PP&E. The Coast Guard has not implemented accurate and complete asset identification, system mapping, and tagging processes for fixed assets, and has not properly accounted for some improvements and impairments to buildings and structures, capital leases, and selected useful lives. For Operating Materials and Supplies (OM&S), the Coast Guard had not implemented policies, procedures, and internal controls to support the assertions related to the OM&S account balances, or fully designed and implemented procedures over physical counts of OM&S. The Coast Guard has not properly identified recorded OM&S, or established processes and controls to fully support the calculated value of certain types of OM&S to approximate historical cost. The Coast Guard had not implemented policies, procedures or internal controls to support assertions related to stewardship PP&E.	**Partially Repeated** (Exhibit I-D)
D.2	TSA did not have policies and procedures to properly account for, monitor, and report PP&E related transactions, including other direct costs, idle or impaired assets, or peripheral equipment. TSA did not have policies or procedures to ensure assets are recorded, depreciated, and disposed of on a timely basis, identify heritage assets, or reconcile the subsidiary ledger.	**Repeated** (Exhibit II-D)

V.2

Independent Auditors' Report
Exhibit V – Status of Prior Year Findings

	Summary of Conditions As Reported in the 2009 DHS Annual Financial Report	Fiscal Year 2010 Status/ Disposition
D.3	CBP did not have adequate accounting policies, procedures, processes or controls to properly account for equipment purchases, transfers, construction or to allocate indirect costs to construction projects. CBP did not properly perform several physical annual inventories of real and personal property.	**Partially Repeated** (Exhibit II-D)
D.4	USCIS did not have adequate policies, procedures, or internal controls to ensure leasehold improvements, internal use software and software in development.	**Corrected**
D.5	NPPD did not have adequate policies, procedures, or internal controls to ensure hardware purchased by contractors was accurately and timely recorded in the general ledger.	**Corrected**
D.6	ICE did not have policies or procedures to properly account for internal use software or software in development in accordance with applicable accounting standards.	**Corrected**
E.	**Actuarial and Other Liabilities**	
E.1	The Coast Guard did not have an effective process to ensure the completeness and accuracy of data provided to, and used by, the actuary for the calculation of medical and postemployment benefit liabilities, and reconciliations between subsidiary and general ledgers for medical expenditures were not effective. The Coast Guard did not have an effective process to prevent overpayments for medical services. The Coast Guard did not have effective processes to account for military personnel data changes, which impacts the completeness and accuracy of leave and payroll accruals as well as data used for actuarial projections. The Coast Guard did not have a reliable methodology to estimate accounts payable. The Coast Guard did not support the completeness, existence, and accuracy assertions of the data utilized in developing the environmental liability estimate.	**Partially Repeated** (Exhibit I-E)
E.2	FEMA did not have sufficient policies and procedures in place to fully comply with the *Single Audit Act Amendments of 1996* and related OMB Circular No. A-133, *Audits of States, Local Governments, and Nonprofit Organizations*.	**Partially Repeated** (Exhibit II-E)
E.3	TSA had not developed policies or procedures to accurately estimate its OTA accrued liability at year-end. TSA did not have policies or procedures to ensure accounts payable accruals are complete and accurate. TSA did not perform an independent analysis of vendor confirmations for which an accrual is based to determine accuracy of the confirmation	**Corrected**

V.3

Independent Auditors' Report
Exhibit V – Status of Prior Year Findings

	Summary of Conditions As Reported in the 2009 DHS Annual Financial Report	Fiscal Year 2010 Status/ Disposition
F	**Budgetary Accounting**	
F.1	The Coast Guard did not have effective policies, procedures and internal controls over Coast Guard's process for validation and verification of UDO balances to ensure that recorded obligations were valid, accurate, recorded timely, and that proper approvals and supporting documentation is maintained. The Coast Guard had not implemented procedures and controls to monitor unobligated commitment activity during the fiscal year. The Coast Guard did not have properly designed and implemented procedures, processes, and internal controls to verify the completeness and accuracy of the year-end obligation pipeline adjustment to record all executed obligations. The Coast Guard did not have controls to ensure procurement transactions are only processed by contracting officers with appropriate warrant authority.	**Repeated** (Exhibit I-F)
F.2	FEMA did not consistently monitor the status of its obligations as part of its normal operations and ensure the timely deobligation of mission assignments and grants. In addition, FEMA could not provide all supporting documentation for the sample of UDOs other than mission assignments and grant UDOs. Significant effort was required to identify the responsible parties and to access certain files or provide information to clearly support the balances reported in the financial statements.	**Partially Repeated** (Exhibit II-F)
F.3	CBP did not enforce its policies and procedures to monitor and deobligate or close-out its obligations in a timely manner.	**Repeated** (Exhibit II-F)
Other Significant Deficiencies:		
G.	**Entity Level Controls**	
G.1	The Coast Guard did not have adequate policies, procedures or controls associated with training for personnel with financial duties. The Coast Guard did not have standardized job descriptions or policies for hiring and evaluating financial employees. The Coast Guard did not have adequate controls with the Standards of Conduct to track and monitor compliance. The Coast Guard did not have an entity-wide policy to address management override of internal controls.	**Repeated** (Exhibit I-A and III-G)

V.4

Independent Auditors' Report
Exhibit V – Status of Prior Year Findings

	Summary of Conditions As Reported in the 2009 DHS Annual Financial Report	Fiscal Year 2010 Status/ Disposition
G.2	FEMA had not sufficiently developed effective methods of communication throughout the agency to ensure that significant financial-related events outside of the OCFO are timely communicated, including review and monitoring of its National Flood Insurance Program. FEMA did not complete the placement of sufficient financial and accounting resources related to mission assignments. FEMA had not completed documentation of policies and procedures for several roles, responsibilities, processes and functions within the agency. FEMA had not committed sufficient resources to ensure that personnel attend required ethics training. FEMA had not developed sufficient policies and procedures to designate position sensitivity for positions using, developing, or operating IT systems or track and maintain the status of background investigations.	**Partially Repeated** (Exhibit II-A and Exhibit III-G)
G.3	TSA had not implemented an agency-wide policy to address intervention of management override of internal controls.	**Corrected**
H.	**Custodial Revenue and Drawback**	
	The CBP Automated Commercial System (ACS) lacked automated controls to detect and prevent excessive drawback claims and overpayments, necessitating inefficient manual processes that do not effectively compensate for these automated controls. The CBP's drawback review policies did not require drawback specialists to review all or a statistically valid sample of related drawback claims against the underlying consumption entries to determine whether, in the aggregate, an excessive amount was claimed. CBP was unable to determine the status of in-bond shipments and lacks policies and procedures that require monitoring of the results of in-bond audits. CBP did not perform an analysis to determine the potential loss of revenue through the in-bond process. CBP Compliance Measurement oversight guidance did not provide complete coverage over the CM program. There were inconsistencies in the performance of risk assessments of Bonded Warehouses and Foreign Trade Zones.	**Repeated** (Exhibit III-H)

V.5

Independent Auditors' Report
Exhibit V – Status of Prior Year Findings

Summary of Conditions As Reported in the 2009 DHS Annual Financial Report		Fiscal Year 2010 Status/ Disposition
Compliance and Other Matters:		
I.	***Federal Managers' Financial Integrity Act of 1982* and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-up*, as revised** The Coast Guard had not fully established effective systems, processes, policies, and procedures to develop and implement internal accounting and administrative controls and conformance of accounting systems. In addition, the Federal Law Enforcement Training (FLETC), National Preparedness Directorate (NPPD), and TSA's control assessment processes require improvement to ensure full compliance with FMFIA.	**Partially Repeated** (Exhibit IV-I)
J.	***Federal Financial Management Improvement Act of 1996*** We noted that DHS and each significant component did not fully comply with at least one of the requirements of FFMIA. In addition, we noted weaknesses in financial systems security, which impact the Department's ability to fully comply with FISMA.	**Repeated** (Exhibit IV-J)
K.	***Single Audit Act Amendments of 1996,*** DHS and its components did not have procedures in place to fully comply with provisions in OMB Circular No. A-133 that require them to timely obtain and review grantee Single Audit reports and follow up on questioned costs and other matters identified in these reports.	**Repeated** (Exhibit IV-K)
L.	***Chief Financial Officers Act of 1990*** The *DHS Financial Accountability Act of 2004* made DHS subject to the *Chief Financial Officers Act of 1990*, as amended, which requires DHS to submit to the Congress and OMB audited financial statements annually. DHS engaged an independent auditor to audit the September 30, 2009, consolidated balance sheet and statement of custodial activity only.	**Repeated** (Exhibit IV-L)

V.6

Independent Auditors' Report
Exhibit V – Status of Prior Year Findings

Summary of Conditions As Reported in the 2009 DHS Annual Financial Report	Fiscal Year 2010 Status/ Disposition
M. *Anti-deficiency Act*	
FEMA had initiated a preliminary review of certain expenditures in FY 2008 that may have violated the *Anti-deficiency Act* (ADA). The Coast Guard management continued to work to resolve two potential ADA violations. NPPD management continued to review the classification and use of certain funds that may identify an ADA violation as well as certain fees collected for attendance at a DHS-sponsored conference. United States Secret Service (USSS) performed a review of certain salaries and expenses that may identify a violation of ADA. In addition, various other management reviews and OIG investigations are on-going within the Department and its components that may identify ADA violations.	**Repeated** (Exhibit IV-M)

V.7

Office of the Chief Financial Officer
U.S. Department of Homeland Security
Washington, DC 20528

Homeland Security

November 12, 2010

MEMORANDUM FOR: Richard L. Skinner
Inspector General

FROM: Peggy Sherry
Deputy Chief Financial Officer

SUBJECT: Fiscal Year (FY) 2010 Financial and Internal Controls Audit

Thank you for the opportunity to comment on the Independent Public Accountant's audit of our balance sheets, the related statement of custodial activities and internal controls as of September 30, 2010 and 2009. We agree with the Independent Public Accountant's conclusions.

Although the report indicates that DHS still faces financial management challenges, the auditor noted the Department's progress in improving the quality and reliability of our financial reporting. During FY 2010, our Components implemented corrective actions that significantly improved key financial management and internal control areas. As we grow closer to obtaining an audit opinion on the consolidated balance sheet and statement of custodial activities, DHS will discover additional opportunities for financial management improvement and will continue to strengthen internal controls and accountability.

The FY 2010 audit results show that our corrective actions are working, and we are already focusing our efforts on the remaining issues before us. I want to thank you for your efforts and the continued dedication by your staff to work collaboratively in addressing our challenges. As we continue our steadfast progress, I look forward to working with the Office of Inspector General and the Independent Public Accountant.

Appendix A
Management's Response

Office of the Chief Financial Officer
U.S. Department of Homeland Security
Washington, DC 20528

Homeland Security

November 12, 2010

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Inspector General

FROM: Peggy Sherry
Deputy Chief Financial Officer

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The FY 2010 audit results show that our corrective actions are working, and we are already focusing our efforts on the remaining issues before us. I want to thank you for your efforts and the continued dedication by your staff to work collaboratively in addressing our challenges. As we continue our steadfast progress, I look forward to working with the Office of Inspector General and the Independent Public Accountant.

Appendix B
Report Distribution

Department of Homeland Security

Secretary
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Assistant Secretary for Office of Policy
Assistant Secretary for Office of Public Affairs
Assistant Secretary for Office of Legislative Affairs
Under Secretary for Management
Acting Chief Financial Officer
Chief Information Officer
Chief Security Officer
Chief Privacy Officer

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Chief, Homeland Security Branch
DHS OIG Budget Examiner

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Congressional Oversight and Appropriations Committees, as appropriate

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- Fax the complaint directly to us at (202) 254-4292;
- Email us at DHSOIGHOTLINE@dhs.gov; or
- Write to us at:
  DHS Office of Inspector General/MAIL STOP 2600,
  Attention: Office of Investigations - Hotline,
  245 Murray Drive, SW, Building 410,
  Washington, DC 20528.

The OIG seeks to protect the identity of each writer and caller.

Other Accompanying Information

The ***Other Accompanying Information*** section contains information on Tax Burden/Tax Gap, Summary of Financial Statement Audit and Management Assurances, Improper Payments Act, and Other Key Regulatory Requirements. Also included in this section is the OIG Report on the Major Management Challenges Facing the Department of Homeland Security followed by Management's Response.

Tax Burden/Tax Gap

Revenue Gap

The Entry Summary Compliance Measurement (ESCM) program collects objective statistical data to determine the compliance level of commercial imports with U.S. trade laws, regulations, and agreements, and is used to produce a dollar amount for Estimated Net Undercollections and a percent of Revenue Gap. The Revenue Gap is a calculated estimate that measures potential loss of revenue owing to noncompliance with trade laws, regulations, and trade agreements using a statistically valid sample of the revenue losses and overpayments detected during ESCM entry summary reviews conducted throughout the year. For FY 2009 and 2008, the Revenue Gap was $285 million and $396 million, respectively. CBP calculated the preliminary FY 2010 Revenue Gap to be $91 million. As a percentage, the preliminary Revenue Gap for FY 2010 represents less than 0.28 percent of all collectible revenue for the year, the lowest it has been in over five years. The estimated over collection and under collection amounts due to noncompliance for FY 2010 were $51 million and $142 million, respectively. The overall trade compliance rate for FY 2009 and FY 2008 is 98.2 and 97.6 percent, respectively. The preliminary overall compliance rate for FY 2010 is 99 percent.

The final overall trade compliance rate and estimated revenue gap for FY 2010 will be issued in February 2011.

Summary of Financial Statement Audit and Management Assurances

Table 1 and Table 2 below provide a summary of the financial statement audit and management assurances for FY 2010.

Table 1. FY 2010 Summary of the Financial Statement Audit

Audit Opinion	Disclaimer				
Restatement	Yes				
Material Weakness	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Ending Balance**
Financial Management and Reporting	1				1
IT Controls and System Functionality	1				1
Fund Balance with Treasury	1				1
Property, Plant, & Equipment and Operating Materials & Supplies	1				1
Actuarial and Other Liabilities	1				1
Budgetary Accounting	1				1
Total Material Weaknesses	**6**	**0**	**0**	**0**	**6**

In FY 2010, the Independent Auditor's integrated financial statement and internal control report identified six material weakness conditions at the Department level; however, portions of prior year material weakness conditions were reduced in severity. For example, CBP implemented corrective actions to reduce the severity of Property, Plant, and Equipment deficiencies. CBP, FEMA, and TSA implemented corrective actions to reduce the severity of Financial Management and Reporting conditions. Finally, USCIS, ICE, TSA, and NPPD corrected several significant deficiencies at the consolidated level.

Table 2. FY 2010 Summary of Management Assurances

Effectiveness of Internal Control Over Financial Reporting (FMFIA Section 2)						
Statement of Assurance	No Assurance					
Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
Financial Reporting and Other Liabilities at USCG	1					1
Fund Balances with Treasury at USCG	1					1
Financial Systems Security at USCG, FEMA, ICE,	1					1
Budgetary Resource Management at USCG	1					1
Property Management at USCG and TSA	1					1
Human Resource Management at USCG	1				✓	0
Total Material Weaknesses	**6**	**0**	**0**	**0**	**(1)**	**5**

Effectiveness of Internal Controls over Operations (FMFIA Section 2)						
Statement of Assurance	Qualified					
Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
Property Management at DHS and TSA	1					1
Financial Assistance Awards Policy and Oversight at DHS and FEMA	1					1
Acquisition Management	1					1
Funds Control at U.S. Coast Guard, ICE, and USSS	1					1
Entity Level Controls at FEMA	1				✓	0
Business Continuity and US-VISIT System Security at CBP	1				✓	0
Total Material Weaknesses	**6**	**0**	**0**	**0**	**(2)**	**4**

Conformance with financial management systems requirements (FMFIA Section 4)						
Statement of Assurance	Systems do not conform to financial management systems requirements					
Non-Conformances	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
Federal Financial Management Systems Requirements, including Financial Systems Security and Integrated Financial Management Systems	1					1
Noncompliance with the U.S. Standard General Ledger	1					1
Federal Accounting Standards	1					1
Total Non-conformances	**3**	**0**	**0**	**0**	**0**	**3**

Compliance with Federal Financial Management Improvement Act (FFMIA)	DHS	Auditor
Overall Susbstantial Compliance	No	No
1. System Requirements	No	
2. Accounting Standards	No	
3. USSGL at Transaction Level	No	

Effectiveness of Internal Control Over Financial Reporting

Pursuant to the DHS FAA, the Department focused its efforts on corrective actions to design and implement Department-wide internal controls. Since FY 2005 DHS has reduced audit qualifications from ten to one and material weaknesses by more than half. In addition, the U.S. Coast Guard's Financial Strategy for Transformation and Audit Readiness has allowed us to increase the auditable balance sheet amounts to approximately ninety percent in FY 2010. Finally, in FY 2010, the Department completed a limited scope evaluation of processes that provide internal control over the Statement of Budgetary Resources, Changes in Net Position, and Net Cost.

DHS reported five material weakness conditions at the Department level in FY 2010, one less material weakness than reported on by the independent auditor. The difference between audit and management's conclusion results from reporting timing and classification differences. One example of the differing conclusion results is the independent audit reports on a U.S. Coast Guard Actuarial Liability material weaknesses that existed throughout FY 2010. Management's conclusion of the U.S. Coast Guard Actuarial Liability condition reports on the status and severity of the condition as of September 30, 2010 while considering interim compensating measures in place since June 30, 2010 that enable the Department to clear a $43 billion audit qualification related to U.S. Coast Guard Actuarial Liabilities. U.S. Coast Guard and the Department will work with the independent auditor in early FY 2011 to measure progress through an independent audit. In addition, differences between condition titles reported by DHS Management and the Independent Public Auditor (IPA) are due to the Department's grouping of material weakness conditions by financial management processes, based on Federal Financial Systems Requirements (FFSR). The FFSR process definitions used by management aid corrective actions and facilitate development of standard controls and business processes.

Significant internal control challenges remain largely at the U.S. Coast Guard. To support the U.S. Coast Guard and other Components, the Department's Chief Financial Officer will conduct weekly working group meetings with Senior Management and Staff. Table 3 below summarizes financial statement audit material weaknesses in internal controls as well as planned corrective actions with estimated target correction dates.

Table 3. FY 2010 Internal Control Over Financial Reporting Corrective Actions

Material Weaknesses in Internal Controls Over Financial Reporting	Year Identified	DHS Component	Corrective Actions	Target Correction Date
Financial Management and Reporting: U.S. Coast Guard has not established an effective financial reporting process due to limited staffing resources, informal policies and procedures, and lack of integrated financial processes and systems.	FY 2003	U.S. Coast Guard	The DHS OCFO will continue efforts to support U.S. Coast Guard in implementing corrective actions to address staffing shortfalls and develop policies and procedures to establish effective financial reporting control activities.	FY 2012
IT Controls and System Functionality: The Department's Independent Public Auditor had identified Financial Systems Security as a material weakness in internal controls since FY 2003 due to inherited control deficiencies surrounding general computer and application controls. The *Federal Information Security Management Act* mandates that Federal Agencies maintain IT security programs in accordance with OMB and National Institute of Standards and Technology guidance.	FY 2003	U.S. Coast Guard, FEMA, and ICE	The DHS OCFO and OCIO will support the U.S. Coast Guard, FEMA, and ICE to design and implement internal controls in accordance with *DHS 4300A Sensitive Systems Handbook, Attachment R: Compliance Framework for CFO Designated Financial Systems.*	FY 2012
Fund Balance with Treasury: U.S. Coast Guard did not implement effective internal controls to accurately clear suspense transactions in order to perform accurate and timely reconciliations of Fund Balance with Treasury (FBWT) accounts.	FY 2004	U.S. Coast Guard	In FY 2010, U.S. Coast Guard made progress in reconciling FBWT payroll activity and will continue efforts to develop short-term compensating controls for non payroll FBWT activity, while longer-term corrective actions are implemented.	FY 2012
Property, Plant, and Equipment: The controls and related processes surrounding U.S. Coast Guard and TSA Property, Plant, and Equipment (PPE) to accurately and consistently record activity are either not in place or contain errors and omissions.	FY 2003	U.S. Coast Guard and TSA	CBP implemented corrective actions to reduce the severity of portions of the PPE material weakness. In addition, U.S. Coast Guard implemented corrective actions to correct Operating Materials and Supplies conditions. TSA made progress towards implementing policies and procedures to identify and account for software capitalization in accordance with Statement of Federal Financial Accounting Standard (SFFAS) No. 10, *Accounting for Internal Use Software*. U.S. Coast Guard will implement policies and procedures to support completeness, existence, and valuation assertions for PPE. The DHS OCFO will continue efforts to support U.S. Coast Guard and TSA implementing corrective actions to address capital asset conditions and develop policies and procedures to establish effective financial reporting control activities.	FY 2012
Budgetary Accounting: Policies and procedures over obligations, disbursements, and validation and verification of undelivered orders for accurate recording of accounts payable were not effective.	FY 2004	U.S. Coast Guard	U.S. Coast Guard developed corrective actions to improve budgetary accounting. However, corrective actions may extend beyond FY 2011 due to resource constraints and magnitude of other corrective actions.	FY 2012
Actuarial and Other Liabilities: U.S. Coast Guard has not completely implemented policies and procedures to account for actuarial liabilities. In addition, internal control weaknesses exist in developing estimates for accounts payable and environmental liabilities at U.S. Coast Guard.	FY 2006	U.S. Coast Guard	U.S. Coast Guard implemented corrective actions in FY 2010 to provide management representations and clear a $43 billion audit qualification related to actuarial liabilities. Progress was made in developing accounts payable estimates, however additional actions will be implemented in FY 2011 to refine estimates. Corrective actions for environmental liabilities will be taken in coordination with PPE corrective actions to develop a complete population of locations where environmental liabilities exists.	FY 2011

Effectiveness of Internal Control Over Operations

The DHS Management Directorate is dedicated to ensuring that Departmental Offices and Components perform as an integrated and cohesive organization, focused on leading the national effort to secure America. Critical to this mission is a strong internal control structure. As we strengthen and unify DHS operations and management, we will continually assess and evaluate internal control to evaluate our progress in ensuring the effectiveness and efficiency of operations and compliance with laws and regulations. For the fourth consecutive year, we have made tremendous progress in strengthening Department-wide internal controls over operations, as evidenced by the following FY 2010 achievements:

- Transformed relations with the U.S. Government Accountability Office (GAO) through issuance of DHS/GAO Protocols and established an audit follow up governance process to improve the efficiency and effectiveness of operations.
- Developed the first-ever DHS Secretary's Workforce Strategy. The Office of the Chief Information Officer was selected as the Pilot Program for the DHS Balanced Workforce Initiative and has successfully implemented Human Resource and Career Development Strategies.
- Received a grade of "A" from the Small Business Administration for success in contract awards. Increased competition rate from 74 percent to 86 percent between FY 2009 and FY 2010. Implemented a Quarterly Operational Assessment measuring specified metrics. Conducted oversight reviews at three Components as well as five DHS-wide reviews, resulting in numerous recommendations for improvement and identification of best practices. Updated the Homeland Security Acquisition Manual to reflect new regulatory and policy requirements.
- The Acquisition Professional Career Program continues to build momentum with 200 participants on-board by September 30, 2010. Professional certification programs have been created for contract specialists, contracting officer's technical representatives, program managers, and test and evaluators. The Office of the Chief Procurement Officer has developed ethics training geared specifically for those individuals who have responsibility for participating in the procurement process.
- Directive 102-01 and a new revision of the Systems Engineering Life Cycle were signed out. Ten Portfolio-based Reviews were conducted this fiscal year. Eight Component Acquisition Executives have been designated. Governance through Executive Steering Committees (ESCs) has been established over high-priority programs such as Transformation and Systems Consolidation (TASC).
- Execution of planned FY 2010 Data Center Consolidation is on track for ICE, USCIS, FEMA, NPPD, and TSA. OneNet Network transitions are ahead of schedule where 95 percent of all transition items are on the GSA contract. A Common Operating Environment has been established with development and test capabilities to be migrated to this rapid provisioning environment.
- Completed a first ever full assessment of the Office of the Chief Acquisition Officer organizational structure and business lines. The purpose of the full assessment is to provide an organizational roadmap and playbook for optimizing the efficiencies and effectiveness of administrative business lines.

- Created a comprehensive Asset Management Plan (AMP). The AMP improves and standardizes current directives; update the current real property manual; and create a personal property manual.
- The DHS HSPD-12 Program, under the direction of the Office of the Chief Security Officer, ended FY 2010 with the issuance of 115,546 Personal Identity Verification cards to DHS employees and contractors. Over this same period of time, card issuance workstations were deployed to more than 130 DHS locations. HSPD-12 has fostered greater collaboration and opportunities for improving how DHS handles information related to employees' identification through all business processes. Plans are in progress for ensuring physical and logical access is efficient across the Department.
- Finalized construction on the DHS Headquarters perimeter security design project that began in February 2010. At present, 40 percent of the perimeter fencing is complete; the vehicle screening building is scheduled for completion and turnover in December 2010; and the security command center is scheduled for completion in April 2011. Its completion and use will be a major milestone in establishing an effective emergency and crisis-response capability.
- The Office of the Chief Security Officer (OCSO) coordinated with State, local, tribal and private sector partners to conduct 51 on-site Fusion Center visits. These trips consisted of pre-construction meetings and post-construction/certification surveys for Fusion Center secure rooms, security training, and attendance at regional Fusion Center conferences. Safeguarding National Security Information training and specialized training was presented at 13 sites. The OCSO certified 18 Fusion Center Secure Rooms to support the Intelligence and Analysis sponsored Homeland Security Data Network deployment to State Fusion Centers.

To address challenges to internal control over operations, the Department's Under Secretary for Management conducts weekly Senior Management Council Oversight meetings.

Table 4 summarizes material weaknesses in internal control over operations as well as planned corrective actions with estimated target correction dates.

Table 4. FY 2010 Internal Control Over Operations Corrective Actions

Material Weaknesses in Internal Controls Over Operations	Year Identified	DHS Component	Corrective Actions	Target Correction Date
Property Management: Oversight and monitoring controls of the Department's investment in property, equipment, and other materials need to be strengthened. TSA identified conditions related to timeliness of property and inventory transactions, supporting documentation, and proper asset classifications.	FY 2008	DHS and TSA	The Department's Office of Chief Administrative Officer (OCAO) will establish an oversight capability in this area. In FY 2010, OCAO completed a first ever full assessment of the OCAO organizational structure and business lines and created a comprehensive Asset Management Plan (AMP). The AMP improves and standardizes current directives; update the current real property manual; and create a personal property manual. In FY 2011, the DHS OCFO and OCAO will partner to provide TSA additional oversight to address operational property challenges that continue to impact internal control over financial reporting.	FY 2011
Financial Assistance Awards Policy and Oversight: There are four conditions affecting stewardship of Federal assistance funding across DHS: (1) the lack of published department-wide Financial Assistance Policy to guide Components' and Awardees' actions; (2) the lack of Component Oversight and Monitoring to ensure their adherence to such policy; (3) the lack of Office of the Inspector General and DHS Management actions being taken in order to resolve and close annual Awardee audit findings; and (4) the lack of basic information regarding how DHS goes about conducting its Financial Assistance Line of Business.	FY 2008	DHS and FEMA	OCFO has acquired resources to establish a Financial Assistance Policy and Oversight (FAPO) Division, with a total of 22 FTE directed by a Senior Executive, to oversee implementation of audit follow up with the Single Audit Act throughout DHS and FEMA.	FY 2011
Acquisition Management: There are five conditions affecting acquisition management at DHS: (1) Inability to effectively achieve proper organizational alignment from achieving mission; (2) Systems oversight and accountability within the acquisition function has improved, but is still not sufficient; (3) Program cost growth and the inadequacy of the cost estimating process at DHS; (4) Gaps identified in the acquisition workforce based on the High Priority Performance Goal 8 survey; and (5) use of suspension and debarment actions for poorly performing contractors.	FY 2008	DHS	DHS will continue efforts to implement policies and procedures through an enhanced acquisition strategy to improve "front end" requirements to the "back end" program management with improved governance across the acquisition life-cycle.	FY 2011
Funds Control: U.S. Coast Guard identified a material weakness within Anti-Deficiency Act (ADA) controls. ICE made progress against the prior year Detention and Removal Program condition related to the monitoring and oversight, however identified additional documentation risks with other areas. Finally, an ADA violation at USSS was reported by the GAO.	FY 2007	U.S. Coast Guard, ICE, and USSS	U.S. Coast Guard is developing enterprise-wide polices and procedures for assessing ADA risks, testing effectiveness of controls and monitoring to fully implement DHS policy. ICE deployed an integrated financial management team to address critical process and internal control issues to resolve conditions in FY 2011. USSS will implement policies and procedures in FY 2011 regarding the administrative control of funds.	FY 2011

Federal Financial Management Improvement Act

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires Federal agencies to implement and maintain financial management systems that comply substantially with:

- Federal financial management system requirements;
- Applicable Federal accounting standards; and
- The U.S. Standard General Ledger at the transaction level.

In assessing compliance with FFMIA, DHS utilizes OMB guidance and considers the results of the OIG's annual financial statement audits and Federal Information Security Management Act (FISMA) compliance reviews. As reported in the Secretary's Management Assurance Statements, DHS financial management systems do not substantially conform to Government-wide requirements. However, significant consolidation efforts are in progress to modernize, certify, and accredit all financial management systems.

Financial Management Systems – Transformation and Systems Consolidation (TASC)

The mission support systems inherited in the stand up of the Department of Homeland Security had serious limitations, based on an assessment conducted in 2003. Specifically, financial systems failed to meet Government standards for accounting, internal controls, and reporting. Significant portions of the DHS financial reports are manually populated with financial data that reside in multiple and varying acquisition and asset systems. DHS faces enormous manual reconciliation tasks and time-consuming complexities of recording accurate, consistent, and timely obligations.

To start to address these deficiencies in DHS financial reporting accuracy and timeliness, the Department is preparing to award the TASC contract, which will enable the Department to move forward with the standardization of business processes and fiscal reporting capabilities.

DHS is seeking approval for the TASC program to award the Indefinite Delivery Indefinite Quantity (IDIQ) contract and initial task orders. Upon award of the contract, the Department has determined, based on business need and factors for successful implementation, that FEMA will be the first Component to migrate to the TASC solution. Once the successful implementation of the initial migration is completed, the TASC Program Management Office will request OMB approval to begin migrating additional Components based on business need and risk factors.

Federal Information Security Management Act (FISMA)

The *E-Government Act of 2002* (Pub. L. 107-347) Title III FISMA provides a framework to ensure the effectiveness of security controls over information resources that support Federal operations and assets. FISMA provides a statutory definition for information security.

The U.S. Department of Homeland Security 2010 Federal Information Security Management Act Report and Privacy Management Report consolidates reports from three DHS offices:

- Chief Information Officer (CIO) / Chief Information Security Officer (CISO);
- Inspector General (OIG); and
- Privacy Office.

Based on the requirements outlined in FISMA and OMB's annual reporting instructions, the OIG in FY 2010 identified progress the Department has made on the following ten key areas of DHS's information system security program:

- System Inventory;
- Certification and Accreditation Process;
- Plan of Action and Milestones;
- Incident Response and Reporting;
- Security Training;
- Remote Access;
- Account and Identity Management;
- Continuous Monitoring;
- Contingency Planning Program; and
- Privacy.

The Department continues to improve and strengthen its security program. The OIG report, "Evaluation of DHS' Information Security Program for Fiscal Year 2010," identified seven recommendations for information security improvements. DHS plans to update the DHS Information Security Performance Plan with enhanced metrics further improving compliance in these areas.

Improper Payments Information Act

The *Improper Payments Information Act* (IPIA) *of 2002* (Pub. L. 107-300) requires agencies to review their programs and activities to identify those susceptible to significant improper payments. In addition, Section 831 of the FY 2002 *Defense Authorization Act* (Pub. L. 107-107) established the requirement for Government agencies to carry out cost-effective programs for identifying and recovering overpayments made to contractors, also known as "Recovery Auditing." The OMB has established specific reporting requirements for agencies with programs that possess a significant risk of improper payments and for reporting on the results of recovery auditing activities.

The IPIA was amended on July 22, 2010 by the *Improper Payments Elimination and Recovery Act* (IPERA) of 2010 (Pub. L. 111-204). IPERA reporting requirements for the Annual Financial Report will not go into effect until FY 2011.

I. Risk Assessments

In FY 2010, risk assessments were conducted on 99 DHS programs, totaling $57 billion in FY 2009 disbursements. Assessments were not conducted on programs with total disbursements less than $10 million. All payment types were assessed except for Federal intra-governmental payments which were excluded after consultation and concurrence with OMB and OIG.

Improper payment estimates in this section are based on statistical estimates for FY 2009. These estimates are then projected for FY 2010 and beyond based on improvements expected from completing corrective actions.

The susceptibility of programs to significant improper payments was determined by qualitative and quantitative factors. These factors included:

- <u>Payment Processing Controls</u> – Management's implementation of internal controls over payment processes including existence of current documentation, the assessment of design and operating effectiveness of internal controls over payments, the identification of deficiencies related to payment processes and whether or not effective compensating controls are present, and the results of prior IPIA payment sample testing.
- <u>Quality of Internal Monitoring Controls</u> – Periodic internal program reviews to determine if payments are made properly. Strength of documentation requirements and standards to support test of design and operating effectiveness for key payment controls. Presence or absence of compensating controls.
- <u>Human Capital</u> – Experience, training, and size of payment staff. Ability of staff to handle peak payment requirements. Level of management oversight and monitoring against fraudulent activity.
- <u>Complexity of Program</u> – Time program has been operating. Complexity and variability of interpreting and applying laws, regulations, and standards required of the program.
- <u>Nature of Payments and Recipients</u> – Type, volume, and size of payments. Length of payment period. Quality of recipient financial infrastructure and procedures. Recipient experience with Federal award requirements.

- Operating Environment – Existence of factors which necessitate or allow for loosening of financial controls. Any known instances of fraud. Management's experience with designing and implementing compensating controls.
- Additional Grant Programs Factors – Federal Audit Clearinghouse information on quality of controls within grant recipients. Identification of deficiencies or history of improper payments within recipients. Type and size of program recipients and sub-recipients. Maturity of recipients' financial infrastructure, experience with administering Federal payments, number of vendors being paid, and number of layers of sub-grantees.

A weighted average of these qualitative factors was calculated. This figure was then weighted with the size of the payment population to calculate an overall risk score.

Based on this year's assessment process, the following programs were deemed to be vulnerable to significant improper payments:

Table 5. Programs at High-Risk for Improper Payments Based on FY 2010 Risk Assessments and Prior Year Payment Sample Testing[1]

Component	Program Name	Disbursements ($ Millions)
CBP	Border Security Fencing	$638
	Custodial – Refund & Drawback	$1,436
FEMA	Disaster Relief Program – Individuals and Households Program (IHP)	$848
	Disaster Relief Program – Vendor Payments	$1,382
	Insurance – National Flood Insurance Program (NFIP)	$3,287
	Grants – Public Assistance Programs (PA)	$5,070
	Grants – Homeland Security Grant Program (HSGP)	$1,300
	Grants – Assistance to Firefighters Grants (AFG)	$429
	Grants – Transit Security Grants Program (TSGP)	$119
ICE[2]	Detention and Removal Operations (DRO)	$1,320
	Federal Protective Service (FPS)	$760
TSA	Aviation Security – Payroll	$2,383
USCG	Active Duty Military Payroll (ADMP)	$2,766
Total Disbursements		**$21,738.00738**

Notes:

1. In FY 2009, OMB granted relief from measuring and reporting annual improper payment information for four programs that DHS tested and reported estimated error amounts below $10 million. These programs were: (1) At CBP – Continued Dumping & Subsidy Offset Act & Payments to Wool Manufacturers, (2) At ICE – Investigations, (3) At USCG – Contract payments for Acquisition, Construction & Improvements and (4) At USCG – Contract payments for Operating Expenses (OE). The next year that DHS will report on these four programs will be in its FY 2013 Annual Financial Report.
2. Only the non-payroll portion of ICE programs was found to be high-risk. Disbursement figures are for non-payroll disbursements.

II. Statistical Sampling Process

For FY 2010 reporting, a stratified sampling design was used to test payments based on FY 2009 disbursement amounts and the assessed risk of the program. The design of the statistical sample plans and the extrapolation of sample errors across the payment populations were completed by a statistician under contract.

Sampling plans provided an overall estimate of the percentage of improper payment dollars within +/-2.5 percent precision at the 90 percent confidence level, as specified by OMB guidance. An expected error rate of five to ten percent of total payment dollars was used in the sample size calculation.

Using stratified random sampling, payments were grouped into mutually exclusive “strata” or groups based on total dollars. A stratified random sample typically required a smaller sample size than a simple random sample to meet the specified precision goal at any confidence level. Once the overall sample size was determined, the individual sample size per stratum was determined using the Neyman Allocation method.

The following procedure describes the sample selection process:

- Identify large payment dollars as the certainty stratum;
- Assign each payment a randomly generated number using a seed;
- Sort payments within each stratum (by ordered random numbers); and
- Select payments following the sample size design. For the certainty strata, all payments are selected.

To estimate improper payment dollars for the population from the sample data, the stratum specific ratio of improper dollars (gross, underpayments, and overpayments, separately) to total payment dollars was calculated.

DHS sample test results are listed in Table 6.

Table 6. DHS Sample Test Results

Component	Program	FY 2009 Payment Population ($millions)	FY 2009 Sample Size ($millions)	Est. Error Amount ($millions)	Est. Error Percentage (%)
CBP	Border Security Fencing	$638	$527	$0	0.03%
	Refund & Drawback	$1,436	$237	$3	0.20%
FEMA	Disaster Relief Program – Individuals and Households Program (IHP)	$848	$4	$23	2.72%
	Disaster Relief Program – Vendor Payments	$1,382	$506	$46	3.32%
	Insurance – National Flood Insurance Program (NFIP)	$3,287	$42	$73	2.22%
	Grants – Public Assistance Programs (PA)[1]	$706	$566	$1	0.21%
	Grants – Homeland Security Grant Program (HSGP)[2]	$115	$92	$2	2.20%
	Grants – Assistance to Firefighters Grants (AFG)	$429	$50	$27	6.32%
	Grants – Transit Security Grants Program (TSGP)[3]	$16	$16	$0	0.09%
	Grants – Emergency Food and Shelter Program (EFSP), ARRA Payments	$86	$17	$5	6.18%
ICE	Detention and Removal Operations[4]	$1,320	$254	$7	0.53%
	Federal Protective Service[4]	$760	$127	$1	0.10%
TSA	Aviation Security – Payroll	$2,383	$2	$0	0.00%
USCG	Operating Expenses - Active Duty Military Payroll	$2,766	$3	$4	0.13%
DHS	**All Programs[5]**	**$16,172**	**$2,443**	**$192**	**1.19%**
DHS	**High-Risk Programs (Est. Error Amount >$10 Million)**	**$5,946**	**$602**	**$169**	**2.84%**

Notes:

1. Sample testing of the Public Assistance Program was done in two stages covering six states (AR, IL, IN, LA, OH, and TX). The six states paid out $3,006 million out of a national total of $5,070 million. The totals in the table are the stage two payment populations for the six states tested. See the Outlook projection table for the national estimated error of $11 million.
2. Sample testing of the Homeland Security Grant Program was done in two stages covering eight states (CO, FL, MI, MO, NV, OH, PA, WA) and Washington, DC. These regions paid out $312 million out of a national total of $1,300 million. The totals in the table are the stage two payment populations for the nine regions. See the Outlook projection table for the national estimated error of $29 million.
3. Sample testing of the Transit Security Grant Program was done in two stages covering eight states (CO, FL, MI, MO, NV, OH, PA, WA) and Washington, DC. These regions paid out $20 million out of a national total of $119 million. The totals in the table are the stage two payment populations for the nine regions. See the Outlook projection table for the national estimated error of $0 million.
4. The estimated error total for Detention and Removal Operations includes $341,829 of duplicate payments which were issued on two Treasury schedules that were paid twice in FY 2009. Federal Protective Service duplicate payments on the same Treasury schedules totaled $13,217.
5. Program total of $16,172 in this table differs from $21,738 total in Improper Payment Reduction Outlook Table for several reasons. For State Administered Grant Programs, the table above lists the population totals for the States tested while the Improper Payment Reduction Outlook Table lists the national payment populations. FEMA's EFSP ARRA Payments are listed above as they were sample tested to meet the improper payment objectives listed in the Recovery Act. They are not listed in the Improper Payment Reduction Outlook Table due to the non-recurring nature of this funding.

Several programs considered at high-risk based on risk assessment grading were not confirmed as at high-risk based on sample test results. The main reason for the estimated error rates falling below $10 million for these programs was the presence of strong compensating controls such as additional levels of payment review for manually intensive processes.

Based on the results of sample testing, corrective action plans are required for the following six programs due to estimated error amounts above $10 million: FEMA's Assistance to Firefighters Grants, FEMA's Disaster Relief Program - Vendor Payments, FEMA's Homeland Security Grant Program, FEMA's Individuals and Households Program, FEMA's National Flood Insurance Program, and FEMA's Public Assistance Program.

III. Corrective Action Plans for High-Risk Programs

Following are corrective actions plans for programs with estimated improper error amounts above $10 million.

FEMA Assistance to Firefighter Grants Program

Table 7. Completed Assistance to Firefighters Grants Program Corrective Actions

Risk Factors	Corrective Actions	Completed Date
Category of Error: Insufficient Supporting Documentation		
1. Missing invoice.	1. Provide applicants with examples of proper supporting documentation when award is granted.	February 2010
Category of Error: Purchases Outside Allowable Timeframe		
2. Purchases before or after the period of performance.	1. If an advance payment is requested, ask applicants whether arrangements have been made to purchase the goods within 30 days of receipt of funding.	January 2010

Table 8. Planned Assistance to Firefighter Grants Program Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Insufficient Supporting Documentation		
1. Grantee was unable to provide supporting documentation relevant to grant payments.	1. Guidance – Develop and distribute to all Grantees a "Grantee Supporting Documentation Retention Strategy" detailing the types of supporting documentation Grantees should retain at each phase of the grant life cycle.	May 2011
	2. Training – Require each grantee to complete the AFG Grant Management Tutorial.	May 2011 (and ongoing)
Category of Error: Purchase Outside Allowable Timeframe		
2. Invoices for purchases from sub-grantees fell outside of the period of performance.	1. System Enhancements – Develop and deploy a modification email notification to be sent to Grantees through AFG System towards the end of the period of performance (at nine months and eleven months) alerting Grantees to make purchases before the deadline.	May 2011
	2. Training – Require each grantee to complete the AFG Grant Management Tutorial	May 2011 (and ongoing)
Category of Error: Drawdown Outside Allowable Timeframe		
3. Grantee received funds beyond 90 days following expiration of the period of performance.	1. System Enhancements – Develop and deploy a modification email notification to be sent to Grantees through AFG System towards the end of the period of performance (at nine months and eleven months) alerting Grantees to make purchases before the deadline.	May 2011
	2. Training – Require each grantee to complete the AFG Grant Management Tutorial.	May 2011 (and ongoing)
Category of Error: Vehicle Down Payment Exceeds 25% of Federal Share		
4. Grantee received and used grant funds that in excess of 25% of the Federal Share.	1. Process Improvement – Implement a quality control process in which vehicle acquisition related payments requests are reviewed by at least two AFG Program specialists.	May 2011
	2. Training – Require each grantee to complete the AFG Grant Management Tutorial.	May 2011 (and ongoing)

FEMA Disaster Relief Program - Vendor Payments

Table 9. Completed Disaster Relief Program Vendor Payments Corrective Actions

Risk Factors	Corrective Actions	Completed Date
Category of Error: Contract Administration		
1. Payment made outside period of performance.	1. Grant access to Pro Trac for appropriate staff.	March 2010
2. Unauthorized staff approved invoices.	2. Document the delegation of authority	March 2010
Category of Error: Payment Errors		
1. Improper invoice.	1. Require that specific information be provided on each invoice.	March 2010
	2. Provide access to supporting documentation in Pro Trac to verify invoice adjustments.	March 2010
2. Missing documents.	3. Require authorized officials to provide supporting documentation with payment requests.	March 2010

Table 10. Planned Disaster Relief Program Vendor Payments Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Contract Administration		
1. Improper Authorization of responsibilities to individuals and unauthorized sign off of payments.	1. Guidance – Revise Acquisition Manual to include a chapter on OCPO roles and responsibilities for contract payments.	May 2011
	2. Process Improvement – Evaluate the ability to upload COTR appointment letter to Pro Trac.	February 2011
	3. Training – Institute mandatory refresher training for contracting officers, contracting officer technical representatives and accounting technicians.	May 2011 (and ongoing)
Category of Error: Payment Errors		
2. Proper invoices not submitted in accordance with contract terms.	1. Guidance – Revise Acquisition Manual to include a chapter on OCPO roles and responsibilities for contract payments.	May 2011
	2. Guidance – Revise contracting officer technical representative handbook to include standard procedures for reviewing invoices.	May 2011
	3. Training – Institute mandatory refresher training for contracting officers, contracting officer technical representatives and accounting technicians.	May 2011 (and ongoing)

FEMA Homeland Security Grant Program

Table 11. Completed Homeland Security Grant Program Corrective Actions

Risk Factors	Corrective Actions	Completed Date
Category of Error: Insufficient Supporting Documentation		
1. Sub-grantees could not provide documentation to support payment requests.	1. Incorporate compliance with external documentation requests as a key metric to be taken into account when evaluating future grant applications.	February 2010
	2. Establish responsiveness and timeliness standards to assess compliance with documentation requests throughout the grant process.	March 2010
	3. Develop a standardized document retention protocol and provide training.	March 2010
	4. Require a certification statement from sub-grantee that all funds will be applied to transactions occurring within the period of performance.	April 2010

Table 12. Planned Homeland Security Grant Program Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Noncompliance with Allowable Cost Guidelines		
1. Exceeding of $1,000,000 construction cost limitation without approval; changes to allowable cost items from one fiscal year to the next not followed by grantees.	1. Guidance – Modify guidance to expand on the requirements related to construction costs. Disallow reimbursement for construction costs which lack proper documentation.	February 2011
	2. Training – Develop a standardized construction cost training program. Provide classroom and electronic training.	March 2011
	3. Process Improvement – Require Grantees and Sub-Grantees to provide additional documentation with the invoices to confirm that expenditures are within allowable cost guidelines.	January 2011
	4. State Oversight – Identify best practices across States and promote nationally.	March 2011

FEMA Individuals and Households Program

Table 13. Planned Individuals and Households Program Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Case Processing Errors		
1. Applicants received payments without supplying necessary documentation; misinterpreting submitted insurance documents.	1. Guidance – Improve caseworker guidance for high risk payment types.	May 2011
	2. System Enhancements – Continue development of NEMIS Help Text including tips and relevant disaster specific guidance.	May 2011 (and ongoing)
	3. Training – Provide caseworker training focusing on new guidance and insurance coverage policies and processing procedures.	May 2011 (and ongoing)
Category of Error: Calculation Errors		
2. Incorrect calculations or applications of Fair Market Rent; valid claims from second inspection were unpaid.	1. System Enhancements - Improve NEMIS or Infoview report platform to ensure accurate processing of awards generated by multiple inspections.	May 2011 (and ongoing)
	2. Guidance – Improve caseworker guidance for use of Fair Market Rent.	May 2011 (and ongoing)
Category of Error: Overlapping Assistance		
3. Transient Sheltering Assistance overlapping with rental assistance due to timing issues.	1. Guidance – Improve caseworker guidance on overlapping assistance risks.	May 2011
	2. System Enhancements – Continue development of NEMIS Help Text including tips and relevant disaster specific guidance.	May 2011 (and ongoing)
Category of Error: Duplication of Benefits		
4. Second inspection resulted in repayment of same line item.	1. Guidance – Improve caseworker guidance on second review risk issues.	May 2011
	2. System Enhancements – Continue development of NEMIS Help Text on second review risks.	May 2011 (and ongoing)

FEMA National Flood Insurance Program

Table 14. Completed National Flood Insurance Program Corrective Actions

Risk Factors	Corrective Actions	Completed Date
Category of Error: Incorrect Payment Calculations and Payment Processing Errors		
1. Misapplied profit costs and fees; improper determination of scope; incorrect application of coverage; insufficient itemization on estimates and inventories; incorrect application of special coverage limits.	1. Conduct educational workshops at the annual National Flood Conference and other industry national and regional conferences.	June 2010
Category of Error: Insufficient Damage Documentation		
1. Lack of invoices, inventories, and estimates.	1. Conduct educational workshops at the annual National Flood Conference and other industry national and regional conferences.	June 2010
2. No direct physical damage documentation.	2. Emphasize damage documentation requirements in the adjuster claims manual when it is updated.	May 2010

Table 15. Planned National Flood Insurance Program Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Insufficient Damage Documentation		
1. Lack of invoices, inventories, estimates and other supporting documentation.	1. Training – Conduct educational workshops at the annual National Flood Conference and other industry and regional conferences.	May 2011
	2. Process Improvement – Document improvements coming from IPIA findings and incorporate into Claims Operation Review procedures.	June 2011
Category of Error: Payment Processing Errors		
2. Incorrect or lacking mortgagee or other lienholder information on payment.	1. Training – Conduct educational workshops at the annual National Flood Conference and other industry and regional conferences.	May 2011
	2. Process Improvement – Document improvements coming from IPIA findings and incorporate into Claims Operation Review procedures.	June 2011

Risk Factors	Corrective Actions	Target Completion Date
	3. System Enhancements – Develop a Claims Operation Review Data Capture Tool to be utilized by NFIP management that records findings and tracks progress on identified errors.	July 2011
Category of Error: Incorrect Estimate/Worksheet Calculation		
3. Incorrect application of coverage, depreciation not applied correctly, and inadequate management controls.	1. Training – Conduct educational workshops at the annual National Flood Conference and other industry and regional conferences.	May 2011
	2. Process Improvement – Document improvements coming from IPIA findings and incorporate into Claims Operation Review procedures.	June 2011
	3. System Enhancements – Develop a Claims Operation Review Data Capture Tool to be utilized by NFIP management that records findings and tracks progress on identified errors.	July 2011

FEMA Public Assistance Program

Note: FEMA's Public Assistance Program had a very low estimated error rate of 0.21%. The risk factors below were seldom encountered but were responsible for a national estimated error amount greater than $10 million.

Table 16. Completed Public Assistance Program Corrective Actions

Risk Factors	Corrective Actions	Completed Date
Category of Error: Insufficient Costs Documentation		
1. Insufficient supporting documentation.	1. Standardize record keeping.	March 2010
	2. Provide record keeping guidance and training.	April 2010
Category of Error: Out-of-Scope Payments		
2. Payments were made outside the period of performance.	1. Provide documentation review guidance to grantees.	April 2010
	2. Provide guidance and training for Category Z project worksheets.	April 2010
Category of Error: Unmet Work Completion Deadline		
3. Documentation was not obtained and/or retained to substantiate valid work extensions.	1. Develop documentation review checklists.	February 2010
	2. Provide guidance and training to grantees on correct invoice review policies.	March 2010
	3. Develop guidance to store work extension documentation with project worksheet in system of record.	February 2010

Risk Factors	Corrective Actions	Completed Date
	4. Modify standard operating procedures to include record keeping guidance.	February 2010
Category of Error: Missing Payment Verification Documentation		
4. Documentation was not obtained and/or retained to substantiate that the correct sub-grantee was paid	1. Develop documentation retention policies.	April 2010

Table 17. Planned Public Assistance Program Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Incorrect SMARTLINK Drawdown		
1. Drawdown taken from an incorrect disaster.	1. Process Improvement – Implement additional internal controls for Grantees with more than one open disaster to ensure project costs are linked to correct disaster.	November 2010
	2. System Enhancements – Encourage States to implement automated controls.	November 2010
Category of Error: Missing Payment Verification Documentation		
2. Lack of payment verification documentation which demonstrates correct Sub-grantee was paid.	1. Process Improvement – Improve Grantee retention and access to payment verification documentation.	November 2010
	2. Monitoring – Increase FEMA's monitoring of Grantee distribution of funds to Sub-grantees.	November 2010 (and ongoing)

IV. Program Improper Payment Reporting

Table 18 summarizes improper payment amounts for DHS high-risk programs and projects future year improvements based on completing corrective actions. Improper payment percent (IP%) and improper payment dollar (IP$) figures are based on statistical estimates for FY 2009. These estimates are then projected for FY 2010 and beyond based on improvements expected from completing corrective actions.

Table 18. Improper Payment Reduction Outlook

Improper Payment Reduction Outlook ($ in millions)												
Program	FY 2009 Outlays	FY 2009 IP%	FY 2009 IP$	FY 2010 Outlays	FY 2010 Est. IP%	FY 2010 Est. IP$	FY 2011 Est. Outlays	FY 2011 Est. IP%	FY 2011 Est. IP$	FY 2012 Est. Outlays	FY 2012 Est. IP%	FY 2012 Est. IP$
Border Security Fencing (CBP)	$638	0.03%	$0	$562	0.01%	$0	$600	0.00%	$0	$600	0.00%	$0
Refund & Drawback (CBP)	$1,436	0.20%	$3	$1,198	0.20%	$2	$1,350	0.07%	$1	$1,350	0.07%	$1
IHP (FEMA)	$848	2.72%	$23	$845	1.25%	$11	$845	1.00%	$8	$845	0.75%	$6
Disaster Relief Program Vendor Payments (FEMA)	$1,382	3.32%	$46	$1,396	3.00%	$42	$1,410	2.50%	$35	$1,424	2.00%	$28
NFIP (FEMA)	$3,287	2.22%	$73	$3,287	2.00%	$66	$3,287	1.75%	$58	$3,287	1.50%	$49
PA (FEMA)	$5,070	0.21%	$11	$5,070	0.19%	$10	$5,070	0.17%	$9	$5,070	0.15%	$8
HSGP (FEMA)	$1,300	2.20%	$29	$1,430	2.00%	$29	$1,573	1.75%	$28	$1,730	1.50%	$26
AFG (FEMA)	$429	6.32%	$27	$438	4.25%	$19	$446	4.00%	$18	$455	3.50%	$16
TSGP (FEMA)	$119	0.09%	$0	$122	0.09%	$0	$125	0.09%	$0	$127	0.09%	$0
DRO (ICE)	$1,320	0.53%	$7	$1,414	0.25%	$4	$1,442	0.12%	$2	$1,471	0.06%	$1
FPS (ICE)	$760	0.10%	$1	$785	0.10%	$1	$809	0.10%	$1	$833	0.10%	$1
Aviation Security – Payroll (TSA)	$2,383	0.00%	$0	$2,518	0.00%	$0	$2,793	0.00%	$0	$2,999	0.00%	$0
ADMP (USCG)	$2,766	0.13%	$4	$2,927	0.13%	$4	$3,006	0.13%	$4	$3,068	0.13%	$4
All Programs	**$21,738**	**1.02%**	**$223**	**$21,992**	**0.84%**	**$186**	**$22,756**	**0.72%**	**$163**	**$23,259**	**0.60%**	**$140**

Note: For the three FEMA programs which were not tested nationally—HSGP, Public Assistance (PA) and TSGP—the error rate from the state(s) tested was applied to the national payment population to produce the estimated error amounts listed above.

Recovery of Improper Payments

ICE paid two Treasury schedules twice on June 15 and 16, 2009. Total duplicate payments were $1,789,764 for USCIS and $11,545,347 for ICE. All duplicate payments were recovered within 180 days.

V. Recovery Auditing Reporting

DHS completed recovery audit work for FY 2009 disbursements and continued collection activities for errors identified in prior year recovery audits. Work was completed at ICE, U.S. Coast Guard, and the Components they cross-service. Work was also completed at CBP and FEMA. In Table 19 which follows, current year (CY) equals FY 2009 disbursements and prior year (PY) covers FY 2005–FY 2008 for DNDO, TSA, and U.S. Coast Guard; FY 2004–FY 2008 for CBP, ICE, MGMT, NPPD, S&T, and USCIS; and FY 2009 for FEMA. Total Amounts Recovered PYs ($000) were adjusted from $292 to $245 at CBP, from $1,730 to $1,724 at ICE, and from $905 to $897 at USCIS to reflect items previously identified for recovery that were subsequently determined to be invalid.

Table 19. Recovery Audit Results

DHS Component	Amount Subject to Review for CY Reporting ($ Millions)	Actual Amount Reviewed and Reported CY ($ Millions)	Amounts Identified for Recovery CY ($000)	Amounts Recovered CY ($000)	Amounts Identified for Recovery PYs ($000)	Amounts Recovered PYs ($000)	Cumulative Amounts Identified for Recovery (CY + PYs) ($000)	Cumulative Amounts Recovered (CY + PYs) ($000)
CBP	$2,397	$2,397	$5	$14	$245	$231	$250	$245
DNDO	$206	$206	$0	$1	$1	$0	$1	$1
FEMA	$1,549	$1,549	$0	$0	$178	$0	$178	$0
ICE	$2,698	$2,698	$24	$30	$1,724	$1,557	$1,748	$1,587
MGMT	$465	$465	$2	$16	$172	$153	$174	$169
NPPD	$478	$478	$0	$0	$190	$190	$190	$190
S&T	$373	$373	$0	$0	$54	$54	$54	$54
TSA	$2,478	$2,478	$0	$0	$722	$722	$722	$722
USCG	$2,970	$2,970	$0	$9	$107	$82	$107	$91
USCIS	$1,105	$1,105	$7	$11	$897	$866	$904	$877
Totals	**$14,719**	**$14,719**	**$38**	**$81**	**$4,290**	**$3,855**	**$4,328**	**$3,936**

VI. Ensuring Management Accountability

The goals and requirements of Presidential Executive Order 13520, "Reducing Improper Payments and Eliminating Waste in Federal Programs (November 20, 2009)" were communicated repeatedly to all levels of staff throughout the Offices of the Chief Financial Officer and to relevant program office and procurement staff. Further, presentations and summary papers were circulated on OMB and Treasury Implementing Guidance on Executive Order 13520, the High-Dollar Overpayments Report, IPERA, the Presidential Memorandum on Recapturing Improper Payments, the DHS "Do Not Pay List" Plan, and the improper payments goals listed in the *American Recovery and Reinvestment Act*.

Continuing an initiative begun in FY 2009, Secretary Napolitano includes recoupment of improper payments as an efficiency measurement which is tracked quarterly. Additionally, managers are responsible for completing internal control work on payment processing as part of the Department's OMB Circular A-123 effort.

VII. Agency Information Systems and Other Infrastructure

The Department is undertaking a Transformation and Systems Consolidation initiative, which is discussed further under the Federal Financial Management Improvement Act.

CBP is upgrading its system to automate the handling of Refund & Drawback payments. The current Automated Commercial System is outdated and lacks functionality, necessitating a dependence on manual processes.

VIII. Statutory or Regulatory Barriers

None.

IX. Overall Agency Efforts

The Department focused its FY 2010 efforts on supporting Presidential Executive Order 13520, sustaining compliance with the *Improper Payments Information Act* (first achieved in FY 2009), and supporting FEMA's efforts to expand improper payments testing of grant programs. The Department took an active role in several Government-wide groups looking at issues related to reducing improper payments to deepen our knowledge base and to remain alert to emerging requirements.

Other Key Regulatory Requirements

Prompt Payment Act

The *Prompt Payment Act* requires Federal agencies to make timely payments (within 30 days of receipt of invoice) to vendors for supplies and services, to pay interest penalties when payments are made after the due date, and to take cash discounts only when they are economically justified. The Department's Components submit Prompt Payment data as part of data gathered for the OMB CFO Council's Metric Tracking System (MTS). Periodic reviews are conducted by the DHS Components to identify potential problems. Interest penalties as a percentage of the dollar amount of invoices subject to the *Prompt Payment Act* has been measured between 0.004 percent and 0.013 percent for the period of October 2009 through September 2010, with an annual average of 0.007 percent (Note: MTS statistics are reported with at least a six week lag).

Debt Collection Improvement Act (DCIA)

DHS implemented a debt collection regulation that supersedes Components' legacy agency regulations. In addition, the DHS Office of the Chief Financial Officer (OCFO) issued comprehensive debt collection policies that provide guidance to the Components on the administrative collection of debt; referring non-taxable debt; writing off non-taxable debt; reporting debts to consumer reporting agencies; assessing interest, penalties and administrative costs; and reporting receivables to the Department of the Treasury. The regulation and policies will help Components meet the reporting requirements in support of the *Debt Collection Improvement Act of 1996* (DCIA).

FY 2009 Biennial User Charges Review

The *Chief Financial Officers Act of 1990* requires each agency CFO to review, on a biennial basis, the fees, royalties, rents, and other charges imposed by the agency for services and items of value provided to specific recipients, beyond those received by the general public. The purpose of this review is to identify those agencies assessing user fees and to periodically adjust existing charges to 1) reflect unanticipated changes in costs or market values, and 2) to review all other agency programs to determine whether fees should be assessed for Government services or the use of Government goods or services.

To ensure compliance with this biennial requirement, each DHS Component is required to compile and furnish individual summaries for each type of user fee by addressing the key points for each user fee, in sufficient detail, to facilitate a review by the OCFO. For FY 2009, six DHS Components were responsible for collecting user fees covering various services provided to the traveling public and trade community. The following is a detailed analysis of the fee collections and costs of the related services:

- ***U.S. Customs and Border Protection (CBP)*** – CBP collects user fees for services provided in connection with the processing of commercial air and commercial vessel passengers and loaded or partially loaded railroad cars carrying passengers or commercial flights arriving into the customs territory. CBP inspection user fee collections in FY 2009 totaled approximately $1.3 billion (14 percent of CBP's budget).

Since FY 2008, the amount of fees collected by CBP has trended downward. As a result of the decline in the number of passengers and conveyances entering the United States, revenues from inspection user fees suffered a reduction of approximately 8 percent in FY 2009.

- ***U.S. Citizenship and Immigration Services (USCIS)*** – USCIS is responsible for collecting fees from people requesting immigration benefits and depositing them into the Immigration Examination Fee Account. These fees are used to fund the full cost of processing immigration and naturalization benefit applications and petitions, biometric services, and associated support services. These fees are also used to recover the cost of providing similar services to asylum and refugee applicants and certain other immigrants at no charge. In addition, USCIS collects fees for fraud reporting and nonimmigrant worker benefit applications. These fees generated a total of $2.2 billion in revenues in FY 2009.

  During the latter part of FY 2008, USCIS began to see a downward trend in application volume. Thus, the resulting revenue was below levels anticipated under the 2007 fee rule. This downward trend continued into FY 2009, with revenue ultimately falling more than $345 million below fee rule assumptions. Although actions were taken to reduce spending in the face of this decline, actual spending exceeded revenue received during the year, which necessitated the use of prior-year fee revenue balances within fee accounts totaling about $259 million.

- ***U.S. Immigration and Customs Enforcement (ICE)*** – ICE collects user fees to provide a mechanism for monitoring and providing information on student and exchange visitor status violators through the Student Exchange and Visitor Program. In addition, ICE receives 17.4 percent of the collections from the CBP immigration inspection user fee to cover the costs incurred by ICE in connection with detention, removal, and investigations of "inadmissible" aliens who attempt to enter the United States at airports and seaports. In FY 2009, ICE collected fees totaling $271 million; however, in conjunction with CBP's shortfall, revenues from immigration inspection user fees suffered a reduction of approximately 8 percent in FY 2009.

- ***Transportation Security Administration (TSA)*** – TSA is responsible for collecting a variety of user fees related to the security of the nation's aviation system. These security fees include:
  - Air Cargo Security Fee;
  - Aviation Security Passenger and Infrastructure Fees;
  - Fees for Security Threat Assessments for HAZMAT Drivers;
  - Flight Training for Aliens Fee;
  - Passenger Civil Aviation Security Service Fee;
  - Registered Traveler Fee;
  - Protection of Sensitive Security Information Fee;
  - Transportation Worker Identification Credential Fee; and
  - Ronald Reagan Washington National Airport Enhanced Security Procedures for Certain Operations Fees.

During FY 2009, TSA collected $2.2 billion in user fees. TSA's offsetting fees from the Aviation Security Passenger Fee (which is based on passenger volume) and the Aviation Security Infrastructure Fee totaled $1.9 billion, which reflects 86 percent of TSA's total user fee collections.

- ***U.S. Coast Guard*** **–** The U.S. Coast Guard charges fees for the following maritime services: 1) Merchant Mariner Licensing and Documentation User Fees, 2) Commercial and Recreational Vessel Documentation User Fees, 3) Vessel Inspection User Fees for U.S and Foreign Vessels requiring a certificate of inspection, and 4) Overseas Inspection and Examination Fees. In FY 2009, the fee collections from these services amounted to $24.3 million.

- ***Federal Emergency Management Agency (FEMA)*** – FEMA collects fees for the Radiological Emergency Preparedness Program, which was established to ensure the safety of citizens living near commercial nuclear power plants in case of an accident and to inform the public about radiological emergency preparedness. This program provides site-specific emergency response training to state, local, and tribal governments. In FY 2009, the fees collected for this program totaled $29.6 million.

On October 28, 2009, the *FY 2010 Department of Homeland Security Appropriations Act* (Pub. L. 111-83) and accompanying House report 111-157 was passed, requiring the Department to provide to Congress a quarterly report on actual FY 2009 user fee collections and future projections across all relevant DHS Components. Therefore, to ensure consistency in reporting, the OCFO conducted the above DHS user fee assessment based on the Component's review, validation, and confirmation of actual cash collections and user fee structures, as identified in the Department of Homeland Security User Fees Report to Congress.

Major Management Challenges

Office of Inspector General

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

Homeland Security

November 10, 2010

MEMORANDUM FOR: The Honorable Janet Napolitano
Secretary

FROM: Richard L. Skinner
Inspector General

SUBJECT: *Major Management Challenges Facing the Department of Homeland Security*

Attached for your information is our annual report, *Major Management Challenges Facing the Department of Homeland Security*, for inclusion in the Department of Homeland Security 2010 *Annual Financial Report*

Should you have any questions, please call me, or your staff may contact Anne L. Richards, Assistant Inspector General for Audits, at (202) 254-4100.

Attachment

Department of Homeland Security
Office of Inspector General

Major Management Challenges Facing the Department of Homeland Security

OIG-11-11 **November 2010**

Office of Inspector General

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

Homeland Security

November 10, 2010

Preface

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

The attached report presents our FY 2010 assessment of the major management challenges facing the Department of Homeland Security. As required by the *Reports Consolidation Act of 2000* (Public Law 106-531), we update our assessment of management challenges annually.

We trust this report will result in more effective, efficient, and economical operations. We express our appreciation to all of those who contributed to the preparation of this report.

Richard L. Skinner

Richard L. Skinner
Inspector General

Office of Inspector General

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

Homeland Security

Major Management Challenges Facing the Department of Homeland Security

In the aftermath of the terrorist attacks against America on September 11th, 2001, the Department of Homeland Security (DHS) was formed from 22 disparate domestic agencies. The creation of DHS represented one of the largest and most complex restructurings in the federal government. The Department of Homeland Security performs a broad range of activities across a single driving mission to secure America from the entire range of threats that we face.

Since its inception, the department has taken aggressive measures to secure our nation's borders, reform our nation's immigration laws, and take on the shared responsibility to make our country more ready and resilient in the face of a terrorist threat or a natural disaster. Although the department has taken steps to become "One DHS"; much remains to be done to establish a cohesive, efficient, and effective organization.

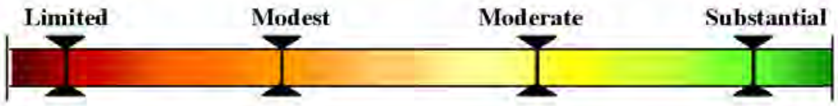
The major management challenges we identify facing DHS, including department-wide and operational challenges, are a major factor in setting our priorities for audits, inspections, and evaluations of DHS' programs and operations. As required by the *Reports Consolidation Act of 2000*, Pub.L.No. 106-531, we update our assessment of management challenges annually. We have made recommendations in many, but not all, of these areas as a result of our reviews and audits of departmental operations. Where applicable, we have footnoted specific reports that require DHS' action.

We have identified the following major management challenges:

- Acquisition Management
- Information Technology Management
- Emergency Management
- Grants Management
- Financial Management
- Infrastructure Protection
- Border Security
- Transportation Security
- Trade Operations and Security

Since the major management challenges have tended to remain the same from year to year, we developed scorecards to distinguish the department's progress in selected areas. This report features scorecards for acquisition management, information technology management, emergency management, grants management, and financial management.

We based the ratings on a four-tiered scale ranging from limited to substantial progress:



- **Limited:** While there may be plans to address critical success factors, few if any have been implemented;
- **Modest:** While some improvements have been made, many of the critical success factors have not yet been achieved;
- **Moderate:** Many of the critical success factors have been achieved; and
- **Substantial:** Most or all of the critical success factors have been achieved.

These five scorecards are summarized in Figure 1 and incorporated in our discussion of the major management challenges.

Figure 1.

	FY 2009	FY 2010
Acquisition Management	Moderate Progress	Moderate Progress
Information Technology Management	Moderate Progress	Moderate Progress
Emergency Management	Moderate Progress	Moderate Progress
Grants Management	Modest Progress	Modest Progress

	FY 2009	FY 2010
Financial Management	**Modest Progress** 	**Modest Progress** 

ACQUISITION MANAGEMENT

DHS relies on contractor support to fulfill its critical mission needs. An effective acquisition management infrastructure is vital to achieve DHS' overall mission. It requires a sound management infrastructure to oversee the complex and large dollar procurements. It must identify mission needs; develop strategies to fulfill those needs while balancing cost, schedule, and performance; and ensure that contract terms are satisfactorily met.

A successful acquisition process depends on the following key factors:

- Organizational Alignment and Leadership—ensures appropriate placement of the acquisition function, defines and integrates roles and responsibilities, and maintains clear, strong executive leadership;
- Policies and Processes—partnering with internal organizations, effective use of project management approaches, and establishment of effective internal controls;
- Acquisition Workforce—commitment to human capital management, integration and alignment of human capital approaches with organizational goals, and investment in people; and
- Knowledge Management and Information Systems—tracking of key acquisition data, analysis of supplies and services spending, and data stewardship.

Acquisition Management Scorecard

The following scorecard illustrates areas where DHS improved its acquisition management practices, as well as areas where it continues to face challenges. We based our assessment on our recent audit reports, GAO reports, congressional testimony, and our broader knowledge of the acquisition function.

Based on the consolidated result of the four acquisition management capability areas, DHS made "**moderate**" overall progress in the area of Acquisition Management.

ACQUISITION MANAGEMENT SCORECARD	
Organizational Alignment and Leadership	**Modest Progress** 

In both FY 2010 and FY 2009 DHS made "modest" progress in improving the acquisition program's organizational alignment and defining roles and responsibilities. This rating remains unchanged because the department continues to depend on a system of dual accountability and collaboration between the chief procurement officer and the component heads, which may sometimes create ambiguity about who is accountable for acquisition decisions. However, DHS maintains that the dual authority model works because the Office of the Chief Procurement Officer (OCPO) retains central authority over all contracting through its contracting officer warrant program and Federal Acquisition Certification - Contracting program. According to the department, the heads of contracting activities and contracting officers function independently of component influence as their authority flows from OCPO rather than the component. DHS' Acquisition Line of Business Integration and Management Directive sets forth existing authorities and relationships within individual components and the department's Chief Procurement Officer.

According to the GAO)[1] DHS has not effectively implemented or adhered to its investment review process, which requires executive decision making at key points in an investment's life cycle. In January of this year, the department published Acquisition Management Directive 102-01. The directive provides policy guidance to identify and track new and ongoing major investments and involves senior management in the investment review process by way of departmental oversight board reviews.

The department's OCPO has made progress in its efforts to improve oversight of contracting activities by conducting reviews and issuing memoranda to component Heads of Contracting Activities (HCA). Specifically, between June 2007 and June 2010, OCPO conducted baseline oversight reviews of component procurement activities and provided each of the eight component HCAs with a report containing recommendations specific to their components. These reviews measured component compliance with applicable Federal regulations, departmental regulations, departmental acquisition manuals, policies, and guidance, and also established a baseline of issues and concerns for future on-site reviews. The reviews focused on major areas consistent with the framework for previously identified management challenges, such as organizational alignment, procurement management, human capital, knowledge and information management, and financial accountability.

[1] GAO-09-29, *Department of Homeland Security: Billions Invested in Major Programs Lack Appropriate Oversight*, November 2008.

ACQUISITION MANAGEMENT SCORECARD

Additionally, on March 2, 2010, OCPO issued a special review of contracts awarded noncompetitively.[2] This report contained recommendations to HCAs for opportunities to improve the availability and accessibility of contract files; accurately code contract file information in the Federal Procurement Data System (FPDS); properly cite the authority to award a contract noncompetitively; and ensure that adequate rationale exists to support justifications and approvals.

Policies and Processes

Moderate Progress

DHS made "moderate" progress in developing and strengthening acquisition management policies and processes. For example, OCPO has updated the Homeland Security Acquisition Manual (HSAM) to improve the level of guidance provided to component HCAs. OCPO issued revisions to the HSAM that included a guide to components in conducting market research.[3] Additionally, OCPO plans to amend the HSAM to require that acquisition personnel include Advanced Acquisition Plan numbers in procurement files, when applicable.[4] The department also effectively conveyed critical information through the issuance of acquisition alerts to HCAs. During this fiscal year, OCPO distributed a DHS acquisition alert containing critical changes in reporting requirements for specific data elements in FPDS and another acquisition alert to familiarize HCAs with changes to competition information in FPDS.[5] Although the department has taken steps towards improving its processes and controls over awarding, managing, and monitoring contract funds, we continue to identify problems in the acquisition area.

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[2] DHS-OCPO, *CPO Special Procurement Oversight Review of Noncompetitive Contracts* (Report No. 10-001-S, March 2, 2010).
[3] DHS-Homeland Security Acquisition Manual, Revisions to HSAM Chapters 3003, 3005, 3009, and Related Appendices (HSAM Notice 2010-02, December 16, 2009).
[4] DHS-OIG, *DHS Contracts Awarded Through Other Than Full and Open Competition During Fiscal Year 2009* (OIG-10-55, February 2010).
[5] DHS-OCPO, *Version 1.4 Changes in the Federal Procurement Data System Next Generation* (DHS Acquisition Alert 10/09, Amendment 1, March 25, 2010); DHS-OCPO, *Changes to Reporting of Competition Information in the Federal Procurement Data System-Next Generation*, October 29, 2009.
[6] An award fee is an amount of money that a contractor may earn in whole or in part by meeting or exceeding subjective criteria stated in an award fee plan.
[7] DHS-OIG, *Internal Controls in the FEMA Disaster Acquisition Process*, (OIG-09-32, February 2009); DHS-OIG, *Challenges Facing FEMA's Disaster Contract Management*, (OIG-09-70, May 2009); DHS-OIG, *FEMA's Acquisition of Two Warehouses to Support Hurricane Katrina Response Operations*, (OIG-09-77, June 2009); DHS-OIG, *FEMA's Temporary Housing Unit Program and Storage Site Management*, (OIG-09-85, June 2009).
[8] GAO-09-630, *Federal Contracting: Guidance on Award Fees Has Led to Better Practices but is Not Consistently Applied*, May 2009.

ACQUISITION MANAGEMENT SCORECARD

As reported last year, DHS has not developed methods for evaluating the effectiveness of an award fee[6] as a tool for improving contractor performance, and Federal Emergency Management Agency (FEMA) needs to accelerate its planned acquisition process improvements for awarding, managing, monitoring, tracking, and closing-out contracts.[7] In May 2009, GAO[8] reported that DHS provided guidance on award fees in its acquisition manual, but individual contracting offices developed their own approaches to executing award fee contracts that were not always consistent with the principles in the Office of Management and Budget's guidance on award fees or among offices within DHS.

Acquisition Workforce	**Moderate Progress** 

Although DHS made "moderate" progress in recruiting and retaining a workforce capable of managing a complex acquisition program, it continues to face workforce challenges across the department. A January 2010 report by the GAO indicated that as of April 2010, the Coast Guard filled 760 of its 951 military and civilian personnel positions in its acquisition branch.[9] The Coast Guard received 100 additional acquisition positions for FY10 and intends to allocate twenty-five percent of these positions to the Offshore Patrol Cutter acquisition program. The Coast Guard is using contractors to fill its acquisition personnel gap and according to GAO, the Coast Guard is mitigating the potential for conflicts of interest and support of inherently governmental functions by releasing guidance to define inherently governmental roles and the role of Coast Guard personnel in contractor oversight.

FEMA has improved acquisition training and greatly increased the number of acquisition staff, but needs to better prepare its acquisition workforce for catastrophic disasters.[10] Further, although FEMA continues to receive additional authorized acquisition staff positions, it has difficulty filling the positions due to the limited number of people with the needed skill set and the fierce competition across federal agencies for skilled acquisition personnel.

Over the past few years, DHS has centralized recruitment and hiring of acquisition personnel, established the Acquisition Professional Career Program to hire and mentor procurement interns, created a tuition assistance program, and structured rotational and development work assignments.[11] Although these are very positive steps, it will, in all likelihood, take years before the department has a fully staffed and fully skilled acquisition workforce.

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[9] GAO-10-268R, *Coast Guard: Service Has Taken Steps to Address historic Personnel Problems, but It is too Soon to Assess the Impact of These Efforts*, January 2010.
[10] DHS-OIG, *Challenges Facing FEMA's Acquisition Workforce*, (OIG-09-11, November 2008).
[11] *Department of Homeland Security FY 2008 Annual Financial Report.*

ACQUISITION MANAGEMENT SCORECARD	
Knowledge Management and Information Systems	**Modest Progress** 

DHS has made "modest" progress in deploying an enterprise acquisition information system and tracking key acquisition data, however it has not fully deployed a department-wide (enterprise) contract management system that interfaces with the financial system. Many procurement offices continue to operate using legacy systems that do not interface with financial systems. With ten procurement offices and more than $17 billion in annual acquisitions and procurement, DHS needs a consolidated acquisition system to improve data integrity, reporting, performance measurement, and financial accountability.

DHS needs to strengthen its controls for developing and implementing its systems consolidation project. The DHS Chief Financial Officer has initiated the Transformation and Systems Consolidation project to acquire an integrated financial, acquisition, and asset management solution for DHS. However, we reported in July 2010 that this project faces challenges because DHS does not have the necessary planning documents in place and approval for this effort; total life cycle cost estimates are not inclusive of all project costs; and staffing projections have not been finalized. [12] Additionally, DHS' Office of Chief Information Officer has had limited involvement with the overall initiative, which increases the risk that the DHS Enterprise Architecture and security requirements may not be incorporated into the new system.

The department has made moderate progress to improve the accuracy and completeness of contract data in FPDS-NG.[13] This system is the only consolidated information source for analyzing competition on procurements and is relied on for reporting to the public and Congress. This year, we reviewed the integrity of reported acquisition data in FPDS-NG and found that, although errors were detected in the data we sampled, the system earned a 94.5 % accuracy rate.[14]

Additional initiatives the department reports as being underway in the acquisition area include piloting the Procurement Enterprise Reporting Application (ERA) that will provide near real-time access to procurement data allowing for the consolidation, analysis, and review of the data from the disparate contract writing systems that will interface with the Federal Procurement Data System-Next Generation (FPDS-NG). User acceptance and data validation exercises are scheduled for October 2010 and the system is expected to be fully operational by January 2011. Also, OCPO outlined additional

[12] DHS-OIG, *DHS Needs to Address Challenges to Its Financial Systems Consolidation Initiative*, (OIG-10-95, July 2010)
[13] DHS-OIG, *DHS Contracts Awarded Through Other Than Full and Open Competition during Fiscal Year 2007*, (OIG-09-94, August 2009)
[14] DHS-OIG, *Department of Homeland Security's Acquisition Data Management Systems*, (OIG-10-42, January 2010).

6

Major Management Challenges Facing the Department of Homeland Security

ACQUISITION MANAGEMENT SCORECARD

steps to ensure continued improvement in data accuracy that include developing training focused on preventing errors, increasing participation in the DHS FPDS working group aimed at improving the accuracy of data input in FPDS, and distributing 56 "data flags" to alert HCAs in identifying and correcting errors in FPDS data.

INFORMATION TECHNOLOGY MANAGEMENT

Creating a unified information technology infrastructure for effective integration and agency-wide management of IT assets and programs remains a challenge for the DHS Chief Information Officer (CIO). The CIO's successful management of IT across the department will require the implementation of strong IT security controls, coordination of planning and investment activities across DHS components, and a commitment to ensuring privacy.

Security of IT Infrastructure.

During our FY 2008 *Federal Information Security Management Act*[15] (FISMA) evaluation, we reported that the department continued to improve and strengthen its security program. Specifically, the department implemented a performance plan to improve on four key areas: Plan of Action and Milestones weaknesses remediation, quality of certification and accreditation, annual testing and validation, and security program oversight. The department also finalized its Sensitive Compartmented Information Systems Information Assurance Handbook, which provides department intelligence personnel with security procedures and requirements to administer its intelligence systems and the information processed.

Although the department's efforts have resulted in some improvements, components are still not executing all of the department's policies, procedures, and practices. Management oversight of the components' implementation of the department's policies and procedures needs improvement in order for the department to ensure that all information security weaknesses are tracked and remediated, and to enhance the quality of system certification and accreditation.

In July 2010 we reported that 5 components maintained 11 external network connections to other agency's human resources systems that are outside of the DHS trusted internet connections (TIC)16. When components are allowed to maintain their own network connections to other federal agencies it increases the number of internet points of presence. This is contradictory to Office of Management and Budget's TIC and DHS OneNet initiatives to improve efficiency and security by reducing the internet points of presence and may pose a security risk to DHS' data if security controls implemented are inadequate.

[15] Title III of the E-Government Act of 2002, Public Law 107-347.
[16] DHS-OIG, *Management Oversight and Component Participation Are Necessary to Complete DHS' Human Resource Systems Consolidation Effort*, (OIG-10-99, July 2010)

IT Management

Some DHS components face challenges when planning for and managing information technology to support DHS' mission. For example, Immigrations and Customs Enforcement (ICE) implemented an Office of the Chief Information Officer (OCIO) organizational strategic plan but did not define key goals and objectives for fulfilling its mission responsibilities. The ICE OCIO also has oversight of information technology spending, but its budget planning process did not capture all component information technology needs. In addition, we reported in July 2010 that DHS has made progress in consolidating its human resource systems.17 However, DHS faces additional challenges with implementing all of the enterprise-wide human resource solutions because many of the components are reluctant to adopt the department's enterprise-wide solutions.

Staffing shortages have also made it difficult for some DHS component CIOs to provide effective IT planning and management oversight. For example, ICE did not have the requisite staff to finalize its IT Strategic Plan. As a result ICE was not able to communicate its IT strategic goals and objectives to its stakeholders, create a formal process to facilitate IT policy development, approval, and dissemination, or establish an agency-wide IT budget process to include all ICE component office technology initiatives and requirements. In addition, the U.S. Citizenship and Immigration Services (USCIS) OCIO found it difficult to update its IT transformation approach, strategy, or plan. Without the necessary staff, USCIS OCIO was unable to document the results and lessons learned from the pilot and proof-of-concept programs that support its IT transformation program.

The department faces significant challenges as it attempts to create a unified IT infrastructure for effective integration and agency-wide management of IT assets and programs. To address these challenges, DHS has several initiatives underway to improve IT operations and reduce costs. One such program is to develop an enterprise-wide IT disaster recovery program to ensure that the department's operations can continue uninterrupted should its IT systems fail. A second related program is DHS' effort to consolidate its various data centers into two enterprise data centers. We reported in April 2009 that DHS had made progress in these two areas by allocating funds to establish the new data centers.[18] However, we noted that more work was needed to ensure the new data centers were fully capable of meeting the department's significant IT disaster recovery needs. We also reported in September 2010, the DHS should undertake additional steps to successfully migrate its systems to these enterprise data centers.[19]

Privacy

DHS continues to face challenges to ensure that uniform privacy procedures and controls are properly addressed and integrated protections are implemented throughout the lifecycle of each process, program, and information system. For example, the implementation of

[17]DHS-OIG, *Management Oversight and Component Participation Are Necessary to Complete DHS' Human Resource Systems Consolidation Effort*, (OIG-10-99, July 2010)
[18] DHS-OIG, *DHS' Progress in Disaster Recovery Planning for Information Systems* (OIG-09-60, April 2009).
[19] DHS-OIG, *Management of DHS' Data Center Consolidation Initiative Needs Improvement*, (OIG-10-120, September 2010).

Homeland Security Presidential Directive -12, *Policy for a Common Identification Standard for Federal Employees and Contractors*, was especially challenging. The department was required to grant the necessary security rights and privileges to users so they could access the department's facilities and networks, but still had to protect the confidentiality and privacy of its users and data.[20]

In July 2010, we reported that ICE demonstrated an organizational commitment to privacy compliance by appointing a privacy officer and establishing the ICE Privacy Office.[21] However, we identified areas for improvement. Specifically, to strengthen its privacy stewardship ICE needed to develop and implement job-related privacy training and oversight to safeguard PII in program operations and establish penalties for violations that correspond with DHS privacy rules of conduct.

IT Management Scorecard

The following scorecard demonstrates where DHS' IT management functions have been strengthened. This high-level assessment identifies progress in six IT management capability areas: IT budget oversight, IT strategic planning, enterprise architecture, portfolio management, capital planning and investment control, and IT security. These six elements were selected based on IT management capabilities required by federal and DHS guidelines for enabling CIOs to manage IT department-wide.

Based on the consolidated result of the six IT management capability areas, DHS has made "**moderate**" progress in IT Management overall.

IT MANAGEMENT SCORECARD	
IT Budget Oversight: ensures visibility into IT spending and alignment with the strategic IT direction.	**Modest Progress** 
The DHS CIO has made improvements in managing department-wide IT budgets in accordance with the *Clinger-Cohen Act*[22] and the department's mission and policy guidance. The DHS 2009-2013 IT Strategic Plan emphases the importance of Component IT spending approval by either the Component-level CIO or the DHS CIO. However, gaining a department-wide view of IT spending was difficult due to some Component CIOs not having sufficient budget control and insight. For example, our 2010 report[23] on the U.S. Immigration and Customs Enforcement found that although the Office of the	

[20] DHS-OIG, *Resource and Security Issues Hinder DHS' Implementation of Homeland Security Presidential Directive 12* (OIG-10-40, January 2010).
[21] DHS-OIG, *Immigration and Customs Enforcement Privacy Stewardship* (OIG-10-100, July 2010).
[22] *Clinger-Cohen Act of 1996*, Public Law 104-106, Division E, February 10, 1996.
[23] DHS-OIG, *Immigration and Customs Enforcement Information Technology Management Progresses But Challenges Remain*, (OIG-10-90, May 2010).

IT MANAGEMENT SCORECARD

Chief Information Officer has oversight of information technology spending, its budget planning process did not capture all component information technology needs. As a result, the OCIO has limited ability to proactively manage and administer all IT resources and assets. Due to the limited benefits realized, IT Budget Oversight has made "modest" progress.

IT Strategic Planning: helps align the IT organization to support mission and business priorities.

Moderate Progress

An effective IT strategic plan establishes an approach to align resources and provides a basis for articulating how the IT organization will develop and deliver capabilities to support mission and business priorities. In January 2009, the department finalized its IT Strategic Plan, which aligns IT goals with overall DHS strategic goals. The plan also identifies technology strengths, weaknesses, opportunities, and threats. Due to the finalization and communication of the DHS IT Strategic Plan and plans to align IT with the department's goals, this area has made "moderate" progress.

Enterprise Architecture: functions as a blueprint to guide IT investments for the organization.

Moderate Progress

The *Clinger-Cohen Act* requires that CIOs develop and implement an integrated IT architecture for the agency to avoid the risk that systems will be duplicative, not well integrated, and limited in optimizing mission performance. The DHS IT Strategic Plan identifies a performance measure for the percentage of IT investments reviewed and approved through the Enterprise Architecture Board. This should further promote and enforce alignment of IT investments across the department. The department has shown "moderate" progress in implementing its enterprise architecture.

Portfolio Management: improves leadership's ability to understand interrelationships between IT investments and department priorities and goals.

Modest Progress

The DHS OCIO has made "Modest" progress in establishing the department's portfolio management capabilities as instructed by OMB Circular A-130.[24] The DHS portfolio management program aims to group related IT investments into defined capability areas to support strategic goals and missions. Portfolio management improves leadership's visibility into relationships among IT assets and department mission and goals across

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[24] Office of Management and Budget Circular A-130, Transmittal 4, *Management of Federal Information Resources*, November 2000.

IT MANAGEMENT SCORECARD

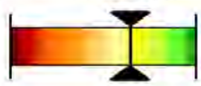
organizational boundaries.

The DHS IT Strategic Plan identifies a goal to effectively manage IT capabilities and implement cross-departmental IT portfolios that enhance mission and business performance. Although progress is being made, the department has not identified fully opportunities to standardize, consolidate, and optimize the IT infrastructure. Based on the limited benefits realized, the department has shown "modest" progress in implementing department-wide portfolio management.

Capital Planning and Investment Control: improves the allocation of resources to benefit the strategic needs of the department.	**Moderate Progress** 

The *Clinger-Cohen Act* requires that departments and agencies create a capital planning and investment control (CPIC) process to manage the risk and maximize the value of IT acquisitions. The CPIC process is intended to improve the allocation of resources to benefit the strategic needs of the department. As part of the CPIC process, agencies are required to submit business plans for IT investments to OMB demonstrating adequate planning.

To address this requirement, DHS' IT Strategic Plan communicated the importance of following the IT investment guidance provided by DHS management directive 0007.1.[25] This directive supports and expands on the Act's requirement for technology, budget, financial, and program management decisions. The department has made "moderate" progress with respect to allocation of resources to benefit its strategic needs.

IT Security: ensures protection that is commensurate with the harm that would result from unauthorized access to information.	**Moderate Progress** 

DHS IT security is rated at "moderate," for progress made during the last 4 years in compliance with FISMA. OMB Circular A-130 requires agencies to provide protection that is commensurate with the risk and magnitude of the harm that would result from unauthorized access to information and systems assets or their loss, misuse, or modification. Regarding intelligence systems, information security procedures have been documented and controls have been implemented, providing an effective level of systems security.

[25] DHS Management Directive 0007.1, *Information Technology Integration and Management* March 2007.

EMERGENCY MANAGEMENT

FEMA's mission is to support citizens and first responders to ensure that as a nation we work together to build, sustain, and improve our capability to prepare for, protect against, respond to, recover from, and mitigate all hazards. The Post-Katrina Emergency Management Reform Act of 2006 (Post-Katrina Reform Act),[26] enacted to address shortcomings exposed by Hurricane Katrina, expanded the scope of the agency's mission, enhanced FEMA's authority, and gave it primary responsibility for the four phases of comprehensive emergency management: preparedness, response, recovery, and mitigation.

In March 2008, we released a report on FEMA's progress in addressing nine key preparedness areas related to catastrophic disasters: overall planning, coordination and support, interoperable communications, logistics, evacuations, housing, disaster workforce, mission assignments, and acquisition management.[27] FEMA's progress in these areas ranged from limited to moderate. In August 2010, we issued an update of our assessment and determined that FEMA has moved beyond limited progress in all areas, achieved modest progress in 2 areas, moderate progress in 7 areas, and substantial progress in 1 area (Mitigation was added as an additional key area).[28]

In our FY2010 reports, we continued our focus on FEMA's logistics systems, contracting practices, processes and procedures for individual and public assistance, and mitigation efforts.

Emergency Management

The following scorecard highlights FEMA's progress in three key areas: logistics, housing, and mitigation.

Based on the consolidated result of the three areas presented here, as well as progress made in acquisition management and disaster grants management, FEMA has made "**moderate**" progress in the area of Emergency Management.

EMERGENCY MANAGEMENT SCORECARD	
Logistics	**Moderate Progress** 
When disaster strikes, FEMA must be prepared to quickly provide goods and services to help state and local governments respond to the disaster. FEMA's response in past	

[26] Public Law 109-295, Title VI – National Emergency Management, of the *Department of Homeland Security Appropriations Act of 2007*.
[27] DHS-OIG, *FEMA's Preparedness for the Next Catastrophic Disaster*, (OIG-08-34, March 2008).
[28] DHS-OIG, *FEMA's Preparedness for the Next Catastrophic Disaster – An Update*, (OIG-10-123, September 2010).

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Major Management Challenges Facing the Department of Homeland Security

EMERGENCY MANAGEMENT SCORECARD

disasters has demonstrated that when this function is lacking, disaster survivors face increased suffering. As a result of a congressionally mandated reorganization in 2007, FEMA created the Logistics Management Directorate, now within Response and Recovery. Beyond the structural reorganization, FEMA has been proactive in logistical improvements; however, more remains to be done.[29]

FEMA has made great strides to improve its logistics capability by: (1) increasing staffing levels; (2) training and developing personnel; (3) enhancing coordination among federal, state, and local governments, nongovernmental organizations, and the private sector; (4) developing plans and exercises to improve readiness; (5) utilizing interagency agreements and contracts for needed commodities; (6) conducting meetings and teleconferences with logistics partners; and (7) reviewing and evaluating performance.

Despite FEMA's progress, corresponding improvements by many state and local governments have lagged behind due to staffing and budget restrictions. FEMA's logistics function is also hampered by the inability of its information systems to communicate directly with the systems of its federal partners. FEMA has several information systems it uses in its logistics function; which can lead to stovepipes and slow down response time. FEMA plans to have its systems interconnected by the end of the logistics transformation that is projected to be complete in 2014.

Housing

Moderate Progress

Since 2009, FEMA has made moderate progress in its disaster housing plans and operations. These improvements include progress in implementing the *National Disaster Housing Strategy*,[30] planning for the purchase, tracking and disposal of temporary housing units; and strengthening state and local commitment to house affected disaster survivors. FEMA has reorganized its Individual Assistance Division to address these action areas.

In January 2009, FEMA released the *National Disaster Housing Strategy*, which summarized FEMA's disaster housing process, including sheltering and housing capabilities, principles and policies. The Strategy has several components including the creation of a National Disaster Housing Task Force; the development of a Disaster Housing Implementation Plan; and a Comprehensive Concept of Operations. On March 16, 2010, the Office of Management and

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[29] DHS-OIG, *FEMA's Logistics Management Process for Responding to Catastrophic Disaster,* (OIG-10-101, July 2010).

[30] FEMA's National Disaster Housing Strategy can be accessed at http://www.fema.gov/pdf/emergency/disasterhousing/NDHS-core.pdf.

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Budget approved the Disaster Housing Implementation Plan. FEMA plans to release the Comprehensive Concept of Operations immediately following the release of the National Disaster Recovery Framework. FEMA developed a Non-Congregate Housing Program that uses hotels, motels or federally-owned unoccupied housing units as a sheltering resource. However, the program's success depends on leveraging the full capabilities of the federal government, state and local governments, the private sector, members of the community, and disaster survivors. In March 2009, FEMA testified that it would consider the use of travel trailers only as a last resort when a state specifically requests them. In light of that decision, FEMA continues working to develop alternative forms of temporary housing. FEMA is working on separate projects with the Department of Housing and Urban Development (HUD) and seven alternative housing manufacturers to develop these housing units. This year, FEMA began an effort to sell more than 101,000 excess temporary housing units through whole-storage site sales conducted by the U.S. General Services Administration (GSA) online auctions. When the auctions closed in January 2010, FEMA had sold most of its excess inventory. The purchasers are in the process of removing the housing units, and FEMA anticipates that all storage sites will be closed by the end of FY 2011. FEMA has developed two approaches to strengthen how state and local governments assist disaster survivors with temporary housing. The first approach is the development of state disaster housing taskforces, which are State entities that are assisted by FEMA to develop best practices, operational guidance and a standardized housing plan for unique disaster housing needs. The second approach is to work with state and local governments to identify temporary group housing sites. However, each approach has specific limitations, such as insufficient numbers of experienced disaster housing staff, limited federal and state funding, and poor coordination with state and local governments. In addition to these areas, we are concerned that FEMA has not clearly defined its roles and responsibilities with regard to the long-term housing needs of disaster survivors (i.e., beyond the standard 18 months of assistance).	
Mitigation	**Moderate Progress** 
Hazard mitigation is a strategic component of our nation's integrated approach to emergency management. Mitigation provides a critical foundation to reduce loss of life and property by closing vulnerabilities and avoiding or lessening the impact of a disaster, leading to safer, more resilient communities. As noted in the 2010 Quadrennial Homeland Security Review Report,	

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> *"... the strategic aims and objectives for ensuring resilience to disasters are grounded in the four traditional elements of emergency management: hazard mitigation, enhanced preparedness, effective emergency response, and rapid recovery. Together, these elements will help create a Nation that understands the hazards and risks we face, is prepared for disasters, and can withstand and rapidly and effectively recover from the disruptions they cause."*

Although FEMA continues to improve its capacity and capability to lead an integrated national approach to hazard mitigation, there are a number of strategic and operational challenges that must be addressed in the years ahead. These challenges will require a focused and systematic effort by key mitigation partners and stakeholders at the federal, state, and local levels.

Challenge: Develop integrated national hazard mitigation strategy

The FY 2010 Quadrennial Homeland Security Review defines broad national objectives for mitigation:

- Reduce the vulnerability of individuals and families: Improve individual and family capacity to reduce vulnerabilities and withstand disasters.
- Mitigate risks to communities: Improve community capacity to withstand disasters by mitigating known and anticipated hazards.

The challenge for FEMA is to translate these objectives into an integrated national hazard mitigation strategy. There is no national consensus on how to address hazard mitigation as part of FEMA's overall preparedness for catastrophic disasters. This is reflected in the fact that hazard mitigation was not included as a component of the initial Target Capabilities List (TCL), although FEMA states that the targeted capabilities define all-hazards preparedness and provide the basis to assess preparedness and improve decisions related to preparedness investments and strategies.[31]

Challenge: Improve local hazard mitigation planning process

The Disaster Mitigation Act of 2000 (P.L. 106-390) amended the Stafford Act to establish specific requirements for state and local hazard mitigation plans. Today, most states, major counties, and cities have active mitigation plans in place.

The challenge going forward, however, is to improve the quality and impact of this mitigation planning enterprise, and, ultimately, to reduce disaster losses and expenditures

[31] Target Capabilities List, page 5, http://www.fema.gov/pdf/government/training/tcl.pdf.

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beyond what they would have otherwise been.

State and local hazard mitigation officials continue to report large gaps in the capacity and will of communities to plan and implement mitigation strategies. This is important because while FEMA provides grant funds and administrative support to the state, it is the local hazard mitigation professionals and stakeholders who develop and implement mitigation projects. When communities lack capacity to mitigate hazards, FEMA's ability to ensure an effective national approach to hazard mitigation is diminished.

To improve local hazard mitigation planning, FEMA should enhance community outreach and awareness, engage stakeholders in preparing and reviewing state and local hazard mitigation plans, simplify and standardize benefit cost processes, and enhance state and local risk assessment and analysis capabilities.

Challenge: Improve hazard mitigation outcomes

FEMA faces multiple challenges in its efforts to improve hazard mitigation outcomes. The most important challenge lies in the scope and complexity of the mitigation landscape—thousands of entities and individuals must work together in a loosely coordinated effort to achieve nationally significant results. Mitigation stakeholders include floodplain managers, risk managers, insurers, property developers, homeowners, government officials, environmentalists, and the public at large bring conflicting priorities and interests to any discussion of mitigation. Further, FEMA is limited by statute to the promotion of effective mitigation practices and lacks the authority to compel property owners to mitigate floods or other hazards. This is true even when hazard mitigation appears desperately needed, as in the case of repetitively flooded properties.

To improve hazard mitigation outcomes, FEMA should look for opportunities to reduce the complexity and scope of mitigation planning guidance to the extent possible to remain consistent with legislative intent while meeting the requirements of state and local mitigation. FEMA should ensure monitoring and follow-up of mitigation actions in state and local plans, integrate hazard mitigation into Emergency Support Function activities and preliminary damage assessments, and assess ongoing mitigation programs for gaps and opportunities for improvement.

GRANTS MANAGEMENT

FEMA assists communities in responding to and recovering from disasters. FEMA provides disaster assistance to communities through the Public Assistance Grant Program, the Hazard Mitigation Grant Program, and the Fire Management Assistance Grant Program. Under each of these grant programs, the affected State is the grantee, and the State disburses funds to eligible subgrantees. FEMA also awards grants to state and local governments; territories; tribal governments; and private, public, profit, and nonprofit organizations to enhance preparedness, protection, response, recovery, and mitigation capabilities throughout the Nation. However, improvements are needed in FEMA's grants management and oversight infrastructure to ensure effective monitoring of grantees.

The Post Katrina Emergency Management Reform Act (PKEMRA) of 2006 centralized most of DHS' grant programs under FEMA's Grant Programs Directorate (GPD). GPD administers 52 distinct disaster and non-disaster grant programs and each year awards between 6,000 and 7,000 individual grants, totaling $7 billion to $10 billion each year. GPD is currently reviewing its basic functions with respect to four key principles: (1) to administer FEMA's grant programs responsibly and economically, (2) to build and sustain the internal capabilities to ensure success, (3) to show how each grant dollar improves the nation's capabilities and provides a strong return on investment, and (4) to carry out its mission within a new and evolving FEMA structure. Given the billions of dollars appropriated annually for preparedness, disaster, and non-disaster grant programs, GPD needs to ensure that internal controls are in place and adhered to, and that grant recipients are sufficiently monitored to achieve successful outcomes. GPD should continue refining its risk-based approach to awarding and monitoring preparedness grants to ensure that the most vulnerable areas and assets are as secure as possible. Sound risk management principles and methodologies will help GPD prepare for, respond to, recover from, and mitigate acts of terrorism and natural disasters.

Grants Management

The following scorecard highlights the department's progress in two key areas: disaster and non-disaster grants management. FEMA is taking steps to improve its grant policies, procedures, systems, and processes which when developed and implemented should strengthen its grants management and oversight infrastructure.

Based on the consolidated result of the two areas presented here, FEMA has made "**modest**" progress in the area of Grants Management.

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Disaster Grants Management

Moderate Progress

In FY 2009, we issued 51 financial assistance (subgrant) audit reports, identifying more than $138 million in questioned costs and over $15 million in funds that could be put to better use. As of August 9, 2010, we had issued 39 subgrant audit reports in FY 2010, with nearly $80 million in questioned costs and nearly $37 million in funding that could be deobligated or collected and be put to better use.

While FEMA does not directly manage subgrants, it is incumbent on FEMA to make certain that States, as grantees, understand the rules and regulations that govern disaster grants and ensure that subgrantees adhere to these. We plan to issue a report in FY 2011 that recaps the reports we issued in FY 2010 and presents some of the most common problems that lead to questioned costs, including inconsistent interpretation of policies by FEMA personnel, grantee and subgrantee non-compliance with the federal regulations governing disaster grants and federal policy on grants management in general, and the lack of grantee monitoring of subgrantee activities.

Non - Disaster Grants Management

Modest Progress

FEMA faces challenges in mitigating redundancy and duplication among preparedness grant programs. The preparedness grant application process risks being ineffective because FEMA does not compare and coordinate grant applications across preparedness programs. Barriers at the legislative, departmental, and state levels impede FEMA's ability to coordinate these programs. Since grant programs may have overlapping goals or activities, FEMA risks funding potentially duplicative or redundant projects. We made recommendations designed to improve the efficacy of these grant programs which FEMA agreed with and outlined plans and actions to implement the recommendations.

Public Law 110-53, *Implementing Recommendations of the 9/11 Commission Act of 2007* required the Office of Inspector General to audit individual states' management of State Homeland Security Program and Urban Areas Security Initiatives grants and annually submit to Congress a report summarizing the results of these audits. In the three complete years since the law was enacted, the states we audited generally did an efficient and effective job of administering the grant management program requirements, distributing grant funds, and ensuring that all the available funds were used.

However, during FY 2010, we issued audit reports in which states, as grantees, were not

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sufficiently monitoring subgrantee compliance with grant terms and could not clearly document critical improvements in preparedness as a result of grant awards. Issued audit reports on homeland security grants management included Maryland, Missouri, South Carolina, and West Virginia. These entities generally did an efficient and effective job of administering the grant funds; however, in addition to problems with performance measurement and subgrantee monitoring, other areas that needed improvement included financial documentation and reporting, compliance with procurement and inventory requirements, and identification of long-term capability sustainment options. We also issued seven draft reports in FY 2010 that will be finalized in early FY 2011.

FINANCIAL MANAGEMENT

DHS continued to improve financial management in FY 2010, but challenges remain. In FY 2010 our Independent auditor performed an integrated financial statement and internal control over financial reporting audit that was limited to the DHS consolidated balance sheet and statement of custodial activity. As in previous years, our Independent auditor was unable to provide an opinion on those statements because the department could not provide sufficient evidence to support its financial statements or represent that financial statement balances were correct. Additionally, the Independent auditor were unable to perform procedures necessary to express an opinion on DHS' internal controls over financial reporting of the balance sheet and statement of custodial activity due to the pervasiveness of the department's material weaknesses.

Although the department continued to remediate material weaknesses and reduced the number of conditions contributing to the disclaimer of opinion on the financial statements, all six material weakness conditions from FY 2009 were repeated in FY 2010. Furthermore, the Independent auditor identified four department-wide control environment weaknesses that have a pervasive impact on the effectiveness of internal controls over consolidated financial reporting, challenges two through four are repeated from FY 2009. Specifically:

- Development and implementation of effective information and communication processes to help ensure that technical accounting issues are identified, analyzed, and resolved in a timely manner. For example, development of an accounting position and/or responses to our questions at Customs and Boarder Protection (CBP), FEMA, and Transportation Security Administration (TSA) at various times throughout the audit is often a time-consuming process that spans several months, even for less complex matters;
- Generally, the components continue to be dependent on the external financial statement audit to discover and resolve technical accounting issues;

- Field and operational personnel do not always share responsibilities for, or are not held accountable for, financial management matters that affect the financial statements, including adhering to accounting policies and procedures and performing key internal control functions in support of financial reporting; and

- The department's financial Information Technology system infrastructure is aging and has limited functionality, which is hindering the department's ability to implement efficient corrective actions and produce reliable financial statements that can be audited. Weaknesses in the general control environment are interfering with more extensive use of IT application controls to improve efficiencies in operations and reliability of financial information.

The Independent auditor noted that the DHS civilian components continued to make some progress in the remediation of IT findings that were reported in FY 2009. The Independent auditor noted that the department closed approximately 30 percent of prior year IT findings. In FY 2010 the Independent auditor issued approximately 140 findings, of which more than 60 percent are repeated from last year. Further, nearly one-third of our repeat findings were for IT deficiencies that management represented were corrected during FY 2010. Disagreement with management's self-assessment occurred almost entirely at FEMA.

In FY 2010, TSA corrected the IT controls and systems functionality weakness condition, while weakness conditions remained unchanged at FEMA, ICE, CBP, USCIS, and Federal Law Enforcement Training Center (FLETC). The weakness conditions at FEMA and ICE are more severe than the conditions at CBP, USCIS, and FLETC.

The remaining significant component-level challenges preventing the department from obtaining an opinion on its consolidated balance sheet and statement of custodial activity are primarily at the Coast Guard. In FY 2010, the Coast Guard made progress with implementing aspects of its *Financial Strategy for Transformation and Audit Readiness* (FSTAR) in the areas necessary to assert to the completeness, existence, and accuracy of Property, Plant, & Equipment (PP&E), actuarial liabilities, and fund balance with Treasury. In addition to its planned FSTAR initiatives for FY 2010, the Coast Guard performed remediation efforts over discrete elements of its balance sheet. This "balance sheet strategy" was designed to achieve additional account balance assertions. As a result, the Coast Guard was able to assert to more than $43 billion of its balance sheet. FSTAR calls for continued remediation of control deficiencies and reconciliation of balances in FY 2011.

***Anti-Deficiency Act* Violation:**

As of September 30, 2010, the department reported 9 instances of potential *Anti-Deficiency Act* (ADA) violations that are in various stages of review. Based on reviews completed in FY 2009 and FY 2010, the department has requested that the OIG perform numerous ADA audits. Currently, the OIG is conducting audits on the following cases of potential ADA violations:

1. National Protection and Programs Directorate's (NPPD) Shared Services process in FY 2006.
2. Coast Guard's FY 03 – FY 07 Shore Facility Operating Expenses.
3. United States Secret Service (USSS) salaries and expenses for presidential candidate nominee protection.
4. Coast Guard's FY 04, FY 05, and FY 07 Acquisition, Construction, and Improvement Appropriation.

The OIG concurred with management's assessment[32] that FLETC's reclassification of the second dormitory as a capital lease caused the required obligation for this lease to exceed FLETC's appropriation authority, resulting in an ADA violation.

We noted that the DHS OCFO has established policy and standards for the administrative control of funds (*DHS Financial Management Policy Manual,* Section 2.5, Updated February 2010).

Financial Management Scorecard

The following scorecard presents the status of DHS' effort to address internal control weaknesses in financial reporting that were identified in FY 2009. The scorecard is divided into two categories: (1) Military – Coast Guard, and (2) Civilian – all other DHS components. The scorecard lists the six material weaknesses identified during the independent audit of the FY 2009 DHS consolidated balance sheet and statement of custodial activity. These weaknesses continued to exist throughout FY 2010 and were again noted in the FY 2010 Independent Auditors' report; however Civilian Components reduced the severity of several material weakness conditions. For a complete description of the internal control weaknesses identified in the FY 2009 audit, see OIG-10-11.[33] To determine the status, we compared the material weaknesses reported by the Independent auditor in FY 2009 with those identified in FY 2010.[34] The scorecard does not include other financial reporting control deficiencies identified in FY 2010 that do not rise to the level of a material weakness, as defined by the American Institute of Certified Public Accountants.

Based on the consolidated result of the six financial management areas included in the report, DHS has made **modest** progress overall in financial management.

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[32] DHS-OIG, *FLETC Leases for Dormitories 1 and 3,* (OIG-10-02, October 2009).
[33] DHS-OIG, *Independent Auditor's Report on DHS' FY 2009 Financial Statements and Internal Control over Financial Reporting,* (OIG-10-11, November 2009).
[34] DHS-OIG, *Independent Auditor's Report on DHS' FY 2010 Financial Statements and Internal Control Over Financial Reporting,* (OIG-11-09, November 2010).

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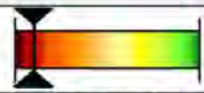
Financial Management and Reporting: Financial reporting is the process of presenting financial data about an agency's financial position, the agency's operating performance, and its flow of funds for an accounting period. Financial management is the planning, directing, monitoring, organizing, and controlling of financial resources, including program analysis and evaluation, budget formulation, execution, accounting, reporting, internal controls, financial systems, grant oversight, bank cards, travel policy, appropriation-related Congressional issues and reporting, working capital funds, and other related functions.

Military	**Limited Progress**	

In previous years, the independent auditors noted that the Coast Guard had several internal control deficiencies that led to a material weakness in financial reporting. To address the material weakness conditions, the Coast Guard developed its *Financial Strategy for Transformation and Audit Readiness*, which is a comprehensive plan to identify and correct conditions that are causing control deficiencies. Significant control deficiencies contributing to a material weakness in financial reporting in FY 2009 included: 1) lack of sufficient financial management personnel to identify and address control weaknesses; and 2) lack of effective policies, procedures, and controls surrounding the financial reporting process.

The Coast Guard has demonstrated limited progress in remediating the numerous internal control weaknesses identified by the Independent auditor during FY 2009. In FY 2010, the Coast Guard completed its planned corrective actions over certain internal control deficiencies, which allowed management to make assertions on the completeness and accuracy of certain account balances. However, many of the corrective actions outlined in the FSTAR are scheduled to occur after FY 2010, and consequently many of the financial reporting weaknesses reported in prior years remained as of the fiscal year end.

A number of the Coast Guard's challenges in financial reporting are due to the lack of an effective general ledger system. The Coast Guard currently uses multiple systems that do not comply with the requirements of the *Federal Financial management Improvement Act*. Additionally, the organization lacks effective policies, procedures, and internal controls to ensure that data supporting financial statements is complete and accurate, and technical accounting issues are identified, analyzed, and resolved in a timely manner.

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Civilian	**Moderate Progress**	
	In FY 2009, the Independent auditor identified department-wide control weaknesses that have a pervasive effect on the effectiveness of internal controls over consolidated financial reporting. The Independent auditor also found financial reporting internal control deficiencies for FEMA, TSA, and CBP. The deficiencies at FEMA and TSA were more significant than deficiencies at CBP. Taken together, these deficiencies contributed to a departmental material weakness. During FY 2010, the department made moderate progress overall in addressing the department-wide control weaknesses over consolidated financial reporting. The Independent auditor noted that during FY 2010, TSA demonstrated some progress by hiring accounting personnel and completing reconciliation of its balance sheet accounts. Additionally, TSA addressed matters that have led to misstatements in the financial statements in previous years. In addition, CBP and FEMA took positive steps in FY 2010 to correct control deficiencies that were reported in prior years. Because of the remediation efforts at CBP, TSA and FEMA, the Independent auditor downgraded the severity of the control deficiencies. As a result, TSA no longer contributes to the qualifications on the Independent Auditors' report. These combined internal control deficiencies contributed to the department's financial management and reporting material weakness in FY 2010.	
Information Technology Controls and Financial Systems Functionality: IT general and application controls are essential for achieving effective and reliable reporting of financial and performance data.		
Military	**Limited Progress**	
	During 2009, the Independent auditor identified 20 IT general control deficiencies, 11 of which were repeat findings from the prior year. The most significant IT deficiencies that could affect the reliability of the financial statements related to the development, implementation, and tracking of IT scripts, and the design and implementation of configuration management policies and procedures. These deficiencies at the Coast Guard contributed to the FY 2009 departmental material weakness over IT controls and financial systems functionality. The Coast Guard has demonstrated limited progress in FY 2010 by remediating eight general control weaknesses identified in previous	

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	years. Specifically, the Coast Guard demonstrated improvement in its user recertification process, data center physical security, and scanning for system vulnerabilities. These remediation efforts enabled the Independent auditor to expand testwork into areas that were previously not practical to audit due to the pervasiveness of IT general control weaknesses. As a result of the expanded IT testing in FY 2010, the auditors have identified new weaknesses. Of the 28 IT control deficiencies the auditors identified during FY 2010, 10 are repeat findings from the prior year and 18 are new findings. One key area that remains a challenge for the Coast Guard is its core financial system configuration management process. For 2010, the auditors again noted that the configuration management process is not operating effectively, and continues to present risks to DHS financial data confidentiality, integrity, and availability. The auditors reported that financial data in the general ledger may be compromised by automated and manual changes that are not properly controlled. The changes are implemented through the use of an IT scripting process, which was instituted as a solution to address functionality and data quality issues. However, the controls over the script process were not properly designed or implemented effectively from the beginning. The auditors noted that while the Coast Guard implemented a new script change management tool during the second half of FY 2010, other deficiencies in the IT script control environment existed throughout the fiscal year.	
Civilian	**Limited Progress**	
	During FY 2009, the Independent auditor identified three areas that continued to present risks to the confidentially, integrity, and availability of DHS' financial data: 1) excessive access to key DHS financial applications, 2) application change control processes that are inappropriate, not fully defined or followed, and are ineffective, and 3) security management practices that do not fully and effectively ensure that financial systems are certified, accredited, and authorized for operation prior to implementation. During FY 2009, FEMA and ICE contributed to an overall material weakness in IT general and applications control, while CBP, FLETC, TSA, and USCIS all had significant deficiencies in this area. For FY 2010, DHS has made limited progress overall in correcting the IT general and applications control weaknesses identified in the FY 2009	

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	Independent Auditor's report. The Independent auditor identified that TSA eliminated its significant deficiency. However, FEMA, ICE, CBP, FLETC, and USCIS continued to contribute to the departmental IT controls and system functionality material weakness condition. Control deficiencies at FEMA and ICE were more severe than deficiencies at CBP, FLETC, and USCIS. Additionally, FEMA may not have a complete understanding of its control deficiencies because FEMA reported that it closed 28 information controls and system functionality weakness conditions but the Independent auditor concurred with management's conclusion on only 5 of the conditions reported as closed. The auditors noted that many of the financial systems in use at DHS components have been inherited from the legacy agencies and have not been substantially updated since DHS' inception. As a result, ongoing financial system functionality limitations are contributing to the department's challenges in addressing systemic internal control weaknesses and strengthening the overall control environment. The FY 2010 Independent Auditor's report identified the following weaknesses in the IT control areas that increase the 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. Additionally, the Independent auditor noted that in some cases financial system functionality is inhibiting DHS' ability to implement and maintain or install internal controls, and that financial system functionality limitations contribute to the department's other material weaknesses.

Fund Balance with Treasury (FBWT): FBWT represents accounts held at the Treasury from which an agency can make disbursements to pay for its operations. Regular reconciliation of an agency's FBWT records with Treasury is essential to monitoring and safeguarding these funds, improving the integrity of various U.S. Government financial reports, and providing a more accurate measurement of budget resources.

Military	**Modest Progress**	
	In FY 2009, the Independent auditor identified several internal control weaknesses related to FBWT which contributed a material weakness in this area at the Coast Guard. Among the internal weakness conditions	

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	the auditors noted in FY 2009 was that the Coast Guard had not developed a comprehensive process, to include effective internal controls, to ensure that FBWT transactions are recorded in the general ledger timely, completely, and accurately. As of the end of FY 2010, the Coast Guard's FBWT represented approximately 11 percent of the department's total FBWT. Overall, the Coast Guard has demonstrated modest progress in addressing the material weaknesses noted during FY 2010. Although the Coast Guard corrected some FBWT control deficiencies, additional corrective actions are planned for FY 2011. Consequently, most of the FY 2009 weakness conditions were reported again in FY 2010. One of the key factors contributing to the FBWT material weakness is that the Coast Guard has not designed and implemented accounting processes, including a financial system that complies with federal financial systems requirements, as defined in the OMB Circular No. A-127, *Financial Management Systems*, to support the FY 2010 FBWT activity and balance.	
Civilian	**N/A**	
	No control deficiencies related to FBWT were identified at the civilian components in FY 2010. Corrective actions implemented in previous years continued to be effective throughout FY 2009 and FY 2010.	
Property, Plant, and Equipment: DHS capital assets and supplies consist of items such as property, plant, and equipment, operating materials; and supplies, including boats and vessels at the Coast Guard, passenger and baggage screening equipment at TSA, and stockpiles of inventory to be used for disaster relief at FEMA.		
Military	**Limited Progress**	
	The Coast Guard maintains approximately 51 percent of the department's PP&E, including a large fleet of boats and vessels. The Coast Guard also maintains significant quantities of operating materials and supplies (OM&S), which consist of tangible personal property to be consumed in normal operation of service marine equipment, aircraft, and other equipment. In FY 2009, internal control weaknesses related to PP&E and OM&S at the Coast Guard contributed to the departmental material weaknesses.	

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	For FY 2010, the Coast Guard has demonstrated limited progress overall in correcting internal control weaknesses related to PP&E identified in the Independent Auditor's report in FY 2009. In addition to its planned FSTAR initiatives for FY 2010, the Coast Guard performed additional remediation efforts over discrete elements of its balance sheet. This "balance sheet strategy" was designed to achieve additional account balance assertions. As a result, the Coast Guard implemented additional measures to resolve the OM&S portion of the material weakness ahead of the planned FSTAR remediation milestone. However, the Coast Guard was unable to accomplish all aspects of its planned remediation efforts. Moreover, most of the corrective actions included in the FSTAR are scheduled to occur over a number of years. Consequently, many of the material weakness conditions noted during FY 2010 also existed in FY 2009. For example, one of the conditions the auditors identified, which is a repeat deficiency from prior years, is that the Coast Guard has not established its beginning PP&E balance necessary to prepare the fiscal year-end balance sheet. The Coast Guard conducted inventory procedures during FY 2010 to assist management in substantiating the existence and completeness of PP&E balances; however, those procedures were not performed over all asset classes (e.g real property). The Independent auditor also noted that the Coast Guard has had difficulty establishing its opening PP&E balances primarily because of poorly designed policies, procedures, and processes implemented more than a decade ago, combined with ineffective internal controls. PP&E was not properly tracked or accounted for many years preceding the Coast Guard's transfer to DHS in 2003, and now the Coast Guard is faced with the formidable challenge of performing a retroactive analysis in order to properly establish the existence, completeness, and accuracy of PP&E. Furthermore, the fixed asset module of the Coast Guard's CAS is not updated timely for effective tracking and reporting of PP&E on an ongoing basis. As a result, the Coast Guard is unable to accurately account for its PP&E, and provide necessary information to DHS OFM for consolidated financial statement purposes.	
Civilian	**Moderate Progress**	
	During FY 2009, CBP and TSA contributed to an overall material weakness in PP&E, while ICE, NPPD, TSA, and USCIS all had significant deficiencies in this area. During FY 2010, DHS demonstrated moderate progress overall in	

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	correcting internal control weaknesses related to PP&E identified in the Independent Auditor's report in FY 2009. ICE, NPPD, and USCIS have fully corrected internal control weakness conditions related to PP&E, while CBP reduced the severity of its control deficiencies. Additionally, TSA completed the reconciliation of its PP&E accounts in FY 2010 and was able to assert that its PP&E balances at September 30, 2010 are fairly stated in the DHS FY 2010 *Annual Financial Report*. Although TSA made some progress in remediating control deficiencies, including having auditable beginning PP&E balance, it was unable to fully address all of the conditions that existed in FY 2009. Consequently, the overall severity of its internal control weakness conditions remained in FY 2010.	
Actuarial and Other Liabilities: Liabilities represent the probable and measurable future outflow or other sacrifice of resources as a result of past transactions or events. The internal control weaknesses reported in this area are related to various types of liabilities, including accounts and grants payable, legal and actuarial, and environmental liabilities.		
Military	**Moderate Progress**	
	The Coast Guard maintains medical, pension, and post-employment travel benefit programs that require actuarial computations to record related liabilities for financial reporting purposes. Other liabilities include accounts payable, environmental, and legal liabilities. In FY 2009, the Independent auditor noted a number of internal control deficiencies related to actuarial liabilities at the Coast Guard, which contributed to a material weakness for the department. During FY 2010, the Coast Guard demonstrated moderate progress overall by completing its planned corrective actions over selected internal control and reporting deficiencies that existed in this process in FY 2009. Specifically, remediation efforts associated with accounts payable, accrued payroll, pension, and medical liabilities allowed management to assert to the completeness and accuracy of over $43 billion of accrued liabilities, which represents more than 50 percent of DHS' total liabilities. However, management was unable to provide sufficient evidential matter that support transactions and balances related to environmental and other liabilities. Among the conditions that remained throughout FY 2010 is the Coast Guard has not implemented effective policies, procedures, and controls to ensure the completeness and accuracy of environmental liabilities.	

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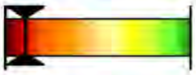
Civilian	**Substantial Progress**	
	For FY 2009, the Independent auditor noted internal control weaknesses related to liabilities at FEMA and TSA. During FY 2010, the civilian components demonstrated substantial progress overall in remediating internal control weaknesses related to actuarial and other liabilities, with TSA fully remediating its control weakness condition. FEMA is recognized as the primary grant-making component of DHS and the FY 2010 Independent Auditor's report noted that FEMA does not have sufficient policies and procedures in place to fully comply with the *Single Audit Act Amendments of 1996* and OMB Circular No. A-133, *Audits of States, Local Governments, and Non-profit Organizations*. As a result, FEMA continued in FY 2010 to contribute to the departmental actuarial and other liabilities material weakness condition.	
Budgetary Accounting: Budgetary accounts are a category of general ledger accounts where transactions related to the receipt, obligation, and disbursement of appropriations and other authorities to obligate and spend agency resources are recorded.		
Military	**Limited Progress**	
	The Coast Guard has over 90 Treasury Account Fund Symbol (TAFS) covering a broad spectrum of budget authority, including annual, multi-year, and no-year appropriations; and several revolving, special, and trust funds. Each TAFS with separate budgetary accounts must be maintained in accordance with OMB and Treasury guidance. In FY 2009, the Independent auditor noted a number of internal control deficiencies related to budgetary accounts that contributed to a material weakness in this area for the department. For FY 2010, the Coast Guard has made limited progress in remediating the internal control weaknesses in this area. Many of the conditions that contributed to a material weakness in budgetary accounting at the Coast Guard in FY 2009 remained throughout FY 2010. For example, the FY 2009 Independent Auditors' report noted that the policies, procedures, and internal controls over the Coast Guard's process for validation and verification of some account balances are not effective to ensure recorded amounts are complete, valid, accurate, and proper approvals and supporting documentation are maintained. These weaknesses	

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	continued to exist in FY 2010, and remediation of these conditions is not planned until after FY 2010.	
Civilian	**Moderate Progress**	
	For FY 2009, internal control weaknesses at CBP and FEMA contributed to a departmental budgetary accounting material weakness. During FY 2010, the department demonstrated moderate progress in correcting the budgetary accounting material weakness. FEMA improved its processes and internal controls over the obligation and monitoring process, but control deficiencies remain. Additionally, CBP implemented policies and procedures requiring the timely review and deobligation of funds when contracts have expired or are complete. However, CBP did not adhere to those policies and procedures. As a result, FEMA and CBP contributed to the departmental budgetary accounting material weakness condition.	

INFRASTRUCTURE PROTECTION

DHS has direct responsibility for leading, integrating, and coordinating efforts to protect 11 critical infrastructure and key resources (CI/KR) sectors: the chemical industry; commercial facilities; critical manufacturing; dams; emergency services; commercial nuclear reactors, materials, and waste; information technology; telecommunications; postal and shipping; transportation systems; and government facilities. In addition, DHS has an oversight role in coordinating the protection of seven sectors for which other federal agencies have primary responsibility. The seven sectors for which DHS has an oversight role are agriculture and food; the defense industrial base; energy; public health and healthcare; national monuments and icons; banking and finance; and water and water treatment systems. The requirement to rely on federal partners and the private sector to deter threats, mitigate vulnerabilities, or minimize incident consequences complicates protection efforts for all CI/KR. Combined with the uncertainty of the terrorist threat and other manmade or natural disasters, the implementation of protection efforts is a great challenge.

In our FY 2009 report, *Efforts to Identify Critical Infrastructure Assets and Systems*, we reported that the National Protection and Programs Directorate is in the process of acquiring the Infrastructure Information Collection System, a replacement for the National Asset Database.[35] It is envisioned that the Infrastructure Information Collection System will greatly reduce critical infrastructure risk management gaps by providing dynamic

[35]DHS-OIG, *Efforts to Identify Critical Infrastructure Assets and Systems*, (OIG-09-86, June 2009).

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Major Management Challenges Facing the Department of Homeland Security

information collection systems that include a range of relevant sources. In addition, the Infrastructure Information Collection System will allow relevant critical infrastructure partners from federal, state, local, and private entities to access various tools that house infrastructure data. We recently closed this recommendation because NPPD has made progress and the unclassified system is now in use. However, the classified system has not been implemented.

Concerning DHS efforts to protect the cyber infrastructure, we reported in June 2010 that the United States Computer Emergency Readiness Team (US-CERT) had made progress in implementing a cybersecurity program to assist federal agencies in protecting their information technology systems against threats.[36] However, US-CERT does not have appropriate enforcement authority to ensure that agencies comply with its mitigation guidance concerning threats and vulnerabilities. Additionally, US-CERT does not have sufficient staff to perform its 24x7 operations and to analyze security information timely. US-CERT had not developed a strategic plan and must improve its information sharing efforts with federal agencies. Finally, US-CERT does not have the capability to monitor federal cyberspace in real-time.

BORDER SECURITY

Securing the nation's borders from illegal entry of aliens and contraband, including terrorists and weapons of mass destruction, continues to be a major challenge. DHS apprehends hundreds of thousands of people and seizes large volumes of cargo entering the country illegally each year. The U.S. Customs and Border the DHS component responsible for securing the nation's borders at and between the ports of entry. To achieve this goal, CBP is implementing the Secure Border Initiative (SBI), a comprehensive multi-year approach intended to help secure the 7,000 miles of international borders that the United States shares with Canada and Mexico. The program, which began in November 2005, seeks to enhance border security and reduce illegal immigration through the use of surveillance technologies, increase staffing levels, increase domestic enforcement of immigration laws, and improve physical infrastructure along the nation's borders.

The technology component of SBI, referred to as SBInet, is a major acquisition program initiated to gain operational control of the borders by designing and deploying a new integrated system of technology, infrastructure, and personnel. The specific objective of SBInet is to provide Border Patrol command centers with the imagery and intelligence to detect, identify, and interdict illegal incursions at and between our land ports of entry. DHS' ability to monitor SBInet has been a continuing concern. Previously, we reported that DHS did not have the acquisition workforce required to adequately plan, oversee, and execute SBInet, and that CBP had not established adequate controls and effective oversight of

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[36] DHS OIG, *U.S. Computer Emergency Readiness Team Makes Progress in Securing Cyberspace, but Challenges Remain* (OIG-10-94, June 2010).

contract workers responsible for providing SBI program support services.[37] Also, the Government Accountability Office identified significant risk of the SBInet program not meeting mission needs and the increased risk of unnecessary program costs resulting from time consuming system rework.[38] Because of these and other concerns related to the efficacy of the implementation of SBInet technologies, the Secretary, in January 2010, requested a department-wide reassessment of the program that will identify alternatives to the current SBInet strategy that may more efficiently and effectively meet border security needs. The Secretary subsequently froze all SBInet funding beyond the initial deployment to the Tucson and Ajo regions until the reassessment is complete.

In June 2010, we reported that CBP needed to improve its control of contractor activities on the SBI technology program. Specifically, program officials did not ensure that contractors maintained up-to-date information in the primary management tool designed to provide managers with advance information regarding potential cost overruns and program progress. In addition, program officials did not ensure that a program event was properly completed before progressing to the next event, and did not adequately document their review and acceptance of accomplishments and criteria at program events. CBP has a low number of government personnel assigned to oversee contractor activities, which increases the program office's risk that program cost and schedule are not adequately managed and that goals are not met. CBP has taken steps to improve SBI technology program oversight by using the Defense Contracting Management Agency personnel to assist with contract administration and reissuing important program documentation.[39]

CBP faces challenges in meeting small business subcontracting goals for the remainder of the Secure Border Initiative Net indefinite delivery, indefinite quantity contract. A change in CBP's acquisition strategy from acquiring technology to acquiring steel for border fence construction reduced opportunities for small business to participate in awards under the Secure Border Initiative Net contract. In response the prime contractor, Boeing, has implemented initiatives to improve small business participation in Secure Border Initiative Net subcontracts to achieve its subcontracting goals. Despite these initiatives, the contractor has not achieved the established goals for small business participation since the reporting period ended September 2007.[40]

Additionally, we previously reported that DHS needs to focus on improving the policies, processes, and procedures that govern the management and care of its detainee population. Prior reviews of ICE's detention and removal operations identified deficiencies in the oversight of immigration detention facilities. ICE has made efforts to strengthen the oversight of ICE detention assets by establishing a Detention Facilities Inspection Group (DFIG). The DFIG provides ICE with an independent inspection arm dedicated to oversight

[37] DHS OIG, *Better Oversight Needed of Support Services Contractors in Secure Border Initiative Programs*, OIG-09-80, June 2009.
[38] Government Accountability Office, *Secure Border Initiative: DHS Needs to Reconsider Its Proposed Investment in Key Technology Program*, GAO-10-340, May 2010
[39] DHS OIG, *Controls Over SBInet Program Cost and Schedule Could Be Improved*, (OIG-10-96, June 2010).
[40] DHS OIG, *CBP Faces Challenges in Achieving Its Goals for Small Business Participation in Secure Border Initiative Network*, (OIG-10-54, February 2010).

of ICE's Detention and Removal Operations (DRO) program. ICE has contracted with private companies to provide on-site compliance verification of the Performance-Based National Detention Standards at all ICE detention facilities. Last year we reported that ICE could further improve documenting the transfer of immigrant detainees and ensuring they received timely medical screenings and physical examinations, required by detention standards.[41] Additionally, ICE needed to determine whether its approach to detention facility bed space management was cost-effective.[42] ICE has been responsive to the issues identified in the two reports and is implementing the recommendations to address these issues.

TRANSPORTATION SECURITY

The nation's transportation system is vast and complex. It consists of about 3.9 million miles of roads, over 100,000 miles of rail, almost 600,000 bridges, over 300 sea ports, over 2 million miles of pipeline, about 500 train stations, and over 5,000 public-use airports. The size of the transportation system, which moves millions of passengers and tons of freight every day, makes it both an attractive target for terrorists and difficult to secure. The nation's economy depends upon implementation of effective, yet efficient transportation security measures. The Transportation Security Administration is responsible for protecting the transportation system and ensuring the freedom of movement for people and commerce. Given the "open" environment, TSA must establish effective security strategies, while maintaining quick and easy access for passengers and cargo. Since its inception, TSA continues to face challenges with strengthening security for aviation, mass transit and other modes of transportation. Although TSA is making progress in addressing these challenges, more needs to be done.

Checkpoint and Checked Baggage

TSA's screening of persons and property continues to be a vital element of the overall aviation security system. The *Aviation and Transportation Security Act*[43] requires TSA to prescribe requirements for screening or inspecting all passengers, goods, and property before entry into the sterile areas of an airport. Our undercover audit of checked baggage screener performance revealed that improvements are needed in the screening process to ensure that dangerous prohibited items that enter the checked baggage system are not cleared for loading onto a passenger aircraft.[44] We recently issued a classified report on our unannounced, covert testing which identified needed improvements for TSA's newly deployed and enhanced screening checkpoint technologies.[45] We evaluated Advanced Imaging

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[41] DHS-OIG, *Immigration and Customs Enforcement's Tracking and Transfers of Detainees*, (OIG-09-41, March 2009).
[42] DHS-OIG, *Immigration and Customs Enforcement Detention Bedspace Management*, (OIG-09-52, April 2009).
[43] Public Law 107-71, November 19, 2001.
[44] DHS-OIG, *Audit of the Effectiveness of the Checked Baggage Screening System and Procedures Used to Identify and Resolve Threats*, (OIG-09-42, March 2009).
[45] DHS-OIG, *Evaluation of Newly Deployed and Enhanced Technology and Practices at the Passenger Screening Checkpoint* (OIG-10-75, March 2010).

Technology, Advanced Technology X-ray equipment, and Liquid Container Screening used to screen passengers or their carry-on items and tested Transportation Security Officer performance in checking passengers' travel documents.

Passenger Air Cargo Security

Approximately 7.6 million pounds of cargo are transported on passenger planes each day. Federal regulations (49 CFR) require that, with limited exceptions, passenger aircraft may only transport cargo originating from a shipper that is verifiably "known" either to the aircraft operator or to the indirect air carrier that has tendered the cargo to the aircraft operator.

TSA could improve its efforts to secure air cargo during ground handling and transportation. We reviewed the effectiveness of the TSA's efforts to secure air cargo while it is handled or transported on the ground, prior to being shipped on passenger aircraft.[46] We determined that personnel were sometimes accessing, handling, or transporting air cargo without the required background checks or training. The agency's inspection process has not been effective in ensuring that requirements for securing air cargo during ground transportation are understood or followed. The inspection process has focused on quantity rather than outcomes and ensuring corrective actions. We reported that automated tools to assist inspectors in analyzing results and focusing their oversight efforts on high-risk areas in air cargo security could be improved.

Although TSA has taken steps to address air cargo security vulnerabilities, our undercover audit demonstrated that the agency does not have assurance that cargo screening methods always detect and prevent explosives from being shipped in air cargo transported on passenger aircraft.[47] We presented test cargo shipments to air carriers and certified cargo screening facilities, and the screeners or equipment did not always identify the test items.

Rail and Mass Transit

Passenger rail systems face a dynamic landscape of potential natural disasters, accidents, and terrorist attacks. Since 1995, there have been more than 250 terrorist attacks worldwide against rail targets, resulting in nearly 900 deaths and more than 6,000 injuries. Recent events on the rail and transit systems in Washington DC, including a derailment, fire, and crash, have raised questions regarding the mass transit agencies' contingency plans and the ability to handle these basic issues, as well as major emergencies. The *Aviation and Transportation Security Act* assigned TSA the responsibility to secure all modes of transportation in the United States.

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[46] DHS-OIG, *Security of Air Cargo During Ground Transportation*, (OIG-10-09, November 2009).
[47] DHS-OIG, *Evaluation of Screening of Air Cargo Transported on Passenger Aircraft*, (OIG-10-119, September 2010).

We evaluated the TSA's effectiveness in supporting mass transit and passenger rail agencies in preparing for and responding to emergency incidents.[48] As TSA expands its presence in non-aviation modes of transportation, it must look critically at how it is deploying resources. TSA could better support passenger rail agencies by improving its assessments of emergency preparedness and response capabilities. The agency could also improve its efforts to train passenger rail agencies and first responders, and ensure that drills and exercises are live and more realistic to help strengthen response capabilities. The agency has focused primarily on security and terrorism prevention efforts, while providing limited staff and resources to emergency preparedness and response.

TRADE OPERATIONS AND SECURITY

CBP is responsible for guarding nearly 7,000 miles of land border the United States shares with Canada and Mexico and 2,000 miles of coastal waters surrounding the Florida peninsula and off the coast of Southern California. The agency also protects 95,000 miles of maritime border in partnership with the United States Coast Guard. CBP assesses all people and cargo entering the U.S. from abroad for terrorist risk. Each year, more than 11 million maritime containers arrive at our seaports. At land borders, another 11 million arrive by truck and 2.7 million by rail. On a typical day CBP processes more than 50,000 truck, rail, and sea containers, along with the personnel associated with moving this cargo across U.S. borders or to U.S. seaports. To manage the potential security threats presented by this large volume of maritime cargo, CBP has implemented a layered approach to prevent cargo linked to terrorism from entering the country.

CBP uses several programs and initiatives including establishing voluntary cooperation and initiatives with government, industry and working with law enforcement and our foreign and domestic trade partners to improve international supply chain security. Among the programs and initiatives are the:

- Customs-Trade Partnership Against Terrorism (C-TPAT), a voluntary government-business initiative designed to improve international supply chain security by providing incentives to businesses that meet certain security standards.

- Container Security Initiative (CSI), an international program in which CBP officers are deployed at overseas ports to work with host nations to target containers that pose a high-risk. Currently, there are 58 CSI ports handling approximately 86% of all U.S. bound cargo.

- Secure Freight Initiative (SFI) a pilot program at foreign ports for testing the feasibility of scanning 100% of U.S. cargo.

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[48] DHS-OIG, *TSA's Preparedness for Mass Transit and Passenger Rail Emergencies,* (OIG-10-68, March 2010).

- Importer Security Filing – CBP requires importers and carriers to submit additional cargo data on vessels destined to the U.S ports to help decision-makers and systems make more informed decisions on cargo.

- Automated Targeting System - CBP employs targeting and law enforcement tools and sophisticated targeting techniques to analyze and screen shipping information to identify the highest risk cargo on which to focus its limited resources.

While CBP continues to enhance its layered strategy, significant issues remain with modernizing trade systems, using resources efficiently, and managing and forging partnerships with foreign trade and customs organizations, and improving the effective use of its targeting systems.

For example, the targeting and examination of high risk shipments continues to be a challenge for CBP. Our most recent review highlighted several areas where improvement can be made. These areas include updating CBP's guidance relating to the physical examinations of high-risk cargo containers that may contain biological, chemical, nuclear, and radiological threats and the need for a risk assessment to determine which pathways, pose the highest risk.[49]

As part of our review of CBP's layered approach, we evaluated the CSI program and noted that while the CSI program has proactive management and oversight processes in place, CSI could improve the future direction of the program by updating its performance measures and integrating its plans with other international maritime cargo security programs.[50]

The challenge of developing and maintaining an integrated approach to cargo security is critical as CBP's moves forward to implement Section 1701 of the *Implementing Recommendations of the 9/11 Commission Act of 2007*, which requires DHS to screen all cargo headed for the United States that is loaded on or after July 1, 2012. Before 100% screening can be fully implemented for all cargo inbound to the U.S., DHS must ensure that it has adequate resources, infrastructure and processes in place and can reach agreement with the international community to resolve issues concerning corresponding resources, oversight, costs, timing, and enforcement considerations as well as a process to resolve disagreements as they arise.

[49] DHS-OIG, *CBP's Ability to Detect Biological and Chemical Threats in Maritime Cargo Containers*, (OIG-10-01, October 2009). DHS-OIG, Cargo Targeting and Examinations, (OIG-10-34, January 2010).
[50] DHS-OIG, *CBP's Container Security Initiative Has Proactive Management and Oversight but Future Direction is Uncertain*, (OIG-10-52, February 2010).

Appendix A
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Management's Response

The Reports Consolidation Act of 2000 requires that, annually, the Office of Inspector General (OIG) prepare a statement summarizing the most serious management and performance challenges facing the Department and an assessment of the Department's progress in addressing those challenges. For FY 2010, the OIG considers the following to be the most serious challenges facing the Department:

- Acquisition Management;
- Information Technology Management;
- Emergency Management;
- Grants Management;
- Financial Management;
- Infrastructure Protection;
- Border Security;
- Transportation Security; and
- Trade Operations and Security.

DHS carries out multiple complex and highly diverse missions. Although the Department is continually striving to improve the efficiency and effectiveness of its programs and operations, the areas identified above merit a higher level of focus and attention. Typically, overcoming challenges in these areas require long-term strategies for ensuring stable operations, sustained management attention, and resources.

The remainder of this section of the report details the Department's efforts in addressing each of the OIG challenges in FY 2010 and the plans it has in place to overcome the issues highlighted by the OIG.

Challenge #1: Acquisition Management

Acquisition Management

An effective acquisition management infrastructure is vital to achieving DHS's overall mission**.** It requires a sound management infrastructure to oversee the complex and large dollar procurements. A successful acquisition process depends on the following key factors: Organizational Alignment and Leadership; Policies and Processes; Acquisition Workforce; and Knowledge management and Information Systems.

Within the Office of the Chief Procurement Officer (OCPO), the acquisition workforce branch focuses on the numbers and skills of staff needed to carry out the functions of managing complex programs and effectively contracting for the products and services necessary to execute those programs and has been successful in building a responsive and skilled acquisition workforce.

Organizational Alignment and Leadership

According to the OIG, in both FY 2010 and FY 2009 DHS made "modest" progress in improving the acquisition program's organizational alignment and defining roles and responsibilities. This rating remains unchanged because the Department continues to depend on a system of dual accountability and collaboration between the Chief Procurement Officer and the Component heads, which may create ambiguity about who is accountable for acquisition decisions. However, DHS maintains that the dual authority model works because the OCPO retains central authority over all contracting through its contracting officer warrant program and Federal Acquisition Certification - Contracting program. According to the Department, the heads of contracting activities and contracting officers function independently of Component influence as their authority flows from OCPO rather than the Component. DHS's Acquisition Line of Business Integration and Management Directive sets forth existing authorities and relationships within individual Components and the Department's Chief Procurement Officer.

According to Government Accountability Office (GAO) report 09-29, DHS has not effectively implemented or adhered to its investment review process, which requires executive decision making at key points in an investment's life cycle. Findings in GAO-09-29 relate to a Management Directive (MD) that is no longer applicable. The report states "According to the Government Accountability Office (GAO), DHS has not effectively implemented or adhered to its investment review process, which requires executive decision making at key points in an investment's life cycle." This report was based on a GAO report completed in November 2008, which in turn was based on data from FY 2007. That report does not refer to the current guidance on acquisition management in MD 102.1; instead, addressed the MD 1400, which has been replaced by MD 102.1. The new, comprehensive Directive 102.1 was just implemented in draft form in November 2008 (FY 2009) and had not been reviewed in any fashion by the GAO in the report cited. Thus, use of that report to support the rating for 2010 is inappropriate and should be deleted from the draft report. DHS Acquisition Directive 102-01 was finalized and approved by the Undersecretary for Management on January 20, 2010.

<u>FY 2010 Accomplishments</u>
DHS OCPO drafted a Directive and Instruction which together are a complete revision of MD 0003, "Acquisition Line of Business Integration and Management." This establishes the accountability and responsibility that are critical to complementing the contracting authorities already in place. Together, the draft directive and instruction confirm the chain of contracting authority from the OCPO to the Heads of Contracting Activity (HCA), and then to the contracting officers. In addition, these documents stipulate the establishment of the DHS HCA Council, which supports the OCPO by providing senior officials with support and guidance on the state of contracting within the Department.

Directive 252-07, "Acquisition Line of Business Integration and Management." Directive 252-07 will:

- Clarify acquisition responsibilities of the Under Secretary for Management;
- Establish a programmatic line of authority via a "Component Acquisition Executive (CAE)"; and
- Clarify and delineate respective responsibilities of HCAs and CAEs.

Directive 102-01 sets forth the acquisition roles and responsibilities of Headquarters and Component personnel. It also defines program threshold levels, the decision authorities for those respective threshold levels and when a program needs to be reviewed. This acquisition management framework is also defined in context of the other key institutional management frameworks, such as strategic requirements determination and the Department's Planning, Programming, Budgeting, and Execution system. In this way, the acquisition management process is interlinked with the other key decision processes such that decisions in any one process are informed by knowledge gained by the others. This is an essential aspect of Department integration.

This year, the USM/Chief Acquisition Officer kicked off the first CAE Council meeting. The CAE is the senior acquisition official within a Component responsible for implementation, management, and oversight of their Component's acquisition processes, and coordinates those processes with the contracting and procurement processes of the Component's HCA. The HCA Council meets on a monthly basis to discuss key issues of concern to OCPO and/or the contracting activities. These meetings are a key ingredient in assuring a coordinated contract effort across DHS. In addition, each year OCPO issues priority letters to the HCAs that set forth their key goals for the upcoming year, including areas such as competition, small business, and Federal Procurement Data System (FPDS) accuracy and program management certifications.

Additionally, eight CAEs have been appointed in accordance with Directive 102-01, "Acquisition Management," to provide structure and accountability to the programmatic aspects of Acquisition. The establishment of the CAE structure will be further institutionalized when Directive 252-07 is approved and issued. Finally, additional directives and instructions are being established to provide further guidance and controls over the acquisition process.

The Acquisition Review Board (ARB) is the cross-Component board that assesses a program's progress and brings essential issues to the Acquisition Decision Authority. In FY 2010 DHS conducted 34 ARBs. These ARBs included Program Reviews and Program Decisions by the Acquisition Decision Authority, as well as, active oversight of Departmental *American Recovery and Reinvestment Act* (ARRA) initiatives.

To complement the ARB process, Component Portfolio Reviews were implemented in 2009 as a means for the Department to review and collaborate with each major program on an annual basis as well as gaining insight on the Components' acquisition oversight processes and staff. This process, jointly executed by the Component and the Department, supports management of the Component's acquisition portfolio and strengthens Departmental governance and oversight. DHS conducted 10 Portfolio Reviews in FY 2010.

<u>Initiatives Underway and Planned</u>

Building upon the 2010 and prior years' accomplishments and momentum, the OCPO will continue to improve organizational alignment and leadership in the following manner:

- Issuance and implementation of Directive 252-07, "Acquisition Line of Business Integration and Management."
- Conduct up to 36 ARBs in FY 2011. Plans are to also increase the number of Service Acquisition ARBs. Additionally, 10 Portfolio Reviews are planned.

- CAE Council meetings will be held as well as the designation of more CAE's throughout the Department where appropriate.

Policies and Processes

DHS made "moderate" progress in developing and strengthening acquisition management policies and processes. The Department has put a great deal of effort into improving its processes and controls over awarding, managing, and monitoring contract funds.

OCPO plans to amend the Homeland Security Acquisition Manual (HSAM) to require that acquisition personnel include Advanced Acquisition Plan (AAP) numbers in procurement files, when applicable.

As reported last year, DHS needs to further develop methods for evaluating the effectiveness of an award fee as a tool for improving contractor performance, and FEMA needs to accelerate its planned acquisition process improvements for awarding, managing, monitoring, tracking, and closing-out contracts.

FY 2010 Accomplishments
On August 23, 2010, OCPO issued an amendment to the HSAM Chapter 3007, Acquisition Planning, and the DHS Acquisition Planning Guide (HSAM Chapter 3007, Appendix H). Included in HSAM Notice 2010-08 was an amendment to HSAM 3007.103(d)(2)(i), which requires that a copy of each AAP and its reference number obtained through the AAP Database be included in the contract file as evidence of acquisition planning. The amendment to HSAM 3007.103(d)(2)(i) was effective upon issuance.

OCPO amended the HSAM 3016.401 to, among other things, require reporting from the Components of key information on each award fee and incentive contract that is awarded as well as reporting key information after the fact on the effectiveness of each award fee and performance incentive. These reports are to be used to evaluate the effectiveness of award fees and performance incentives and to develop best practices. We believe this will result in a process of continual improvement of DHS award fee and incentive contracting. OCPO issued supplemental guidance on June 10, 2010, detailing specific steps to be taken to ensure each award fee contract would be consistent with new Government-wide policy. We believe the combination of the amended Federal Acquisition Regulation (FAR) and the supplemental OCPO guidance, along with the training, will significant increase adherence to award fee policies.

OCPO's revised Acquisition Planning Guide (HSAM 3007, Appendix H, page H-20) requires acquisition planners, where appropriate, to describe "the type of incentive, the rationale for the selection of an incentive, and plans for managing the incentive contract (i.e., award fee plan)." Where appropriate, planners are also required to "discuss relevant agency data collected on award fees and incentive paid to contractors and include performance measures to evaluate such data to determine the effectiveness of award and incentive fees as a tool for improving contractor performance and achieving desired program outcomes (FAR 16.401(f))."

In addition to amending policies, OCPO has developed and launched Award Fee training for the Components. OCPO has also developed a two-hour award fee training course on the new FAR and

OCPO guidance. The course has been presented to DHS contracting personnel during FY 2010 and will continued to be offered in FY 2011.

To assure compliance with HSAM, Homeland Security Acquisition Regulation (HSAR), and Department of Defense (DOD) directives, OCPO performs program management and procurement management reviews. As previously noted, for program management, during FY 2010, there were 34 ARBs and 10 portfolio reviews performed. For procurement oversight, OCPO performed three Component specific reviews (OPO, ICE, and USSS), as well as seven DHS-wide reviews (Indefinite Delivery Indefinite Quantity (IDIQ) contracts, noncompetitive contracts, acquisition plans, contract pricing, time and material contracting, locating contract files, and firm fixed price level of effort contracts).

Initiatives Underway and Planned

Building upon the 2010 and prior years' accomplishments and momentum, the OCPO will continue to improve its policies and processes in the following manner:

- Continue to provide Award Fee training to DHS Components.
- Monitor reporting from the Components of key information on each award fee and incentive contract awarded to evaluate the effectiveness of award fees and performance incentives and develop best practices.
- In collaboration with the Office of General Counsel–Ethics, launch mandatory Procurement Ethics training for DHS acquisition workforce through a variety of mediums, e.g., on-site training, webinars.
- Maintain currency and accuracy of the HSAR and HSAM.
- Issue as an Appendix to HSAM 3015, a DHS Debriefing Guide to standardize processes within DHS as a means of strengthening DHS's commitment to transparency.
- Conduct up to 36 ARBs in FY 2011. Plans are to also increase the number of Service Acquisition ARBs. Additionally, ten Portfolio Reviews are planned.
- In addition to the oversight review on award fees, OCPO plans to conduct three Component specific reviews (CBP, USCG, and TSA), and at least four DHS-wide reviews (invoicing, interagency contracting, ARRA funds, and contract closeout).

Acquisition Workforce

Within OCPO, the acquisition workforce branch focuses on the numbers and skills of staff needed to carry out the functions of managing complex programs and effectively contracting for the products and services necessary to execute those programs. Achieving an effective acquisition workforce includes a corporate commitment to sound human capital management integrated with and aligned to organizational goals. Challenges DHS faces in this area are related to:

- A shortage of acquisition professionals to support the mission needs of the Department, creating a challenge for recruiting, developing, certifying and retaining a highly skilled workforce.
- Recruiting staff with the necessary skills for ensuring an effective acquisition program across multiple acquisition career fields.
- Identifying the appropriate number of acquisition personnel across Component contracting activities in a dynamic operational environment.

<u>2010 Accomplishments</u>

Common to the Federal Government, DHS has a shortage of trained and credentialed acquisition professionals. OCPO has made progress in building a skilled acquisition workforce in the following manner:

- We have continued the expansion of the Acquisition workforce office within the OCPO, providing staff and resources in recognition of the fact that workforce planning and management is critical to the success of the Department.
- Requested FY 2011 centralized funding to continue the acquisition intern program, known as the Acquisition Professional Career Program, to grow the DHS acquisition workforce by an additional 100 participants. In FY 2010 we successfully hired and placed 105 participants, culminating in a total of 200 participants in the program. Concurrently, we expanded from hiring for three acquisition disciplines (contracting, program management, systems engineering) to hiring for six acquisition disciplines, adding participants in logistics, business cost estimating, and information technology. Furthermore, we have begun the geographic expansion of the program to include hiring four participants for the U.S. Coast Guard in Norfolk, Virginia and recruiting for candidates to fill program requirements in Glynco, Georgia (for FLETC) and Mt. Weather, Virginia (for FEMA).
- Increased the size of the contracting/procurement workforce for a net gain of 76 contracting professionals from 1,326 in FY 2009 to 1,402 (as of 10/31/2010).
- Issued 843 Program Manager (PM) certifications (all levels) in FY 2010, increasing the total number of PM certifications to 2,486 (from program inception through FY 2010).
- Issued 1,933 Contracting Officers Technical Representative (COTR) certifications in FY 2010, increasing the total number of COTR certifications issued to 10,213 (from inception through FY 2010).
- In addition to the courses received from the Federal Acquisition Institute and the Defense Acquisition University, the DHS centralized acquisition training program provided 52 separate course titles, 300 course offerings, with 8,900 seats. Also completed the program management courseware for the three levels of PM certification in support of DHS policies and the PM professional competencies.
- Expanded the acquisition workforce by finalizing DHS certification programs for the following career fields: Test and Evaluation, Logistics, and Business Cost Estimating and Acquisition Financial Management.
- Developed the Department's first full acquisition human capital plan, providing a baseline for annual plans to help identify the recruitment, hiring, training, and certification needs of the acquisition workforce.
- FEMA has focused on ways to strengthen its acquisition workforce for catastrophic disasters and has developed two new specialized acquisition teams to focus on areas of critical need. FEMA proposed the establishment of a Disaster Acquisition Response Team (DART) and a Local Business Transition Team (LBTT) to offer critical support during disaster response efforts. To date, FEMA has established a unique structure that will allow these specialized teams to function as a national asset while being embedded in Regions IV, VI, and IX. In addition to these regions, the LBTT will also be present in Region V. The DART will focus on the administration and closeout of disaster contracts. The LBTT will focus on the implementation of Section 307 of the Robert T. Stafford Act, which addresses increased use of local vendors to satisfy contracting needs.

Initiatives Underway and Planned
Building upon the 2010 and prior years' accomplishments and momentum, the OCPO will continue to build a skilled acquisition workforce in the following manner:

- Requested FY 2011 centralized funding to continue to build the acquisition intern program, known as the Acquisition Professional Career Program, by 100 full-time equivalents for a cumulative total of 300 by the end of FY 2011.
- Assist the Component acquisition offices in filling existing vacancies through centralized, targeted recruitment efforts.
- Continue to increase the knowledge, skills and abilities and close the competency gaps of the acquisition workforce through training and development. The DHS centralized acquisition training program will provide 70 separate course titles, 325 course offerings, with 10,000 seats available for certification and recertification, professional career development, and continuous learning opportunities. These classes will be in addition to those received from the Federal Acquisition Institute and the Defense Acquisition University.
- Establish a DHS consolidated Training and Development Center for conducting certification and recertification, professional career development, and continuous learning classes.
- Build the courseware for the three levels of the Test and Evaluation (T&E) certification program in support of DHS policies and the T&E professional competencies.
- Expand the acquisition workforce by finalizing the DHS certification program for the systems engineering career field.

Knowledge Management and Information Systems

DHS made "modest" progress in deploying an enterprise acquisition information system and tracking key acquisition data, and is in the process of deploying a Department-wide (enterprise) contract management system that interfaces with the financial system. Many procurement offices continue to operate using legacy systems that do not interface with financial systems. With ten procurement offices and more than $17 billion in annual acquisitions and procurement, DHS needs a consolidated acquisition system to improve data integrity, reporting, performance measurement, and financial accountability. In FY 2009, of the $14.2 billion in contract awards reported to FPDS, the contract writing systems interfaced to financial systems accounted for 64 percent of the dollars awarded and 76 percent of the actions awarded. For the one contract writing system lacking a financial system interface, internal controls for reconciliation monitoring have been implemented.

Additionally, the Department has made moderate progress to improve the accuracy and completeness of contract data in Federal Procurement Data System – Next Generation (FPDS-NG). This system is the only consolidated information source for analyzing competition on procurements and is relied on for reporting to the public and Congress. This year, we reviewed the integrity of reported acquisition data in FPDS-NG and found that the system earned a 94.5 percent accuracy rate.

FY 2010 Accomplishments
DHS has implemented a quarterly operational report with automated dashboards that provide data on areas such as competition, small business, workforce certifications, late payments, protests, claims, and undefinitized contract actions.

DHS OCPO developed a Procurement Enterprise Reporting Application (ERA). ERA provides near real-time reporting, produces dashboards and quality control metrics and facilitates data analysis of DHS contract data down to individual contract line items. ERA is presently interfaced with FPDS and Enterprise PRISM.

The OCPO initiated a data integrity project that proactively checks FPDS-NG data for anomalies. Once anomalies are identified, Components are notified and they take corrective action. This effort is improving overall data integrity and has been implemented in addition to the FPDS annual certification by OCPO, and the FPDS training provided by OCPO to the Components during FY 2010.

DHS OCPO implemented the Enterprise Procurement Information Center (EPIC), a collaboration portal that facilitates document, task, calendar, announcement, and link management. EPIC also provides business process automation through custom workflows and provides team and project sites for collaboration and training.

The OCPO completed migration from the National Institute of Health's Contractor Performance System (CPS) to DOD's Contractor Performance Assessment Reporting System (CPARS). Over 4,800 Federal DHS personnel were trained on contractor performance policies and regulations and CPARS system navigation and use.

The OCPO initiated a data integrity project that proactively checks FPDS-NG data for anomalies. Once anomalies are identified, Components are notified and they take corrective action. This effort is improving overall data integrity and has been implemented in addition to the FPDS annual certification by OCPO, and the FPDS training provided by OCPO to the Components during FY 2010.

OCPO will continue to expand EPIC functionality; institute a contractor performance assessment reporting verification and validation process; support the Transformation and Systems Consolidation (TASC) effort; institute additional data integrity checks in the Enterprise PRISM contract writing system; and, further automate the quarterly operational report so that, rather than a quarterly report, all data is real-time for use by the contracting activities and OCPO to monitor key areas and take proactive corrective action where needed.

<u>Initiatives Underway and Planned</u>
The OCPO has the following initiatives planned or underway:

- FPDS-NG data integrity reports will be run more frequently in search of anomalies and automatic notification of errors will be emailed to Component points of contact.
- OCPO will continue to expand EPIC functionality.
- OCPO will institute a contractor performance assessment reporting verification and validation process.
- The DHS Chief Financial Officer has initiated TASC to acquire an integrated financial, acquisition, and asset management solution to DHS. The TASC program office is finalizing all planning documents according to the Acquisition MD 102-01. The original Life Cycle Cost Estimate is being refined and a staffing plan was developed and continues to be refined to include the certifications, qualifications, and work experience levels of all staff required

to manage a program of the size and complexity of TASC. OCPO will continue to support the TASC effort.

Challenge #2: Information Technology Management

DHS has completed many activities in FY 2010 to significantly reduce many of the major information technology (IT) management challenges in creating a unified IT infrastructure for effective integration and agency-wide management of IT assets. The challenge for the Chief Information Officer (CIO) will be to continually review and update these and other activities based on improved governance, new technologies, revised management practices and guidance pertaining to IT Security Controls, IT Infrastructure Integration, Privacy Concerns, and Budget Oversight/Capital Planning and Investment Control.

Information Security Controls

FY 2010 Accomplishments
The DHS Chief Information Security Officer (CISO) completed the FY 2010-2014 Information Security Strategic Plan. It outlines how the Department will continue to provide information security to support DHS's mission and objectives and articulates the goals for the next five years. The strategic plan was developed collectively with the DHS Components, and outlines the goals, objectives, priorities, and initiatives at the enterprise and the Component levels. The plan emphasizes the use of improved governance and communications to mature the DHS information security program into a cohesive, coordinated, Department-wide "Team Security" program. It expands beyond Federal Information Security Management Act (FISMA) compliance to embrace enterprise services and improved business processes for developing and delivering enterprise security for the Department's mission technology.

The DHS Information Security Program focuses on enterprise security and collaboration between information security functions at all DHS Components. The Security Program goes beyond just Headquarters and the Information Security Office, encompassing Component security programs through the DHS Chief Information Security Officer (CISO) Council, serving as the governing body. The CISO Council consists of the DHS Headquarters, National Security Systems and eight DHS Components (CBP, FEMA, FLETC, ICE, TSA, USCG, USCIS and USSS).

The DHS CISO has designated four DHS Strategic Goals. These four goals are strategically and operationally the most important to achieve the overall DHS information security mission in the near term. These are:

- Goal 1: Strengthen Information Security Governance Framework;
- Goal 2: Improve Compliance Activities;
- Goal 3: Embrace Enterprise Services; and
- Goal 4: Enhance Business Acumen and Resource Allocation.

The Department continued to show improvements in FISMA compliance for the 677 operational systems in use in the Department, particularly in the areas of security controls testing, Privacy, Plan-of-Action and Milestones (POA&M) management, and focused security operations.

DHS improved the Department's classified cyber threat information processing capability and improved overall analytical capability to understand and respond to sophisticated threats. The CISO conducted in-depth technical reviews of the Department's IT systems to assess quality assurance and validate compliance with DHS security requirements. Additionally, the CISO implemented weakness remediation plan for operations systems by focusing on POA&M management.

Initiatives Underway and Planned
In FY 2011, continued improvement in the Department's classified cyber threat information processing capability and analytical capability is planned, as well as conducting in-depth technical reviews of the Department's IT systems. Implementation of the Information Security Strategic Plan will continue and provide the Department a secure and trusted computing environment based on risk management principals to effectively share information.

IT Infrastructure Integration

FY 2010 Accomplishments
In an effort to acquire and implement systems and other technologies to streamline operations within DHS Component organizations, DHS consolidated operations in two Enterprise Data Centers. These centers are secure, geographically diverse to enable disaster recovery, and engineered for redundancy (backup) and interoperability, permitting ample redundancy (backup) in the event of a disaster or other service disruption. As a core IT infrastructure service, enterprise data center services enable information sharing across Components while meeting critical mission requirements for the "One DHS Enterprise Architecture", minimizing infrastructure costs and enhancing the disaster recovery posture of the Department.

DHS established a Trusted Internet Connection (TIC) at each Enterprise Data Center thereby reducing the number of internet access points. The Trusted Internet Connection effort simplifies management standardization of information security controls across the DHS infrastructure, reducing multiple points of vulnerability, improving response, enhancing forensics capabilities, and reducing cost. This is a major step in the DHS wide area network consolidation (OneNet) and demonstrates significant progress towards OMB's Trusted Internet Connection goals. All Continental United States OneNet Wide Area Network Circuits were transitioned to Networx.

Initiatives Underway and Planned
The Department has the following initiatives planned or underway:

- In FY 2011, DHS will add new infrastructure capabilities and continue the consolidation to the DHS Enterprise Data Centers and OneNet. In June 2011, DHS will deploy Policy Enforcement Points as a way of ensuring Component security information requirements are maintained while migrating all the Components behind the TIC infrastructure. A High-Assurance Gateway will be used to handle exemptions needed to enforce a strict security policy. Consolidating Network Switching Nodes into the data centers and adding a reverse proxy capability as a means for protecting applications outside the TIC are also part of the FY 2011 plan for OneNet.
- Email infrastructure is also undergoing a major transformation as DHS creates two Enterprise Secure Message Gateways, one at each Enterprise Data Center, and

decommissions the single gateway currently servicing the DHS. The dual gateways will provide the necessary capacity and redundancy (backup) to ensure this important application serves the DHS customer needs for the foreseeable future. In FY 2011, DHS Components will begin migrating to the DHS Email as a Service (EaaS) offering. EaaS provides a cost-effective, scalable and fully redundant infrastructure capable of supporting the entire Department's email requirements.

- DHS Office of the Chief Information Officer (OCIO) will continue to upgrade and modernize key business applications, and establish a secure, utility computing environment for deploying mission and enterprise capabilities. This approach is consistent with private sector and OMB's direction to move toward cloud services to improve IT security and gain operational efficiencies.
- Additionally, DHS will continue to address Component disaster recovery capabilities within and between enterprise data centers.

Information Sharing with Partners

<u>FY 2010 Accomplishments</u>
The DHS OCIO updates the Enterprise Architecture on a continual basis to ensure standards, specifications, and technologies that collectively support the secure delivery, exchange, and construction of business and application components (service components) are current. The National Information Exchange Model (NIEM) will continue to develop as the standard for information exchange internal and external to the Department supporting law enforcement, intelligence and emergency management missions at all levels of government.

Since FY 2008, DHS has been serving as the lead Program Management Office and Executive Director of the NIEM program for the U.S. Government and its state, local, tribal and private sector partners. As the current steward for the NIEM program office, DHS is deeply committed to the institutionalization of NIEM across the Department and with its international, state, local, tribal and private sector partners. DHS's significant growth in the utilization of standards and data sharing is consistent with the President's National Strategy for Information Sharing.

The Enterprise Data Management program continues to provide the architecture and governance for the understanding of data assets within and across the Department. This program supports the development of the Department-wide roadmap for data to improve mission effectiveness and efficiency, eliminating existing stovepipe data systems, and increasing interoperability and information sharing. Data architecture is the key governance tool to assure that mission needs drive technology investments. Additionally, through the use of data architecture practices Data Reference Model, the Enterprise Data Management Office (EDMO) is expected to recommend realignment of IT investments or acquisitions through the identification of targets at an estimated reduction of $10 million in annual IT costs by reducing the systems under maintenance, or driving common requirements for the development of centralized services.

EDMO's program plans integrate information sharing requirements and enable access across all levels of government, first responders, and stakeholders in the private sector through the use of the NIEM, a common vocabulary and process for the development of Information Exchanges such as the Nationwide Suspicious Activity Initiative Report standard. The development of these information exchanges requires collaboration with DHS Components and external partners and articulates clear business rules and user access guidelines that ensure secure information sharing.

Initiatives Underway and Planned

DHS will continue expansion and use of NIEM for data exchanges with state and local partners, and roll out a formal NIEM training curriculum to the Department to meet the needs of diverse stakeholders. Additionally, DHS plans to increase the rate of NIEM adoption to 90 percent for all new development in the major DHS IT Level 1 and 2 Programs.

Privacy Concerns

FY 2010 Accomplishments

DHS's efforts to address privacy concerns while integrating its myriad systems and infrastructures demonstrate that privacy and information security are closely linked, and strong practices in one area typically supports the other. In fact, security is one of the Fair Information Practice Principles. To that end, the CISO works closely with the Privacy Office to monitor the privacy requirements under the FISMA.

The DHS FY 2008 Information Security Performance Plan was updated to further improve the quality of the DHS Certification and Accreditation process and included the addition of Privacy as one of the key process areas. The FISMA scorecard was updated to include a status of systems requiring privacy related Privacy Impact Assessments (PIA) and/or System of Records Notice (SORN) records. The privacy metrics are designed to provide the status of completed PIAs or SORNs for those systems requiring such information. The metric is not applied to systems other than those designated by the Chief Privacy Officer as sensitive privacy systems.

On a quarterly and annual basis, DHS reports to OMB its progress in conducting PIAs and issuing SORNs for IT systems that are required to go through the FISMA Certification and Accreditation. At the end of the FY 2007 reporting period, October 1, 2007, DHS conducted PIAs on 26 percent of the IT systems that required PIAs and 66 percent of the IT systems were covered by a SORN. As of August 31, 2010, DHS improved its FISMA privacy numbers to 70 percent for PIAs and 94 percent for SORNS.

One of the requirements for protecting privacy sensitive systems is the process of authorizing, approving, and tracking personal identifiable information extracts from DHS systems. In response to this requirement, the DHS Privacy Office established a Data Extracts Working Group. The group, made up of privacy personnel from various Components, is developing a set of Standard Operating Procedures to establish uniform practices throughout the Department for authorizing, approving, and tracking data extracts.

The Privacy Office is also working with the Screening Coordination Office, Office of the CIO, Office of General Counsel and Intelligence and Analysis to conceptualize the framework requirements for a more secure and controlled Information Sharing Environment. This Information Sharing working group conducted assessments of SORNs for ten highly requested data sets as well as a series of fact finding interviews for the users of these same data sets in order to develop a set of policy and technology recommendations. These recommendations will help drive additional privacy and security controls for information sharing to DHS and external partners and provide input to the DHS Information Sharing Governance Board for continuing this effort and piloting a proof of concept for the Controlled Homeland Security Information Environment.

Accessibility Concerns
Ensuring that employees and customers with disabilities have equal access to information and data is important to meeting the DHS mission. Integration of Section 508 compliance into IT governance activities and decision-making processes is the key strategy DHS is currently using to ensure that moving forward, all IT systems are, in fact, accessible according to the Section 508 Electronic and Information Technology Standards.

Accessibility is also being integrated into the FISMA processes so that a full compliance picture can be developed. Additionally, quarterly Web compliance reporting, standardized accessibility testing procedures, associated educational products, and subject matter expert technical assistance services have been implemented to guide all information and data-related products towards full Section 508 compliance.

Initiatives Underway and Planned
In FY 2010, DHS plans to continue efforts to ensure electronic information and data are fully accessible to members of the public and employees with disabilities by developing an enterprise-wide tracking system for accessibility-related activities and information. DHS will continue efforts to define additional privacy and security controls for improved information sharing for DHS and external partners to highly requested DHS data sets.

Additionally, in FY 2011 DHS plans to assist the Program Manager for the Information Sharing Environment with the development of a NIEM-based functional standards for the process of automating and standardizing Request-for-Information/Request-for-Action) as well as the identification of Privacy Attributes for Personally Identifiable Information within NIEM.

Budget Oversight/Capital Planning and Investment Control

FY 2010 Accomplishments
In FY 2010, DHS developed NIEM information exchanges for the OMB E-Government IT Dashboard to standardize Capital Planning and Investment Control data elements across Federal agencies. In FY 2010, DHS delivered to OMB NIEM exchanges for agency Exhibit 53 and Tech Stat submissions.

At the request of Deputy Secretary Lute, the DHS CIO initiated a Department-wide Portfolio Review of all major IT investments to support the FY 2012-2016 Program Budget Review. To promote effective alignment of IT resources, it is critical that the Department evaluate IT resource allocation plans from a portfolio perspective. There are Department-wide, systemic challenges in effectively managing existing large IT programs, balancing investments in new capabilities against infrastructure, and effective reuse of IT systems and capabilities across Components. With a candid, transparent, and open dialog amongst Components, we can better ensure that the budget will deliver value for the resources expended while trimming costs, streamlining operations, eliminating duplication, and leverage capabilities across the enterprise.

A series of reviews was held concentrating on similar Component investments over the month of July 2010 to address portfolios of IT programs. Component leadership participated and articulated the mission effectiveness and status for each existing or planned program. As a result of these reviews, Resource Allocation Decision recommendations were provided to DHS leadership.

The IT Acquisition Review process has resulted in 444 IT acquisition requests and over $6.3 billion in requests being reviewed by the Enterprise Review Board to validate alignment to the Homeland Security Enterprise Architecture improved security and accessibility requirements through introduction of specific, contractually binding language; the improved progress of the Wide Area Network consolidation into DHS OneNet, and accelerated transition to the DHS's consolidated Data Centers. Planned accomplishment for FY 2010 support the Quadrennial Homeland Security Review (QHSR), are consistent with the direction expressed in OCIO Strategic Plan for FYs 2009–2013 and align with DHS mission priorities.

OMB recently identified three DHS programs for the Federal-wide High Risk List. OCIO assisted the programs with developing their Remediation Plans. Since the launch of the OMB IT Dashboard in July 2009, DHS has been updating the milestones on a monthly basis, and is developing a process for periodic review by the CIO during FY 2011 for all major IT programs.

Initiatives Underway and Planned

The DHS OCIO is working to ensure E-Government initiative alignment to the DHS Segment Architecture Methodology, the Program Management Center of Excellence standards and best practices, and the Enterprise Portfolio Governance Structure. Additionally, DHS through stewardship of the NIEM Program Objective Memorandum, will deliver a new standardized NIEM-based information exchange that allows for all Federal agencies to deliver information on the OMB Exhibit 300 in an efficient and easy to use manner.

Challenge #3: Emergency Management

FEMA's mission is to support citizens and first responders to ensure that as a nation we work together to build, sustain, and improve our capability to prepare for, protect against, respond to, recover from, and mitigate all hazards. The *Post-Katrina Emergency Management Reform Act of 2006* (Post-Katrina Reform Act), enhanced FEMA's authority, and gave it primary responsibility for the four phases of comprehensive emergency management: preparedness, response, recovery, and mitigation. The challenge for FEMA is to improve progress in three key areas: logistics, housing, and mitigation.

Disaster Sourcing: Develop and implement Single Point Ordering process

FY 2010 Accomplishments

The Single Point Ordering (SPO) concept was field-tested during the 2007 California fires; however, it has not yet been fully implemented with formalized, standardized processes throughout FEMA. SPO is defined as an agency-wide integrated process to centralize, manage and track resource orders for disaster supplies, equipment, personnel, teams and services. After several Focus Groups, FEMA conducted a three-day pilot Single Point Order Tracking (SPOT) Practitioner's Course during April 27–29, 2010. The class was made up of 20 students representing FEMA Joint Field Office positions such as Ordering Unit Leader, Logistics Section Chief, Mission Assignment Coordinator, Finance/Administration Section Chief, Human Resources Specialist, and a U.S. Army

Corps of Engineers (ESF #3) and Mass Care (ESF #6) representative. This resulted in refinement of SPOT business processes and a draft SPOT FEMA Directive (FD 145-2).

Initiatives Underway and Planned
The SPOT FEMA Directive 145-2 is currently in staffing. Subsequent to issuance of the SPOT Directive, a SPOT Operating Manual will be staffed and published providing more detailed business processes. These defined business processes will drive and refine the requirement for automated support.

Emergency Management – Housing

FY 2010 Accomplishments
FEMA restructured the Annual Disaster Housing Plan incorporating a new strategic direction. Now titled The Disaster Temporary Housing Operational Guide, the document describes FEMA's approach to working with Federal partners, states, territories, tribes, voluntary agencies, local communities, and individual disaster survivors to prepare for and respond to disaster-related sheltering and temporary housing needs. This guide is based on key concepts that are further defined in the *National Disaster Housing Strategy* and supersedes the 2009 Disaster Housing Plan and all previous Disaster Housing Plans.

FEMA awarded contracts to five manufacturers to produce Motor Homes (MHs) and Park Models (PMs) meeting FEMA's stringent specifications. The first task order was issued in November 2009 to meet the minimum order obligation of the Government. These IDIQ contracts are composed of five one-year options with a contractual ceiling to manufacture up to 135,000 MHs and PMs. These units can be either standard units or Uniform Federal Accessibility Standards (UFAS) compliant units to meet the diverse needs of the disability community.

In FY 2010, FEMA continued to identify and evaluate alternative housing units through the Joint Housing Solutions Group (JHSG). The group is comprised of housing and building science experts from FEMA, the U.S. Department of Housing and Urban Development (HUD), the DHS Office of Health Affairs, and private sector partners, including the National Institute of Building Sciences. The JHSG completed an initial assessment of numerous candidate alternative units, culminating in the award of two competitive contracts for nine different models (six units in 2009 and three units in 2010).

During FY 2010 FEMA continued to work closely with HUD to evaluate the effectiveness of the Disaster Housing Assistance Program pilot as an alternative to long term direct housing. This pilot program leverages the local public housing agencies to help displaced eligible applicants locate rental housing in and around the damaged communities.

Initiatives Underway and Planned
In FY 2010 JHSG completed a one year report on the first six units against four critical factors: timeliness, livability, range of use and cost. In 2011, JHSG will be evaluating and providing a report on the performance of the three most recent units. These efforts continue to provide valuable information on housing units and operations, critical for our ability to recommend housing unit and operations solutions.

Through the JHSG and Uniform Federal Accessibility Standards Units, FEMA will finalize review and analysis of the current projects and work to identify benefits of these programs to incorporate into FEMA's current procurement strategies. These efforts will support the timely delivery of temporary emergency housing to disaster survivors.

Mitigation: Develop integrated national hazard mitigation strategy

FY 2010 Accomplishments
The Federal Insurance and Mitigation Administration (FIMA) initiated steps to develop a Federal Insurance and Mitigation Strategic Plan.

Initiatives Underway and Planned
FIMA will utilize ongoing activities to develop a National Mitigation Strategy. These activities will include the National Emergency Management Association (NEMA) White Paper on Mitigation, the FIMA Strategic Plan and the results of the National Flood Insurance Program (NFIP) Reform workgroup.

The Federal Insurance and Mitigation Strategic Plan will be based on the following Strategic Direction:

- FIMA will effectively use science, technology, social media and communication programs to provide timely, accurate and relevant information in order to enhance the credibility of FIMA's work and mission. These strategies must reflect FEMA's core values of integrity, respect, compassion and fairness.
- FIMA will clearly communicate as we deliver on our mission to engage the public, the private sector, Government agencies, and our FEMA colleagues in understanding the natural hazard risks and strategies to buy down those risks.
- FIMA will holistically integrate sustainable hazard mitigation in the context of other community environmental and economic sustainability objectives, both pre and post disaster. By improving efforts to orient our programs towards community mitigation engagement in the management of future development decisions, FIMA will foster long-term mitigation strategies to reduce losses and assist communities and the nation in protecting from unnecessary future disaster impacts.

Improve local hazard mitigation planning process

FY 2010 Accomplishments
The *Disaster Mitigation Act of 2000* (Pub. L. 106-390) amended the Stafford Act to establish specific requirements for state and local hazard mitigation plans. Today, most states, major counties, and cities have active mitigation plans in place. During FY 2010, the FIMA, Risk Analysis Division, accomplished the following: (a) increased resources committed to mitigation planning through contractual assistance for plan reviews, training and technical assistance; (b) integrated mitigation planning into the RiskMAP life cycle to provide direct technical assistance to local communities engaged in new flood mapping activities; (c) focused on risk awareness as a communication and outreach goal of RiskMAP for mitigation planning; and (d) published *Hazard Mitigation: Integrating Best Practices into Planning* with the American Planning Association to provide guidance to local community planners on mitigation in local comprehensive plans. FIMA

is also developing an online training course to expand reach of mitigation planning training to the 19,000+ communities that are due to update their plans in the next few years.

Initiatives Underway and Planned
FIMA is revising the plan review process to ensure consistency in plan reviews and to focus approved mitigation plans on measurable mitigation strategies and implementation. FIMA is also initiating FY 2011 RiskMAP projects to include mitigation planning technical assistance direct to communities engaged in new flood risk studies. A plan is also underway to develop a new metric to measure actions that result from RiskMAP projects for communities with mitigation plans that identify flood risks.

Improve hazard mitigation outcomes

FY 2010 Accomplishments
State and local mitigation plans have demonstrated continuous improvement in mitigation programs through regularly scheduled updates. Almost 18,000 jurisdictions (66 percent of the Nation's population) currently have approved mitigation plans, and all States either have completed or are on target to complete plan updates, including nine States that currently have Enhanced Mitigation Plans that demonstrate a higher level of commitment to mitigation. FEMA has reconciled and clarified over 140 policy memos issued since the early 1990s, and integrated them into a streamlined guidance document that provides annual program guidance for the five hazard mitigation assistance programs.

Initiatives Underway and Planned
In FY 2011, FEMA will review its plan review process to ensure consistency in plan reviews and to focus approved mitigation plans on measurable mitigation strategies and implementation. Newly initiated FY 2011 RiskMAP projects will include mitigation planning technical assistance direct to communities engaged in new flood risk studies. RiskMAP also will monitor mitigation actions in communities with mitigation plans that identify flood risks.

FEMA is assisting NEMA to help advance the key recommendation described in its White Paper, which is to initiate a National Mitigation Alliance. This alliance will identify impediments and solutions to implementation of mitigation strategies at the state, tribal, and local levels. The Alliance will begin meeting in November 2010.

Challenge #4: Grants Management

FEMA assists communities in responding to and recovering from terrorist attacks and disasters. FEMA provides disaster assistance to communities through the Public Assistance Grant Program, the Hazard Mitigation Grant Program, and the Fire Management Assistance Grant Program. FEMA also awards grants to state and local governments; territories; tribal governments; and private, public, profit, and nonprofit organizations to enhance preparedness, protection, response, recovery, and mitigation capabilities throughout the Nation. The challenge for FEMA is to improve FEMA's grants management and oversight infrastructure to ensure effective monitoring of grantees.

<u>FY 2010 Accomplishments</u>

In FY 2010, the Grant Programs Directorate (GPD) took the following actions in the area of grants management, increasing emphasis on the effective monitoring of FEMA's grants recipients as well as its oversight structure:

- Launched the multi-year Programmatic Grants Monitoring Improvement Initiative in FY 2010 in an effort to expand and enhance programmatic monitoring capacity. The initiative has expanded both the breadth and depth of monitoring activities, as well as forming comprehensive plans for the future growth of grants monitoring at FEMA.
- Expanded monitoring activities from three to seven grants programs in spring 2010. The programs monitored include:
  - Homeland Security Grant Program;
  - Transit Security Grant Program;
  - Emergency Management Performance Grant Program (EMPG);
  - Port Security Grant Program;
  - Intercity Bus Security Grant Program Intercity Passenger Rail (IPR – Amtrak) and Freight Rail Security Grant Program; and
  - Trucking Security Program.

In the area of systems development, GPD's Non-Disaster (ND) Grants system is complete for functionality that supports application submission through award package creation. GPD has conducted targeted communication and outreach activities to key stakeholder groups. In conjunction with the OCIO, GPD researched other grants management systems and documented lessons learned. Stakeholder feedback was gathered via one-on-one interviews and focus groups to design a system that would be flexible, user-friendly, and have functionalities needed to effectively manage stakeholders' grant programs.

GPD is enhancing its oversight infrastructure as well through increased regional management of grant awards. FEMA regions are currently responsible for all programmatic and business management functions for the EMPG, Drivers' License Security Grant Program, Emergency Operations Centers (EOC) and Regional Catastrophic Grant Program grants from award to closeout. The regionalization of these grants has improved the grantee's ability to quickly implement projects related to these awards, as these grantees have long established relationships with the FEMA regions from their work in Mitigation and Disaster Response and Recovery. The regions have also been responsive to the grantee's immediate needs in regards to programmatic and budget approvals, grant extensions, the completion of Grant Adjustment Notices and Environmental and Historic Preservation (EHP) reviews.

<u>Initiatives Underway and Planned</u>

GPD's monitoring plans envision grants monitoring as a systematic year-round effort that spans the grants lifecycle, is applied to all preparedness grant programs in GPD's portfolio, and is fully coordinated among program, financial and other monitoring activities. Implemented by both FEMA Headquarters and Regions, the lifecycle approach efficiently extracts monitoring-related information from existing year-round grants management activities and uses it to supplement more traditional, episodic monitoring activities (e.g., monitoring site visits). Using this approach, the initiative has designed a standard set of monitoring activities that can be prioritized and implemented based on grantee and program need. Data collected through these monitoring activities is combined and centrally stored to create a comprehensive monitoring record that can be examined to proactively resolve common challenges experienced by grantees and to uncover opportunities to improve GPD's own administrative effectiveness and efficiency.

In fall 2010, monitoring will be introduced for the:

- Tribal Homeland Security Grant Program, and the
- EOC Grant Program.

Thus, within the next month, GPD will have monitoring protocols and content in place to monitor 68.12 percent of the total grant funding expended from FY 2006–2009, as well as the foundation for facilitated expansion of monitoring to additional programs. We look to continue expanding our monitoring efforts into FY 2011 and beyond.

GPD's programmatic monitoring data is currently collected in a centralized Access database application that allows for cohesion among and data analysis across grant programs. The centralized nature of the database also allows for facilitated data sharing and analysis of data over time. In fall 2010, the Grants Monitoring Improvement Initiative will also begin to transition monitoring data to a web-based environment that will allow for greater ease of use, more sophisticated analytics, and greater data coordination with other reporting efforts. When fully implemented, this approach will enable a nimble, cost-effective, and well-integrated grants information management strategy that will facilitate proper grants management practices, verify that grant funds are administered in accordance with the guidance issued to grantees, mitigate improper use of grant funds, and provide valuable information to GPD as it seeks to maximize the value and effectiveness of its preparedness grants portfolio.

The functionality offered within ND Grants will provide FEMA with a flexible system that can quickly adapt to changing business needs. ND Grants will accomplish the following:

- Support the entire grants management life cycle from application to closeout.
- Provide real time acknowledgement of information as well as notify FEMA employees and grantees of pending actions.
- Offer integrated reporting that effectively measures award outlays and demonstrates how awards tie.
- Provide a user friendly interface that clearly highlights pending actions to be completed.
- Automate and standardize processes to manage the entire grants management lifecycle.
- Collect grant data in a structured, searchable format allowing data manipulation and customization for preparation, analysis, and reporting.

GPD plans to expand upon the progress that is underway while continuing to improve our grants monitoring infrastructure. Actions planned include:

- Continued expansion of monitoring activity to another two to three preparedness grant programs.
- Alignment of monitoring data with GPD internal controls and performance metrics to provide for accurate, ongoing evaluation of monitoring performance.

- Working to incorporate the monitoring database into the Grants Reporting Tool, allowing for greater cohesiveness with other grant administrative processes and a more holistic information management system.
- Updating monitoring content and protocols for all currently monitored programs and working to monitor these programs against expanded requirements (e.g., (EHP)).

Challenge #5: Financial Management

FY 2010 Accomplishments

DHS has made significant progress improving internal controls over financial reporting. From FY 2005–2010, DHS has reduced the number of audit qualifications from 10 to 1 and Department-wide material weaknesses in internal controls over financial reporting by more than half. The number of Component conditions contributing to material weaknesses has gone from 25 to 9.

In FY 2010, DHS ended the practice of conducting stand-alone audits at the Components—except for CBP because of its significant revenue activities—and is focused on getting a qualified audit opinion on the Consolidated Balance Sheet by FY 2011. Component standalone audits at the Department served their purpose in successfully demonstrating that strong controls exist within the individual reporting entities of DHS Financial Management. Moving forward, there will be tremendous long-term value to standardizing processes DHS-wide, rather than building individual Component financial reporting capabilities, and in focusing our efforts on managing risk.

We still face challenges, but made significant progress in strengthening internal controls and implementing corrective actions within several key financial management areas. In FY 2010, the Department:

- Performed targeted risk assessments to identify weaknesses in accounting and financial reporting and developed and implemented Mission Action Plans for those high-risk areas. Monitoring of implementation and effectiveness is ongoing.
- Has made significant progress in ensuring controls are in place to prevent Antideficiency Act violations related to FY 2010 activity.
- Addressed financial management and business process challenges and shared best practices and lessons learned by identifying subject matter experts in critical risk areas and leveraging their expertise through cross-Component working groups. In addition, DHS updated its "Component Requirements Guide," which contains approximately 40 standard financial reporting processes.
- Analyzed the skill sets of essential financial management personnel and developed a plan to improve core competencies in key financial management areas.
- Substantially completed the Financial Management Policy Manual, which is designed to ensure DHS maintains efficient and transparent operations and our resources are not vulnerable to waste, fraud, and mismanagement.
- Provided training to all new employees in the DHS financial management community to develop a common set of core competencies, including the responsibilities of all financial managers to support and reinforce strong internal controls and the principles of fiscal law.

Components have worked hard to implement corrective actions and as a result have made good progress in key financial management and internal control areas.

- In FY 2010, the U.S. Coast Guard can assert to the following balance sheet items: Investments, Legal Liabilities, Actuarial Pension Liabilities, Actuarial Medical Liabilities, Operational Materials & Supplies (OM&S), and Fund Balance with Treasury – Payroll. Most significant, U.S. Coast Guard can assert to more than $43 billion in actuarial pension and medical liabilities. U.S. Coast Guard will continue to execute its strategic plan to assert to all balance sheet items in FY 2011, with a focus on Accounts Receivable, Accounts Payable, Environmental Liabilities, FBwT and PP&E. These assertions will better position the Department to obtain a qualified balance sheet opinion in FY 2011.
- USCIS, ICE, and NPPD corrected—and CBP reduced the severity of—deficiencies that contributed to the Department's PP&E and OM&S material weakness condition by implementing new policies, better processes, and strong internal controls. Additional personnel and new processes also helped CBP correct its deficiency condition in Financial Management and Reporting.
- New controls and processes helped TSA eliminate its audit qualification for PP&E and reduce the severity of its material weakness condition in Financial Reporting. TSA remediated three prior deficiency conditions by improving the control environment for IT Controls, Actuarial and Other Liabilities, and Other Entity Level Controls.
- FEMA reduced the severity of its deficiency condition in Financial Management and Reporting by improving the accuracy of key estimates, completing data cleanup, and improving data entry and field issues within the Integrated Financial Management Information System. FEMA also developed control procedures for Treasury Information Executive Repository and General Ledger reconciliations.

The Department is proud of these accomplishments and acknowledges the resolve and leadership of our financial management community. Over the years, Department-wide efforts provide case studies with five consistent critical success factors for accomplishing corrective action results:

- Engaged leadership that involves staff at all levels across business lines of the organization in internal control.
- Developing a good corrective action plan with clearly defined outcomes and a critical path to those outcomes.
- Availability of adequate resources for the successful execution of corrective actions.
- Consistent execution supported by disciplined project management.
- Confidence that corrective actions are credible due to the verification and validation of results through test of design and operational effectiveness.

<u>Initiatives Underway and Planned</u>
While we have made progress, we recognize that significant internal control challenges remain, largely at U.S. Coast Guard. The Department's Chief Financial Officer is actively engaged with senior management and staff at each Component, overseeing corrective actions to ensure continued progress across the Department.

DHS is committed to good stewardship of taxpayer dollars, and to demonstrating that commitment by obtaining an opinion on the Consolidated Balance Sheet. In support of that goal, the Department will:

- Work with the U.S. Coast Guard as it implements the corrective actions in the Financial Strategy for Transformation and Audit Readiness planned for FY 2011 and beyond.
- Continue targeted risk assessments to identify and remediate weaknesses in accounting and financial reporting.
- Implement a modernized financial management system and establish standard business processes to ensure DHS sustains its progress. Progress that relies on manual processes may not be sustainable without a modernized system. In the interim, DHS will continue to implement compensating controls designed to help ensure completeness, accuracy, authorization, and validity of financial transactions.

Challenge #6: Infrastructure Protection

DHS works closely with Federal partners and the private sector to deter threats, mitigate vulnerabilities, and minimize incident consequences for all Critical Infrastructure and Key Resources (CIKR).

Furthermore, the protection of the Nation's cybersecurity has been identified by the OIG as a challenge that requires the development of a comprehensive strategy and management plan that identifies areas needing improvement and the development of a comprehensive information sharing and collection environment.

Infrastructure Protection

FY 2010 Accomplishments

The National Infrastructure Protection Plan (NIPP) CIKR Sector Partnership has facilitated the regular meeting and operation of inter-agency, inter-modal, inter-discipline sector, and cross-sector working groups to address issues such as cybersecurity, surface transportation security risk assessments, and electric-telecommunications interdependencies and incident coordination. Many of these activities have been organized through the Government Coordinating Councils (GCC), which represent inter-agency forums for identification of common or overlapping issues or programs that require coordination. An increase in meetings and updating of charters confirm the commitment to the Partnership and the value of programs and initiatives supported by the Partnership councils. The following accomplishments were seen in FY 2010:

- 611 sessions, including the GCC/Sector Coordinating Councils (SCC), Critical Infrastructure Partnership Advisory Council (CIPAC) Plenary, and working group meetings were held.
- Seven Councils (GCC/SCC) updated their charters.
- The CIPAC charter was renewed for another two years.
- The National Infrastructure Advisory Council charter was renewed for another two years.
- The Energy Sector completed a roadmap to identify and set NIPP implementation goals and priorities.

Increasing the reach of the partnership enables CIKR partnerships to become an interlocking, well-coordinated network of mutually supportive and sustainable relationships containing all key CIKR stakeholder elements. In the reporting period, the partnership:

- Enhanced communication, targeting specific disciplines such as State Homeland Security Advisors, State Emergency Management Directors, and State Critical Infrastructure Protection Managers to facilitate two-way collaboration on Infrastructure Protection (IP) mission issues of common interest.
- In collaboration with The Conference Board, issued "Protecting Critical Infrastructure: A Cross-Border Action Plan" (November 2009), which proposes a plan for Canada-U.S. collaboration. It recognizes that both countries have extensive plans in place for protecting CIKR and supports a plan at a regional, cross-border level that is aligned with the national plans.
- In partnership with Verizon Business, the U.S. Secret Service published a study focusing on data theft, security breaches, and cyber-crime trends. The report provides an easy to understand study, containing metrics and statistics that underscore critical IT security and general risk-mitigation information. The main objective of the study is to help expand the collective understanding of breaches and continue to augment advanced detection and prevention efforts. Its list of key recommendations and lessons learned from both Secret Service cases and Verizon cases, spans the spectrum of both public and private sectors, and is applicable anywhere in the world. This report was released to the public on July 28, 2010.

Initiatives Under Way and Planned
IP has instituted a major initiative to incorporate the CIKR Information Sharing Environment into the Nation's fusion centers, with the pilot completed in northern California in the first quarter of calendar year 2010. This dovetails with continued effort to increase the reach of the partnership to enable CIKR partnerships to become an interlocking, well-coordinated network of mutually supportive and sustainable relationships containing all key CIKR stakeholder elements. Part of the effort included the creation of and continued sponsoring of the CIKR Alliance Network that leverages trade associations and subject matter experts to enhance communication in the field and increase participation on Sector Partnership activities.

NPPD received the OIG draft report "Protective Security Advisor Program Efforts to Build Effective Critical Infrastructure Partnerships: Oil and Natural Gas Subsector" in mid-August. An initiative underway during the audit fieldwork creates new performance metrics based on established program goals and objectives aligned with IP, NPPD, and DHS goals and objectives as articulated in the DHS QHSR and Bottom-Up Review.

Understanding that the Protective Security Advisor (PSA) Program has grown and matured since its inception to become a focal point for IP activities and interaction with state, local, tribal, territorial and private sector partners, new metrics have been developed to better capture the program's impact on securing the Nation's critical infrastructure. The Protective Security Coordination Division, which operates the PSA Program, is using 180-day assessment follow-up interviews to capture data on how the PSAs, IP, NPPD and DHS as a whole are "buying down risk" for the Nation's critical infrastructure owners and operators, and demonstrating progress in protecting critical infrastructure. This implementation data is being used to develop qualitative metrics for the PSA Program that demonstrate how PSA activities contribute to PSA Program, IP, NPPD, and DHS critical infrastructure protection and resilience goals and objectives.

Cybersecurity and Communications

FY 2010 Accomplishments

Recently, the United States Computer Emergency Readiness Team (US-CERT) developed and began distributing to an initial set of agencies a Department and Agency Cybersecurity Activity Report that helps each agency understand its EINSTEIN 2 activity in the context of the larger, consolidated dataset of ongoing attacks and threats across the Federal Executive Branch civilian agency enterprise. EINSTEIN is the automated process for collecting, correlating, analyzing, and sharing computer security information across the Federal Government to improve our Nation's situational awareness. Moreover, a product that summarizes Government-wide EINSTEIN 2-related activity and other cyber information across Federal Executive Branch civilian agencies was developed and its distribution to all partner agencies began on a weekly basis in August 2010. To better perform its operations, US-CERT increased its staff to 56 people with another 28 people selected and currently in the hiring pipeline (i.e. the security clearance and suitability process). Hiring actions also have been taken with respect to another 14 US-CERT positions.

Initiatives Under Way and Planned

US-CERT is preparing a strategic plan and developing corresponding performance measures. Additionally, US-CERT is developing a comprehensive performance management plan which builds on the strategic plan's performance measures to ensure accountability while identifying successes and areas for improvement. US-CERT began using an operational draft concept of operations and will update this document upon approval of the strategic plan, as US-CERT implements lessons learned during ongoing exercises and as the National Cybersecurity and Communications Integration Center reaches full operational capability. In addition, US-CERT is developing a comprehensive information sharing and collaboration environment as part of the EINSTEIN program to support continuous communications concerning cybersecurity vulnerabilities and indicators. This portal, which will incorporate direct input from partners and constituents, is slated to provide access to near real-time analysis reports derived from EINSTEIN 2 data, incident handling services, data analysis tools, and collaboration mechanisms (e.g. wiki services, instant messaging, and virtual meeting capabilities). A prototype was demonstrated at the Government Forum of Incident Response and Security Teams National Conference held in San Antonio, Texas August 15-20, 2010, which brings together technical and tactical practitioners of security response teams responsible for securing Government information technology systems. In addition to the comprehensive information sharing and collaboration environment, a cyber threat correlation tool is being implemented for US-CERT to improve its ability to provide agencies with actionable cyber vulnerability analysis.

Challenge #7: Border Security

Strengthening security at the border with additional personnel and resources

FY 2010 Accomplishments
DHS prevents and investigates illegal movements across our borders, including the smuggling of people, drugs, cash, and weapons. The Southwest Border Initiative, which began in March 2009 and continued through 2010, is a series of unprecedented steps to crack down on Mexican drug cartels by deploying additional personnel and technology, increasing information sharing, working closely with the Mexican government, and improving Federal coordination with state, local and tribal law enforcement authorities.

Over the past twenty one months, DHS has dedicated historic levels of personnel, technology, and resources to the Southwest border. Today, the Border Patrol is better staffed than at any time in its 86-year history, having nearly doubled the number of agents from approximately 10,000 in 2004 to more than 20,500 in 2010. ICE has increased the number of Federal agents deployed to the Southwest border from 3,034 in FY 2008 to approximately 3,300 in FY 2010, and currently has a quarter of all its personnel in the Southwest border region—the most ever. Since March 2009, DHS has doubled the number of personnel assigned to Border Enforcement Security Task Forces; increased the number of ICE intelligence analysts working along the Southwest border focused on cartel violence; quintupled deployments of Border Liaison Officers; and begun screening 100 percent of southbound rail shipments for illegal weapons, drugs, and cash – for the first time ever. DHS has also deployed additional canine teams trained to detect drugs and weapons and non-intrusive inspection technology that helps to identify anomalies in passenger vehicles at the Southwest border. Furthermore, DHS has completed 649 miles of fencing out of nearly 652 miles mandated by Congress, including 299 miles of vehicle barriers and 350 miles of pedestrian fence, with the remaining 3 miles scheduled to be complete by the end of the calendar year.

These initiatives and investments have yielded impressive results. Seizures of contraband along the Southwest border have increased across the board under the Obama administration and illegal crossings continue to decline. In fiscal years 2009 and 2010, CBP seized more than $104 million in southbound illegal currency—an increase of approximately $28 million compared to 2007–2008. Further, in fiscal years 2009 and 2010, CBP and ICE seized more than $282 million in illegal currency, more than 7 million pounds of drugs, and more than 6,800 weapons along the southwest border—increases of more than $73 million, more than 1 million pounds of drugs and more than 1,500 weapons compared to 2007-2008. Additionally, nationwide Border Patrol apprehensions of illegal aliens decreased from nearly 724,000 in FY2008 to approximately 463,000 in FY2010, a 36 percent reduction, indicating that fewer people are attempting to illegally cross the border. Moreover, in fiscal years 2009 and 2010, ICE made over 20,102 criminal arrests along the Southwest border, an increase of approximately 12 percent compared to 2007–2008. Over 12,857 of these arrests were of drug smugglers and over 2,562 of these arrests were of human smugglers.

Initiatives Underway and Planned
The passage and signing of Southwest border security supplemental legislation will provide DHS additional capabilities to secure the Southwest border at and between our ports of entry and reduce the illicit trafficking of people, drugs, currency and weapons. Specifically, this bill provides

$14 million for improved tactical communications systems along the Southwest border; $32 million for two additional CBP unmanned aircraft systems; $176 million for an additional 1,000 Border Patrol agents to be deployed between ports of entry; $68 million to hire 250 new CBP officers at ports of entry and to maintain 270 officers currently deployed to ports of entry; $80 million for 250 new ICE agents; and $6 million to construct two forward operating bases along the Southwest Border to improve coordination of border security activities.

Improving policies, processes, and procedures that govern the management/care of detainee population

FY 2010 Accomplishments
In August 2009, Secretary Napolitano and Assistant Secretary of Immigration and Customs Enforcement John Morton announced a major overall of the nation's immigration detention system—prioritizing health, safety and uniformity among detention facilities while ensuring security, efficiency and fiscal responsibility. Reform efforts through FY 2010 include initiatives to centralize contracts under ICE headquarters supervision; develop an assessment tool to identify aliens suitable for alternatives to detention; house non-criminal non-violent populations at facilities commensurate with risk; expand legal support services programs; devise and implement a medical classification system; launch a public, Internet-based detainee locator tool to assist attorneys, family members, and other relevant parties in locating detained individuals in ICE custody; and more than double the number of Federal personnel providing onsite oversight at the facilities where the majority of detainees are housed to ensure accountability and reduce reliance on contractors.

Initiatives Underway and Planned
ICE has drafted the Performance Based National Detention Standards 2010, which will enhance the Detention Reform initiative begun in 2009.

ICE is developing new approaches to bed space management. The ICE Detention Facility Map aligns bed location with arrest activity, population characteristics, driving distances to offices and airports, access to families, legal resources and consulates, and provides for a "right-sized" system. This effort has already enabled ICE to reduce the number of facilities used from 341 to 270.

ICE is piloting new classification instruments for both bed space and medical classifications. These efforts will augment other bed space reforms to permit ICE DRO to improve planning for new bed space. The new Intake Risk Assessment and Classification Tool began its pilot in the Baltimore and Washington Field Offices in May 2010.

Challenge #8: Transportation Security

TSA faces the challenge of establishing effective security strategies, while maintaining quick and easy access for passengers and cargo. The OIG recognized that a continuing challenge facing TSA involves strengthening security for aviation, mass transit, and other modes of transportation.

Passenger Air Cargo Security

<u>FY 2010 Accomplishments</u>
TSA achieved the 100 percent domestic cargo screening requirement for passenger planes in August 2010 and requires the screening of 100% of high-risk international inbound air cargo.

TSA is creating modules that will ensure consistency in training across regulated parties. The modules will include training covering the following areas:

- Acceptance and transfer procedures;
- Cargo screening procedures;
- Chain of custody measures;
- Facility security;
- Security coordinator training; and
- Handling of Sensitive Security Information and Personally Identifiable Information.

Each module will include instructor and student guides and tests. TSA finalized the modules in October 2010 and will post the materials for industry comment.

Training modules are currently under development and include chapters covering screening protocols and the use screening technology. This training will ensure a consistent, high level of improvised explosive device (IED) and anomaly recognition training for personnel conducting screening and will increase industry's compliance with screening protocol requirements in the Security Programs. Screening training modules will include:

- Cargo Screening;
- Roles and Responsibilities for Screening Cargo;
- Physical Search;
- IED Recognition;
- Advanced Technology X-ray;
- Explosives Trace Detection;
- Explosives Detection System; and
- Electronic Metal Detection.

TSA has established Special Emphasis Inspections (SEIs) to focus on areas such as air cargo access control and Security Threat Assessments (STA). For the second straight year, TSA has conducted Headquarters (HQ) directed SEIs on these areas with more than 200 STA-based SEIs conducted in FY 2010 than in FY 2009. Additional SEIs involving access control, cargo acceptance and the Indirect Air Carrier program are underway and have shown signs of improved compliance rates. Improved compliance rates in FY 2010 have been seen in the following areas:

- Access Control SEI compliance rate increased from 94% to 96.5% from FY 2009 to FY 2010;
- Cargo Acceptance SEI compliance rate increased from 98.5% to 99.1%;
- Indirect Air Carrier based SEI compliance rate improved 1%; and the
- Overall compliance rate for all SEIs improved from 95.8% to 97.9%.

TSA has taken significant efforts to improve the national oversight and inspection program. In FY 2010, TSA implemented a risk-based approach to inspections, which employs a process that denotes the air cargo compliance risk of each entity in the supply chain, so that inspections can be carried out in a manner which is geared at minimizing this risk. From FY 2010 Quarter 1 to Quarter 3, High Risk entities were diminished by 5.9 percent, Moderate Risk entities were diminished by 8.4 percent and Low Risk entities increased by 17.6 percent. The average risk score across all entities was decreased by 13.54 points. Over 25,000 risk-based inspections and tests were conducted across the system by mid-year FY 2010.

TSA has also worked to provide additional tools to Transportation Security Inspectors (TSIs) and TSA field management to better analyze work results and focus oversight efforts. Primarily, the HQ-issued risk scores analyze three years worth of data to present to the field a risk score that represents where the need to inspect exists.

TSA established the first ever TSA-CBP liaison to the CBP National Targeting Center for Cargo (NTC-C). TSA has established a permanent member of the CBP NTC-C who resides on the NTC-C floor and shares data, intelligence, analyses, testing, and inspection results as necessary.

TSA has increased its TSI training sessions from quarterly to monthly in FY 2010. These training sessions have been focusing on conducting high-quality cargo screening inspections. TSA has also developed and implemented an air cargo screening lab, based at the Security Enforcement Training Academy. This lab uses actual screening equipment and processes to put TSIs through real world practical exercises to hone skills necessary for conducting air cargo screening location inspections.

TSA is also developing a domestic air cargo screening assessment program, in which TSIs will conduct tests and assessments of cargo screening methods, practices, and personnel on a regular and recurring basis.

Initiatives Underway and Planned

TSA will educate industry on the use of the modules in fall 2010. The training modules will initially be released as voluntary in order to receive user feedback. After receiving industry comments, TSA intends to re-issue the materials as a mandatory TSA training program to be incorporated into the standard security programs.

TSA plans to continue the use of SEIs and to track the compliance rates.

TSA will continue its risk-based approach to inspections in FY 2011. TSA plans to implement additional risk scores for all cargo air carriers and aircraft operators. Compliance Dashboards will be enhanced.

Additional roles and integration of the NTC-C liaison will be explored to include joint training and enhanced interaction in TSA operations such as SEIs and Cargo Strikes.

TSA plans to initiate a pilot program for the air cargo screening assessment program in FY 2011. The Office of Security Operations (OSO) is already coordinating this effort with various TSA organizations and is leveraging already existing process and protocols to the extent possible from the Aviation Screening Assessment Program.

TSA is exploring the development of additional TSI training to include advanced air cargo screening oversight and air cargo risk profiling.

TSA is in the process of obtaining additional screening equipment for the cargo lab and developing a cargo screening inspection course.

Rail and Mass Transit

FY 2010 Accomplishments

In July 2010, Secretary Napolitano launched the first phase of DHS' nationwide "If You See Something, Say Something" campaign and announced a new national information-sharing partnership with Amtrak as part of the nationwide Suspicious Activity Reporting (SAR) initiative—highlighting the public's role in keeping our country safe and the Obama administration's commitment to bolstering surface transportation security.

The "If You See Something, Say Something" campaign—originally implemented by New York City's Metropolitan Transit Authority and funded, in part, by $13 million from DHS' Transit Security Grant Program—is a simple and effective program to raise public awareness of indicators of terrorism, crime and other threats and emphasize the importance of reporting suspicious activity to the proper transportation and law enforcement authorities.

The campaign complements the national SAR initiative—a partnership among Federal, state, and local law enforcement to establish a standard process for law enforcement to identify and report suspicious incidents or activity and share that information nationally so it can be analyzed to identify broader trends. The partnership with Amtrak is a new national information-sharing partnership in which DHS and the Department of Justice (DOJ) work with Amtrak to utilize the latest intelligence in law enforcement trainings on how to identify suspicious behaviors associated with new and evolving threats. Amtrak officers will also utilize an upgraded reporting system—made available by the Transportation Security Administration—to refer suspicious activity reports to DHS and the Federal Bureau of Investigation for analysis and follow-up.

TSA has also been working with the DHS's Science and Technology sponsored Transportation Security - Centers of Excellence program in developing a course to better train Bus Operators in security awareness related areas, called BOARD for Bus Operator Awareness Research and Development project.

The Bomb Squad Response to Transportation Systems training and exercise program has been very active this fiscal year with mass transit related training events in Phoenix, Arizona; Oakland, California; Miami, Florida; National Capital Region/DC; and Norfolk, Virginia. Between 50 and 150 bomb technicians have been trained at each of these events.

The Mass Transit and Passenger Rail Security Division has planned, coordinated and executed the deployment of marine mammal systems (MMS) from the Space and Naval Warfare Systems Center Pacific, Biosciences Division (Code 715) to support the protection of underwater critical infrastructure in mass transit (Bay Area Rapid Transit, San Francisco Bay Region) during "Golden Guardian 2010," a state-level exercise focused on terrorism in west coast ports. The underwater detection capability, via the MMS, was also identified as a potential capability to facilitate re-opening a port, post attack.

During FY 2010, the effectiveness of the TSA's Surface Transportation Security Inspection Program (STSIP) was enhanced through implementation of the following programs, initiatives, and organizational changes:

- The TSA, through the STSIP, concluded its first full year of inspections of freight, passenger, and transit rail operators to determine compliance with rail security regulations issued in 2009, (49 Code of Federal Regulations (CFR) Part 1580). These were TSA's first compliance inspections performed in rail. In FY 2010, the STSIP completed over 4,000 such inspections to determine industry compliance with these requirements.
- In FY 2010, TSA further enhanced the effectiveness of surface inspectors through providing additional training to surface inspectors on new programs and processes intended to enhance the effectiveness of the workforce. The STSIP conducted a national training conference for all TSI-Surface and their supervisors (Assistant Federal Security Director (AFSD-Is)/AFSD-Surface/Supervisory TSIs) to provide the workforce with the latest guidance and updates on security programs such as 49 CFR Part 1580, inspections, freight rail risk reduction surveys, and Baseline Assessment for Security Enhancement reviews in mass transit. TSA also continued to provide railroad operations training to other TSA field elements (including Federal Security Directors, Deputy Federal Security Directors, Federal Air Marshals, Special Agents in Charge, Assistants to the Special Agent in Charge, Area Directors, Deputy Area Directors, etc.), in order to increase agency-wide awareness and expertise on issues involving surface transportation security.
- In an effort to provide more direct oversight of the surface transportation security program, a realignment of personnel devoted to surface transportation was accomplished in January 2010. TSA created six Regional Security Inspectors in an effort to create uniformity among field reporting lines.
- In FY 2010, the STSIP continued the build out and expansion of surface related training at the Transportation Technology Center in Pueblo, Colorado. The STSIP also facilitated completion of modifications to classroom space and dedicated personnel to the site to develop the TSI-Surface curriculum and to deliver training material. This team is also responsible for the future expansion of the TSA space at the Pueblo site and the development of expanded training courses that will cross all surface modes of transportation.

<u>Initiatives Underway and Planned</u>
The BOARD program will be rolled out to the transit bus operator community over the next two years. This effort may also be expanded to include the Bus Dispatch/Operations Centers and bus

operator security management. An initial training effort for all transit bus operators will be conducted followed by a recurrent training effort.

We expect to expand the Intermodal-Security Training and Exercise Program training program with our stakeholders as expeditiously as resources will allow. We also intend to continue to coordinate with Department of Transportation/Federal Transit Administration on response and recovery issues to help identify existing gaps that we can target in our program.

TSA is working on a Mass Transit and Passenger Rail employee training rule to establish standards for employee training.

TSA will continue working with the American Public Transportation Association in the development of standards and guidance. These standards and guidance will inform the training process through the Baseline Assessment for Security Enhancement as well as training smart practices.

TSA will work with the mass transit and passenger rail law enforcement communities as well as Government agencies to develop and coordinate existing response plans.

TSA will advance its chemical and biological response and detection capabilities through additional research and development activities in conjunction with S&T.

TSA will work closely with transit agencies on the use of TSA resources (transportation security officers, behavior detection officers, surface inspectors, and Federal Air Marshals) to support passenger and baggage screening efforts; similar resources have been supporting Visible Intermodal Prevention and Response efforts since December 2005.

In FY 2011, the effectiveness of TSA's STSIP will be enhanced through implementation of the following programs and initiatives:

The STSIP will continue expansion of the Surface Transportation Security Training Center in Pueblo, Colorado to provide training opportunities in all surface modes. The dedicated training center will allow TSA to train greater numbers of field employees and managers on surface transportation programs and issues, thus increasing the level of agency expertise in surface transportation. This is expected to continue to increase internal awareness of the mission of the surface inspector workforce and its utilization.

TSA expects to issue a Notice of Proposed Rulemaking that, when final, will require certain training requirements for mass transit, freight rail, intercity bus, and motor carrier entities as a result of the 9/11 Act. When these regulations are final, surface inspectors will be charged with monitoring industry compliance. In FY 2011, the TSA will begin to examine and develop compliance protocols for these regulations and related inspector training.

Training

<u>FY 2010 Accomplishments</u>
In 2010, TSA's Operational and Technical Training Division (OTT), within the OSO has finalized a Strategic Plan for the management of the technical training program.

OTT recently developed a Curriculum Development roadmap tool that visually depicts the forecast for all curriculum-related activities on the horizon.

Initiatives Underway and Planned
TSA is exploring the feasibility of establishing a TSA Academy for Transportation Security Officers. An Integrated Project Team will be launched at the start of FY 2011, to develop a comprehensive alternatives analysis for senior leadership consideration.

While TSA has always had an On-the-Job Training (OJT) program, TSA is in the final stages of a more structured and formalized OJT Program, which will include a structured training curriculum for the TSOs who will sign up to serve as an OJT Instructor.

TSA has scheduled a pilot to be conducted in the second quarter of FY 2011, and if minimal and/or no changes are required as a result of the pilot conducted, TSA plans to implement this program system wide in the third quarter of FY 2011.

Challenge #9: Trade Operations and Security

CBP is at the frontline of protecting the nation from threats, including those posed by maritime cargo. CBP has implemented a multilayered approach to security, using a risk management approach to strategically apply resources to prioritized enforcement objectives and threats.

Targeting and Examining High Risk Cargo

FY 2010 Accomplishments
CBP's multilayered approach to security includes obtaining advance information about cargo; using targeting techniques to assess risk and building a knowledge base about the people and companies involved in the supply chain; fostering partnerships with the private sector and collaborating with other Federal agencies and departments; expanding enforcement efforts to points earlier in the supply chain than simply our borders; and maintaining robust inspection regimes, including non-intrusive inspection equipment and radiation detection technologies, at our ports of entry.

CBP requires advanced electronic cargo information, as mandated in the Trade Act of 2002 (24-Hour Rule, through regulations), for all inbound shipments in all modes of transportation. CBP requires the electronic transmission of additional data, as mandated by the SAFE Port Act, through the Importer Security Filing and Additional Carrier Requirements rule (Security Filing "10+2"), which became effective as an Interim Final Rule on January 26, 2009, and went into full effect on January 26, 2010. Under the Security Filing "10+2" rule, importers are responsible for supplying CBP with ten trade data elements 24 hours prior to vessel lading, and ocean carriers are required to provide their vessel stow plans no later than 48 hours after departure and their container status messages no later than 24 hours after creation or receipt. This advance data allows CBP targeting specialists to identify risk factors earlier in the supply chain.

The National Targeting Center – Cargo (NTC-C) analyzes this advance cargo information using the Automated Targeting System (ATS) before shipments reach the United States and identifies high-risk, shipments. This information is used by CBP and other agencies to support enforcement actions, such as seizures and arrests.

In addition to this advance information, CBP works with the trade community through the Customs Trade Partnership Against Terrorism (C-TPAT), a voluntary public-private sector partnership program in which CBP works with the principal stakeholders of the international supply chain such as importers, carriers, consolidators, licensed customs brokers, and manufacturers to ensure the highest possible levels of cargo security.

C-TPAT membership consists of 10,056 Certified Partners which includes 4,440 importers, 2,803 carriers, 859 brokers, 826 consolidators/3PLs, 58 marine port authority and terminal operators and 1,070 foreign manufactures. C-TPAT has conducted 16,242 on site validations of manufacturing and logistics facilities in 97 countries representing some of the most terrorist prone and high risk areas of the world. C-TPAT currently has 142 Supply Chain Security Specialists located in 7 operational field offices.

Initiatives Underway and Planned

CBP is continuing to work with the trade community to further leverage private sector resources to enhance supply chain security. Additionally, CBP is working with foreign partners to establish bi-national recognition and enforcement of C-TPAT.

Container Security Initiative

FY 2010 Accomplishments

CBP partners with foreign governments through the Container Security Initiative (CSI) to prevent and deter terrorist threats before they reach American ports. CSI enables CBP to identify and inspect high-risk U.S.-bound cargo containers at foreign ports prior to departure. Through CSI, CBP stations multidisciplinary teams of officers to work with host country counterparts to identify and examine containers that are determined to pose a high risk for terrorist activity. CSI, the first program of its kind, was announced in January 2002 and is currently operational in 58 foreign seaports—covering more than 80 percent of the maritime containerized cargo shipped to the United States.

CBP officers stationed at CSI ports, with assistance from CSI personnel at the National Targeting Center–Cargo (NTC–C), review 100 percent of the manifests originating and/or transiting those foreign ports for containers that are destined for the United States. In this way, CBP identifies and examines high risk containerized maritime cargo prior to lading at a foreign port and before shipment to the United States.

Initiatives Underway and Planned

As the CSI program has matured, CBP looked for opportunities to increase efficiencies and reduce costs by shifting functions to the NTC–C. CBP's ability to target high risk containers has progressed to the point that much of the work can be done from CBP's U.S. location rather than through a physical presence overseas. CBP is exploring opportunities to utilize emerging technology in some locations, which will allow the program to become more efficient and less costly. In January 2009, CBP began to reduce the number of personnel stationed overseas who perform targeting functions, increasingly shifting the targeting of high risk containers to personnel stationed at the NTC–C. This shift in operations reduces costs without diminishing the effectiveness of the CSI program. CBP will remain operational in all 58 locations in fiscal year 2011 with sufficient personnel in country to conduct the examinations of high risk shipments with the host government and to maintain relationships with their host-country counterparts.

Scanning of Cargo

FY 2010 Accomplishments
The Secure Freight Initiative (SFI) is an effort to enhance the U.S. Government's ability to scan containers for nuclear and radiological materials at seaports worldwide and better assess the risk of inbound containers. SFI is currently deployed at five overseas pilot ports and reflects close collaboration with other Federal agencies, foreign governments, and the trade community. SFI provides carriers of maritime containerized cargo greater confidence in the security of the shipment they are transporting, and promotes the secure flow of commerce.

Initiatives Underway and Planned
CBP provided a report to Congress on April 13, 2010 entitled, "Risk-Based, Layered Approach to Supply Chain Security" in response to language in the House Report 111-157 and the Conference Report 111-298 accompanying the FY 2010 Department of Homeland Security Appropriations Act (Pub. L. 111-83). The act required that CBP provide a report on its strategy to achieve meaningful and effective cargo and supply chain security in lieu of 100-percent scanning of cargo. CBP agrees with Congress's conclusion in House Report 111-157 that, "at least for now, a 100-percent scanning goal is not feasible, and even if it were, would come at an unacceptably high cost monetarily and in the displacement of other efforts." CBP achieves meaningful cargo and supply chain security in the absence of the total scanning requirements by employing a risk-based, layered approach that includes collecting advanced information on cargo entering the United States, working with partners in the shipping industry to improve their security, and focusing on high-risk shipments. CBP has determined that this approach to enhancing security across all potential transit vectors is more efficient and cost effective than alternative approaches that focus exclusively on a single layer of defense.

Acronym List

Acronyms

AAP – Advanced Acquisition Plan
ADMP – Active Duty Military Payroll
AFG – Assistance to Firefighters Grants
AFR – Annual Financial Report
AMP – Asset Management Plan
ARB – Acquisition Review Board
ARRA – American Recovery and Reinvestment Act
ATA – American Trucking Association
BEST – Border Enforcement Security Task Force
BP – British Petroleum
BPD – Bureau of Public Debt
BUR – Bottom-Up Review
CAE – Component Acquisition Executive
CBP – U.S. Customs and Border Protection
CBRN – Chemical, Biological, Radiological, and Nuclear
CDL – Community Disaster Loan
CDP – Center for Domestic Preparedness
CDSOA – Continued Dumping and Subsidy Offset Act
CFO – Chief Financial Officer
CFR – Code of Federal Regulations
CIKR – Critical Infrastructure and Key Resources
CIO – Chief Information Officer
CIPAC – Critical Infrastructure Partnership Advisory Council
CISO – Chief Information Security Officer
COBRA – Consolidated Omnibus Budget Reconciliation Act of 1985
COTR – Contract Officer's Technical Representative
COTS – Commercial Off-the-Shelf
CPARS – Contractor Performance Assessment Reporting System
CSI – Container Security Initiative
CSRS – Civil Service Retirement System
C-TPAT - Customs Trade Partnership Against Terrorism
CY – Current Year
DADLP – Disaster Assistance Direct Loan Program
DART – Disaster Acquisition Response Team
DC – District of Columbia
DHS – Department of Homeland Security
DHS FAA – Department of Homeland Security Financial Accountability Act
DNDO – Domestic Nuclear Detection Office
DNSSEC – Domain Name System Security
DOC – Department of Commerce
DOD – Department of Defense
DOL – Department of Labor
DRO – Detention and Removal Operations
EaaS – Email as a Service
EDMO – Enterprise Data Management Office
EDS – Explosive Detection System
EFSP – Emergency Food and Shelter Program
EHP – Environmental and Historic Preservation
EMI – Emergency Management Institute
EOC – Emergency Operations Centers
EMPG – Emergency Management Performance Grant Program
EPIC – Enterprise Procurement Information Center
ERA – Enterprise Reporting Application
ESCM – Entry Summary Compliance Measurement
FAR – Federal Acquisition Regulation
FBwT – Fund Balance with Treasury
FCRA – Federal Credit Reform Act of 1990
FECA – Federal Employees Compensation Act
FEMA – Federal Emergency Management Agency

FERS – Federal Employees Retirement System

FFMIA – Federal Financial Management Improvement Act of 1996

FFSR – Federal Financial Systems Requirements

FIMA – Federal Insurance and Mitigation Administration

FISMA – Federal Information Security Management Act

FLETC – Federal Law Enforcement Training Center

FMFIA – Federal Managers' Financial Integrity Act

FOSC – Federal On-scene Coordinators

FPDS – Federal Procurement Data System

FPDS-NG – Federal Procurement Data System-Next Generation

FPS – Federal Protective Service

FSIO – Financial Systems Integration Office

FY – Fiscal Year

GAAP – Generally Accepted Accounting Principles

GAO – Government Accountability Office

GCC – Government Coordinating Councils

GCCF – Gulf Coast Claims Facility

GPD – Grant Programs Directorate

GSA – General Services Administration

HCA – Heads of Contracting Activity

HQ – Headquarters

HSA – Homeland Security Act of 2002

HSAM – Homeland Security Acquisition Manual

HSAR – Homeland Security Acquisition Regulation

HSGP – Homeland Security Grant Program

HSPD – Homeland Security Presidential Directive

HUD – Housing and Urban Development

ICAO – International Civil Aviation Organization

ICCB – Internal Control Coordination Board

ICE – U.S. Immigration and Customs Enforcement

IDI – Injured Domestic Industries

IDIQ – Indefinite Delivery Indefinite Quantity

IED – Improvised Explosive Device

IEFA – Immigration Examination Fee Account

IHP – Individuals and Household Programs

IMP – Integrated Management Plan

INA – Immigration Nationality Act

IP – Improper Payment

IPERA – Improper Payments Elimination and Recovery Act

IPIA – Improper Payments Information Act of 2002

IT – Information Technology

JHSG – Joint Housing Solutions Group

JIATF – Joint Interagency Task Force

LBTT – Local Business Transition Team

LOI – Letters of Intent

MD – Management Directive

MD&A – Management's Discussion and Analysis

MERHCF – Medicare-Eligible Retiree Health Care Fund

MGMT – Management Directorate

MMS – Marine Mammal Systems

MRS – Military Retirement System

MTS – Metric Tracking System

ND – Non-Disaster

NEMA – National Emergency Management Association

NFIP – National Flood Insurance Program

NIEM – National Information Exchange Model

NIPP – National Infrastructure Protection Plan

NPFC – National Pollution Funds Center

NPPD – National Protection and Programs Directorate

NTC-C – National Targeting Center for Cargo

OCFO – Office of the Chief Financial Officer
OCIO – Office of the Chief Information Officer OCPO – Office of the Chief Procurement Officer
OHA – Office of Health Affairs
OIG – Office of Inspector General
OJT – On-the-Job Training
OMB – Office of Management and Budget
OM&S – Operating Materials and Supplies
OPA – Oil Pollution Act of 1990
OPEB – Other Post Retirement Benefits
OPM – Office of Personnel Management
ORB – Other Retirement Benefits
OSLTF – Oil Spill Liability Trust Fund
OSO – Office of Security Operations
OTT – Operational and Technical Training Division
PA – Public Assistance
PA&E – Program Analysis and Evaluation
PCS – Process Control Systems
PIA – Privacy Impact Assessment
PM – Program Manager
POA&M – Plan of Action and Milestones
PP&E – Property, Plant, and Equipment
PSA – Protective Security Advisor
Pub. L. – Public Law
PY – Prior Year
QHSR – Quadrennial Homeland Security Review
Recovery Act – The American Recovery and Reinvestment Act of 2009
RSSI – Required Supplementary Stewardship Information
SAT – Senior Assessment Team
SBI – Secure Border Initiative
SBInet – Secure Border Initiative Network
SBR – Statement of Budgetary Resources
SCC – Sector Coordinating Council
SEI – Special Emphasis Inspection
SFFAS – Statement of Federal Financial Accounting Standards
SFI – Secure Freight Initiative
SFRBTF – Sport Fish Restoration Boating Trust Fund
SMC – Senior Management Council
SPO – Single Point Ordering
SPOT – Single Point Order Tracking
S&T – Science and Technology Directorate
STA – Security Threat Assessment
STSIP – Surface Transportation Security Inspection Program
TAFS – Treasury Account Fund Symbol
TASC – Transformation and Systems Consolidation
TIC – Trusted Internet Connection
TME – Tactical Modeling
TSA – Transportation Security Administration
TSE – Transportation Security Equipment TSGP – Transit Security Grants Program
TSI – Transportation Security Inspector
T&E – Test and Evaluation
U.S. – United States
U.S.C. – United States Code
US-CERT - United States Computer Emergency Readiness Team
USCG – U.S. Coast Guard
USCIS – U. S. Citizenship and Immigration Services
USSS – U.S. Secret Service
WHTI – Western Hemisphere Travel Initiative
WYO – Write Your Own

Homeland Security