U.S. Department of Homeland Security Annual Financial Report

Fiscal Year 2012

Homeland Security

Our Vision

A homeland that is safe, secure, and resilient against terrorism and other hazards.

About this Report

The *U.S. Department of Homeland Security Annual Financial Report for Fiscal Year (FY) 2012* presents the Department's detailed financial information relative to our mission and the stewardship of those resources entrusted to us. It also highlights the Department's priorities, strengths, and challenges in implementing programs to enhance the safety and security of our Nation.

For FY 2012, 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, which consists of the following three reports:

- ***DHS Annual Financial Report***: Delivery date – November 15, 2012.
- ***DHS Annual Performance Report***: Delivery date – February 4, 2013. The *DHS Annual Performance Report* is submitted with the Department's Congressional Budget Justification.
- ***DHS Summary of Performance and Financial Information:*** Delivery date – February 15, 2013.

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

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Homeland Security

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Message from the Secretary

November 14, 2012

I am pleased to submit the Department of Homeland Security's (DHS) Annual Financial Report for Fiscal Year (FY) 2012. 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. This report also outlines our major goals and priorities within the framework of the Quadrennial Homeland Security Review (QHSR), Bottom-Up Review (BUR), and DHS Strategic Plan for Fiscal Years 2012-2016.

In each mission area, we have continued to grow and mature as a department by strengthening and building upon our existing capabilities, enhancing partnerships across all levels of government and with the private sector, and streamlining our operations and increasing efficiencies.

This November marks the tenth anniversary of the creation of DHS, the largest reorganization of the Federal Government since the formation of the Department of Defense. After ten years of effort, we have helped build a more effective and integrated Department, a strengthened homeland security enterprise, and a more secure America that is better equipped to confront the range of threats we face.

Priority Areas

We continue to build on the significant progress made by focusing on the Department's five key mission areas: preventing terrorism and enhancing security; securing and managing our borders; enforcing and administering our immigration laws; safeguarding and securing cyberspace; and ensuring resilience to disasters. Additionally, DHS provides essential support to national and economic security and strives to maximize the effectiveness and efficiency of its operations by maturing and strengthening our management functions.

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

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 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 bolstering information sharing; providing grants, plans and training to our homeland security and law enforcement partners; and facilitating rebuilding and recovery where disasters strike.

Providing Essential Support to National and Economic Security

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.

Maturing and Strengthening the Department

Over the past four years, we have led the development and implementation of a comprehensive, strategic management approach to enhance Department-wide maturation and integration. We have made key investments to strengthen the homeland security enterprise, increase unification and integration, address challenges raised by the U.S. Government Accountability Office (GAO), and build upon the management reforms that have been implemented under this Administration.

Along with efforts to strengthen financial management, DHS has also made an unprecedented commitment to efficiency to better support frontline operations by building a culture of fiscal discipline and accountability throughout the Department. Through the DHS-wide Efficiency Review and other cost saving initiatives, we have implemented a variety of initiatives to cut costs, share resources across our Components, and consolidate and streamline operations wherever possible. To date, these efforts have identified over $4 billion in cost avoidances and cuts.

At the same time, we have challenged our workforce to fundamentally rethink how to do business—from the largest to the smallest investments. In both 2011 and 2012, DHS has conducted formal base budget reviews looking at all aspects of the Department's budget to find savings and better align with operational needs.

This report highlights the Department's activities and accomplishments in each of these mission areas in FY 2012 and discusses upcoming initiatives that will build on these efforts to achieve a safer and more secure nation.

Management Assurances and Performance Measurement

Last year, DHS achieved a milestone that is a pivotal step towards increasing transparency and accountability for the Department's resources. For the first time since FY 2003, DHS earned a qualified audit opinion on its Consolidated Balance Sheet and Statement of Custodial Activity—highlighting the significant progress the Department has made in improving our financial management. Through these and other efforts across the Department, we will continue 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 level of accountability and transparency. This year, the Department expanded the scope of the FY 2012 financial statement audit to include three additional statements. Building on last year's success, the Department obtained a full-scope qualified audit opinion.

DHS is committed to improving performance measurement and accountability and I am able to provide reasonable assurance, based on our internal controls evaluations, that the performance measures reported for the Department in our performance and accountability reports are complete and reliable. DHS's performance and accountability reports for this and previous years are available on our public website: http://www.dhs.gov/xabout/budget/editorial_0430.shtm.

DHS has significantly improved the processes and structures in place to help ensure consistent operations for each of our financial accounting centers and financial management offices within our Components. 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.

Very Truly Yours,

Janet Napolitano

Management's Discussion and Analysis

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

Mission and Organization

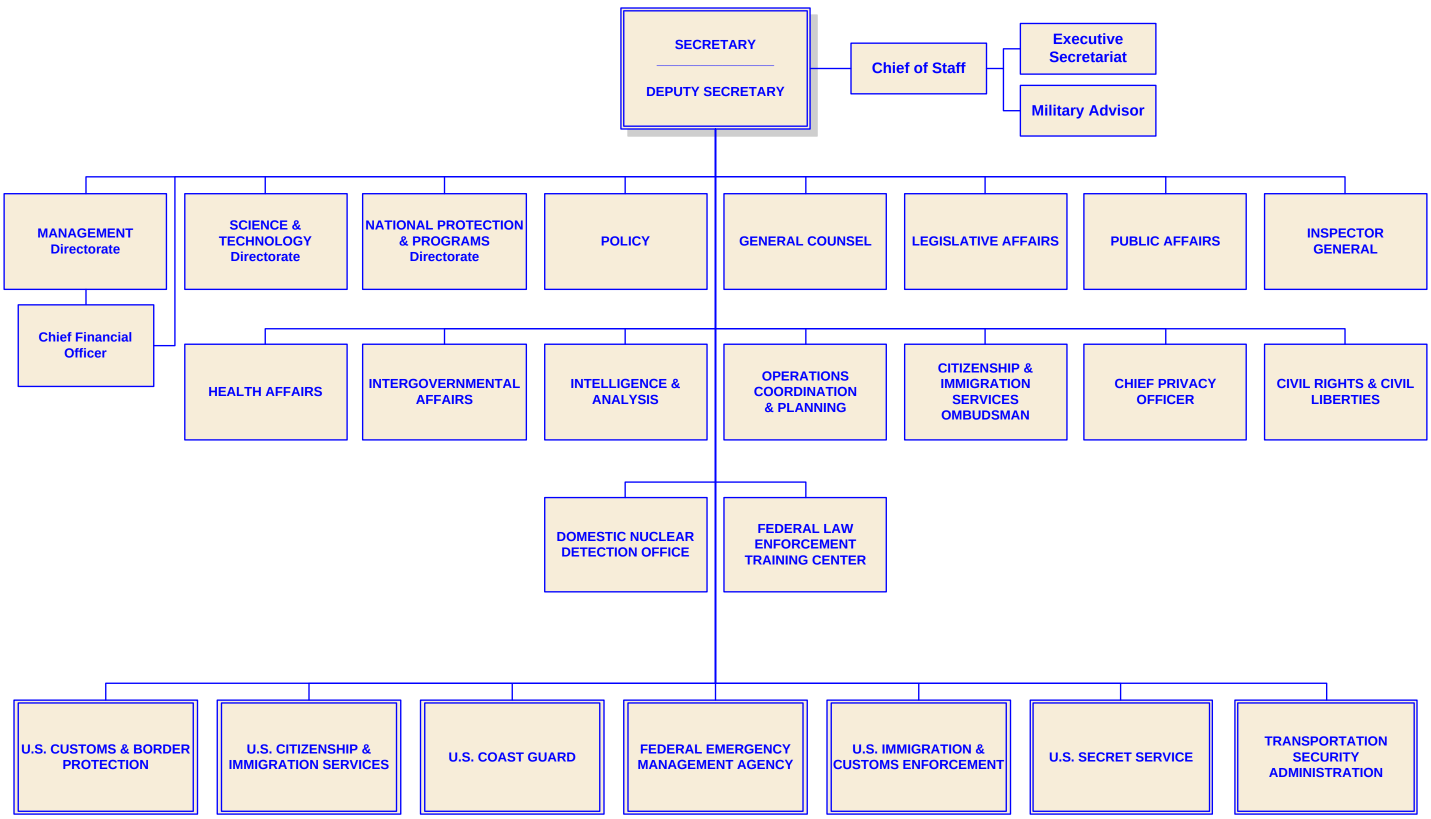
Mission

We will lead efforts to achieve a safe, secure, and resilient homeland. We will counter terrorism and enhance our security; secure and manage our borders; enforce and administer our immigration laws; protect cyber networks and critical infrastructure; and ensure resilience from disasters. We will accomplish these missions while providing essential support to national and economic security and maturing and strengthening both the Department of Homeland Security and the homeland security enterprise.

Our Organization

DHS's seven operational Components, listed along the bottom of the chart below, lead the Department's front-line activities to protect our Nation. The remaining DHS Components of the 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 about the Department's structure, visit our website at http://www.dhs.gov/organization.

DHS Organizational Chart



Strategic Plan Summary

The *U.S. Department of Homeland Security Strategic Plan for Fiscal Years (FY) 2012-2016* presents the Department's missions, goals, and objectives. The plan was published on February 13, 2012 and can be accessed at http://www.dhs.gov/xlibrary/assets/dhs-strategic-plan-fy-2012-2016.pdf. The Strategic Plan continues the Department's efforts to prioritize front-line operations while maximizing the effectiveness and efficiency of every taxpayer dollar the Department receives. The Plan was developed from the deliberations and conclusions of the Quadrennial Homeland Security Review (QHSR) and describes the homeland security missions and the Department's efforts to provide essential support to national and economic security and to mature and strengthen DHS. The missions and goals of the Department are provided below.

Mission 1: 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 threats to and vulnerability of critical infrastructure, key resources, essential leadership, and major events from terrorist attacks and other hazards.

Goal 1.1: Preventing Terrorist Attacks – Prevent malicious actors from conducting terrorist attacks within or against the United States.

Goal 1.2: Prevent the Unauthorized Acquisition or Use of Chemical, Biological, Radiological, and Nuclear (CBRN) Materials and Capabilities – Prevent malicious actors from acquiring or moving dangerous chemical, biological, radiological, and nuclear materials or capabilities within the United States.

Goal 1.3: Manage Risks to Critical Infrastructure, Key Leaders, and Events – Reduce the vulnerability of key sectors to attack or disruption.

Mission 2: Securing and Managing Our Borders

The protection of the Nation's borders—land, air, and sea—from the illegal entry of people, weapons, drugs, and other contraband while facilitating lawful travel and trade is vital to homeland security, as well as the Nation's economic prosperity. 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.

Goal 2.1: Secure U.S. Air, Land, and Sea Borders – Prevent the illegal flow of people and goods across U.S. air, land, and sea borders.

Goal 2.2: Safeguard Lawful Trade and Travel – Facilitate and secure lawful trade and travel.

Goal 2.3: Disrupt and Dismantle Transnational Criminal Organizations – Disrupt and dismantle transnational organizations that engage in smuggling and trafficking across the U.S. border.

Mission 3: 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.

Goal 3.1: 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.

Goal 3.2: 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.

Mission 4: Safeguarding and Securing Cyberspace

DHS is responsible for protecting the federal Executive Branch civilian agencies and while working collaboratively with the private sector to protect the Nation's critical infrastructure. This includes the "dot-gov" world, where the government maintains essential functions that provide services to the American people, as well as privately owned critical infrastructure which includes the systems and networks that support the financial services industry, the energy industry, and the defense industry.

Goal 4.1: 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.

Goal 4.2: Promote Cybersecurity Knowledge and Innovation – Ensure that the Nation is prepared for the cyber threats and challenges of tomorrow.

Mission 5: Ensuring Resilience to Disasters

DHS coordinates the comprehensive federal efforts to prepare for, protect against, respond to, recover from, and mitigate a terrorist attack, natural disaster or other large-scale emergency, while working with individuals, communities, the private and nonprofit sectors, faith-based organizations, federal, state local, tribal, and territorial partners to ensure a swift and effective recovery. The Department's efforts to build a ready and resilient Nation include fostering a Whole Community approach to emergency management nationally; building the Nation's capacity to stabilize and recover from a catastrophic event; bolstering information sharing and building unity of effort and common strategic understanding among the emergency management team; building plans and providing training to our homeland security partners; and promoting preparedness within the private sector.

Goal 5.1: Mitigate Hazards – Strengthen capacity at all levels of society to withstand threats and hazards.

Goal 5.2: Enhance National Preparedness through a Whole Community Approach to Emergency Management – Engage all levels and segments of society in improving preparedness.

Goal 5.3: Ensure Effective Emergency Response – Strengthen nationwide response capacity to stabilize and recover from a catastrophic event.

Goal 5.4: Rapidly Recover from a Catastrophic Event – Improve the Nation's ability to adapt and rapidly recover.

In addition to the core missions of the Department described above, DHS provides focus in two areas: 1) providing essential support to national and economic security; and, 2) maturing and strengthening DHS.

Providing Essential Support to National and Economic Security

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; 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 homeland security missions.

Goal: Collect Customs Revenue and Enforce Import/Export Controls – Maximize the collection of customs revenue and protect U.S. intellectual property rights and workplace standards.

Goal: Ensure Maritime Safety and Environmental Stewardship – Prevent loss of life in the maritime environment, maintain the marine transportation system, and protect and preserve the maritime environment.

Goal: Conduct and Support Other Law Enforcement Activities – Prevent the exploitation of individuals and provide law enforcement training for the execution of other non-DHS federal laws and missions.

Goal: Provide Specialized National Defense Capabilities – Support national defense missions and post-conflict reconstruction and stabilization.

Maturing and Strengthening DHS

Maturing and strengthening DHS and the entire homeland security enterprise—the collective efforts and shared responsibilities of federal, state, local, tribal, territorial, non-governmental, and private-sector partners, as well as individuals, families, and communities—is critical to the Department's success in carrying out its core missions and operational objectives. This includes enhancing shared awareness of risks and threats, building capable, resilient communities, and fostering innovative approaches and solutions through cutting-edge science and technology, while continuing to improve Department management and accountability.

Goal: Improve Cross-departmental Management, Policy, and Functional Integration – Transform and increase the integration of departmental management.

Goal: Enhance DHS Workforce – Continue to build human resource programs that support departmental mission goals and objectives, create high technical proficiency, and address the needs of the Department's employees in executing DHS missions.

Goal: Enhance Intelligence, Information Sharing, and Integrated Operations – Institute optimal mechanisms to integrate the Department's intelligence elements, increase operational capability, and harmonize operations.

Performance Overview

The performance overview provides a summary of each homeland security mission and focus area, selected accomplishments, key performance measures, and future initiatives to strengthen the Department's efforts in achieving a safer and more secure Nation. A complete list of all the performance measures, with full descriptions and explanations, will be published in the DHS FY 2012-2014 Annual Performance Report in February 2013.

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 meeting the following goals:

- **Preventing Terrorist Attacks –** Prevent malicious actors from conducting terrorist attacks within or against the United States.
- **Prevent the Unauthorized Acquisition or Use of Chemical, Biological, Radiological, and Nuclear 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 Leaders, and Events –** Reduce the vulnerability of key sectors to attack or disruption.

TSA Pre✓™

The Transportation Security Administration (TSA) employs risk-based, intelligence-driven operations to prevent terrorist attacks and to reduce the vulnerability of the Nation's transportation system to terrorism. TSA Pre✓™ is a pre-screening initiative that allows eligible passengers to volunteer information about themselves to possibly expedite their screening experience. Eligible passengers enter a separate security lane, and may pass through metal detectors without needing to remove shoes, light outerwear, belts, or remove laptops and 3-1-1 compliant liquids/gels from their carry-on.

Currently, eligible passengers include U.S. citizens flying on participating airlines as well as those who are members of U.S. Customs and Border Protection (CBP) Trusted Traveler programs, including Global Entry, SENTRI, and NEXUS. Beginning November 15, 2012, Canadian citizens traveling domestically in the United States who are members of NEXUS are also qualified to participate in TSA Pre✓™. TSA will always incorporate random and unpredictable security measures throughout the airport and no individual will be guaranteed expedited screening.

More than three million passengers have received expedited screening through TSA Pre✓™ security lanes since the initiative began in October 2011. TSA Pre✓™ will be available at 35 of the Nation's busiest airports by the end of 2012.

Below are highlighted performance measures related to *Preventing Terrorism and Enhancing Security*.

- **Percent of international air enplanements vetted against the terrorist watch list through Secure Flight:** TSA vets international air travelers against the terrorist watch list through the Secure Flight Program, continuing to achieve 100 percent screening in FY 2012. Secure Flight increases the security of air travel by screening every passenger against the latest intelligence before a boarding pass is issued.
- **Percent of overall compliance of domestic airports with established aviation security indicators:** Through the use of rigorous compliance inspections, TSA identifies air carrier compliance for U.S. flagged aircraft operating domestically with established security indicators. In FY 2012, TSA identified that 94.5 percent of domestic airports comply with established security indicators. Compliance rates will fluctuate as new aviation security requirements are implemented. In addition, corrective actions were issued to noncompliant airports to remedy any deficiencies.
- **Percent of air cargo screened on commercial passenger flights originating from the United States and territories:** TSA ensures the security of air cargo while facilitating the flow of legitimate commerce. In FY 2012—for the second year in a row—TSA screened 100 percent of cargo on commercial passenger flights originating from the United States and territories, up from 50 percent in FY 2009.
- **Percent of total U.S. Secret Service protection activities that are incident-free for protection of national leaders, foreign dignitaries, designated protectees and others during travel or at protected facilities:** The U.S. Secret Service (USSS) continues to meet its goal of 100 percent incident-free protection for our Nation's leaders, foreign dignitaries, and others during travel or while at protected facilities.

2012 NATO Summit Protection

The 2012 North Atlantic Treaty Organization (NATO) Summit—held in Chicago, Illinois in May 2012—was the largest gathering of world leaders on U.S. soil, outside of the United Nations General Assembly in New York City and was designated as a National Security Special Event (NSSE). When an NSSE is declared, the U.S. Secret Service becomes the lead agency for developing and executing a comprehensive operational security plan in coordination with Federal and local law enforcement partners, state and local governments, and the military.

In addition to securing nine different venues for 60 visiting delegations, the U.S. Secret Service provided protective details for 42 visiting heads of state or government in addition to the President. In total, more than 50 federal, state, local, and military agencies participated in the planning and execution of the security plan.

Future Initiatives

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.

Below are a few initiatives that advance our efforts to achieve the Department's counterterrorism goals:

- Continue TSA's risk-based security initiative through a layered security approach that includes state-of-the-art technologies, better passenger identification techniques, trusted traveler programs like TSA Pre✓™ and other measures both seen and unseen.
- Continue efforts to secure the global supply chain through a layered detection system that interdicts dangerous goods and dangerous people at the earliest point possible. DHS's intelligence and targeting programs support a flexible enforcement capability that detects potential threats to our security, economy, and public safety, and shares intelligence with law enforcement agencies. Recent advances in technology and modeling, coupled with the expansion of the National Targeting Center, will increase operational efficiencies and enhance our ability to interdict potential terrorists, high-risk cargo, and other threats before they reach the United States.
- Continue efforts with respect to threats of nuclear and high-consequence biological attack, consistent with the *National Security Strategy*, while maintaining robust programs for prevention, interdiction, detection, and disruption of chemical and radiological attacks. Continue efforts to prevent and protect against radiological and nuclear terrorism through execution of the *National Strategic Five-Year Plan for Improving the Nuclear Forensics and Attribution Capabilities of the United States, Global Nuclear Detection Architecture Strategic Plan 2010*, and associated implementation plans.
- Continue to implement a multi-hazard approach to critical infrastructure protection and resilience through the deployment of Infrastructure Protective Security Advisors to state and local fusion centers, conducting inspections of high-risk chemical facilities, and outreach to critical infrastructure stakeholders.

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 meeting 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.

Southwest Border Security

Under this Administration, DHS has dedicated historic levels of personnel, technology, and resources to the Southwest Border. Today, the Border Patrol is staffed at higher levels on the Southwest Border than at any time in its 88-year history, having more than doubled the number of agents from approximately 9,100 in 2001 to more than 18,500 today. Under the Southwest Border Initiative, DHS has doubled the number of personnel assigned to Border Enforcement Security Task Forces; increased the number of intelligence analysts focused on cartel violence; tripled deployments of Border Liaison Officers to work with their Mexican counterparts; increased screening of southbound shipments for illegal weapons, drugs, and cash; and expanded unmanned aircraft system coverage to the entire Southwest Border.

Along the Southwest Border, DHS has deployed thousands of technology assets, including mobile surveillance units, thermal-imaging systems, large- and small-scale non-intrusive inspection equipment, and three Unmanned Aircraft Systems. For the first time, DHS unmanned aerial capabilities now cover the Southwest Border from California to Texas—providing critical aerial surveillance assistance to personnel on the ground. Attempts to cross the Southwest Border illegally, as measured by Border Patrol apprehensions, have decreased 49 percent in the past four years and are 78 percent less than what they were at their peak.

Below are highlighted performance measures related to *Securing and Managing Our Borders*.

1. **Percent of people apprehended multiple times along the Southwest Border:** The number of individuals attempting illegal entry across the Southwest Border multiple times has decreased. In FY2012, the percent of individuals who were apprehended multiple times for illegal entry has decreased to 17 percent, meeting our target of less than 19 percent.
2. **Percent of detected conventional aircraft incursions resolved along all borders of the United States:** CBP's Air and Marine Operations Center uses its capabilities, as well as those of the Department of Defense and civilian radar, to identify and track suspect aircraft incursions along our borders. In FY 2012, CBP successfully resolved 96 percent of confirmed border incursions, up from 95 percent in FY 2011.
3. **Percent of imports compliant with U.S. trade laws:** Annually, CBP conducts an extensive and thorough analysis of import compliance with U.S. trade laws. Due to CBP's risk-based targeting approach, CBP continues to experience high compliance rates achieving 96.5 percent import compliance in FY 2012.
4. **Security compliance rate for high-risk maritime facilities:** As part of its border security mission, the U.S. Coast Guard conducts routine and unannounced examinations of Maritime Transportation Security Act regulated facilities. In FY 2012, 98.7 percent of these examinations were found to be in compliance. Corrective actions were issued to noncompliant facilities to remedy the deficiencies.

Facilitating Legal Trade and Travel

Active Lane Management: CBP is leveraging its Trusted Traveler Programs and the growing prevalence of radio frequency identification travel documents to initiate the "active lane management" concept at our land border ports of entry (POEs). Active Lane Management involves monitoring and making adjustments to a POE's lane designations as traffic conditions and infrastructure limitations warrant expediting traffic and enhancing security. Ready Lanes, Dedicated Commuter Lanes, and Light Emitting Diode signage are established best practices being deployed so Port Directors can re-designate lanes and communicate to the public in order to expedite both trusted and "ready" traffic.

Business Transformation at Ports of Entry: In order to strengthen security and expedite legal travel and trade at POEs, CBP is engaged in a series of business transformation initiatives. These initiatives involve reassessing core processes, incorporating technology enhancements, assessing utilization of law enforcement staffing, and developing automation efforts. Efficiencies and new technologies that have already been implemented, such as the Western Hemisphere Travel Initiative, Radio Frequency Identification enabled documents, License Plate Readers, Trusted Traveler Programs, and Non-Intrusive Inspection equipment are saving CBP hundreds of millions of dollars and creating a workforce multiple of several thousand positions.

Future Initiatives

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.

Below are a few initiatives that advance our efforts to achieve the Department's border security goals:

- Continue the Administration's robust border security efforts, while facilitating legitimate travel and trade through the sustainment of historic deployments of personnel along U.S. borders.
- Continue interdiction efforts at U.S. POEs through outbound vehicle and passenger processing, counter-surveillance, and perimeter enforcement to respond to evolving threats.
- Continue modifications, improvements, and maintenance to land, sea, and air POEs. This infrastructure facilitates nearly $150 billion in economic activity and expedites travel for more than 340 million international visitors per year.
- Enhance the Automated Commercial Environment system to eliminate unnecessary paperwork and enable electronic processing of manifests, entry forms, and other documentation to expedite trade and travel. Over time, this system will provide a single window for CBP to interact, manage, and oversee import and export data, custodial revenue management, and enforcement systems to provide end-to-end visibility of the entire trade cycle.

Enforcing and Administering Our Immigration Laws

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 meeting 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.

USCIS's Electronic Immigration Application System

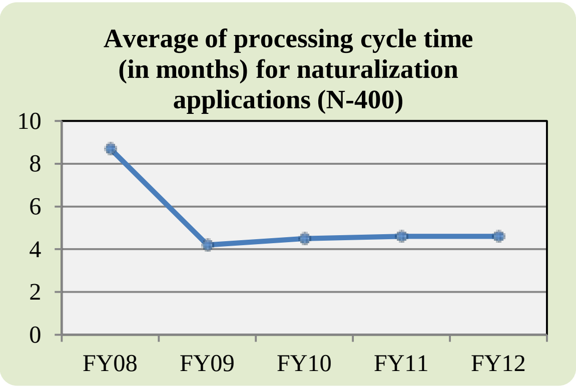
In 2012, U.S. Citizenship and Immigration Services (USCIS) launched the first two phases of its electronic immigration application system, known as USCIS ELIS. The system has been created to modernize the process for filing and adjudicating immigration benefits.

Historically, USCIS customers have had to apply for most benefits by mail and USCIS employees then review paper files and ship documents between offices to complete their adjudication. Under ELIS, eligible individuals can establish an account and apply online to extend or change their nonimmigrant status for certain visa types. ELIS also enables USCIS officers to review and adjudicate online filings from multiple agency locations across the country.

Benefits of using ELIS include filing applications and paying fees online, faster average processing times, and the ability to update user profiles, receive notices, and respond to requests electronically. The system also includes enhanced tools to combat fraud and identify national security concerns. As of September 30, 2012, 4,679 primary applications have been initiated online through ELIS.

Since the launch of ELIS in May 2012, the ELIS Customer Satisfaction Surveys show overwhelmingly positive results with 90.3 percent of respondents reporting a positive overall experience with ELIS and 94 percent of respondents would recommend ELIS to another USCIS applicant.

Below are highlighted performance measures related to *Enforcing and Administering Our Immigration Laws*.



- **Average of processing cycle time (in months) for naturalization applications (N-400):** An N-400, Application for Naturalization, is filed by an individual applying to become a United States citizen. USCIS has implemented several improvement programs to quickly and effectively adjudicate naturalization requests and have consistently achieved their target of processing naturalization applications in less than five months on average. In FY 2012, USCIS met their target of less than five months for the fourth year in a row achieving an average processing time of 4.6 months.

- **Overall customer service rating of the immigration process:** This measure gauges the overall satisfaction of the immigration process and is based on the results from the following areas: accuracy of information; responsiveness to customer inquiries; accessibility to information; and customer satisfaction. In FY 2012, USCIS achieved an overall customer service rating of 93 percent, up from 80 percent in FY 2011.
- **Average length of stay in detention of all convicted criminal aliens prior to removal from the United States (in days):** This measure assesses the length of time convicted criminal aliens are detained in one of U.S. Immigration and Customs Enforcement's (ICE) detention facilities while awaiting a final order of removal. In FY 2012 the average length of stay in detention of all convicted criminal aliens prior to removal was 31.9 days, meeting the target of less than 35 days and down 13.8 percent from 37 days in FY 2010.

Future Initiatives

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.

Below are a few initiatives that advance our efforts to achieve the Department's immigration enforcement and administration goals:

- Deploy additional near-term functionality for use in USCIS ELIS to include improved user account access and electronic signature of benefit request forms. In addition, new functionality will provide USCIS adjudicators improved decision notification options, risk data, and reporting capabilities.
- Continue our focus on monitoring and compliance, promoting adherence to worksite-related laws, Form I-9 inspections, and expansion of the E-Verify program.
- Bolster USCIS's effort to support immigrant integration efforts, including programs supporting English language acquisition and citizenship education.
- Support initiatives that focus finite resources on criminal aliens and other high priority cases.
- Implement Secure Communities nationwide in FY 2013, and in collaboration with the U.S. Department of Justice (DOJ), focus resources on the detained docket to increase the identification and removal of criminal aliens and other priority individuals. ICE is working with DHS's Office for Civil Rights and Civil Liberties and the DOJ on an oversight and evaluation process for Secure Communities, which includes additional training to state and local law enforcement.

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. By statute and Presidential Directive, DHS is the lead for the Federal Government to secure civilian government computer systems; working with industry to defend privately owned and operated critical infrastructure; and, working with state, local, tribal, and territorial governments to secure their information systems.
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.

Cyber Workforce Initiative

DHS is focused on building the next generation of cyber security professionals to support the Department's work today and in the future. In June 2012, Secretary Napolitano announced a new initiative through the Homeland Security Advisory Council, in conjunction with public and private sector partners, to develop an agile cyber workforce across the Federal Government. Since its creation, the Department has increased its cybersecurity workforce by more than 600 percent while working with universities to develop and attract talent through competitive scholarships, fellowships, and internship programs.

Below are highlighted performance measures related to *Safeguarding and Securing Cyberspace*.

- **Percent of traffic monitored for cyber intrusions at civilian Federal Executive Branch agencies:** This measure assesses DHS's increased vigilance in identifying malicious activity across Federal Executive Branch civilian agency networks. DHS operators monitor these networks using EINSTEIN intrusion detection system sensors, which are deployed to Trusted Internet Connection locations that minimize agencies' external gateways to the network. In FY 2012, 73 percent of Federal Executive Branch civilian network traffic was monitored for cyber intrusion using advanced technology, exceeding the target of 55 percent. DHS plans to have full operating capability by FY 2015.
- **Average amount of time required for initial response to a request for assistance from public and private sector partners to prevent or respond to major cyber incidents (in minutes):** Through the implementation of targeted process improvements and the adoption of agile incident response standard operating procedures, DHS responded on average within 14.1 minutes to major cyber incidents. This was a more than two hour improvement over the FY 2011 results of 138 minutes, meeting the target of less than 90 minutes.
- **Percent of intelligence reports rated "satisfactory" or higher in customer feedback that enable customers to manage risks to cyberspace:** This measure gauges the extent to

which the DHS Intelligence Enterprise is satisfying their customers' needs related to understanding the threats as they relate to cybersecurity. The DHS Intelligence Enterprise actively seeks out and identifies cyber threats, and once found, communicates this information to those who can take action to assess, manage, and resolve the threat. In FY 2012 the DHS Intelligence Enterprise obtained an 88 percent rating of satisfactory or higher, exceeding their target of 80 percent.

Industrial Control Systems Cyber Emergency Response Team

DHS provides key analysis and assistance through its Industrial Control Systems Cyber Emergency Response Team (ICS-CERT) to protect the industrial control systems that help operate the U.S. power grid, manufacturing systems and other essential critical infrastructure from dangerous malware and viruses that may cause damage or destroy key resources.

In early December 2011, ICS-CERT responded to a cybersecurity incident affecting a rail company. The initial report indicated that the rail company was experiencing a cyber attack to its secondary communications equipment. ICS-CERT, working in coordination with asset owners, analyzed various data and determined that the incident was not the result of a targeted attack. In this case, the rail company quickly implemented effective measures to maintain the safety of its operation and worked closely with ICS-CERT to understand the incident and take appropriate mitigation measures.

In addition, DHS's ICS-CERT has been working since March 2012 with critical infrastructure owners and operators in the oil and natural gas sector to address a series of cyber intrusions targeting natural gas pipeline companies. In conjunction with the FBI and other federal agencies, ICS-CERT is working with affected organizations to prepare mitigation plans customized to their current network and security configurations to detect, mitigate, and prevent such threats.

Future Initiatives

Below are a few initiatives that advance our efforts to achieve the Department's cybersecurity goals:

- Support the acceleration of the National Cybersecurity Protection System's prevention capability (E^3A) on civilian government computer systems to prevent and detect intrusions.
- Continue to provide high-quality, cost-effective virtual cybersecurity education and training to develop and grow a robust cybersecurity workforce that is able to protect against and respond to national cybersecurity threats and hazards.
- Increase outreach to Critical Infrastructure and Key Resource owners and improve control systems cybersecurity awareness, incident response, coordination, and information sharing.
- Enhance information sharing processes with critical infrastructure owners and operators to create shared situational awareness of cyber threats across sectors and facilitate collaborative incident response though the National Cybersecurity and Communications Integration Center.

- Build on the National Cyber Incident Response Plan, which enables DHS to coordinate the response of multiple federal agencies, state and local governments, international partners, and private industry to incidents at all levels.

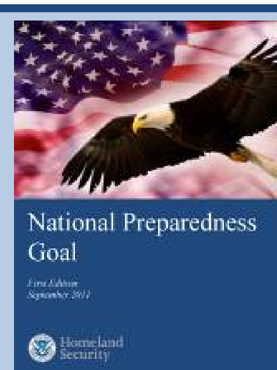
Ensuring Resilience to Disasters

Despite ongoing vigilance and efforts to protect this country and its citizens, major accidents and disasters, as well as attacks, may occur. The challenge is to build the capacity of American communities to be resilient in the face of disasters and other threats. Our vision of a resilient Nation is one with the capabilities required across the whole community to prevent, protect against, mitigate, respond to, and recover from the threats and hazards that pose the greatest risk.

We will achieve this mission through meeting the following goals:

- **Mitigate Hazards –** Strengthen capacity at all levels of society to withstand threats and hazards.
- **Enhance National Preparedness through a Whole Community Approach to Emergency Management –** Engage all levels and segments of society in improving preparedness.
- **Ensure Effective Emergency Response –** Strengthen nationwide response capacity to stabilize and recover from a catastrophic event.
- **Rapidly Recover from a Catastrophic Event –** Improve the Nation's ability to adapt and rapidly recover.

National Preparedness Goal



In October 2011, DHS announced the release of the country's first-ever National Preparedness Goal. The goal is the first deliverable required under Presidential Policy Directive (PPD) 8: National Preparedness. The goal sets the vision for nationwide preparedness and identifies the core capabilities and targets necessary to achieve preparedness across five mission areas laid out under PPD 8—prevention, protection, mitigation, response, and recovery.

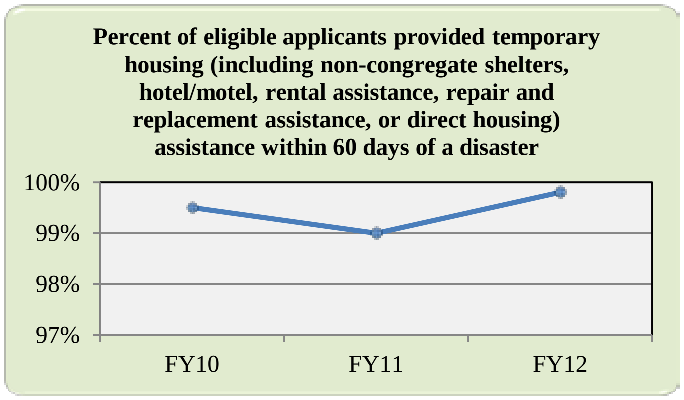
In March 2012, the National Preparedness Report (NPR) was released which focuses on the five mission areas outlined in the National Preparedness Goal. Within these mission areas are 31 core capabilities central to preparedness. The NPR assesses each core capability and identifies areas where the Nation has made significant progress, opportunities for improvement and reinforces the core principles of national preparedness. Areas of national strength identified in the NPR include planning, operational coordination, intelligence and information sharing, and other response-related capabilities.

The NPR is part of a series of deliverables required under PPD 8 aimed at strengthening the security and resilience of the United States through systematic preparation for the threats that pose the greatest risk to the security of the Nation, including acts of terrorism, cyber attacks, pandemics, and catastrophic natural disasters.

Below are highlighted performance measures related to *Ensuring Resilience to Disasters*.

- **Percent of time that critical communications for response operations are established within 12 hours:** This measure reflects the percent of time that critical communications are established for the Federal Emergency Management Agency's (FEMA) on-site emergency responders within 12 hours of the deployment of Mobile Emergency Response Support. FEMA met its target of 100 percent in establishing critical communications for response operations within 12 hours in FY 2012.

- **Percent of eligible applicants provided temporary housing (including non-congregate shelters, hotel/motel, rental assistance, repair and replacement assistance, or direct housing) assistance within 60 days of a disaster**: State and local governments and FEMA's Emergency Support Function-6 partners provide emergency sheltering for those in need during the initial stages of a declared emergency. Once the emergency is contained and FEMA supports the community in beginning full recovery efforts, individuals may receive temporary housing assistance which includes transitional sheltering assistance (hotel/motel), rental assistance, repair and replacement assistance, or direct housing (temporary housing units). In FY 2012, FEMA placed eligible applicants in temporary housing within 60 days 99.8 percent of the time, exceeding their target of 97 percent.



- **Reduction in the potential cost of natural disasters to communities and their citizens:** FEMA uses a risk-based strategic approach to deploy mitigation grants, conduct outreach, and provide technical assistance to support state and local initiatives that result in safer communities by reducing the loss of life and property. Through the deployment of mitigation initiatives, long-term costs are avoided. In FY 2012, it is estimated that a reduction of $3.12 billion dollars in the potential cost of natural disasters to communities and their citizens was avoided, exceeding the target of $2.4 billion.

- **Percent of calls made by National Security/Emergency Preparedness users during emergency situations that DHS ensured were connected:** The ability of our National Security and Emergency Preparedness personnel to communicate effectively during emergency situations is vital. The call completion rate is the percent of calls that a national security/emergency preparedness user successfully completes via public telephone network to communicate with the intended user, location, or system, during an emergency situation. In FY 2012, the call completion rate was 99.4 percent, meeting our annual target and up from the FY 2011 result of 97.8 percent.

Hurricane Isaac Response and Recovery Efforts

On the evening of August 28, 2012, Hurricane Isaac made landfall along the coast of Louisiana and continued to impact Gulf Coast communities for days thereafter. Within hours, both Louisiana and Mississippi received Presidential disaster declarations allowing federal assistance to flow into those states. FEMA and other federal agencies deployed prior to the storm and located in states all along the Gulf Coast to prepare for and be ready to respond to the damages of Isaac. Supply centers in the anticipated impact areas were stocked with supplies including large and small generators in expectation of widespread power outages.

Hurricane Isaac demonstrated the value of mitigation projects put in place following Hurricane Katrina allowing communities along the Gulf Coast to successfully respond to and recover from Isaac's impact.

Future Initiatives

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 bolstering information sharing and providing grants, plans, and training to our homeland security and law enforcement partners. To be successful, DHS must foster a national approach to disaster management built upon a foundation of proactive engagement at the community level that builds community resilience and supports local emergency management needs.

Below are a few initiatives that advance our efforts to achieve our resilience goals:

- Continue to build the core capabilities of state and local law enforcement and emergency management communities, providing the tools needed to respond to evolving threats through grants, training, fusion centers, and intelligence analysis and information sharing.
- Support the proposed National Preparedness Grants Program to create a robust national preparedness capability. DHS will leverage a comprehensive process to assess regional and national capability gaps, identify and prioritize cross jurisdictional and readily deployable capabilities, and require grantees to regularly report progress in the acquisition and development of these capabilities.
- Using the results from the National Preparedness Report, FEMA will work with Whole Community partners to leverage grants, training, and technical assistance to bolster the 31 core capabilities central to preparedness.

Providing Essential Support to National and Economic Security

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; 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:

- **Collect Customs Revenue and Enforce Import/Export Controls –** Maximize the collection of customs revenue and protect U.S. intellectual property rights and workplace standards.
- **Ensure Maritime Safety and Environmental Stewardship –** Prevent loss of life in the maritime environment, maintain the marine transportation system, and protect and preserve the maritime environment.
- **Conduct and Support Other Law Enforcement Activities –** Prevent the exploitation of individuals and provide law enforcement training for the execution of other non-DHS federal laws and missions.
- **Provide Specialized National Defense Capabilities –** Support national defense mission and post-conflict reconstruction and stabilization.

Below are highlighted performance measures related to *Providing Essential Support to National and Economic Security*.

- **Percent of revenue successfully collected:** This measure estimates the collected duties expressed as a percent of the all collectable revenue due from commercial imports to the United States directed by trade laws, regulations, and agreements. In FY 2012, 98.9 percent (estimated) of collectable revenue was collected.
- **Five-year average number of commercial and recreational boating deaths and injuries:** This measure reports the sum of the five-year average numbers of reportable commercial mariner, commercial passenger, and recreational boating deaths and injuries and is a long-term trend indicator of the U.S. Coast Guard Maritime Prevention Program's impact on marine safety. In FY 2012, there were 4,473 commercial and recreational boating deaths and injuries, a decrease from FY 2011 and meeting the five-year average target of fewer than 4,642.
- **Availability of maritime navigation aids:** This measure indicates the hours that short-range federal aids-to-navigation are available. There are about 50,000 short range aids-to-navigation throughout the United States to support improved safety and navigability on our open waters. The U.S. Coast Guard has a long history of maintaining these navigational aids and consistently achieves its target of 97.5 percent availability. In FY 2012 the availability of maritime navigations aids was 98.3 percent, exceeding the target.
- **Number of Federal law enforcement training programs and/or academies accredited or re-accredited through the Federal Law Enforcement Training Accreditation**

process: This performance measure reflects the cumulative number of federal law enforcement training programs and/or academies accredited or re-accredited through the Federal Law Enforcement Training Accreditation (FLETA) process. Accreditation ensures that training and services provided meet professional training standards for law enforcement and re-accreditation is conducted every three years to remain current. The cumulative results through FY 2012 of 83 accreditations or re-accreditations exceeded FLETA's target of 74.

Future Initiatives

Below are a few initiatives that advance our efforts to achieve our national and economic security goals:

- Continue the U.S. Coast Guard's recapitalization of cutters; boats; aircraft; Command, Control, Communications, Computers, Intelligence, Surveillance, and Reconnaissance (C4ISR) systems; and infrastructure to improve the security of the maritime environment, and to improve mission readiness and response capability. Through a balanced approach, limited resources will be effectively deployed to support operations and mission execution.
- Leverage a new operational partnership between ICE and USSS through the Electronic Crimes and Financial Crimes Task Forces to enhance national security, target large-scale producers of child pornography, and prevent attacks against critical U.S. infrastructure.
- Continue to target the gap in lost revenue from commercial imports through the use of various enforcement methods such as audits, targeting, and statistical random sampling to bridge revenue gap and identify non-compliance with U.S. trade laws, regulations and agreements.

Maturing and Strengthening DHS

The strategic aims and objectives for maturing and strengthening DHS are drawn from the common themes that emerge from each of the mission areas. Ensuring a shared awareness and understanding of risks and threats, building capable communities, creating unity of effort, and enhancing the use of science and technology underpin our national efforts to prevent terrorism and enhance security, secure and manage our borders, enforce and administer our immigration laws, safeguard and secure cyberspace, and ensure resilience to disasters.

We will continue to make progress in maturing and strengthening DHS by focusing on the following goals:

- **Improve Cross-Departmental Management, Policy, and Functional Integration –** Transform and increase the integration of departmental management.
- **Enhance DHS Workforce –** Continue to build human resource programs that support departmental mission goals and objectives, create high technical proficiency, and address the needs of the Department's employees in executing DHS missions.

- **Enhance Intelligence, Information Sharing, and Integrated Operations –** Institute optimal mechanisms to integrate the Department's intelligence elements, increase operational capability, and harmonize operations.

Future Initiatives

Below are a few initiatives that advance our efforts to achieve our maturing and strengthening goals:

- Improve the Department's comprehensive and strategic approach to strengthen the homeland security enterprise by increasing unification and integration, addressing challenges raised by GAO, and building upon the management reforms that have been implemented under this Administration.
- Using a phased approach, modernize the financial systems within DHS to provide integrated financial management services.
- Execute the Balanced Workforce Strategy, which is designed to ensure the Department has the appropriate mix of federal employees and contractors to fulfill our mission in a manner that is cost-effective and ensures appropriate federal oversight.
- Improve the Department's acquisition workforce capacity—including additional systems engineers, program managers, logisticians, and business cost estimators, to ensure operational requirements are properly developed and included in DHS contracts to provide greater oversight and accountability.
- Continue expansion of the Secretary's Department-wide Efficiency Review to maximize the effectiveness and efficiency of limited resources.

Financial Overview

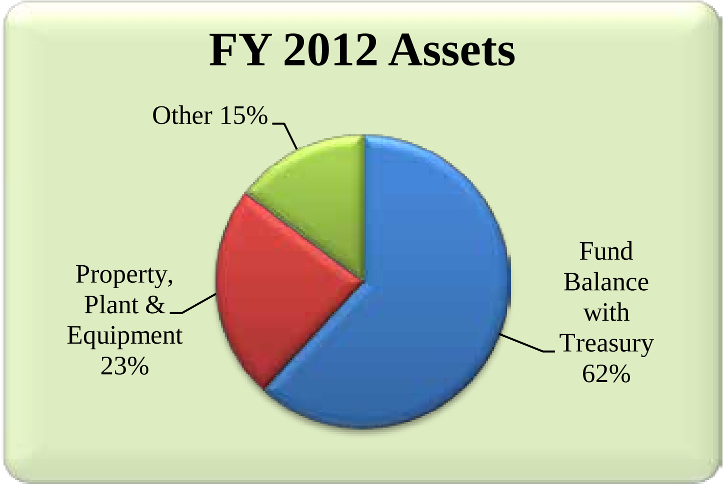
DHS's budgetary resources were approximately $79.5 billion for FY 2012, approximately $1 billion more than in FY 2011. The budget represents our plan for efficiently and effectively achieving the strategic objectives set forth by the Secretary to carry out our mission and to ensure that DHS manages its 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. These financial statements provide the results of our operations and financial position, including long-term commitments and obligations. 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. The audit of the Department's principal financial statements was performed by KPMG LLP.

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.

Total Assets

As of September 30 (in Millions)	FY 2012	FY 2011
Fund Balance with Treasury	$ 53,875	$ 55,960
General Property, Plant, and Equipment, Net	20,491	20,037
Other	12,790	10,892
Total Assets	$ 87,156	$ 86,889



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, 2012, DHS had $87 billion in assets, representing a $267 million increase from FY 2011.

Fund Balance with Treasury (FBwT), the Department's largest asset, comprises 62 percent ($54 billion) of the total assets. Included in FBwT is the remaining balance of DHS's unspent prior-year budgets plus miscellaneous receipts. FBwT decreased by approximately $2 billion from FY 2011 primarily due to FEMA disbursements related to Hurricane Irene and CBP disbursements related to border station construction and lawsuit

U.S. Coast Guard assets account for approximately half of the property, plant, and equipment assets of DHS.

settlements. In addition, funds were available for disbursement for a longer period than in FY 2011 due to the timing of the passage of the FY 2012 appropriations bill

Property, Plant, and Equipment (PP&E) is the second largest asset, comprising 23 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 2012, PP&E increased by approximately $454 million dollars. The increase in FY 2012 is due to CBP's construction of new border stations and land ports of entry, as well as MGMT's purchase of additional equipment for DHS consolidated data centers. Other sources of the increase include the St. Elizabeths construction project; routine upgrades of TSA Explosive Detection X-ray systems; and USCIS' deployment of new software systems over the course of the fiscal year in support of the transition towards an electronic-based adjudication process.

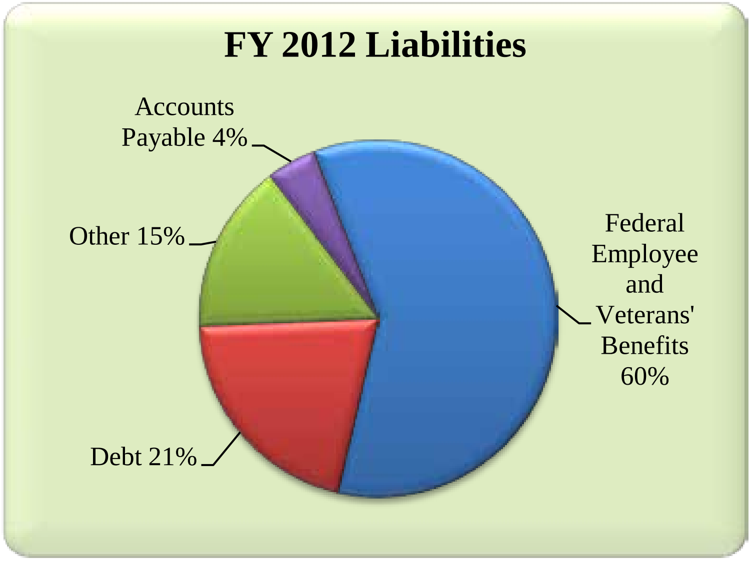
Liabilities – What We Owe

At September 30, 2012, DHS reported approximately $87 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.

Total Liabilities

As of September 30 (in Millions)	FY 2012	FY 2011
Federal Employee and Veterans' Benefits	$ 51,953	$ 49,664
Debt	18,072	17,754
Other	13,456	15,453
Accounts Payable	3,890	4,598
Total Liabilities	$ 87,371	$ 87,469

DHS's largest liability is for Federal Employee and Veterans' Benefits, representing 60 percent of total liabilities. This liability increased approximately $2.3 billion from FY 2011. The increase in FY 2012 primarily relates to U.S. Coast Guard changing its discount rate and assumptions used to calculate the Military Retirement and Health System actuarial liabilities. For more information, see Note 16 in the Financial Information Section. 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 (see Note 14 in the Financial Information section).

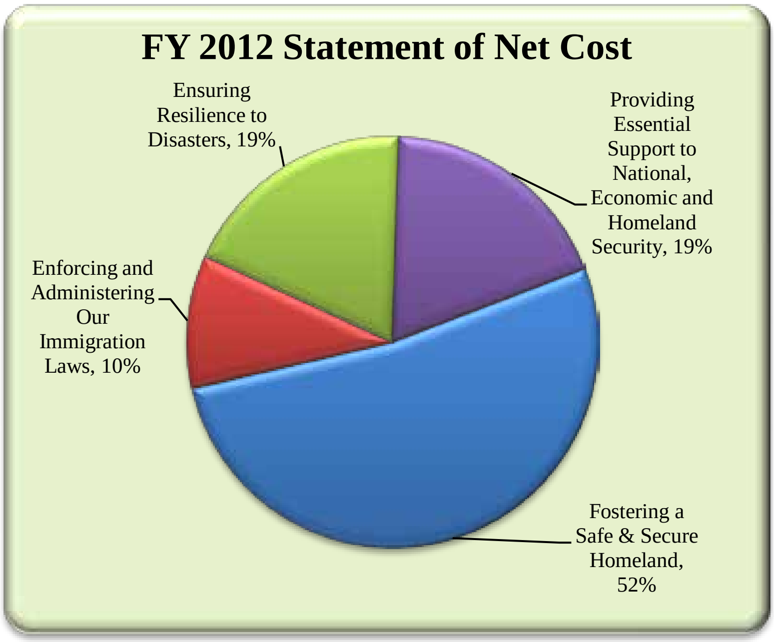



The National Flood Insurance Program and the Disaster Assistance Direct Loan Program operations of FEMA account for 100 percent of the overall debt of DHS.

Debt is DHS's second-largest liability, representing 21 percent of total liabilities. This debt results from Department of Treasury loans and related interest payable to fund the National Flood Insurance Program (NFIP) and Disaster Assistance Direct Loan Program operations of FEMA. Total debt increased approximately $318 million from FY 2011. Direct Loans increased in FY2012 per OMB's direction to FEMA to reinstate loans that were written off in prior years based on the *Disaster Assistance Recoupment Fairness Act of 2011.* Given the current premium rate structure, FEMA will be unable to pay its debt when due, and legislation will need to be enacted to provide funding to repay the Bureau of Public Debt. This is discussed further in Note 15 in the Financial Information section.

Other liabilities, comprising 15 percent of the Department's liabilities, includes unpaid wages and benefits for current DHS employees, deferred revenue, insurance liabilities, environmental liabilities, and other. Other liabilities decreased approximately $2 billion from FY 2011. The decrease occurred primarily due to FEMA basing its FY 2011 insurance liability actuarial estimates on historical averages in accordance with industry practices. However, the events related to this accrual estimate did not conform to historical averages. Four 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 revenue. The Department's FY 2012 Statement of Net Cost displays DHS costs and revenue and groups the five strategic goals and two focus areas into four major missions. The first, *Fostering a Safe and Secure Homeland*, includes Missions 1, *Preventing Terrorism and Enhancing Security*, 2, *Securing and Managing Our Borders*, and 4, *Safeguarding and Securing Cyberspace.* This major mission, which involves the security and prevention aspects of the DHS Strategic Plan, represents 52 percent of the

Department's net cost. *Providing Essential Support to the National, Economic and Homeland Security* consists of the two focus areas of the DHS Strategic Plan: Providing Essential Support to National and Economic Security and Maturing and Strengthening DHS and represents 19 percent of the Department's net cost. *Ensuring Resilience to Disasters* is Mission 5 of the strategic plan and represents 19 percent of total net costs. *Enforcing and Administering Our Immigration Laws* is Mission 3 of the strategic plan and represents 10 percent of the Department total. The consolidation of the seven strategic goals into four major missions allows the average reader of the Statement of Net Cost to clearly see how resources are spent towards the common goal of a safe, secure, and resilient America. Note 23 in the Financial Information section shows costs by responsibility segment aligned to the major missions.

As a result of the Department's new strategic plan, combined with the change in the Statement of Net Cost presentation and cost-tracing methods implemented in FY 2012, DHS is not presenting the FY 2011 Statement of Net Cost comparative to FY 2012. The Department presents its FY 2011 Statement of Net Cost and related note disclosures by responsibility segment, as it appeared in the FY 2011 Annual Financial Report (AFR).

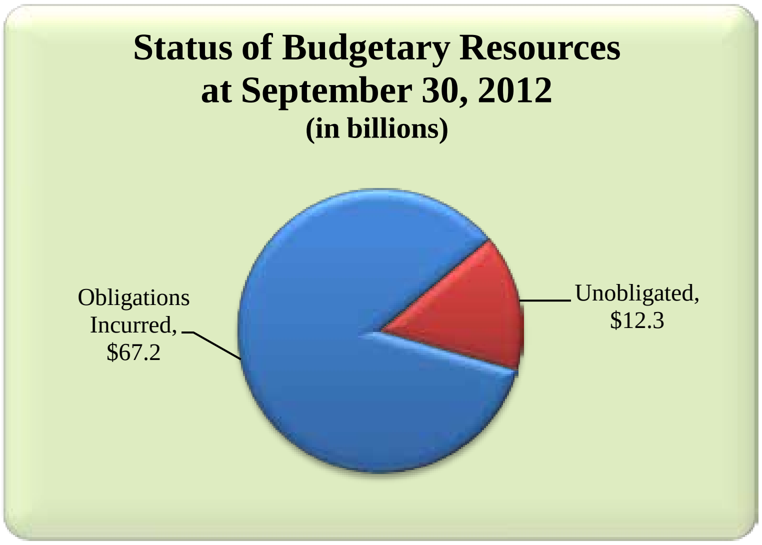
During FY 2012, the Department earned approximately $11.6 billion in revenue; this is an increase of about $619 million from $11 billion as of September 30, 2011. The increase is primarily due to an increase in FEMA's flood insurance premium revenue; acceleration of USCIS' H-1B applications, work authorizations, and adjustment status applications; and an increase in Federal Protective Service fees. The Department classifies revenue as either exchange ("earned") or non-exchange revenue. Exchange revenue arises 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 revenue on behalf of the Federal Government. This non-exchange revenue is presented in the Statement of Custodial Activity, rather than the Statement of Net Cost.

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. Net position increased in FY 2012. This increase is primarily due to an overall decrease in net costs from FY 2011 and an adjustment due to a change in accounting principle for repairable spares at U.S. Coast Guard in FY 2012. For more information, see Note 32 in the Financial Information Section.

Statement of Budgetary Resources

This statement provides information on the status of the approximately $79.5 billion in budgetary resources available to DHS during FY 2012. The authority was derived from appropriations of $55.4 billion, $11.2 billion in authority carried forward from FY 2011, $10 billion in collections, and $2.9 billion of miscellaneous authority.



The total amount of resources available increased by approximately $1 billion from FY 2011. The change is primarily due to an increase in FEMA's disaster funding in FY 2012.

Of the total budget authority available, DHS incurred a total of $67.2 billion in obligations from salaries and benefits, purchase orders placed, contracts awarded, or similar transactions. These obligations will require payments during the same or future period. As of September 30, 2012, $12.3 billion of the $79.5 billion was not yet obligated. The $12.3 billion represents $8.5 billion in apportioned funds available for future use, and $3.8 billion in unapportioned funds.

Statement of Custodial Activities

This statement presents the disposition of revenue collected and disbursed by DHS on behalf of other recipient entities. 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. CBP collects revenue from a variety of duties, excise taxes, and various other fees. Non-exchange revenue is either retained by the Department to further its mission or returned to Treasury's General Fund. Total cash collections increased by more than $1 billion in FY 2012. This is due to increased importing, which resulted in additional cash collections for customs duties at CBP.

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. When a heritage asset is predominantly used for general government operations, the heritage asset is considered a multi-use heritage asset. The U.S. Coast Guard has over 700 memorials, recreational areas, and other historical areas designated as multi-use heritage assets. CBP has four historical buildings and structures located in Puerto Rico, and FEMA has one training facility that is used by the United States Fire Administration for training in Emmitsburg, Maryland. In addition, CBP, USCIS, TSA, and S&T have collection-type assets that consist of documents, artifacts, immigration and naturalization files, architectural and building artifacts used for education, and a historical lighthouse at Plum Island Animal Disease Center.

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.

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 Federal Government, a sovereign entity.

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 management is responsible for establishing, maintaining, and assessing internal control to provide reasonable assurance that the 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. In addition, the *Department of Homeland Security Financial Accountability Act* (Pub. L. 108-330) requires a separate management assertion and an audit opinion on the Department's internal controls over financial reporting.

In FY 2006, the Office of Management & Budget revised its Circular A-123 to address internal control reporting changes to align with private industry regulatory requirements. At that time, DHS management prepared a multi-year plan to implement its evaluation of controls over financial reporting as required under the revised guidance. Since FY 2006, DHS management has made significant improvements in management controls across DHS operations and financial management and reporting. Staff and management at Headquarters and in the Components have worked steadily and extensively to remediate operating and financial reporting controls such that DHS will be able to sustain its financial statement opinion and be able to achieve an opinion over internal control in the near future.

In FY 2011, DHS controls and financial management were improved such that DHS achieved its first opinion on the Balance Sheet and Statement of Custodial Activity. This was a major milestone for the Department. This year DHS achieved an opinion on all its financial statements, and is able to provide a qualified assurance over financial reporting controls. Much work remains to improve financial management processes and procedures in order to meet and sustain these critical milestones over time and become more efficient.

In assessing the Department's operational and financial management controls, management executes annual assessments to evaluate the status of internal controls to support the Secretary's annual assurance statement. These annual assessments are part of a multi-year implementation plan and management is required to assess controls to determine the extent and materiality of the deficiencies.

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. 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.

DHS instituted an Accountability Structure, which 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 Readiness Support 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.

Component Senior Leadership provided assurance statements to the SAT that serve as the primary basis for the Secretary's assurance statements. These assurance statements are also based on information gathered from various sources including management-initiated internal control assessments, program reviews, and evaluations. In addition, these statements consider the results of reviews, audits, inspections, and investigations performed by the DHS Office of Inspector General (OIG) and the Government Accountability Office (GAO).

Secretary's Assurance Statement

November 14, 2012

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.

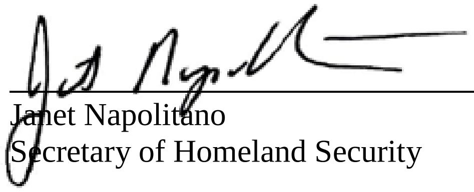
In accordance with the *Federal Managers' Financial Integrity Act* (FMFIA) and the *Department of Homeland Security Financial Accountability Act* (DHS FAA), I have directed an evaluation of internal control at the Department of Homeland Security in effect during the fiscal year (FY) ending September 30, 2012. This evaluation was conducted in accordance with Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*. The Department provides reasonable assurance that the objectives of FMFIA, Section 2 over non-financial operations have been achieved, with the exception of three material weaknesses related to Financial Assistance Awards Policy and Oversight, Acquisition Management, and Funds Control.

The Department has completed its FY 2012 limited-scope evaluation of internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations, in accordance with our OMB approved plan; OMB Circular A-123, Appendix A; and departmental requirements. The Department provides reasonable assurance that our internal controls over financial reporting were operating effectively as of September 30, 2012, with the exception of three business processes – Financial Reporting; Property, Plant, and Equipment; and Budgetary Accounting – and IT systems and functionality, where material weaknesses have been identified and remediation is in process, as further described in the Other Accompanying Information. In addition, DHS does not currently have consolidated financial management systems that conform to the objectives of FMFIA, Section 4, and the *Federal Financial Management Improvement Act* (FFMIA). The Department will continue efforts to ensure that management control systems are in place to achieve the mission of the Department.

The Department follows a risk-based approach in determining which business processes will be assessed during the current year. Based on the results of the work performed, no additional material weaknesses were identified in the business processes listed in the Other Accompanying Information Section of this report.

We have made significant financial management improvements over the last several years enabling these historic milestones. The Department has identified, mitigated and reduced our material weaknesses related to internal controls over financial reporting to an unprecedented level and we are now able to provide reasonable assurance as required by law and regulation. We are committed to fully mitigating and eliminating the remaining material weaknesses such that we can provide full assurance and subsequently achieve an unqualified opinion on internal control. The outcome of the FY 2012 full scope audit and its resulting opinion on the Department's financial statements represents a major milestone for DHS management. In addition, we are providing reasonable assurance over financial reporting in pursuit of our opinion on internal control.

We will continue 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 level of accountability and transparency.



Janet Napolitano
Secretary of Homeland Security

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 uses 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, significant system improvement efforts are in progress to modernize, certify, and accredit all financial management systems to conform to Government-wide requirements.

Financial Management Systems

Pursuant to the CFO Act, the DHS CFO is responsible for developing and maintaining agency accounting and financial management systems to ensure systems comply with applicable accounting principles, standards, and requirements and with internal control standards. As such, the DHS OCFO will oversee and coordinate all financial system modernization efforts.

DHS has adopted a hybrid approach to modernizing financial management systems across the Department. Our approach includes:

- Expanding business intelligence and standardizing data across Components to quickly provide enterprise-level reporting.
- Targeting investments in financial systems modernization in a cost-effective manner and minimizing duplication in infrastructure in accordance with emerging technologies and guidance, prioritizing essential system modernizations for the Components with the most critical need.

In accordance with OMB guidance, DHS will plan and implement incremental Component-level financial system modernization projects in order to deliver functionality faster and reduce risks often associated with large, complex IT projects. By splitting the projects into smaller, simpler segments with clear deliverables, DHS can ensure delivery of timely, well-managed solutions. DHS will also leverage existing infrastructure and evolving technologies, such as shared service providers and cloud-based solutions.

DHS has made great strides during the past year in our Financial Systems Modernization initiative. The Financial Systems Modernization Playbook (Playbook) articulates the vision and actions DHS is undertaking to strengthen access to and the quality of financial information to support decision making. It communicates our plan for expanding business intelligence capability to provide enterprise-level information and for strengthening financial systems in a cost-effective manner. These standards will also strengthen internal controls throughout the Department to provide more efficient operations.

DHS plans to continue forward by executing the financial system modernization activities as described in the Playbook. Specific goals for FY 2013 include the FEMA Technical refresh, a decision on the U.S. Coast Guard path forward, and a decision on the ICE path forward for financial systems modernization.

Federal Information Security Management Act

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 2012 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 reported that DHS continued to improve its information security program during FY 2012. For example, the CISO:

- Developed the *Fiscal Year 2012 DHS Information Security Performance Plan t*o enhance DHS's information security program and continue to improve existing processes, such as continuous monitoring, Plan of Action and Milestones (POA&M), and security authorization.
- Updated the Department's baseline IT security policies and procedures in DHS Sensitive Systems Policy Directive 4300A and its companion, *DHS 4300A Sensitive Systems Handbook*, to reflect the changes made in DHS security policies and various NIST guidance.
- In April 2012, the DHS CISO issued its second *State of Cybersecurity at The Department of Homeland Security* report. The report outlines how DHS anticipates and addresses emerging security risks from new technology products and advanced threat actor techniques, including its new initiatives and programs that ensure a secure computing environment within the Department. The report presents relevant information to employees for protecting their information and increasing the Department's cybersecurity awareness.
- The overall quality of security authorization documentation continues to improve in FY 2012. Compared with FY 2011, DHS identified fewer deficiencies in the security authorization documentation for the systems that were selected for review.

The OIG report, *Evaluation of DHS' Information Security Program for Fiscal Year 2012*, identified six recommendations for information security improvements. The CISO concurred with the recommendations and corrective actions are already underway to address each.

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*** on the Balance Sheet, Statements of Net Cost, Statements of Changes in Net Position, Statements of Budgetary Resources and Statements 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 KPMG LLP.

Message from the Chief Financial Officer

November 14, 2012

This Annual Financial Report (AFR) is our principal financial statement of accountability to the American people, the President of the United States, and the Congress. The AFR gives a comprehensive view of the Department of Homeland Security's financial activities and demonstrates the Department's commitment to ensuring strong financial management and proper stewardship of taxpayer dollars.

Since the Department was stood up in 2003, we have worked diligently to strengthen financial management to support our mission and produce timely, reliable financial data. The passage of the *DHS Financial Accountability Act* in 2004 reinforced our efforts to mature Department operations. We developed robust financial policies, processes, and internal controls to ensure efficient and effective use of Department resources. We continued to execute our proven strategy of targeted risk assessment and strong oversight of corrective actions as we underwent a full-scope audit for the first time in FY 2012.

This is an exciting time for the DHS financial management community. In FY 2011, the Department achieved a significant milestone by earning a qualified audit opinion on the Balance Sheet and Statement of Custodial Activity. Building on this success, in FY 2012 the Department presented all five financial statements for audit for the first time in its history. I am proud to say that our first full-scope audit resulted in a qualified audit opinion. We increased the Department's auditable Balance Sheet balances in FY 2012 to approximately 90 percent of its $87.2 billion in assets and liabilities—up from 63 percent in FY 2009. In addition, the Department is able to provide reasonable assurance that our internal controls over financial reporting were operating effectively as of September 30, 2012, with the exception of the four remaining material weaknesses identified in the Secretary's Assurance Statement.

This progress is due to the hard work and dedication of employees across the Department, starting with strong leadership support. Secretary Napolitano established a goal of obtaining an opinion on a full-scope financial statement audit in FY 2012. All DHS Component Heads committed to support that goal by improving financial reporting and working to eliminate material weaknesses and significant deficiencies. Working together as One DHS, the financial management community instituted sound business processes and standards that we can build on to sustain our successes for years to come.

This unified effort produced substantial results and was instrumental in the Department meeting its audit goals in FY 2012. We continued to improve the quality of our Balance Sheet balances while expanding the work to ensure successful audit of the remaining statements. Together, we established a manageable, sustainable, and auditable process for reporting the Statement of Net Cost, allowing us to effectively allocate costs and gain greater visibility into Department outcomes. We conducted thorough analysis to identify and resolve potential issues early in the year, allowing us to deliver an auditable $79.6 billion Statement of Budgetary Resources.

The U.S. Coast Guard made tremendous progress in supporting their Property, Plant & Equipment line item and can assert to an additional $2.1 billion in Real Property and Environmental Liabilities. To complete this effort in such a short time, the Coast Guard reallocated resources to perform a one-time, accelerated assessment of the full value of Coast Guard property, and several Components sent teams to support their work. The Coast Guard is now well-positioned to assert to the entire line item in FY 2013. I am proud of this culture of collaboration, which I believe is critical our success.

The Department complies with the *CFO Act of 1990*, which outlined a roadmap for government agencies to develop financial data to be used in decision making, to allow for enhanced financial accountability, and to improve internal controls. We have increased the quality of financial data and information standards, we are achieving success in the financial systems arena, and we are sufficiently staffed with highly qualified financial management professionals—all key goals of the CFO Act. With this year's full-scope audit opinion, we achieved a major component of the CFO Act.

I am proud of the hard work and dedication of the entire financial management community as we continue to ensure taxpayer dollars are managed with integrity, accuracy, steady attention, and effort and that the systems and processes used for all aspects of financial management demonstrate the highest level of accountability and transparency. We will continue to work together to better manage resources, provide timely enterprise-level information to support critical decision making, reduce costs by eliminating redundant or non-conforming systems, and promote good business practices through standardization of processes and data where possible.

Sincerely,

Peggy Sherry

Peggy Sherry
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), and the *Department of Homeland Security Financial Accountability Act of 2004* (Pub. L. 108-330). Other requirements include the Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*, as amended. The responsibility for the integrity of the financial information included in these statements rests with the management of DHS. The audit of the Department's principal financial statements was performed by KPMG LLP. The independent auditors' report accompanies the principal financial statements.

The Department's principal financial statements consist of the following:

1. The Consolidated **Balance Sheets** present, as of September 30, 2012 and 2011, 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).

2. The Consolidated **Statements of Net Cost** present the net cost of DHS operations for the fiscal years ended September 30, 2012 and 2011. DHS net cost of operations is the gross cost incurred by DHS less any exchange revenue earned from DHS activities.

3. The Consolidated **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, 2012 and 2011.

4. The Combined **Statements of Budgetary Resources** present how and in what amounts budgetary resources were made available to DHS during FY 2012 and FY 2011, the status of these resources at September 30, 2012 and 2011, the changes in the obligated balance, and budget authority and outlays of budgetary resources for the fiscal years ended September 30, 2012 and 2011.

5. The Consolidated **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, 2012 and 2011.

6. The **Notes to the Financial Statements** provide detail and clarification for amounts on the face of the financial statements as of September 30, 2012 and 2011.

Financial Statements

Department of Homeland Security
Balance Sheets
As of September 30, 2012 and 2011
(In Millions)

		2012		2011 (Restated)
ASSETS				
Intragovernmental				
Fund Balance with Treasury (Notes 2 and 3)	$	53,875	$	55,960
Investments, Net (Note 5)		4,551		4,159
Accounts Receivable (Note 6)		259		271
Other (Note 13)				
Advances and Prepayments		1,517		1,832
Total Intragovernmental	**$**	**60,202**	**$**	**62,222**
Cash and Other Monetary Assets (Notes 2 and 4)		114		76
Accounts Receivable, Net (Notes 2 and 6)		888		645
Taxes, Duties, and Trade Receivables, Net (Notes 2 and 7)		2,701		2,732
Direct Loans, Net (Note 8)		322		10
Inventory and Related Property, Net (Note 9)		1,750		527
General Property, Plant, and Equipment, Net (Note 11)		20,491		20,037
Other (Note 13)				
Advances and Prepayments		688		640
TOTAL ASSETS	**$**	**87,156**	**$**	**86,889**
Stewardship Property, Plant, and Equipment (Note 12)				
LIABILITIES				
Intragovernmental				
Accounts Payable	$	2,001	$	2,154
Debt (Note 15)		18,072		17,754
Other (Note 18)				
Due to the General Fund		2,727		2,844
Accrued FECA Liability		334		374
Other		567		532
Total Intragovernmental	**$**	**23,701**	**$**	**23,658**
Accounts Payable		1,889		2,444
Federal Employee and Veterans' Benefits (Note 16)		51,953		49,664
Environmental and Disposal Liabilities (Note 17)		668		569
Other (Notes 18, 19, 20, and 21)				
Accrued Payroll and Benefits		2,454		2,198
Deferred Revenue and Advances from Others		2,845		2,716
Insurance Liabilities		833		3,537

(Continued)

Department of Homeland Security
Balance Sheets
As of September 30, 2012 and 2011
(In Millions)

	2012	2011 (Restated)
Refunds and Drawbacks	177	131
Other	2,851	2,552
Total Liabilities	**$ 87,371**	**$ 87,469**
Commitments and Contingencies (Notes 18, 19, 20, and 21)		
NET POSITION		
Unexpended Appropriations		
Unexpended Appropriations-Other Funds	$ 43,076	$ 45,274
Cumulative Results of Operations		
Cumulative Results of Operations-Earmarked Funds (Note 22)	(12,055)	(14,840)
Cumulative Results of Operations-Other Funds	(31,236)	(31,014)
Total Net Position	**$ (215)**	**$ (580)**
TOTAL LIABILITIES AND NET POSITION	**$ 87,156**	**$ 86,889**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statement of Net Cost
For the Year Ended September 30, 2012
(In Millions)

Major Missions (Note 23)		**2012**
Fostering a Safe & Secure Homeland		
Gross Cost	$	30,453
Less Earned Revenue		(3,924)
Net Cost		**26,529**
Enforcing and Administering Our Immigration Laws		
Gross Cost		8,659
Less Earned Revenue		(3,330)
Net Cost		**5,329**
Ensuring Resilience to Disasters		
Gross Cost		13,392
Less Earned Revenue		(3,903)
Net Cost		**9,489**
Providing Essential Support to National, Economic and Homeland Security		
Gross Cost		9,959
Less Earned Revenue		(478)
Net Cost		**9,481**
Total Department of Homeland Security		
Gross Cost		62,463
Less Revenue Earned		(11,635)
Net Cost Before Loss on Pension, ORB, or OPEB Assumption Changes		50,828
(Gain)/Loss on Pension, ORB, or OPEB Assumption (Note 16)		(171)
NET COST OF OPERATIONS	**$**	**50,657**

Due to an FY 2012 update to the Department's Strategic Plan, the Statements of Net Cost for FY 2012 and FY 2011 will not be comparable and are presented separately. Please refer to Summary of Significant Accounting Policies, Basis of Presentation and Note 23 for additional information.

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statement of Net Cost
For the Year Ended September 30, 2011
(In Millions)

Directorates and Other Components (Note 23)	**2011 (Unaudited)**
U.S. Customs and Border Protection	
Gross Cost	$ 12,042
Less Earned Revenue	(178)
Net Cost	**11,864**
U.S. Coast Guard	
Gross Cost	11,689
Less Earned Revenue	(668)
Net Cost	**11,021**
U.S. Citizenship and Immigration Services	
Gross Cost	2,513
Less Earned Revenue	(3,046)
Net Cost	**(533)**
Federal Emergency Management Agency	
Gross Cost	17,158
Less Earned Revenue	(3,705)
Net Cost	**13,453**
Federal Law Enforcement Training Center	
Gross Cost	441
Less Earned Revenue	(37)
Net Cost	**404**
National Protection and Programs Directorate	
Gross Cost	2,417
Less Earned Revenue	(914)
Net Cost	**1,503**
U.S. Immigration and Customs Enforcement	
Gross Cost	5,763
Less Earned Revenue	(149)
Net Cost	**5,614**

(Continued)

Department of Homeland Security
Statement of Net Cost
For the Year Ended September 30, 2011
(In Millions)

Directorates and Other Components (Continued)	**2011 (Unaudited)**
Office of Health Affairs	
Gross Cost	290
Less Earned Revenue	-
Net Cost	**290**
Departmental Operations and Other	
Gross Cost	1,924
Less Earned Revenue	(8)
Net Cost	**1,916**
U.S. Secret Service	
Gross Cost	1,848
Less Earned Revenue	(14)
Net Cost	**1,834**
Science and Technology Directorate	
Gross Cost	888
Less Earned Revenue	(18)
Net Cost	**870**
Transportation Security Administration	
Gross Cost	7,469
Less Earned Revenue	(2,279)
Net Cost	**5,190**
Total Department of Homeland Security	
Gross Cost	64,442
Less Earned Revenue	(11,016)
Net Cost Before Loss on Pension, ORB, or OPEB Assumption Changes	53,426
(Gain)/Loss on Pension, ORB, or OPEB Assumption Changes (Note 16)	400
NET COST OF OPERATIONS	**$ 53,826**

Due to an FY 2012 update to the Department's Strategic Plan, the Statements of Net Cost for FY 2012 and FY 2011 will not be comparable and are presented separately. Please refer to Summary of Significant Accounting Policies, Basis of Presentation and Note 23 for additional information.

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, 2012
(In Millions)

	2012			
	Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
Cumulative Results of Operations				
Beginning Balances	$ (14,840)	$ (31, 014)	$ -	$ (45,854)
Adjustments:				
Change in Accounting Principle (Note 32)	(640)	1,351	-	711
Beginning Balance, as Adjusted	(15,480)	(29,663)	-	(45,143)
Budgetary Financing Sources				
Appropriations Used	-	47,458	-	47,458
Non-exchange Revenue	1,817	8	-	1,825
Donations and Forfeitures of Cash and Cash Equivalents	3	-	-	3
Transfers In/Out Without Reimbursement	(3,117)	2,520	-	(597)
Other Financing Sources				
Transfers In/Out Without Reimbursement	(7)	(7)	-	(14)
Imputed Financing	131	1,428	173	1,386
Other	2,897	(449)	-	2,448
Total Financing Sources	1,724	50,958	173	52,509
Net Cost of Operations	1,701	(52,531)	(173)	(50,657)
Net Change	3,425	(1,573)	-	1,852
Cumulative Results of Operations	**(12,055)**	**(31,236)**	**-**	**(43,291)**
Unexpended Appropriations				
Beginning Balance	-	45,274	-	45,274
Budgetary Financing Sources				
Appropriations Received	-	46,010	-	46,010
Appropriations Transferred In/Out	-	205	-	205
Other Adjustments	-	(955)	-	(955)
Appropriations Used	-	(47,458)	-	(47,458)
Total Budgetary Financing Sources	-	(2,198)	-	(2,198)
Total Unexpended Appropriations	**-**	**43,076**	**-**	**43,076**
NET POSITION	**$ (12,055)**	**$ 11,840**	**$ -**	**$ (215)**

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, 2011
(In Millions)

	2011 (Unaudited) (Restated)			
	Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
Cumulative Results of Operations				
Beginning Balances	$ (13,816)	$ (31,295)	$ -	$ (45,111)
Adjustments:				
Correction of Errors-Prior Year (Note 34)	-	478	-	478
Beginning Balance, as Adjusted	(13,816)	(30,817)	-	(44,633)
Budgetary Financing Sources				
Appropriations Used	-	47,840	-	47,840
Non-exchange Revenue	1,735	8	-	1,743
Donations and Forfeitures of Cash and Cash Equivalents	3	-	-	3
Transfers In/Out Without Reimbursement	(2,546)	1,909	-	(637)
Other Financing Sources				
Transfers In/Out Without Reimbursement	(70)	184	-	114
Imputed Financing	70	1,644	192	1,522
Other	2,249	(229)	-	2,020
Total Financing Sources	1,441	51,356	192	52,605
Net Cost of Operations	(2,465)	(51,553)	(192)	(53,826)
Net Change	(1,024)	(197)	-	(1,221)
Cumulative Results of Operations	**(14,840)**	**(31,014)**	**-**	**(45,854)**
Unexpended Appropriations				
Beginning Balances	-	51,612	-	51,612
Budgetary Financing Sources				
Appropriations Received	-	42,704	-	42,704
Appropriations Transferred In/Out	-	61	-	61
Other Adjustments	-	(1,263)	-	(1,263)
Appropriations Used	-	(47,840)	-	(47,840)
Total Budgetary Financing Sources	-	(6,338)	-	(6,338)
Total Unexpended Appropriations	**-**	**45,274**	**-**	**45,274**
NET POSITION	**$ (14,840)**	**$ 14,260**	**$ -**	**$ (580)**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Budgetary Resources
For the Years Ended September 30, 2012 and 2011
(In Millions)

	2012		2011 (Unaudited)	
	Budgetary	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**
BUDGETARY RESOURCES				
Unobligated Balance Brought Forward, October 1	$ 11,853	$ 33	$ 15,188	$ -
Adjustment to Unobligated Balance, Brought Forward, October 1 (Note 32)	(640)	-	-	-
Unobligated Balance Brought Forward, October 1, As Adjusted	11,213	33	15,188	-
Recoveries of Prior Year Unpaid Obligations	3,349	195	4,492	35
Other Changes in Unobligated Balance	(761)	-	(650)	-
Unobligated Balance from Prior Year Budget Authority, Net	13,801	228	19,030	35
Appropriations	55,399	-	49,907	-
Borrowing Authority (Note 25)	(275)	322	-	-
Spending Authority from Offsetting Collections	10,229	(201)	9,452	-
TOTAL BUDGETARY RESOURCES	**$ 79,154**	**$ 349**	**$ 78,389**	**$ 35**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred (Note 24)	$ 66,825	$ 348	$ 66,536	$ 2
Unobligated Balance, End Of Year				
Apportioned	8,542	-	7,573	-
Exempt from Apportionment	10	-	6	-
Unapportioned (Note 3)	3,777	1	4,274	33
Total Unobligated Balance, End of Year	12,329	1	11,853	33
TOTAL BUDGETARY RESOURCES	**$ 79,154**	**$ 349**	**$ 78,389**	**$ 35**

(Continued)

Department of Homeland Security
Statements of Budgetary Resources
For the Years Ended September 30, 2012 and 2011
(In Millions)

	2012 Budgetary	2012 Non-Budgetary Credit Reform Financing Accounts	2011 (Unaudited) Budgetary	2011 (Unaudited) Non-Budgetary Credit Reform Financing Accounts
CHANGE IN OBLIGATED BALANCE				
Unpaid Obligations, Brought Forward, October 1	$ 47,082	$ 208	$ 48,641	$ 261
Uncollected Customer Payments From Federal Sources, Brought Forward, October 1	(2,230)	(223)	(2,384)	(260)
Obligated Balance, Start of Year, Net	44,852	(15)	46,257	1
Obligations Incurred	66,825	348	66,536	2
Outlays, Gross	(67,741)	(343)	(63,581)	(20)
Change in Uncollected Customer Payments from Federal Sources	544	207	154	37
Actual Transfers, Unpaid Obligations, Net	(10)	-	(22)	-
Recoveries of Prior Year Unpaid Obligations	(3,349)	(195)	(4,492)	(35)
Obligated Balance, End of Year				
Unpaid Obligations, End of Year (Note 29)	42,807	18	47,082	208
Uncollected Customer Payments from Federal Sources, End of Year	(1,686)	(16)	(2,230)	(223)
Obligated Balance, End of Year, Net	**$ 41,121**	**$ 2**	**$ 44,852**	**$ (15)**
BUDGET AUTHORITY AND OUTLAYS, NET				
Budget Authority, Gross	$ 65,353	$ 121	$ 59,359	$ -
Actual Offsetting Collections	(10,836)	(8)	(10,359)	(37)
Change in Uncollected Customer Payments from Federal Sources	544	207	154	37
Budget Authority, Net	**$ 55,061**	**$ 320**	**$ 49,154**	**$ -**
Outlays	$ 67,741	$ 343	$ 63,581	$ 20
Actual Offsetting Collections	(10,836)	(8)	(10,359)	(37)
Outlays, Net	56,905	335	53,222	(17)
Distributed Offsetting Receipts	(7,481)	-	(6,246)	-
Agency Outlays, Net	**$ 49,424**	**$ 335**	**$ 46,976**	**$ (17)**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Custodial Activity
For the Years Ended September 30, 2012 and 2011
(In Millions)

	2012	2011
Revenue Activity (Note 30)		
Sources of Cash Collections:		
Duties	$ 30,492	$ 29,254
User Fees	1,601	1,533
Excise Taxes	3,105	2,894
Fines and Penalties	72	69
Interest	65	42
Miscellaneous	196	171
Total Cash Collections	35,531	33,963
Accrual Adjustments, Net	137	339
Total Custodial Revenue	**35,668**	**34,302**
Disposition of Collections		
Transferred to Others:		
Federal Entities:		
U.S. Department of Agriculture	9,345	9,870
Treasury General Fund Accounts	22,163	21,026
U.S. Army Corps of Engineers (Note 33)	1,539	1,469
Other Federal Agencies	35	28
Non-Federal Entities:		
Government of Puerto Rico	15	7
Government of the U.S. Virgin Islands	-	2
Other Non-Federal Entities	130	124
(Increase)/Decrease in Amounts Yet to be Transferred	191	428
Refunds and Drawbacks (Notes 18 and 30)	2,250	1,348
Retained by the Department	-	-
Total Disposition of Custodial Revenue	**35,668**	**34,302**
Net Custodial Activity	**$ -**	**$ -**

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements

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Notes to the Financial Statements

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 managing our borders; enforcing and administering our immigration laws; protecting our cyber networks and critical infrastructure; and ensuring resilience from disasters. In addition, DHS contributes in many ways to elements of broader U.S. national and economic security while also working to mature and strengthen the Department and 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 Inspector General (OIG), the Domestic Nuclear Detection Office (DNDO), the Office of Intelligence and Analysis (I&A), and the Office of Operations Coordination and Planning (OPS)
- **U.S. Secret Service (USSS)**
- **Science and Technology Directorate (S&T)**
- **Transportation Security Administration (TSA)**

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

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* and the *DHS Financial Accountability Act of 2004*.

The Department's financial statements have been prepared from the accounting records of the Department based on guidance in U.S. generally accepted accounting principles (GAAP) and OMB Circular A-136, *Financial Reporting Requirements*, as amended. 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.

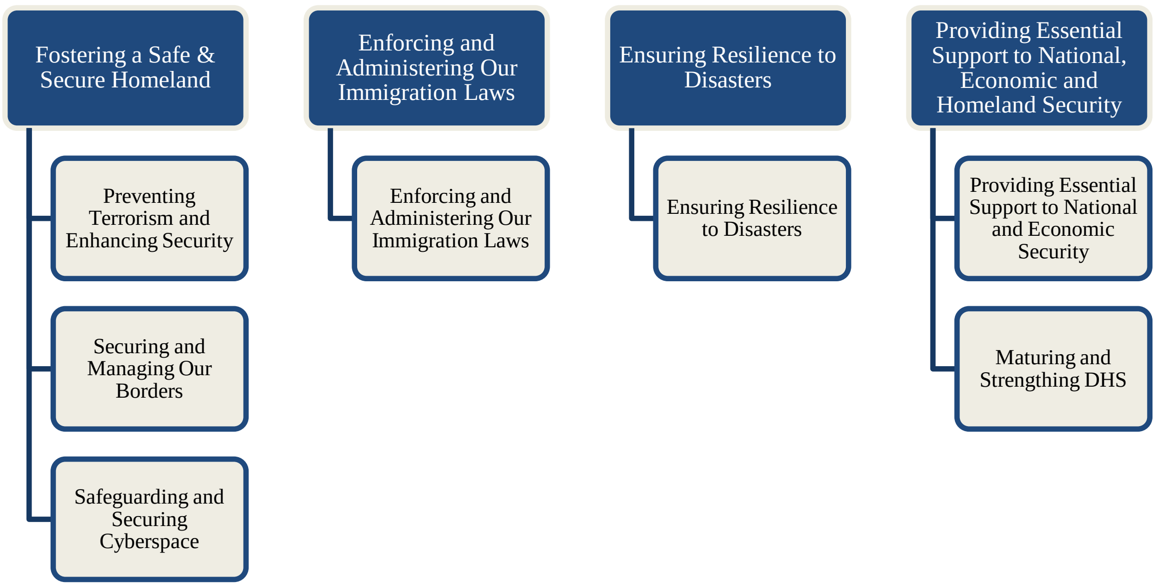
The Department's financial statements reflect the reporting of departmental activities, including appropriations received to conduct operations and revenue generated from operations. The financial statements also reflect the reporting of certain non-entity (custodial) functions performed by the Department 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 revenue are collections or revenue accruals from other federal entities, and intragovernmental costs are payments or expense 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 Federal 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 Federal Government acting in its capacity as a sovereign entity.

In FY 2012, the Department presents its Statement of Net Cost by consolidating the five goals and two focus areas described in the DHS Strategic Plan into four major missions. The consolidation of the five goals and two focus areas into four major missions allows the reader of the financial statements to see how resources are spent towards a common objective of a safe, secure, and more resilient America. The diagram below shows the relationship between the Department's strategic goals and its major missions:



The Department's new strategic plan applies prospectively beginning in FY 2012. Accordingly, DHS is not presenting the FY 2011 Statement of Net Cost comparative to FY 2012. The Department will present FY 2011 as it appeared in the FY 2011 Annual Financial Report (AFR), by responsibility segment.

In FY 2012, OMB Circular A-136 prescribed a new format to be used to present the Statement of Budgetary Resources. In the new Statement of Budgetary Resources (SBR) format, significant balances and underlying detail lines from the SF-133, *Report on Budget Execution and Budgetary Resources*, are aggregated to the major categories deemed most significant for broad government-wide display purposes. The Department is presenting FY 2012 and FY 2011 SBR using this new format.

C. Basis of Accounting

Transactions are recorded on an accrual and a budgetary basis of accounting. Under the accrual basis, revenue is 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 revenue 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 revenue; 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 maintains cash in commercial bank accounts. Insurance companies receive and process certain receipts and disbursements on behalf of 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 Federal 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 result from various immigration and user fees, premiums and policy fees from insurance companies and policyholders, breached bonds, reimbursable services, oil spill cost recoveries, 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.

Taxes, duties, and trade receivables consist of duties, user fees, fines and penalties, refunds and drawback overpayments, and interest associated with import/export activity, which have been established as a specifically identifiable, legally enforceable claim which remain uncollected as of year-end.

For additional information, see Note 6, Accounts Receivable, Net and Note 7, Taxes, Duties, and Trade Receivables, 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, allowances and commission expenses to insurance companies, and other grant activity. The allowances and commission expenses are amortized over the life of the policy. Disaster recovery and assistance grant advances are expensed as they are used by the recipients. Advances are made within the amount of the total grant obligation.

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 their municipal operating 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 Federal 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

Department operating materials and supplies (OM&S) consist primarily of goods, including repairable spare parts, consumed during the maintenance of assets used to perform DHS missions, including vessels, small boats, electronic systems, and aircraft.

OM&S managed by the U.S. Coast Guard Inventory Control Points in Elizabeth City, North Carolina, and Baltimore, Maryland consists of consumable and reparable items that are valued at historical cost using a moving average cost and accounted for using the consumption method. OM&S reparable items that are in a "held for repair" status are recorded at historical cost with an allowance for the cost of the repair. Excess, obsolete, and unserviceable OM&S are stated at net realizable value.

In FY 2012, the U.S. Coast Guard changed its accounting for repairable spare parts to classify such assets as OM&S, which are not depreciated. This change in accounting was recorded effective October 1, 2011. Prior to October 1, 2011, repairable spares were accounted for as PP&E and depreciated using the same useful life as the associated asset. This change in accounting principle was made during the U.S. Coast Guard's process of reconciling unaudited PP&E balances and implementing corrective policies and processes affecting PP&E in FY 2012, and for consistency with the reporting of similar assets at CBP. For additional information, see Note 32, Explanation for Changes in Accounting Principles on the Statement of Changes in Net Position.

OM&S held at CBP sites consists of aircraft parts, vessel parts, and Office of Technology Innovation and Acquisition (OTIA) parts and CBP uniforms to be used in CBP's operations. Aircraft and OTIA parts and materials are recorded at average unit cost. Vessel parts and uniforms are recorded using the First-In-First-Out valuation method. Both methods approximate actual acquisition costs.

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 Federal Government. Prohibited forfeited items such as counterfeit goods, narcotics, or firearms are held by the

Department until disposed of or destroyed. Nonprohibited seized and forfeited property is transferred to, held, and maintained by 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 the asset is placed in service. Costs 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 or budgetary estimates. 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 (COTS) software, 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.

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 or 2) it would cause the Component to not be in compliance with GAAP. Bulk purchases are subject to a $1 million capitalization threshold, unless one of the above Component criteria is met.

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

Asset Description	Capitalization Threshold	Service Life
Land	Zero to $200,000	Not Applicable
Improvements to land	Zero to $200,000	3 years to 50 years
Buildings	$50,000 to $200,000	6 years to 50 years
Equipment	Zero to $200,000	3 years to 74 years
Capital leases and leasehold improvements	$50,000 to $200,000	2 years to 30 years
Software	$50,000 to $750,000	3 years to 10 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, memorials, and recreation areas 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 Federal 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 accrues contingent liabilities where a loss is determined to be probable and the amount can be reasonably estimated. The Department discloses contingent liabilities where the conditions for liability recognition have not been met and the likelihood of unfavorable outcome is more than remote. Disclosures are made for probable loss contingencies that cannot be reasonably estimated, as well as reasonably possible loss contingencies. 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, and Note 34, Restatement.

R. Liabilities for Grants 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 and unpaid recipient expenditures using historical disbursement data in compliance with

Technical Release 12. Grants and cooperative agreement liabilities are recorded as grants payable to the public and reported as Other Liabilities in the accompanying Balance Sheets.

S. Insurance Liabilities

Insurance liabilities are primarily the result of the Department's sale or continuation-in-force of flood insurance policies within the 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. Due to the high number of variables that influence projection of the ultimate payments to cover insurance liabilities, actual incurred losses and loss adjustment expenses may not conform to the assumptions inherent in the estimation of the liability. Periodically, the ultimate settlement of losses and the related loss adjustment expenses may vary substantially 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, Note 20, Insurance Liabilities, and Note 26, Permanent Indefinite Appropriations.

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. Legislation will need to be enacted to provide funding to repay the Bureau of the Public Debt 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 25, 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.

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), Military Health System, and other post-employment benefits (OPEB), as well as the Military Retirement System (MRS), post-employment military travel benefits, and USSS's Uniformed Division and Special Agent Pension and the actuarial FECA liability. 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.

This actuarial FECA liability includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. 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.

The Department recognizes liabilities and expenses for MRS, post-employment military travel benefits, and Uniformed Division and Special Agent Pension. Gains and losses from changes in long-term assumptions used to measure these liabilities are reported as a separate line item on the Statement of Net Cost, consistent 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.*

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 11.9 percent of base pay for regular FERS employees and 26.3 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 one percent of base pay and matches employee contributions up to an additional four 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 accrued liability is the portion of the present value of the future benefits expected to be paid that is attributed to past service (service by participants rendered prior to the date of determination). The remaining portion of that present value is attributed to future service (service by participants rendered on or after the date of determination) and is the present value of the future employer normal costs. The normal cost (current period expense) and the attribution of the present value of the future benefits between past service and future service are determined using the individual entry age normal actuarial cost method.

The discount rates used to measure the actuarial liabilities for U.S. Coast Guard are based on the seven-year average historical rates of return on marketable Treasury securities at September 30 of each year. The rates used in this average are the rates for securities that will mature on the dates on which future benefit payments are expected to be made.

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 category of military healthcare liability is 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 of military healthcare liability is for the pre-Medicare-eligible retirees and beneficiaries. The U.S. Coast Guard is the administrative entity for its Military Health System, and in accordance with SFFAS No. 5, recognizes the liability on its financial statements. Benefits are funded on a pay-as-you-go basis from the current year U.S. Coast Guard appropriations.

Post-Employment Military Travel Benefit. U.S. Coast Guard uniformed service members and their family or survivors are authorized a one-time permanent-change-of-station (PCS) transfer benefit to the members' home of record upon separation or retirement, including permanent disability and preretirement death in service. The benefit is 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.

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 revenue, often supplemented by other financing sources that remain available over time. These specifically identified revenue 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 revenue.

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 revenue, non-exchange revenue, 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 generally 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.

Appropriations Received on the Statement of Changes in Net Position differs from that reported on the Statement of Budgetary Resources because Appropriations Received on the Statement of Changes in Net Position do not include appropriated dedicated and earmarked receipts. Dedicated and earmarked receipts are accounted for as either exchange or non-exchange revenue.

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. OMB granted an exemption from reporting this fund as a parent. 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 revenue is recognized when earned and is derived from transactions where both the Government and the other party receive value (i.e., goods have been delivered or services have been rendered). DHS exchange revenue include, but are not limited to: immigration fees, NFIP insurance premiums, Student Exchange Visa Program fees, and aviation security fees. Reimbursable exchange revenue include, but are not limited to: services provided to the Government of Puerto Rico for the collection of duties, taxes, and fees, services for personnel, medical, housing and various types of maritime support, the Federal Protective Service Guard personnel, and oil spill clean-up costs.

The majority of DHS non-exchange revenue is derived from the custodial collections of user fees, taxes, customs duties, fines and penalties, interest on the fines and penalties, and the refund and drawbacks related to these collections. Non-exchange revenue 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 revenue 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 Sheet 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 revenue are recognized ratably over the life of the policies. Deferred revenue relates to unearned premiums which represent the unexpired portion of policy premiums. USCIS fees are related to adjudication of applications for immigration and naturalization services that are used to provide special benefits to recipients and pay the regulatory costs from the adjudication process. USCIS requires advance payments of the fees for adjudication of applications or petitions for immigration and naturalization benefits; therefore the recognition of revenue is deferred until the application is processed or adjudicated.

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 are assessed 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. The liability for refunds and drawbacks consists of amounts owed for refunds of duty and other trade related activity and drawback claims. CBP accrues a monthly liability for refunds and drawback claims approved at month-end, but paid subsequent to month-end.

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 30, Custodial Revenue.

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. Reclassifications

In FY 2012, certain FY 2011 balances were reclassified to conform to FY 2012 presentation. In addition, the FY 2012 financial statements were affected by changes in accounting principles adopted during the current year. For additional information, see Note 32, Explanation for Changes in Accounting Principles, and Note 33, Reclassifications.

AB. Restatement

In FY 2012, the Department restated certain FY 2011 balances to correct the FY 2011 U.S. Coast Guard's environmental and disposal liabilities balance. For additional information, see Note 34, Restatement.

2. Non-Entity Assets

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

	2012	2011
Intragovernmental:		
Fund Balance with Treasury	$ 1,345	$ 1,430
Accounts Receivable	3	-
Total Intragovernmental	1,348	1,430
Public:		
Cash and Other Monetary Assets	5	32
Accounts Receivable, Net	46	35
Taxes, Duties, and Trade Receivables, Net	2,701	2,732
Total Public	2,752	2,799
Total Non-Entity Assets	4,100	4,229
Total Entity Assets	83,056	82,660
Total Assets	**$ 87,156**	**$ 86,889**

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 liabilities at September 30, 2012 and 2011. 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):

	2012	2011
Appropriated Funds	$ 47,296	$ 48,733
Trust Funds	42	217
Revolving, Public Enterprise, and Working Capital Funds	1,122	1,284
Special Funds	4,353	4,817
Deposit Funds	1,062	909
Total Fund Balance with Treasury	**$ 53,875**	**$ 55,960**

Appropriated funds consist of amounts appropriated annually by Congress to fund the operations of the Department. Appropriated funds include clearing funds totaling $13 million and $20 million at September 30, 2012 and 2011, respectively, which represent reconciling differences with Treasury balances. As of September 30, 2012 and 2011, restricted non-entity fund balance with Treasury was $1,345 million and $1,430 million, respectively.

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, oil spill related claims and activities, and administrative expenses related to the collection of the Harbor Maintenance Fee. 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. Examples of Department public enterprise funds include the Direct Loans program and NFIP. The Working Capital Fund is a fee-for-service fund established to support operations of Department Components.

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. In addition, some special funds are included in budgetary status as available for obligations. For additional information, see Note 27, Legal Arrangements Affecting the Use of Unobligated Balances.

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):

	2012	2011
Budgetary Status		
Unobligated Balances: (Note 33)		
Available	$ 8,552	$ 7,579
Unavailable	3,778	4,307
Obligated Balance Not Yet Disbursed	41,123	44,837
Total Budgetary Status	53,453	56,723
Reconciling Adjustments:		
Receipt, Clearing, and Deposit Funds (Note 32)	1,798	932
Borrowing Authority (Note 25)	(1,078)	(1,427)
Investments	(4,496)	(4,106)
Receivable Transfers and Imprest Fund	(368)	(356)
Receipts Unavailable for Obligation	2,989	2,652
Authority Temporarily Precluded from Obligation	39	50
SFRBTF; Oil Spill Liability Trust Fund	1,538	1,492
Total Fund Balance with Treasury	**$ 53,875**	**$ 55,960**

Portions of the Unobligated Balances Available, Unavailable, and Obligated Balance Not Yet Disbursed contain CBP's user fees of $67 million and $714 million at September 30, 2012 and 2011, respectively, which are restricted by law in its use to offset costs incurred by CBP. CBP changed its reporting of Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) user fees in FY 2012, as the result of new guidance from OMB. For additional information, see Note 32, Explanation for Changes in Accounting Principle.

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 Fund Balance with Treasury and budgetary status accounts simultaneously, certain adjustments are required to reconcile the budgetary status to non-budgetary 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, 2012 and 2011. For additional information, see Note 32, Explanation for Changes in Accounting Principle.

- 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. For additional information, see Note 25, Available Borrowing Authority.
- 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) and Oil Spill Liability Trust Fund are Treasury-managed funds. These funds receive revenue 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):

	2012	2011
Cash	$ 114	$ 52
Seized Monetary Instruments	-	24
Total Cash and Other Monetary Assets	**$ 114**	**$ 76**

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. The cash balance increased because there were no major flooding events in FY 2012, and subsequently, cash collected to be remitted to FEMA exceeded actual claim payments. Seized Monetary Instruments are held until disposition. The decrease in seized monetary instruments is due to USSS depositing those funds into the Treasury Executive Office for Asset Forfeiture fund in FY 2012. As of September 30, 2012 and 2011, restricted non-entity cash and other monetary assets were $5 million and $32 million, respectively (see Note 2).

5. Investments, Net

Investments at September 30, 2012, consisted of the following (in millions):

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	$ 2,554	$ 34	$ 11	$ 2,599	N/A
SFRBTF	Effective interest method	1,942	4	3	1,949	N/A
General Gift Fund	Effective interest method	1	-	-	1	N/A
Total Nonmarketable		4,497	38	14	4,549	N/A
Gifts and Donations	Straight Line Method	2	-	-	2	N/A
Total Nonmarketable, Market Based		2	-	-	2	N/A
Total Investments, Net		**$ 4,499**	**$ 38**	**$ 14**	**$ 4,551**	**N/A**

Investments at September 30, 2011, consisted of the following (in millions):

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	$ 2,225	$ 30	$ 8	$ 2,263	N/A
SFRBTF	Effective interest method	1,882	10	3	1,895	N/A
General Gift Fund	Effective Interest Method	1	-	-	1	N/A
Total Nonmarketable		4,108	40	11	4,159	N/A
Total Investments, Net		**$ 4,108**	**$ 40**	**$ 11**	**$ 4,159**	**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. Non-marketable market-based Treasury Securities are issued by the Bureau of Public Debt to Federal accounts. They are not traded on any securities exchange, but mirror prices of particular Treasury securities trading in the Government securities market.

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):

	2012	2011
Intragovernmental	**$ 259**	**$ 271**
With the Public:		
Accounts Receivable	1,304	819
Allowance for Doubtful Accounts	(416)	(174)
Total With the Public	**888**	**645**
Accounts Receivable, Net	**$ 1,147**	**$ 916**

Accounts Receivable increased in FY 2012 due to additional billings related to the Oil Spill Trust Fund. As of September 30, 2012 and 2011, total restricted non-entity accounts receivable were $49 million and $35 million, respectively (see Note 2).

7. Taxes, Duties, and Trade Receivables, Net

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

As of September 30, 2012:

Receivables Category	Gross Receivables	Allowance	Total Net Receivables
Duties	$ 2,286	$ (132)	$ 2,154
Excise Taxes	143	(8)	135
User Fees	198	(9)	189
Fines/Penalties	845	(747)	98
Antidumping and Countervailing Duties	1,311	(1,186)	125
Total Taxes, Duties, and Trade Receivables, Net	**$ 4,783**	**$ (2,082)**	**$ 2,701**

As of September 30, 2011:

Receivables Category	Gross Receivables	Allowance	Total Net Receivables
Duties	$ 2,353	$ (148)	$ 2,205
Excise Taxes	164	(8)	156
User Fees	148	(2)	146
Fines/Penalties	775	(652)	123
Antidumping and Countervailing Duties	1,001	(899)	102
Total Taxes, Duties, and Trade Receivables, Net	**$ 4,441**	**$ (1,709)**	**$ 2,732**

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 60 days 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, the Department records an allowance, net of interest, on fines and penalties of approximately 88 percent and 84 percent at September 30, 2012 and 2011, respectively 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).

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 revenue as a result of a major disaster and have demonstrated a need for federal financial assistance in order to perform their municipal operating functions.

The CDLs are established at the current Treasury rate for a term of five years. A CDL has a maximum amount of $5 million. The CDL amount cannot exceed 25 percent of the annual operating budget of the local government for the fiscal year in which the major disaster occurred, unless the loss of tax and other revenue for the local government is at least 75 percent of the annual operating budget. In this case, the CDL amount cannot exceed 50 percent of the annual operating budget. These CDLs can be cancelled.

The exception is the Special CDL (SCDL) 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, SCDLs may exceed $5 million and may be cancelled in accordance with the following *Stafford Act* amendments: the *Community Disaster Loan Act of 2005* (Pub. L. 109-88), the *U.S. Troop Readiness, Veteran's Care, Katrina Recovery, and Iraq Accountability Appropriations Act* (Pub. L. 110-28), the *Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery, 2006* (Pub. L. 109-234), and 44 CFR, *Emergency and Management Assistance*.

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

	2012	2011
	Loans Receivable, Net	Loans Receivable, Net
Community Disaster Loans	**$ 322**	**$ 10**

Direct Loans increased in FY2012 per OMB's direction to FEMA to reinstate loans that were written off in prior years based on the *Disaster Assistance Recoupment Fairness Act of 2011*.

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, 2012:	Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
Community Disaster Loans	**$ 348**	**$ 51**	**$ (77)**	**$ 322**

As of September 30, 2011:	Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
Community Disaster Loans	**$ 423**	**$ 54**	**$ (467)**	**$ 10**

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

	2012	2011
Community Disaster Loans	**$ -**	**$ 18**

As of September 30, 2012, FEMA had no disbursements related to Community Disaster Loans because no major flood events occurred.

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

Subsidy Expense for New Direct Loans Disbursed as of September 30

Community Disaster Loans	Interest Differential	Defaults and Other	Total
2012	**$ -**	**$ -**	**$ -**
2011	**$ 4**	**$ 14**	**$ 18**

Direct Loan Modifications and Reestimates

Community Disaster Loans	Total Modifications	Interest Rate Reestimates	Technical Reestimates	Total Reestimates
2012	**$ -**	**$ -**	**$ (311)**	**$ (311)**
2011	**$ -**	**$ -**	**$ (17)**	**$ (17)**

Total Direct Loan Subsidy Expense

	2012	2011
Community Disaster Loans	**$ (311)**	**$ 1**

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

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

	2012	2011
	Community Disaster Loans	Community Disaster Loans
Interest Subsidy Cost	2.49%	3.47%
Other	83.57%	90.54%

The Other line represents the subsidy rates for direct loans that are partially cancelled or cancelled in full if specified conditions are met. Historically, a high percentage of the borrowers have met the conditions for cancellation, thus resulting in a high direct loan subsidy rate.

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

	2012	2011
Beginning balance of the subsidy cost allowance	$ 467	$ 1,102
Add subsidy expense for direct loans disbursed during the reporting years by component:		
Interest rate differential costs	-	4
Other subsidy costs	-	14
Adjustments:		
Loans written off	(81)	(654)
Subsidy allowance amortization	2	18
Ending balance of the subsidy cost allowance before reestimates	388	484
Add subsidy reestimate by component		
Technical/default reestimate	(311)	(17)
Ending balance of the subsidy cost allowance	**$ 77**	**$ 467**

The amount of loans written off during FY 2011 is attributable to Hurricanes Katrina and Rita loans being cancelled at the end of the fifth year.

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

	2012	2011
Community Disaster Loans	**$ -**	**$ 1**

9. Inventory and Related Property, Net

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

	2012	2011
Operating Materials and Supplies (OM&S) (Note 32)		
Items Held for Use	$ 1,065	$ 330
Items Held for Future Use	31	33
Items Held for Repair	703	24
Excess, Obsolete and Unserviceable Items	26	23
Less: Allowance for Losses	(234)	(19)
Total OM&S, Net	**1,591**	**391**
Inventory		
Inventory Purchased for Resale	91	64
Less: Allowance for Losses	(5)	(1)
Total Inventory, Net	**86**	**63**
Stockpile Materials Held in Reserve	**73**	**73**
Total Inventory and Related Property, Net	**$ 1,750**	**$ 527**

In FY 2012, the U.S. Coast Guard changed the classification of all of its existing reparable spare parts, previously classified as General PP&E, into OM&S as presented on the Balance Sheet at September 30, 2012. For additional information, see Note 32, Explanation for Changes in Accounting Principles.

10. Seized and Forfeited Property

Prohibited seized property item counts as of September 30 and seizure and forfeiture activity for FY 2012 and 2011 are as follows:

Fiscal Year Ended September 30, 2012:

Seized Property:	Beginning Balance	New Seizures	Remissions	New Forfeitures	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Marijuana	2,086	1,242,474		(1,244,141)	1,632	2,051
Cocaine	74	19,186		(19,206)	29	83
Heroin	3	1,900		(1,897)	(2)	4
Ecstasy	1	152		(151)	16	18
Steroids	165	546		(605)	41	147
Firearms and Explosives (in number of items)	2,989	1,814	(427)	(1,124)	(140)	3,112
Counterfeit Currency (US/Foreign, in number of items)	5,050,108	1,810,735	(2,180,660)	-	(386)	4,679,797

Forfeited Property:	Beginning Balance	New Forfeitures	Transfers	Destroyed	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Marijuana	120,467	1,244,141	(912)	(428,978)	(793,483)	141,235
Cocaine	23,931	19,206	(386)	(19,899)	1,969	24,821
Heroin	2,368	1,897	(2)	(1,518)	23	2,768
Ecstasy	1,058	151	(1)	(308)	21	921
Steroids	293	605	-	(558)	-	340
Firearms and Explosives (in number of items)	1,011	1,124	(1,196)	(5)	91	1,025

Fiscal Year Ended September 30, 2011:

Seized Property:	Beginning Balance	New Seizures	Remissions	New Forfeitures	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Marijuana	1,857	1,385,602	-	(1,387,482)	2,109	2,086
Cocaine	169	26,999	-	(27,020)	(74)	74
Heroin	8	1,892	-	(1,897)	-	3
Ecstasy	9	451	-	(451)	(8)	1
Steroids	578	312	-	(722)	(3)	165
Firearms and Explosives (in number of items)	1,482	4,446	(1,340)	(1,502)	(97)	2,989
Counterfeit Currency (US/Foreign, in number of items)	4,574,155	1,650,034	-	-	(1,174,081)	5,050,108

Forfeited Property:	Beginning Balance	New Forfeitures	Transfers	Destroyed	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Marijuana	116,025	1,387,482	(711)	(537,859)	(844,470)	120,467
Cocaine	24,601	27,020	(881)	(22,579)	(4,230)	23,931
Heroin	6,085	1,897	(135)	(2,223)	(3,256)	2,368
Ecstasy	1,107	451	-	(481)	(19)	1,058
Steroids	17	722	-	(446)	-	293
Firearms and Explosives (in number of items)	647	1,502	(1,563)	(7)	432	1,011

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 due to inventory counts, changes in legal status of property type, or discontinuance of cases. The total adjustments for counterfeit currency include items that were destroyed during the fiscal year. 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 illegal drugs. The U.S. Coast Guard and ICE usually dispose of these properties within three days by transferring them 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, 2012:	Service Life	Cost	Accumulated Depreciation/ Amortization	Total Net Book Value
Land and Land Rights	N/A	$ 223	N/A	$ 223
Improvements to Land	3-50 yrs	2,094	382	1,712
Construction in Progress	N/A	3,517	N/A	3,517
Buildings, Other Structures and Facilities	6-50 yrs	6,475	3,019	3,456
Equipment (Note 32):				
Automated Data Processing Equipment	3-5 yrs	1,062	735	327
Aircraft	12-40 yrs	4,991	2,402	2,589
Vessels	5-74 yrs	6,714	3,281	3,433
Vehicles	4-8 yrs	995	721	274
Other Equipment	5-20 yrs	6,955	4,093	2,862
Assets Under Capital Lease	2-10 yrs	79	43	36
Leasehold Improvements	2-30 yrs	1,245	524	721
Internal Use Software	3-10 yrs	3,049	2,136	913
Internal Use Software - in Development	N/A	428	N/A	428
Total General Property, Plant, and Equipment, Net		**$ 37,827**	**$ 17,336**	**$ 20,491**

The table above represents the general PP&E balances for all DHS Components as of September 30, 2012. Of these balances, the following balances associated with U.S. Coast Guard PP&E remain unaudited as of September 30, 2012: $14,384 million of the total gross cost, $6,088 million of the total accumulated depreciation/amortization, and $8,296 million of the net book value.

As of September 30, 2011:	Service Life	Cost	Accumulated Depreciation/ Amortization	Total Net Book Value
Land and Land Rights	N/A	$ 208	N/A	$ 208
Improvements to Land	3-50 yrs	1,998	276	1,722
Construction in Progress	N/A	3,270	N/A	3,270
Buildings, Other Structures and Facilities	6-50 yrs	5,907	2,699	3,208
Equipment:				
Automated Data Processing Equipment	3-5 yrs	548	373	175
Aircraft	12-40 yrs	5,862	2,964	2,898
Vessels	5-74 yrs	6,572	3,106	3,466
Vehicles	4-8 yrs	880	620	260
Other Equipment	5-20 yrs	6,985	4,038	2,947
Assets Under Capital Lease	2-10 yrs	80	40	40
Leasehold Improvements	2-30 yrs	989	432	557
Internal Use Software	3-10 yrs	2,485	1,781	704
Internal Use Software - in Development	N/A	582	N/A	582
Total General Property, Plant, and Equipment, Net		**$36,366**	**$16,329**	**$20,037**

The table above represents the general PP&E balances for all DHS Components as of September 30, 2011. Of these balances, the following balances associated with U.S. Coast Guard's PP&E remain unaudited as of September 30, 2011: $18,407 million of the total cost, $8,542 million of the total accumulated depreciation/amortization, and $9,865 million of the net book value.

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):

2012	Beginning Balance	Additions	Withdrawals	Total
Collection-type Assets				
USCG (unaudited)	20,041	367	(280)	20,128
CBP	2	-	-	2
USCIS	5	-	-	5
TSA	7	4	-	11
S&T	-	2	-	2
Non-collection-type Assets				
USCG (unaudited)	60	-	(9)	51
Multi-use Heritage Assets				
USCG (unaudited)	746	1	(26)	721
CBP	4	-	-	4
FEMA	1	-	-	1
Total Stewardship Property, Plant and Equipment	**20,866**	**374**	**(315)**	**20,925**

2011	Beginning Balance	Additions	Withdrawals	Total
Collection-type Assets				
USCG (unaudited)	19,552	694	(205)	20,041
CBP	2	-	-	2
USCIS	5	-	-	5
TSA	3	4	-	7
Non-collection-type Assets				
USCG (unaudited)	60	-	-	60
Multi-use Heritage Assets				
USCG (unaudited)	764	-	(18)	746
CBP	4	-	-	4
FEMA	1	-	-	1
Total Stewardship Property, Plant and Equipment	**20,391**	**698**	**(223)**	**20,866**

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.

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

The U.S. Coast Guard possesses a wide range of heritage assets, such as ship 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 ships' 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.

CBP possesses 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 the 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. TSA also possesses an explosives trace detection portal machine in order to preserve it as an important example of new aviation security technology that was deployed to airports across the country after the September 11, 2001 terrorist attacks to keep the traveling public safe. 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.

S&T provides operational management support for the Plum Island Animal Disease Center, which is located adjacent to Orient Point, New York. This facility houses the historic Plum Island Lighthouse, which is designated on the National Register of Historic Places. The fourth-order Fresnel lens from the lighthouse is on loan for display at the East End Seaport Museum in Greenport, New York.

13. Other Assets

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

	2012	2011
Intragovernmental:		
Advances and Prepayments	$ 1,517	$ 1,832
Total Intragovernmental	**1,517**	**1,832**
Public:		
Advances and Prepayments	688	640
Total Public	**688**	**640**
Total Other Assets	**$ 2,205**	**$ 2,472**

14. Liabilities Not Covered by Budgetary Resources

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

	2012	2011
Intragovernmental:		
Debt (Note 15)	$ 17,750	$ 17,750
Due to the General Fund (Note 18)	2,727	2,844
Accrued FECA Liability (Note 18)	334	374
Other	90	14
Total Intragovernmental	20,901	20,982
Public:		
Federal Employee and Veterans' Benefits:		
Actuarial FECA Liability (Note 16)	2,229	2,055
Military Service and Other Retirement Benefits (Note 16)	49,724	47,609
Environmental and Disposal Liabilities (Restated) (Notes 17 and 34)	666	566
Other:		
Accrued Payroll and Benefits (Note 18)	1,228	1,220
Contingent Legal Liabilities (Note 21)	691	601
Capital Lease Liability (Note 19)	45	48
Other	57	76
Total Public	54,640	52,175
Total Liabilities Not Covered by Budgetary Resources	75,541	73,157
Liabilities Covered by Budgetary Resources	11,830	14,312
Total Liabilities	**$ 87,371**	**$ 87,469**

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.

15. Debt

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

As of September 30, 2012	Beginning Balance	Net Borrowing	Ending Balance
Debt to the Treasury General Fund:			
Debt for the NFIP	$ 17,750	$ -	$ 17,750
Debt for Credit Reform	4	318	322
Total Debt to the Treasury General Fund	$ 17,754	$ 318	$ 18,072
Total Debt	**$ 17,754**	**$ 318**	**$ 18,072**

As of September 30, 2011	Beginning Balance	Net Borrowing	Ending Balance
Debt to the Treasury General Fund:			
Debt for the NFIP	$ 18,501	$ (751)	$ 17,750
Debt for Credit Reform	4	-	4
Total Debt to the Treasury General Fund	$ 18,505	$ (751)	$ 17,754
Total Debt	**$ 18,505**	**$ (751)**	**$ 17,754**

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 Disaster Assistance Direct Loan Program.

NFIP loans from Treasury are typically for a three-year term. Interest rates are obtained from the BPD and range by cohort year from 0.13 percent to 1.63 percent as of September 30, 2012, and from 0.25 percent to 2.00 percent as of September 30, 2011. Interest is paid semi-annually on March 31 and September 30. The total interest paid was $89 million and $61 million as of September 30, 2012 and 2011, respectively. The increase in total interest paid in FY 2012 was due to FEMA refinancing matured NFIP loans with higher Department of Treasury interest rates and extended terms. 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. The loan and interest payments are financed by the flood premiums from policy holders and map collection fees. Given the current rate structure, FEMA will be unable to pay its debt when payment is due. Due to the size of the debt incurred for damages sustained for Hurricanes Katrina and Rita, legislation will need to be enacted to provide funding to repay the Bureau of Public Debt 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 2012 and FY 2011 were 2.40 percent and 3.69 percent, 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):

	2012	2011
U.S. Coast Guard Military Retirement and Healthcare Benefits	$ 45,967	$ 43,777
USSS DC Pension Plan Benefits	3,757	3,833
U.S. Coast Guard Post-Employment Military Travel Benefits and Other	-	(1)
Actuarial FECA Liability	2,229	2,055
Total Federal Employee and Veterans' Benefits	**$ 51,953**	**$ 49,664**

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

As of September 30, 2012	USCG Defined Benefit Plan	USCG Post-Retirement Healthcare	USSS Defined Benefit Plan	Total
Beginning Liability Balance:	$ 36,036	$ 7,741	$ 3,833	$ 47,610
Expenses:				
Normal Cost	1,434	330	247	2,011
Interest on the Liability Balance	1,624	246	-	1,870
Actuarial Losses/(Gains):				
From Experience	(396)	(77)	(90)	(563)
From Assumption Changes	2,365	(1,973)	-	392
Other	-	-	13	13
Total Expense	5,027	(1,474)	170	3,723
Less Amounts Paid	1,167	196	246	1,609
Ending Liability Balance	**$ 39,896**	**$ 6,071**	**$ 3,757**	**$ 49,724**

As of September 30, 2011	USCG Defined Benefit Plan	USCG Post-Retirement Healthcare	USSS Defined Benefit Plan	Total
Beginning Liability Balance:	$ 33,761	$ 8,715	$ 3,833	$ 46,309
Expenses:				
Normal Cost	1,240	450	246	1,936
Interest on the Liability Balance	1,583	339	-	1,922
Actuarial Losses/(Gains):				
From Experience	(907)	(495)	-	(1,402)
From Assumption Changes	1,478	(1,078)	-	400
Other	-	19	(1)	18
Total Expense	3,394	(765)	245	2,874
Less Amounts Paid	1,119	209	245	1,573
Ending Liability Balance	**$ 36,036**	**$ 7,741**	**$ 3,833**	**$ 47,610**

U.S. Coast Guard. The U.S. Coast Guard's military service members (both current active component and reserve component) 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 with retired pay and benefits for active component members upon credit of at least 20 years of active service at any age. Reserve component members may retire after 20 years of creditable service with retired pay and health benefits beginning at age 60. Reserve component members may qualify for retired pay at an earlier age (but not earlier than age 50) if they perform certain active service after January 28, 2008, but in such cases Military Health System (MHS) benefits for themselves and their dependents do not begin until the member attains age 60.

The U.S. Coast Guard's MHS is a post-retirement medical benefit plan that covers all active component and reserve component members of the U.S. Coast Guard. The accrued MHS 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 for retirees 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 creditable active service. The retired pay base depends upon the date of initial entry into military service (DIEMS). For DIEMS of

September 8, 1980, or later, the retired pay base would be the mean of the highest 36 months of basic pay earned (or would have earned if on active duty). For DIEMS of September 7, 1980, or earlier, the retired pay base would be the basic pay rate in effect on the first day of retirement (if a commissioned officer or an enlisted member) or the basic pay rate in effect on the last day of active duty before retirement (if a warrant officer). Personnel who became members after August 1, 1986, may elect to receive a $30,000 Career Status Bonus after 15 years of service in return for reductions in retired pay.

If a U.S. Coast Guard member is disabled, the member is entitled to disability benefits, assuming (1) the disability is at least 30 percent under a Department of Veterans Affairs (VA) Schedule of Rating Disability and (2) the disability results from injuries or illnesses incurred in the line of duty. Disability retired pay is equal to the basic pay (as of the separation date) multiplied by the larger of the VA disability rating or 2.5 percent times the years of creditable service.

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

1. DOD decrement tables are only used for mortality. Disability, withdrawal, and retirement tables reflecting actual U.S. Coast Guard experience were developed based on an U.S. Coast Guard experience study dated September 30, 2009;
2. Cost of living increases are three percent annually (only for the retirement plan);
3. Healthcare cost increase assumptions are based on the annual liability report provided by DOD and vary, depending on the year and type of care;
4. The discount rate percent is determined in accordance with SFFAS No. 33 and is calculated independently for pensions and healthcare. The current discount rate is 4.18 percent for the retirement system and 4.16 percent for the health system.

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 seven 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, 2012, are:

1. Life expectancy is based upon the RP 2000 Combined Healthy Mortality Table;
2. Cost of living increases are 3.5 percent annually;
3. Rates of salary increases are 3.5 percent annually;
4. Annual rate of investment return is 7.25 percent; and
5. Rates of withdrawal for active service by gender and age.

B. 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 $2,229 million and $2,055 million at September 30, 2012 and 2011, respectively.

17. Environmental and Disposal Liabilities

Environmental and disposal liabilities at September 30, 2012 and 2011 are $668 million and $569 million (restated), respectively. 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 Department's environmental liabilities are due to light stations, lighthouses, long-range navigation, 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. Asbestos-related liabilities are those for the abatement of both friable and non-friable asbestos.

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.

In FY 2012, the Department restated certain FY 2011 balances to correct the FY 2011 U.S. Coast Guard's environmental and disposal liabilities balance. For additional information, see Note 34, Restatement.

18. Other Liabilities

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

As of September 30, 2012	Current	Non-Current	Total
Intragovernmental:			
Due to the General Fund (Note 14)	$ 2,727	$ -	$ 2,727
Accrued FECA Liability (Note 14)	114	220	334
Advances from Others	113	-	113
Employer Benefits Contributions and Payroll Taxes	295	-	295
Other Intragovernmental Liabilities	158	1	159
Total Intragovernmental Other Liabilities	**$ 3,407**	**$ 221**	**$ 3,628**
Public:			
Accrued Payroll and Benefits (See B. below)	$ 2,454	$ -	$ 2,454
Deferred Revenue and Advances from Others (See B. below)	2,019	826	2,845
Insurance Liabilities (Note 20)	802	31	833
Refunds and Drawbacks	177	-	177
Contingent Legal Liabilities (Note 21)	340	364	704
Capital Lease Liability (Note 19)	6	39	45
Other	2,046	56	2,102
Total Other Liabilities with the Public	**$ 7,844**	**$ 1,316**	**$ 9,160**
Total Other Liabilities	**$ 11,251**	**$ 1,537**	**$ 12,788**

As of September 30, 2011	Current	Non-Current	Total
Intragovernmental:			
Due to the General Fund	$ 2,844	$ -	$ 2,844
Accrued FECA Liability	160	214	374
Advances from Others	228	-	228
Employer Benefits Contributions and Payroll Taxes	280	-	280
Other Intragovernmental Liabilities	21	3	24
Total Intragovernmental Other Liabilities	**$ 3,533**	**$ 217**	**$ 3,750**
Public:			
Accrued Payroll and Benefits (See B. below)	$ 2,198	$ -	$ 2,198
Deferred Revenue and Advances from Others (See B. below)	2,005	711	2,716
Insurance Liabilities (Note 20)	3,422	115	3,537
Refunds and Drawbacks	131	-	131
Contingent Legal Liabilities (Note 21)	233	376	609
Capital Lease Liability (Note 19)	6	42	48
Other	1,893	2	1,895
Total Other Liabilities with the Public	**$ 9,888**	**$ 1,246**	**$ 11,134**
Total Other Liabilities	**$ 13,421**	**$ 1,463**	**$ 14,884**

The overall increase in Accrued Payroll and Benefits is due to a higher number of days being accrued for payroll in FY 2012 than FY 2011. The increase in refunds and drawbacks is due to Antidumping/Countervailing Duty cases being resolved in FY 2012 and trade acts being enacted in October 2011 which allowed for retroactive refunds of duties paid. The decrease occurred primarily due to FY 2011 insurance liability actuarial estimates being based on historical averages. Eventually, the events related to this accrual did not conform to historical averages.

A. Intragovernmental Other Liabilities

Due to the General Fund. Amounts due to the Treasury General Fund primarily 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 $174 million and $165 million, respectively, for the fiscal years ended September 30, 2012 and 2011.

B. Other Liabilities with the Public

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

	2012	2011
Accrued Funded Payroll and Benefits	$ 1,133	$ 905
Accrued Unfunded Leave	1,221	1,211
Unfunded Employment Related Liabilities	7	9
Other	93	73
Total Accrued Payroll and Benefits	**$ 2,454**	**$ 2,198**

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

	2012	2011
USCIS Application Fees	$ 827	$ 712
FEMA Unearned NFIP Premium	2,000	1,981
Advances from Others	18	23
Total Deferred Revenue	**$ 2,845**	**$ 2,716**

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.

Other Liabilities. Other public liabilities consist primarily of immigration bonds, 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, 2012, estimated future minimum lease commitments under operating leases, which are non-cancelable, for equipment and GSA-controlled leases were as follows (in millions):

	Land and Buildings	Vehicles and Other Equipment	Total
FY 2013	$499	$1	$500
FY 2014	459	-	459
FY 2015	425	-	425
FY 2016	407	-	407
FY 2017	389	-	389
After FY 2017	1,446	-	1,446
Total Future Minimum Lease Payments	**$3,625**	**$1**	**$3,626**

The estimated future lease payments for operating leases are based on lease contract terms considering payments made during the year ended September 30, 2012.

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):

	2012	2011
Land and Buildings	$ 68	$ 69
Software	11	11
Accumulated Amortization	(43)	(40)
Assets under Capital Lease, Net	**$ 36**	**$ 40**

As of September 30, 2012, estimated future minimum lease payments under capital leases, which were all non-GSA, were as follows (in millions):

	Land and Buildings
FY 2013	$ 6
FY 2014	6
FY 2015	6
FY 2016	6
FY 2017	6
After FY 2017	33
Total Future Minimum Lease Payments	63
Less: Imputed Interest and Executory Costs	(18)
Total Capital Lease Liability	**$ 45**

20. 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):

	2012	2011
Beginning Balance	$ 3,537	$ 482
Change in Incurred Losses		
Change from Events of the Current Year	1,083	3,914
Change from Events of Prior Years	(1,519)	29
Less: Amounts Paid During Current Period		
Paid for Events of the Current Year	(369)	(438)
Paid for Events of Prior Years	(1,899)	(450)
Total Insurance Liability	**$ 833**	**$ 3,537**

Insurance liabilities for the periods ended September 30, 2012 and 2011, were $833 million and $3,537 million, respectively, and consist primarily of NFIP insurance liabilities. The NFIP insurance liability 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. The decrease from FY 2011 occurred primarily due to insurance liability actuarial estimates being based on historical averages. Eventually, the events related to this accrual did not conform to historical averages, resulting in reduced actual payments and a change in the estimate in FY 2012.

Insurance liabilities related to estimated claims (incurred but not reported) and claims received but not yet approved for payment are covered by a permanent and indefinite appropriation, which is available to pay all valid claims after adjudication. Accordingly, these insurance liabilities are covered by budgetary resources.

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 2012			
Probable	$ 704	$ 704	$ 1,263
Reasonably Possible		$ 509	$ 978

The claims above generally 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, 2012, was $704 million, of which $13 million was funded.

Asserted and pending legal claims for which loss was reasonably possible is estimated to range from $509 million to $978 million at September 30, 2012.

As of September 30, 2012, 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 Department of Commerce, 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, 2012 and 2011 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, 2012 and 2011, CBP had 16 aircraft, loaned from DOD with a replacement value of up to $23 million per aircraft. As of September 30, 2012, the U.S. Coast Guard had four vessels on loan from DOD with a total replacement value of $48 million.

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, 2012, DHS estimates total payments related to cancelled appropriations to be $264 million, of which $119 million for contractual arrangements may require future funding.

TSA entered into 12 Letters of Intent for Modifications to Airport Facilities with 11 major airports in which TSA may reimburse the airports up to 90 percent (estimated total of $1.5 billion) of the costs to modify the facilities for security purposes. These letters of intent (LOI) would not obligate TSA until funds have been appropriated and obligated. An LOI, though not a binding commitment of federal funding, represents TSA's intent to provide the agreed-upon funds in future years if the agency receives sufficient appropriations to cover the agreement. TSA received $200 million in both FY 2012 and FY 2011 to fund LOIs. 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, 2012, TSA has received invoices or documentation for costs incurred totaling $13.9 million for the invoices that have not yet been paid.

22. Earmarked Funds

Earmarked funds are financed by specifically identified revenue, often supplemented by other financing sources that remain available over time. These specifically identified revenue 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 revenue and other financing sources only for designated activities, benefits, or purposes; 2) explicit authority for the earmarked fund to retain revenue 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 revenue and other financing sources that distinguished the earmarked fund from the Federal Government's general revenue.

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

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	Oil Spill Liability Trust Fund	Aviation Security Capital Fund	All Other Earmarked Funds	Total Earmarked Funds
Balance Sheet as of September 30, 2012								
ASSETS								
Fund Balance with Treasury	$ 67	$ 34	$ 1,939	$ 1,026	$ 6	$ 1,239	$ 921	$ 5,232
Investments, Net	-	1,949	-	-	2,599	-	3	4,551
Accounts Receivable	135	124	10	3	501	-	66	839
Taxes Receivable	123	-	-	-	-	-	-	123
Other	-	-	278	627	-	-	2	907
Total Assets	**$ 325**	**$ 2,107**	**$ 2,227**	**$ 1,656**	**$ 3,106**	**$ 1,239**	**$ 992**	**$ 11,652**
LIABILITIES								
Other Liabilities	$ 144	$ 1,302	$ 1,144	$ 20,730	$ 329	$ 26	$ 32	$ 23,707
Total Liabilities	**$ 144**	**$ 1,302**	**$ 1,144**	**$ 20,730**	**$ 329**	**$ 26**	**$ 32**	**$ 23,707**
NET POSITION								
Cumulative Results of Operations	$ 181	$ 805	$ 1,083	$ (19,074)	$ 2,777	$ 1,213	$ 960	$ (12,055)
Total Liabilities and Net Position	**$ 325**	**$ 2,107**	**$ 2,227**	**$ 1,656**	**$ 3,106**	**$ 1,239**	**$ 992**	**$ 11,652**
Statement of Net Cost for the Year Ended September 30, 2012								
Gross Program Costs	$ 472	$ 118	$ 2,517	$ 988	$ 431	$ 51	$ 1,003	$ 5,580
Less: Earned Revenue	-	-	(2,629)	(3,494)	(257)	(250)	(651)	(7,281)
Net Cost of Operations	**$ 472**	**$ 118**	**$ (112)**	**$ (2,506)**	**$ 174**	**$ (199)**	**$ 352**	**$ (1,701)**
Statement of Changes in Net Position for the Year Ended September 30, 2012								
Net Position Beginning of Period	$ 796	$ 773	$ 848	$ (21,568)	$ 2,469	$ 1,014	$ 828	$ (14,840)
Prior-Period Adjustment Due to Changes in Accounting Principle	(640)	-	-	-	-		-	(640)
Net Position Beginning of Period, as Adjusted	156	773	848	(21,568)	2,469	1,014	828	(15,480)
Net Cost of Operations	(472)	(118)	112	2,506	(174)	199	(352)	1,701
Non-exchange Revenue	463	663	-	1	517	-	173	1,817
Other	34	(513)	123	(13)	(35)	-	311	(93)
Change in Net Position	25	32	235	2,494	308	199	132	3,425
Net Position, End of Period	**$ 181**	**$ 805**	**$ 1,083**	**$ (19,074)**	**$ 2,777**	**$ 1,213**	**$ 960**	**$ (12,055)**

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	Oil Spill Liability Trust Fund	Aviation Security Capital Fund	All Other Earmarked Funds	Total Earmarked Funds
Balance Sheet as of September 30, 2011								
ASSETS								
Fund Balance with Treasury	$ 717	$ 9	$ 1,743	$ 1,211	$ 200	$ 1,030	$ 832	$ 5,742
Investments, Net	-	1,895	-	-	2,263	-	1	4,159
Accounts Receivable	98	132	7	2	309	-	42	590
Taxes Receivables	86	-	-	-	-	-	-	86
Other	-	-	187	567	-	-	8	762
Total Assets	**$ 901**	**$ 2,036**	**$ 1,937**	**$ 1,780**	**$ 2,772**	**$ 1,030**	**$ 883**	**$ 11,339**
LIABILITIES								
Other Liabilities	$ 105	$ 1,263	$ 1,089	$ 23,348	$ 303	$ 16	$ 55	$ 26,179
Total Liabilities	**$ 105**	**$ 1,263**	**$ 1,089**	**$ 23,348**	**$ 303**	**$ 16**	**$ 55**	**$ 26,179**
NET POSITION								
Cumulative Results of Operations	$ 796	$ 773	$ 848	$ (21,568)	$ 2,469	$ 1,014	$ 828	$ (14,840)
Total Liabilities and Net Position	**$ 901**	**$ 2,036**	**$ 1,937**	**$ 1,780**	**$ 2,772**	**$ 1,030**	**$ 883**	**$ 11,339**
Statement of Net Cost for the Year Ended September 30, 2011 (unaudited)								
Gross Program Costs	$ 407	$ 126	$ 2,433	$ 5,312	$ 319	$ 38	$ 859	$ 9,494
Less: Earned Revenue	-	-	(2,578)	(3,313)	(330)	(250)	(558)	(7,029)
Net Cost of Operations	**$ 407**	**$ 126**	**$ (145)**	**$ 1,999**	**$ (11)**	**$ (212)**	**$ 301**	**$ 2,465**
Statement of Changes in Net Position for the Year Ended September 30, 2011 (unaudited)								
Net Position Beginning of Period	$ 789	$ 794	$ 640	$ (19,563)	$ 2,005	$ 807	$ 712	$ (13,816)
Net Cost of Operations	(407)	(126)	145	(1,999)	11	212	(301)	(2,465)
Non-exchange Revenue	406	638	-	1	547	-	143	1,735
Other	8	(533)	63	(7)	(94)	(5)	274	(294)
Change in Net Position	7	(21)	208	(2,005)	464	207	116	(1,024)
Net Position, End of Period	**$ 796**	**$ 773**	**$ 848**	**$ (21,568)**	**$ 2,469**	**$ 1,014**	**$ 828**	**$ (14,840)**

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, contained in tax reform legislation, for processing barges and bulk carriers for Canada and Mexico, was added later that year. These fees are deposited into Customs User Fees accounts (TAFS 705695.30 and 70X5695).

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 non-reimbursable 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 U.S.C. § 58c. The authority to use these funds is contained in the annual DHS Appropriations Act.

CBP changed its reporting of COBRA user fees in FY 2012, as the result of new guidance from OMB. This resulted in a decrease in Fund Balance with Treasury in the Customs User Fees earmarked column in FY 2012. For additional information, see Note 32, Explanation for Changes in Accounting Principles.

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 revenue transferred from custodial activities of the Treasury, which are deposited in a Treasury account. The revenue 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 reauthorizations of SFRBTF and expenditure of Boating Safety funds for the National Recreational Boating Safety Program were enacted in 2012 in the *Moving Ahead for Progress in the 21st Century Act (Pub. L. 112-141)*, 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 revenue 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 *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 in force.

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.

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 NFIP 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 to the policyholders. Congress has mandated that the NFIP funds be used only to pay claims and claims-related loss adjustment expenses caused by flooding.

The NFIP's primary source of revenue comes from premiums collected to insure policyholders' homes. These resources are inflows to the Government and are not the result of intragovernmental flows. When claims exceed revenue, FEMA has borrowing authority that can be accessed to satisfy outstanding claims. The following TAFS are part of the NFIP 706/70717, 707/80717, 708/90717, 706/74236, 7074236, 707/84236, 7084236, 708/94236, 70X4236.

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; costs and expenses reasonably necessary for the implementation of OPA (subject to congressional appropriations); and other specific appropriations by the Congress.

The OSLTF has four major funds: the Principal Fund (TAFS 70X8185), Emergency Fund (TAFS 70X8349), Claims Fund (TAFS 70X8312) and Trust Fund Share of Expenses (TAFS 70 8314) appropriated annually to the U.S. Coast Guard. 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 appropriation 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 expended from the OSLTF 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. Trust Fund Share of Expenses is funded by annual Congressional appropriations from the OSLTF that are then distributed to the U.S. Coast Guard Operating Expenses; Acquisition, Construction and Improvements; and Research, Development, Test and Evaluation appropriations.

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.

Liability for the spill is joint and severable under the OPA, 33 U.S.C. 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 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. Currently, the Federal Government is in litigation with the responsible parties to recover natural resource damages and civil penalties due to the Government under the *Clean Water Act*.

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 was 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 established a $20 billion escrow account, funded over the next three years, to pay spill-related costs, including claims paid by the GCCF. Establishment of this account does not represent a cap or floor on any amount that may ultimately be paid by BP. In June 2012 the GCCF transitioned to a court-supervised settlement program.

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 set forth in 26 U.S.C. 9509(c)(2). The status of OSLTF available funds, costs incurred by the Federal Government, and billings to the responsible parties as of September 30, 2012, is described below.

Status of OSLTF Funds and Costs Incurred and Billed. Through September 30, 2012, the total amount of Deepwater Horizon costs incurred was $1,033.5 million, of which $750.7 million is incurred against OSLTF, and $282.8 million in incurred against the U.S. Coast Guard. This amount includes Total Incident Cost of removal of $849.8 million, $39 million for the initiation of the natural resource assessment, and $144.7 million in Natural Resource Damage claims. U.S. Coast Guard has billed the responsible parties for $888.9 million. As of September 30, 2012, BP had paid $711.8 million. The billed amounts include $334.7 million in costs for all U.S. Coast Guard personnel, ships, aircraft, and cutters directly supporting the FOSC, and the $382 million in OSLTF funds obligated by the FOSC to other federal, state and local government agencies for their role in the response.

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); if not compensated, they may then file an action in court or file a claim against the OSLTF through the NPFC.

Aviation Security Capital Fund

Vision 100--Century of Aviation Reauthorization Act (Pub. L. 108-176) established the Aviation Security Capital Fund. Annually, the first $250 million derived from Aviation Security fees are deposited into this fund. TSA reimburses airport sponsors for projects to (1) replace baggage conveyer systems related to aviation security, (2) reconfigure terminal baggage areas as needed to install explosive detection systems, (3) enable the Under Secretary to deploy explosive detection systems behind the ticket counter, in the baggage sorting area, or in line with the baggage handling system, and (4) make other airport security capital improvements.

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
- 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

- 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
- 70X0603: Coast Guard Housing Fund, U.S. Coast Guard, Department of Homeland Security, 14 U.S.C. § 687(c)
- 70X5710: Coast Guard Housing Fund, U.S. Coast Guard, Department of Homeland Security, 14 U.S.C. § 687(c)

23. Net Costs by Sub-Organization and Major Missions

The Department's FY 2012 Statement of Net Cost displays DHS costs and revenue and groups the five strategic goals and two focus areas into four major missions. The first, *Fostering a Safe and Secure Homeland*, includes Missions 1, 2, and 4 of the strategic plan. *Enforcing and Administering Our Immigration Laws* and *Ensuring Resilience to Disasters* are Missions 3 and 5 of the strategic plan, respectively. *Providing Essential Support to National, Economic and Homeland Security* consists of the two focus areas of the DHS Strategic Plan: Providing Essential Support to National and Economic Security and Maturing and Strengthening DHS.

As a result of the Department's new strategic plan, combined with the change in the Statement of Net Cost presentation and cost tracing methods implemented in FY 2012, DHS is not presenting the FY 2011 Statement of Net Cost comparative to FY 2012. The Department presents its FY 2011 Statement of Net Cost and related note disclosures by responsibility segment as it appeared in the FY 2011 Annual Financial Report (AFR).

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*.

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.

To more accurately reflect the actual costs incurred by each of the major missions, the Department is presenting the net costs by sub-organization and major missions net of eliminations.

The "All Other" column in the FY 2012 footnote reports net costs for the following Components: DNDO, FLETC, NPPD, OHA, OIG, S&T, USSS, I&A, and OPS.

For the year ended September 30, 2012 (in millions)

Major Missions	**FEMA**	**CBP**	**USCG**	**ICE**	**TSA**	**USCIS**	**MGMT**	**All Other**	**Total**
Fostering a Safe & Secure Homeland									
Intragovernmental Gross Cost	$ -	$ 2, 904	$ 755	$ 572	$ 1,777	$ -	8	$ 1,379	$ 7,395
Public Gross Cost	-	7,024	4,988	1,215	5,878	-	3	3,950	23,058
Gross Cost	-	9,928	5,743	1,787	7,655	-	11	5,329	30,453
Intragovernmental Revenue	-	(40)	(106)	(6)	(1)	-	-	(1,006)	(1,159)
Public Revenue Earned	-	(117)	(236)	(87)	(2,319)	-	-	(6)	(2,765)
Less Revenue Earned	-	(157)	(342)	(93)	(2,320)	-	-	(1,012)	(3,924)
Net Cost	**-**	**9,771**	**5,401**	**1,694**	**5,335**	**-**	**11**	**4,317**	**26,529**
Enforcing and Administering Our Immigration Laws									
Intragovernmental Gross Cost	$ -	$ 471	$ -	$ 904	$ -	$ 811	$ -	$ 14	$ 2,200
Public Gross Cost	-	1,165	-	3,379	-	1,781	-	134	6,459
Gross Cost	-	1,636	-	4,283	-	2,592	-	148	8,659
Intragovernmental Revenue	-	(6)	-	(42)	-	(8)	-	(2)	(58)
Public Revenue Earned	-	(24)	-	(38)	-	(3,210)	-	-	(3,272)
Less Revenue Earned	-	(30)	-	(80)	-	(3,218)	-	(2)	(3,330)
Net Cost	**-**	**1,606**	**-**	**4,203**	**-**	**(626)**	**-**	**146**	**5,329**
Ensuring Resilience to Disasters									
Intragovernmental Gross Cost	$ 1,171	$ -	$ 2	$ -	$ -	$ -	$ -	$ 122	$ 1,295
Public Gross Cost	11,742	-	100	1	-	-	-	254	12,097
Gross Cost	12,913	-	102	1	-	-	-	376	13,392
Intragovernmental Revenue	(337)	-	-	-	-	-	-	(5)	(342)
Public Revenue Earned	(3,552)	-	(7)	-	-	-	-	(2)	(3,561)
Less Revenue Earned	(3,889)	-	(7)	-	-	-	-	(7)	(3,903)
Net Cost	**9,024**	**-**	**95**	**1**	**-**	**-**	**-**	**369**	**9,489**

Major Missions	FEMA	CBP	USCG	ICE	TSA	USCIS	MGMT	All Other	Total
Providing Essential Support to National, Economic and Homeland Security									
Intragovernmental Gross Cost	$ -	$ 196	$ 1,037	$ 21	$ -	$ -	$ 526	$ 97	$ 1, 877
Public Gross Cost	-	498	6,481	43	-	-	755	305	8,082
Gross Cost	-	694	7,518	64	-	-	1,281	402	9,959
Intragovernmental Revenue	-	(3)	(147)	-	-	-	(3)	(12)	(165)
Public Revenue Earned	-	(11)	(297)	(3)	-	-	-	(2)	(313)
Less Revenue Earned	-	(14)	(444)	(3)	-	-	(3)	(14)	(478)
Net Cost	**-**	**680**	**7,074**	**61**	**-**	**-**	**1,278**	**388**	**9,481**
Total Department of Homeland Security									
Intragovernmental Gross Cost	$ 1,171	$ 3,571	$ 1,794	$ 1,497	$ 1,777	$ 811	$ 534	$ 1,612	$ 12,767
Public Gross Cost	11,742	8,687	11,569	4,638	5,878	1,781	758	4,643	49,696
Gross Cost	12,913	12,258	13,363	6,135	7,655	2,592	1,292	6,255	62,463
Intragovernmental Revenue	(337)	(49)	(253)	(48)	(1)	(8)	(3)	(1,025)	(1,724)
Public Revenue Earned	(3,552)	(152)	(540)	(128)	(2,319)	(3,210)	-	(10)	(9,911)
Less Revenue Earned	(3,889)	(201)	(793)	(176)	(2,320)	(3,218)	(3)	(1,035)	(11,635)
Net Cost Before Loss on Pension, ORB, or OPEB	**9,024**	**12,057**	**12,570**	**5,959**	**5,335**	**(626)**	**1,289**	**5,220**	**50,828**
(Gain)/Loss on Pension, ORB, or OPEB Assumption	-	-	(81)	-	-	-	-	(90)	(171)
NET COST OF OPERATIONS	**$ 9,024**	**$ 12,057**	**$ 12,489**	**$ 5,959**	**$ 5,335**	**$ (626)**	**$ 1,289**	**$ 5,130**	**$ 50,657**

For the year ended September 30, 2011 (in millions) (Unaudited)

Directorates and Other Components	**Intragovernmental Consolidated**	**With the Public**	**Total**
U.S. Customs and Border Protection			
Gross Cost	$ 3,548	$ 8,494	$ 12,042
Less Earned Revenue	(48)	(130)	(178)
Net Cost	**3,500**	**8,364**	**11,864**
U.S. Coast Guard			
Gross Cost	842	10,847	11,689
Less Earned Revenue	(197)	(471)	(668)
Net Cost	**645**	**10,376**	**11,021**
U.S. Citizenship and Immigration Services			
Gross Cost	735	1,778	2,513
Less Earned Revenue	(3)	(3,043)	(3,046)
Net Cost	**732**	**(1,265)**	**(533)**
Federal Emergency Management Agency			
Gross Cost	1,429	15,729	17,158
Less Earned Revenue	(351)	(3,354)	(3,705)
Net Cost	**1,078**	**12,375**	**13,453**
Federal Law Enforcement Training Center			
Gross Cost	59	382	441
Less Earned Revenue	(35)	(2)	(37)
Net Cost	**24**	**380**	**404**
National Protection and Programs Directorate			
Gross Cost	490	1,927	2,417
Less Earned Revenue	(914)	-	(914)
Net Cost	**(424)**	**1,927**	**1,503**
U.S. Immigration and Customs Enforcement			
Gross Cost	1,427	4,336	5,763
Less Earned Revenue	(25)	(124)	(149)
Net Cost	**1,402**	**4,212**	**5,614**
Office of Health Affairs			
Gross Cost	206	84	290
Less Earned Revenue	-	-	-
Net Cost	**206**	**84**	**290**

Directorates and Other Components	**Intragovernmental Consolidated**	**With the Public**	**Total**
Departmental Operations and Other			
Gross Cost	$650	$1,274	$1,924
Less Earned Revenue	(8)	-	(8)
Net Cost	**642**	**1,274**	**1,916**
U.S. Secret Service			
Gross Cost	493	1,355	1,848
Less Earned Revenue	(14)	-	(14)
Net Cost	**479**	**1,355**	**1,834**
Science and Technology Directorate			
Gross Cost	355	533	888
Less Earned Revenue	(9)	(9)	(18)
Net Cost	**346**	**524**	**870**
Transportation Security Administration			
Gross Cost	1,789	5,680	7,469
Less Earned Revenue	(1)	(2,278)	(2,279)
Net Cost	**1,788**	**3,402**	**5,190**
Total Department of Homeland Security			
Gross Cost	12,023	52,419	64,442
Less Earned Revenue	(1,605)	(9,411)	(11,016)
Net Cost Before Loss on Pension, ORB, or OPEB Assumption Changes	10,418	43,008	53,426
(Gain)/Loss on Pension, ORB, or OPEB Assumption Changes	-	400	400
Net Cost	**$ 10,418**	**$ 43,408**	**$ 53,826**

24. 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, 2012:	**Apportionment Category A**	**Apportionment Category B**	**Exempt from Apportionment**	**Total**
Obligations Incurred – Direct	$ 36,655	$ 23,668	$ 2,011	$ 62,334
Obligations Incurred – Reimbursable	4,206	620	13	4,839
Total Obligations Incurred	**$ 40,861**	**$ 24,288**	**$ 2,024**	**$ 67,173**

Year Ended September 30, 2011 (Unaudited):	**Apportionment Category A**	**Apportionment Category B**	**Exempt from Apportionment**	**Total**
Obligations Incurred – Direct	$ 36,638	$ 23,801	$ 1,229	$ 61,668
Obligations Incurred – Reimbursable	4,008	850	12	4,870
Total Obligations Incurred	**$ 40,646**	**$ 24,651**	**$ 1,241**	**$ 66,538**

25. Available Borrowing Authority

At the beginning of FY 2012, the Department, through FEMA's NFIP, had available borrowing authority of $1,427 million. During FY 2012, FEMA received $100 million in borrowing authority and used $396 million of borrowing authority. Additionally, FEMA decreased its indefinite borrowing authority by $53 million, which leaves a balance of $1,078 million as of September 30, 2012. For FY 2011, FEMA had a beginning balance of $1,427 million (unaudited) in borrowing authority. During FY 2011, FEMA did not receive new or use any borrowing authority, which left 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 Disaster Assistance Direct Loan program account.

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.

Debt results from Treasury loans and related interest payable to fund NFIP and Disaster Assistance Direct Loan Program (DADLP) operations of FEMA.

26. Permanent Indefinite Appropriations

Permanent indefinite appropriations are 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 five 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.

- FEMA has a permanent and indefinite appropriation that is used to collect insurance premiums to pay flood claims and claims-related expenses to policyholders as a result of flood disasters. This appropriation has definite borrowing authority to fulfill its commitments in the event premiums collected are insufficient to liquidate obligations.

- The U.S. Coast Guard has a permanent and indefinite appropriation that is used to cover costs associated with retired members' healthcare. The Medicare-Eligible Retiree Health Care Fund (MERHCF) is a DOD special fund that provides benefits for a Medicare-eligible member of a participating military service or other uniformed service entitled to retired or retainer pay and such member's Medicare-eligible dependents and survivors. The DOD office of the actuary determines the amount of the annual U.S. Coast Guard contribution to the MERHCF. A Treasury warrant in a permanent indefinite appropriation is provided for the amount of the U.S. Coast Guard payment to MERHCF each year.

27. 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 and Fund Balance with Treasury are special funds of $1.2 billion and $1 billion at September 30, 2012, and September 30, 2011, 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 COBRA User Fees Account, totaling approximately $68 million and $729 million at September 30, 2012 and 2011, respectively, is restricted by law in its use to offset specific costs incurred by the Department. For additional information, see Note 32, Explanation for Changes in Accounting Principles.

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.

28. 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 2011 Statement of Budgetary Resources (SBR) and the actual amounts reported for FY 2011 in the Budget of the Federal Government. Since the FY 2012 financial statements will be reported prior to the release of the Budget of the Federal Government, DHS is reporting for FY 2011 only. Typically, the Budget of the Federal Government with the FY 2012 actual data is published in February of the subsequent year. Once published, the FY 2012 actual data will be available on the OMB website at: www.whitehouse.gov/omb.

	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
FY 2011 Actual Balances per the FY 2012 Budget of the U.S. Government (in millions) (Unaudited)	**$ 74,336**	**$ 64,652**	**$ 6,246**	**$ 51,810**
Reconciling Items:				
Accounts that are expired that are not included in Budget of the United States	2,255	550	-	-
Distributed Offsetting Receipts not included in the Budget of the United States, Net Outlays	-	-	-	(6,246)
Refunds and drawbacks not included in the Budget of the United States	1,186	1,186	-	1,178
Byrd Program (Continued Dumping and Subsidy Offset) not included in the Budget of the United States	638	126	-	126
Biodefense Countermeasure Program not included in the Budget of the United States	-	-	-	90
Miscellaneous Differences	9	24	-	1
Per the 2011 SBR (Unaudited)	**$ 78,424**	**$ 66,538**	**$ 6,246**	**$ 46,959**

29. 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 received by the Department. Undelivered orders for the periods ended September 30, 2012 and 2011, were $37,509 million and $42,011 million (unaudited), respectively.

The decrease in undelivered orders, unpaid, end of period, is primarily due to a decrease in obligations related to disaster funding as well as a focused effort by Components to improve processes related to prior year obligation and recoveries review.

30. Custodial Revenue

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 includes duties, excise taxes, and various non-exchange fees collected by CBP. CBP assesses duties, taxes, and fees on goods and merchandise brought into the United States from foreign countries. For additional information, see Note 1.X., Exchange and Non-exchange Revenue.

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

1. **Duties:** amounts collected on imported goods collected on behalf of the Federal Government.

2. **User fees:** amounts designed to maintain U.S. harbors and to defray the cost of other miscellaneous service programs.

3. **Excise taxes:** amounts collected on imported distilled spirits, wines, tobacco products, and other miscellaneous taxes collected on the behalf of the Federal Government.

4. **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, 2012 and 2011 (in millions):

2012 Tax Disbursements	Tax Year			
	2012	2011	2010	Prior Years
Total tax refunds and drawbacks disbursed	**$ 952**	**$ 707**	**$ 89**	**$ 502**

2011 Tax Disbursements (Unaudited)	Tax Year			
	2011	2010	2009	Prior Years
Total tax refunds and drawbacks disbursed	**$ 720**	**$ 271**	**$ 90**	**$ 267**

Total tax refunds and drawbacks disbursed consist of non-exchange customs duties revenue refunded.

The disbursements include interest payments of $28 million and $42 million for the fiscal years ended September 30, 2012 and 2011, respectively. The decrease in interest payments is due to more timely processing of prior fiscal year entries in FY 2012 as compared to FY 2011.

The disbursement totals for refunds include antidumping and countervailing duties collected that are refunded pursuant to rulings by the Department of Commerce (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.

31. 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 2012 and FY 2011 are as follows:

	2012	2011 (Unaudited)
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred (Note 24)	$ 67,173	$ 66,538
Less: Spending Authority from Offsetting Collections and Recoveries	(13,650)	(14,731)
Obligations Net of Offsetting Collections and Recoveries	53,523	51,807
Less: Offsetting Receipts	(7,481)	(6,246)
Net Obligations	46,042	45,561
Other Resources		
Donations and Forfeiture of Property	-	-
Transfers In (Out) Without Reimbursement	(14)	114
Imputed Financing from Costs Absorbed by Others	1,386	1,522
Other	2,448	2,020
Net Other Resources Used to Finance Activities	3,820	3,656
Total Resources Used to Finance Activities	**$ 49,862**	**$ 49,217**

	2012	2011 (Unaudited)
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	$ (3,930)	$ (1,742)
Resources that Fund Expenses Recognized in Prior Periods	4,367	1,099
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	-	37
Other	(891)	(729)
Resources that Finance the Acquisition of Assets	3,323	3,425
Other Resources or Adjustments to Net Obligated Resources that Do Not Affect Net Cost of Operations	2,089	1,344
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	4,958	3,434
TOTAL RESOURCES USED TO FINANCE THE NET COST OF OPERATIONS	**$ 44,904**	**$ 45,783**
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	$ 31	$ 60
Increase in Environmental and Disposal Liability	99	5
Increase in Exchange Revenue Receivable from the Public	(2)	-
Upward/Downward Reestimates of Credit Subsidy Expense	(327)	(2)
Other		
Increase in Insurance Liabilities	-	3,740
Increase in Actuarial Pension Liability	3,784	2,274
Increase in Actuarial Health Insurance Liability	-	-
Increase in USCG Military Post-Employment Benefits and Other	1	-
Other	108	-
Total Components of Net Cost of Operations that Will Require or Generate Resources in Future Periods	3,694	6,077
Components not Requiring or Generating Resources		
Depreciation and Amortization	2,384	2,271
Revaluation of Assets or Liabilities	17	566
Other	(342)	(871)
Total Components of Net Cost of Operations that Will Not Require or Generate Resources	2,059	1,966
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	**5,753**	**8,043**
NET COST OF OPERATIONS	**$ 50,657**	**$ 53,826**

32. Explanation for Changes in Accounting Principles

Effective October 1, 2011, the U.S. Coast Guard reclassified all of its existing reparable spare parts, previously classified as General PP&E, into OM&S as presented on the Balance Sheet at September 30, 2012. The reclassification resulted from U.S. Coast Guard's reconciliation of unaudited PP&E balances in FY 2012, and is now consistent with the accounting policies for similar assets at other DHS Components. Accounting for these assets during FY 2012 and beyond is consistent with Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standards No. 3, *Accounting for Inventory and Related Property*, and Interpretation 7, *Items Held for Remanufacture*. Accordingly, balances are presented net of an allowance for repair, and removed from OM&S using the consumption method. DHS applied the change prospectively beginning in FY 2012 with a net increase to OM&S of $1,218 million, a net decrease to PP&E of $507 million, and an adjustment to beginning of the year cumulative results of operations totaling $711 million on the Statement of Changes in Net Position. This change more clearly represents the actual and reasonable utilization and classification of the assets.

In FY 2012, CBP changed its reporting of *Consolidated Omnibus Budget Reconciliation Act of 1985* (COBRA) user fees resulting from elimination of the North American Free Trade Agreement country exemptions from 1994 to 1997. These fees are restricted by law for use until made available as provided in Appropriation Acts. Guidance issued by OMB in August 2012 requires COBRA fees to be deposited in a new "unavailable receipt account" rather than reporting as an unapportioned budgetary resource. The change results in an adjustment to unobligated balance brought forward, October 1, 2011 of $640 million. COBRA user fees are now reported as "Non-budgetary" Fund Balance with Treasury until the collections are either withdrawn by Treasury or made available to CBP by law.

33. Reclassifications

During FY 2012, the Department implemented a requirement for Components to report apportioned budgetary resources existing at September 30 in a consistent manner. Prior to FY 2012, some Components reported apportioned available funds that required OMB reapportionment in the following year as unavailable at September 30. This practice was intended to facilitate preparation of OMB Standard Form 132 (SF-132), *Apportionment and Reapportionment Schedule,* in the subsequent year. This policy resulted in a reclassification of $906 million from unavailable budgetary resources to available on the September 30, 2011 Statement of Budgetary Resources. Total budgetary resources reported at September 30, 2011 did not change as a result of this reclassification.

In FY 2012, a reclassification was made to the FY 2011 Statement of Custodial Activity to report disposition of collections for the U.S. Army Corps of Engineers as a separate line item. Previously, these collections were reported on the Treasury General Fund line.

34. Restatement

A. ***Environmental Liabilities.*** The Department restated FY 2011 financial statements to correct the U.S. Coast Guard's environmental and disposal liabilities balance. The restated balance of environmental and disposal liabilities is due to correction of errors related to: 1) a change in methodology for estimating lighthouse costs per square footage, 2) modified populations and revised methodology for environmental clean-up costs, restoration projects, and lighthouses, and 3) for recognizing the liability related to lead-based paint. These corrections required adjustments to the Balance Sheet, Statement of Changes in Net Position, and related footnotes as follows:

A.1 – Decrease in Environmental Disposal Liabilities of $478 million; and
A.2 – Increase in Cumulative Results of Operations of $478 million.

BALANCE SHEET, in millions	2011	Effects of Restatement	2011 (Restated)	Description Reference
ASSETS				
Intragovernmental				
Fund Balance with Treasury	$ 55,960	$ -	$ 55,960	
Investments, Net	4,159	-	4,159	
Accounts Receivable	271	-	271	
Other				
Advances and Prepayments	1,832	-	1,832	
Total Intragovernmental	**$ 62,222**	**$ -**	**$ 62,222**	
Cash and Other Monetary Assets	76	-	76	
Accounts Receivable, Net	645	-	645	
Taxes, Duties, and Trade Receivables, Net	2,732	-	2,732	
Direct Loans, Net	10	-	10	
Inventory and Related Property, Net	527	-	527	
General Property, Plant, and Equipment, Net	20,037	-	20,037	
Other				
Advances and Prepayments	640	-	640	
TOTAL ASSETS	**$ 86,889**	**$ -**	**$ 86,889**	
LIABILITIES				
Intragovernmental				
Accounts Payable	$ 2,154	$ -	$ 2,154	
Debt	17,754	-	17,754	
Other				
Due to the General Fund	2,844	-	2,844	
Accrued FECA Liability	374	-	374	
Other	532	-	532	
Total Intragovernmental	**$ 23,658**	**$ -**	**$ 23,658**	
Accounts Payable	2,444	-	2,444	
Federal Employee and Veterans' Benefits	49,664	-	49,664	
Environmental and Disposal Liabilities	1,047	(478)	569	A.1
Other				
Accrued Payroll and Benefits	2,198	-	2,198	
Deferred Revenue and Advances from Others	2,716	-	2,716	
Insurance Liabilities	3,537	-	3,537	
Refunds and Drawbacks	131	-	131	
Other	2,552	-	2,552	
Total Liabilities	**$ 87,947**	**$ (478)**	**$ 87,469**	A

BALANCE SHEET, in millions	2011	Effects of Restatement	2011 (Restated)	Description Reference
NET POSITION				
Unexpended Appropriations				
Unexpended Appropriations-Other Funds	$ 45,274	$ -	$ 45,274	
Cumulative Results of Operations				
Cumulative Results of Operations-Earmarked Funds	(14,840)	-	(14,840)	
Cumulative Results of Operations-Other Funds	(31,492)	478	(31,014)	A.2
Total Net Position	**$ (1,058)**	**$ 478**	**$ (580)**	A
TOTAL LIABILITIES AND NET POSITION	**$ 86,889**	**$ -**	**$ 86,889**	

STATEMENT OF CHANGES IN NET POSITION, in millions	**2011**	**Effects of the Restatement**	**2011 (Restated)**	**Description Reference**
Cumulative Results of Operations				
Beginning Balances	$ (45,111)	$ -	$ (45,111)	
Adjustments:				
Correction of Errors - Prior Year	-	478	478	A
Beginning Balance, as Adjusted	$ (45,111)	478	(44,633)	A
Budgetary Financing Sources				
Appropriations Used	47,840	-	47,840	
Non-exchange Revenue	1,743	-	1,743	
Donations and Forfeitures of Cash and Cash Equivalents	3	-	3	
Transfers In/Out Without Reimbursement	(637)	-	(637)	
Other Financing Sources				
Transfers In/Out Without Reimbursement	114	-	114	
Imputed Financing	1,522	-	1,522	
Other	2,020	-	2,020	
Total Financing Sources	52,605	-	52,605	
Net Cost of Operations	(53,826)	-	(53,826)	
Net Change	(1,221)	-	(1,221)	
Cumulative Results of Operations	**(46,332)**	**478**	**(45,854)**	A.2
Unexpended Appropriations				
Beginning Balance	51,612	-	51,612	
Budgetary Financing Sources				
Appropriations Received	42,704	-	42,704	
Appropriations Transferred In/Out	61	-	61	
Other Adjustments	(1,263)	-	(1,263)	
Appropriations Used	(47,840)	-	(47,840)	
Total Budgetary Financing Sources	(6,338)	-	(6,338)	
Total Unexpended Appropriations	**45,274**	**-**	**45,274**	
NET POSITION	**$ (1,058)**	**$ 478**	**$ (580)**	A

35. Subsequent Events

In late October 2012, Hurricane Sandy made landfall in the mid-Atlantic region of the United States, impacting the physical landscape, the people and the region's economy. At this time, FEMA is conducting response and recovery activities in fulfillment of its mission. Funding for these activities is covered by the Disaster Relief Fund and the National Flood Insurance Program. The Department has not received a supplemental appropriation and this event will have no effect on the actuarial liabilities recorded on the FY 2012 financial statements.

In addition, various categories of U.S. Coast Guard's PP&E assets, such as piers, buildings, and coastal navigation equipment, suffered damage from Hurricane Sandy. To date, the U.S. Coast Guard was still performing damage assessments and formulating cost estimates.

Required Supplementary Stewardship Information

Unaudited, see accompanying Independent Auditors' Report

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 2012) in Human Capital, Research and Development, and Non-Federal Physical Property are shown below:

Summary of Stewardship Investments (in millions)

	FY 2012	FY 2011	FY 2010	FY 2009	FY 2008
Research and Development	$ 859	$ 881	$ 834	$ 911	$ 886
Human Capital	108	112	109	111	98
Non-Federal Physical Property	226	229	286	420	204
Total	$ 1,193	$ 1,222	$ 1,229	$ 1,442	$ 1,188

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 improve and develop new 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.

<u>TSA</u>

TSA has invested in three categories of Applied Research Projects. These Applied Research Projects include:

- Human factors research intended to enhance screener capabilities, improve person machine performance, 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 and tracking.

<u>U.S. Coast Guard</u>

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

- *Ballast Water Treatment.* Develop a means to certify ballast water treatment system to ensure aquatic nuisance species are eradicated before entering U.S. waters.
- *Operations Research.* 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.
- *Oil Spill Response.* Develop and evaluate the most promising capabilities and techniques for recovering heavy viscous oil on the ocean floor and in the water column and integrate those capabilities and techniques with heavy oil detection systems, 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.
- *Maritime requirements.* Adapted an existing optimization model to U.S. Coast Guard maritime requirements, and developed a proof-of-concept model which optimally randomizes patrol schedules weighted towards high-valued targets. Evaluated proof-of-concept model in one port against one threat vector. Developed concept for model to allow an assessment of the U.S. Coast Guard Domestic Icebreaking mission performance.

Significant accomplishments in development:

- *Ballast Water Treatment.* Experiments have been conducted to find appropriate stains and techniques for determining the effectiveness of ballast water treatment samples as well as appropriate volumes to analyze sparse samples. Automated analysis concepts and techniques are also being investigated.
- *Operations Research.* 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.
- *Oil Spill Response.* Initiated development of prototype recovery systems, which can be integrated with previously evaluated detection systems.

The following major new applications developments are ongoing:

- *Operations Research.* Review acquisition, deployment, and operational assumptions about C4ISR in the Coast Guard and determine how increasing C4ISR investments are proposed to improve operational performance. Research tools, methods, and measures of effectiveness that can support a quantitative assessment of the operational performance impacts of C4ISR investments. Develop a prototyping capability for demonstration.
- *Navigation Technologies.* 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:

- *Energy Conservation/Green Technologies.* Completed deployment of a demonstration tidal energy generator in the vicinity of an active pier at Coast Guard STA Eastport, ME.

Developed a method to measure the carbon footprint of a U.S. Coast Guard vessel. Initiated studies of alternative fuel use on U.S. Coast Guard outboard powered boats.

- *Biometrics.* 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.

<u>S&T</u>

- *Commercial Mobile Alert Service* (CMAS). CMAS is a national alerts and warnings capability developed to distribute Presidential alerts; America's Missing: Broadcast Emergency Response, or AMBER Alerts; and imminent threat alerts (i.e., emergencies such as tornadoes to cell-phones. In FY 2012, New York City partnered with S&T and FEMA to conduct the first end-to-end test of CMAS.
- *Foot-and-Mouth Disease* (FMD) *Vaccine*. Develops next-generation, licensable vaccines for foreign animal diseases that can be produced in the United States. In FY 2012, S&T scientists in collaboration with industry partners received a conditional license from the United States Department of Agriculture for a single serotype live adenovirus-vectored FMD vaccine. This is the first successful FMD vaccine technology developed in 50 years and the first FMD vaccine licensed for use in the United States.
- *Secure Transit Corridors Technology.* Demonstration project provides CBP and industry participants with a system to detect unauthorized door openings, anomalies and events, as well as provide encrypted in-transit tracking throughout the international supply chain to expedite legal cargo shipments at border. In FY 2012, S&T installed the capability at participant locations in Canada, Mexico, and the United States and commenced test cargo runs.

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, S&T, and TSA have made significant investments in human capital.

<u>FEMA</u>

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.

- 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 is the only congressionally chartered Weapons of Mass Destruction training center for civilians.

S&T

S&T provides grants to institutions, colleges and universities through its Homeland Security Science, Technology, Engineering and Mathematics (HS-STEM) Career Development Grants Program. Funding can be used to award scholarships and fellowships to students in HS-STEM disciplines. Awards are also granted for Minority Serving Institutions, Scientific Leadership Awards (SLA), and institutional awards to support the development of HS-STEM teaching initiatives, curriculum development, and scholarships in HS-STEM fields.

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.

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 entered into 12 LOIs with 11 airports 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 Other Transaction Agreements with 36 airports. These agreements are funded by the American Recovery and Reinvestment Act. TSA obligated $613 million: $551 million for electronic baggage screening program and $62 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 has entered into OTAs with 47 freight forwarders totaling $34.1 million.

Intercity Bus Security Program. This program provided funds to improve security for intercity bus operators and passengers. TSA awarded grants, which are administered by FEMA, 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.

Port Security Grant Program. This program provides grants to critical national seaports to support the security efforts at the port through enhanced facility and operational security. These grants contribute to important security upgrades such as surveillance equipment, access controls to restricted areas, communications equipment, and the construction of new command and control facilities.

Required Supplementary Information

Unaudited, see accompanying Independent Auditors' Report

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, 2012, on general PP&E and heritage assets was estimated to range from $832 million to $1,080 million, 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 2011, the Department reported estimated deferred maintenance ranging from $832 million to $1,113 million on general PP&E 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, 2012, follows (in millions):

	Low estimate	High estimate	Asset Condition
Building & Structures	$ 816	$ 928	Good to Poor
Equipment (vehicles and vessels)	11	106	Good to Fair
Equipment (Other)	-	36	Good to Fair
Heritage assets	5	10	Good to Poor
Total	**$ 832**	**$ 1,080**	

2. Statement of Budgetary Resources

The principal Statement of Budgetary Resources (SBR) combines the availability, status, and outlays of the Department's budgetary resources during FY 2012 and FY 2011. The following table provides the SBR disaggregated by DHS Components rather than by major budget account because DHS manages its budget at the Component level,

In FY 2012, OMB Circular A-136 prescribed a new format to be used to present the SBR. Accordingly, the Department is presenting FY 2012 and FY 2011 information using the new format.

Schedule of FY 2012 Budgetary Resources Disaggregated by Sub-Organization Accounts (in millions) (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	$ 2,268	$ 1,916	$ 1,111	$ 3,616	$ 99	$ 699	$ 28	$ 256	$ 221	$ 66	$ 58	$ 1,548	**$ 11,886**
Adjustment to Unobligated Balance, Brought Forward, October 1 (Note 32)	(640)	-	-	-	-	-	-	-	-	-	-	-	**(640)**
Unobligated Balance Brought Forward, October 1, As Adjusted	1,628	1,916	1,111	3,616	99	699	28	256	221	66	58	1,548	**11,246**
Recoveries of Prior Year Unpaid Obligations	351	270	98	2,135	12	224	5	108	89	25	51	176	**3,544**
Other Changes in Unobligated Balance	(93)	(107)	(8)	(172)	(9)	(164)	(3)	(37)	(13)	(34)	2	(123)	**(761)**
Unobligated Balance from Prior Year Budget Authority, Net	1,886	2,079	1,201	5,579	102	759	30	327	297	57	111	1,601	**14,029**
Appropriations	13,718	10,672	2,868	10,648	271	5,954	165	1,569	1,213	1,930	668	5,723	**55,399**
Borrowing Authority (Note 25)	-	-	-	47	-	-	-	-	-	-	-	-	**47**
Spending Authority from Offsetting Collections	1,619	460	37	3,298	72	168	39	911	1,164	51	129	2,080	**10,028**
TOTAL BUDGETARY RESOURCES	**$ 17,223**	**$ 13,211**	**$ 4,106**	**$ 19,572**	**$ 445**	**$ 6,881**	**$ 234**	**$ 2,807**	**$ 2,674**	**$ 2,038**	**$ 908**	**$ 9,404**	**$ 79,503**
STATUS OF BUDGETARY RESOURCES													
Obligations Incurred (Note 24)	$ 15,912	$ 11,110	$ 2,779	$ 15,730	$ 374	$ 6,102	$ 198	$ 2,299	$ 2,363	$ 1,959	$ 792	$ 7,555	**$ 67,173**
Unobligated Balance, End Of Year													
Apportioned	639	1,724	356	3,313	53	176	28	209	277	39	112	1,616	**8,542**
Exempt from Apportionment	-	7	-	3	-	-	-	-	-	-	-	-	**10**
Unapportioned (Note 3)	672	370	971	526	18	603	8	299	34	40	4	233	**3,778**
Total Unobligated Balance, End of Year	1,311	2,101	1,327	3,842	71	779	36	508	311	79	116	1,849	**12,330**
TOTAL BUDGETARY RESOURCES	**$ 17,223**	**$ 13,211**	**$ 4,106**	**$ 19,572**	**$ 445**	**$ 6,881**	**$ 234**	**$ 2,807**	**$ 2,674**	**$ 2,038**	**$ 908**	**$ 9,404**	**$ 79,503**

Schedule of FY 2012 Budgetary Resources Disaggregated by Sub-Organization Accounts (in millions) (page 2 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
CHANGE IN OBLIGATED BALANCE													
Unpaid Obligations, Brought Forward, October 1	$ 4,713	$ 5,036	$ 1,018	$ 24,546	$ 175	$ 1,997	$ 342	$ 2,133	$ 1,566	$ 399	$ 1,089	$ 4,276	**$ 47,290**
Uncollected Customer Payments From Federal Sources, Brought Forward, October 1	(164)	(366)	(10)	(576)	(118)	(105)	(7)	(705)	(157)	(21)	(220)	(4)	**(2,453)**
Obligated Balance, Start of Year, Net	4,549	4,670	1,008	23,970	57	1,892	335	1,428	1,409	378	869	4,272	**44,837**
Obligations Incurred	15,912	11,110	2,779	15,730	374	6,102	198	2,299	2,363	1,959	792	7,555	**67,173**
Outlays, Gross	(16,117)	(11,046)	(2,733)	(15,968)	(427)	(6,249)	(203)	(2,504)	(2,451)	(1,863)	(988)	(7,535)	**(68,084)**
Change in Uncollected Customer Payments from Federal Sources	1	180	(5)	466	71	-	(1)	(12)	19	(22)	53	1	**751**
Actual Transfers, Unpaid Obligations, Net	-	-	-	(10)	-	-	-	-	-	-	-	-	**(10)**
Recoveries of Prior Year Unpaid Obligations	(351)	(270)	(98)	(2,135)	(12)	(224)	(5)	(108)	(89)	(25)	(51)	(176)	**(3,544)**
Obligated Balance, End of Year													
Unpaid Obligations, End of Year	4,158	4,831	965	22,164	110	1,626	332	1,819	1,389	469	842	4,120	**42,825**
Uncollected Customer Payments from Federal Sources, End of Year	(164)	(187)	(14)	(111)	(47)	(105)	(8)	(716)	(138)	(42)	(167)	(3)	**(1,702)**
Obligated Balance, End of Year, Net	**$ 3,994**	**$ 4,644**	**$ 951**	**$ 22,053**	**$ 63**	**$ 1,521**	**$ 324**	**$ 1,103**	**$ 1,251**	**$ 427**	**$ 675**	**$ 4,117**	**$ 41,123**
BUDGET AUTHORITY AND OUTLAYS, NET													
Budget Authority , Gross	$ 15,337	$ 11,132	$ 2,905	$ 13,993	$ 343	$ 6,122	$ 204	$ 2,480	$ 2,377	$ 1,981	$ 797	$ 7,803	**$ 65,474**
Actual Offsetting Collections	(1,620)	(625)	(33)	(3,843)	(143)	(168)	(38)	(899)	(1,183)	(28)	(182)	(2,082)	**(10,844)**
Change in Uncollected Customer Payments from Federal Sources	1	180	(5)	466	71	-	(1)	(12)	19	(22)	53	1	**751**
Budget Authority, Net	**$ 13,718**	**$ 10,687**	**$ 2,867**	**$ 10,616**	**$ 271**	**$ 5,954**	**$ 165**	**$ 1,569**	**$ 1,213**	**$ 1,931**	**$ 668**	**$ 5,722**	**$ 55,381**
Outlays	$ 16,117	$ 11,046	$ 2,733	$ 15,968	$ 427	$ 6,249	$ 203	$ 2,504	$ 2,451	$ 1,863	$ 988	$ 7,535	**$ 68,084**
Actual Offsetting Collections	(1,620)	(625)	(33)	(3,843)	(143)	(168)	(38)	(899)	(1,183)	(28)	(182)	(2,082)	**(10,844)**
Outlays, Net	14,497	10,421	2,700	12,125	284	6,081	165	1,605	1,268	1,835	806	5,453	**57,240**
Distributed Offsetting Receipts	(3,462)	(53)	(3,173)	(337)	-	(192)	-	1	-	(13)	-	(252)	**(7,481)**
Agency Outlays, Net	**$ 11,035**	**$ 10,368**	**$ (473)**	**11,788**	**$ 284**	**$ 5,889**	**$ 165**	**$ 1,606**	**$ 1,268**	**$ 1,822**	**$ 806**	**$ 5,201**	**$ 49,759**

Schedule of FY 2011 Budgetary Resources Disaggregated by Sub-Organization Accounts (in millions) (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	$ 2,647	$ 2,407	$ 1,010	$ 5,581	$ 135	$ 752	$ 20	$ 272	$ 494	$ 136	$ 160	$ 1,574	$ **15,188**
Recoveries of Prior Year Unpaid Obligations	607	448	132	2,678	11	247	5	87	123	9	38	142	**4,527**
Other Changes in Unobligated Balance	(79)	(109)	(18)	(225)	(7)	(116)	(1)	(3)	(47)	(22)	(5)	(18)	**(650)**
Unobligated Balance from Prior Year Budget Authority, Net	3,175	2,746	1,124	8,034	139	883	24	356	570	123	193	1,698	**19,065**
Appropriations	12,363	10,511	2,747	7,162	271	5,751	139	1,626	1,164	1,773	767	5,633	**49,907**
Spending Authority from Offsetting Collections	1,458	528	28	2,868	116	182	34	920	1,028	27	205	2,058	**9,452**
TOTAL BUDGETARY RESOURCES	**$ 16,996**	**$ 13,785**	**$ 3,899**	**$ 18,064**	**$ 526**	**$ 6,816**	**$ 197**	**$ 2,902**	**$ 2,762**	**$ 1,923**	**$ 1,165**	**$ 9,389**	**$ 78,424**
STATUS OF BUDGETARY RESOURCES													
Obligations Incurred (Note 24)	14,728	11,870	2,788	14,448	426	6,117	169	2,646	2,540	1,858	1,107	7,841	**66,538**
Unobligated Balance, End Of Year													
Apportioned	627	1,602	333	3,075	31	152	21	175	184	17	53	1,303	**7,573**
Exempt from Apportionment	-	2	-	4	-	-	-	-	-	-	-	-	**6**
Unapportioned (Note 3)	1,641	311	778	537	69	547	7	81	38	48	5	245	**4,307**
Total Unobligated Balance, End of Year	2,268	1,915	1,111	3,616	100	699	28	256	222	65	58	1,548	**11,886**
TOTAL BUDGETARY RESOURCES	**$ 16,996**	**$ 13,785**	**$ 3,899**	**$ 18,064**	**$ 526**	**$ 6,816**	**$ 197**	**$ 2,902**	**$ 2,762**	**$ 1,923**	**$ 1,165**	**$ 9,389**	**$ 78,424**

Schedule of FY 2011 Budgetary Resources Disaggregated by Sub-Organization Accounts (in millions) (page 2 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
CHANGE IN OBLIGATED BALANCE													
Unpaid Obligations, Brought Forward, October 1	$ 5,062	$ 4,671	$ 966	$ 26,407	$ 202	$ 2,065	$ 440	$ 1,963	$ 1,640	$ 361	$ 1,164	$ 3,961	**$ 48,902**
Uncollected Customer Payments From Federal Sources, Brought Forward, October 1	(172)	(386)	(9)	(945)	(127)	(95)	(10)	(455)	(257)	(22)	(161)	(5)	**(2,644)**
Obligated Balance, Start of Year, Net	4,890	4,285	957	25,462	75	1,970	430	1,508	1,383	339	1,003	3,956	**46,258**
Obligations Incurred	14,728	11,870	2,788	14,448	426	6,117	169	2,646	2,540	1,858	1,107	7,841	**66,538**
Outlays, Gross	(14,470)	(11,058)	(2,604)	(13,608)	(442)	(5,938)	(262)	(2,388)	(2,491)	(1,812)	(1,143)	(7,385)	**(63,601)**
Change in Uncollected Customer Payments from Federal Sources	8	20	(1)	369	9	(10)	3	(250)	99	3	(60)	1	**191**
Actual Transfers, Unpaid Obligations, Net	-	-	-	(22)	-	-	-	-	-	-	-	-	**(22)**
Recoveries of Prior Year Unpaid Obligations	(607)	(448)	(132)	(2,678)	(11)	(247)	(5)	(87)	(123)	(9)	(38)	(142)	**(4,527)**
Obligated Balance, End of Year													
Unpaid Obligations, End of Year	4,713	5,036	1,018	24,547	175	1,997	342	2,134	1,565	399	1,089	4,275	**47,290**
Uncollected Customer Payments from Federal Sources, End of Year	(164)	(367)	(10)	(576)	(118)	(105)	(7)	(705)	(157)	(20)	(220)	(4)	**(2,453)**
Obligated Balance, End of Year, Net	**$ 4,549**	**$ 4,669**	**$ 1,008**	**$ 23,971**	**$ 57**	**$ 1,892**	**$ 335**	**$ 1,429**	**$ 1,408**	**$ 379**	**$ 869**	**$ 4,271**	**$ 44,837**
BUDGET AUTHORITY AND OUTLAYS, NET													
Budget Authority, Gross	$ 13,821	$ 11,039	$ 2,775	$ 10,030	$ 387	$ 5,933	$ 173	$ 2,546	$ 2,192	$ 1,800	$ 972	$ 7,691	**$ 59,359**
Actual Offsetting Collections	(1,467)	(547)	(26)	(3,992)	(125)	(173)	(36)	(668)	(1,127)	(30)	(145)	(2,060)	**(10,396)**
Change in Uncollected Customer Payments from Federal Sources	8	20	(1)	369	9	(10)	3	(250)	99	3	(60)	1	**191**
Budget Authority, Net	**$ 12,362**	**$ 10,512**	**$ 2,748**	**$ 6,407**	**$ 271**	**$ 5,750**	**$ 140**	**$ 1,628**	**$ 1,164**	**$ 1,773**	**$ 767**	**$ 5,632**	**$ 49,154**
Outlays	$ 14,470	$ 11,058	$ 2,604	$ 13,608	$ 442	$ 5,938	$ 262	$ 2,388	$ 2,491	$ 1,812	$ 1,143	$ 7,385	**$ 63,601**
Actual Offsetting Collections	(1,467)	(547)	(26)	(3,992)	(125)	(173)	(36)	(668)	(1,127)	(30)	(145)	(2,060)	**(10,396)**
Outlays, Net	13,003	10,511	2,578	9,616	317	5,765	226	1,720	1,364	1,782	998	5,325	**53,205**
Distributed Offsetting Receipts	(2,744)	(280)	(2,934)	139	-	(175)	-	(1)	(1)	-	-	(250)	**(6,246)**
Agency Outlays, Net	**$ 10,259**	**$ 10,231**	**$ (356)**	**$ 9,755**	**$ 317**	**$ 5,590**	**$ 226**	**$ 1,719**	**$ 1,363**	**$ 1,782**	**$ 998**	**$ 5,075**	**$ 46,959**

3. Statement of Custodial Activity

Substantially all duty, tax, and fee revenue collected by CBP are remitted to various General Fund accounts maintained by Treasury and the U.S. Department of Agriculture. Treasury further distributes this revenue to other federal agencies in accordance with various laws and regulations. CBP either transfers the remaining revenue (generally less than one percent of revenue collected) directly to other federal agencies or the Governments of Puerto Rico and the U.S. Virgin Islands. Refunds of revenue 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 2012 and FY 2011, CBP had the legal right to collect $2.7 billion of receivables. In addition, there were $2.6 billion and $2.3 billion representing records still in the protest phase for FY 2012 and FY 2011, respectively. CBP recognized as write-offs $78 million and $109 million, respectively, of assessments that the Department had statutory authority to collect at September 30, 2012 and 2011, but have no future collection potential. Most of this amount represents fines, penalties, and interest.

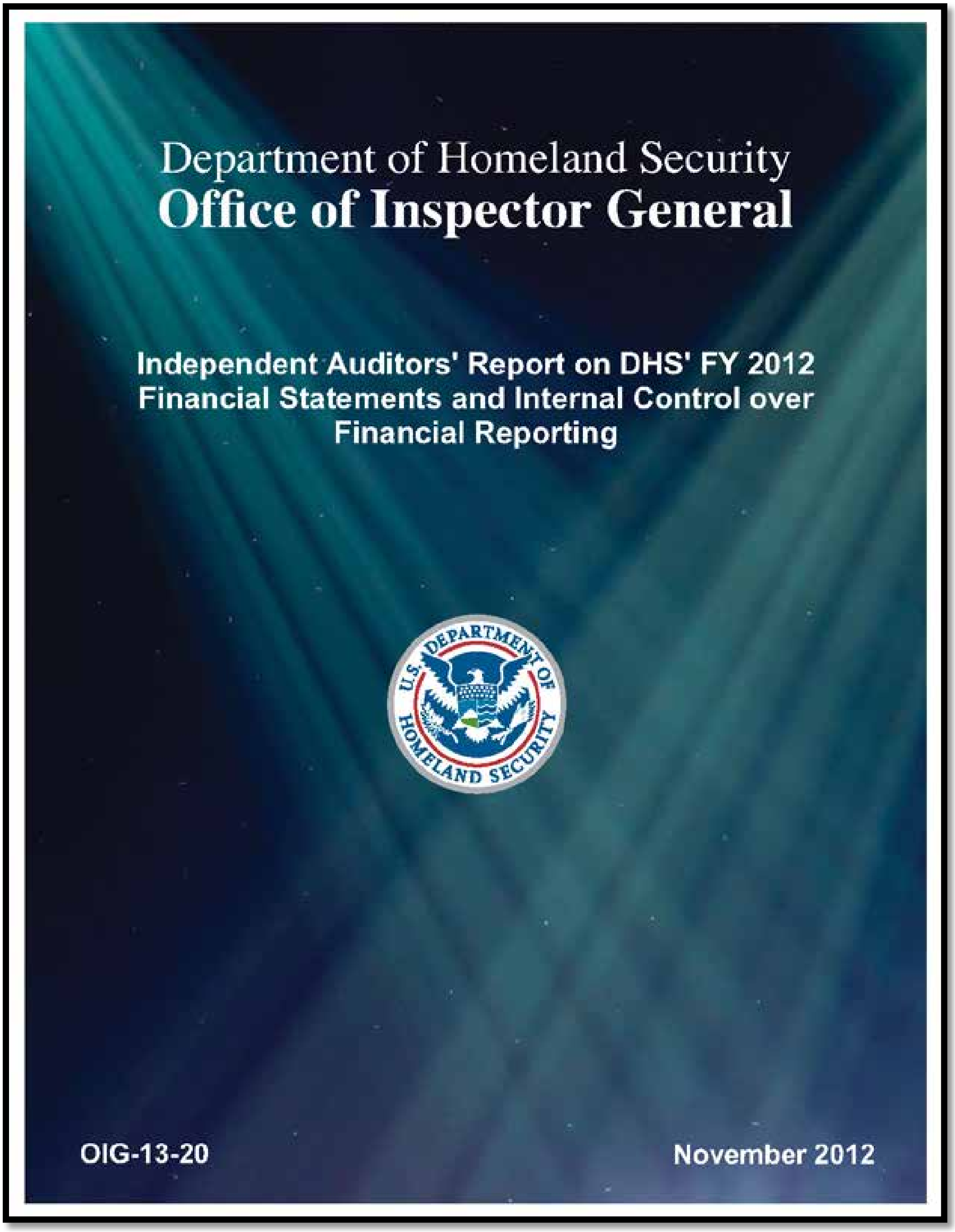
4. Risk Assumed Information

The Department has performed an analysis of the contingencies associated with the unearned premium reserve for the NFIP. This FY 2012 estimate represents losses that might occur in FY 2013 on policies that were in-force as of September 30, 2012. The calculation utilizes the current estimate of the long-term average loss year, which includes an estimate of a rare but catastrophic loss year. A large portion of the long-term average loss year is derived from those catastrophic years.

The NFIP subsidizes rates for some classes of policyholders. These subsidized rates produce a premium less than the loss and loss adjustment expenses expected to be incurred during the long-term average loss year described above. Accordingly, there is a risk that paid flood losses during the remainder of the term for those subsidized policies will exceed the unearned premium liability.

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. A range is developed and applied to the results of the calculation of unpaid expected losses by $600 to $650 million. Actual flood losses are highly variable from year to year. For the majority of years, the unearned premium reserve for the NFIP is adequate to pay the losses and expenses associated with the unearned premium. In those years with catastrophic flooding, the reserve and the average across all years will be inadequate because of the subsidies in premium levels.

Independent Auditors' Report



OFFICE OF INSPECTOR GENERAL
Department of Homeland Security

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

November 14, 2012

MEMORANDUM FOR: The Honorable Janet Napolitano
Secretary

FROM: Charles K. Edwards
Acting Inspector General

Charles K. Edwards

SUBJECT: *Independent Auditors' Report on DHS' FY 2012 Financial Statements and Internal Control over Financial Reporting*

The attached report presents the results of the U.S. Department of Homeland Security's (DHS) financial statements audit for fiscal year (FY) 2012 and the results of an examination of internal control over financial reporting of those financial statements. 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 2012 *Annual Financial Report*. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the integrated audit.

The Department continued to improve financial management in FY 2012 and has achieved a significant milestone. This is the first year the Department has completed a full scope audit on all financial statements. The independent auditors issued a qualified opinion on the financial statements. Nevertheless, the Department still has work to do to meet the goal of becoming fully auditable in FY 2013. KPMG was unable to perform procedures necessary to form an opinion on DHS' internal control over financial reporting of the FY 2012 financial statements. Further, as stated in the Secretary's Assurance Statement, the Department has material weaknesses in internal control over financial reporting. In order to sustain or improve upon the qualified opinion, the Department must continue remediating the remaining control deficiencies.

Summary

KPMG expressed a qualified opinion on the Department's balance sheet as of September 30, 2012, and the related statements of net cost, changes in net position, and custodial activity, and combined statement of budgetary resources for the year then ended (referred to as the "fiscal year (FY) 2012 financial statements"). DHS was unable to represent that property, plant, and equipment (PP&E) account balances were correct and was unable to provide sufficient evidence to support these balances in the financial statements. Additionally, as stated in the Secretary's Assurance Statement, the Department has material weaknesses in internal control over financial reporting, thus

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Department of Homeland Security

KPMG was unable to opine on DHS' internal control over financial reporting of the financial statements as of September 30, 2012.

The report discusses eight significant deficiencies in internal control, five of which are considered material weaknesses, and four instances of noncompliance with laws and regulations, as follows:

Significant Deficiencies That Are Considered To Be Material Weaknesses

- Financial Reporting
- Information Technology Controls and Financial System Functionality
- Property, Plant, and Equipment
- Environmental and Other Liabilities
- Budgetary Accounting

Other Significant Deficiencies

- Entity-Level Controls
- Grants Management
- Custodial Revenue and Drawback

Non-compliance with Laws and Regulations

- *Federal Managers' Financial Integrity Act of 1982* (FMFIA),
- *Federal Financial Management Improvement Act of 1996* (FFMIA)
- *Single Audit Act Amendments of 1996*
- *Anti-deficiency Act* (ADA)

Moving DHS' Financial Management Forward

Although the Department continued to remediate material weaknesses and reduce the number of conditions contributing to the material weaknesses, all five material weakness conditions identified in FY 2011 were repeated in FY 2012. DHS made some progress in remediating two of the material weaknesses. Specifically, USCG properly stated environmental liability balances, which resulted in the auditors retroactively removing the qualification related to this area in FY 2011. Also USCG was able to remediate a number of internal control weakness related to IT scripting, and continues to make progress in PP&E with the goal of being able to assert to the entire PP&E balance by January 2013. In previous years, the DHS Secretary has issued a statement of no assurance on the Department's internal controls over financial reporting. However, in FY 2012 the Department provided qualified assurance that internal control over

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Department of Homeland Security

financial reporting was operating effectively at September 30, 2012, and acknowledges that material weaknesses continue to exist in key financial processes. Consequently, the independent auditors were unable to render an opinion on DHS' internal controls over financial reporting in FY 2012.

While the Department continues to make progress, there are also some concerns that should be addressed in 2013, to avoid losing momentum, and slipping backwards. The Department must continue remediation efforts, and stay focused, in order to achieve its goal of a full clean opinion in 2013. The goal is in reach, and is achievable in 2013.

*****

KPMG is responsible for the attached Independent Auditors' Report dated November 14, 2012, and the conclusions expressed in the report. We do not express opinions on financial statements or internal control or conclusions on compliance with laws and regulations.

Consistent with our responsibility under the *Inspector General Act*, we are providing copies of 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 L. Richards, Assistant Inspector General for Audits, at 202-254-4100.

Attachment

OFFICE OF INSPECTOR GENERAL
Department of Homeland Security

Excerpts from the DHS Annual Financial Report

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Exhibit II – Significant Deficiencies II.1

Exhibit III – Compliance and Other Matters III.1

Exhibit IV – Status of Prior Year Findings IV.1

Criteria – Index of Financial Reporting and Internal Control Criteria Index.1

Appendixes

Appendix A: Report Distribution 2

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

Independent Auditors' Report

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

We have audited the accompanying balance sheet of the U.S. Department of Homeland Security (DHS or Department) as of September 30, 2012, and the related statements of net cost, changes in net position, and custodial activity, and combined statement of budgetary resources for the year then ended (referred to as the "fiscal year (FY) 2012 financial statements"). We have also audited the accompanying balance sheet of DHS as of September 30, 2011, and the related statement of custodial activity for the year then ended (referred to as the "FY 2011 financial statements"). We were also engaged to audit the Department's internal control over financial reporting of the FY 2012 financial statements. The objective of our audits was to express an opinion on the fair presentation of the FY 2012 and 2011 financial statements (referred to as the financial statements), and the effectiveness of internal control over financial reporting of the FY 2012 financial statements.

In connection with our audit, we tested DHS's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on the FY 2012 financial statements. We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources, for the year ended September 30, 2011 (referred to as "other FY 2011 financial statements").

Summary

Except as discussed in our Opinion on the Financial Statements, we concluded that DHS's FY 2012 and 2011 financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

As discussed in our Opinion on the Financial Statements, the Department changed its financial reporting presentation of the statement of net cost, and statement of budgetary resources, in FY 2012; changed its method of accounting for repairable spare parts, and certain user fees, in FY 2012; and restated its environmental liability balances as presented in the FY 2011 financial statements.

Also, as discussed in our Opinion on the Financial Statements, the Department has intergovernmental debt of approximately $17.8 billion used to finance the *National Flood Insurance Program* (NFIP). The Department has determined that future insurance premiums and other anticipated sources of revenue may not be sufficient to repay this debt. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As stated in the Internal Control over Financial Reporting section of this report:

We were unable to perform procedures necessary to form an opinion on DHS's internal control over financial reporting.

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

- Financial Reporting
- Information Technology Controls and Financial System Functionality
- Property, Plant, and Equipment
- Environmental and Other Liabilities
- Budgetary Accounting

Significant deficiencies in internal control over financial reporting have been identified in the following areas:

- Entity-Level Controls
- Grants Management
- Custodial Revenue and Drawback

As discussed in the Compliance and Other Matters section of this report, the results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed the following instances of noncompliance or other matters 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:

- *Federal Managers' Financial Integrity Act of 1982*
- *Federal Financial Management Improvement Act of 1996*
- *Single Audit Act Amendments of 1996*
- *Anti-deficiency Act*

We also reported other matters related to compliance with the *Anti-deficiency Act* at U.S. Coast Guard (Coast Guard), and Intelligence & Analysis.

The following sections discuss our opinion on the accompanying DHS FY 2012 and 2011 financial statements; why we were unable to express an opinion on internal control over financial reporting; our tests of DHS's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements and other matters; and management's and our responsibilities.

Opinion on the Financial Statements

We have audited the accompanying balance sheet of the U.S. Department of Homeland Security as of September 30, 2012, and the related statements of net cost, changes in net position, and custodial activity, and combined statement of budgetary resources for the year then ended. We have also audited the accompanying balance sheet of DHS as of September 30, 2011, and the related statement of custodial activity for the year then ended.

In FY 2012, Coast Guard continued an extensive project to reconcile its financial statement accounts, obtain sufficient evidence to support historical transactions, and prepare auditable financial statements. While substantial progress was made in FY 2012, Coast Guard was unable to complete certain reconciliations or provide evidence supporting certain components of general property, plant, and equipment (PP&E), and heritage and stewardship assets, as presented in the accompanying FY 2012 financial statements and notes. Accordingly, we were unable to complete our audit procedures over these components of the PP&E balance. The unaudited PP&E balances, as reported in the accompanying balance sheet are $8.3 billion or approximately 40 percent of total PP&E net book value at September 30, 2012.

In our opinion, except for the effects on the FY 2012 financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to apply adequate audit procedures to certain PP&E balances and heritage and stewardship assets, as discussed in the preceding paragraph, the FY 2012 financial statements referred to above present fairly, in all material respects, the financial position of DHS as of September 30, 2012, and its net costs, changes in net position, custodial activities, and budgetary resources, for the year ended September 30, 2012, in conformity with U.S. generally accepted accounting principles.

In our report dated November 12, 2011, we expressed an opinion on the Department's FY 2011 financial statements qualified for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence supporting general PP&E balances, heritage and stewardship assets, and environmental liabilities, at September 30, 2011. Since that date, the Department has provided us with evidence supporting the environmental liability balances, and has restated such liabilities in the accompanying September 30, 2011 balance sheet. Accordingly, our present opinion on the FY 2011 financial statements is different from that expressed in our previous report.

In our opinion, except for the effects on the FY 2011 financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to apply adequate procedures to general PP&E, and heritage and stewardship assets, as discussed in the preceding paragraph, the FY 2011 financial statements referred to above present fairly, in all material respects, the financial position of DHS as of September 30, 2011 and its custodial activity for the year then ended, in conformity with U.S. generally accepted accounting principles. Coast Guard PP&E, as reported in the accompanying balance sheet is $9.9 billion, or approximately 50 percent of total PP&E net book value, as of September 30, 2011.

We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the year ended September 30, 2011 and accordingly, we do not express an opinion on these other FY 2011 financial statements.

As discussed in Notes 1B and 23 of the financial statements, the Department changed its presentation of the statement of net cost for the year ended September 30, 2012 to present costs and revenues by major mission, to conform to its strategic plan issued during FY 2012, as required by OMB Circular No. A-136, *Financial Reporting Requirements*, as amended. The statement of net cost for the year ended September 30, 2011 has not been adjusted to conform to the current year presentation.

As discussed in Note 1B of the financial statements, the Department changed its presentation for reporting the statement of budgetary resources in FY 2012, based on new reporting requirements under OMB Circular No. A-136, *Financial Reporting Requirements*, as amended. The statement of budgetary resources for FY 2011 has been reclassified to conform to the current year presentation.

As discussed in Note 32 of the financial statements, the Department changed its method of accounting for repairable spare parts maintained by the Coast Guard, and for certain user fees collected by Customs and Border Protection. These accounting changes were reflected in the FY 2012 financial statements.

As discussed in Note 34 of the financial statements, the Department has restated environmental liabilities as presented in the September 30, 2011 balance sheet.

As discussed in Notes 1T and 15 of the financial statements, the Department has intergovernmental debt of approximately $17.8 billion used to finance the *National Flood Insurance Program*. Due to the subsidized nature of the NFIP, the Department has determined that future insurance premiums, and other anticipated sources of revenue, may not be sufficient to repay this debt. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis (MD&A), Required Supplementary Information (RSI), and Required Supplementary Stewardship Information (RSSI) sections of the DHS FY 2012 Annual Financial Report (AFR) be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We were unable to complete limited procedures over MD&A, RSSI, and RSI information presented in the AFR as prescribed by professional standards because of the limitations on the scope of our audit described in the second and fourth paragraphs of this section of our report. We did not audit the MD&A, RSSI, and RSI information presented in the AFR and accordingly, we express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The information in the Other Accompanying Information section of the AFR and the information on pages 189 through 289 are presented for the purposes of additional analysis and are not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

Internal Control Over Financial Reporting

We were engaged to audit the Department's internal control over financial reporting of the FY 2012 financial statements 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 2012 DHS *Secretary's Assurance Statement*, included in MD&A on pages 34-35 of the AFR, as required by OMB Circular No. A-123. We did not test all controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

The FY 2012 DHS *Secretary's Assurance Statement* states that the Department provides qualified assurance that internal control over financial reporting was operating effectively at September 30, 2012, and acknowledges that material weaknesses continue to exist in key financial processes. This conclusion is based on the Department's limited-scope evaluation of internal control over financial reporting conducted in FY 2012 and previous years.

KPMG

Because of the limitation on the scope of our audit described in the second paragraph of the Opinion on the Financial Statements section, and the nature of managements assertion on the effectiveness of internal control over financial reporting described in the preceding paragraph, 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's internal control over financial reporting.

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.

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 Reporting
- Information Technology Controls and Financial Systems Functionality
- Property, Plant, and Equipment
- Environmental and Other Liabilities
- Budgetary Accounting

Deficiencies identified that contribute to a material weakness at the consolidated level are presented in Exhibit I.

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's 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 audit. Significant deficiencies have been identified in the following areas:

- Entity-Level Controls
- Grants Management
- Custodial Revenue and Drawback.

Deficiencies identified that contribute to a significant deficiency at the consolidated level are presented in Exhibit II.

Other deficiencies in internal control, potentially including additional material weaknesses and significant deficiencies, may have been identified and reported had we been able to apply sufficient audit procedures to general property, plant, and equipment including heritage and stewardship assets, as described in the second paragraph of the Opinion on the Financial Statements; and had we been able to perform all procedures necessary to express an opinion on DHS's internal control over financial reporting of the FY 2012 financial statements.

A summary of the status of material weaknesses and significant deficiencies reported in FY 2011 is included as Exhibit IV. 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.

Compliance and Other Matters

The results of certain of our tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed the following four instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04, and are described in Exhibit III:

- *Federal Managers' Financial Integrity Act of 1982*
- *Federal Financial Management Improvement Act of 1996*

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- *Single Audit Act Amendments of 1996*
- *Anti-deficiency Act*

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

The results of our tests of FFMIA disclosed instances described in Exhibits I, and II where DHS's 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.

Other instances of noncompliance with laws, regulations, contracts, and grant agreements may have been identified and reported, had we been able to apply sufficient audit procedures to general property, plant, and equipment including heritage and stewardship assets as described in the second paragraph of our Opinion on the Financial Statements, and perform all procedures necessary to complete our audit of internal control over financial reporting.

Other Matters: We also reported other matters related to compliance with the *Anti-deficiency Act* at the Coast Guard and Intelligence & Analysis in Exhibit III.

* * * * * * *

Responsibilities

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

Auditors' Responsibilities. Our responsibility is to express an opinion on the financial statements of DHS based on our audits. Except as discussed in the second and fourth paragraphs of our Opinion on Financial Statements above, we conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 07-04. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit also includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall financial statement presentation.

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

As part of obtaining reasonable assurance about whether DHS's FY 2012 financial statements are free of material misstatement, we performed tests of DHS's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the FY 2012 financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, 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 audit, and accordingly, we do not express such an opinion.

DHS's written response to the deficiencies in internal control, instances of noncompliance or other matters identified in our audit is presented attached to our report, and was not subjected to the auditing procedures applied in the audit of the DHS's financial statements and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the DHS's management, the DHS's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 14, 2012

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 audit of the U.S. Department of Homeland Security (Department or DHS)'s financial statements as of, and for the year ended, September 30, 2012, and our engagement to audit internal control over financial reporting of those financial statements. Our findings and the status of prior year findings are presented in five exhibits:

Exhibit I Significant deficiencies in internal control identified throughout the Department. All of the significant deficiencies reported in Exhibit I are considered material weaknesses at the DHS consolidated level. Beginning in FY 2012 internal control findings identified at the Coast Guard are presented with all other DHS components in Exhibit I, whereas previously Coast Guard findings were presented separately.

Exhibit II Significant deficiencies identified throughout the Department that are not considered a material weakness at the DHS consolidated financial statement level.

Exhibit III 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 IV The status of our findings reported in FY 2011.

Criteria *Index of Financial Reporting and Internal Control Criteria*

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 as of September 30, 2012. 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.

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 financial statements as of September 30, 2012 and for the year then ended.

We have also performed follow-up procedures on findings identified in previous engagements to audit the DHS financial statements. To provide trend information for the DHS components, Exhibits I and II contain Trend Tables next to the heading of each finding. The Trend Tables in Exhibits I and II depict the severity and current status of findings, by component that has contributed to that finding from FY 2010 through FY 2012. Listed in the title of each material weakness and significant deficiency included in Exhibits I and II, are the DHS components that contributed to the finding in FY 2012.

The criteria supporting our findings, such as references from technical accounting standards, various rules and regulations, including requirements issued by the Office of Management and Budget and the U.S. Treasury, and internal Departmental and component directives, is presented in the *Index of Financial Reporting and Internal Control Criteria* behind Exhibit IV.

A summary of our findings in FY 2012 and FY 2011 are presented in the Tables below:

Table 1 Presents a summary of our internal control findings, by component, for FY 2012.
Table 2 Presents a summary of our internal control findings, by component, for FY 2011.

We have reported five material weaknesses and three significant deficiencies at the Department level in FY 2012, shown in Table 1.

i.1

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

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

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

TABLE 2 – SUMMARIZED DHS FY 2011 INTERNAL CONTROL FINDINGS
(Balance Sheet and Statement of Custodial Activity Audit)

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

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

All components of DHS, as defined in Note 1A – *Reporting Entity,* to the financial statements, were included in the scope of our audit of the DHS financial statements as of September 30, 2012, and our engagement to audit internal control over financial reporting of those financial statements. Accordingly, our audit and engagement to 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 material weakness or significant deficiency at the DHS consolidated financial statement level.

i.2

Independent Auditors' Report
Exhibit I – Material Weaknesses

I-A Financial Reporting (USCG, TSA, ICE)

Trend Table			
	2012	2011	2010
USCG	Deficiencies are more severe*	Deficiencies are more severe*	Deficiencies are more severe*
TSA	Deficiencies are less severe*	Deficiencies are less severe*	Deficiencies are less severe*
ICE	Deficiencies are less severe*	N/A	N/A
USCIS	C	Deficiencies are less severe*	N/A

Key – Trend Table	
C	Deficiencies are corrected
N/A	No deficiencies reported
(yellow)	Deficiencies are less severe*
(red)	Deficiencies are more severe*
* See Introduction	

Background: The U.S. Coast Guard (Coast Guard or USCG) continued to make financial reporting improvements in fiscal year (FY) 2012, by completing its planned corrective actions over selected internal control deficiencies, as described in the *Financial Strategy for Transformation and Audit Readiness* (FSTAR). These remediation efforts allowed management to make new assertions in FY 2012 related to the auditability of its financial statement balances, including approximately $500 million of environmental liabilities and $3 billion of real property. The FSTAR calls for continued remediation of control deficiencies and reconciliation of balances in FY 2013. Consequently, some financial reporting control weaknesses that we reported in the past remain uncorrected at September 30, 2012.

Transportation Security Administration (TSA) continued to make progress in strengthening internal controls. However, we noted that deficiencies remain in some financial reporting processes throughout the component.

Immigration and Customs Enforcement (ICE) financial reporting deficiencies were identified primarily as a result of expanded audit procedures for the full-scope financial statement audit.

USCIS substantially completed corrective actions in financial reporting processes in FY 2012.

Conditions: We noted the following internal control weaknesses related to financial reporting at Coast Guard, TSA, and ICE.

1. The Coast Guard does not have properly designed, implemented, and effective policies, procedures, processes, and controls surrounding its financial reporting process to:

   - Ensure that all non-standard adjustments (i.e., journal entries, top side adjustments, and scripts) impacting the general ledger are adequately researched, supported, and reviewed prior to their recording in the general ledger, or identify and document the financial statement impact of all "non-GAAP" policies.

   - Completely support beginning balance and year-end close-out related activity in its three general ledgers.

   - Ascertain that intra-governmental activities and balances are identified and coded to the correct trading partner. Additionally, differences, especially with agencies outside DHS, are not consistently investigated and resolved in a timely manner in coordination with the Department's Office of Financial Management (OFM).

   - Maintain general ledger activity in compliance with the United States Standard General Ledger (USSGL) at the transaction level.

2. TSA:

   - Has weak or ineffective controls affecting some key financial reporting processes. The control deficiencies noted included weaknesses in transactional and supervisory reviews over capital acquisitions including internal use software, expenses, budgetary accounts, and lease reporting.

   - Controls are not functioning within an acceptable degree of precision over management's quarterly review of financial statements and supervisory reviews over journal vouchers, including understanding the business events that trigger a financial reporting event.

I.1

Independent Auditors' Report
Exhibit I – Material Weaknesses

- Has not fully engaged certain program and operational personnel and data into the financial reporting process.
- Is not fully compliant with the USSGL requirements at the transaction level.

3. ICE:

- Has not fully developed its agency-specific financial reporting process with sufficient policies, procedures, and internal controls. The control deficiencies contributed to the need for corrective adjustments in the financial statements. For example, we noted that ICE:
  - Does not have effective controls over the accrual and subsequent reversal of payroll expense; and
  - Does not have an effective process to identify material subsequent events that may impact year-end financial statement balances or note disclosures.
- Has not dedicated adequate resources to effectively respond to audit inquiries in a timely manner, with accurate information, and to identify potential technical accounting issues. Specifically, we noted ICE:
  - In some instances, was unable to provide documentation in a timely manner to support some journal entry transactions and prior period adjustments. Journal entry activity represented a substantial portion of the transactions in the general ledger detail for certain accounts including undelivered orders and operating expenses;
  - In some instances, was unable to timely respond to audit requests for accounts payable and undelivered order general ledger detail, and adjustments of prior year unpaid undelivered orders; and
  - Was unable to effectively identify potential technical accounting issues, analyze the relevant facts and circumstances, and respond to auditor inquiries on a timely basis.
- Is not fully compliant with the USSGL requirements at the transaction level.

Cause/Effect: The Coast Guard does not have an effective general ledger system. The Coast Guard uses three general ledgers, developed over a decade ago. This legacy system has severe functional limitations contributing to the Coast Guard's challenge of addressing systemic internal control weaknesses in financial reporting, strengthening the control environment, and complying with relevant Federal financial system requirements and guidelines, notably Comment **III-J**, *Federal Financial Management Improvement Act of 1996* (FFMIA). The Coast Guard has installed a shadow general ledger system to duplicate transaction postings as a control over financial reporting. See information technology (IT) system functionality issues described at Comment **I-B**, *Information Technology Controls and Financial Systems Functionality.* The conditions supporting our findings collectively limit the Coast Guard's ability to process, store, and report financial data in a manner that ensures accuracy, confidentiality, integrity, and availability of data without substantial manual intervention. These conditions contribute to the Coast Guard's continuing challenges with preparing auditable general property, plant, and equipment balances as further described in Comment **I-C**, *Property, Plant, and Equipment.*

In recent years, TSA has implemented several new procedures and internal controls to correct known deficiencies. However, some procedures still require modest improvements to fully consider all circumstances or potential errors that could occur in the process. The control deficiencies contributed to substantive and classification errors in the financial statements, discovered during our audit.

ICE faces challenges in developing and maintaining adequate lines of communications both within the ICE OFM and amongst its various and decentralized program offices. Communication between financial managers and personnel responsible for contributing to financial reports was not sufficient to consistently generate clear and usable information. In addition, ICE does not have sufficient coordination with IT personnel, including contractors, who are responsible for generating certain financial reports. Also see Comment **II-F**, *Entity-Level Controls.*

Independent Auditors' Report
Exhibit I – Material Weaknesses

Because of the conditions noted above, and described throughout Exhibits I and II, the Department was unable to provide full assurance that internal controls over financial reporting were operating effectively at September 30, 2012, and has acknowledged in the Secretary's Assurance Statement presented in *Management's, Discussion, and Analysis* section of the FY 2012 Annual Financial Report that material weaknesses and other internal control deficiencies continue to exist in some key financial processes.

Criteria: Presented in *Index of Financial Reporting and Internal Control Criteria,* after Exhibit IV.

Recommendations: We recommend that:

1. USCG:
   a. Continue the implementation of the FSTAR as planned in FY 2013;
   b. Implement accounting and financial reporting processes including an integrated general ledger system that is FFMIA compliant; and
   c. Establish new or improve existing policies, procedures, and related internal controls to ensure that:
      i) All non-standard adjustments (i.e., journal entries, top side adjustments, and scripts) impacting the general ledger are adequately researched, supported, and reviewed prior to their recording in the general ledger;
      ii) All "non-GAAP" policies are identified and their quantitative and qualitative financial statement impacts have been documented;
      iii) 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; and
      iv) All intra-governmental activities and balances are reconciled on a timely basis, accurately reflected in the financial statements, and differences are resolved in a timely manner in coordination with the Department's OFM.
2. TSA:
   a. Emphasize and train employees on the critical aspects of key transactional and supervisory review controls including the precision of the review, the need for supporting documentation, and impact to the financial statements;
   b. Work with the TSA leasing office to implement formal and effective processes for identification, evaluation, and recording of cancellable, non-cancellable, and capital leases;
   c. Expand the monthly financial statement review process to incorporate operational and business activities into the evaluation and assessment process; and
   d. Continue to analyze alternatives, including evaluation of systems, to enable FFMIA compliance.
3. ICE:
   a. Develop and implement agency-specific financial reporting policies, procedures, supporting sub-processes, and internal controls to ensure that accruals and subsequent reversals are correct, and subsequent event reviews are effective in identifying material transactions that affect the financial statements;
   b. Implement procedures to involve financial management, and others as needed, when making accounting policy decisions to ensure that adopted accounting policies are technically correct, supported, and properly reflect the business transaction in the financial statements;
   c. Assess resource needs and assign sufficient staff to respond to audit inquiries with accurate and complete information in a timely manner; and
   d. Develop formal policies and procedures to ensure compliance with the USSGL requirements at the transaction level.

I.3

Independent Auditors' Report
Exhibit I – Material Weaknesses

I-B Information Technology Controls and Financial System Functionality (USCG, CBP, USCIS, FEMA, ICE)

	2012	2011	2010
USCG			
CBP			
USCIS			
FEMA			
ICE			

See page I.1 for table explanation

Background: During DHS' financial statement integrated audit, we evaluated select general Information Technology (IT) controls (GITC) using the objectives defined by U.S. Government Accountability Office (GAO)'s *Federal Information System Controls Audit Manual* (FISCAM), in five key control areas: security management, access control, configuration management, segregation of duties, and contingency planning. In addition to GITCs, 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.

During our FY 2012 assessment of IT general and application controls, we noted that the DHS components made progress in the remediation of IT findings we reported in FY 2011. We closed approximately 70 (46 percent) of our prior year IT findings.

New findings in FY 2012 resulted primarily from additional IT systems and business processes that came within the scope of our audit this year, and were noted at all DHS components. CBP and FEMA had the greatest number of new findings. We also considered the effects of financial system functionality when testing internal controls and evaluating findings. Many key DHS financial systems are not compliant with FFMIA and OMB Circular Number A-127, *Financial Management Systems,* as revised. DHS financial system functionality limitations add substantially to the Department's challenges of addressing systemic internal control weaknesses, and limit the Department's ability to leverage IT systems to effectively and efficiently process and report financial data.

Conditions: Our findings, which are a cross-representation of common general IT control deficiencies identified throughout the Department's components, related to IT general and application controls and financial systems functionality follow:

Related to IT general and application controls:

1. *Access Controls*:
   - Deficiencies in management of application and/or database accounts, network, and remote user accounts.
   - Ineffective safeguards over logical and physical access to sensitive facilities and resources.
   - Lack of generation, review, and analysis of system audit logs and adherence to DHS requirements.
   - Excessive access of authorized personnel to sensitive areas containing key financial systems, and data center access controls were not properly enforced.
2. *Configuration Management*
   - Lack of documented policies and procedures.
   - Script management test plans were not documented to meet the minimum DHS requirements.
   - Security patch management and configuration deficiencies were identified during the vulnerability assessment on the platforms supporting the key financial applications and general support systems.
   - Evidence to support authorized modifications to key financial systems was not maintained.
   - Internal requirements to conduct Functional Configuration Audits (FCAs) and Physical Configuration Audits (PCAs) were not followed at one component.

I.4

Independent Auditors' Report
Exhibit I – Material Weaknesses

3. *Security Management:*
   - Systems certification and accreditation were not completed and documented.
   - IT Security personnel lack mandatory role-based training or compliance was not documented and monitored, and computer security awareness training was not monitored.
   - Background investigations of federal employees and contractors employed to operate, manage and provide security over IT systems were not being properly conducted, nor consistently tracked and monitored.
4. *Contingency Planning:*
   - Service continuity plans were not tested nor updated to reflect the current environment, and an alternate processing site has not been established for high risk systems.
   - Authorized access to backup media was not periodically reviewed and updated; at one component procedures to periodically test backups was not implemented.
5. *Segregation of Duties:*
   - Lack of evidence to show that least privilege and segregation of duties controls exist, including policies and procedures to define conflicting duties and access rights.

These control findings, including other significant deficiencies and criteria are described in greater detail in a separate *Limited Official Use* letter provided to DHS management.

Related to financial system functionality:

Coast Guard (some conditions impact TSA as a user of Coast Guard's IT accounting systems):

- The core financial system configuration management process relies on an IT script process as a solution primarily to compensate for system functionality and data quality issues.
- The component is unable to routinely query its various general ledgers to obtain a complete population of financial transactions, and consequently must create many manual custom queries that delay financial processing and reporting processes.
- A key financial system is limited in processing overhead cost data and depreciation expenses in support of the property, plant and equipment financial statement line item.
- Production versions of financial systems are outdated and do not provide the necessary core functional capabilities (e.g., general ledger capabilities).
- The budgetary module of the core financial system is not activated. As a result, key attributes (e.g., budget fiscal year) are missing and potential automated budgetary entries (e.g., upward adjustments) are not used. This has created the need for various manual workarounds and non-standard adjustments (i.e., topsides) to be implemented.
- 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:
  - Receipt of goods and services upon delivery. As a result, the Coast Guard records a manual estimate of potential receipted goods and services at year end in the general ledger;
  - 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;

I.5

Independent Auditors' Report
Exhibit I – Material Weaknesses

- Maintaining adequate posting logic transaction codes to ensure that transactions are recorded in accordance with generally accepted accounting principles (GAAP); and
- Tracking detailed transactions associated with intragovernmental business and eliminating the need for default codes such as Trading Partner Identification Number that cannot be easily researched.

Other Department Components:

We noted many cases where financial system functionality is inhibiting DHS' ability to implement and maintain internal controls, notably IT application controls supporting financial data processing and reporting. Financial system functionality limitations also contribute to other control deficiencies reported in Exhibits I and II, and compliance findings presented in Exhibit III. We noted persistent and pervasive financial system functionality conditions at all of the significant DHS components in the following general areas:

- Inability of financial systems to process, store, and report financial and performance data to facilitate decision making, safeguarding and management of assets, and prepare financial statements that comply with GAAP.
- Technical configuration limitations, such as outdated systems that are no longer fully supported by the software vendors, impaired DHS' ability to fully comply with policy in areas such as IT security controls, notably password management, audit logging, user profile changes, and the restricting of access for off-boarding employees and contractors.
- System capability limitations prevent or restrict the use of applications controls to replace less reliable, more costly manual controls. Or in some cases, require additional manual controls to compensate for IT security or control weaknesses.

Cause/Effect: DHS management recognizes the need to upgrade its financial systems. Until serious legacy IT issues are addressed, and updated IT solutions implemented, compensating controls and other complex manual workarounds must support its IT environment and financial reporting. As a result, DHS' difficulty in attesting to a strong control environment, to include effective general IT controls and reliance on key financial systems, will continue.

The conditions supporting our findings collectively limit DHS' ability to process, store, and report financial data in a manner to ensure accuracy, confidentiality, integrity, and availability. Some of the weaknesses may result in material errors in DHS' financial data that are not detected in a timely manner through the normal course of business. In addition, because of the presence of IT control and financial system functionality weaknesses; there is added pressure on mitigating controls to operate effectively. Because mitigating controls are often more manually focused, there is an increased risk of human error that could materially affect the financial statements.

Recommendation: We recommend that the DHS Office of the Chief Information Officer (OCIO), in coordination with the Office of the Chief Financial Officer (OCFO) continue the *Financial Systems Modernization* initiative, and make necessary improvements to the Department's financial management systems and supporting IT security controls. Specific recommendations are provided in a separate *Limited Official Use* letter provided to DHS management.

I.6

Independent Auditors' Report
Exhibit I – Material Weaknesses

I-C Property, Plant, and Equipment (USCG, CBP, ICE)

	2012	2011	2010
USCG			
CBP			
ICE		N/A	C
TSA	C		
MGMT	C		N/A

See page I.1 for table explanation

Background: The Coast Guard maintains approximately 50 percent of all DHS general property, plant, and equipment (PP&E). 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. The Coast Guard categorizes PP&E as personal property (i.e., aircraft, vessels, vehicles, leasehold improvements, software, information technology, and other equipment), real property (i.e., land, improvements to land, buildings, other structures, and facilities), or construction-in-process (CIP).

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.

In FY 2012, the Coast Guard continued to perform remediation to address PP&E process and control deficiencies, specifically those associated with land, buildings and other structures, vessels, small boats, aircraft, and CIP. However, remediation efforts were not fully completed in FY 2012, and consequently, most of the conditions cited below have been repeated from our FY 2011 report.

Customs and Border Protection (CBP) has acquired substantial new technology, facilities, and other assets in recent years through purchase and construction. CBP's new 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.

ICE underwent a process to identify assets that had been inappropriately expensed in prior fiscal years, resulting in corrective adjustments made to the financial statements in FY 2012.

The Management Directorate (MGMT) implemented new processes to remediate PP&E control deficiencies in FY 2012.

TSA substantially completed corrective actions in property, plant, and equipment accounting processes in FY 2012. Remaining control deficiencies affecting PP&E are broadly related to financial reporting, and have been grouped with conditions cited at Comment **I-A**, *Financial Reporting*

Conditions: We noted the following internal control weaknesses related to PP&E at USCG, CBP, and ICE:

1. USCG:

- Has not fully established accurate and auditable PP&E balances as of September 30, 2012 for personal property and CIP balances reported in the financial statements and related disclosures and supplementary information. For example, USCG has not:
  - Implemented sufficient internal controls and related processes to accurately, consistently, and timely record additions to PP&E, (including all costs necessary to place the asset in service e.g., other direct costs), transfers from other agencies, disposals, and CIP activity.
  - Sufficiently supported its methodologies, assumptions, and underlying data, for indirect costs allocated to PP&E projects.
  - 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 personal property assets to the fixed assets system.
  - Properly accounted for improvements and impairments to personal property assets, capital leaseholds, selected useful lives for depreciation purposes, and capitalization thresholds, consistent with GAAP.

I.7

Independent Auditors' Report
Exhibit I – Material Weaknesses

- Has not implemented policies, procedures, and effective controls to ensure the accuracy of all underlying data elements and assumptions used to record real property balances, such as land, buildings and other structures.
- Has not 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.
- Has not 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.

2. CBP:

- Does not always adhere to procedures and processes to properly account for asset purchases and transfers, construction, depreciation, or disposal of assets in a timely manner. For example, CBP did not:
  - Ensure all asset additions are recorded accurately and timely, and are correctly valued in the financial statements.
  - Transfer certain assets from CIP to "in-use" assets in a timely manner.
  - Record some asset disposals timely and in accordance with policy.
  - Maintain complete documentation supporting the timely and accurate accounting for asset transactions, so that it is available for audit.

3. ICE:

- Does not have adequate processes and controls in place to identify internal-use software projects that should be considered for capitalization. After a project has been identified for capitalization, ICE did not have adequate processes to capitalize costs associated with the software project. Similar control weaknesses exist for other types of PP&E and indirect costs at ICE.
- Does not have adequate policies and procedures to ensure that assets acquired are recorded in the general ledger in a timely manner. The majority FY 2012 additions to PP&E that we tested were purchased in previous years, but not recorded in the general ledger until the current year.

Cause/Effect: The Coast Guard has had difficulty establishing its opening PP&E balances and accounting for leases, primarily because of poorly designed policies, procedures, and processes implemented more than a decade ago, combined with ineffective internal controls, and IT system functionality difficulties, See Comment **I-B**, *Information Technology Controls and Financial System Functionality*. Additionally, due to limited resources, the Coast Guard deferred corrective actions associated with personal property and stewardship PP&E to FY 2013. As a result, the Coast Guard is unable to accurately account for personal property, CIP, stewardship PP&E, and leases, and provide necessary information to DHS OFM for consolidated financial statement purposes.

CBP does not have fully implemented policies and procedures, or does not have sufficient oversight of its adherence to policies and procedures, to ensure that all PP&E transactions are recorded timely and accurately, or to ensure that all assets are recorded and properly valued in the general ledger.

ICE had not incurred substantial costs for internal use software until recent years, and previously treated capital expenditures as period costs as incurred. When ICE increased spending on capital projects, appropriate systems and processes were not established to properly account for the costs, or identify costs that qualify for capitalization as internal use software. In FY 2012, ICE completed a review of past and current projects, and recorded an adjustment to the financial statements to properly reflect capitalized internal use software.

Independent Auditors' Report
Exhibit I – Material Weaknesses

Criteria: Presented in *Index of Financial Reporting and Internal Control Criteria,* after Exhibit IV.

Recommendations: We recommend that:

1. USCG:

   a. Continue remediation efforts to establish PP&E balances in the financial statements and related disclosures and supplementary information, including appropriate controls and related processes to accurately and timely record additions to PP&E, transfers from other agencies, improvements, impairments, capital leases, indirect costs, and disposals. Additionally, continue to implement controls over the completeness, existence, accuracy, and valuation of all CIP related balances and activity;

   b. Establish new or improve existing policies, procedures, and related internal controls to sufficiently support methodologies, assumptions, and underlying data, for indirect costs allocated to PP&E projects;

   c. Implement processes and controls to facilitate identification and tracking, and to ensure that the status of assets is accurately tracked in the subsidiary ledger;

   d. Implement internal controls to ensure the accuracy of underlying data elements, calculations, and assumptions used to support real property balances;

   e. Develop and implement a process to identify and evaluate lease agreements to ensure that they are appropriately classified as operating or capital, and are properly reported in the financial statements and related disclosures; and

   f. Develop and implement policies, procedures, and internal controls to support the completeness, existence, accuracy, and presentation and disclosure assertions related to supplementary information for stewardship PP&E.

2. CBP:

   a. Ensure that existing policies and procedures for recording asset additions, reclassifications, and retirements are followed, and properly communicated throughout CBP;

   b. Enhance supervisory and monitoring controls to review PP&E transactions in a timely manner; and

   c. Maintain complete documentation supporting asset transactions recorded in the general ledger.

3. ICE:

   a. Develop and implement sustainable processes and controls to identify internal-use software projects at the time of project inception, and to timely record capitalized software costs and associated indirect costs; and

   b. Develop and implement policies and procedures to ensure that assets acquired are recorded in a timely manner.

I-D Environmental and Other Liabilities (USCG)

	2012	2011	2010
USCG			
See page I.1 for table explanation			

Background: The Coast Guard's environmental liabilities represent approximately $500 million or 75 percent of total DHS environmental liabilities. During FY 2012, the Coast Guard completed the final phases of a multi-year remediation plan to address process and control deficiencies related to environmental liabilities.

The Coast Guard estimates accounts payable by adjusting the prior year accrual estimate based on an analysis of actual payments made subsequent to September 30 of the prior year.

I.9

Independent Auditors' Report
Exhibit I – Material Weaknesses

Conditions: We noted the following internal control weaknesses related to environmental liabilities and other liabilities at the Coast Guard:

Regarding Environmental Liabilities:

The Coast Guard did not:

- Implement policies and procedures to develop, record, and periodically review environmental liability estimates until later in FY 2012.
- Implement effective controls to ensure the completeness and accuracy of all underlying data components used in the calculation of environmental liability balances.
- Have documented policies and procedures to update, maintain, and review schedules tracking environmental liabilities where Coast Guard is not the primary responsible party (e.g., Formerly Used Defense Sites) at the headquarters level.

By the end of FY 2012, management implemented new internal controls that they believe will address these deficiencies.

Regarding Other Liabilities:

The Coast Guard did not effectively implement existing policies and procedures associated with the:

- Validation (i.e., "look back") performed over the prior year accounts payable estimate. Specifically, the Coast Guard did not consider all of the relevant factors contributing to the variance identified in the analysis and determine the impact on the current year estimate.
- Consideration of potentially relevant current year data on the accounts payable estimate. As a result, current year data that may have a significant impact on the estimate could be overlooked and not identified until a true-up is performed in the subsequent year.
- Statistical calculation of the accounts payable estimate. Errors were identified in the treatment of sample items that impacted the extrapolation of the statistical results and related accounts payable estimate.

Cause/Effect: The Coast Guard did not fully complete its remediation plans to develop, document, and implement policies and procedures to prepare and record environmental liability estimates in accordance with applicable accounting standards until the fourth quarter of FY 2012. As a result, internal control weaknesses existed throughout the year, environmental liability balances were misstated until the fourth quarter of FY 2012, and $478 million in adjustments to the prior period financial statements were identified and recorded.

The Coast Guard did not fully implement and document their existing accounts payable accrual procedures. Additionally, the management review controls over samples used in the accounts payable estimate were not operating effectively. Without consideration of applicable look back results and current year data and effective review of underlying data used in the calculation of accounts payable, a misstatement in the accounts payable estimate may occur and not be identified in a timely manner (i.e., until validation is performed in a subsequent period).

Criteria: Presented in *Index of Financial Reporting and Internal Control Criteria,* after Exhibit IV.

Recommendations: We recommend that the Coast Guard:

Regarding Environmental Liabilities:

1. Ensure that existing policies and procedures over the completeness and accuracy of underlying data used in the calculation of environmental liability balances are properly followed and performed; and
2. Develop and implement policies and procedures to update, maintain, and review schedules tracking environmental liabilities where Coast Guard is not the primary responsible party (e.g., Formerly Used Defense Sites) at the headquarters level.

Independent Auditors' Report
Exhibit I – Material Weaknesses

Regarding Other Liabilities:

3. Improve the enforcement of existing policies and procedures related to the accounts payable estimate. In particular, emphasize the importance of the consideration and documentation of applicable look back results and current year data, and effective review of underlying data, used in the calculation of the accounts payable estimate.

I-E Budgetary Accounting (USCG, FEMA, ICE, MGMT, FLETC)

	2012	2011	2010
USCG			
FEMA			
ICE		N/A	N/A
MGMT		N/A	N/A
FLETC		N/A	N/A

See page I.1 for table explanation

Background: DHS has numerous sources and types of budget authority, including annual, multi-year, no-year and permanent and indefinite appropriations, as well as 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.

Coast Guard implemented corrective actions plans over various budgetary accounting processes in FY 2012; however, some control deficiencies reported in FY 2011 remain, and new deficiencies were identified.

In FY 2012, FEMA continued to improve its processes and internal controls over the obligation and monitoring process; however, some control deficiencies remain.

As the financial service reporting provider, ICE is responsible for recording budgetary transactions and administering budgetary processes across different types of funds at NPPD, Science and Technology Directorate (S&T), MGMT, and Office of Heath Affairs (OHA). In FY 2011, ICE identified and began remediating deficiencies in the system posting logic related to downward and upward adjustments of prior year unpaid undelivered orders. In FY 2012, ICE continued to address these issues with certain types of obligations.

The Management Directorate is responsible for the operations and financial oversight of several programs including the DHS Working Capital Fund. The Working Capital Fund provides shared services to DHS agencies. In FY 2012, MGMT recorded several corrective adjustments that were indicative of deficiencies in internal controls over financial reporting at the process level.

The Federal Law Enforcement Training Center (FLETC) budgetary reporting process came within the scope of our audit this year, and as a result new control deficiencies were identified.

Conditions: We noted the following internal control weaknesses related to budgetary accounting at USCG FEMA, ICE, MGMT, and FLETC:

1. USCG:
   - Has not fully implemented existing policies, procedures, and internal controls to ensure that obligations are reviewed and approved and undelivered order balances are monitored to ensure their timely deobligation when appropriate.
   - Does not have fully implemented policies, procedures, and internal controls over the monitoring of reimbursable agreements, and related budgetary unfilled customer orders, to ensure activity, including closeout and de-obligation, as appropriate, is recorded timely and accurately.
   - Does not have sufficient policies and procedures for recording the appropriate budgetary entries upon receipt of goods, and prior to payment.
2. FEMA:
   - Did not effectively certify the status of its obligations to ensure validity prior to fiscal year end.

I.11

Independent Auditors' Report
Exhibit I – Material Weaknesses

- Could not readily provide all supporting documentation for obligations and deobligations made during the year and for undelivered orders we audited at June 30, 2012 and September 30, 2012.
- Did not properly review budgetary funding transactions recorded in the general ledger.
- Did not timely and effectively complete management reviews over the monthly reconciliations of the SF-132, *Apportionment and Reapportionment Schedule,* to the SF-133, *Report on Budget Execution and Budgetary Resources.*

3. ICE

- Lacks effective controls over the verification and validation (V&V) of undelivered orders which resulted in substantive errors (invalid obligations) identified through our audit. Specifically, we noted that:
  - V&V reviews performed by the ICE financial managers indicate reliance on responses from field office personnel to determine the validity of open obligations which are sometimes inaccurate, or do not provide sufficient information for the ICE financial managers to make an informed decision about the balance, rendering the V&V process ineffective.
  - Controls were not operating effectively to consistently produce documentation to support the underlying events that support a downward and upward adjustment of prior year unpaid, undelivered orders. We identified errors in total downward and upward adjustments posted in FY 2012 of 20 percent and 50 percent, respectively. In addition, adjustments were not recorded correctly against certain types of obligations in the general ledger.
- Does not have an effective process to match advances to obligations at the transaction level.

4. MGMT:

- Lacks effective controls to effectively monitor undelivered order balances to appropriately de-obligate or adjust undelivered order balances on a timely basis.
- Internal controls are not properly designed to adequately monitor unfilled customer order balances, related to both Working Capital Fund and non-Working Capital Fund activity. Specifically, we noted:
  - Multiple adjustments to MGMT's unfilled customer order balances as well as to component undelivered order balances were recorded and subsequently reversed; and
  - Unfilled customer orders whose period of performance had expired were not properly drawn down to the outstanding obligation balance.

5. FLETC:

- Management did not have controls in place to perform a thorough review of the FY 2012 unfilled customer order beginning balances, related to reimbursable construction, to ensure beginning balances were properly recorded.

Cause/Effect: The Coast Guard's decentralized structure enables obligations to be made throughout the country by various authorized personnel, contributes to the challenge of enforcing existing policies, procedures, and internal controls surrounding budgetary accounting and has caused various control gaps in the internal control environment. Additionally, financial system functionality issues prohibit the Coast Guard from implementing and maintaining automated internal controls to supplement their existing manual controls. For example, the Coast Guard relies on manual workarounds to identify undelivered orders and recoveries since the budgetary module of the financial system is not active. Also see Comment **I-B,** *Information Technology Controls and Financial System Functionality.* Lastly, remediation efforts associated with unfilled customer orders and reimbursable agreements are not scheduled to be completed until after FY 2012. Weak controls in budgetary accounting increase the risk that the Coast Guard will misstate budgetary balances, and may unintentionally lead to a violation of the *Anti-deficiency Act* by overspending its budget authority.

I.12

Independent Auditors' Report
Exhibit I – Material Weaknesses

FEMA's annual undelivered order certification process was not effectively designed. Also, FEMA's administrative functions are geographically separated from programmatic operations which make consistent enforcement of policy challenging. Certain offices within FEMA do not have effective document maintenance policies and procedures, making the location of certain supporting documentation difficult. We noted that for certain undelivered order balances significant effort was required to coordinate and identify the responsible parties, to access certain files, locate files, or to provide information in a form that clearly supported the balances reported in the financial statements. Without adequate documentation, FEMA is unable to support the validity of obligation status. In addition, In addition, FEMA personnel have not fully adhered to the existing procedures for the recording of funding transactions because of lack of oversight by management. As a result, FEMA's financial information submitted to DHS for financial statement purposes may contain significant budgetary account errors if they are not detected

ICE's validation and verification process was not adequate to identify invalid undelivered orders, resulting in an overstatement of undelivered orders as obligations are not closed out in a timely manner. In addition, ICE recorded erroneous upward and downward adjustments of prior year obligations that were not correct or identified during OFM's review of current year activity. ICE implemented a review of downward and upward adjustments of prior year obligations in the current year, however the review control was not designed effectively to detect and correct material invalid recoveries. In some instances, the financial system configuration contributed to these errors. This deficiency is also related to the conditions described in Comment **II-F,** *Entity Level Controls,* and Comment **III-J,** *Federal Financial Management Improvement Act of 1996* (FFMIA).

The Management Directorate conducted an internal review of undelivered order and unfilled customer order balances in FY 2012. The results of the review indicated that Management's validation and verification process did not consistently result in the timely deobligation of undelivered orders. In addition, Management was not updating the status of its customer agreements, in a timely manner to prevent a misstatement to its account balances, and that the controls in place to address this risk at the process level are not operating effectively.

FLETC did not have effective management review controls over funding received from the ordering agency, and matching those funds to the proper type of funds available to it, resulting in a misstatement in beginning balances.

Criteria: Presented in *Index of Financial Reporting and Internal Control Criteria,* after Exhibit IV.

Recommendations: We recommend that:

1. USCG:
   a. Continue to improve the enforcement of existing policies and procedures related to processing obligation transactions and the periodic review and validation of undelivered orders. In particular, emphasize the importance of performing effective reviews of open obligations, obtaining proper approvals, and retaining supporting documentation; and
   b. Continue with current remediation efforts to develop and implement policies, procedures, and internal controls over the monitoring of reimbursable agreements and unfilled customer orders to ensure activity, including closeout and de-obligation, is recorded timely and accurately.
   c. Implement sufficient policies and procedures for recording the appropriate budgetary entries timely upon receipt of goods, and prior to payment.
2. FEMA:
   a. Revise the established annual undelivered order certification process to ensure that outstanding obligations are properly certified for validity prior to fiscal year end;
   b. Continue to improve procedures for storing and locating documentation supporting undelivered order information, including points of contact, so that supporting information is readily available for management review and audit purposes;

Independent Auditors' Report
Exhibit I – Material Weaknesses

c. Implement improved review procedures for budgetary funding transactions recorded in the general ledger; and

d. Develop and implement monitoring controls to ensure that management reviews of the monthly SF-132 to SF-133 reconciliations are completed timely and effectively.

3. ICE:

a. Improve controls over the verification and validation of undelivered orders to identify outstanding obligations that need to be closed out and/or adjusted for financial statement presentation;

b. Implement policies and procedures to ensure that financial managers work with field office personnel to perform a rigorous review of the open obligations and maintain appropriate documentation of these reviews; and

c. Improve the process of recording recoveries and upward adjustments of prior year obligations, including identification and adjustment for offsetting transactions.

d. Implement an effective process to match advances to obligations at the transaction level.

4. MGMT:

a. Develop and implement changes to current policies and procedures to ensure timely review and accurate reporting of budgetary balances.

5. FLETC:

a. During FY 2012, FLETC corrected this condition, by establishing multi-year and annual funds to match the funds of the ordering agency, and implemented an enhanced process to review unfilled customer orders related to construction.

II-F Entity-Level Controls (Department-wide, and TSA, FEMA, ICE, NPPD)

Background: Entity-level controls encompass the over-all control environment throughout the entity. This includes the governance and management functions and the attitudes, awareness, and actions of those charged with governance, and management concerning the entity's internal control and its importance in the entity. The control environment sets the tone of an organization, influencing the control consciousness of its people. Entity-level controls are often categorized as environmental controls, risk assessment, monitoring or communications, as defined by the *Committee of Sponsoring Organizations* of the Treadway Commission (COSO), and the Government Accountability Office. These controls must be effective, to create and sustain an organizational structure that is conducive to reliable financial reporting.

	2012	2011	2010
Ethics Division		N/A	N/A
TSA			C
FEMA			
ICE		N/A	N/A
NPPD		N/A	N/A

See page I.1 for table explanation

In the past three years, DHS 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*. The Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, (OMB Circular No. A-123) assessment is also designed to assist with the remediation of control deficiencies, in accordance with an OMB approved plan.

The conditions below should be read in conjunction with Comment **I-B**, *Information Technology Controls and Financial System Functionality*, which describes entity-level control weaknesses related to Department and component IT systems.

The DHS Office of Ethics manages the Department's ethics programs, and provides liaison to the U.S. Office of Government Ethics, and administers the DHS financial disclosure program. DHS requires certain employees whose duties involve the exercise of discretion in sensitive areas to file a confidential financial disclosure report, known as the Office of Government Ethics (OGE) 450. Certain other senior DHS officials may be required to file a public financial disclosure report, known as the OGE 278. The forms are reviewed by an ethics official to determine whether any potential conflicts exist between the official duties and private financial interests and affiliations.

Conditions:

1. Headquarters Ethics Division and Components: We noted that pervasive process and internal control deficiencies exist throughout the Department related to compliance with Federal requirements over financial disclosure forms. Specifically, the Department and components have ineffective controls to ensure proper and timely filing, review, and certification of public financial disclosure (OGE 278 and 450) forms. At every component selected for testwork, including, CBP, USCIS, Coast Guard, FEMA, ICE, NPPD, and TSA we noted at least one of the following deficiencies:

   - Untimely submission of the financial disclosure form (either OGE 278 or OGE 450).
   - Untimely review and/or certification of the financial disclosure form by the designated Ethics Official.
   - The financial disclosure form was not submitted by the individual.
   - The filing status of the individual was undetermined, or a listing of disclosure filers was not complete.

In addition to the conditions cited above we noted the following entity-level control deficiencies at DHS components:

Independent Auditors' Report
Exhibit II – Significant Deficiencies

2. TSA:
   - Lacks formalized documented policies and procedures to ensure that new IT systems are properly developed and reviewed, by the appropriate offices and levels of management prior to implementation.
   - Lacks organizational policies and procedures outside of the TSA OFM needed to ensure timely, accurate, and valid responses to auditor requests of information and inquiries.
3. FEMA:
   - Has not certified its policies and procedures on a biennial basis to validate they are accurate and current, as required by FEMA Directive No. 112-1.
   - Did not formalize a process to ensure that personnel attend required ethics training.
   - Has not developed sufficient policies and procedures to properly conduct and track the status of background investigations and maintain related documentation.
4. ICE:
   - Does not effectively communicate financial reporting roles and responsibilities within ICE OFM, between program offices and with DHS customer components.
   - Does not have effective financial systems contractor oversight to ensure that financial information provided by contractors for use by management and the financial statement auditor is adequately prepared and reviewed.
   - Has not fully developed processes to identify and manage risks through the annual risk assessment process, and to monitor adherence to financial management policies and procedures of staff that reside outside ICE OFM.
5. NPPD:
   - Lacks policies and procedures to ensure a central accounting infrastructure is in place that is able to support a strong system of internal controls, including areas with technical requirements.
   - Does not effectively monitor financial activities across the organization to ensure transactions are recorded completely, accurately, and timely.
   - Lacks communication and review processes between the NPPD OFM and its service provider to ensure the accuracy of financial information.

Cause/Effect: The DHS headquarters Ethics Division does not have adequate policies and procedures to ensure required financial disclosure reports are received and the final review and certification is completed within the timelines established by the United States Office of Government Ethics. In addition, the Ethics Division and human resources do not have adequate communication to accurately identify those individuals who are required to file financial disclosure forms. Untimely filing and review of OGE Form 278 and OGE Form 450 forms may lead to undetected conflicts of interest that undermine the public trust of high-level Federal officials and certain executive branch employees.

TSA has not yet fully developed its processes, controls, and training throughout the agency to ensure that important programmatic matters that may affect financial reporting are communicated to TSA's OFM. Consequently, TSA was at times dependent on the external financial statement audit process to identify business process changes with financial reporting impact and the associated risks of misstatement or account balance errors in the financial statements.

FEMA has not fully developed and implemented processes to certify all policies and procedures and to ensure compliance with relevant ethics training requirements. In addition, FEMA has not dedicated sufficient resources to ensure that the appropriate minimum investigative or re-investigative requirements specified by DHS are fulfilled and documented within the system of record for agency personnel security

II.2

Independent Auditors' Report
Exhibit II – Significant Deficiencies

data prior to granting a Personal Identity Verification card, which is a pre-condition for granting system access.

ICE OFM devotes a significant portion of its resources to other agencies within the Department as a financial reporting service provider. In addition, ICE' own internal operations are decentralized. As such, a reliable system of communications including internal policies and procedures, and service level agreements with DHS customers that clearly define roles and responsibilities for internal control and data integrity are needed. Difficulties with IT financial systems are partially due to ICE's use of a proprietary financial system and do not currently have the ability to extract usable information without the aid of the system contractor.

NPPD's organization has grown to include a diverse set of operations including cyber security, infrastructure protection, the Federal Protective Service (FPS), and the US-VISIT program, creating communication and information challenges. NPPD does not have sufficient central accounting infrastructure that is able to support a strong system of internal controls, especially for transactions that require unique understanding of technical requirements such as accounting for internal use software.

Criteria: Presented in *Index of Financial Reporting and Internal Control Criteria,* after Exhibit IV.

Recommendations: We recommend that:

1. Office of Ethics and Various Components:
   a. Review existing policies, including processes involving review and enforcement of required procedures, and implement updated polices and controls as necessary to ensure compliance with applicable regulations over filing and review of financial disclosure forms.
2. TSA:
   a. Develop formalized, documented, policies and procedures to ensure systems are properly evaluated for basics requirements by the appropriate offices and levels of management prior to implementation.
   b. Develop policies and procedures, including monitoring and training for employees both inside and outside the TSA OFM on the importance to maintain accurate, valid supporting documentation, available for audit.
3. FEMA:
   a. Complete the efforts underway to ensure that formal policies and procedures are reviewed and certified on a biennial basis in accordance with FEMA Directive No. 112-1;
   b. Complete development and implementation of procedures to track compliance with and monitor the completion of the annual and new hire ethics training requirements; and
   c. Review, revise as needed, and implement policies and procedures to properly initiate, process, and track background investigations and maintain related documentation.
4. ICE:
   a. Develop and implement policies and procedures to bolster the communication between ICE OFM and program offices, and within the ICE OFM.
5. NPPD:
   a. Further the development of the accounting infrastructure through the implementation of standardized processes;
   b. Develop and implement policies and procedures to foster communication between NPPD's OFM and the program offices, and;
   c. Develop and implement policies and procedures to facilitate communication between NPPD OFM and the accounting service provider.

II.3

Independent Auditors' Report
Exhibit II – Significant Deficiencies

II-G Grants Management (FEMA only)

	2012	2011	2010
FEMA			
See page I.1 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, many of which are repeat findings, related to grants management.

FEMA:

- Did not compile a complete list of grantees requiring single audits 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*).
- Did not issue Management Decision Letters timely for OMB Circular A-133 audit reports available in the Federal Audit Clearinghouse.
- Did not maintain accurate and timely documentation related to reviews performed of grantees' OMB Circular A-133 audit reports.
- Did not maintain accurate and timely documentation related to site visits/desk reviews performed for grantees.
- Did not consistently follow-up with grantees who have failed to submit quarterly financial reports timely.
- Did not consistently maintain documentation necessary to support grant-related activities.
- Did not consistently and effectively reconcile grantee quarterly financial reports to FEMA systems.
- Did not have a process in place to create and track comprehensive lists of FEMA grants that are eligible for close-out, and has not completed the close-out process in a timely manner.

Cause/Effect: FEMA has not fully implemented policies and procedures over its grant program in order ensure compliance with the *Single Audit Act* and OMB Circular A-133. In addition, FEMA has not implemented effective monitoring procedures over certain grant activities and the maintenance of related documentation. As a result, misreported grantee expenses may not be detected, which may impact the fair presentation of FEMA's grant accrual balances, undelivered orders, and expenses. Further, the diversity of grant programs and systems within FEMA causes difficulty in assembling a comprehensive status of grants eligible for close-out, which could result in untimely closure of grants and an overstatement of undelivered orders.

Criteria: Presented in *Index of Financial Reporting and Internal Control Criteria,* after Exhibit IV.

Recommendations: We recommend that FEMA:

1. Complete the implementation of policies and procedures to ensure full compliance with the *Single Audit Act* and the related OMB Circular No. A-133 related to receipt and review of grantees' single audit reports;
2. Implement monitoring procedures over completing financial site visits/desk reviews; obtaining, timely reviewing and reconciling required quarterly grantee reports; and maintaining related documentation;
3. Develop and implement procedures to create and track comprehensive lists of FEMA grants that are eligible for close-out; and
4. Implement a continuous quality assurance and grants monitoring process to include review of corrective actions resulting from implementation of the recommendations in 1 – 3 above.

II.4

Independent Auditors' Report
Exhibit II – Significant Deficiencies

II-H Custodial Revenue and Drawback (CBP Only)

	2012	2011	2010
CBP			
See page I.1 for table explanation			

Background: Customs and Border Protection (CBP) collects approximately $35.5 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 over the Entry Process include conditions identified in In-bond, Bonded Warehouse and Foreign Trade Zones. 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.

The conditions cited below have existed for several years. Management has stated that the time-frame for remediation of these conditions is dependent on funding for IT system upgrades. In FY 2012 CBP deployed a new system to replace the existing in-bond oversight functions, called the In-Bond Compliance Module. This module was implemented in early September 2012 and is intended to create a more effective in-bond monitoring system. However, for the majority of the period under audit, CBP was following policies and procedures that led to ineffective and inefficient processes in in-bond and CBP was using a system with limitations that restricted CBP's ability to accurately monitor the in-bond process, both at the Headquarters and port levels.

For the remaining conditions in Drawback, BW, and FTZ, a systems fix is currently unfunded. However, improvements have been made in the controls surrounding BWs and FTZs, specifically at the BW and FTZ facilities. Furthermore, in FY 2012 CBP continued its review efforts to reassess the Drawback process as a whole.

Conditions: We noted the following internal control weaknesses related to custodial activities at CBP:

Related to Drawback:

- The Automated Commercial System (ACS) lacks the controls necessary to prevent, or detect and correct excessive drawback claims. The programming logic in ACS does not link drawback claims to imports at a detail level. In addition, ACS does not have the capability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries and export documentation upon which the drawback claim is based. Further, ACS has not been configured to restrict drawback claims to 99 percent of each entry summary.
- 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 against import entries.

Related to the Entry Process:

- During the audit period, CBP was unable to determine the status of the in-bond shipments and lacked policies and procedures that required monitoring the results of in-bond audits and review of overdue air in-bonds. CBP did not formally analyze the rate and types of violations found, to determine the effectiveness of the in-bond program, and did 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 was not a potentially significant loss of revenue.

II.5

Independent Auditors' Report
Exhibit II – Significant Deficiencies

- Headquarters has developed national databases which contain an inventory of all BWs and FTZs; however, these databases were not designed to document the assessed risk of each BW or FTZ, scheduled compliance reviews, or the results of compliance reviews. CBP headquarters cannot verify the results of the compliance reviews to determine overall program effectiveness.

Cause/Effect: IT system functionality and outdated IT systems contribute to the weaknesses identified above, in Comment **I-B**, *Information Technology Controls and Financial System Functionality*. For example, under the system in place for the majority of FY 2012 CBP was unable to determine the status of the in-bond shipments with the information available within ACS, and CBP did not have the ability to run an oversight report to determine if ports completed all required audits. CBP could not perform a comprehensive analysis to determine the overall compliance rate of the in-bond program. 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 ports 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.

CBP does not have the ability to perform a complete analysis over the effectiveness of the BW and FTZ programs. CBP headquarters cannot effectively monitor the BW/FTZ program if a complete population of all BWs and FTZs is not compiled.

Criteria: Presented in *Index of Financial Reporting and Internal Control Criteria*, after Exhibit IV.

Recommendations: We recommend that CBP:

1. *Related to Drawback*:

   a. Since the incorporation of drawback processing is not scheduled for the Automated Commercial Environment production, CBP should continue to pursue alternative compensating controls and measures that may ultimately identify the potential revenue loss exposure to CBP. These alternative internal controls over drawback claims may lead to 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, where feasible, to prevent overpayment of a drawback claim; and

   c. Continue to analyze current policies and procedures performed at the Drawback Centers. Determine the benefit of current procedures and revise as necessary.

2. *Related to the Entry Process:*

   a. With the new In-Bond Compliance Module implementation, certain monitoring reports no longer exist; therefore, CBP should ensure the new in-bond compliance system is properly functioning, timely address systemic issues that may arise, and provide additional policy and direction, if necessary;

   b. CBP headquarters should provide oversight and assistance to the field to ensure ports are following procedures and monitor and review the in-bond process to ensure a high in-bond compliance rate;

   c. Continue the implementation of a national database of BWs and FTZs and develop procedures to ensure completeness of the compliance review results submitted to CBP headquarters; and

   d. Increase CBP headquarters monitoring over the BW and FTZ compliance review program by developing a method to determine the program's overall effectiveness.

II.6

Independent Auditors' Report
Exhibit III – Compliance and Other Matters

All of the compliance and other matters described below are repeat conditions from FY 2011.

III-I *Federal Managers' Financial Integrity Act of 1982* (FMFIA)

DHS' implementation of OMB Circular No. A-123, facilitates compliance with the FMFIA. The *DHS Financial Accountability Act of 2004* requires DHS to submit an annual audit opinion of internal control over financial reporting. DHS has an OMB approved plan to correct existing material weaknesses in internal control, before fully implementing the requirements of OMB Circular No. A-123 on all business processes. Accordingly, the DHS Secretary's Assurance Statement dated November 12, 2012, as presented in Management's Discussion and Analysis of the Department's 2012 *Annual Financial Report* (AFR), acknowledges the existence of material weaknesses and the limited scope assessment, and therefore provides qualified assurance that internal control over financial reporting was operating effectively as of September 30, 2012, based on the testwork performed to date. Management's findings are similar to the control deficiencies we have described in Exhibits I and II.

While we noted the Department overall has taken positive steps toward full compliance with FMFIA, OMB Circular No. A-123, and the *DHS Financial Accountability Act* of 2004, 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 Circular No. A-123 approved plan 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 2013.

III-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, U.S. Customs and Border Protection, the Federal Emergency Management Agency (FEMA), U.S. Immigration and Customs Enforcement, and Transportation Security Administration did not fully comply with at least one of the requirements of FFMIA. The reasons for noncompliance are reported in Exhibits I and II. The Secretary of DHS has stated in the Secretary's Assurance Statements dated November 14, 2012 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 the FY 2012 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.

III.1

Independent Auditors' Report
Exhibit III – Compliance and Other Matters

We also noted weaknesses in financial systems security, reported by us in Comment **I-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 and II in FY 2013.

III-K ***Single Audit Act Amendments of 1996*** **(*Single Audit*)**

FEMA is the only DHS component that has a significant grant making operation. The *Single Audit Act Amendments of 1996*, as implemented by OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* requires agencies awarding grants to monitor their grantees, ensure they receive grantee reports timely, and follow-up on Single Audit findings to ensure that grantees take appropriate and timely action. Although FEMA has implemented a system to monitor grantees and their audit findings, FEMA did not fully comply with provisions in OMB Circular No. A-133 in FY 2012. We noted that FEMA's monitoring efforts were inconsistent and FEMA did not obtain and review all grantee *Single Audit* reports in a timely manner.

Recommendation: We recommend that FEMA implement the recommendations in Comment **II-G**, *Grants Management.*

III-L ***Anti-deficiency Act*** **(ADA)**

Various management reviews and OIG investigations are on-going within the Department and its components that may identify ADA violations, as follows:

- The Coast Guard management continues to work to resolve two potential ADA violations relating to (1) funds used in advance of an approved apportionment from OMB and (2) the improper execution of the obligation and disbursement of funds for the lease of passenger vehicles.
- National Protection and Programs Directorate (NPPD) management has completed the review, initiated in FY 2007, over the classification and use of certain funds that resulted in an ADA violation. NPPD is in the process of responding to the OIG report and transmitting notifications of the violation.
- The Management Directorate has completed its investigation of whether rental charges at the Office of the Federal Coordinator for Gulf Coast Rebuilding (OFCGCR) incurred in FY 2009 were not properly committed or obligated and determined that the OFCGCR committed a violation in FY 2009. MGMT is in the process of developing the notification package.
- Intelligence and Analysis (I&A) is investigating the potential ADA violation due to a difference in calculation of apportionments while under continuing resolution in FY 2012.

Recommendation: 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, where necessary.

Independent Auditors' Report
Exhibit IV – Status of Prior Year Findings

FY 2011 Control Deficiencies As Reported	Summary of Significant Changes in FY 2012	FY 2012 Control Deficiencies As Reported
Material Weaknesses:		
A – Financial Management and Reporting (USCG, TSA, USCIS)	• USCIS substantially corrected financial reporting deficiencies reported in previous years. • The Coast Guard made progress by correcting financial reporting control deficiencies in accounts receivable, and improving their ability to provide accurate and timely information to DHS OFM for financial statement reporting. No new financial reporting deficiencies were identified at USCG in FY 2012. • The Coast Guard's most significant remaining financial reporting deficiencies include supporting non-standard adjustments, supporting certain year-end close-out balances, and reconciling intergovernmental transactions. • TSA is in an advanced stage of remediation of its financial reporting deficiencies. The remaining issues involve the need for incremental but important improvements to strengthen its internal controls over several financial reporting processes. Deficiencies previously reported in budgetary accounting are similar to, and therefore combined with, other financial reporting issues. • New financial reporting control weaknesses were identified at ICE related to year end close process, accounting for accrued payroll, ability to timely support transactions and identify potential accounting issues.	**Repeated** (Exhibit I-A) (USCG, TSA, ICE)
B – Information Technology Controls and Financial Systems Functionality (USCG, CBP, FEMA, USCIS, ICE)	• DHS components made progress in the remediation of IT findings we reported in FY 2011. We closed approximately 70 (46 percent) of our prior year IT findings. CBP, FEMA, and TSA made the most progress in closing IT findings from the prior year. • However, at end of FY 2012, over 175 IT findings existed, of which approximately 75 (43 percent) were repeat findings identified in prior years, and 100 (57 percent) were new findings. New findings resulted primarily from new IT systems and business processes that came within the scope of our audit this year, and were noted at all DHS components. CBP and FEMA had the greatest number of new findings. • Financial systems functionality continues to be a significant contributor to the IT material weakness, and is impairing DHS's ability to install application controls, and leverage IT systems to improve cost effectiveness and provide reliable management information.	**Repeated** (Exhibit I-B) (USCG, CBP, FEMA, USCIS, ICE)
C – Property, Plant, and Equipment (USCG, CBP, TSA, MGMT)	• The Coast Guard continued to execute remediation efforts to address PP&E process and control deficiencies; however, remediation efforts were not complete as of September 30, 2012. Consequently, many of the control weaknesses reported in FY 2011 have been repeated in our FY 2012 report. • The Coast Guard made progress in reconciling real property balances, and was able to fully assert to the reliability of approximately $3 billion of real property balances. We were able to complete audit procedures over real property as of September 30, 2012, narrowing our scope limitation to other PP&E	**Repeated** (Exhibit I-C) (USCG, CBP, ICE)

IV.1

Independent Auditors' Report
Exhibit IV – Status of Prior Year Findings

FY 2011 Control Deficiencies As Reported	Summary of Significant Changes in FY 2012	FY 2012 Control Deficiencies As Reported
	balances, such as personal property and construction in process. Real property represents approximately 25 percent of total Coast Guard property. • TSA substantially corrected PP&E control deficiencies reported in previous years. • CBP made modest progress in correcting PP&E control deficiencies by implementing policies and procedures in FY 2012, however, personnel did not always follow the new policies. • Management Directorate implemented new processes to correct some deficiencies, allowing for downgrade in severity of our findings in FY 2012. • New control weaknesses were identified at ICE primarily related to accounting for internal use software, and a lack of adequate policies and procedures.	
D – Environmental and Other Liabilities (USCG)	• During FY 2012, the Coast Guard completed the final phases of a multi-year remediation plan to inventory, value, and properly state environmental liabilities. As a result, the Coast Guard restated the FY 2011 financial statements, to present the correct environmental liability balance as of September 30, 2011. An adjustment totaling $478 million was recorded to restate and reduce environmental liabilities. • Because the Coast Guard's remediation procedures were not completed until late in FY 2012, many of process and control deficiencies related to environmental liabilities reported in FY 2011 continued to exist during of FY 2012, and have been repeated in our FY 2012 report.	**Partially Repeated** (Exhibit I-D) (USCG)
E – Budgetary Accounting (USCG, FEMA)	• Budgetary accounting control deficiencies at USCG were repeated FY 2012. • FEMA continued to improve its processes and internal controls over the obligation and monitoring process; however, some control deficiencies remain in FY 2012. • New budgetary control deficiencies were identified at ICE primarily in processes intended to validate obligations. In addition, controls over upward and downward adjustments were not effective at ICE. • New budgetary control deficiencies were identified at Management Directorate over accounting for undelivered orders and unfilled customer orders. • New budgetary control deficiencies were identified at FLETC over accounting for unfilled customer orders, at the beginning of the year, that were remediated by September 30, 2012. • The new budgetary control findings cited above are attributable primarily to the increase in the scope of our audit in FY 2012, to include the Statement of Budgetary Resources.	**Repeated** (Exhibit I-E) (USCG, FEMA, ICE, MGMT, FLETC)
Significant Deficiencies:		
F –Entity Level Controls (FEMA, TSA)	• FEMA continued to improve its entity level internal controls, however some control deficiencies reported in FY 2010 remain. • TSA continued to make progress in remediating entity level control deficiencies, however further improvement is needed to fully correct all conditions.	**Repeated** (Exhibit II-F) (Ethics Division, TSA, FEMA, ICE, NPPD)

IV.2

Independent Auditors' Report
Exhibit IV – Status of Prior Year Findings

FY 2011 Control Deficiencies As Reported	Summary of Significant Changes in FY 2012	FY 2012 Control Deficiencies As Reported
	• Throughout the Department and within the Ethics Division, we noted pervasive control weaknesses over administration of financial disclosure process for Department employees and executives, as mandated by regulation. We noted deficiencies related to this process in every component selected for testwork. • New higher-level control weaknesses involving communications, contractor oversight, annual risk assessment processes, and personnel training were noted at ICE. • New higher-level control weakness, were identified at NPPD, primarily related to communications to / from their service provider (ICE) and the DHS Office of Financial Management.	
G – Fund Balance with Treasury (USCG)	• The Coast Guard substantially corrected fund balance with Treasury control deficiencies reported in previous years.	**Corrected**
H – Grants (FEMA)	• Grant accounting control deficiencies identified at FEMA in previous years were substantially repeated FY 2012.	**Repeated** (Exhibit II-G) (FEMA)
I – Custodial Revenue (CBP)	• Deficiencies related to custodial revenue – entry and drawback were repeated in FY 2012.	**Repeated** (Exhibit II-H) (CBP)
Compliance and Other Matters:		
I – *Federal Managers' Financial Integrity Act of 1982*	• The Department overall has taken positive steps toward full compliance with FMFIA, OMB Circular No. A-123, and the *DHS Financial Accountability Act* of 2004. However, the Department has not fully established effective systems, processes, policies, and procedures to ensure that internal controls are operating effectively throughout the Department.	**Repeated** (Exhibit IV – I)
J – *Federal Financial Management Improvement Act of 1996*	• The Department overall has taken positive steps toward full compliance with FFMIA. The USCG, CBP, FEMA, 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 and II.	**Repeated** (Exhibit IV – J)
K – *Single Audit Act Amendments of 1996*	• FEMA did not fully comply with provisions in OMB Circular No. A-133 in FY 2012.	**Repeated** (Exhibit IV – K)
L – *Chief Financial Officers Act of 1990*	• DHS was compliant with the Chief Financial Officers Act in FY 2012, by completing a full-scope financial statement audit.	**Corrected**
M – *Anti-deficiency Act*	• Various management reviews and OIG investigations are on-going within the Department and its components that may identify ADA violations.	**Repeated** (Exhibit IV – L)

IV.3

Independent Auditors' Report
Exhibit IV – Status of Prior Year Findings

FY 2011 Control Deficiencies As Reported	Summary of Significant Changes in FY 2012	FY 2012 Control Deficiencies As Reported
N – *Government Performance and Results Act of 1993*	• DHS completed the Quadrennial Homeland Security Review (QHSR) and released and updated strategic plan in FY 2012. In addition, DHS has presented its net cost of operations by major program that relates to major goals described in the strategic plan. DHS' Statement of Net Cost and related disclosures for FY 2012 are now in compliance with OMB Circular A-136, *Financial Reporting Requirements*.	**Corrected**

IV.4

Department of Homeland Security
Index of Financial Reporting and Internal Control Criteria
(Listed Alphabetically by Criteria Source)

Criteria	Reference	Report Exhibit
Bonded Warehouse Manual for Customs and Border Protection Officers and Bonded Warehouse Proprietors (HB 3500-11, January 2012)	Section 1.1	II-H
CBP Directive 5320-028D, *Commitment, Obligation, and Expenditure Procedures for Goods and Services*	Section 7.5.1	I-C
CBP *Personal Property Management Handbook, HB 5200-13B*	Chapter 8	I-C
CBP's *Real Property Inventory Procedures*		I-C
Coast Guard Financial Reporting Management Manual	Sections 9.B, 9.C.4	I-C
Coast Guard Intragovernmental Reimbursable Agreement Procedural Handbook	Section D	I-E
Coast Guard's Standard Operating Procedure: *Financial Reporting of Personal Property Categorized as Stewardship (Heritage) Asset Footnoted, dated April 20, 2012*	Section 3: Scope	I-C
Code of Federal Regulations, Title 5	Part 2634, 2638	II-F
Code of Federal Regulations, Title 19	§ 19.4, § 191.51, § 18.2, § 18.6, § 18.8, § 146.3	II-H
Compliance Review Handbook for Bonded Warehouses (HB 3500-09, December 2007)		II-H
Compliance Review Handbook for Foreign Trade Zones (HB 3500-10, July 2008)		II-H
DHS Component Requirements Guide for Financial Reporting	Section 4, 34	I-E, II-F
	Section 30, 22	I-A
	Section 43	I-C
DHS Financial Accountability Act, dated Oct. 16, 2004	Section 4	I-A, II-F
DHS Management Directives System MD Number: 0480.1	Section V	II-F
DHS Instruction 121-01-007, DHS Personnel Suitability and Security Program	Chapter 2, Section E	II-F
DHS Sensitive Systems Policy Directive 4300A v. 9.0.2, updated March 19, 2012	Sections 3.7, 3.9, 3.15.1, and 4.1.1	II-F
Ethics in Government Act of 1978	Title I, various sections	II-F
Federal Financial Accounting And Auditing Technical Release 2: *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government*	Sections 1 and 2	I-D
Federal Financial Management Improvement Act of 1996	Section 803	I-A, I-C, I-E
Federal Managers' Financial Integrity Act of 1982	Section 2	I-A, I-C, I-E, II-F
FEMA Budget Procedures Memorandum 10-02	Section 4 Subsections (d), (g), (h), (j)	I-E
FEMA OCFO SF-132/133, *Reconciliation Process SOP*	Sections VII and VIII	I-E
GAO's *Standards for Internal Control in the Federal Government*	Control Activities	I-A, I-D, I-E, II-G
	Examples of Control Activities (Accurate and Timely Recording of Transactions and Events)	I-E, II-G

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Department of Homeland Security
Index of Financial Reporting and Internal Control Criteria
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Criteria	Reference	Report Exhibit
	Examples of Control Activities (Appropriate Documentation of Transactions and Internal Control)	I-A, I-D, I-E, II-G
	Information and Communications	I-C
	Presentation of the Standards	I-A, I-D
GAO's *Principles of Federal Appropriations Law, Third Edition, Volume II*	Chapter 7	I-E
Grants Programs Directorate, *Financial Monitoring Plan*	Section 3.1	II-G
Memorandum: In-Bond Guidance, dated April 7, 2010		II-H
Mission Assignment Standard Operating Procedure 2600-007, *Financial Reporting of Mission Assignments*, updated March 20, 2012		I-E
National Institute of Standards and Technology (NIST) Special Publication (SP) 800-53, *Recommended Security Controls for Federal Information Systems*	Appendix F, sections CM-1 and CM-3	II-F
Office of Federal Financial Management, *Core Financial System Requirements*	Accounts Payable Process	I-D
Office of Field Operations, Cargo and Conveyance Security's *General Order Merchandise Procedures; In-Bond Oversight*, August 24, 2011		II-H
Office of Field Operations, *Guide for In-Bond Cargo, Version 1.0*, March 31, 2006		II-H
OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*	Compliance with FFMIA (footnote 16)	I-E
OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget, August 2012*	Sections 20, 20.5 (a), 130.9 Appendix B, Section 1	I-E
OMB Circular No. A-123, *Management's Responsibility for Internal Control*, Revised	1. Purpose	I-A, II-F
	3. Policy	I-C, I-E, II-H
	I. Introduction	I-A, I-C, I-E, II-F, II-H
	II. Standards	I-A, I-E, II-F
	III. Integrated Internal Control Framework	I-E
	IV. Assessing Internal Control	II-H
	Appendix A Section III. Assessing Internal Control Over Financial Reporting	I-A
OMB Circular No. A-127, *Financial Management Systems*, Revised	Section 6 (subpart K) Section 8 (subpart C)	I-A
Office of Management and Budget (OMB) Circular A-130, *Management of Federal Information Resources*	3. Analysis	II-F
Office of Management and Budget (OMB) Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations, Revised to show changes published in the Federal Register of June 27, 2003 and June 26, 2007*	Subparts B, D	II-G
OMB Circular No. A-136, *Financial Reporting Requirements*, Revised	Section V.3	I-A

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Department of Homeland Security
Index of Financial Reporting and Internal Control Criteria
(Listed Alphabetically by Criteria Source)

Criteria	Reference	Report Exhibit
Single Audit Act Amendments of 1996	31 USC §§7502 and 7504	II-G
Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*	Paragraph 77	I-E
Statement of Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*	Paragraph 19	I-D
Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*	Paragraph 13, 20, 26, 34, 35, 38, 39, 77, 84 End Note 8	I-C
	Paragraph 85, 94	I-D
Statement of Federal Financial Accounting Standards (SFFAS) No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*	Paragraph 78, 79	I-E
Statement of Federal Financial Accounting Standards (SFFAS) No. 10, *Accounting For Internal Use Software*	Executive Summary (Paragraph 5) Paragraphs 16, 20	I-A, I-C
Statement of Federal Financial Accounting Standards (SFFAS) No. 14, *Amendments to Deferred Maintenance Reporting*	Paragraph 1	I-C
Statement of Federal Financial Accounting Standards (SFFAS) No. 21, *Reporting Correction of Errors and Changes in Accounting Principles*	Paragraph 10 & 11	I-C
Statement of Federal Financial Accounting Standard (SFFAS) No. 23, *Eliminating the Category National Defense Property, Plant and Equipment,*	Paragraphs 11, 12, 13	I-C
Statement of Federal Financial Accounting Standards (SFFAS) No. 29, *Heritage Assets and Stewardship Land*	Summary paragraph Paragraph 26	I-C
Statement of Federal Financial Accounting Standards (SFFAS) No. 35, *Estimating the Historical Cost of General Property, Plant, and Equipment: Amending Statements of Federal Financial Accounting Standards 6 and 23*	Paragraph 12	I-C
Statement of Federal Financial Accounting Standards No. 39: *Subsequent Events: Codification of Accounting and Financial Reporting Standards Contained in the AICPA Statements on Auditing Standards*	Paragraph 8, 12, 13	I-A
Treasury Financial Manual, Volume 1 T/L 684 Bulletin No. 2012-09	Part 2, Chapter 4700 Appendix 10	I-A
US Code Title 31, Chapter 15	Sections 1501, 1535, 1554	I-E
US Code Title 44, Chapter 31	Section 3101	I-C, I-D
US Code Title 44, Chapter 35	Section 3544	II-F
USSGL	Transaction A714	I-E

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

Homeland Security

November 14, 2012

MEMORANDUM FOR: Charles K. Edwards
Acting Inspector General

FROM: Peggy Sherry
Chief Financial Officer

SUBJECT: Fiscal Year (FY) 2012 Financial and Internal Controls Audit

I am pleased to accept your audit report on the Department's Consolidated Financial Statements and internal controls for FY 2012 and Consolidated Balance Sheet, related Consolidated Statement of Custodial Activity, and internal controls for FY 2011. 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 continuing progress in improving the quality and reliability of our financial reporting. During FY 2012, our Components implemented corrective actions that significantly improved key financial management and internal control areas. This year's audit opinion on all financial statements demonstrates that the Department is committed to being a responsible steward of taxpayer dollars.

The FY 2012 audit results show that our corrective actions are working, and we are already focusing our efforts on remediating the remaining issues as we prepare for an unqualified audit opinion on a full-scope audit in FY 2013. 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
Report Distribution

Department of Homeland Security

Secretary
Deputy Secretary
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Deputy Chief of Staff
General Counsel
Executive Secretary
Director, GAO/OIG Liaison Office
Assistant Secretary for Office of Policy
Assistant Secretary for Office of Public Affairs
Assistant Secretary for Office of Legislative Affairs
Under Secretary for Management
Chief Financial Officer
Chief Information Officer
Chief Information Security Officer
Acting Chief Privacy Officer

Office of Management and Budget

Chief, Homeland Security Branch
DHS OIG Budget Examiner

Congress

Congressional Oversight and Appropriations Committees, as appropriate

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Should you be unable to access our website, you may submit your complaint in writing to: DHS Office of Inspector General, Attention: Office of Investigations Hotline, 245 Murray Drive, SW, Building 410/Mail Stop 2600, Washington, DC, 20528; or you may call 1 (800) 323-8603; or fax it directly to us at (202) 254-4297.

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.

Unaudited, see accompanying Auditors' Report

Tax Burden/Tax Gap

Revenue Gap

The Entry Summary of Trade Compliance Measurement (TCM) 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 Under-Collections, 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 TCM entry summary reviews conducted throughout the year.

Entry Summary of Trade Compliance Measurement
($ in millions)

	FY 2012	FY 2011
Estimated Revenue Gap	$484.0	$342.0
Preliminary Revenue Gap of all collectable revenue for year (%)	1.21%	.91%
Estimated Over-Collection	$65	$64
Estimated Under-Collection	$549	$406
Overall Trade Compliance Rate (%)	96.47%	96.71%

The preliminary overall compliance rate for FY 2012 is 96.47 percent. The final overall trade compliance rate and estimated revenue gap for FY 2012 will be issued in February 2013.

Schedule of Spending

The Schedule of Spending (SOS) presents an overview of how departments or agencies are spending money. The SOS presents total budgetary resources, gross outlays, and fiscal year-to-date total obligations for the reporting entity on a combined basis. The data used to populate this schedule is the same underlying data used to populate the Statement of Budgetary Resources (SBR). This is the first fiscal year the Department is presenting the SOS, thus the presentation does not include prior year information.

What Money is Available to Spend. This section presents resources that were available to spend as reported in the SBR. "Total Resources" refers to "Total Budgetary Resources" as described in the SBR. "Amounts not Agreed to be Spent" represent apportioned resources and resources exempt from apportionment not obligated at year end. "Amounts not Available to Spend" are not apportioned by Congress; therefore, are unavailable for obligation. Total "Amounts Agreed to be Spent" refers to obligations incurred in all sections.

How was the Money Spent. This section presents services or items that were purchased. The major categories presented represent the Department's Components or sub-agencies. Those Components that have a material impact on the SBR are presented separately. Other Components are summarized into Directorates and Other Components, which includes DNDO, FLETC, I&A and OPS, MGMT, OHA, OIG, NPPD, S&T, USCIS, and USSS. The items in this section align to OMB Budget Object Class definitions found in OMB Circular No. A-11; however, the amounts reported here reflect outlays (not obligations) by budget object class reconciled to total obligations incurred. "Amounts Remaining to be Spent" represent the fiscal year change in the obligated balances plus any recoveries of prior year obligations, adjusted for transfers of unpaid obligations. A negative balance on this line can occur when payments against both current and prior years' obligations exceed current year obligations. This is expected in years of declining budgetary resources.

The Department encourages public feedback on the presentation of this schedule.

Department of Homeland Security
Schedule of Spending
For the Year Ended September 30, 2012
(In Millions)

	2012
What Money is Available to Spend?	
Total Resources	**$ 79,503**
Less Amount Available but Not Agreed to be Spent	8,552
Less Amount Not Available to be Spent	3,778
TOTAL AMOUNT AGREED TO BE SPENT	**67,173**
How was the Money Spent?	
U.S. Customs and Border Protection	
Personnel Compensation and Benefits	9,428
Contractual Services and Supplies	3,140
Acquisition of Assets	1,325
Grants, Fixed Charges, and Other Spending	2,224
Total Spending	**16,117**

U.S. Coast Guard	
Personnel Compensation and Benefits	5,213
Contractual Services and Supplies	4,767
Acquisition of Assets	878
Grants, Fixed Charges, and Other Spending	188
Total Spending	**11,046**
Federal Emergency Management Agency	
Personnel Compensation and Benefits	1,083
Contractual Services and Supplies	2,904
Acquisition of Assets	587
Grants, Fixed Charges, and Other Spending	11,394
Total Spending	**15,968**
U.S. Immigration and Customs Enforcement	
Personnel Compensation and Benefits	2,868
Contractual Services and Supplies	3,235
Acquisition of Assets	129
Grants, Fixed Charges, and Other Spending	17
Total Spending	**6,249**
Transportation Security Administration	
Personnel Compensation and Benefits	4,661
Contractual Services and Supplies	2,394
Acquisition of Assets	369
Grants, Fixed Charges, and Other Spending	111
Total Spending	**7,535**
Directorates and Other Components	
Personnel Compensation and Benefits	3,760
Contractual Services and Supplies	6,675
Acquisition of Assets	567
Grants, Fixed Charges, and Other Spending	167
Total Spending	**11,169**
Department Totals	
Personnel Compensation and Benefits	27,013
Contractual Services and Supplies	23,115
Acquisition of Assets	3,855
Grants, Fixed Charges, and Other Spending	14,101
Total Spending	**68,084**
Total Spending for the Department	**68,084**
Amounts Remaining to be Spent	**(911)**
TOTAL AMOUNT AGREED TO BE SPENT	**$ 67,173**

Summary of Financial Statement Audit and Management Assurances

Table 1 and Table 2 below provide a summary of the financial statement audit results and management assurances for FY 2012.

Table 1. FY 2012 Summary of the Financial Statement Integrated Audit Results

Audit Opinion	**QUALIFIED**				
Restatement	**YES**				
Material Weakness	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Ending Balance**
Financial Reporting	1				1
IT Controls & System Functionality	1				1
Property, Plant & Equipment	1				1
Environmental & Other Liabilities	1				1
Budgetary Accounting	1				1
Total Material Weaknesses	**5**	**0**	**0**	**0**	**5**

In FY 2012, the Independent Auditor's Report on the integrated financial statement audit identified five material weakness conditions at the Department level. Corrective actions were implemented by management, which resulted in several conditions at the Department level being reduced in severity or resolved from prior year. For example, Fund Balance with Treasury at U.S. Coast Guard was resolved; Financial Reporting at USCIS was resolved; Property Plant and Equipment at TSA and MGMT was resolved; and IT Controls and System Functionality and Budgetary Accounting was reduced in severity at U.S. Coast Guard.

In FY 2012, the Department is providing reasonable assurance on internal controls over financial reporting, with the exception of four material weaknesses identified in Table 2. Management has performed its evaluation, and the assurance is provided based upon the cumulative assessment work performed on Entity Level Controls, Environmental Liabilities, Fund Balance with Treasury, Human Resources and Payroll Management, Payment Management, Insurance Management, and Revenue and Receivables. DHS management has remediation work to continue in FY 2013; however, no additional material weaknesses were identified as a result of the work performed in these business process areas. The following Table provides those areas where material weaknesses were identified and remediation work continues.

DHS reported one less material weakness at the Department level than reported by the independent auditor. The difference between the audit results and management's conclusion is due to reporting requirement timing differences. The differing conclusion is the independent audit reports on a U.S. Coast Guard Environmental Liability material weakness that existed during FY 2012. Management's conclusion considers the effectiveness of controls as of September 30, 2012. The U.S. Coast Guard implemented procedures during FY 2012, which reduced the severity of the material weakness as of September 30, 2012 for management's assurance.

Table 2. FY 2012 Effectiveness of Internal Control Over Financial Reporting

Effectiveness of Internal Control Over Financial Reporting (FMFIA Section 2)					
Statement of Assurance	**Qualified**				
Material Weakness	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Ending Balance**
Financial Reporting	1				1
IT Controls & System Functionality	1				1
Property, Plant & Equipment	1				1
Environmental & Other Liabilities	1		ü		0
Budgetary Accounting	1				1
Total Material Weaknesses	**5**	**0**	**(1)**	**0**	**4**
Effectiveness of Internal Control Over Operations (FMFIA Section 2)					
Statement of Assurance	**Qualified**				
Material Weakness	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Ending Balance**
Financial Assistance Awards Policy & Oversight	1				1
Acquisition Management	1				1
Funds Control	1				1
Entity Level Controls	1		ü		0
Total Material Weaknesses	**4**	**0**	**(1)**	**0**	**3**
Conformance with Financial Management Systems Requirements (FMFIA Section 4)					
Statement of Assurance	**Systems Do Not Conform with Financial System Requirements**				
Non-Conformances	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Ending Balance**
Federal Financial Management Systems Requirements, including Financial Systems Security & Integrate 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**	**3**
Compliance with Federal Financial Management Improvement Act (FFMIA)		**DHS**		**Auditor**	
Overall System 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 *Department of Homeland Security Financial Accountability Act* (FAA), the Department has focused its efforts on evaluating corrective actions to assess whether previously reported material weaknesses continue to exist. In cases where material weaknesses continue to exist, the Department focused on identifying significant financial reporting areas where assurance can be provided and developed interim compensating measures to support the Secretary's commitment to obtain an opinion on all financial statements. Since FY 2005 DHS reduced audit qualifications from 10 to 1, and material weaknesses by half. For the seventh consecutive year, we have made tremendous progress strengthening Department-wide internal controls over financial reporting, as evidenced by the following FY 2012 achievements:

- The U.S. Coast Guard corrective actions significantly reduced risk related to financial scripts and Fund Balance with Treasury reconciliations resulting in reducing the severity of IT Controls and System Functionality and fully remediating weaknesses related to Fund Balance with Treasury. In addition, U.S. Coast Guard implemented the Audit Command Language as a mitigating control and reduced the severity of weaknesses related to Budgetary Accounting. Most significantly, the U.S. Coast Guard corrected the audit qualification related to Environmental Liabilities by developing a new methodology.
- The Offices of the Chief Financial Officer and Chief Information Security Officer partnered to provide direct assistance to Components in executing financial system security corrective actions and performing validation and verification procedures, resulting in a material weakness correction at the U.S. Coast Guard and continued risk reductions of system security vulnerabilities at FEMA, ICE, and USCIS.
- TSA's corrective actions fully remediated a longstanding material weakness in Property, Plant, and Equipment by developing sustainable processes, policies, and procedures for effective internal controls related to Internal Use Software and reconciliation of property balances.
- USCIS executed corrective actions and fully remediated weaknesses related to Financial Reporting by updating processes and related procedures over the recording of deferred revenue.

Significant internal control challenges remain in the areas of Financial Reporting; IT Controls and System Functionality; Property, Plant, and Equipment; and Budgetary Accounting. To support the remediation effort, the Department's Chief Financial Officer conducts weekly risk management meetings with applicable Components, 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 2012 Internal Control Over Financial Reporting Corrective Actions

Material Weakness	Component	Year Identified	Target Correction Date
	USCG, ICE, and TSA	FY 2003	FY 2013
Financial Reporting	DHS has not established an effective financial reporting process due to the lack of integrated financial processes and systems. U.S. Coast Guard materially contributes, while ICE and TSA significantly contribute to the Department's overall material weakness.		
Corrective Actions	The DHS OCFO will continue to support U.S. Coast Guard, ICE, and TSA in implementing corrective actions to establish effective financial reporting control activities.		

Material Weakness	Component	Year Identified	Target Correction Date
	USCG, FEMA, CBP, ICE, and USCIS	FY 2003	FY 2013
IT Controls and System Functionality	The Department's Independent Public Auditor has 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. FEMA materially contributes, while U.S. Coast Guard, CBP, ICE, and USCIS significantly contribute to the Department's overall material weakness. 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. In addition, the Department's financial systems do not conform to the *Federal Financial Management Improvement Act*.		
Corrective Actions	The DHS OCFO and OCIO will support the U.S. Coast Guard, FEMA, CBP, ICE, and USCIS design and implementation of internal controls in accordance with DHS 4300A, *Sensitive Systems Handbook, Attachment R: Compliance Framework for CFO Designated Financial Systems*. In addition, the Department will continue to move forward with financial system modernization.		

Material Weakness	Component	Year Identified	Target Correction Date
	USCG, CBP, and ICE	FY 2003	FY 2013
Property, Plant, and Equipment	The controls and related processes surrounding U.S. Coast Guard Property, Plant, and Equipment (PP&E) to accurately and consistently record activity are either not in place or contain errors and omissions. In addition, significant deficiencies were identified at CBP and ICE which contribute to the overall material weakness.		
Corrective Actions	U.S. Coast Guard will implement policies and procedures to support completeness, existence, and valuation assertions for PP&E. The DHS OCFO will continue efforts to support U.S. Coast Guard and other Components in implementing corrective actions to address capital asset conditions and develop policies and procedures to establish effective financial reporting control activities.		

Material Weakness	Component	Year Identified	Target Correction Date
	USCG, FEMA, ICE, MGMT, and FLETC	FY 2004	FY 2012
Budgetary Accounting	The Department identified weaknesses in the Budgetary Resource Management process such as the lack of fully implemented policies and procedures, ineffective monitoring controls, and lack of effective verification and validation of obligations. The U.S. Coast Guard, FEMA, ICE, MGMT, and FLETC contribute to the overall Department level material weakness.		
Corrective Actions	The DHS OCFO will continue to support U.S. Coast Guard, FEMA, ICE, MGMT, I&A/Ops, and FLETC in implementing corrective actions to establish effective financial reporting control activities.		

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 the Department's frontline operations to lead efforts to achieve a safe, secure, and resilient homeland. 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 controls to ensure the effectiveness and efficiency of operations and compliance with laws and regulations. For the seventh consecutive year, we have made tremendous progress in strengthening Department-wide internal controls over operations, as evidenced by the following FY 2012 achievements:

- The Office of the Chief Financial Officer (OCFO) improved stewardship of Federal assistance funding across DHS. The OCFO published eleven policies in FY 2012 to guide Components' and Awardees' actions; began work on a Financial Assistance Oversight Review Guide which will support adherence to DHS policy and government-wide standards; improved identification and tracking of Office of the Inspector General and DHS Management actions taken to resolve and close annual Awardee audit findings; and submitted to the Under Secretary for Management a Directive and Instructions to define the financial assistance line of business.
- The OCFO implemented corrective action plans for all programs with estimated improper error amounts above $10 million. This work led to a reduction in estimated improper payments for DHS high-risk programs. In addition, the OCFO completed independent reviews for all high-risk IPERA programs and ARRA spending; attained a 94 percent cumulative recoupment/resolution rate for high-dollar overpayments identified in the Secretary's quarterly reports to the DHS OIG, OMB, and the public; and developed and began implementation of a DHS *Do Not Pay* Implementation Plan.
- The DHS OCFO conducted a risk-based compliance assessment over Component Fleet and Travel cards and the use of travel vouchers, in relation to Federal and Departmental guidance. The Department established a baseline measure of controls currently in place and developed a corrective action plan for deficiencies identified during this process. Internal progress review briefings were held for each card program which allowed Senior Component Accountable Officials to brief the Department's Chief Financial Officer, Chief Procurement Officer, and Chief Readiness Support Officer on best practices, performance metrics, and common challenges.
- The Under Secretary for Management established the Program Accountability and Risk Management Office (PARM) in FY 2011 to govern program investment oversight. PARM's mission is to reduce the risk that programs will exceed their budget and schedule or fail to meet mission requirements. For example, by obtaining life cycle cost estimates in FY 2012 for developing programs, PARM reduced the DHS risk of program cost overruns. Estimates are targeted at programs outside of the operations and maintenance phase where life cycle cost estimates are the most valuable.
- DHS made significant improvements to the acquisition workforce by improving the balance of program management staff to the rest of the acquisition workforce and by balancing the number and expertise of DHS employees with appropriate use of contractors. DHS was lauded in FY 2012 by the GAO for its documented improvements in this area.

- The Chief Readiness Support Officer created and actively promoted a new Internal Control Program Webpage which was actively updated throughout the Fiscal Year.
- The Office of the Chief Readiness Support Officer achieved substantial remediation of OIG findings relating to Control Over Firearms. The underlying work included development of a Component monthly sensitive assets loss, damage, destruction report and quarterly scorecard; review of all Component policies and procedures; implementation of an Equipment Control Class sensitive assets methodology; publication of a revised DHS Firearm Asset Policy; and conducting an analysis of firearms losses from FY 2006 to FY 2008 versus FY 2009 to FY 2011.
- The Office of the Chief Information Officer implemented the usage of HSPD-12 Smartcards for logical access to the DHS Headquarters Network for all DHS Headquarters Federal and contract staff users in the National Capitol Region; increased the level of Information Technology program and portfolio governance across the Department by establishing 3 Portfolio Governance Boards and 17 Executive Steering Committees; implemented a process to continuously review and evaluate the health of all IT programs on the Major Acquisition Oversight List; completed the implementation of TechStat at the Component level; and chartered six Primary Function Executive Steering Committees to oversee investments delivering similar capabilities.
- The Office of the Chief Human Capital Officer (OCHCO) conducted an in-depth assessment of operational service delivery effectiveness, and implemented corrective actions, including functional and geographic realignments of staff, to improve service delivery. The OCHCO ensured alignment of DHS workforce planning processes to new government-wide practices; updated the DHS Workforce Planning Guide; and established a skills gap assessment strategy to pilot with selected DHS mission critical occupations.
- The Chief Security Officer (CSO) reinvigorated the influence and scope of the CSO Council; addressed internal control challenges by re-directing security support resources across Components as needed; worked with the CSO Council to introduce the Security Professional Education Development (Sped) Program; and leveraged a Congressional inquiry concerning the security clearance suspension process and EEO complaints into a Department-wide review.

To address challenges to internal control over operations, the Department’s Under Secretary for Management conducts quarterly Internal Progress Review 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 2011 Internal Control Over Operations Corrective Actions

Material Weakness	**Component**	**Year Identified**	**Target Correction Date**
	DHS and FEMA	FY 2008	FY 2014
Financial Assistance Awards Policy and Oversight	Significant progress has been made on conditions affecting stewardship of Federal assistance funding across DHS listed in last year's report. Eleven policies were published in FY 2012, and twenty-seven policies will be published in FY 2013 to guide Components' and Awardees' actions. Standard templates were developed through DHS-wide working groups, and a Financial Assistance Oversight Review Guide is in development to ensure adherence to DHS policy and government-wide standards. Progress has been made in identifying and tracking Office of the Inspector General and DHS Management actions taken to resolve and close annual Awardee audit findings. Headquarters offices are working with Components to assist in timely notification and closeout of OMB Circular A-133 audit requirements. Through the Deputy Secretary's initiative to *Improve the Health of DHS Financial Assistance* a Directive and Instruction have been submitted for USM approval to define the financial assistance line of business, including the business models, areas of high risk, gaps in key controls, and clear lines of responsibility.		
Corrective Actions	Publish the twenty-seven policies described above, support all policies through training, and continue efforts to further establish and improve the Line of Business.		

Material Weakness	**Component**	**Year Identified**	**Target Correction Date**
	DHS	FY 2008	FY 2013
Acquisition Management	During FY 2012 significant progress was made to reduce the severity of this challenge, but work remains, and sustainment needs to be achieved. DHS financial and procurement systems are not integrated which leaves our processes vulnerable. However, progress has been made to mitigate these vulnerabilities. DHS established the Program Accountability and Risk Management Office (PARM) to govern oversight while the Chief Procurement Officer is responsible for procurement oversight. This restructuring ensures proper oversight for the function as well as program accountability.		
Corrective Actions	Continue oversight policy development and remediation efforts. Improve training for cost estimation, understanding regulation and acquisition documentation. Improve Acquisition workforce through training and targeted recruiting. Improve communications with the government vendor community.		

Material Weakness	**Component**	**Year Identified**	**Target Correction Date**
	USCG, ICE, and USSS	FY 2006	FY 2013
Funds Control	U.S. Coast Guard repeated the prior year Anti-Deficiency Act (ADA) controls material weakness. ICE made progress against prior-year conditions by developing an Administrative Control of Funds Directive; however, additional work is needed to implement the Directive across ICE program offices. Finally, USSS has not completely implemented funds control policies and procedures to address prior-year ADA violations reported by GAO.		
Corrective Actions	U.S. Coast Guard is developing enterprise-wide policies and procedures for assessing ADA risks, testing effectiveness of controls, and monitoring to fully implement DHS policy. ICE plans to conduct verification and validation procedures to ensure their Administrative Control of Funds Directive is effectively implemented. USSS will update their policies and procedures for the Monthly Execution Report to fully reflect implemented process improvements. The DHS OCFO will validate and verify this work.		

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. The IPIA was amended on July 22, 2010, by the *Improper Payments Elimination and Recovery Act* (IPERA) *of 2010* (Pub. L. 111-204). IPERA strengthened the requirement for government agencies to carry out cost-effective programs for identifying and recovering overpayments made to contractors, also known as "recovery auditing." 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. As noted below, DHS will implement corrective action plans for all programs with estimated improper error amounts above $10 million. Key achievements for FY 2012 include: the reduction in estimated improper payments for high risk programs, the completion of full independent reviews of the components, the creation of the Do Not Pay Implementation Plan; and a 94 percent cumulative recoupment rate for high-dollar overpayments identified in the Secretary's quarterly report to the DHS OIG, OMB, and the public. In the tables which follow, all table amounts are rounded to the nearest whole dollar.

I. Risk Assessments

In FY 2012, DHS conducted risk assessments on 55 DHS programs, totaling nearly $18 billion in FY 2011 disbursements. We completed risk assessments for all programs unless total disbursements were less than $10 million or testing was required based on prior year results. We assessed all payment types except for federal Intra-governmental payments which were excluded based on changes to the definition of an improper payment contained in IPERA and as listed in the resulting OMB implementing guidance and government charge card payments which are separately tested under OMB Circular A-123 Appendix B, *Improving the Management of Government Charge Card Programs*. Agencies were also given the option of excluding payroll payments.

Improper payment estimates in this section are based on statistical estimates for FY 2011 payments. These estimates are then projected for FY 2012 and beyond, based on the timing and significance of improvements expected from completing corrective actions.

The susceptibility of programs making 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.

- Human Capital – Experience, training, and size of payment staff. Ability of staff to handle peak payment requirements. Level of management oversight and monitoring against fraudulent activity.
- Complexity of Program – Time program has been operating. Complexity and variability of interpreting and applying laws, regulations, and standards required of the program.
- Nature of Payments and Recipients – 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 that 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.
- Contract Payment Management – Identification of contract management weaknesses identified in previous payment testing. Discrepancies between Contracting Officer Representatives (COR) reviewing and approving invoices with CORs listed in contract. Contractors reviewing and approving invoices on behalf of the COR. Lack of familiarity with goods and services listed on invoices. Time available to review invoices prior to payment. Sufficiency of supporting documentation to support invoice amount prior to payment. Completeness of contract file in order to verify agreed upon amounts for goods and/or services.

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 2012 Risk Assessments and Prior Year Payment Sample Testing

Component	Program Name	FY 2012 Disbursements (Based on FY 2011 Actual Data) ($ Millions)
CBP	Border Security Fencing	$197
	Custodial – Refund & Drawback	$1,343
FEMA[1]	Disaster Relief Program – Individuals and Households Program (IHP)	$880
	Disaster Relief Program – Vendor Payments	$494
	Insurance – National Flood Insurance Program (NFIP)	$794
	Grants – Public Assistance Programs (PA)	$2,990
	Grants – Homeland Security Grant Program (HSGP)	$1,472
	Grants – Assistance to Firefighters Grants (AFG)	$471
	Grants – Emergency Food and Shelter Program (EFSP)	$45
	Grants – Transit Security Grants Program (TSGP)	$196
ICE	Enforcement and Removal Operations (ERO)	$1,570
NPPD	Federal Protective Service (FPS)	$733
Total Disbursements		**$11,185**

Note 1: All FEMA disbursement totals are national figures. Selected States and Territories were tested for the State-Administered programs HSGP, PA, TSGP. See Table 2 for a listing of states and territories tested for these programs in FY 2012.

II. Statistical Sampling

For FY 2012 reporting, a stratified sampling design was used to test payments based on FY 2011 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 M-03-13 guidance. An expected error rate of 3 to 10 percent of total payment dollars was used in the sample size calculation.

Using a stratified random sampling approach, 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:

- Grouped payments into mutually exclusive strata;
- Assigned each payment a randomly number generated using a seed;
- Sorted the population by stratum and random number within stratum; and

- Selected the number of payments within each stratum (by ordered random numbers) 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 2012 Payment Population (Based on FY 2011 Actual Data) ($ millions)	FY 2012 Sample Size (Based on FY 2011 Actual Data) ($ millions)	FY 2012 Est. Error Amount (Based on FY 2011 Actual Data) ($ millions)	FY 2012 Est. Error Percentage (Based on FY 2011 Actual Data) (%)
CBP	Border Security Fencing	$197	$146	$0	0.03%
	Refund & Drawback	$1,343	$141	$0	0.01%
FEMA	Disaster Relief Program – Individuals and Households Program (IHP)	$880	$3	$3	0.29%
	Disaster Relief Program – Vendor Payments	$494	$155	$15	3.09%
	Insurance – National Flood Insurance Program (NFIP)	$794	$34	$6	0.75%
	Grants – Public Assistance Programs (PA)[1]	$701	$328	$0	0.06%
	Grants – Homeland Security Grant Program (HSGP)[2]	$555	$128	$1	1.05%
	Grants – Assistance to Firefighters Grants (AFG)	$471	$78	$8	1.60%
	Grants – Transit Security Grants Program (TSGP)[3]	$44	$25	$1	4.63%
	Grants – Emergency Food and Shelter Program (EFSP)	$45	$14	$1	2.51%
ICE	Enforcement and Removal Operations (ERO)	$1,570	$389	$133	8.47%
NPPD	Federal Protective Service	$733	$172	$10	1.37%
DHS	**All Programs[4]**	**$7,827**	**$1,613**	**$178**	**2.27%[5]**
DHS	**High Risk Programs[6]**	**$2,797**	**$716**	**$158**	**5.65%**

Note 1. Note 1: Sample testing of the Public Assistance Program was done in two stages covering eight States (CA, FL, HI, MS, MT, ND, SD, and TN) and American Samoa. These States and Territory paid out $701 million out of a national total of $2,990 million. The totals in the table are the stage two payment populations for the States and Territory tested in FY 2012. See Table 18 Improper Payment Reduction Outlook for the national estimated error rate and amount.

Note 2. Sample testing of the Homeland Security Grant Program was done in two stages covering 15 States (AK, AR, CA, CT, DE, GA, MA, MD, ME, MS, NH, OR, SD, TX, and UT), America Samoa, Guam, Puerto Rico, and U.S. Virgin Islands. These States and Territories paid out $555 million out of a national total of $1,472 million. The totals in the table are the stage two payment populations for the States and Territories tested. See Table 18 Improper Payment Reduction Outlook for the national estimated error rate and amount.

Note 3. Sample testing of the Transit Security Grant Program was done in two stages covering eleven States (FL, HI, KS, MA, MN, MO, OR, PA, VA, TX, and WA). These States paid out $44 million out of a national total of $196 million. The totals in the table are the stage two payment populations for the nine States. See Table 18 Improper Payment Reduction Outlook for the national estimated error rate and amount.

Note 4. Program total of $7,827 in this table differs from $11,185 total in Table 18 Improper Payment Reduction Outlook. For State-Administered grant programs, the table above lists the population totals for the States tested, while Table 18 Improper Payment Reduction Outlook lists the national payment populations.
Note 5. Percentage figures based on cumulative totals.
Note 6. Totals for programs with estimated error amounts of $10 million or greater as listed in this table.

Several programs considered at high risk based on risk assessment grading were not confirmed as 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 national estimated error amounts above $10 million:

1. FEMA's Assistance to Firefighters Grants;
2. FEMA's Disaster Relief Program - Vendor Payments;
3. FEMA's Emergency Food and Shelter Program;
4. FEMA's National Flood Insurance Program;
5. ICE's Enforcement and Removal Operations Program; and,
6. NPPD's Federal Protective Service Program.

Also provided is an update to corrective actions listed in the FY 2011 Annual Financial Report for FEMA's Public Assistance Program.

III. Corrective Actions

The following tables list corrective actions for programs with estimated improper error amounts above $10 million. These corrective actions are targeted at addressing the root causes behind administrative and documentation errors caused by the absence of the supporting documentation necessary to verify the accuracy of the claim; or inputting, classifying, or processing applications or payments incorrectly by DHS, a state agency, or a third party who is not the beneficiary. Authentication and medical necessity errors and verification errors were either not identified or were immaterial to the estimated error rates and amounts of DHS high-risk programs.

Status of Prior Year Corrective Action Plans for FEMA High-Risk Programs

Table 7. Assistance to Firefighters Grant Program Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Incorrect Information on Application		
1. Failure to Provide Accurate Information on Application	1. Update AFG Program Guidance and tutorials to instruct potential applicants to register in the National Fire Incident Reporting System and provide required information in support of their grant application.	Completed June 2012
	2. Perform additional grantee outreach and direct applicants to include their Fire Department Identification Number as part of their grant application.	Completed June 2012
Category of Error: Purchase Outside Allowable Timeframe		
1. Purchase Made Outside the Period of Performance	1. Conduct semi-annual grantee outreach and include language in the correspondence reminding grantees to monitor their disbursement progress as it relates to their respective grant's period of performance.	Completed June 2012
	2. Develop and deliver training for program staff to include a notification in Comments section in the AFG system when reviewing payments during or after the tenth month of a grantee's period of performance.	Funding required
Category of Error: Unallowable Use of Excess Funds		
1. Use of Excess Funds without Supporting Amendment or to Purchase Ineligible Goods and/or Services	1. Require each applicant to complete the *AFG Grant Management Tutorial* that is currently available on the AFG Program website.	Completed June 2012
Category of Error: Insufficient Documentation		
1. Failure to Submit Supporting Documentation	1. Develop grantee documentation organization and retention guidance and offer associated record keeping training.	March 2013
	2. Develop a plan that outlines procedures for conducting annual audits of grantee supporting documentation.	March 2013

Table 8. Disaster Relief Fund Vendor Payments Program Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Insufficient Policies to Prevent Improper Payments		
1. Acquisition manual needs to be strengthened	1. Update acquisition manual to include a chapter on procurement roles and responsibilities for contract payments. Specific points to include: contracting officer delegations; invoice requirements including reviews against regulations, contract terms and conditions; requirements for adequate supporting documentation; procedures for establishing billing rates; and a description of billing mechanisms required for different contract types.	March 2013
	2. Revise acquisition manual sections on standard billing language, procedures for product substitution and/or pricing variances, and requirements and procedures for issuing contract modifications.	March 2013
2. COTR manual needs to be strengthened	1. Add a chapter on how to review invoices for approval.	March 2013
3. Vendor payments standard operating procedures need to be strengthened	1. Add a chapter on invoice reviews required in each step of the invoice payment cycle.	March 2013
4. Training needed on invoicing roles and responsibilities throughout the contract life-cycle	1. Institute mandatory and refresher training for contracting officers, contracting officer's technical representatives, and accounting technicians.	March 2013
Category of Error: Non-Contract Payments		
1. Standard operating procedures needed	1. Develop a process and standard operating procedures for authorizing and paying non-contract payments such as lease payments and bills of lading.	March 2013
Category of Error: Acceptance and Receiving		
1. Reports and contract file maintenance needs improvement	1. Develop a standard inspection, acceptance, and receiving report for contracting officer's technical representatives and complete training on its proper completion and use.	March 2013
	2. Implement an electronic contract file maintenance system.	September 2013

Table 9. Emergency Food and Shelter Program Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Insufficient Supporting Documentation		
1. Missing Proof of Purchase	1. Develop guidance around the supporting documentation checklist to state that unless the checklist is completely satisfied, the documentation will not be accepted by EFSP.	Completed December 2011
2. Missing Proof that Payment Still Due	1. Develop improved guidance for utility or rent assistance to clarify that the local recipient organization (LRO) must have proof that payment is still due if paid beyond 60 days after the LRO was notified of the request for assistance.	Completed March 2012
3. Missing LRO Documentation: o Missing required certification documents, o Missing Proof of Payment	1. Establish a filing system to maintain required LRO certification documents, including but not limited to the following forms: (1) Local Board Certification, (2) Local Board Roster, (3) Lobbying Certification, (4) Local Board Plan, (5) Interim Report, and (6) Final Report.	Completed December 2011
4. Missing All Supporting Documentation	1. Review the existing National Board Program requirements training for possible modification of documentation requirements and other grant management improvement opportunities.	Completed March 2012
	2. Provide grantees with technical assistance on maintaining adequate documentation for transactions using EFSP funds.	Completed December 2011
Category of Error: Purchase Outside Allowable Timeframe		
1. Purchase Made Outside the Period of Performance	1. Require local boards to conduct outreach activities with LROs throughout the period of performance.	Completed December 2011
	2. Require LROs to perform a self assessment of the purchase and/or initiation dates on all supporting documentation before submission to the local board to ensure that all expenditures are within the specified period of performance of the appropriate spending phase.	March 2013
Category of Error: Spending Condition Non-compliance		
1. Spending Condition Errors	1. Develop a mandatory on-line training course to be taken and passed by all local boards and LROs awarded funding.	Funding required
2. Incorrect Rent, Mortgage or Utility Payment: o Current Payments Made Too Early o Allowable Assistance Payment Exceeded	1. Leverage existing LRO rent/mortgage and utility assistance letters to create standardized forms for spending and other categories where compliance problems persist with submission of LRO supporting documentation.	Completed March 2012

Table 10. National Flood Insurance Program Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Incorrect Estimate / Worksheet Calculation Errors		
1. Insurance coverage incorrectly applied by adjusters. Claim estimates included items not covered under Flood insurance policy.	1. Training: Conduct educational workshops at the annual National Flood Conference and other industry national and regional conferences. 2. Process Improvement: Increase the frequency of claims operation reviews until satisfactory progress has been made by insurers and flood vendors.	Completed May 2012
Category of Error: Payment Processing Errors		
1. Incorrect Application of Salvage	1. Training: Conduct educational workshops at the annual National Flood Conference and other industry national and regional conferences 2. Process Improvement: Increase the frequency of claims operation reviews until satisfactory progress has been made by insurers and flood vendors. 3. System Enhancements: Develop process to leverage the current transaction record reporting and processing reports and other NFIP financial and statistical data mechanisms to help insurers and flood vendors identify payment processing errors electronically.	Completed May 2012
Category of Error: Insufficient Damage Documentation		
1. Lack of supporting documentation for adjuster estimates on lump-sum items. Increased Cost Compliance claims not supported with required claim documentation.	1. Training: Conduct educational workshops at the annual National Flood Conference and other industry national and regional conferences. 2. Process Improvement: Increase the frequency of claims operation reviews until satisfactory progress has been made by insurers and flood vendors.	Completed May 2012

Table 11. Public Assistance (PA) Program Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Incorrect Entity Paid		
1. Incorrect Federal Information Processing Standards Number	1. Improve grantee project worksheet (PW) development procedures by incorporating a quality check after the initial PW is completed to confirm all information within the PW is relevant and correct prior to submitting the final version into the system of record.	Completed October 2011
Category of Error: Unmet Work Completion Deadline		
1. Failure to Complete Work During Period of Performance	1. Increase grantee documentation review guidance and create and conduct Public Assistance payment processing training.	Completed March 2012
Category of Error: Scope Discrepancy between Project Worksheet Scope of Work (SOW) and Supporting Documentation		
1. Discrepancies Found between PW SOW and Supporting Documentation	1. Require FEMA project specialists and Public Assistance coordinators to take training courses on proper PW data entry and development, project writing skills, and audit review requirements.	Completed October 2011
	2. Develop reference guides and/or checklists for costs documentation reviews to improve consistency of scope reviews.	Completed October 2011
	3. Offer grantee invoice and force account documentation review guidance or training to ensure the scope of supporting documentation falls within the scope of the PW/SA.	Completed October 2011
Category of Error: Calculation Error between Force Account Summary Sheet and Closeout PW		
1. Mathematical Calculation Error	1. Develop guidance for grantees to eliminate use of rounding in payment calculations to improve accuracy of disbursements of grant funds to sub-grantees.	March 2013
Category of Error: Direct Administrative Costs Not Supported in Closeout PW		
1. Direct Administrative Costs Not Included in Closeout PW	1. Improve guidance and outreach to grantees on payment calculations, quality control, and overall accuracy of information when closing out a PW.	Completed October 2011

Corrective Action Plans for FY12 FEMA High-Risk Program

Table 12. Planned Disaster Relief Fund Vendor Payments Program Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Insufficient Policies to Prevent Improper Payments		
1. FEMA COR manual needs to be updated for revised DHS COR policy	1. Update FEMA COR manual to be consistent with DHS COR policy regarding the following: o Clarify who has the authority to approve cost reimbursable and T&M payments (DHS COR manual section 7.14); o Clarify impact of DCAA-DHS MOU requiring 1st invoices be routed through DCAA on cost reimbursable contracts.	March 2013
2. Vendor payments standard operating procedures need to be strengthened	1. Add a chapter on invoice reviews required in each step of the invoice payment cycle.	March 2013
3. Training needed on invoicing roles and responsibilities throughout the contract life-cycle	1. Institute mandatory and refresher training for contracting officers, contracting officer's technical representatives, and accounting technicians.	March 2013
Category of Error: Non-Contract Payments		
1. Standard operating procedures needed	1. Develop a process and standard operating procedures for authorizing and paying non-contract payments such as lease payments and bills of lading.	March 2013
Category of Error: Acceptance and Receiving		
1. Reports and contract file maintenance needs improvement	1. Develop a standard inspection, acceptance, and receiving report for contracting officer's technical representatives and complete training on its proper completion and use.	January 2013
	2. Implement an electronic contract file maintenance system.	September 2013

Table 13. Planned Transit Security Grants Program Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Insufficient Supporting Documentation		
1. Missing Invoices and Missing Proof of Payment	1. Enhance T*SGP Guidance* related to grant financial management guidelines, standardized minimum reporting requirements, and financial recordkeeping to reduce gaps in the Grantee and Sub-Grantee invoice and/or other expenditure documentation.	March 2013
	2. Require Grantees and Sub-Grantees to comply with document retention requirements past the required three-year grant period.	March 2013
	3. Conduct training for TSGP program and financial officers to include compliance with standardized financial management practices, responding to documentation requests, and document retention	March 2013
Category of Error: Unallowable Costs		
1. Grantee paid overtime to employees beyond standard grant allowable timeframe of six months.	1. Enhance *HSGP Guidance* related to grant financial management guidelines, standardized minimum reporting requirements, and financial recordkeeping to reduce gaps in the Grantee and Sub-Grantee invoice and/or other expenditure documentation.	March 2013
	2. Include language in the Sub-Grantee contracts to specify allowable cost activities in all of the cost categories for the respective award year.	March 2013
	3. Require that Grantees provide allowable cost rationale and documentation to support decision making.	March 2013

Corrective Action Plan for ICE High-Risk Program

Table 14. Completed ERO Corrective Actions

Risk Factors	Corrective Actions	Completed Date
Category of Error: Missing Documentation		
1. Insufficient documentation to support and/or validate financial transactions	1. Provide payment documentation requirements and instructions to the program offices. Instructions to detail the following: (1) invoices that do not contain all invoice backup documentation must be rejected by the receiving and acceptance official, (2) compliance required with record retention guidelines according to National Archives and Records Administration, and (3) the need for program offices to maintain and have readily available all service agreements and memoranda of understanding.	May 2012
	2. Automate FY 2012 IPERA documentation collection by establishing a central SharePoint collaboration site.	March 2012
Category of Error: Invalid / Improper Invoice		
1. Vendor payments delayed or made incorrectly due to inadequate information	1. Conduct refresher training for payment technicians on elements of a proper invoice and ensure that improper invoices are rejected upon receipt.	May 2012
Category of Error: Contract Quality		
1. Improper processing of contracts and obligations; not in compliance with the Federal Acquisition Regulation	1. Implement new receipt and acceptance requirements.	September 2012
Category of Error: Payment Quality and Accuracy		
1. Improper processing of vendor payments and disbursements	1. Conduct refresher training for contracting officer, contracting officer's representatives (COR), and/or program manager to ensure review of invoices to contracted pricing, invoice alignment to correct obligations, and accurate and complete supporting documentation.	May 2012
	2. Conduct refresher training for finance centers and implement an updated checklist to incorporate the review of invoices for date (discount/penalty), correct contract, and correct obligation lines.	May 2012

Table 15. Planned ERO Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Identify and Correct Known Errors in ICE Detention Agreements		
1. Payments may be made inaccurately due to amount, vendor, and/or without appropriate supporting documentation	1. Establish a tracking report for identified vendor and pricing errors.	November 2012
	2. Modify detention agreements to correct known vendor errors.	December 2012
	3. Modify detention agreements to correct known pricing errors.	February 2013
	4. Identify FY 2012 invoice documentation for detention agreements currently located at ERO Offices and upload to centralized system of record for retention.	April 2013
Category of Error: Updates Needed to Marshal Service Agreements (MSA) used for ICE Detainees		
1. Payment may be made for ineligible items	1. Review MSAs to ensure ICE is included within the scope of the agreement and, when necessary, notify Procurement of need to add ICE to scope.	December 2012
	2. MSAs modified to include ICE in scope and updated agreement stored in system of record.	February 2013
Category of Error: More Robust Invoice Review and Approval Needed		
1. Payment may be made inaccurately due to amount, vendor, and/or without appropriate supporting documentation	1. Issue interim guidance regarding invoice review and approval to Contracting Officer Representatives (COR).	November 2012
	2. Conduct training sessions for CORs on interim guidance.	December 2012
	3. Develop invoice review checklist and reference guide. Conduct training sessions, as appropriate.	March 2013
	4. Issue final guidance.	March 2013
	5. Update checklist and reference guide. Conduct training sessions for CORs and accounting technicians on final guidance.	April 2013
Category of Error: Inaccurate Contracting Officer Representative Designations		
1. Payment may be made inaccurately due to not being received by a duly authorized official	1. Review existing detention agreements for missing of inaccurate COR designation.	February 2013
	2. Update detention agreement to reflect designated COR.	March 2013

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Poor Obligating and Receiving and Acceptance Procedures		
1. Payments may be made inaccurately due to amount, vendor, not received by duly authorized official, obligation not recorded properly, and/or without appropriate supporting documentation	1. Update procedures for obligating detention agreements.	February 2013
	2. Review, and if necessary, update guidance on completing requisitions for detention agreements to include coordination with Procurement to align contract requirements.	March 2013
	3. Update procedures regarding detention agreements receiving and acceptance. Provide guidance and instruction to CORs.	March 2013
Category of Error: Review and Update Marshal Service Agreements (MSA) used for ICE Detainees		
1. Payment may be made for ineligible items	1. Review MSAs to ensure ICE is included within the scope of the agreement and, when necessary, notify Procurement of need to add ICE to scope.	December 2012
	2. MSAs modified to include ICE in scope and updated agreement stored in system of record.	February 2013
Category of Error: Enhancements Needed to Documentation Retention, Obligation, and Receiving/Acceptance Procedures for Telecommunications Orders		
1. Payment may be made inaccurately without appropriate supporting documentation	1. Issue updated guidance on telecommunication order processing and recording.	March 2013
	2. Update guidance for obligating telecommunications orders and for receiving and acceptance.	May 2013
Category of Error: Contract Quality		
1. Improper processing of contracts and obligations; not in compliance with the Federal Acquisition Regulation	1. Establish and provide “Subject to Availability of Funds” guidance regarding notification to vendor for funds availability, receipt of invoice, and payment of interest.	May 2013

Corrective Action Plan for NPPD High-Risk Program

The corrective actions implemented by NPPD and FPS will strengthen contract oversight and improve the review and processing of invoices and contract modifications.

Table 16. Completed Federal Protective Service Program Corrective Actions

Risk Factors	Corrective Actions	Completed Date
Category of Error: Contract Oversight		
1. Contractor approving payment of invoices on behalf of the COTR	1. Remove contractors from the process of paying invoices, including terminating contractor access to Webview. Coordinate all Webview access requests through NPPD.	November 2011
2. Contract administration weakness	1. FPS Acquisition Division will establish a team of senior procurement officials and operational procurement staff to identify improvements to contract administration including invoicing and documentation.	March 2012
	2. FPS Acquisition Division will coordinate with program offices and contracting officers to identify and provide written delegations of authority to federal employees which facilitate an efficient invoice review and approval process.	January 2012
	3. Provide training to contracting officers, COTRs, and appropriate program officials on invoice review and contract modifications. Emphasis will be on the timely correction of errors on invoices and contract lines.	June 2012

Table 17. Planned Federal Protective Service Program Corrective Actions

Risk Factors	Corrective Actions	Target Completion Date
Category of Error: Contract Oversight		
1. Contractor approving payment of invoices on behalf of the COR	1. Provide CORs with support to review and approve payments within Webview.	March 2013
	2. Issuance of updated Invoicing Policy (POP 603R1). POP 603R1 will provide additional support to CORs by requiring COs to approve all invoices submitted for payment. This will reduce the administrative responsibilities currently placed on the CORs. Per DHS Acquisition policy, the contacting officer may delegate certain authorities to the CORs such as reviewing invoices of any contract type; however approving authority may only be delegated to CORs for Firm Fixed Price type contracts. Most of FPS's contracts are other than Firm Fixed Price.	March 2013
3. Contract Administration Weakness	1. Continue to implement the recommendations of the IPERA Contract Administration Improvement Team and monitor progress/quality improvements	September 2013
	2. Issuance of updated Invoicing Policy (POP 603R1). POP 603R1 will address identified contract administration weaknesses, align FPS processes with the HSAM, and adopt the "best practices" of OPO and NPPD.	March 2013

Funds Stewardship

FEMA worked closely with primary grant recipients to ensure proper stewardship of funds at the sub-recipient levels. For example, on the Emergency Food and Shelter Program, FEMA worked closely with The United Way's National Board. As a result, the National Board issued a memo highlighting that additional rounds of funding to local boards would be dependent upon receipt of timely supporting documentation for tested sample payments. Significant additional documentation came in which supported as proper many test sample payments. FEMA also assisted states in improving the guidance they provide local entities for several state administered FEMA grant programs.

IV. Program Improper Payment Reporting

Table 18 summarizes improper payment amounts for DHS high-risk programs. Improper payment percent (IP%) and improper payment dollar (IP$) results are provided from last year's testing of FY 2009 payments and this year's testing of FY 2010 payments. Data for projected future−year improvements is based on the timing and significance of completing corrective actions.

Table 18. Improper Payment Reduction Outlook

Improper Payment Reduction Outlook ($ in millions)															
Program	PY Outlays	PY IP%	PY IP$	CY Outlays	CY IP%	CY IP$	CY +1 Outlays	CY +1 Est. IP%	CY +1 Est. IP$	CY + 2 Est. Outlays	CY + 2 Est. IP%	CY + 2 Est. IP$	CY + 3 Est. Outlays	CY + 3 Est. IP%	CY + 3 Est. IP$
	(Based on FY 2010 Actual Data)			(Based on FY 2011 Actual Data)			Based on FY 2012 Actual and Estimated Data)			(Based on 2013 Estimated Data)			(Based on 2014 Estimated Data)		
Border Security Fencing (CBP)[3]	$336	0.01%	$0	$197	0.03%	$0	$173	0.01%	$0	$159	0.01%	$0	$157	0.01%	$0
Refund & Drawback (CBP)	$1,198	0.28%	$3	$1,343	0.01%	$0	$1,949	0.01%	$0	$1,300	0.01%	$0	$1,300	0.01%	$0
IHP (FEMA)	$679	0.31%	$2	$880	0.29%	$3	$880	0.29%	$3	$1,022	0.29%	$3	$1,227	0.29%	$4
Disaster Relief Program Vendor Payments (FEMA)	$582	2.87%	$17	$494	3.09%	$15	$494	2.50%	$12	$791	2.00%	$16	$949	1.50%	$14
NFIP (FEMA)	$1,085	1.21%	$13	$794	0.75%	$6	$863	0.75%	$6	$1,036	0.75%	$8	$1,243	0.75%	$9
PA (FEMA)[1]	$3,532	0.32%	$11	$2,990	0.31%	$9	$2,990	0.30%	$9	$3,588	0.25%	$9	$4,306	0.20%	$9
HSGP (FEMA)[1]	$1,516	0.34%	$5	$1,472	1.00%	$15	$1,472	1.00%	$15	$1,766	1.00%	$18	$2,120	0.50%	$11
AFG (FEMA)	$385	5.09%	$20	$471	1.60%	$8	$421	1.50%	$6	$505	1.50%	$8	$606	1.50%	$9
TSGP (FEMA)[1]	$109	0.68%	$1	$196	1.77%	$3	$196	1.50%	$3	$235	1.50%	$4	$282	1.50%	$4
EFSP (FEMA)	$201	7.64%	$15	$45	2.51%	$1	$100	2.00%	$2	$120	1.50%	$2	$144	1.50%	$2
ERO (ICE)	$1,332	8.12%	$108	$1,570	8.47%	$133	$1,652	8.12%	$134	$1,652	5.70%	$94	$1,668	2.28%	$38
FPS (NPPD)	$811	3.27%	$27	$733	1.37%	$10	$900	1.00%	$9	$900	0.50%	$5	$900	0.50%	$5
All Programs[2]	**$11,766**	**1.89%**	**$222**	**$11,185**	**1.82%**	**$203**	**$12,090**	**1.65%**	**$200**	**$13,075**	**1.26%**	**$165**	**$14,901**	**0.70%**	**$104**

Note1: FEMA has three State-Administered Programs—HSGP, PA, and TSGP—that are tested on a three-year cycle. To calculate the national error rate for FY 2011 actual data, error rates from States tested in FY 2011 and FY 2012 were applied to the FY 2011 State payment populations. A weighted average of these tested States was applied as the estimated error rate for States which will be tested in FY 2013. Beginning in FY 2013, a weighted average estimate will no longer be required as all States will have been tested and consequently have a known estimated error rate. These estimated error rates will be updated during the second three-year cycle of improper payment testing. Estimated outlays for FEMA programs were calculated by averaging the total disbursements for the past three fiscal years, due to the volatile nature of the programs tested. TSGP estimated outlay figures were based on the past two fiscal years that this program was tested.

Note 2: Two programs tested in FY 2011 were not tested in FY 2012 as: (1) the underlying payments were payroll, (2) the estimated error amounts for these programs were under $10 million, and (3) the estimated error rates were 0.13% or less. These two programs are TSA's Aviation Security Payroll and

USCG's Active Duty Military Payroll. In dropping these programs from the Improper Payment Reduction Outlook Table, the Totals for All Programs for PY will differ from the All Program CY totals published in the FY 2011 Annual Financial Report.

Note 3: The prior year outlays figure for CBP's Border Security Fencing Program were increased from the $251 million figure listed in the FY 2011 DHS Annual Financial Report to correct for $85 million in payments which were misidentified by CBP as adjustments. Full details are listed in the DHS Office of Inspector General Report, *Department of Homeland Security's Compliance with the Improper Payments Elimination and Recovery Act of 2010* (OIG-12-48).

Overpayments and Underpayments Details

The table that follows provides overpayment and underpayment breakouts for the Department's high-risk programs. The table shows that over 99 percent of the Department's estimated improper payments are due to overpayments.

Table 19. Overpayment and Underpayment Detail on DHS Sample Test Results

		FY 2012 Gross Total (Based on FY 2011 Actual Data)		FY 2012 Overpayment Total (Based on FY 2011 Actual Data)		FY 2012 Underpayment Total (Based on FY 2011 Actual Data)	
Component	**Program**	**Est. Error Amount ($ millions)**	**Est. Error Percentage (%)**	**Est. Error Amount ($ millions)**	**Est. Error Percentage (%)**	**Est. Error Amount ($ millions)**	**Est. Error Percentage (%)**
CBP	Border Security Fencing (CBP)	$0	0.03%	$0	0.02%	$0	0.01%
	Refund & Drawback (CBP)	$0	0.01%	$0	0.01%	$0	0.00%
FEMA	IHP (FEMA)	$3	0.29%	$3	0.29%	$0	0.00%
	Disaster Relief Fund Vendor Payments (FEMA)	$15	3.09%	$15	3.07%	$0	0.02%
	NFIP (FEMA)	$6	0.75%	$6	0.75%	$0	0.00%
	PA (FEMA)[1]	$9	0.31%	$9	0.30%	$0	0.01%
	HSGP (FEMA)[1]	$15	1.00%	$15	1.00%	$0	0.00%
	AFG (FEMA)	$8	1.60%	$8	1.60%	$0	0.00%
	TSGP (FEMA)[1]	$3	1.77%	$3	1.77%	$0	0.00%
	EFSP (FEMA)	$1	2.51%	$1	2.51%	$0	0.00%
ICE	ERO (ICE)	$133	8.47%	$132	8.42%	$1	0.05%
NPPD	FPS (NPPD)	$10	1.37%	$10	1.37%	$0	0.00%
DHS	**All Programs[2]**	**$203**		**$202**		**$1**	

Note 1: Figures for FEMA's State-Administered Programs (HSGP, PA and TSGP) are based on the National error estimates listed in Table 14.

Note 2: TSA and USCG were removed from the sample test results for FY12 as described in Note 2 to Table 18.

V. Recapture of Improper Payments

DHS completed recovery audit activities for FY 2011 disbursements and continued collection activities for errors identified in prior-year recovery audits. Work was completed at CBP and ICE (and its cross-serviced Components). Recovery activity is underway, but not completed, at FEMA and the U.S. Coast Guard (and its cross-serviced Components). In late FY 2012, FEMA implemented a more rigorous approach to recovery auditing. As a result, FEMA's recovery audit activities are taking longer and are expected to produce improved results. The additional services related to the alternative approach were not available from the recovery audit vendor until late in the fiscal year. The objective of this alternative activity is to determine if the expanded scope produces a more cost-beneficial result for FEMA and the Department.

The U.S. Coast Guard followed up on its telecommunications payments targeted recovery audit activities performed in FY 2011. An in-depth review of claims submitted to telecommunications vendors performed in early FY 2012 revealed that additional scrutiny was necessary to present fully supportable and recoverable claims. As a result, the U.S. Coast Guard rescinded the initial claims, collaboratively worked with the recovery audit vendor to provide the necessary claim information, and re-established updated claims to the telecommunications vendors. The recovery audit vendor has begun, but not yet completed, recovery audit work over FY 2010 and FY 2011 general payments for the U.S. Coast Guard and its cross-serviced Components.

The U.S. Secret Service entered FY 2012 intending to complete a recovery audit over FY 2010 and FY 2011 payments (stated in the FY 2011 Annual Financial Report). After full consideration of the security restrictions, which necessitate that all recovery audit work be performed on-site, the relatively small size of the U.S. Secret Service, and vendor feedback; the U.S. Secret Service performed a cost analysis and determined that a general recovery audit would not be cost effective at this time. FLETC also updated their cost analysis and determined that a general recovery audit would not be cost effective at this time.

As reported in the FY 2011 Annual Financial Report, the U.S. Coast Guard hired a recovery audit vendor in FY 2011 to perform a targeted, in-depth examination of telecommunications invoices. This examination of 14,000 telecommunications invoices from FY 2005 through FY 2010 initially identified errors totaling $4,144,859, of which $64,460 was recovered, and $4,080,399 underwent collection. All of these improper payments were overpayments. In FY 2012, these claims were re-examined and rescinded after some of the initial claims were challenged by the telecommunications providers. Upon further examination, and support, the U.S. Coast Guard re-established $1,495,732 in claims. An additional claim of $118,457 is pending, and $9,045 in third–party overcharges was recovered.

The low recoupment rate of these payment errors reflects: (1) the fact that this was the U.S. Coast Guard's initial targeted recovery audit of telecommunications payments, (2) the complexity of the invoices examined, (3) the need to centralize the collection of the overpayments within a decentralized procurement activity, and (4) the need for due diligence in the validation of the correctness of potential claims.

Identified payment errors for telecommunications invoices include: (1) international and domestic rate charges in excess of published rates, (2) plan errors due to pricing not following requested General Services Administration (GSA) discounted plan, (3) inconsistent rate charges for the same service in the same geographic region, (4) charges for federal and state taxes, (5) discovery of unauthorized third–party billings (i.e., cramming), (6) unexplained increases in land line charges, and (7) zero usage charges.

Telecommunications invoices were selected for a targeted recovery audit due to: (1) inconsistent billing practices and invoice format between carriers; (2) pricing complexities including numerous pricing elements across multiple pages; (3) charges listed in lump sum amounts with discounts generally applied making it difficult to establish true price points; (4) multiple telecommunications companies and services billing on a single invoice; and (5) inability of staff to perform consistent in-depth reviews of invoices due to technical proficiency and monthly payment volume.

Immediate benefits from this targeted recovery audit activity included the cancelling of long distance services from accounts where it was not required, producing an immediate cost savings of $102,335 and the identification of numerous circuits, telephone lines, and data pipes no longer in use. Estimated future cost savings could be in excess of two million dollars. In addition to following up on these items, the U.S. Coast Guard is evaluating procurement policy, acquisition procedures, and payment controls to fully leverage the benefits of this recovery audit contract work. An operations team consisting of specialists in telecommunications, information technology, procurement, financial management, and legal has been assembled to rectify known billing issues, and to develop a corrective action plan to improve systemic process and payment errors ensuring the non-recurrence going forward. The U.S. Coast Guard will apply the lessons learned from these recovery auditing activities to develop automated monitoring controls. Vendor-wide memos will be distributed requesting rate changes for all accounts with non-GSA rates. Internal certifications and continuous training will be provided to the designated account representatives who order telecommunications services. In addition, telecommunications contracts will be modified as appropriate to include language eliminating the use of third–party billings.

In Table 20, which follows, current year (CY) equals FY 2011 disbursements for all Components except DNDO, TSA, and U.S. Coast Guard where CY equates to FY 2010 and FY 2011 disbursements. Prior year (PY) represents FY 2005–FY 2009 for DNDO, TSA, and U.S. Coast Guard; FY 2004–FY 2010 for CBP, ICE, MGMT, NPPD, OHA, S&T, and USCIS; and FY 2009–FY 2010 for FEMA.

Table 20. Payment Recapture Audit Reporting

Comp.	Type of Payment (contract, grant, benefit, loan, or other)	Amount Subject to Review for CY Reporting ($ millions)	Actual Amount Reviewed and Reported (CY) ($ millions)	Amount Identified for Recovery (CY) ($000)	Amount Recovered (CY) ($000)	% of Amount Recovered out of Amount Identified (CY)	Amount Outstanding (CY) ($000)	% of Amount Outstanding out of Amount Identified (CY)	Amount Determined Not to be Collectable (CY) ($000)	% of Amount Determined Not to be Collectable out of Amount Identified (CY)	Amounts Identified for Recovery (PYs) ($000)	Amounts Recovered (PYs) ($000)[1]	Cumulative Amounts Identified for Recovery (CY + PYs) ($000)	Cumulative Amounts Recovered (CY + PYs) ($000)	Cumulative Amounts Outstanding (CY + PYs) ($000)	Cumulative Amounts Determined Not to be Collectable (CY + PYs) ($000)
CBP	contract	$2,088	$2,088	$13	$8	62%	$5	38%	$0	0%	$250	$246	$263	$254	$5	$2
DNDO[1]	contract	$320	$0	$0	$0	n/a	$0	0%	$0	n/a	$1	$1	$1	$1	$0	$0
FEMA[2]	contract	$1,257	$0	$0	$0	n/a	$0	0%	$0	n/a	$181	$0	$181	$0	$3	$178
ICE	contract	$1,978	$1,978	$1	$1	100%	$0	100%	$0	0%	$1,755	$1,622	$1,756	$1,623	$9	$124
MGMT[3]	contract	$529	$529	$0	$0	n/a	$0	0%	$0	n/a	$210	$210	$210	$210	$0	$0
NPPD[3]	contract	$1,372	$1,372	$2	$2	100%	$0	0%	$0	0%	$216	$216	$216	$216	$0	$0
OHA[3]	contract	$47	$47	$0	$0	n/a	$0	0%	$0	n/a	$0	$0	$0	$0	$0	$0
S&T[3]	contract	$468	$468	$0	$0	n/a	$0	0%	$0	n/a	$55	$55	$55	$55	$0	$0
TSA[1]	contract	$4,424	$0	$0	$0	n/a	$0	0%	$0	n/a	$722	$722	$722	$722	$0	$0
USCG[1]	contract	$5,865	$0	$0	$0	n/a	$0	0%	$0	0%	$4,252	$165	$4,252	$165	$1,630	$2,457
USCIS[3]	contract	$800	$800	$0	$0	n/a	$0	0%	$0	n/a	$904	$892	$904	$892	$3	$9
DHS Totals		**$19,148**	**$7,282**	**$16**	**$11**	**69%**	**$5**	**31%**	**$0**	**0%**	**$8,546**	**$4,129**	**$8,560**	**$4,138**	**$1,650**	**$2,772**

Note 1. DNDO and TSA are cross-serviced by the U.S. Coast Guard. The amount subject to review for CY reporting for DNDO, TSA, and the U.S. Coast Guard cover FY 2010 and FY 2011 disbursements. The individual year total disbursement figures are: for DNDO - $159 million in FY 2011 and $161 million in FY 2010; for TSA - $2,274 million in FY 2011 and $2,150 million in FY 2010; and for the U.S. Coast Guard - $3,045 million in FY 2011 and $2,820 million in FY 2010. Recovery audit activities are underway at all three Components.

Note 2. The recovery audit activities at FEMA are using some new techniques which make it hard to estimate a percent completed. Consequently, the actual amount reviewed and reported CY for FEMA is listed as $0.

Note 3. MGMT, NPPD, OHA, S&T, and USCIS are cross-serviced by ICE.

Note 4. The DHS Totals do not list FLETC and the U.S. Secret Service as these Components completed cost analysis which determined that recovery audit work would not be cost effective at this time.

Table 21. Payment Recapture Audit Targets

Component	Type of Payment (contract, grant, benefit, loan, or other)	CY Amount Identified ($000)	CY Amount Recovered ($000)	CY Recovery Rate (Amount Recovered / Amount Identified)	CY +1 Recovery Rate Target	CY + 2 Recovery Rate Target	CY + 3 Recovery Rate Target
CBP	Contract	$13	$8	62%	100%	100%	100%
ICE	Contract	$1	$1	100%	100%	100%	100%
NPPD	Contract	$2	$2	100%	100%	100%	100%
DHS Totals		**$16**	**$11**	**69%**			

Table 22. Aging of Outstanding Overpayments

Component	Type of Payment (contract, grant, benefit, loan, or other)	CY Amount Outstanding (0 6 months) ($000)	CY Amount Outstanding (6 months to 1 year) ($000)	CY Amount Outstanding (over 1 year) ($000)
CBP	Contract	$5	$0	$0
DHS Totals		**$5**	**$0**	**$0**

Table 23. Disposition of Recaptured Funds

Component	Type of Payment (contract, grant, benefit, loan, or other)	Agency Expenses to Administer the Program ($000)	Payment Recapture Auditor Fees ($000)	Financial Management Improvement Activities ($000)	Original Purpose ($000)	Office of Inspector General ($000)	Returned to Treasury ($000)
CBP	Contract	$0	$2	$0	$6	$0	$0
ICE	Contract	$0	$0	$0	$1	$0	$0
NPPD	Contract	$0	$0	$0	$2	$0	$0
DHS Totals		**$0**	**$2**	**$0**	**$9**	**$0**	**$0**

The table that follows shows the importance of the Secretary’s quarterly high-dollar overpayments reporting. These reports began with January-March 2010 reporting.

Table 24. Overpayments Recaptured Outside of Payment Recapture Audits

Source of Recovery	Amount Identified (CY) ($000)	Amount Recovered (CY) ($000)	Amount Identified (PY) ($000)	Amount Recovered (PY) ($000)	Cumulative Amount Identified (CY+PYs) ($000)	Cumulative Amount Recovered (CY+PYs) ($000)
High-Dollar Overpayments Reporting	$7,768	$7,097	$13,818	$13,089	$21,586	$20,186
IPIA High-Risk Program Testing	$0	$0	$1,070	$245	$1,070	$245
Post Payment Reviews	$0	$0	$2,620	$2,582	$2,620	$2,582
DHS Totals	**$7,768**	**$7,097**	**$17,508**	**$15,916**	**$25,276**	**$23,013**

VI. Ensuring Management Accountability

The goals and requirements of IPERA were communicated to all levels of staff throughout the Offices of the Chief Financial Officer and to relevant program office and procurement staff. The Department's Chief Financial Officer and senior staff and FEMA's Chief Financial Officer and senior staff have incorporated improper payment reduction targets in their annual performance plans. FEMA grant program managers have communicated to primary recipients that continued funding is contingent upon supporting the Department's improper payments efforts.

Managers are responsible for completing internal control work on payment processing as part of the Department's OMB Circular A-123 effort.

Management's improper payments efforts at all Federal Agencies are subject to an annual compliance review by the Agency's Office of Inspector General. In March 2012, the DHS Office of Inspector General issued *Department of Homeland Security's Compliance with the Improper Payments Elimination and Recovery Act of 2010* (OIG-12-48). This report noted two corrections that need to be included in this report.

The first correction is to Table 17 Payment Recapture Audit Reporting (page 208 of the FY 2011 DHS Annual Financial Report). The amount subject to review for current year reporting and the actual amount reviewed and reported had incorrect payment population figures for ICE and NPPD due to the counting of $813 million of Federal Protective Services' payments under ICE instead of the correct NPPD. The reported payment population for ICE was listed as $2,837 million when $2,024 million was correct. The reported payment population for NPPD was listed as $553 million when $1,366 million was correct. The reporting for this year includes Federal Protective Services' payments under NPPD.

The second correction involved $85 million of payments for CBP's Border Security Fencing Program that CBP mistook as adjustments. These payments were tested after the publication of the FY 2011 DHS Annual Financial Report. A total of four improper payments totaling $16,514 were identified (an error rate consistent with payments tested and reported in the Annual Financial Report). The payment population for FY 2010 payments for CBP's Border Security Fencing Program should therefore have been listed as $336 million rather than $251 million. This correction is noted in Table 14.

VII. Agency Information Systems and Other Infrastructure

The Department's agency information systems efforts are discussed under the section related to the *Federal Financial Management Improvement Act*.

VIII. Statutory or Regulatory Barriers

None.

IX. Overall Agency Efforts

The Department is striving to leverage lessons learned from the battle to reduce and recover improper payments to other operational areas. At FEMA, for example, improper payment corrective actions support improvements to grants management and better coordination between recipients and sub-recipients. At NPPD, close cooperation between finance and procurement shops will help the Department address contract management administration weakness that does not directly lead to improper payments but raises risks. At U.S. Coast Guard, an audit of telecommunications bills supports the strengthening of acquisition practices and the identification of cost savings.

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 0.001 percent and 0.005 percent for the period of October 2011 through September 2012, with an annual average of 0.003 percent (Note: MTS statistics are reported with at least a six week lag).

Debt Collection Improvement Act (DCIA)

In compliance with the *Debt Collection Improvement Act of 1996* (DCIA), DHS manages its debt collection activities under the DHS DCIA regulation. The regulation is implemented under DHS's 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.

FY 2011 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 2011, 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 is responsible for collecting a variety of user fees related to customs duties, inspections, and immigration. These fees include—

1. Agriculture Quarantine and Inspection
2. Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA)

3. Immigration Enforcement Fines
4. Immigration
5. Land Border Inspection
6. Electronic System for Travel Authorization
7. Harbor Maintenance
8. Merchandise Processing
9. Puerto Rico Trust Fund
10. Small Airports
11. U.S. Virgin Islands
12. Miscellaneous

During FY 2011, CBP collected approximately $4.5 billion in user fees.

Federal Emergency Management Agency (FEMA) **–** FEMA is responsible for collecting fees related to the Radiological Emergency Preparedness Program and the National Flood Insurance Fund. During FY 2011, FEMA collected approximately $3.2 billion in user fees.

U.S. Immigration and Customs Enforcement (ICE) **–** ICE is responsible for collecting a variety of user fees related to immigration. These fees include—

- Immigration Inspection
- Breached Bond Detention Fund
- Student & Exchange Visitors Program
- I-246 Stay of Deportation or Removal

During FY 2011, ICE collected approximately $172.1 million in user fees.

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 fees include—

- Passenger Civil Aviation Security Service (September 11th Security)
- Aviation Security Infrastructure (Air Carrier)
- Air Cargo Security Requirements (Indirect Air Cargo)
- Ronald Reagan Washington National Airport: Enhanced Security Procedures for Certain Operations (GA@DCA)
- Other Security Threat Assessment
- Secure Identification Display Area
- Transportation Worker Identification Credential
- Protection of Sensitive Security Information
- Alien Foreign Student Pilot
- Security Threat Assessments for Hazmat Drivers

During FY 2011, TSA collected approximately $2.3 billion in user fees.

U.S. Coast Guard – U.S. Coast Guard is responsible for collecting a variety of user fees related to maritime safety and security. These fees include—

- Commercial Vessel Documentation
- Recreational Vessel Documentation
- Merchant Mariner Licensing & Documentation
- Commercial Vessel Inspection
- Overseas Vessel Inspection

During FY 2011, U.S. Coast Guard collected approximately $23.5 million in user fees.

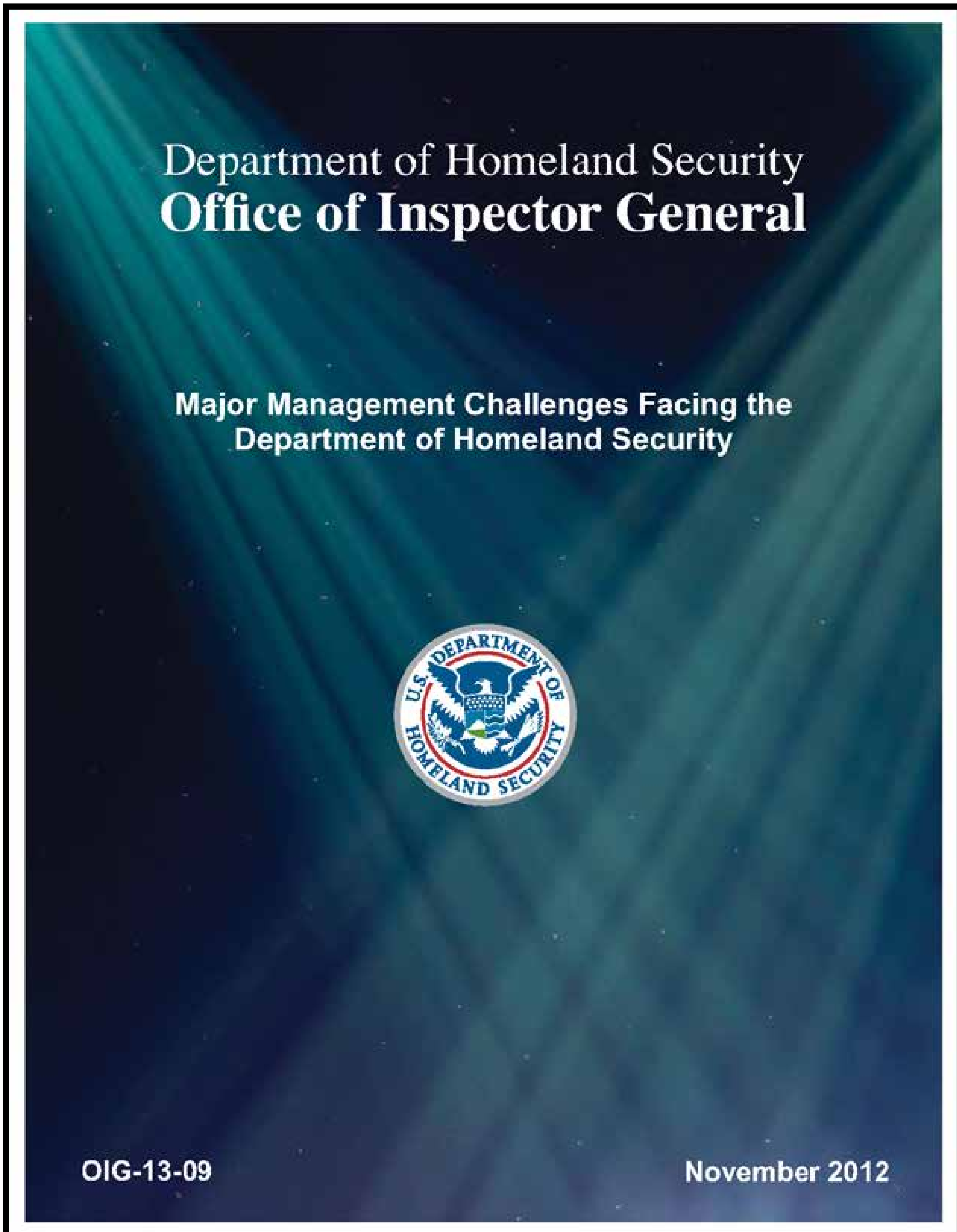
U.S. Citizenship and Immigration Services (USCIS) – USCIS is responsible for collecting a variety of user fees related to the immigration and naturalization process. These fees include—

- Fraud Prevention and Detection
- H-1B Non-Immigrant Petitioner
- Immigration Examinations

During FY 2011, USCIS collected approximately $3.0 billion in user fees.

The OCFO conducted the above DHS user fee assessment based on 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 Facing the Department of Homeland Security



OFFICE OF INSPECTOR GENERAL
Department of Homeland Security

Major Management Challenges Facing the Department of Homeland Security

The attached report presents our fiscal year 2012 assessment of the major management challenges facing the Department. As required by the *Reports Consolidation Act of 2000* (Public Law 106-531), we update our assessment of management challenges annually. As stipulated, the report summarizes what the Inspector General considers to be the most serious management and performance challenges facing the agency and briefly assesses the agency's progress in addressing those challenges.

As in previous years, the Department's major challenges are reported in broad areas. For better understanding of how these areas relate to the overall operations of the organization, they have been categorized into two main themes: Mission Areas and Accountability Issues.

Mission Areas

- Intelligence
- Transportation Security
- Border Security
- Infrastructure Protection
- Disaster Preparedness and Response

Accountability Issues

- Acquisition Management
- Financial Management
- IT Management
- Grants Management
- Employee Accountability and Integrity
- Cyber Security

OFFICE OF INSPECTOR GENERAL
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Mission Areas

Securing the Nation against the entire range of threats that we face in an evolving landscape is a difficult task. The vision and purpose of the Department of Homeland Security (DHS) is to ensure a homeland that is safe, secure, and resilient against terrorism and other hazards where American interests, aspirations, and way of life can thrive.[1] At its establishment in 2003, the Department faced the challenge of building a cohesive, effective, and efficient Department from 22 disparate agencies, while simultaneously performing the mission for which it was created. As a whole, DHS has made progress in coalescing into a more cohesive organization to address its key mission areas to secure our Nation's borders, increase our readiness, build capacity in the face of a terrorist threat or a natural disaster, and enhance security in our transportation systems and trade operations.

Intelligence

Overview

Intelligence is vital to DHS' framework for securing the Nation. The development, blending, analysis, and sharing of intelligence with appropriate Federal, State, local, tribal, and territorial officials, as well as with private sector partners, must be timely and well coordinated to effectively predict terrorist acts.

Department intelligence programs, projects, activities, and personnel, including the intelligence elements of seven key DHS components, as well as the Office of Intelligence and Analysis (I&A), make up the DHS Intelligence Enterprise. I&A is charged with ensuring that intelligence from the DHS Intelligence Enterprise is analyzed, fused, and coordinated to support the full range of DHS missions and functions, as well as the Department's external partners. The components, most of which predate the creation of the Department, have intelligence elements that provide support tailored to their specialized functions and contribute information and expertise in support of the Department's broader mission set.[2]

[1] http://www.dhs.gov/our-mission

[2] Statement for the Record of Caryn A. Wagner, Under Secretary and Chief Intelligence Officer, Office of Intelligence and Analysis, before the Subcommittee on Counterterrorism and Intelligence House Committee on Homeland Security, "The DHS Intelligence Enterprise - Past, Present, and Future," June 1, 2011.

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Challenges

Improving and enhancing support to fusion centers remains a challenge for the Department. To promote greater information sharing and collaboration among Federal, State, and local intelligence and law enforcement entities, State and local authorities established fusion centers throughout the country. A fusion center is a collaboration of two or more agencies to receive, gather, analyze, and disseminate information intending to detect, prevent, investigate, and respond to criminal or terrorist activity. The State and Local Program Office (SLPO), within the Office of Intelligence and Analysis, is responsible for coordinating and ensuring departmental support to the National Network of Fusion Centers.

In our fiscal year (FY) 2012 review, *"DHS' Efforts to Coordinate and Enhance Its Support and Information Sharing with Fusion Centers,"* we assessed: (1) whether the SLPO satisfies the intent of DHS' recommitment to the State, Local, and Regional Fusion Center Initiative; (2) whether planned SLPO efforts will ensure coordinated support of DHS and its components to provide needed information and resources to fusion centers; and (3) if any functional or organizational challenges in DHS hinder its successful support of fusion centers.

Accomplishments

DHS indicated that it has taken significant steps to improve the integration and coordination of intelligence products and processes across the Department. An enhanced analytic plan developed by I&A links data from disparate sources to help identify unattributed cyber intrusions threatening Federal and private sector networks. We determined that since July 2009, the SLPO has increased field support to fusion centers, worked to improve fusion center capabilities, and engaged DHS components. Efforts to develop a department-wide fusion center support strategy are ongoing, but improvements are needed to enhance the I&A's field deployments and DHS component support.[3]

[3] DHS-OIG, *DHS' Efforts to Coordinate and Enhance Its Support and Information Sharing with Fusion Centers* (OIG-12-10, November 2011).

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Transportation Security

Overview

The Transportation Security Administration (TSA) is responsible for protecting the transportation system and ensuring the freedom of movement for people and commerce. The Nation's economy depends upon secure, yet efficient transportation security measures. Airport security includes the use of various technologies to screen passengers and their baggage for weapons, explosives, and other prohibited items, as well as to prevent unauthorized access to secured airport areas. As part of its responsibility, TSA is required to assess and test airport security measures on an ongoing basis to ensure compliance with policies and procedures and prevent security breaches.

Challenges

In spite of TSA's efforts, it continues to face challenges in passenger and baggage screening, airport security, the Secure Flight Program, airport badging, passenger air cargo security, training, as well as in providing oversight for the security of all modes of transportation including rail and mass transit.

Aviation

In regard to passenger and baggage screening, the *Aviation and Transportation Security Act* requires TSA to prescribe requirements for screening or inspecting all passengers, goods, and property before entry into secured areas of an airport.[4]

In its review of airport security, DHS OIG conducted covert testing of airport access controls as well as passenger and baggage screening.[5] Although test results are classified, access control and checkpoint screening vulnerabilities were identified at the domestic airports tested. Although Transportation Security Officers (TSO) were ultimately responsible for not fully screening checked baggage, our audit identified additional improvements that TSA can make in the evaluation of new or changed procedures, and improvements in supervision of TSOs that could have mitigated the situation.

In FY 2012, a congressional request led to a review of TSA's policies and practices governing its use of full-body x-ray screening equipment (general-use backscatter units)

[4] Public Law 107-71, November 19, 2001.
[5] DHS-OIG, *(U) Covert Testing of Access Controls to Secured Airport Areas* (OIG-12-26, January 2012).

for airport security. Congressman Edward J. Markey was concerned about the safety of the doses of radiation emitted by the units. TSA began deploying general-use backscatter units in March 2010, with 247 units operating in 39 commercial airports around the country at the time of publication of the FY 2012 backscatter unit report. In the United States, an x-ray system is considered compliant with requirements for general-purpose security screening of humans if it complies with standards of the American National Standards Institute.

Independent radiation studies conducted by professional organizations concluded that radiation levels emitted from backscatter units were below the acceptable limits. TSA entered into interagency agreements for additional radiation safety surveys and dosimetry measurement of the dose of radiation emitted by a radiation-generating device monitoring studies to document radiation doses to agency personnel and individuals being screened. All studies concluded that the level of radiation emitted was below acceptable limits.

The Secure Flight Program was implemented in October 2008 in an effort to bolster the TSA security directives established after the terrorist attacks of September 11, 2001. Under this program, TSA receives specific passenger and non-traveler data from the airlines and matches it against the government's watch list. TSA then transmits a boarding pass, with results back to the aircraft operator, so a boarding pass can be issued.

TSA relies on designated airport operator employees to process the badging applications. A July 2011 audit report showed that individuals who pose a threat may obtain airport badges and gain access to secured airport areas.[6] We analyzed vetting data from airport badging offices and identified badge holder records with omissions or inaccuracies in security threat assessment status, birthdates, and birthplaces. These problems existed because TSA did not: (1) ensure that airport operators had quality assurance procedures for the badging application process; (2) ensure that airport operators provided training and tools to designated badge office employees; and (3) require Transportation Security Inspectors to verify the airport data during their reviews.

Through passenger air cargo security, approximately 7.6 million pounds of cargo are transported on passenger planes each day. The Code of Federal Regulations (49 CFR) requires 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. Through covert testing we identified vulnerabilities in cargo screening procedures employed by

[6] DHS-OIG, *TSA's Oversight of the Airport Badging Process Needs Improvement (Redacted)* (OIG-11-95, July 2011).

air carriers and cargo screening facilities to detect and prevent explosives from being shipped in air cargo transported on passenger aircraft.[7] Although TSA has taken steps to address air cargo security vulnerabilities, the agency did not have assurance that cargo screening methods always detected and prevented explosives from being shipped in air cargo transported on passenger aircraft.

We conducted a review to determine how TSA identifies, reports, tracks and mitigates security breaches at airports nationwide.[8] We determined that TSA does not have guidance for and oversight of the reporting process. This need for guidance resulted in the agency missing opportunities to strengthen airport security. TSA agreed with the recommendations in our report, and as a first step, is developing a standard definition of a security breach. In addition, TSA is also updating its airport performance metrics to track security breaches and airport checkpoint closures at the national, regional, and local levels.

Rail and Mass Transit

Passenger rail stations are attractive terrorist targets because of the large number of people in a concentrated area. Amtrak provides passenger rail service for nearly 27 million passengers every year, using approximately 22,000 miles of rail in 46 states and the District of Columbia. Although grant recipients, such as Amtrak, transit agencies, and State and local authorities, coordinated risk mitigation projects at high-risk rail stations, Amtrak did not always use grant funds to implement mitigation strategies at the highest risk rail stations, in terms of casualties and economic impact.[9] Amtrak did not mitigate critical vulnerabilities reported in risk assessments. These vulnerabilities remain because TSA: (1) did not require Amtrak to develop a corrective action plan addressing its highest ranked vulnerabilities; (2) approved Amtrak investment justifications for lower risk vulnerabilities; and (3) did not document roles and responsibilities for the grant award process.

Accomplishments

TSA has taken action as recommended by our audit and inspection work. For instance, the agency began developing detailed utilization reports to ensure that the AIT units deployed are being used efficiently. TSA has also developed more training for TSOs, which should help their performance.

[7] DHS-OIG, *Evaluation of Screening of Air Cargo Transported on Passenger Aircraft* (OIG-10-119, September 2010).
[8] DHS-OIG, *Transportation Security Administration's Efforts To Identify and Track Security Breaches at Our Nation's Airports* (OIG-12-80, May 2012).
[9] GAO, *Department of Homeland Security: Oversight and Coordination of Research and Development Should Be Strengthened* (GAO-12-837, September 2012).

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Since the Secure Flight Program assumed responsibility for passenger prescreening, TSA has provided more consistent passenger prescreening. The program has a defined system and processes to conduct watch list matching. To ensure that aircraft operators follow established procedures, the Secure Flight Program monitors records and uses its discretion to forward issues for compliance investigation. The program also includes privacy safeguards to protect passenger personal data and sensitive watch list records and information. The Secure Flight Program focuses on addressing emerging threats through multiple initiatives.

TSA issued a management directive giving the Operational and Technical Training Division responsibility for overall management of the analysis, design, development, and implementation of TSO training programs.

To identify and track security breaches better, TSA is refining the definition of what constitutes such breaches and implementing a tool to provide more oversight in this area. In addition, TSA is also updating its airport performance metrics to track security breaches and airport checkpoint closures at the national, regional, and local levels.

TSA continues to work on improving operations, keeping us informed of the progress made in response to our work.

Border Security

Overview

Securing the Nation's borders from illegal entry of aliens and contraband, including terrorists and weapons of mass destruction, while welcoming all legitimate travelers and trade, continues to be a major challenge. DHS apprehends hundreds of thousands of people and seizes large volumes of illicit cargo entering the country illegally each year. United States Customs and Border Protection (CBP) is responsible for securing the Nation's borders at and between the ports of entry. Within CBP, the mission of the Office of Border Patrol helps secure 8,607 miles of international borders.

Challenges

Although CBP has made progress in securing our borders, it continues to face challenges in the areas of the Free and Secure Trade program (FAST), bonded facilities, unmanned aircraft systems, and U.S. Visitor and Immigrant Status Indicator Technology (US-VISIT).

FAST is a commercial clearance program for pre-enrolled commercial truck drivers entering the United States from Canada and Mexico designed to facilitate the free flow

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of trade. FAST allows for expedited processing of enrolled trusted travelers, including FAST drivers who fulfill certain eligibility requirements. However, FAST's eligibility processes do not ensure that only eligible drivers remain in the program. CBP is hampered in ensuring that Mexican citizens and residents in the program are low risk because Mexico does not share Southern border FAST information with the United States to assist in vetting and monitoring drivers' eligibility. Although renewal is required every 5 years, ineligible drivers may be actively enrolled in the program, exposing the agency to increased risk of compromised border security.[10]

CBP is responsible for cargo security, including the accountability of the transfer to and storage of cargo at privately owned and operated bonded facilities. Based on audited background checks at 41 bonded facilities at five seaports, CBP did not have effective management controls to ensure that bonded facility employees do not pose a security risk at these facilities. Additionally, CBP neither issued national requirements for background checks on employees of bonded facilities nor ensured that port directors had management controls over background checks at these facilities. As a result, background checks were inconsistent and often ineffective. This may put bonded facilities at greater risk for terrorist exploitation, smuggling, and internal conspiracies. CBP and United States Immigration and Customs Enforcement's (ICE's) Joint Fraud Investigative Strike Teams conducted unannounced investigations of bonded facilities resulting in the detention of more than 350 undocumented workers and workers with outstanding arrest warrants.[11]

Unmanned aircraft systems help secure the Nation's borders from illegal entry of aliens, including terrorists, and contraband, including weapons of mass destruction. These long-endurance, medium-altitude remotely piloted aircrafts provide reconnaissance, surveillance, targeting, and acquisition capabilities. CBP did not adequately plan resources needed to support its current unmanned aircraft inventory. Although CBP developed plans to use the unmanned aircraft's capabilities, its Concept of Operations planning document did not adequately address processes: (1) to ensure that required operational equipment was at each launch and recovery site; (2) for stakeholders to submit unmanned aircraft mission requests; (3) to determine how mission requests were prioritized; and (4) to be reimbursed for missions flown for stakeholders. CBP risks having substantially invested in a program that limits resources and its ability to achieve Office of Air and Marine mission goals.[12]

[10] DHS-OIG, *Free and Secure Trade Program-Continued Driver Eligibility* (OIG-12-84, May 2012).
[11] DHS-OIG, *CBP's Management Controls Over Bonded Facilities* (OIG-12-25, January 2012).
12 DHS-OIG, *CBP's Use of Unmanned Aircraft Systems in the Nation's Border Security* (OIG-12-85, May 2012).

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CBP faces challenges in systematically identifying and flagging potential use of fraudulent biographic identities in its US-VISIT system.[13] An analysis of data showed 825,000 instances in which the same fingerprints were associated with different biographic data. These differences ranged from misspelled names and transposed birth dates to completely different names and birth dates. In some cases individuals may have supplied different names and dates of birth at ports of entry; in others individuals may have used different biographic identities at a port of entry after they had applied for a visa under a different name or been identified as a recidivist alien. Inaccurate and inconsistent information reduces the accuracy of US-VISIT data monitoring and impedes the ability to verify that individuals attempting to enter the United States are providing their true names and dates of birth.

Accomplishments

CBP indicated it continues to develop a streamlined and cost-effective process to be used by port offices when conducting background vetting of bonded facility applicants, officers and principals. This process will add significant oversight, tracking and reporting capabilities to the background vetting process and will allow CBP to determine the criminal history of any current or prospective bonded facility applicant. According to CBP officials, US-VISIT has programs to identify individuals who may have overstayed the condition of their visas and manually analyzes entry and exit data to associate fingerprints with biographic information. Stronger oversight of this program will keep better track of individuals entering the United States.

Infrastructure Protection

Overview

Protecting the Nation's critical physical and cyber infrastructure is crucial to the functioning of the American economy and our way of life. Critical infrastructure provides the means and mechanisms by which critical services are delivered to the American people; the avenues that enable people, goods, capital, and information to move across the country. The Department leads the effort, in collaboration with Federal, State, local, regional, and private sector partners, to enhance the protection and resilience of critical infrastructure. Ensuring the security of our critical infrastructure and key resources remains a great challenge.

[13] DHS-OIG, *US-VISIT Faces Challenges in Identifying and Reporting Multiple Biographic Identities* (OIG-12-111, August 2012).

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Challenges

Catastrophic failures in critical structures such as dams could affect more than 100,000 people and have economic consequences surpassing $10 billion. Yet, the Department could not ensure that risk assessments of dams were conducted or that security risks were identified and mitigated.[14] Specifically, the Department did not review all critical dam risk assessments conducted by other departments and agencies, did not conduct security reviews at 55 percent of critical dams, and did not ensure completion of corrective actions to mitigate risk were completed. Cooperation and collaboration with its security partners is essential to DHS' success in assessing risk and consequently, protecting critical infrastructure such as dams. The *National Infrastructure Protection Plan* prescribes a voluntary partnership between the government and the private sector to manage such risks. The Department does not have the authority to require dam owners to undergo security reviews or implement corrective actions.

DHS' Federal Protective Service (FPS) is responsible for the safety and security of more than 9,000 Federal facilities; the service employs 1,225 Federal staff members and uses 15,000 contracted security guards to carry out its mission. In August 2008, FPS funded a $21 million, 7-year contract to develop and maintain the Risk Assessment and Management Program (RAMP). RAMP was intended to assess and analyze risks to Federal facilities and recommend and track countermeasures, as well as manage post inspections, guard contracts, and guard certification compliance. However, in May 2011, FPS ceased development of RAMP because it was not cost effective and had not met its original goals. In July 2011, the Government Accountability Office (GAO) reported that RAMP's actual costs were more than three times the original $21 million development contract amount, the program was behind schedule, and the system could not be used as intended to complete security assessments or guard inspections. The contract was extended for 1 year to operate and maintain RAMP. Although FPS has stopped its development, the system is still being used to manage its guard force, and it contains historical data that FPS wants to retain and maintain. As of August 2012, FPS had determined its data needs and was working with the RAMP vendor to preserve historical documents and guard-related data.[15] DHS has completed data capture and decommissioned RAMP.

Additionally, according to an August 2012 GAO report, FPS has not effectively led the government facilities sector.[16] It has not obtained data on facilities or coordinated or assessed risk, all of which are key to risk management and safeguarding of critical

[14] DHS-OIG, *DHS Risk Assessment Efforts in the Dams Sector* (OIG-11-110, September 2011).
[15] DHS-OIG, *Federal Protective Service's Exercise of a Contract Option for the Risk Assessment and Management Program* (OIG-12-67, August 2012).
[16] GAO, *Critical Infrastructure: DHS Needs to Refocus its Efforts to Lead the Government Facilities Sector* (GAO-12-852, August 2012).

facilities. Furthermore, FPS has not built effective partnerships across different levels of government, needs a dedicated funding line for its activities in this area, and does not have an action plan for protecting facilities.

Accomplishments

To improve protection of the Dams Sector, DHS is nearing completion of its OIG-recommended assessment of the appropriateness of a legislative proposal to establish regulatory authority for the Dams Sector assets similar to that in the Chemical Sector. At the same time, the Department continues to make strides under the voluntary framework. This includes 100 percent completion of Infrastructure Protection assessments on privately-owned assets included on the FY 2011 Dams Sector critical assets list.

In regard to RAMP, DHS indicated it has minimized FPS costs and saved the government at least $13.2 million by stopping its development and paying the contractor only to operate and maintain the program. FPS also leveraged existing technology to develop the Modified Infrastructure Survey Tool nationwide. During the development, FPS continuously monitored the security posture of Federal facilities by responding to incidents, testing countermeasures, and conducting guard post inspections. Additionally, FPS has taken actions to enhance its coordination with sector-specific agencies for the government facilities sector. These include establishing new relationships with the State, Local, Tribal and Territorial Government Coordinating Council to ensure broader state and local participation in sector coordination procedures.

Disaster and Preparedness Response

Overview

The Federal Emergency Management Agency's (FEMA) task of coordinating emergency support following disasters has become more challenging as the number of events to which it responds has risen each year—from 25 to 70 since 1980. Additionally, FEMA spends an average of $4.3 billion each year in its response efforts. Although the agency has improved its disaster response and recovery, challenges remain.

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Challenges

FEMA faces challenges in determining whether to declare events Federal disasters. FEMA uses preliminary disaster assessments to ascertain the impact and magnitude of damage from disasters and the resulting needs of individuals, businesses, the public sector, and the community. These assessments also help to determine whether events become federally declared disasters. In May 2012, we reported that, in deciding whether to declare an event a Federal disaster, FEMA used an outdated indicator that did not accurately measure the ability of State and local governments' to pay for damages.[17] If FEMA had updated the indicator, many recent disasters might not have met the financial conditions for Federal assistance.

In September 2012, GAO also noted that FEMA needed to improve the criteria it used to assess a jurisdiction's ability to recover from disasters.[18] In addition, GAO determined that FEMA had no specific criteria for assessing requests to raise the Federal share for emergency work to 100 percent. Finally, FEMA's administrative costs frequently exceeded its targets.

In evaluating FEMA's disaster recovery in Louisiana, we determined that only 6.3 percent of Katrina-related Public Assistance projects had been closed in the 72 months since the hurricane made landfall.[19] As of July 12, 2011, FEMA had obligated $10.2 billion in Public Assistance grants to support Louisiana's recovery from Hurricane Katrina. However, projects, especially time critical ones such as Debris Clearance and Emergency Work, were years past the closeout deadlines. FEMA, state officials, and subgrantees said the catastrophic damage was the major cause of delay in completing and closing out the Public Assistance projects. According to some officials, delays were also due to issues with the Federal Government's commitment to reimburse Louisiana for 100 percent of all Public Assistance project costs, FEMA's project procurement process, the agency's Public Assistance decision-making, and Louisiana staff resources. We recommended that FEMA develop project management policies, procedures, and timelines for Public Assistance projects that are 100 percent federally funded, coordinate with Louisiana and local governments to evaluate the status of Public Assistance projects, and expedite project closures.

FEMA must have a trained, effective disaster workforce to carry out its mission. As part of this effort, FEMA has a system to credential, or qualify and certify emergency

[17] DHS-OIG, *Opportunities to Improve FEMA's Public Assistance Preliminary Damage Assessment Process* (OIG-12-79, May 2012).
[18] GAO, *Federal Disaster Assistance: Improved Criteria Needed to Assess a Jurisdiction's Capability to Respond and Recover on Its Own* (GAO-12-838, September 2012).
[19] DHS-OIG, *Efforts to Expedite Disaster Recovery in Louisiana* (OIG-12-30, January 2012).

response providers through experience, training, and demonstrated performance. At the time of our June 2012 audit, however, FEMA had not completely implemented a credentialing program and had not identified an IT system to track the training, development, and deployment of disaster employees.[20] Additionally, the agency did not provide a detailed IT plan, documented costs, project schedule, and capability and/or performance requirements.

Our December 2011 audit report showed that some recipients of FEMA Public Assistance grants did not comply with a requirement to obtain and maintain insurance.[21] We also reported that States and FEMA could improve their monitoring and oversight to ensure recipients satisfy this requirement and do not receive financial aid for damages that are, or should be, covered by insurance. State and local governments are encouraged to obtain insurance to supplement or replace Federal Government assistance, but the Public Assistance program provides a disincentive to carry insurance. Although FEMA has been aware of this issue for more than 10 years, it has been slow to address it.

Providing the most efficient and cost-effective temporary post-disaster housing has been a major challenge for FEMA. The deployment of a large number of such housing after Hurricanes Katrina and Rita proved to be difficult. Later, some homes were found to contain high levels of formaldehyde, which led to health problems for disaster survivors. In the aftermath of these disasters, Congress provided FEMA funds to explore options for mitigating future disaster housing issues, including $400 million for an Alternative Housing Pilot Program and $1.4 million for the Disaster Housing Pilot Project.[22]

In the Alternative Housing Pilot Program, it was determined that the units developed were unlikely to match FEMA's needs for temporary housing. The Disaster Housing Pilot Project tested and evaluated 10 different types of housing units and provided options for more cost-effective, future housing, but FEMA put the project on hold because of inadequate funding. FEMA also terminated efforts to develop temporary housing units without indoor air quality issues, although in 2011, these efforts had resulted in model units with acceptable air quality levels. For future disasters, FEMA decided to house displaced disaster victims exclusively in mobile homes built to Department of Housing and Urban Development standards, which will eliminate many past problems. However, these units will likely cost more, are not suitable for flood plains, and will not fit on most urban home sites. The inability to use urban sites may hinder FEMA's capability to

[20] DHS-OIG, *FEMA's Progress in Implementing Employee Credentials* (OIG-12-89, June 2012).
[21] DHS-OIG, *FEMA's Process for Tracking Public Assistance Insurance Requirements* (OIG-12-18, December 2011).
[22] DHS-OIG, *Future Directions of FEMA's Temporary Housing Assistance Program* (OIG-12-20, December 2011).

respond quickly to disasters because alternative sites are limited, take more time to develop, and are frequently blocked by local communities. These sites are also much more expensive than private sites.

Accomplishments

FEMA continues to work on improving preliminary disaster assessments and recovery operations, keeping us informed of the progress made in response to our work. The Disaster Housing Pilot Project was created to evaluate innovative housing options by using them as student housing at a FEMA training facility. It is part of the effort to identify and evaluate alternative means of housing disaster survivors as directed by the Post-Katrina Act. Although the results of the evaluations are not yet complete, the project is providing a cost-effective means of identifying and testing alternative housing units.

FEMA is also pursuing data collection tools that will provide enhanced capabilities to perform Preliminary Damage Assessments (PDA) and record information in an efficient and consistent manner. FEMA is assessing the best available options for development of such a tool for PDAs, based on efforts to explore development of such a tool and in light of available technologies. Based on the findings of the assessment, FEMA plans to develop and implement the improved PDA data collection tool in FY13. This will improve PDA data collection, streamline the PDA process through use of an electronic system for data collection and reporting, and enhance the effectiveness of the PDA process.

According to FEMA, as of October 1, 2012, the FEMA Qualification System (FQS) became operational. FQS establishes the system for qualification and certification of the FEMA incident workforce through experience, training, and demonstrated performance. Throughout the year, milestones have been met to implement this critical program along with our other disaster workforce initiatives. While there will be continued development and expansion of the program FQS has been implemented for the entire incident management workforce.

FEMA is implementing other initiatives to improve disaster budgeting and program management once a declaration has been made that will enhance FEMA's ability to manage and budget for expenditures from the Disaster Relief Fund.

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Accountability Issues

As the third largest agency in the Federal Government, DHS is responsible for managing a large workforce, and significant Federal resources. DHS is responsible for an annual budget of more than $59 billion, employs more than 225,000 employees and operates in more than 75 countries. At its establishment in 2003, DHS faced building a cohesive and efficient organization from 22 disparate agencies, while simultaneously performing the critical mission for which it was created. As a whole, DHS has made progress in coalescing into a more effective organization, establishing policies and procedures to set the groundwork for effective stewardship over its resources but challenges remain.

Acquisition Management

Overview

Effective oversight and management of acquisition processes is vital to DHS. At the time of our reporting in 2012, the Department had approximately 160 acquisition programs with estimated life cycle costs of more than $144 billion. DHS' acquisitions were numerous, varied, and complex, including everything from ships, aircraft, and vehicles to real estate, computer technology, and maintenance services.

Challenges

During FY 2012 both OIG and GAO conducted audits of acquisition management, examining individual acquisition programs and the underlying policies and procedures. We identified challenges the Department faces in the Secure Border Initiative. For example, along the southwest border, CBP has spent $1.2 billion to construct physical barriers as part of the Secure Border Initiative. As part of that effort, CBP did not effectively manage the purchase and storage of steel for fence construction, which cost about $310 million. It purchased steel before legally acquiring land or meeting international treaty obligations. In addition, CBP did not provide effective contract oversight, including not paying invoices on time and not reviewing the contractor's selection of a higher-priced subcontractor. As a result of these issues, CBP purchased more steel than needed, incurred additional storage costs, paid interest on late payments, and approved a higher-priced subcontractor, resulting in expenditures of nearly $69 million that could have been put to better use.[23]

A November 2011 GAO review of the subsequent southwest border strategy, the Arizona Border Surveillance Technology Plan, showed that DHS did not document the analysis justifying the specific types, quantities, and deployment locations of border surveillance technologies proposed in the plan.[24] Without documentation DHS was hindered in its ability to verify that processes were followed, identify underlying analyses, assess the validity of the decisions made, and justify the requested funding.

Acquisition and resource management will continue to be a challenge for the United States Coast Guard (USCG) as it strengthens acquisition management capabilities and develops acquisition program baselines for each asset. According to GAO, the approved baselines for 10 of 16 programs did not reflect cost and schedule plans because programs breached the cost or schedule estimates in those baselines, changed in scope, or were not expected to receive funding to execute baselines as planned.[25] According to DHS, during 2012, two USCG program baselines were approved by DHS, two are pending DHS approval, and one is in USCG routing.

Since 2003, under a program to replace its aging HU-25 Falcon fleet, the USCG has taken delivery of 13 Ocean Sentry Maritime Patrol medium-range surveillance aircraft. In most instances, the USCG awarded the Ocean Sentry Maritime Patrol aircraft contracts effectively. However, it could have improved its oversight of the latest contract, awarded in July 2010 to the European Aeronautic Defense and Space Company North America for three aircraft valued at nearly $117 million. For this contract, the USCG was aware of conclusions by the Defense Contract Audit Agency regarding non-chargeable costs and noncompliance with the Federal Acquisition Regulation by the subcontractor, European Aeronautic Defense and Space Company/Construcciones Aeronáuticas Sociedad Anónima. The USCG was aware of the conclusions, and could have conducted additional follow up to ensure that the subcontractor had implemented recommendations made by the Defense Contract Audit Agency. The USCG also did not obtain sufficient support to ensure it excluded non-chargeable costs when awarding the latest contract.[26]

The Department continues to face challenges in integrating the 22 disparate legacy agencies and these challenges have a direct affect on acquisition management

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[23] DHS-OIG, *U.S. Customs and Border Protection's Management of the Purchase and Storage of Steel in Support of the Secure Border Initiative* (OIG-12-05, November 2011).
[24] GAO-OIG, *Portfolio Management Approach Needed to Improve Major Acquisition Outcomes*, (GAO-12-918, September 2012).
[25] GAO, *More Information on Plans and Costs Is Needed before Proceeding* (GAO-12-22, November 2011).
[26] DHS-OIG, *U.S. Coast Guard's Maritime Patrol Aircraft* (OIG-12-73, April 2012).

decisions. According to a September 2012 GAO report, DHS acquisition policy does not fully reflect several key portfolio management practices, such as allocating resources strategically, and DHS has not yet re-established an oversight board to manage its investment portfolio across the Department.[27] For example, there have been numerous efforts to find efficiencies between CBP's and USCG's aviation fleets. The Secretary's FY 2013 budget emphasized consolidating and streamlining systems and operations to ensure cost savings. In a March 2012 hearing, the Secretary highlighted efforts to increase the effectiveness of DHS' aviation assets through increased coordination and collaboration. In 2010, CBP and the USCG signed a joint strategy to unify their aviation management information systems. However, as of July 2012, CBP planned to acquire a new, separate IT system for its aircraft, which would continue past practices of obtaining disparate systems that did not share information with other components, including the USCG. We recommended that CBP terminate this planned acquisition and transition its aviation logistics and maintenance tracking to the USCG's system, in accordance with the Secretary's efficiency initiatives and the joint strategy. By transitioning to the USCG's system, CBP could improve the effectiveness of aviation management information tracking and save more than $7 million.[28]

Accomplishments

According to DHS, it has made progress in improving program governance, increasing insight into program performance, and building acquisition and program management capabilities. DHS has implemented requirements for tiered acquisition program reviews intended to increase its ability to identify and mitigate program risk. The Department has also implemented a Decision Support Tool to provide visibility into program health and has established Centers of Excellence to provide guidance.

In August, 2012, we reported that DHS was progressing toward the implementation of an information technology infrastructure at the St. Elizabeth's Campus in Washington, DC.[29] Specifically, DHS partnered with the General Services Administration to use its interagency information technology contracting vehicles. The General Services Administration also awarded a task order on behalf of DHS to acquire information technology resources for the Technology Integration Program.

The Department has created an Acquisition Workforce Development initiative to improve its acquisition workforce. This initiative includes expanding training opportunities and offering certification programs in Cost Estimating, Program Financial

[27] GAO, *DHS Requires More Disciplined Investment Management to Help Meet Mission Needs* (GAO-12-833, September 2012).
[28] DHS-OIG, *CBP Acquisition of Aviation Management Tracking System* (OIG-12-104, August 2012).
[29] DHS-OIG, *Adherence to Acquisition Management Policies Will Help Reduce Risks to the Technology Integration Program*, (OIG-12-107, August 2012).

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Management, Life Cycle Logistics, and Test and Evaluation and Systems Engineering. When the outcomes of this initiative are achieved the Department's acquisition workforce will be ready to acquire and sustain the systems and services necessary to secure the homeland, while ensuring that the Department and taxpayers received the best value for the expenditure of public resources.

Financial Management

Overview

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

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

Challenges

Managerial Cost Accounting

The Department does not have the ability to provide timely cost information by major program, and by strategic and performance goals. The Department's financial management systems do not allow for the accumulation of costs, at the consolidated level, by major program, nor allow for the accumulation of costs by responsibility segments directly aligned with the major goals and outputs described in each entity's strategic and performance plan. Further, the Department needs to develop a plan to implement managerial cost accounting, including necessary information systems functionality. Currently, the Department must use manual data calls to collect cost information from the various components and compile consolidated data.

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OIG conducted several audits during FY 2012 and identified a number of components that did not have the ability to provide various cost data when requested. For example:

- During the audit of TSA's Aviation Channeling Service Provider program (OIG 12-132-AUD-TSA) we learned that TSA did not track and report all project costs related to the program. According to TSA program officials, it was impossible to provide exact costs because the expenditures were not tracked in detail.
- During the audit examining CBP's acquisition and conversion of H-60 helicopters (OIG 12-102-AUD-CBP), CBP officials received high-level cost information from the U.S. Army, but it did not include the detail necessary to adequately oversee the CBP H-60 programs. For example, the Army conducted approximately 15,000 tests on CBP H-60 components, but CBP could not identify the tests that were completed or the specific costs. In addition, for each CBP H-60 helicopter, financial data from three sources listed a different total cost for each helicopter.
- During the audit of CBP's use of radiation portal monitors at seaports (OIG 12-033-AUD-CBP), we found instances in which the acquisition values for the monitors were incorrect and could not be supported.

Anti-Deficiency Act Violations

The Department continues to have challenges in complying with the Anti-Deficiency Act (ADA). As of September 30, 2012, the Department and its components reported five potential ADA violations in various stages of review, including one potential ADA violation identified in FY 2012, which the Department is currently investigating. The four other ADA violations involve: (1) expenses incurred before funds were committed or obligated; (2) pooled appropriations to fund shared services; (3) a contract awarded before funds had been re-apportioned; and (4) improper execution of the obligation and disbursement of funds to lease passenger vehicles.

Financial Statement Audit

The following five items show the status of DHS' effort to address internal control weaknesses in financial reporting. These were identified as material weaknesses in the FY 2011 independent audit of DHS' consolidated balance sheet and statement of custodial activity. All five material weaknesses remain in FY 2012.

Financial Reporting

Financial reporting presents financial data on an agency's financial position, its operating performance, and its flow of funds for an accounting period.

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In FY 2011 the USCG, USCIS, and TSA contributed to the material weakness in this area. While some findings reported in FY 2011 were corrected, other findings at USCG and TSA remained in FY 2012. Also, in FY 2012, new financial reporting findings were identified at ICE.

As in the previous year, the auditors reported this year that the USCG does not have properly designed, implemented, and effective policies, procedures, processes, and controls surrounding its financial reporting process. The USCG uses three general ledgers, developed over a decade ago. This legacy system has severe functional limitations that contribute to its ability to address systemic internal control weaknesses in financial reporting, strengthen the control environment, and comply with relevant Federal financial system requirements and guidelines.

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

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

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Information Technology Controls and Financial Systems Functionality

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

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

For FY 2012, DHS made some progress in correcting the IT general and application control weaknesses identified in FY 2011. DHS and its components remediated 46 percent of the prior year IT control weaknesses, with CBP, FEMA, and TSA making the most progress in remediation. Although CBP and FEMA made progress in correcting their prior year issues, in FY 2012, the most new issues were noted at these two components. New findings resulted primarily from new IT systems and business processes that came within the scope of the FY 2012 financial statement audit and that were noted at all DHS components.

The auditors noted many cases in which financial system functionality inhibits DHS' ability to implement and maintain internal controls, notably IT application controls supporting financial data processing and reporting. As a result, ongoing financial system functionality limitations are contributing to the Department's challenge to address systemic internal control weaknesses and strengthen the overall control environment.

In FY 2012, five IT control weaknesses remained and presented risks to the confidentiality, integrity, and availability of DHS' financial data: (1) access controls; (2) configuration management; (3) security management; (4) contingency planning; and (5) segregation of duties.

Property, Plant and Equipment

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

During FY 2011, TSA, the USCG, CBP, and the Management Directorate contributed to a departmental material weakness in PP&E. During FY 2012, TSA and Management Directorate substantially completed corrective actions in PP&E accounting processes. In FY 2012, the USCG continued to remediate PP&E process and control deficiencies, specifically those associated with land, buildings and other structures, vessels, small boats, aircraft, and construction in process. However, remediation efforts were not fully completed in FY 2012. The USCG had difficulty establishing its opening PP&E balances and accounting for leases, primarily because of poorly designed policies, procedures, and processes implemented more than a decade ago, combined with ineffective internal controls and IT system functionality difficulties.

As in prior years, CBP has not fully implemented policies and procedures, or does not have sufficient oversight of its adherence to policies and procedures, to ensure that all PP&E transactions are recorded promptly and accurately, or to ensure that all assets are recorded and properly valued in the general ledger. Further in FY 2012, ICE did not have adequate processes and controls in place to identify internal-use software projects that should be considered for capitalization.

Environmental and Other Liabilities

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

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

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Budgetary Accounting

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

The USCG implemented corrective actions plans over various budgetary accounting processes in FY 2012; however, some control deficiencies reported in FY 2011 remain, and new deficiencies were identified. Although FEMA also continued to improve its processes and internal controls over the obligation and monitoring process, some control deficiencies remain.

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

Accomplishments

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

According to DHS' Office of Financial Management, there is improved access to and better quality of financial management information. The Department has implemented business intelligence tools to help organize, store, and analyze data more efficiently. According to the office, the Department can now take information from individual budgets and display it for the enterprise, allowing views of DHS' budget allocation by mission area. Additionally, the Department is developing management tools (Decision Support Tool) to help compile department-wide program cost information. The Decision Support Tool should provide a central dashboard to assess and track the health of acquisition projects, programs, and portfolios by showing key indicators of program health, such as cost, funding, and schedule.

IT Management

Overview

As technology constantly evolves, the protection of the Department's IT infrastructure becomes increasingly more important. The Department's Chief Information Officer (CIO) has taken steps to mature IT management functions, improve IT governance, and integrate IT infrastructure. Specifically, at the Department level, the CIO has increased IT governance oversight and authority by reviewing component IT programs and acquisitions. Although the Department's documented processes were still draft, these steps have enabled the CIO to make strategic recommendations to reduce costs and duplication through activities such as infrastructure integration, as well as data center and network consolidation.

Challenges

Several DHS components continue to face IT management challenges. For example, in a November 2011 audit, we reported that USCIS delayed implementing its transformation program because of changes in the deployment strategy and system requirements that were insufficiently defined prior to selecting the IT system solution.[30] Other challenges, such as the governance structure, further delayed the program. As a result, USCIS continued to rely on paper-based processes to support its mission, which made it difficult for the component to process immigration benefits efficiently, combat identity fraud, and provide other government agencies with information to identify criminals and possible terrorists quickly. USCIS took steps to address some of these challenges by moving to an agile development approach, instead of a "waterfall" process. This change improved program monitoring and governance and increased the focus on staffing issues.

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[30] DHS-OIG, *U.S. Citizenship and Immigration Services' Progress in Transformation* (OIG-12-12, November 2011).

According to a June 2012 audit, CBP needs to address systems availability challenges, due in part to an aging IT infrastructure.[31] Limited interoperability and functionality of the technology infrastructure made it difficult to fully support CBP mission operations. As a result, CBP employees chose to use alternative solutions, which may have hindered CBP's ability to accomplish its mission and ensure officer safety.

DHS has matured key information IT functions, such as portfolio management. However, in May 2012, we reported that recruiting people with the necessary skills to perform certain management functions remains a challenge. Also, DHS needs to improve its budget review process so that the CIO can identify and resolve issues before components finalize their IT investments.[32] In addition, GAO reported in July 2012 that DHS had a vision for its new IT governance process, which included a tiered oversight structure with distinct roles and responsibilities throughout the Department. However, DHS' IT governance policies and procedures were not finalized, which meant less assurance that its new IT governance would consistently support best practices and address previously identified weaknesses in investment management.[33]

CBP needs to improve its compliance with Federal privacy regulations. It also needs to establish an Office of Privacy with appropriate resources and staffing. Although DHS has a directive to ensure compliance with all privacy policies and procedures issued by the Chief Privacy Officer, an April 2012 audit disclosed that CBP made limited progress toward instilling a culture of privacy that protects sensitive personally identifiable information.[34] Without a component-wide approach that minimizes the collection of employee Social Security numbers, privacy incidents involving these numbers will continue to occur.

Accomplishments

The Department has created initiatives to improve IT Program Governance and Information Security. These programs are designed to prioritize programs to meet Department business needs, eliminate duplicate functions and systems, increase program accountability and strengthen internal controls.[35] Progress has been made to meet the goals of these initiatives and once fully achieved, the Department will have increased accountability for its information technology programs.

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[31] DHS-OIG, *CBP Information Technology Management: Strengths and Challenges* (OIG-12-95, June 2012).
[32] DHS-OIG, *DHS Information Technology Management Has Improved, But Challenges Remain* (OIG-12-82, May 2012).
[33] GAO, *DHS Needs to Further Define and Implement Its New Governance Process* (GAO-12-818, July 2012).
[34] DHS-OIG, *U.S. Customs and Border Protection Privacy Stewardship* (OIG-12-78, April 2012).
[35] DHS, *Integrated Strategy for High Risk Management: Implementation and Transformation* (June 2012).

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According to DHS, the CIO has created performance measures to help establish accountability and determine progress and accomplishments in IT Program Governance. For example, one measure is the number of IT segments covered by portfolio governance. Since IT segments represent a subset of the Department's mission and a business portfolio, this measure has resulted in an increase in the number of IT functions that have governance in place. In the beginning of FY 2012, only 5 of 30 IT segments were covered by portfolio governance. By the end of FY 2012, the Office of the CIO achieved its target to attain portfolio governance for 10 of 30 (33 percent) IT segments. By the end of FY 2013, the office will capture an additional 5 segments to reach its goal of 50 percent (15 of 30). By FY 2016, the goal is to have all 30 functional areas with IT governance.

Grants Management

Overview

More than $35 billion in homeland security grants have been provided over the past 10 years to States, territories, local, and tribal governments to enhance capabilities to plan, prepare for, prevent, respond to, and recover from natural disasters, acts of terrorism, and other manmade disasters. In grants management, FEMA is challenged to ensure the grants process is transparent, efficient, and effective. FEMA must also provide oversight to a large number of geographically dispersed grant recipients to ensure Federal funds are used for their intended purposes.

Challenges

FEMA can improve its efforts in strategic planning, performance measurement, oversight, and sustainment, including tracking States' milestones and accomplishments for homeland security grant-funded programs. FEMA needs to improve its strategic management guidance for State Homeland Security Grants. In our most recent *Annual Report to Congress*, we summarized State Homeland Security strategies and identified deficiencies related to measurable goals and objectives. Although current guidance for State Homeland Security strategies encourage revisions every 2 years, such revisions are not required. Additionally, we identified State Homeland Security strategies that do not have goals and objectives that are specific, measurable, achievable, results-oriented, and time-limited. Without a measurable goal or objective, or a process to gather results oriented data, States may not be assured that their preparedness and response capabilities are effective. States are also less capable of determining progress toward goals and objectives when making funding and management decisions.

FEMA has not provided sufficient guidance on establishing metrics and measuring performance. Our audits show that States continue to need the proper guidance and documentation to ensure accuracy or track milestones. Providing guidance on the appropriate metrics and requiring documentation of those metrics would help States understand the effectiveness of each grant program.

FEMA also needs to strengthen its guidance on reporting progress in achieving milestones as part of the States' annual program justifications. We determined that States' milestones for these continuing investment programs could not be compared to those in previous years' applications. Additionally, the status of the previous year milestones was not always included in applications. Because of these weaknesses, FEMA could not determine, from the annual application process, whether a capability had been achieved, what progress had been made, or how much additional funding was needed to complete individually justified programs. Without this information, FEMA could not be assured it made sound investment decisions.

Because of insufficient information on milestones and program accomplishments, FEMA annually awarded Homeland Security Grant Program funds to States for ongoing programs without knowing the accomplishments from prior years' funding or the extent to which additional funds were needed to achieve certain capabilities. Tracking accomplishments and milestones are critical to making prudent management decisions because of the changes that can occur between years or during a grant's period of performance.

FEMA needs to improve its oversight to ensure States are meeting their reporting obligations in a timely manner so that the agency has the information it needs to make program decisions and oversee program achievements. Improved oversight will also ensure that States are complying with Federal regulations on procurements and safeguarding of assets acquired with Federal funds. In our annual audits of the State Homeland Security Program, we repeatedly identified weaknesses in the States' oversight of grant activities. Those weaknesses include inaccuracies and untimely submissions of financial status reports; untimely allocation and obligation of grant funds; and not following Federal procurement, property, and inventory requirements.

Delays in the submission of Financial Status Reports may have hampered FEMA's ability to monitor program expenditures effectively and efficiently. They may also have prevented the States from drawing down funds in a timely manner and ultimately affected the functioning of the program. Delays also prevented the timely delivery of plans, equipment, exercises, and training for first responders.

In our audits in FYs 2011 and 2012, we noticed an emerging trend with issues related to program sustainment. States did not prepare contingency plans addressing potential

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funding shortfalls when DHS grant funding was significantly reduced or eliminated. In an era of growing budget constraints it is important to use resources for projects that can be sustained. FEMA addressed this issue in its FY 2012 grant guidance by focusing on sustainment rather than new projects.

Accomplishments

Although significant issues in grants management remain, progress has been made. In most instances, audited States efficiently and effectively fulfilled grant requirements, distributed grant funds, and ensured available funds were used. The States also continued to use reasonable methodologies to assess threats, vulnerabilities, capabilities, and needs, as well as allocate funds accordingly. Our audits have identified several effective tools and practices used by some States that could benefit all States; FEMA and the States also willingly shared information. FEMA has been responsive to our recommendations and the agency is taking action to implement those recommendations. At the Headquarters level, DHS is establishing a governance body that will determine high-risk areas such as those cited above, develop strategies to mitigate those risks and employ standardized formats, templates, and processes to ensure consistent financial assistance activities throughout DHS. Some of these standardized templates and processes are already in place.

Employee Accountability and Integrity

Overview

The smuggling of people and goods across the Nation's borders is a large scale business dominated by organized criminal enterprises. The Mexican drug cartels today are more sophisticated and dangerous than any other organized criminal groups in our law enforcement experience. Drug trafficking organizations are becoming increasingly more involved in systematic corruption of DHS employees to further alien and drug smuggling. The obvious targets of corruption are front line Border Patrol Agents and CBP officers; less obvious are those employees who can provide access to sensitive law enforcement and intelligence information, allowing the cartels to track investigative activity or vet their members against law enforcement databases. Although the number of DHS employees implicated in such enterprises is very small — less than 1 percent — the damage from even one corrupt employee represents a significant management challenge to the Department.

Border corruption affects national security. As demonstrated by investigations led by our investigators, border corruption may consist of cash bribes, sexual favors, or other

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gratuities in return for allowing contraband or undocumented aliens through primary inspection lanes; orchestrating illegal border crossings; leaking sensitive law enforcement information to persons under investigation; selling law enforcement intelligence to smugglers; and providing needed documents such as immigration papers. Corrupt employees most often are paid not to inspect, as opposed to allowing prohibited items, such as narcotics, to pass into the U.S. A corrupt DHS employee may accept a bribe for allowing what appears to be simply undocumented aliens into the U.S. while unwittingly helping terrorists enter the country. Likewise, what seems to be drug contraband could be weapons of mass destruction, such as chemical or biological weapons, or bomb-making material.

Challenges

We have seen a 95 percent increase in complaints against CBP employees alone since FY 2004 and a 25 percent increase from just fiscal year 2010 to 2011. In FY 2011, we received and disposed of 17,998 allegations involving all DHS employees. As of July 15, 2012, we had 1,591 open cases. Corruption-related allegations are a priority of the Office of Investigations, which opens 100 percent of all credible allegations of corruption it receives. The majority of both complaints received and investigations initiated by the OIG, however, are for allegations of other than corruption-related activity.

Since FY 2004, our investigations have resulted in 358 CBP related convictions and 166 ICE related convictions. In one case, we received information that a CBP Officer was using his position at a large urban airport to support an international drug trafficking organization. Our investigators joined a multiagency investigation, led by the ICE Office of Professional Responsibility (OPR), which resulted in the dismantling of the entire drug trafficking organization and the arrest of multiple offenders, including the CBP Officer. On at least 19 separate occasions, the CBP Officer had bypassed airport security using his own badge to smuggle money and weapons for the drug traffickers. In December 2010, he was convicted and sentenced to 8 years in prison.

A Border Patrol Agent at the Sonoita, Arizona, Border Patrol Station, was observed acting suspiciously while questioning others about the technology used to interdict smugglers. The agent had only entered on duty at Sonoita in March 2009, shortly after graduating from the Border Patrol Academy. We opened an investigation and developed evidence that the agent had sold to a purported drug trafficker sensor maps, trail maps, landmarks, and terminology used by the Border Patrol to combat smuggling. Evidence showed that on at least four occasions, the agent accepted bribes totaling around $5,000. The agent was arrested in October 2009. On August 12, 2010, he pled guilty in Federal court to one count of bribery. On May 3, 2011, he was sentenced to 20

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months incarceration, 36 months supervised release, and was ordered to pay restitution in the amount of $5,500.

Proper filing of Office of Government Ethics (OGE) forms is vital to ensuring public trust in high-level Federal officials and executive branch employees. In FY 2012, auditors observed that the ethics management function at DHS is decentralized. Ethics officials in each component's Office of Counsel are delegated the authority to implement ethics program requirements in their component. The Headquarters Ethics Office did not have internal written policies and procedures to ensure required financial disclosure reports were received, reviewed, and certified within the timelines established by OGE. The auditors discovered that some employees were submitting forms late, ethics officials were not certifying them timely, and in some cases, employees did not submit the required forms.

Additionally, TSA reported that an attorney-advisor had backdated employee public financial disclosure forms provided to the auditors in the prior year so the forms appeared to comply with the OGE requirements. According to a DHS ethics official, TSA's management acted promptly to report this information and to rescind the attorney's ethics authority and to reassign the attorney, as well as his first and second line supervisors to other work. The attorney subsequently resigned from TSA on the day he was scheduled to be interviewed by TSA's Office of Inspection.

Accomplishments

Within DHS, the primary authority for investigating allegations of criminal misconduct by DHS employees lies with OIG; ICE OPR has authority to investigate those allegations involving employees of ICE and CBP. The components play a crucial, complementary role to our, as well as, ICE OPR investigative function. The components focus on preventive measures to ensure the integrity of the DHS workforce through robust pre-employment screening of applicants, including polygraph examinations at CBP; thorough background investigations of employees; and integrity and security briefings that help employees recognize corruption signs and dangers. These preventive measures are critically important in fighting corruption and work hand-in-hand with OIG's criminal investigative activities.

Congress recognized the importance of these complementary activities by enacting the *Anti-Border Corruption Act of 2010*. This Act requires CBP, by January 4, 2013, to administer applicant screening polygraph examinations to all applicants for employment in law enforcement positions prior to hiring. CBP met this goal in October 2012. The Act also requires CBP to initiate timely periodic background reinvestigations of CBP personnel. Agency statistics reveal that CBP declares 60 percent of applicants who are administered a polygraph examination unsuitable for employment because of prior drug use or criminal histories.

It is important to emphasize that the vast majority of employees within DHS are dedicated civil servants focused on protecting the Nation. Less than one percent of employees have committed criminal acts or other egregious misconduct.

Cyber Security

Overview

Cyber security is our Nation's firewall because it is always on alert for constant threats to networks, computers, programs, and data. It contains technologies, processes, and practices that protect our systems from attack, damage, or unauthorized access.

Challenges

In FY 2012, we reviewed the Department's efforts to guide components on securing portable devices that connect to networks, as well as how several components were applying this guidance; examined threats to IT security, including those from international and insider sources; and performed the annual *Federal Information Security Management Act of 2002* (FISMA), as amended, audit for the Department to determine its compliance with the development, documentation, and implementation of a DHS-wide information security program.

Portable Device Security

In a June 2012 audit, we determined that DHS still faced challenges using portable devices to carry out its mission and increase the productivity of its employees.[36] For example, some components had not developed policies and procedures to govern the use and accountability of portable devices. Unauthorized devices were also connected to workstations at selected components. Finally, DHS had not implemented controls to mitigate the risks associated with the use of portable devices or to protect the sensitive information that these devices store and process.

Another June report showed weaknesses in the component-wide adoption of FEMA's automated property management system, reporting of lost and stolen laptops, implementation of hard drive encryption, use of a standardized laptop image, timely installation of security patches, documentation of laptop sanitization, and accounting

[36] DHS-OIG, *DHS Needs To Address Portable Device Security Risks* (OIG-12-88, June 2012).

for wireless networks.[37] These weaknesses put laptops and the sensitive information stored and processed on them at risk of exploitation.

In a May 2012 audit, we reported that USCIS' laptop controls did not sufficiently safeguard its laptops from loss or theft and did not protect the data on the laptops from disclosure.[38] Specifically, USCIS did not have an accurate and complete inventory of its laptops, and its inventory data was not reported accurately and consistently in electronic databases. Additionally, many laptops were not assigned to specific users; USCIS did not provide adequate physical security for its laptops; and not all of USCIS' laptops used the latest encryption software or operating systems and associated service packs.

International Threats

In August 2012, we reported that the NPPD Office of Cybersecurity and Communications needed to establish and implement a plan to further its international affairs program with other countries and industry to protect cyberspace and critical infrastructure.[39] For more efficient and effective operations, NPPD should streamline its international affairs functions to coordinate foreign relations better and consolidate resources. In addition, the United States Computer Emergency Readiness Team needs to strengthen its communications and information-sharing activities with and among its counterparts to promote international incident response and the sharing of best practices.

Although TSA has shown progress, it can further develop its cyber security program by implementing insider threat policies and procedures, a risk management plan, and insider threat specific training and awareness programs for all employees. TSA can also strengthen its situational awareness security posture by centrally monitoring all information systems and augmenting current controls to better detect or prevent instances of unauthorized removal or transmission of sensitive information outside of its network.[40]

Federal Information Security Management Act

Although the Department's efforts have resulted in some improvements in its security program, components are still not executing all Department's policies, procedures, and

[37] DHS-OIG, *Progress Has Been Made in Securing Laptops and Wireless Networks at FEMA* (OIG-12-93, June 2012).
[38] DHS-OIG, *U.S. Citizenship and Immigration Services' Laptop Safeguards Need Improvements* (OIG-12-83, May 2012).
[39] DHS-OIG, *DHS Can Strengthen Its International Cybersecurity Programs* (OIG-12-112, August 2012).
[40] DHS-OIG, *Transportation Security Administration Has Taken Steps To Address the Insider Threat But Challenges Remain* (OIG-12-120, September 2012).

practices. DHS needs to improve its oversight of the components' implementation of its policies and procedures to ensure that all information security weaknesses are tracked and remediated, and to enhance the quality of system authorizations. Other information security program areas also need improvement including configuration management, incident detection and analysis, specialized training, account and identity management, continuous monitoring, and contingency planning.

Accomplishments

DHS and its components have taken actions to govern, track, categorize, and secure portable devices in support of their missions. Specifically, DHS and some components have developed policies, procedures, and training on the use of portable devices. Additionally, some components include portable devices as part of overall accountable personal property inventory. FEMA has improved its inventory and configuration management controls to protect its laptop computers and the sensitive information it stores and processes. It has also implemented technical controls to protect the information stored on and processed by its wireless networks and devices.
Threats to, and emanating from, cyberspace are borderless and require robust engagement and strong partnerships with countries around the world. Thus, the NPPD has established multiple functions to support its international affairs program, to promote cyber security awareness and foster collaboration with other countries and organizations. To foster collaboration and develop international cyber security partnerships, NPPD and its subcomponents participate in international cyber exercises, capacity building workshops, and multilateral and bilateral engagements. The directorate also uses innovative technologies to share cyber data with its partner nations.

TSA's progress in addressing the IT insider threat is evidenced by its agency-wide Insider Threat Working Group and Insider Threat Section responsible for developing an integrated strategy and program to address insider threat risk. Further, TSA conducted insider threat vulnerability assessments that included personnel, physical, and information systems at selected airports and offsite offices, as well as reviews of privileged user accounts on TSA unclassified systems. Additionally, TSA has strengthened its Security Operations Center responsible for day-to-day protection of information systems and data that can detect and respond to insider threat incidents.

The *Federal Information Security Management Act* evaluation showed that the Department continued to improve and strengthen its security program.[41] Specifically, DHS implemented a performance plan to improve in four key areas: remediation of

[41] Title III of the *E-Government Act of 2002*, Public Law 107-347.

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weaknesses in plans of action and milestones, quality of certification and accreditation, annual testing and validation, and security program oversight.

OIG Focus in 2013

In planning projects for FY 2013, we have placed particular emphasis on major management challenges, while aligning our work with DHS' missions and priorities in its *Strategic Plan for Fiscal Years 2012 Through 2016*. In addition, we will respond to legislative mandates, as well as undertake congressionally requested projects that may arise. DHS' mission is to prevent terrorism and enhance security, secure and manage our borders, enforce and administer our immigration laws, safeguard and secure cyberspace, and ensure resilience to disaster. The Department places priority on providing essential support to national and economic security and on maturing and becoming stronger.

In the mission areas of intelligence, transportation security, border security, infrastructure protection, and disaster preparedness and response, we are planning reviews of TSA, CBP, and FEMA, among other components and directorates. In addition to projects already in progress, our upcoming work will cover various aspects of airport security and passenger screening, securing our land borders, and disaster assistance. We also have work underway and are planning to review programs at USCIS, the USCG, and ICE. In the area of accountability, we are examining or plan to examine DHS' and its component's and directorate's controls over acquisitions and critical financial systems and data, information security, privacy stewardship, management of disaster preparedness grants, and cyber security, among other mandated and discretionary reviews.

Although not all planned projects may be completed in the upcoming fiscal year, we will continue to work with DHS to enhance effectiveness and efficiency and prevent waste, fraud, and abuse.

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Department of Homeland Security

Appendix A
Management Comments to the Draft Report

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

Homeland Security

November 1, 2012

Charles K. Edwards
Acting Inspector General
Office of Inspector General
U.S. Department of Homeland Security
245 Murray Lane SW, Building 410
Washington, DC 20528

Re: OIG Draft Report: "Major Management Challenges Facing the Department of Homeland Security, Fiscal Year (FY) 2012" (Project No. 12-169-AUD-NONE)

Dear Mr. Edwards:

Thank you for the opportunity to review and comment on this draft report. The U.S. Department of Homeland Security (DHS) appreciates the Office of Inspector General's (OIG's) perspective on the most serious management and performance challenges facing the Department. A more detailed response is provided in the Department's FY 2012 *Annual Financial Report (AFR)*.

This month marks the tenth anniversary of the creation of DHS, the largest federal reorganization since the formation of the Department of Defense. Since its inception, DHS has made significant progress becoming a more effective and integrated Department, strengthening the homeland security enterprise, and building a more secure America that is better equipped to confront the range of threats our Nation faces. As Secretary Napolitano has stated, "America is a stronger, safer, and more resilient country because of the work DHS and its many partners do every day."

The Department continues to grow and mature by strengthening and building upon existing capabilities, enhancing partnerships across all levels of government and with the private sector, and streamlining operations and increasing efficiencies within its five key mission areas: (1) preventing terrorism and enhancing security, (2) securing and managing our borders, (3) enforcing and administering our immigration laws, (4) safeguarding and securing cyberspace, and (5) ensuring resilience to disasters.

Through frameworks such as the *Quadrennial Homeland Security Review*, *Bottom-Up Review*, and *DHS Strategic Plan for FYs 2012–2016*, DHS has developed and implemented a comprehensive, strategic management approach to enhance Department-wide maturation and integration. DHS has also made significant progress to integrate and transform its management functions through the *Integrated Strategy*, first published in January 2011, which presents a clear roadmap to transform management by enhancing both vertical and horizontal integration. The strategy focuses on *all* management disciplines, especially human capital, acquisition, and financial management.

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The Under Secretary for Management has led the Department-wide effort to coalesce, or integrate, the Department's management infrastructure. The Department's strategy for the past 2 years has been to make substantial progress to implement 18 specific initiatives, each with clear action plans and performance metrics. By doing so, the degree of risk has been reduced proportionately and the Department is moving closer to a transformative state. To date, nearly 65 percent of the stated outcomes have been "mostly" or "fully" addressed and the Department is on track to meet the outcome goals for the remaining outcome metrics.

Again, thank you for the opportunity to review and comment on this draft report. This report and the Department's detailed management response to the issues identified will be included in the Department's FY 2012 AFR, as required by law. Technical comments on the draft were previously provided under separate cover for OIG consideration.

Please feel free to contact me if you have any questions. We look forward to working with you in the future.

Sincerely,

Jim H. Crumpacker
Director
Departmental GAO-OIG Liaison Office

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Appendix B
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To expedite the reporting of alleged fraud, waste, abuse or mismanagement, or any other kinds of criminal or noncriminal misconduct relative to Department of Homeland Security (DHS) programs and operations, please visit our website at www.oig.dhs.gov and click on the red tab titled "Hotline" to report. You will be directed to complete and submit an automated DHS OIG Investigative Referral Submission Form. Submission through our website ensures that your complaint will be promptly received and reviewed by DHS OIG.

Should you be unable to access our website, you may submit your complaint in writing to: DHS Office of Inspector General, Attention: Office of Investigations Hotline, 245 Murray Drive, SW, Building 410/Mail Stop 2600, Washington, DC, 20528; or you may call 1 (800) 323-8603; or fax it directly to us at (202) 254-4297.

The OIG seeks to protect the identity of each writer and caller.

Management's Response

The Reports Consolidation Act of 2000 (P.L. 106-531) requires that, annually, the U.S. Department of Homeland Security (DHS) 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 Fiscal Year (FY) 2012, OIG has identified the Department's major challenges in 11 broad areas, including 5 it characterized as Mission Areas and 6 as Accountability Issues:

Mission Areas

- Intelligence
- Transportation Security
- Border Security
- Infrastructure Protection
- Disaster Preparedness and Response

Accountability Issues

- Acquisition Management
- Financial Management
- IT Management
- Grants Management
- Employee Accountability and Integrity
- Cyber Security

Created with the founding principle of protecting the American people from terrorist and other threats, DHS and its many partners across the Federal Government, public and private sectors, and communities throughout the country have strengthened the homeland security enterprise to better mitigate and defend against dynamic threats. DHS missions include preventing terrorism and enhancing security, securing and managing our borders, enforcing and administering our immigration laws, safeguarding and securing cyberspace, and ensuring resilience to disasters.

The Department appreciates OIG's work in identifying specific areas for improvement as well as for preparing its statement on the related audits. DHS carries out multiple complex and highly diverse missions. While the Department continually strives to improve the efficiency and effectiveness of its programs and operations, as progress is achieved and as new initiatives begin, new management challenges can arise.

Overcoming major management challenges requires long-term strategies for ensuring stable operations as well as sustained management attention and resources. This section of the report details the Department's efforts to address each of the aforementioned challenges and the plans it has in place to overcome specific issues highlighted by OIG.

Challenge #1: Intelligence

DHS is focused on getting resources and information out of Washington D.C., and into the hands of state and local law enforcement to provide them with the tools to identify and combat threats in their communities. Because state and local law enforcement are often in the best position to notice the first signs of a planned attack, homeland security efforts must be integrated into the police work that they do every day, providing officers on the front lines with a clear understanding of the tactics, behaviors, and other indicators that could point to terrorist activity.

OIG's assessment focused specifically on the November 2011 review of the Office of Intelligence and Analysis's role in fusion centers. The Department appreciates OIG's acknowledgement of the progress made in providing field support to fusion centers and improving fusion center capabilities to prevent, protect against, and respond to threats.

DHS has enhanced the abilities of the National Network of Fusion Centers to:

- Receive classified and unclassified threat information from the Federal Government;
- Analyze that information in the context of their local environment in order to assess the risk posed to the local environment;
- Disseminate relevant information to local agencies to inform operational activities and resource planning; and
- Gather and assess tips, leads, and suspicious activity reporting from local agencies, and share terrorism-related reports with the Federal Bureau of Investigation-led Joint Terrorism Task Forces for further investigation.

Challenge #2: Transportation Security

The Transportation Security Administration (TSA) has created a multi-layered system of transportation security that mitigates risk and maximizes TSA's ability to stay ahead of evolving terrorist threats while protecting privacy and facilitating the flow of legitimate travel and commerce. TSA has addressed a number of OIG's concerns regarding aviation security, including those highlighted below:

Passenger and Baggage Screening

TSA holds all employees to the highest professional and ethical standards and has zero tolerance for misconduct in the workplace. Accountability is an important aspect of the Agency's work, and TSA takes prompt and appropriate action with any employee who does not follow procedures.

Although TSA concurs with OIG's recommendations regarding the evaluation of new or changed procedures and steps to improve supervision of personnel, it disagrees with the assertion that screening violations might not have occurred if TSA developed changes in screening procedures more comprehensively and fully evaluated the effects of such changes.

TSA has addressed OIG's recommendations by conducting a review of job duties, responsibilities, and competencies to update position descriptions for checked baggage supervisors and managers. In 2011, TSA established the Office of Professional Responsibility to provide greater consistency in employee misconduct penalty determinations and a more expeditious and standardized adjudication process. In 2012, TSA launched a new training course designed to help supervisors establish a leadership presence while on duty as well as technical training to support security screening measures. TSA also created an Integrated Project Team to develop best practices and tailor metrics to aid management at airports across the Nation and continues to monitor standard operating procedure compliance across the agency.

Additionally, TSA has made progress in implementing training initiatives associated with front-line supervisors and managers, such as the Essentials of Supervising Screening Operations course that includes leadership, technical, and administrative training modules specifically designed for the Supervisory Transportation Security Officer workforce. TSA has also designed a Leading People and Managing Operations course for Transportation Security Managers, which combines both leadership and technical training into one comprehensive program. TSA will continue to develop and analyze the training needs of our supervisory and management workforce to improve overall effectiveness and performance.

Airport Security

TSA is responsible for implementing a process to ensure employees working in secured airport areas are properly vetted and badged while providing oversight for the designated airport-operator employees who perform the badging application process.

DHS agrees with OIG's recommendation to refine and use one comprehensive definition of what constitutes a security breach and to develop a comprehensive oversight program to ensure accurate reporting and corrective actions take place. To address concerns regarding access control, TSA issued tools to all airports that airport operators can use to recognize fraudulent documents. TSA also offered "Airport Fraud ID Training" for all airport operators as well as briefings from Transportation Security Inspectors to augment available threat information. TSA continues to work to ensure airport operators are aware of the tools available to them, including OIG's unique algorithm tool, which may be used by airport operators to verify IDs.

In addition, the TSA Office of Compliance conducts regular briefings on fraudulent documentation and identification and will continue to discuss the issue during inspectors' monthly compliance conference calls.

Passenger Air Cargo Security

DHS agrees with OIG's assertion that improvements can be made in the air cargo screening process to prevent the introduction of explosives into air cargo on passenger aircraft. TSA has taken important steps to enhance the security of international inbound cargo on passenger and all-cargo aircraft. These include:

- Issuing new screening requirements aimed at focusing more detailed screening measures on high-risk shipments;
- Instituting working groups with air cargo stakeholders to identify ways to enhance air cargo security; and

- Initiating an Air Cargo Advance Screening pilot to more readily identify high-risk cargo for additional screening prior to aircraft departing from foreign airports to the United States.

TSA has also worked closely with its international and private-sector partners to increase the security of air cargo without restricting the movement of goods and products. By December 2012, TSA will require 100-percent physical screening of all air cargo bound for the U. S. This important step not only builds on the 100-percent screening of identified high-risk international cargo, it also incorporates TSA's risk-based, intelligence-driven procedures into the prescreening process to determine screening protocols on a per-shipment basis.

TSA continues to pursue bilateral efforts with foreign government partners through its National Cargo Security Program recognition program, which leverages foreign government supply chain security programs by allowing an air carrier to implement the security program of the country from which it is operating once TSA has determined that such programs provide a level of security commensurate with current U.S. air cargo security requirements.

Security Incident Reporting
DHS agrees with OIG's recommendation to refine its processes to better identify, track, report, and reduce breaches.

To address security vulnerabilities, TSA and the Federal Emergency Management Agency (FEMA) use the Quilt, which incorporates technology tools and best practices to facilitate management, tracking, and execution of all mitigation projects. In addition, Amtrak has updated the Transit Risk Assessment Model (TRAM), which formed the basis for the Quilt and has helped Amtrak focus its resources in a risk-based fashion. The updated TRAM, together with the DHS Top Transit Asset List and the TSA-conducted Baseline Assessment for Security Enhancement reviews of Amtrak's system, ensure that the Quilt remains the key tracking mechanism and management tool for Amtrak's security vulnerabilities.

Challenge #3: Border Security

U.S. Customs and Border Protection (CBP) screens all travelers entering the United States using a risk-based approach. Automated advance data, combined with intelligence and new biometric travel documents, facilitate travel while keeping our borders safe. CBP ensures the efficient and secure movement of cargo, using a multi-layered approach to identify risk, including enhanced screening requirements for known and established shippers.

National Protection and Programs Directorate's (NPPD's) United States Visitor and Immigrant Status Indicator Technology (US-VISIT) is working to develop a comprehensive corrective action plan to address the two recommendations from OIG. US-VISIT continues to work with domestic and international partners to provide biometric and biographic identity services. Addressing OIG recommendations, US-VISIT has reviewed the discrepant records provided by OIG, identified preliminary data filters to run against OIG's identified data inconsistencies, and assessed preliminary results. In addition, US-VISIT is developing a list of common data entries that can be identified as obviously erroneous. If US-VISIT's review of the OIG-referred data inconsistencies identifies instances of biographic fraud, US-VISIT will refer these instances to the appropriate law enforcement entities for identity fraud resolution and possible inclusion on the biometric watchlist.

Trusted Traveler Programs

CBP's Trusted Traveler Programs provide expedited travel for pre-approved, low-risk travelers through dedicated lanes and kiosks. The Free and Secure Trade (FAST) program is a commercial clearance program for known low-risk commercial truck drivers entering the United States from Canada and Mexico. Using FAST to help manage risk enables CBP to direct more resources to high or unknown risk commerce.

OIG found that CBP's initial enrollment process for FAST generally ensures that only low-risk drivers participate in the program; however, OIG identified some vulnerabilities in the enrollment process. To address these recommendations, CBP has worked to improve processing and oversight of the carrier enrollment certification process.

Cargo Security

In late 2011, OIG conducted a review of CBP cargo security systems at bonded facilities, which are privately owned and operated buildings in which merchandise may be stored without payment of duty for up to 5 years from the date of importation. OIG encouraged CBP to implement management controls to ensure employees are properly vetted at bonded facilities.

The bonded facilities used by CBP have physical and custodial security measures in place to ensure the safety and security of the merchandise. CBP is developing a streamlined and cost-effective process to conduct background vetting of bonded facility applicants, officers, and principals. This process will add significant oversight, tracking, and reporting capabilities to the background vetting process. In addition, CBP has a layered approach to cargo security and takes a number of actions to mitigate security risks though cargo targeting and screening before the cargo arrives at a bonded facility.

Unmanned Aircraft Systems (UAS)

The UAS program provides command, control, communication, intelligence, surveillance, and reconnaissance capability to complement crewed aircraft and watercraft, and ground interdiction agents for CBP. OIG made recommendations to improve planning of the CBP UAS program, including the level of operation and resource requirements, along with addressing stakeholder needs.

CBP's Strategic Air and Marine Plan, currently under review, details operational plans and capabilities assessments, which define CBP's planned UAS acquisition and sustainment over the next 5 years and beyond. CBP continues to refine its processes for coordinating and supporting stakeholders' mission requests, working closely with DHS, the Office of Management and Budget (OMB), and Congress.

Challenge #4: Infrastructure Protection

Our Nation's critical infrastructure—both physical and cyber—enables people, goods, capital, and information to move across the country and underpins the Nation's defense, manufacturing of goods, production of energy, and overall system of commerce. Protecting our critical infrastructure and enhancing its resilience is imperative to our economic and national security.

Working with Industry
Through our work with interagency and private-sector partners, DHS has made great strides in enhancing the security of critical infrastructure. DHS has the lead in enhancing security and resilience in 11 critical infrastructure sectors, including the Dams Sector where the Department has worked with private-sector partners to develop guidance and training resources on protective measures, crisis management, and security awareness.

DHS supports the Dams Sector at the regional level, providing public- and private-sector partners with education and training opportunities that offer guidance on protective measures and crisis management in addition to conducting vulnerability assessments that identify potential security improvements. As recommended by OIG, DHS is working with partners to assess whether regulatory authority is needed over the Dams Sector. At the same time, the Department continues to make strides under the voluntary framework, which includes DHS assessments on 100 percent of privately owned assets included on the FY 2011 Dams Sector critical assets list.

Working with Federal Partners
Under the National Infrastructure Protection Plan risk management framework, the Federal Protective Service (FPS) is the sector-specific lead agency for the government facilities sector, which includes a wide variety of critical facilities and assets owned or leased at the federal, state local, tribal, and territorial levels.

One area of significant progress related to risk assessment and the implementation of a risk management program is the ongoing implementation of FPS's solution for conducting facility security assessments using an automated assessment tool. DHS agrees with OIG's recommendation to cease development of the legacy application known as the Risk Assessment and Management Program and to pursue a standalone tool for facility security assessments. In cooperation with the National Protection and Programs Directorate, FPS has identified an interim solution to process facility security assessments by leveraging the Infrastructure Survey Tool and its host portal and environment, the Link Encrypted Network System. FPS has completed development efforts of the Modified Infrastructure Survey Tool, which was deployed in April 2012.

FPS has also taken actions to enhance coordination efforts as the sector-specific agency for the Government Facilities Sector, including establishing new relationships with the State, Local, Tribal, and Territorial Government Coordinating Council to ensure broader state and local participation in sector coordination mechanisms and engaging with the Government Facilities Sector Government Coordinating Council and the Interagency Security Committee to identify and address cross-cutting issues. Through these partnerships, FPS will develop an action plan to develop appropriate data on critical government facilities, a sector-specific risk assessment methodology, and metrics and performance data to track progress toward the sector's strategic goals.

Challenge #5: Disaster Preparedness and Response

As noted by OIG, over the past few years, FEMA has experienced a substantial increase in the number of events it responds to annually, while making significant improvements in disaster response and recovery.

Federal Disaster Declarations
Both OIG and the GAO issued reports this past year concerning the indicators used to assess governors' requests for major disaster declarations authorizing public assistance (PA) funding. When making PA disaster declaration recommendations, FEMA considers all factors in 44 CFR 206.37, including the per capita indicator as well as the estimated cost of the assistance, the available resources of state and local governments, localized impacts, insurance coverage, recent multiple disasters, hazard mitigation, and other federal assistance programs.

While it is important to note that more factors than the per capita indicator are currently considered when evaluating a governor's request for a major disaster declaration, FEMA agrees that a review of the criteria used to determine a state's response, recovery, and fiscal capabilities is warranted. In response to OIG and GAO recommendations, FEMA will conduct a review of the indicators currently used, and will assess whether the current statewide per capita indicator appropriately addresses a state's capacity to effectively respond to and recover from a major disaster. FEMA will also review potential guidance or criteria that could be used in assessing requests for an adjustment of the federal cost share to 100-percent federal funding for emergency work (PA Categories A and B) in the initial days after an incident.

FEMA is also implementing other initiatives to improve disaster budgeting and program management once a disaster declaration has been made, which will enhance FEMA's ability to manage and budget for expenditures from the Disaster Relief Fund.

Preliminary Damage Assessments and Public Assistance
In an effort to improve the quality and consistency of PA Preliminary Damage Assessments (PDA), FEMA developed the "Preliminary Damage Assessment" course to provide guidance and training on the PA PDA process. The class provides instruction on working with state and local governments to perform damage assessments, accurately document damages, formulate cost estimates, and ensure that appropriate eligibility issues are considered for the assessment of the work scope and project costs. The course is taught on a regular basis and often includes participation by state representatives.

FEMA is also pursuing data collection tools that will provide enhanced capabilities to perform PDAs and record information in an efficient and consistent manner. FEMA is currently assessing the best available options for this tool, building on previous efforts and currently available technologies. Based on the findings of the assessment, FEMA plans to develop and implement the improved PDA data collection tool in FY 2013. This will improve PDA data collection, streamline the PDA process through use of an electronic system for data collection and reporting, and enhance the effectiveness of the PDA process.

FEMA is committed to improving its services to PA applicants in Louisiana and has addressed two OIG recommendations designed to improve the PA project management process by developing

Standard Operation Procedures (SOPs) and training courses. FEMA also meets regularly to ensure continuing progress on the closeout process. FEMA has drafted an updated SOP, *Public Assistance Program Management and Grants Closeout,* which defines and standardizes the activities associated with the closeout phase, promotes consistency in delivering and monitoring the PA program, and creates a common understanding of the expectations and requirements for the assistance provided. Additionally, FEMA has implemented an incentive for rapid project closeout, as authorized under the *Post-Katrina Emergency Management Reform Act*. Under this initiative, FEMA will provide reimbursement for eligible additional direct management costs for projects that are completed by August 29, 2013.

Insurance Requirements

FEMA agrees with OIG's recommendations to improve oversight and tracking of its PA insurance requirements to ensure that all PA applicants have obtained and maintained insurance as a condition of receiving federal disaster assistance. FEMA is working with regional personnel to develop a new process designed to streamline the insurance review process and prevent duplication, while completing insurance reviews earlier in the project formulation process. Additionally, FEMA is planning to migrate data from the National Emergency Management Information System into the Emergency Management Mission Integrated Environment to create a more robust centralized source for verification of insurance information.

OIG references a proposed rulemaking that was published approximately 10 years ago as evidence that FEMA has been slow to address insurance issues. FEMA acknowledges that there are certain issues regarding insurance requirements that must be addressed through the long-term regulatory process but notes that the agency has addressed issues pertaining to insurance requirements through the issuance of guidance, including both to recipients of PA funding and to field personnel involved in the implementation of the PA Program.

Temporary Housing

OIG recommended increased FEMA oversight, reporting requirements on cost and program effectiveness, and an evaluation of administrative fees for the Disaster Housing Assistance Programs. In response to this recommendation, FEMA is currently evaluating and incorporating preliminary lessons learned from both the Alternative Housing Pilot Program and Joint Housing Solutions Group into future direct housing operations as deemed appropriate by local state-led Disaster Housing Task Forces and coordinated through the Housing Recovery Support Function of the National Disaster Recovery Framework.

Additionally, FEMA and the Department of Housing and Urban Development are developing an interagency agreement that would increase the frequency of reports and ensure the inclusion of specific program and financial data. The agreement will also contain a new administrative fee structure. FEMA will continue to assess the safety and efficient delivery of direct housing units during future disasters.

Workforce Tracking and Training

FEMA agrees with OIG that credentialing emergency providers will strengthen FEMA's ability to deliver high-quality and efficient services during disaster response. Since November 2011[1], FEMA

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[1] Not reflected in the period of time in which the OIG conducted its review.

has made significant progress in implementing employee credentialing and addressing the recommendations in OIG's report. The progress has been so significant that OIG praised FEMA for their responsive actions and now considers all three recommendations resolved.

Among the improvements, the FEMA Qualification System (FQS) became operational on October 1, 2012, and has been implemented for the entire incident management workforce. FQS establishes the system for qualification and certification of the FEMA incident workforce through experience, training, and demonstrated performance. In addition, the Incident Workforce Management Office is working to address the immediate lessons learned and incorporate them into longer-term metrics that should be completed in the next 2 to 3 months.

Additionally, since the June 2012 audit, FEMA began using the Bureau of Land Management's Incident Qualifications and Certification System (IQCS). IQCS is an information system that tracks training and certifications for FQS and shares training and certification data across all involved agencies. The Reservist workforce data is currently being added to IQCS, with expected completion by December 31, 2012. Specific training on the FEMA IQCS, "Train the Trainer," is scheduled for November 2012, and additional trainings will be scheduled in each FEMA Region and Headquarters for all FEMA users.

Lastly, the budget for training and course development was approved for FY 2012 and submitted for FY 2013 and many of the courses that support the FQS have been developed and implemented. This is an ongoing process, and the Incident Workforce Management Office staff continues to coordinate with the FEMA Response Training, Exercise, and Doctrine office for further development, revision, and consolidation of coursework that supports the FQS.

Challenge #6: Acquisition Management

As noted by OIG, the Department has made significant progress in the area of acquisition management and DHS appreciates OIG's recognition of its work improving the acquisition workforce.

DHS recognizes the importance of effective acquisition management and has worked to improve program governance at both the Department and Component level. One of DHS's key changes was the establishment of a three-tiered governance model. The first part of the model is the Acquisition Review Board (ARB), which serves as the principal decision authority. The second component of the system is the Executive Steering Committee, which the ARB may establish on a case-by-case basis to provide interim oversight and guidance to select programs between Acquisition Decision Events. The third part of the governance model consists of regular portfolio reviews for groupings of programs with related missions. Each Component also conducts its own internal reviews. The tiered system provides more nimble, responsive oversight capability, enhancing vertical integration, improving program oversight, and reducing risk.

Another improvement is the establishment of the Component Acquisition Executive (CAE) structure, which creates a single program management authority within each Component. The CAE structure encourages collaboration and promotes standardization. As a result, the Department is better able to conduct oversight, share information and verify that *all* acquisition programs are complying with Management Directive (MD) 102-01, the policy that governs program management across the Department.

In an effort to further improve the ARB and provide more empirical data for decision making, DHS implemented the Decision Support Tool (DST) and the Quarterly Program Accountability Report (QPAR). The DST provides DHS leaders, governance boards, and program managers a central dashboard for assessing and tracking major acquisition projects, programs, and portfolios, improving the acquisition process. The QPAR, a byproduct of the DST, provides DHS leadership with a high-level analysis of program health and identifies early warning signs of issues that can be rectified through increased technical support, monitoring, and training. By using these tools, DHS is better positioned to mitigate risks within acquisition management.

Components are also taking important steps to ensure efficient, effective acquisitions management. For example, after the ARB identified opportunities for improved documentation and planning for its new border security technology plan, CBP began working closely with the DHS Management Directorate to ensure all documentation followed DHS guidance and internal controls. Separately, and in response to an OIG recommendation, CBP is coordinating with the U.S. Coast Guard and other partners to develop a comprehensive assessment of commercial and/or other government-owned alternative aviation logistics and maintenance information technology (IT) systems, to further ensure efficiencies and intradepartmental collaboration where appropriate.

In response to an OIG recommendation to improve the award and oversight of U.S. Coast Guard's Ocean Sentry Maritime Patrol Aircraft and future acquisitions, U.S. Coast Guard agrees that for cost-type contract actions, it is important to give full consideration to Defense Contract Audit Agency (DCAA) audit reports, and plans to use cost analysis that use DCAA findings for any future modifications to the Ocean Sentry Maritime Patrol Aircraft (MPA) and any other contract that requires certified cost data action. U.S. Coast Guard notes, however, that not conducting a cost analysis for this particular contract award was in full compliance with the applicable regulations. In the case of the award of this MPA contract, submission of certified cost or pricing was not required or permitted under the Federal Acquisition Regulation because the Contracting Officer appropriately determined and documented that the proposed price was established in a competitive environment subject to price analysis.

In late 2011, OIG released a report regarding CBP's internal controls related to the purchase and use of steel. While DHS disagreed with OIG's overall conclusions, it recognized that the subcontract review included some deficiencies. DHS conducted an independent review of issues presented in the report, and CBP established an integrated working group to develop and communicate policies and procedures for reconciling invoices and identifying risk-based steps for processing contracts. Remaining steel not used for initial construction work is being used for maintenance and new construction work, which allows CBP to use existing infrastructure and ensure the steel is of the same quality and finish as the currently installed steel.

Challenge #7: Financial Management

DHS is committed to demonstrating the highest level of accountability, transparency, and stewardship of taxpayer dollars. In January 2011, Secretary Napolitano committed the Department to the goal of receiving a qualified audit opinion on the Consolidated Balance Sheet and Statement of Custodial Activity. DHS met that goal. Secretary Napolitano set a goal for FY 2012 to obtain a qualified opinion on a full-scope financial statement audit. DHS met the Secretary's goal yet again.

From FY 2006–2012, DHS has reduced the number of audit qualifications from 10 to 1, Department-wide material weaknesses in internal controls over financial reporting from 10 to 5, and from FY 2011–2012 the number of Component conditions contributing to material weaknesses from 7 to 4 while expanding the audit from two financial statements to all five financial statements. Also, in FY 2012, the FY 2011 environmental liabilities qualification on the financial statements was retroactively removed.

In FY 2012, the Department obtained a qualified full-scope audit opinion on the Consolidated Balance Sheet, and the Statements of Custodial Activity, Budgetary Resources, Net Cost and Net Position. The Department is now in compliance with the *Chief Financial Officers Act of 1990* by completing a full-scope financial statement audit. In addition, DHS completed the Quadrennial Homeland Security Review, released a strategic plan, presented its net cost of operations by major mission that relate to major goals described in the strategic plan, and achieved compliance with the *Government Performance and Results Act of 1993.*

The Department was also able to provide a qualified assurance on internal control over financial reporting: our first major milestone toward obtaining an opinion on internal control.

DHS made significant progress in strengthening internal controls and implementing corrective actions within several key financial management areas. Management developed an internal controls and risk management strategy to outline material line items and an approach to ensure controls were in place to prevent and/or detect and correct material misstatements. As part of this strategy, management incorporated key objectives and risks from multiple offices within the Department as well as the Components. In FY 2012:

- The Department prepared audit readiness risk assessments from each Component identifying potential risks related to a full-scope financial statement audit;
- Components developed corrective actions to remediate deficiencies in select business process;
- Component Heads committed to correct material weaknesses, significant deficiencies, reportable conditions, or any other internal control deficiencies that could impact the Secretary's goal of obtaining an opinion on a full scope financial statement audit and to support remediation actions listed in the Mission Action Plans. These commitment statements were included as an element of each Component Head's performance plan to the Secretary;
- The Department conducted assessments over business processes impacting the first-ever audited Statements of Budgetary Resources, Net Cost, and Net Position and developed mission action plans for weaknesses identified;
- Leadership met regularly throughout the fiscal year with Components to review the status of progress against mission action plans;

The progress made in financial management at DHS over the past few years is due to the hard work of dedicated employees at the DHS Office of the Chief Financial Officer and Components across the Department. We have put in place training, policies, processes, and structures to help ensure consistent operations for each of our financial accounting centers and financial management offices within DHS Components.

- The Department implemented a new training program that offered courses to the financial management community in subjects ranging from appropriations law and federal accounting fundamentals to budget formulation/execution and the U.S. Standard General Ledger.
- The Department continued to refine and update the Financial Management Policy Manual to provide all DHS employees with standard processes to follow for budgetary policy, financial reporting, financial assistance, and travel and bank card management.
- U.S. Coast Guard remediated remaining control deficiencies related to Fund Balance with Treasury and corrected the Department's significant deficiency.
- U.S. Citizenship and Immigration Services (USCIS) substantially corrected financial reporting deficiencies reported in previous years.
- The U.S. Coast Guard made progress by correcting financial reporting control deficiencies in accounts receivable, and improving their ability to provide accurate and timely information for financial statement reporting.
- The U.S. Coast Guard was able to fully assert to the reliability of approximately $3 billion of real property balances.
- The U.S. Coast Guard continued to execute remediation efforts to address property, plant, and equipment (PP&E) process and control deficiencies.
- TSA substantially corrected PP&E control deficiencies reported in previous years.
- Management Directorate implemented new PP&E processes to correct deficiencies and has made improvements.

This progress has created momentum and further motivated DHS to reach the goal of a clean opinion on a full-scope audit in the future. The Department's Chief Financial Officer (CFO) will remain actively engaged with senior management and staff at each Component, overseeing corrective actions to ensure continued progress across the Department.

<u>Managerial Cost Accounting</u>

With the expansion to a full-scope audit in FY 2012, the DHS Statement of Net Cost (SNC) underwent audit for the first time. The Department focused audit readiness efforts for bringing the SNC into compliance with Federal Accounting Standards Advisory Board, *Standard SFFAS 4, Managerial Cost Accounting*, and OMB Circular A-136. A DHS Office of the Chief Financial Officer (OCFO) team researched SNC presentations from 22 other *Chief Financial Officers Act of 1990* agencies and OMB A-136 to learn and apply best practices and to develop an approach of presenting SNC by 'major missions' that are related to DHS's strategic goals. The team led representatives from all 15 reporting Components through a series of workshops and individual working sessions. They worked with each Component to establish and document cost/revenue-tracing methods and allocation methodologies for aligning costs to mission areas that would stand up to the scrutiny of the test work for the expanded scope audit.

The team partnered with DHS senior leadership to develop meaningful groupings of the seven strategic goals that effectively illustrate and communicate DHS net costs to the general public. This presentation allows the reader of the SNC to better understand how resources are spent toward the Department's common goal of a safe, secure, and resilient America.

The Department is modernizing its core financial systems, implementing a common accounting structure, and developing data standards and business intelligence tools to collect and crosswalk cost data at program/project/activity level across DHS Components. Improving access to and the quality of financial management information is a key leadership priority at DHS. To effectively support the DHS mission, the Department has implemented the use of a group of business intelligence tools that help organize, store, and analyze data more efficiently. Through the use of business intelligence, we are beginning to provide mission-level views of resources. We can now take information from individual budgets and display them for the enterprise, providing views of how our dollars are allocated by mission area.

The Department is developing a suite of management tools, including the Decision Support Tool (DST), to assist in compiling Department-wide program cost information. The DST reached full operating capability in May 2012. The DST provides DHS leadership, governance boards, and program managers with a central, web-enabled dashboard for assessing and tracking the health of acquisition projects, programs, and portfolios. It creates graphs, charts, and other views of key indicators of program health, such as cost, funding, and schedule. The DST has proven to be an effective tool for increasing the accuracy and currency of major acquisition performance data, as well as leadership's access to that data. This has resulted in greater transparency and more informed decision making.

Antideficiency Act

In FY 2012, the Department continued to implement its plan to improve compliance with the *Antideficiency Act* (ADA). This multi-year plan includes policy reviews, Department-wide training, and internal control test work to prevent ADA violations. The Department also continued to work to increase awareness of funds control across the Department and to mitigate the risk of future violations. We conducted specific training on appropriations law and how to avoid ADA violations. In FY 2012 we completed development of an online course scheduled for launch through Department and Component learning systems in FY 2013.

Financial Statements Audit

In FY 2011, the Department achieved a significant milestone by earning a qualified audit opinion on the Balance Sheet and Statement of Custodial Activity. Earning this opinion was a pivotal step to increasing transparency and accurately accounting for the Department's resources.

Building on this success, in FY 2012 the Department presented all five financial statements for audit for the first time in its history, bringing the Department into compliance with the *Chief Financial Officers Act of 1990.* Our first full-scope audit resulted in a qualified audit opinion. This opinion is a significant step toward a clean audit opinion, and evidence of our continued commitment to good governance as we strengthen and mature management processes and standards across the Department.

In support of our goal of continued progress toward a clean opinion on a full-scope audit, the Department will:

- Continue targeted risk assessments to identify and remediate material weaknesses and significant deficiency conditions in accounting and financial reporting.
- Continue to implement our plan to modernize our core financial management systems. The DHS CFO issued a *Financial Systems Modernization Playbook*, which presents the Department's plan for strengthening financial systems and business intelligence capabilities as we prioritize essential system modernization for Components with the most critical need.
- Establish standard, key business processes and internal controls; and implement a standard line of accounting across financial systems to ensure DHS sustains its audit progress.
- Obtain a retroactive clean, full-scope audit opinion on FY 2012 financial statements.

We recognize that maturing our Department is a collective effort, and we continue to implement initiatives to strengthen and mature the Department across many areas.

Challenge #8: IT Management

DHS recognizes that as security risks and technology change, the adaptability of the Department's IT Infrastructure becomes critical. As a result, DHS and its Components have worked to improve several areas of IT management, including program governance, information security, and security awareness.

For example, U.S. Citizenship and Immigration Services (USCIS) has demonstrated success in agile software development. In May 2012, the USCIS Office of Transformation launched the first release of the USCIS Electronic Immigration System and plans to push releases every 4 months. The initial release facilitates a move towards electronic systems and contains many of the foundational elements needed for all form types. It also enables Immigration Service Officers to review and adjudicate online filings from multiple agency locations across the country. Customers are provided with multiple functions, including online applications to extend or change their status for certain nonimmigrant classifications. USCIS employees are also provided with several electronic tools that support their mission, some of which include running additional background check rules and updating fraud or system check risk records. The second release, in September 2012, further enhances tools available to USCIS employees to view, access, and update records, and allows customers to submit supporting documentation.

In April 2012, OIG recognized USCIS efforts to ensure that staff in the Office of Transformation possess the necessary skills to implement the transformation program. These efforts included an emphasis on Project Management Professional certification and the scheduling and implementation of Agile and Scrum Product owner classes and workshops. As a result of these advancements, USCIS was able to address concerns from previous OIG reports.

In the area of systems availability, CBP acknowledges OIG's concern regarding an aging IT infrastructure and its effect on mission operations. CBP is conducting a comprehensive study of IT infrastructure investment priorities and has dedicated funding to replace the outmoded switches identified by OIG by t August 31, 2013. Further, CBP is taking steps to address the problem of employees choosing to use alternative investment strategies by enforcing the Information Technology Acquisition Review (ITAR) process, identified by OIG. By increasing employee awareness of the ITAR process and identifying proposed acquisitions that are non-compliant, IT acquisitions are expected to be more timely and conform to approved technologies.

CBP also acknowledges the importance of protecting personally identifiable information (PII) and continues to make progress in minimizing its exposure. To this end, CBP has begun modernizing the TECS, which will provide access with DHS standard user names and discontinue use of Social Security Numbers as user identification. Other PII will also be masked. Moreover, CBP requires users to undergo privacy training and pass a test before gaining access to the system, which further sensitizes employees to the protections required for handling PII and encourages a culture of privacy.

DHS is conducting annual portfolio reviews to improve the IT budget review process. These reviews enable the Chief Information Officer to make recommendations to the Components in the Resource Allocation Decision process before IT investments are finalized. The Department's IT governance policies and procedures have been developed and are in the formal approval process. The policy on IT Portfolio Management addresses how IT investments are managed as portfolios, defines portfolio criteria (including selection, control, and evaluation criteria), and includes accompanying instructions that address board/council roles and responsibilities. In addition, the IT governance policies and procedures address how the Investment Review Board is to maintain responsibility for lower-level board activities, investment selection, and prioritization criteria. These improvements further support DHS's IT governance, which is addressing identified weaknesses in investment management.

Challenge #9: Grants Management

DHS has been supporting state and local efforts across the homeland security enterprise to build capabilities for the past 10 years, awarding more than $37 billion in grant funding. FEMA concurs with OIG's recommendations to strengthen management, performance, and oversight of ongoing individual state Homeland Security Grant Program projects.

As a result of improvement efforts in grants management, FEMA has met all agency-established and congressionally mandated deadlines and requirements for more than 2,700 grant awards and cooperative agreements and has issued 26 funding opportunity announcements with clear strategic objectives and priorities. Additionally, FEMA has continued to document policies, SOPs, and processes in order to ensure open competition, prevent Anti-Deficiency Act violations, and comply with congressional notification requirements. At the Headquarters level, DHS is establishing a governance body that will determine high-risk areas, develop strategies to mitigate those risks and employ standardized formats, templates, and processes to ensure consistent financial assistance activities throughout DHS. Some of these standardized templates and processes are already in place. With regards to Environmental and Historic Preservation reviews and budget reviews, FEMA will continue to refine it processes and procedures related to outstanding reviews and evaluations.

While FEMA has made significant improvements in monitoring grantees, it agrees with OIG that a more robust grants monitoring process is critical. FEMA has reduced the number of open OMB Circular A-133 audits by more than 60 percent and has overseen more than 1,200 grants in accordance with risk management strategies—focusing not only on congressional and other mandates, but also on audit findings and improper payments. FEMA has also continued to work toward ensuring that all grant funding was obligated by the grantees within the grant's original period of performance, and that those awards were accepted within 90 days and expended within 90 days of the end of the period of performance.

FEMA has developed and implemented a Grant Closeout Process SOP that has streamlined the closeout process. Through a new tracking tool that captures the status of all FEMA grants and a new 6-month pre-closeout management requirement for the early identification of grant closeout issues, FEMA had closed more than 800 grants as of September 30, 2012.

FEMA has also improved the grant reporting system and state reporting through both workforce and system changes. FEMA is currently developing and completing the build for the Non-Disaster (ND) Grant System, a project-based application and reporting system that will allow FEMA to track and measure individual project completion. The project is scheduled for completion in FY 2014 and will help to modify the grant reporting system and ensure grantees report adjustments to project milestones during the grant period of performance. System improvements also include additional training opportunities through newly implemented computer-based training, expanded external communications of emerging grant issues for stakeholders, and development and implementation of relevant standard reporting forms and formats for grant management updates.

When fully implemented, ND Grants will consolidate all of FEMA's non-disaster grant programs into one system that covers the entire grants management lifecycle. Once fully deployed, ND Grants will:

- Support the entire grants management lifecycle 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 impact the overall preparedness of the Nation;
- Provide a user-friendly interface that clearly highlights pending actions to be completed;
- Automate and standardize processes to manage the entire grants management lifecycle; and
- Collect grant data in a structured, searchable format allowing data manipulation and customization for preparation, analysis, and reporting.

FEMA is also developing a curriculum for a comprehensive grantee technical assistance program that ensures that all Grants Program Directorate staff complete training requirements within 90 days of assignment or within 6 months of joining FEMA.

Strategic Management

In response to an OIG recommendation to improve strategic management guidance for State Homeland Security Grants, FEMA's National Preparedness Directorate—the group responsible for the Homeland Security Strategy and its guidance—plans to release updated guidance on strategic planning by January 31, 2013. States will then revise their homeland security strategies to comply with the updated guidelines.

Looking forward, several of OIG's recommendations to improve the grants management process are addressed by the proposed FY 2013 National Preparedness Grants Program (NPGP). As part of the FY 2013 NPGP, FEMA will consolidate current grant programs into a comprehensive grant program (excluding Emergency Management Performance Grant (EMPG) and Assistance to Fire Fighter Grants). This consolidation will enable grantees to develop and sustain core capabilities outlined in the National Preparedness Goal (NPG) instead of requiring grantees to meet the mandates from multiple individual, often disconnected, grant programs. Consolidating grant programs will also support the recommendations of the Redundancy Elimination and Enhanced Performance for Preparedness Grants Act and streamline the grant application process. This increased efficiency will enable grantees to focus on how federal funds can add value to the jurisdiction's prioritization of threats, risks, and consequences, while contributing to national preparedness capabilities. The FY 2012 grants budget begins to prepare grantees for this transition by combining several grant programs.

Performance Measurement

FEMA GPD is actively working to better assess current preparedness capabilities and capability gaps nationwide. All states and territories that receive federal preparedness assistance are required to submit an annual State Preparedness Report (SPR) capability assessment. In 2011, FEMA redesigned the SPR assessment to account for capability targets relevant to the jurisdiction and to measure current capability levels for each of the 31 core capabilities associated with the NPG. As a result of this redesign, all grantees are required to demonstrate how proposed projects address gaps and deficiencies in core capabilities, satisfying an OIG recommendation. States and urban areas are also required to complete Threat and Hazard Identification and Risk Assessments (THIRA) by December 31, 2012. The THIRA will be used to develop capability targets for FY 2013 and beyond.

Grant funding will be focused on projects that are resolving gaps or sustaining existing capabilities identified in the state and urban area THIRAs.

FEMA has also adjusted its grant application process and the FY 2013 Investment Justification (IJ) template to include information on whether an investment is a continuation of an existing investment from a previous fiscal year. The IJ will request information about the scope and milestones of the previous investment and whether the investment is meeting its stated goals and objectives. This will allow FEMA and/or peer reviewers to evaluate the IJ and the proposed investment within the context of previous investments for the same activity.

Oversight

In an effort to improve FEMA's oversight to ensure states are meeting their reporting obligations in a timely manner, FEMA grantees will leverage the information contained within the THIRA when applying for homeland security grants. In addition, FEMA launched a long-term approach to enhance financial and programmatic monitoring within its regions. This approach implements risk management principles to direct resources to grantees and programs with the greatest need. As part of a multi-year process, FEMA has refined criteria for deciding which grants to monitor, standardized regional financial and program monitoring activities, and expanded ongoing oversight activities to ensure early identification of issues. This approach builds upon the established monitoring approach and will continuously advance FEMA's grants management capability.

FEMA develops annual monitoring plans with individual region-specific schedules and an overview of FEMA's annual approach to monitoring grants. GPD's multi-year monitoring initiative employs a standard set of activities that can be prioritized and implemented on the basis of the grantee's or program's risk or need. The monitoring initiative also uses information that is collected through a variety of methods, including site visits, desk reviews, and regular financial and programmatic reporting by grantees.

The FY 2012 approach lays the foundation for future risk-based monitoring, which will support FEMA's and DHS's risk management philosophy. Regions and headquarters assess the monitoring needs of each grant/grantee selected for monitoring, using eight key indicators: 1) spending patterns, 2) grant dollar value, 3) grantee responsiveness, 4) Administrator's priority, 5) new FEMA grantee/grantee with new personnel, 6) number of grants managed by grantee, 7) prior financial monitoring findings, and 8) program type.

FEMA will continue working with the regions and headquarters in FY 2013 to develop a risk-based monitoring approach. Anticipated features of the FY 2013 approach include:

- Increased communication and collaboration among financial and programmatic monitoring stakeholders to identify grants and grantees in need of monitoring;
- Integrated financial and programmatic monitoring for preparedness grants managed within the Preparedness Grants Division, including a joint monitoring pilot of HSGP grants; and
- Expanded "Standard Oversight Activities."

This approach will build on the FY 2012 monitoring approach and drive FEMA toward continuously advancing its grants management capability.

GPD is also increasing the regional role in managing grant awards, which has resulted in more robust regions and an increased level of monitoring of grantees. FEMA regions are currently responsible for the EMPG, Driver's License Security Grant Program, Emergency Operations Center, Regional Catastrophic Grant Program, Metropolitan Medical Response Grants, and Citizen Corps Program awards from award to closeout. This ongoing regionalization has enabled grantees to quickly implement projects related to these awards.

Sustainment

FEMA believes it is essential that a portion of grant funding be used to sustain core capabilities through the training of personnel and lifecycle replacement of equipment. Beginning in FY 2012, in order to use grant funding to build new capabilities, grantees must ensure that the capabilities are cross jurisdictional and readily deployable, helping to elevation nationwide preparedness. All capabilities being built or sustained must have a clear linkage to one or more core capabilities in the NPG.

Challenge #10: Employee Accountability and Integrity

DHS supports OIG in its role conducting investigations of misconduct cases, including direct investigative support on such cases by ICE and CBP upon OIG request or referral.

Specifically, under the terms of a Memorandum of Understanding (MOU) between OIG and CBP, the CBP Office of Internal Affairs (IA) provides investigative support, upon request, to DHS OIG on CBP-related misconduct cases. Further, under the terms of a separate MOU between ICE and CBP, CBP IA partners with ICE Office of Professional Responsibility (OPR) to conduct investigations on CBP-related misconduct cases referred to ICE OPR by OIG.

The OIG has realized efficiencies created by cooperative investigative efforts of employee misconduct and corruption allegations. A new business model, based on the foundation established by the MOUs, has led to improved information sharing, cooperative investigations, and sharing of resources among the components. These combined efforts have helped to eliminate the case backlog and significantly accelerate the investigation of corruption allegations.

CBP's employs a comprehensive integrity strategy which includes a thorough initial screening of applicants, pre-employment polygraph examinations of law enforcement candidates, and a background investigation that commences upon the initial selection of a prospective employee. Each tool is capable of identifying vulnerabilities and in combination provides for a thorough vetting of the men and women seeking employment with, or employed by, CBP. Periodic reinvestigations of an employee's background are conducted every five years throughout an onboard employee's career and may identify emerging integrity and conduct concerns that have the potential to impact execution of the CBP mission.

CBP currently polygraphs all applicants for law enforcement positions before being hired consistent with the statutory requirements of the Anti-Border Corruption Act.

DHS views employee integrity to be crucial to ensuring that all Department operations are performed with the highest degree of ethical conduct. DHS recognizes that its ethics program plays a critical role in ensuring that employees have resources and counselors to provide them with guidance, information, and training, and to assist them in remedying potential conflicts of interest and other ethics questions. DHS agrees with the OIG that improvements in the financial disclosure process and procedures will strengthen the ethics program.

The OIG observed that DHS ethics program management is decentralized. The Department follows the requirements for management of an ethics program which are set forth in U.S. Office of Government Ethics (OGE) regulations and aligns ethics program management with the way in which legal services are delivered to component officials. The Department also agrees that increased oversight regarding the ethics program throughout DHS is warranted.

The Department's ethics program aims for 100 percent compliance with ethics regulations, including the timely filing of financial disclosure reports. For the 2012 filing season, less than one percent of the public filers (i.e., the officials holding the most senior or sensitive Department positions) filed their reports late. Those that file late incur a financial penalty that they must pay to the U.S. Treasury.

In 2012, DHS completed the second year of using an electronic financial disclosure filing system for public filers, which has significantly improved the overall management of processing the reports across DHS. The headquarters Ethics Office has implemented an improved database tracking system and expanded the information that is tracked for each filer. In addition, the headquarters Ethics Office is drafting and will issue formal procedural guidance for financial disclosure reporting across the Department and the Ethics Office is developing a process to enhance its oversight of financial disclosure reporting in the Department's components. These improvements will strengthen the ethics program and support a DHS culture of high ethical standards.

Challenge #11: Cyber Security

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.

Portable Device Security
DHS agrees with OIG's recommendation to track and promote the use of portable devices in support of the Department's missions. The following are examples of the Department's commitment to mitigate security risks posed by portable devices:

- Three Components have developed specific portable device policies and procedures and aligned them with the Department's guidance.
- Five Components use an asset management system to record and track inventory of sensitive items, such as smartphones, tablet computers, and thumb drives.
- Four Components provide specific training on the acceptable use of portable devices to their users, in addition to general IT security awareness.

By engaging in these activities, Components are able to ensure that users have a full understanding of use, management, accountability, and incident response in the event that a device is lost or stolen.

Additionally, the policies governing the use of portable devices provide another layer of controls. DHS has mandated that Universal Serial Bus (USB) thumb drives are to be classified, captured, and tracked in DHS's asset management systems as sensitive personal property. The Department has also revised its asset management Equipment Control Class matrix to include USB thumb drives and provides designations on the basis of whether they meet DHS's encryption requirements. This designation helps ensure that sensitive information is placed on the appropriate storage device. The Department's property manual was also revised to include language referencing the DHS Sensitive Systems Policy, which covers USB drives.

In the laptop security audit, OIG reported that USCIS's controls did not sufficiently safeguard laptops from loss or theft, while information on these systems was not protected from disclosure. In response to OIG's recommendations, USCIS has completed the annual inventory on all personal property and is working to ensure that:

- Government-furnished equipment is appropriately addressed in contracts;
- Procedures adequately address the process to update laptops with encryption software and patches;
- Rules of behavior cover laptop protection and maintenance rules; and
- Laptop locks are issued to all laptop owners.

International Threats

OIG reviewed TSA's progress toward protecting its information systems and data from the threat posed by trusted employees. This includes insider threat management processes, the ability of selected employees to monitor and report suspicious behavior, as well as insider threat security training and awareness.

OIG found that TSA has made progress in addressing the IT insider threat and conducting vulnerability assessments, but recommended that TSA further develop its program by implementing insider threat policies and procedures for all employees.

TSA implements a risk-based strategy to address insider threat, including protective measures to detect and prevent unauthorized use of sensitive information outside TSA's network and recognizes that sensitive information can be copied or disseminated through various methods and implements physical and automated security controls to prevent inadvertent access to sensitive data. TSA has also implemented a robust program to mitigate insider cyber threats including operating a 24-hour hotline number and email address for employees and stakeholders to report possible insider cyber threat incidents. The agency has also developed policies and procedures for the establishment, integration, and implementation of the Insider Threat Program as well as specific insider cyber threat training.

The OIG also found that DHS has established policies and procedures to build upon and create new relationships to facilitate collaboration with international partners and is taking steps to strengthen operational collaboration with international counterparts to reduce cyber vulnerabilities and improve incident response and information sharing capabilities. In addition, DHS is working with the international community and industry to share its expertise and goals regarding cybersecurity.

DHS recognizes the importance of information sharing and operational collaboration at all levels and has dedicated significant resources to physical and cybersecurity international engagement. To that end, NPPD's Office of Cybersecurity & Communications (CS&C) is developing a strategic implementation plan for its international engagement with clearly defined priorities and goals. DHS continues to streamline its international affairs activities and processes to improve transparency and will examine its current internal policies and procedures related to establishing open dialogues with foreign partnerships regarding cyber threats and vulnerabilities. Finally, DHS will conduct information sharing assessments and develop operational policies and procedures subject to Federal government information sharing and privacy requirements.

Federal Information Security Management Act (FISMA)

DHS agrees with OIG's assessment that DHS needs to make improvements in several information security program areas, including incident detection and analysis, continuous monitoring, account and identity management, and specialized training. In order to address these issues, DHS has taken several steps to align with the Administration's cybersecurity priorities, including:

- Implementation of trusted Internet connections;
- Continuously monitoring the Department's information systems;
- Employing personal identity verification compliant credentials to improve logical access for its systems; and
- Updating the DHS Information Security Performance Plan with enhanced metrics.

In the area of FISMA compliance, DHS continued to improve and strengthen its information security program during FY 2012. For example, the Chief Information Security Officer:

- Developed the *FY 2012 DHS Information Security Performance Plan* to enhance DHS's information security program and improve existing processes, such as continuous monitoring, Plans of Action and Milestones, and security authorization.
- Updated the Department's governing IT security policies and procedures in both the *DHS Sensitive Systems Policy Directive 4300A* and its companion, *DHS 4300A Sensitive Systems Handbook*, to reflect the changes made in DHS security policies and various National Institute of Standards and Technology guidance.
- Issued the second *State of Cybersecurity at The Department of Homeland Security* report outlining how DHS anticipates and addresses emerging security risks from new technology products and advanced threat actor techniques, including its new initiatives and programs that ensure a secure computing environment within the Department. The report presents relevant information to employees for protecting their information and increasing the Department's cybersecurity awareness.

Concluding Comment

The Department concurs with OIG's assessment that:

> …DHS has made progress in coalescing into a more cohesive organization to address its key mission areas to secure our Nation's borders, increase our readiness, capacity, and resiliency in the face of a terrorist threat or a natural disaster, and implement increased levels of security in our transportation systems and trade operations.

The Department appreciates OIG's perspective on the most serious management and performance challenges facing the Department as well as recognition of the significant progress and substantial accomplishments DHS has made to date.

Acronym List

Acronyms

ADA – Anti-Deficiency Act
AFG – Assistance to Firefighters Grants
AFR – Annual Financial Report
ARB – Acquisition Review Board
ARRA – American Recovery and Reinvestment Act
ATA – American Trucking Association
BP – British Petroleum
BPD – Bureau of Public Debt
BUR – Bottom-Up Review
C4ISR – Command, Control, Communications, Computers, Intelligence, Surveillance, and Reconnaissance
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
CFO – Chief Financial Officer
CFR – Code of Federal Regulations
CIO – Chief Information Officer
CISO – Chief Information Security Officer
CMAS – Commercial Mobile Alert Service
COBRA – Consolidated Omnibus Budget Reconciliation Act of 1985
COR – Contracting Officer Representative
COTR – Contract Officer's Technical Representative
COTS – Commercial Off-the-Shelf
CSO – Chief Security Officer
CSRS – Civil Service Retirement System
CY – Current Year
DADLP – Disaster Assistance Direct Loan Program
DC – District of Columbia
DCAA – Defense Contract Audit Agency
DHS – Department of Homeland Security
DHS FAA – Department of Homeland Security Financial Accountability Act
DIEMS – Date of Initial Entry into Military Service
DNDO – Domestic Nuclear Detection Office
DOC – U.S. Department of Commerce
DOD – U.S. Department of Defense
DOJ – U.S. Department of Justice
DOL – U.S. Department of Labor
DST – Decision Support Tool (DST)
EDS – Explosive Detection System
EFSP – Emergency Food and Shelter Program
ELIS – Electronic Immigration Application System
EMI – Emergency Management Institute
EMPG – Emergency Management Performance Grant Program
ERO – Enforcement and Removal Operations
FAA – Department of Homeland Security Financial Accountability Act
FAST – Free and Secure Trade Program
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
FISMA – Federal Information Security Management Act
FLETA – Federal Law Enforcement Training Accreditation
FLETC – Federal Law Enforcement Training Center
FMD – Foot-and-Mouth Disease
FMFIA – Federal Managers' Financial Integrity Act

FOSC – Federal On-scene Coordinators
FPS – Federal Protective Service
FQS – FEMA Qualification System
FY – Fiscal Year
GAAP – Generally Accepted Accounting Principles
GAO – U.S. Government Accountability Office
GCCF – Gulf Coast Claims Facility
GPD – Grant Programs Directorate
GSA – General Services Administration
HSA – Homeland Security Act of 2002
HSAM – Homeland Security Acquisition Manual
HSGP – Homeland Security Grant Program
HSPD – Homeland Security Presidential Directive
HS-STEM – Homeland Security Science, Technology, Engineering and Mathematics
IA – Internal Affairs
I&A – Office of Intelligence and Analysis
ICCB – Internal Control Coordination Board
ICE – U.S. Immigration and Customs Enforcement
ICS-CERT – Industrial Control Systems Cyber Emergency Response Team
IEFA – Immigration Examination Fee Account
IHP – Individuals and Household Programs
IJ – Investment Justification
INA – Immigration Nationality Act
IP – Improper Payment
IPERA – Improper Payments Elimination and Recovery Act
IPIA – Improper Payments Information Act of 2002
IQCS – Incident Qualifications and Certification System
IT – Information Technology
ITAR – Information Technology Acquisition Review
LOI – Letters of Intent
LOR – Local Recipient Organization
MD – Management Directive
MD&A – Management's Discussion and Analysis
MERHCF – Medicare-Eligible Retiree Health Care Fund
MGMT – Management Directorate
MHS – Military Health System
MOU – Memorandum of Understanding
MPA – Maritime Patrol Aircraft
MRS – Military Retirement System
MSA – Marshal Service Agreements
MTS – Metric Tracking System
NATO – North Atlantic Treaty Organization
ND – Non-Disaster
NFIP – National Flood Insurance Program
NPFC – National Pollution Funds Center
NPG – National Preparedness Goal
NPGP – National Preparedness Grants Program
NPPD – National Protection and Programs Directorate
NPR – National Preparedness Report
NSSE – National Security Special Event
OCFO – Office of the Chief Financial Officer
OCHCO – Office of the Chief Human Capital Officer
OCIO – Office of the Chief Information Officer
OHA – Office of Health Affairs
OIG – Office of Inspector General
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
OPR – Office of Professional Responsibility
OPS – Office of Operations Coordination and Planning
ORB – Other Retirement Benefits
OSLTF – Oil Spill Liability Trust Fund
OTA – Other Transaction Agreements

OTIA – Office of Technology Innovation and Acquisition

PA – Public Assistance

PARM – Program Accountability and Risk Management Office

PCS – Permanent Change of Station

PDA – Preliminary Damage Assessments

PII – Personally Identifiable Information

POE – Port of Entry

POA&M – Plan of Action and Milestones

PPD – Presidential Policy Directive

PP&E – Property, Plant, and Equipment

Pub. L. – Public Law

PY – Prior Year

QHSR – Quadrennial Homeland Security Review

QPAR – Quarterly Program Accountability Report

RAMP – Risk Assessment and Management Program

RSSI – Required Supplementary Stewardship Information

SAT – Senior Assessment Team

SBR – Statement of Budgetary Resources

SCDL – Special Community Disaster Loan

SFFAS – Statement of Federal Financial Accounting Standards

SFRBTF – Sport Fish Restoration Boating Trust Fund

SMC – Senior Management Council

SNC – Statement of Net Cost

SOP – Standard Operation Procedure

SPR – State Preparedness Report

S&T – Science and Technology Directorate

TAFS – Treasury Account Fund Symbol

THIRA – Threat and Hazard Identification and Risk Assessments

TRAM – Transit Risk Assessment Model

Treasury – U.S. Department of the Treasury

TSA – Transportation Security Administration

TSGP – Transit Security Grants Program

U.S. – United States

USB – Universal Serial Bus

U.S.C. – United States Code

USCG – U.S. Coast Guard

USCIS – U. S. Citizenship and Immigration Services

USSS – U.S. Secret Service

US-VISIT – United States Visitor and Immigrant Status Indicator Technology

VA – U.S. Department of Veterans Affairs

WYO – Write Your Own

Homeland Security

Homeland Security