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.

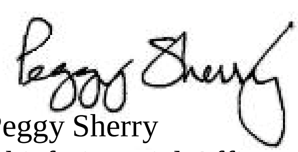
This unified effort produced substantial results and was instrumental in the Department meeting its audit goals in FY 2012. We continued to improve the quality of our Balance Sheet balances while expanding the work to ensure successful audit of the remaining statements. Together, we established a manageable, 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
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)

	Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
	2012			
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

Table of Contents for Notes to the Financial Statements

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.

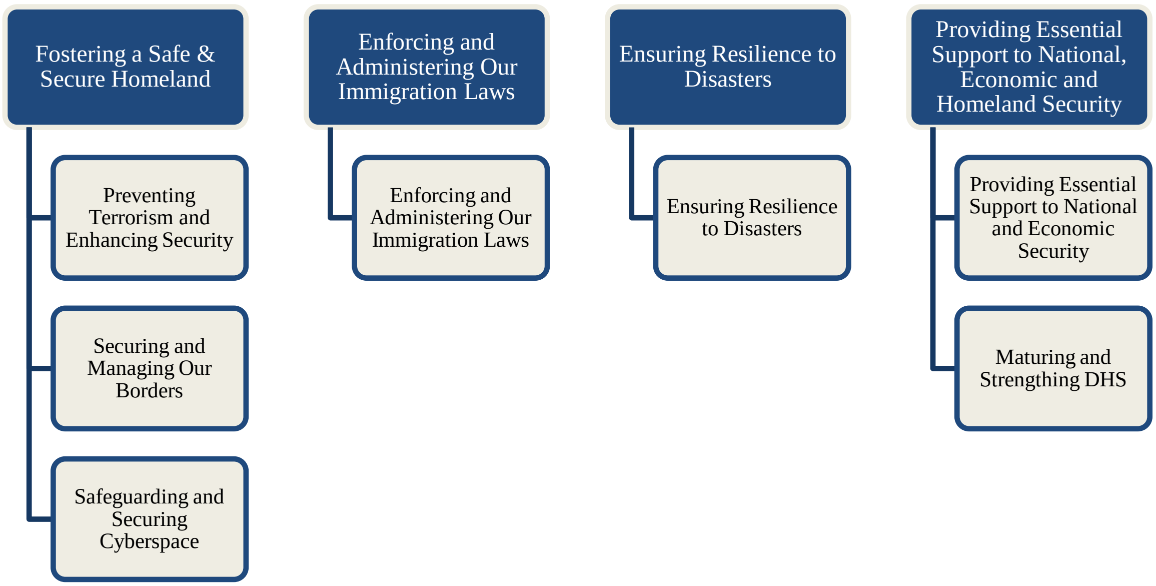
The Department's financial statements reflect the reporting of departmental activities, including appropriations received to conduct operations and revenue generated from operations. The financial statements also reflect the reporting of certain non-entity (custodial) functions performed by the Department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

S&T

- *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.

FEMA

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

- The National Fire Academy has been developed by FEMA to promote the professional development of the fire and emergency response community and its allied professionals. The National Fire Academy also develops and delivers educational and training courses with a national focus to supplement and support state and local fire service training programs.
- The Emergency Management Institute (EMI) serves as the national focal point for the development and delivery of emergency management training to enhance the capabilities of Federal, state, local, and tribal government officials, volunteer organizations, and the public and private sectors to minimize the impact of disasters on the American public.

- 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.

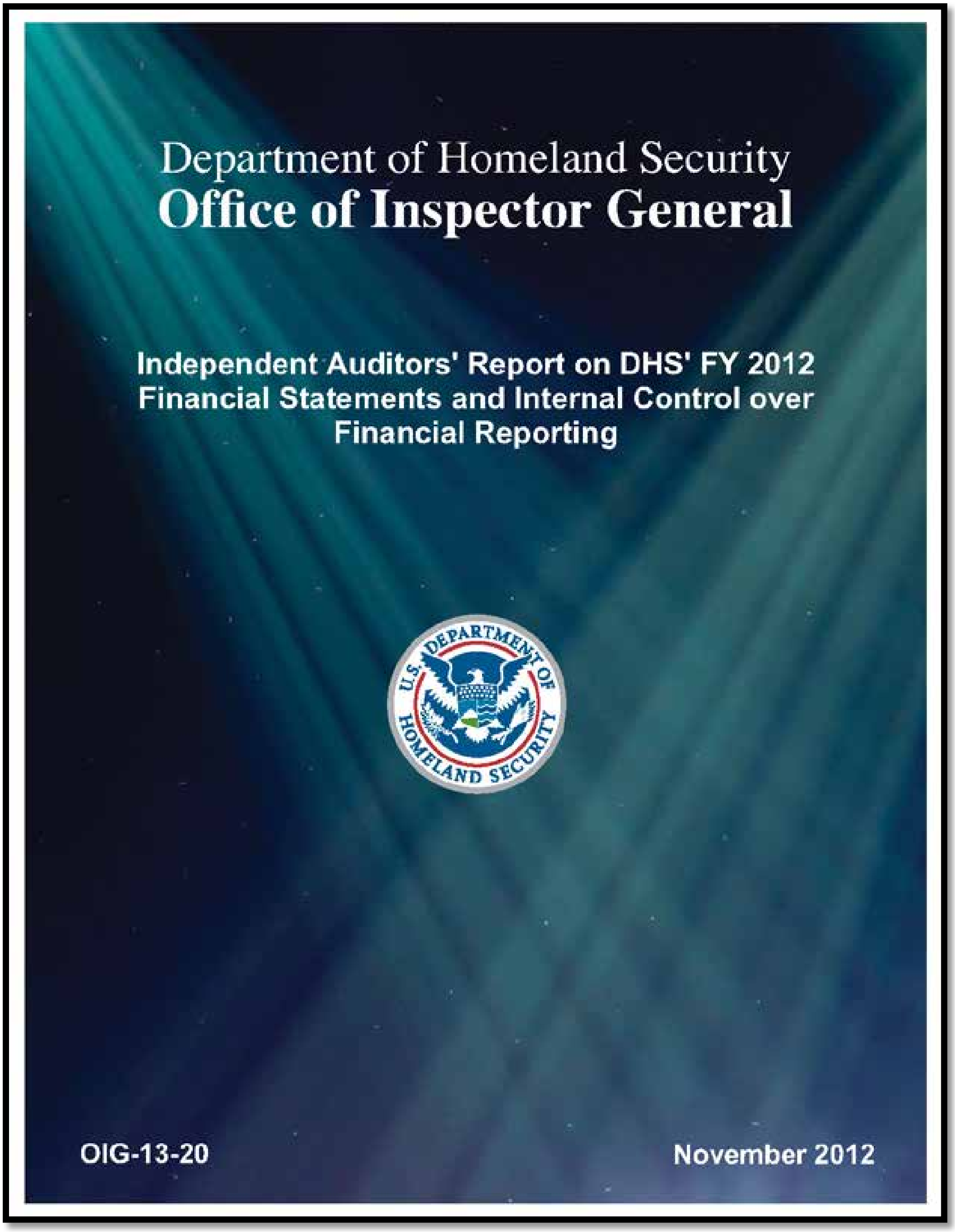
4. Risk Assumed Information

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


Department of Homeland Security
Office of Inspector General

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

OIG-13-20

November 2012

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

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

OFFICE OF INSPECTOR GENERAL
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

2

OFFICE OF INSPECTOR GENERAL
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

Table of Contents

Appendixes

www.oig.dhs.gov OIG-13-20

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.

3

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*

- *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			
TSA			
ICE		N/A	N/A
USCIS	C		N/A

Key – Trend Table	
C	Deficiencies are corrected
N/A	No deficiencies reported
	Deficiencies are less severe*
	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.

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.

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.

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.

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.

I.14

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

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.

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.

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.

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.

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

Index.1

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

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

Index.2

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

Index.3

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.

OFFICE OF INSPECTOR GENERAL
Department of Homeland Security

Appendix A
Report Distribution

Department of Homeland Security

Secretary
Deputy Secretary
Chief of Staff
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

ADDITIONAL INFORMATION AND COPIES

To obtain additional copies of this document, please call us at (202) 254-4100, fax your request to (202) 254-4305, or e-mail your request to our Office of Inspector General (OIG) Office of Public Affairs at: DHS-OIG.OfficePublicAffairs@oig.dhs.gov.

For additional information, visit our website at: www.oig.dhs.gov, or follow us on Twitter at: @dhsoig.

OIG HOTLINE

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.