Financial Information

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

November 16, 2009

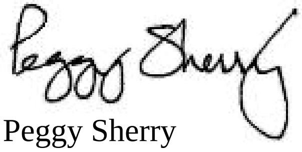
This Annual Financial Report serves as our principal financial statement of accountability to the American taxpayer, the President of the United States, and the Congress, and demonstrates the Department of Homeland Security's commitment towards ensuring strong financial management and stewardship of taxpayer dollars.

The Fiscal Year (FY) 2009 audit shows the Department continues to make measurable and sustainable progress in implementing corrective actions and improving the quality and reliability of our financial reporting. The Department is on target to have three favorable opinions on audits of individual Component Balance Sheets and two favorable opinions on full scope audits at U.S. Customs and Border Protection and the Federal Law Enforcement Training Center in FY 2009. We have also isolated the conditions that prevent completion of the consolidated audit of the Balance Sheet and Statement of Custodial Activity to one Component.

We remain fully committed to addressing our outstanding financial management challenges and our collective efforts are producing results. Over the past year, we reduced the severity of control deficiencies at four Components and we can now assert to over 50 percent of the Department's total liabilities. We also achieved compliance with the *Improper Payments Information Act*, the *Debt Collection Improvement Act*, and the *Government Performance and Results Act.* We completed the Department's multi-year plan to implement OMB Circular No. A-123, *Managements Responsibility for Internal Control*, and reduced the number of Component conditions that contributed to our material weaknesses in internal control over financial reporting by more than half since FY 2006. As we increase the number of standalone audits and scrutiny on our account balances, DHS will discover additional opportunities for financial management improvement and continue to strengthen internal controls and accountability.

I express my sincere appreciation to the Department's dedicated financial professionals who are working tirelessly together to improve financial management and accountability in support of our critical mission. We remain committed to obtaining financial excellence and look forward to continuing to build on our achievements in FY 2010.

Sincerely,



Peggy Sherry
Acting Chief Financial Officer

Introduction

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

- The **Balance Sheets** present as of September 30, 2009 and 2008, those resources owned or managed by DHS that represent future economic benefits (assets), amounts owed by DHS that will require payments from those resources or future resources (liabilities), and residual amounts retained by DHS comprising the difference (net position).

- The **Statements of Net Cost** present the net cost of DHS operations for the fiscal years ended September 30, 2009 and 2008. DHS net cost of operations is the gross cost incurred by DHS less any exchange revenue earned from DHS activities.

- The **Statements of Changes in Net Position** present the change in DHS's net position resulting from the net cost of DHS operations, budgetary financing sources, and other financing sources for the fiscal years ended September 30, 2009 and 2008.

- The **Statements of Budgetary Resources** present how and in what amounts budgetary resources were made available to DHS during FY 2009 and FY 2008, the status of these resources at September 30, 2009 and 2008, the changes in the obligated balance, and outlays of budgetary resources for the fiscal years ended September 30, 2009 and 2008.

- The **Statements of Custodial Activity** present the disposition of custodial revenue collected and disbursed by DHS on behalf of other recipient entities for the fiscal years ended September 30, 2009 and 2008.

- The **Notes to the Financial Statements** provide detail and clarification for amounts on the face of the financial statements for the fiscal years ended September 30, 2009 and 2008.

Limitations of Financial Statements

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

Financial Statements

Department of Homeland Security
Balance Sheets
As of September 30, 2009 and 2008
(In Millions)

	2009 (Unaudited)	2008 (Unaudited) (Restated)
ASSETS		
Intragovernmental		
Fund Balance with Treasury (Notes 2 and 3)	$57,172	$63,157
Investments, Net (Note 5)	3,417	3,103
Accounts Receivable (Note 6)	369	310
Other (Note 13)		
Advances and Prepayments	2,688	2,852
Due from Treasury (Note 2)	-	151
Total Intragovernmental	**$63,646**	**$69,573**
Cash and Other Monetary Assets (Notes 2 and 4)	57	67
Accounts Receivable, Net (Notes 2 and 6)	449	488
Taxes, Duties, and Trade Receivables, Net (Notes 2 and 7)	1,874	2,078
Direct Loans, Net (Note 8)	55	21
Inventory and Related Property, Net (Note 9)	562	518
General Property, Plant, and Equipment, Net (Note 11)	17,546	14,586
Other (Note 13)		
Advances and Prepayments	591	649
TOTAL ASSETS	**$84,780**	**$87,980**
Stewardship Property, Plant, and Equipment (Note 12)		
LIABILITIES		
Intragovernmental		
Accounts Payable	$2,107	$1,999
Debt (Note 15)	19,004	17,719
Other (Note 18)		
Due to the General Fund	1,969	2,397
Accrued FECA Liability	370	361
Other	720	394
Total Intragovernmental	**$24,170**	**$22,870**
Accounts Payable	2,810	2,905
Federal Employee and Veterans' Benefits (Note 16)	41,013	36,230
Environmental and Disposal Liabilities (Note 17)	1,011	1,028
Other (Notes 18, 19, 20, and 21)		
Accrued Payroll and Benefits	1,936	1,787
Deferred Revenue and Advances from Others	2,629	3,080
Unliquidated Antidumping and Countervailing Duties	106	161
Insurance Liabilities	508	5,531

Department of Homeland Security
Balance Sheets
As of September 30, 2009 and 2008
(In Millions)

	2009 (Unaudited)	2008 (Unaudited) (Restated)
Refunds and Drawbacks	126	130
Other	1,825	1,434
Total Liabilities	**$76,134**	**$75,156**
Commitments and Contingencies (Notes 19, 20, and 21)		
NET POSITION (Note 34)		
Unexpended Appropriations		
Unexpended Appropriations - Other Funds	$49,319	$55,239
Cumulative Results of Operations		
Cumulative Results of Operations-Earmarked Funds (Note 22)	(15,507)	(19,359)
Cumulative Results of Operations - Other Funds	(25,166)	(23,056)
Total Net Position	**$8,646**	**$12,824**
TOTAL LIABILITIES AND NET POSITION	**$84,780**	**$87,980**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Net Cost
For the Years Ended September 30, 2009 and 2008
(In Millions)

Directorates and Other Components (Notes 23 and 24)	**2009 (Unaudited)**	**2008 (Unaudited) (Restated)**
U.S. Customs and Border Protection		
Gross Cost	$10,672	$9,783
Less Earned Revenue	(166)	(160)
Net Cost	**10,506**	**9,623**
U.S. Coast Guard		
Gross Cost	13,832	9,516
Less Earned Revenue	(432)	(509)
Net Cost	**13,400**	**9,007**
U.S. Citizenship and Immigration Services		
Gross Cost	2,429	2,191
Less Earned Revenue	(2,696)	(2,215)
Net Cost	**(267)**	**(24)**
Federal Emergency Management Agency		
Gross Cost	14,748	18,500
Less Earned Revenue	(3,193)	(3,027)
Net Cost	**11,555**	**15,473**
Federal Law Enforcement Training Center		
Gross Cost	449	451
Less Earned Revenue	(36)	(40)
Net Cost	**413**	**411**
National Protection and Programs Directorate		
Gross Cost	885	825
Less Earned Revenue	-	(1)
Net Cost	**885**	**824**
U.S. Immigration and Customs Enforcement		
Gross Cost	6,320	5,448
Less Earned Revenue	(988)	(928)
Net Cost	**5,332**	**4,520**

Department of Homeland Security
Statements of Net Cost
For the Years Ended September 30, 2009 and 2008
(In Millions)

Directorates and Other Components (Notes 23 and 24)	2009 (Unaudited)	2008 (Unaudited) (Restated)
Office of Health Affairs		
Gross Cost	414	157
Less Earned Revenue	-	-
Net Cost	**414**	**157**
Departmental Operations and Other		
Gross Cost	1,776	1,316
Less Earned Revenue	(2)	(1)
Net Cost	**1,774**	**1,315**
U.S. Secret Service		
Gross Cost	1,818	1,747
Less Earned Revenue	(16)	(11)
Net Cost	**1,802**	**1,736**
Science and Technology Directorate		
Gross Cost	968	774
Less Earned Revenue	(4)	(6)
Net Cost	**964**	**768**
Transportation Security Administration		
Gross Cost	7,032	6,618
Less Earned Revenue	(2,243)	(2,385)
Net Cost	**4,789**	**4,233**
NET COST OF OPERATIONS	**$51,567**	**$48,043**

The accompanying notes are an integral part of these statements.

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

	2009 (Unaudited) Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
Cumulative Results of Operations				
Beginning Balances	$(19,359)	$(23,056)	$ -	$(42,415)
Budgetary Financing Sources				
Appropriations Used	-	49,252	-	49,252
Nonexchange Revenue	3,526	4	-	3,530
Donations and Forfeitures of Cash and Cash Equivalents	2	-	-	2
Transfers In/Out Without Reimbursement	(1,835)	1,640	-	(195)
Other	-	(56)	-	(56)
Other Financing Sources				
Donations and Forfeitures of Property	-	4	-	4
Transfers In/Out Reimbursement	12	(1)	-	11
Imputed Financing	55	937	226	766
Other	-	(5)	-	(5)
Total Financing Sources	1,760	51,775	226	53,309
Net Cost of Operations	2,092	(53,885)	(226)	(51,567)
Net Change	3,852	(2,110)	-	1,742
Cumulative Results of Operations	**(15,507)**	**(25,166)**	**-**	**(40,673)**
Unexpended Appropriations				
Beginning Balance	-	55,239	-	55,239
Budgetary Financing Sources				
Appropriations Received	-	46,067	-	46,067
Appropriations Transferred In/Out	-	(2,064)	-	(2,064)
Other Adjustments	-	(671)	-	(671)
Appropriations Used	-	(49,252)	-	(49,252)
Total Budgetary Financing Sources	-	(5,920)	-	(5,920)
Total Unexpended Appropriations	**-**	**49,319**	**-**	**49,319**
NET POSITION	**$(15,507)**	**$24,153**	**$ -**	**$8,646**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Changes in Net Position
For the Year Ended September 30, 2008
(In Millions)

	2008 (Unaudited) (Restated)			
	Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
Cumulative Results of Operations				
Beginning Balance	$(16,236)	$(22,647)	$ -	$(38,883)
Adjustments:				
Correction of Errors (Note 32)	(15)	(842)	-	(857)
Other (Note 32)	-	73	-	73
Beginning Balance, as Adjusted	(16,251)	(23,416)	-	(39,667)
Budgetary Financing Sources				
Appropriations Used	-	41,051	-	41,051
Nonexchange Revenue	3,823	6	-	3,829
Donations and Forfeitures of Cash and Cash Equivalents	2	-	-	2
Transfers In/Out Without Reimbursement	(2,123)	1,854	-	(269)
Other	-	(25)	-	(25)
Other Financing Sources				
Donations and Forfeitures of Property	-	14	-	14
Transfers In/Out Reimbursement	(43)	61	-	18
Imputed Financing	2	751	15	738
Other	-	(63)	-	(63)
Total Financing Sources	1,661	43,649	15	45,295
Net Cost of Operations	(4,769)	(43,289)	(15)	(48,043)
Net Change	(3,108)	360	-	(2,748)
Cumulative Results of Operations	**(19,359)**	**(23,056)**	**-**	**(42,415)**
Unexpended Appropriations				
Beginning Balances	-	47,342	-	47,342
Budgetary Financing Sources				
Appropriations Received	-	50,253	-	50,253
Appropriations Transferred In/Out	-	(683)	-	(683)
Other Adjustments	-	(622)	-	(622)
Appropriations Used	-	(41,051)	-	(41,051)
Total Budgetary Financing Sources	-	7,897	-	7,897
Total Unexpended Appropriations	**-**	**55,239**	**-**	**55,239**
NET POSITION	**$(19,359)**	**$32,183**	**$ -**	**$12,824**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Budgetary Resources
For the Years Ended September 30, 2009 and 2008
(In Millions)

	2009 (Unaudited) Budgetary	2009 (Unaudited) Non-Budgetary Credit Reform Financing Accounts	2008 (Unaudited) (Restated) Budgetary	2008 (Unaudited) (Restated) Non-Budgetary Credit Reform Financing Accounts
BUDGETARY RESOURCES				
Unobligated Balance, Brought Forward, October 1	$21,431	$4	$17,251	$131
Recoveries of Prior Year Unpaid Obligations	4,280	-	3,824	-
Budget Authority:				
Appropriations	52,839		57,653	-
Borrowing Authority	-	51		
Spending Authority from Offsetting Collections:				
Earned:				
Collected	9,541	88	9,450	172
Change in Receivables from Federal Sources	124	-	(19)	-
Change in Unfilled Customer Orders:				
Advances Received	280	-	84	-
Without Advance From Federal Sources	(506)	(30)	(357)	(37)
Expenditure Transfers from Trust Funds	48	-	48	-
Subtotal	62,326	109	66,859	135
Nonexpenditure Transfers, Net; Anticipated and Actual	(1,576)	-	(210)	-
Temporarily Not Available Pursuant to Public Law	(4)	-	(14)	-
Permanently Not Available	(1,212)	(47)	(883)	(251)
TOTAL BUDGETARY RESOURCES	**$85,245**	**$66**	**$86,827**	**$15**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred (Note 25):				
Direct	$67,635	$66	$56,737	$11
Reimbursable	4,227	-	8,659	-
Subtotal	71,862	66	65,396	11
Unobligated Balance:				
Apportioned	7,706	-	7,222	4
Exempt from Apportionment	5	-	91	-
Subtotal	7,711	-	7,313	4
Unobligated Balance Not Available	5,672	-	14,118	-
TOTAL STATUS OF BUDGETARY RESOURCES	**$85,245**	**$66**	**$86,827**	**$15**

Department of Homeland Security
Statements of Budgetary Resources
For the Years Ended September 30, 2009 and 2008
(In Millions)

	2009 (Unaudited)		2008 (Unaudited) (Restated)	
	Budgetary	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**
CHANGE IN OBLIGATED BALANCE				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, October 1	$47,103	$323	$42,746	$480
Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(2,427)	(323)	(2,802)	(361)
Total Unpaid Obligated Balance, Net	44,676	-	39,944	119
Obligations Incurred, Net	71,862	66	65,396	11
Gross Outlays	(67,896)	(95)	(57,191)	(168)
Obligated Balance Transferred, Net				
Actual Transfers, Unpaid Obligations	(25)	-	(25)	-
Total Unpaid Obligated Balance Transferred, Net	(25)	-	(25)	-
Recoveries of Prior Year Unpaid Obligations, Actual	(4,280)	-	(3,824)	-
Change in Uncollected Customer Payments from Federal Sources	383	30	376	38
Obligated Balance, Net, End of Period				
Unpaid Obligations	46,764	294	47,103	323
Uncollected Customer Payments from Federal Sources	(2,044)	(293)	(2,427)	(323)
Total, Unpaid Obligated Balance, Net, End of Period	**$44,720**	**$1**	**$44,676**	**$ -**
NET OUTLAYS				
Gross Outlays	$67,896	$95	$57,191	$168
Offsetting Collections	(9,869)	(88)	(9,582)	(172)
Distributed Offsetting Receipts	(5,213)	-	(6,048)	-
NET OUTLAYS	**$52,814**	**$7**	**$41,561**	**$(4)**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Custodial Activity
For the Years Ended September 30, 2009 and 2008
(In Millions)

	2009 (Unaudited)	2008 (Unaudited)
Revenue Activity (Note 31)		
Sources of Cash Collections:		
Duties	$22,633	$27,320
User Fees	1,405	1,796
Excise Taxes	2,555	2,457
Fines and Penalties	63	89
Interest	25	26
Miscellaneous	127	149
Total Cash Collections	26,808	31,837
Accrual Adjustments	(392)	133
Total Custodial Revenue	**26,416**	**31,970**
Disposition of Collections		
Transferred to Others:		
Federal Entities:		
U.S. Department of Agriculture	7,698	8,258
U.S. Department of Labor	94	87
U.S. Department of State	70	45
National Science Foundation	89	104
Treasury General Fund Accounts	17,373	20,973
Other Federal Agencies	30	23
Non-Federal Entities:		
Government of Puerto Rico	2	12
Government of the U.S. Virgin Islands	-	2
Other Non-Federal Entities	13	875
(Increase)/Decrease in Amounts Yet to be Transferred	(433)	237
Refunds and Drawbacks (Notes 18 and 31)	1,367	1,296
Retained by the Department	113	58
Total Disposition of Custodial Revenue	**26,416**	**31,970**
Net Custodial Activity	**$ -**	**$ -**

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements (Unaudited)

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

Notes to the Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

A. Reporting Entity

The Department of Homeland Security (DHS or the Department) was established by the *Homeland Security Act of 2002 (HSA), P.L. 107-296*, dated November 25, 2002, as an executive department of the U.S. Federal Government. DHS strives to lead the national effort to secure America. This mission includes the prevention and deterrence of terrorist attacks and protection against, and response to, threats and hazards to the Nation. In addition, DHS's mission is to ensure the safety and security of borders, welcome lawful immigrants and visitors, and promote the free flow of commerce. In support of DHS's mission, the Secretary has established additional goals to build a nimble, effective emergency response system and a culture of preparedness, and to strengthen and unify DHS operations and management. The Department is composed of 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)**
- **U.S. Immigration and Customs Enforcement (ICE),** including the Federal Protective Service (FPS)[2]
- **Office of Health Affairs (OHA)**
- **Departmental Operations and Other**, including the Management Directorate (MGMT), the Office of the Secretary, the Office of the Inspector General (OIG), the Domestic Nuclear Detection Office (DNDO), the Office of Intelligence and Analysis, and the Office of Operations Coordination and Planning
- **U.S. Secret Service (USSS)**
- **Science and Technology Directorate (S&T)**
- **Transportation Security Administration (TSA)**

The Department received supplemental appropriations during FY 2009 as a result of *The American Recovery and Reinvestment Act of 2009* (Recovery Act) (P.L. 111-5). Seven DHS Components received funding to carry out Recovery Act programs in support of the Department's mission. MGMT received funding for the consolidation of DHS headquarters; CBP received funding to strengthen border patrol security; ICE received funding for information sharing automation; TSA received funding for enhanced screening technology; U.S. Coast Guard received funding for bridge alteration construction and shore and vessel preservation; FEMA received funding for grant assistance and additional funding for emergency food and shelter; and OIG received funding for oversight and audit of programs, grants, and projects funded under the Recovery Act. Additional Recovery Act information can be found at www.recovery.gov.

[1] Financial reporting Components are to be distinguished from direct report Components presented in the Department's organization chart.
[2] Federal Protective Service was transferred to the National Protection and Programs Directorate in FY 2010.

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 the combined budgetary resources of the Department pursuant to the *Government Management Reform Act of 1994 (P.L. 103-356)* and the *Chief Financial Officers Act of 1990 (P.L. 101-576)*, as amended by the *Reports Consolidation Act of 2000 (P.L. 106-531)*.

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

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

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

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

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

C. Basis of Accounting

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

D. Use of Estimates

Management has made certain estimates and assumptions in the reporting of the financial statement balances and associated disclosures. Actual results could differ from these estimates. Significant estimates include: the year-end accruals of accounts and grants payable; contingent legal and environmental liabilities; accrued workers' compensation; allowance for doubtful accounts receivable; allowances for obsolete inventory and operating materials and supplies (OM&S) balances; allocations of indirect common costs to construction-in-progress; capitalized property, plant, and equipment; depreciation; subsidy re-estimates; deferred revenues; National Flood Insurance Program (NFIP) insurance liability; actuarial assumptions related to workers' compensation; military and other pension, retirement and post-retirement benefit assumptions; allowances for doubtful duties, fines, penalties, and certain non-entity receivables; and payables related to custodial activities and undeposited collections.

E. Entity and Non-Entity Assets

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

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

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

F. Fund Balance with Treasury

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

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

G. Cash and Other Monetary Assets

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

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

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

H. Investments, Net

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

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

I. Accounts Receivable, Net

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

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

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

J. Advances and Prepayments

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

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

For additional information, see Note 13, Other Assets.

K. Direct Loans, Net

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

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

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

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

L. Inventory and Related Property, Net

OM&S are tangible personal property consumed during normal operations. Department OM&S consist primarily of goods consumed during the service of vessels and aircraft. OM&S are valued based on an average unit cost, weighted moving average method, or on actual prices paid. OM&S are expensed when consumed or issued for use. Excess, obsolete, and unserviceable OM&S are stated at net realizable value net of an allowance, which is based on the condition of various asset categories as well as historical experience with using and disposing of such assets.

Inventory is tangible personal property that is held for sale or used in the process of production for sale. 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. Inventories on hand at year-end are stated at cost using standard price/specific identification, first-in/first-out, last acquisition price, 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.

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

The Department's prohibited seized property results primarily from criminal investigations and passenger/cargo processing. 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; nonprohibited seized property includes items that are not inherently illegal to possess or own, such as monetary instruments, real property, and tangible personal property of others.

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

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

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

N. General Property, Plant, and Equipment, Net

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

Costs for construction projects are recorded as construction-in-progress until completed and are valued at actual (direct) costs plus applied overhead and other indirect costs. In cases where historical cost information was not maintained, PP&E is capitalized using an estimated cost based on the cost of similar assets at the time of acquisition or the current cost of similar assets discounted for inflation since the time of acquisition. The U.S. Coast Guard uses market analysis as an alternative valuation method to record PP&E assets when the historical cost is unknown. For those assets that are unique or uncommon, formal appraisals are conducted to determine acquisition cost. The Department owns some of the buildings in which Components operate. Other buildings are provided by the General Services Administration (GSA), which charges rent equivalent to the commercial rental rates for similar properties.

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

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

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

Asset Description	Capitalization Threshold	Service Life
Land	Zero to $200,000	Not Applicable
Improvements to land	Zero to $200,000	2 years to 40 years
Buildings	$50,000 to $200,000	6 years to 40 years
Equipment	$5,000 to $200,000	2 years to 74 years
Capital leases and leasehold improvements	$5,000 to $200,000	2 years to 50 years
Software	$5,000 to $750,000	2 years to 7 years

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

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

O. Stewardship Property, Plant, and Equipment

Stewardship PP&E includes heritage assets and stewardship land 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 primarily of buildings and structures owned by CBP and the U.S. Coast Guard.

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

P. Liabilities

Liabilities represent the probable and measurable future outflow or other sacrifice 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, and there is no certainty that the appropriations will be enacted. The U.S. Government, acting in its sovereign capacity, can abrogate liabilities of the Department arising from any transaction or event other than contracts.

Q. Contingent Liabilities

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

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

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

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

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

R. Grants Liabilities and Cooperative Agreements

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

S. Insurance Liabilities

Insurance liabilities are the result of the Department's sale or continuation-in-force of NFIP, which is managed by FEMA. The insurance liability represents an estimate of NFIP losses that are unpaid at the Balance Sheet date. Although FEMA's Insurance Underwriting Operations believes the liability for unpaid losses and loss adjustment expenses is reasonable and adequate in the circumstances, actual incurred losses and loss adjustment expenses may not conform to the assumptions inherent in the estimation of the liability. Accordingly, the ultimate settlement of losses and the related loss adjustment expenses may vary from the estimate reported in the financial statements.

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

T. Debt and Borrowing Authority

Debt is reported within Intragovernmental Liabilities and results from Treasury loans and related interest payable to fund NFIP and Disaster Assistance Direct Loan Program (DADLP) operations of FEMA. Most of this debt is not covered by current budgetary resources. The premiums collected by FEMA for the NFIP do not cover the cash outlays.

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

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

U. Accrued Payroll and Benefits

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

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

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

The FECA liability consists of two elements. The first element, accrued FECA liability, is based on actual claims paid by DOL but not yet reimbursed by the Department. The Department reimburses

DOL for the amount of actual claims as funds are appropriated for this purpose. In general, there is a two- to three-year time period between payment by DOL and reimbursement to DOL by the Department. As a result, the Department recognizes an intragovernmental liability for the actual claims paid by DOL and to be reimbursed by the Department.

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

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

V. Federal Employee and Veterans' Benefits

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 the Office of Personnel Management (OPM) rather than the Department.

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

Similar to CSRS and FERS, OPM reports the liability for future payments to retired employees who participate in the Federal Employees Health Benefits Program and Federal Employees Group Life Insurance Program. The Department reports both the full annual cost of providing these other retirement benefits (ORB) for its retired employees and reporting contributions made for active employees. In addition, the Department recognizes an expense and liability for other post-employment benefits (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 Military Retirement System (MRS) is a defined benefit plan that includes pension benefits, disability benefits, and survivor benefits and covers all retired active duty and reserve military members of the U.S. Coast Guard. The plan is a pay-as-you-go system funded through annual appropriations. The actuarial unfunded accrued liability reported on the accompanying Balance Sheet is determined by subtracting the sum of the present value of future employer normal costs, the present value of any expected future employee contributions, and any plan assets from the present value of the future benefits expected to be paid. The normal cost (current period expense) is computed using the individual entry age normal actuarial cost method.

Military Health System for Retirees and Beneficiaries Liability. There are two categories of the Military Healthcare liability for the U.S. Coast Guard retirees and beneficiaries. The first is the Military Healthcare liability for the Medicare-eligible U.S. Coast Guard military retirees and beneficiaries. The U.S. Department of Defense (DOD) is the administrative entity for the Medicare-Eligible Retiree Health Care Fund (MERHCF) and, in accordance with Statement of Federal Financial Accounting Standards (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 the MERHCF for Medicare-eligible retirees, their dependents, and survivors. Benefits for U.S. Coast Guard members who retired prior to the establishment of the MERHCF are provided by payments from the Treasury to the MERHCF. 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 U.S. Coast Guard uses the current year actual costs to project costs for all future years.

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

Post-Employment Military Travel Benefit. U.S. Coast Guard uniformed service members are entitled to travel and transportation allowances for travel performed or to be performed under orders upon separation from the service, including the member's termination, retirement, permanent disability, or preretirement death in service. These allowances are provided whether or not the member is on active duty at the time of travel and without regard to the comparative costs of the various modes of transportation.

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

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

employer/employee contributions, as well as any plan assets, from the present value of future cost of benefits. Current period expense is computed using the aggregate cost method.
For more information on civilian pension and OPEB, MRS liability, post-employment military travel benefits, and Uniformed Division and Special Agent Pension liability, see Note 16, Federal Employee and Veterans' Benefits.

W. Earmarked Funds

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

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

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

X. Revenue and Financing Sources

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

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

Allocation Transfers. The Department is a party to allocation transfers with other Federal agencies as both a transferring (parent) entity and a receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. In general, all financial activity related to these allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations, and budget apportionments are derived. The Department allocates funds, as the parent, to the Department of Health and Human Services. During FY 2008, OMB granted an exemption from reporting this fund as a parent for FY 2008 and future periods. Therefore, financial activity related to these funds is no longer reported in the DHS financial statements and related footnotes. Based on the exemption granted by OMB, this change did not result in a restatement or reclassification of prior year amounts. DHS receives allocation transfers, as the child, from GSA, the U.S. Department of Transportation, and the Environmental Protection Agency.

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

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

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

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

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

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

Refunds and drawback of duties, taxes, and fees are recognized when payment is made. A permanent, indefinite appropriation is used to fund the disbursement of refunds and drawbacks. Disbursements are recorded as a decrease in the amount transferred to Federal entities as reported on the Statements of Custodial Activity.

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

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

Y. Fiduciary Activities

Fiduciary activities are those 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 interest that the Federal Government must uphold. Federal accounting standards require the Department to distinguish the information relating to its fiduciary activities from all other activities. Fiduciary activities are not recognized on the accompanying financial statements. The Department's fiduciary activities are currently immaterial, and therefore, no additional disclosure is necessary.

Z. Taxes

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

AA. Restatements and Reclassifications

In FY 2009, the Department restated certain FY 2008 balances and made certain reclassifications to FY 2008 balances to conform to FY 2009 presentation. For additional information, see Note 32, Restatements.

2. Non-Entity Assets

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

	2009 (Unaudited)	2008 (Unaudited) (Restated)
Intragovernmental:		
Fund Balance with Treasury	$1,415	$966
Due From Treasury	-	151
Total Intragovernmental	1,415	1,117
Cash and Other Monetary Assets	10	15
Accounts Receivable, Net	17	21
Taxes, Duties, and Trade Receivables, Net	1,874	2,078
Total Public	1,901	2,114
Total Non-Entity Assets	3,316	3,231
Total Entity Assets	81,464	84,749
Total Assets	**$84,780**	**$87,980**

Non-entity Fund Balance with Treasury consists of 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 and 7) are offset by non-entity accrued liabilities at September 30, 2009 and 2008. Non-entity receivables due from Treasury represent an estimate of duty, tax, and/or fee refunds and drawbacks that will be reimbursed by a permanent and indefinite appropriation account and will be used to pay estimated refunds and drawbacks payable. Duties and taxes receivable 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):

	2009 (Unaudited)	2008 (Unaudited) (Restated)
Appropriated Funds	$51,844	$57,063
Trust Funds	28	54
Revolving, Public Enterprise, and Working Capital Funds	428	896
Special Funds	4,223	4,555
Deposit Funds	649	589
Total Fund Balance with Treasury	**$57,172**	**$63,157**

Appropriated funds consist of amounts appropriated annually by Congress to fund the operations of the Department. Appropriated funds include clearing funds totaling $(32) million and $(42) million at September 30, 2009 and 2008, respectively (unaudited), which represent reconciling differences with Treasury balances.

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

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

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

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

B. Status of Fund Balance with Treasury

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

	2009 (Unaudited)	2008 (Unaudited) (Restated)
Budgetary Status		
Unobligated Balances:		
Available	$7,711	$7,317
Unavailable	5,672	14,118
Obligated Balance Not Yet Disbursed	44,721	44,676
Total Budgetary Status	58,104	66,111
Reconciling Adjustments:		
Receipt, Clearing, and Deposit Funds	712	655
Borrowing Authority	(1,427)	(3,415)
Investments	(3,375)	(3,063)
Receivable Transfers and Imprest Fund	(270)	(260)
Receipts Unavailable for Obligation	1,960	1,744
Authority Temporarily Precluded from Obligation	43	39
SFRBTF - Oil Spill Liability Trust Fund	1,425	1,346
Total Fund Balance with Treasury	**$57,172**	**$63,157**

Portions of the Unobligated Balances Available, Unavailable, and Obligated Balance Not Yet Disbursed contain CBP's user fees of $732 million and $768 million at September 30, 2009 and 2008, respectively (unaudited), which are restricted by law in its use to offset costs incurred by CBP.

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

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

- Receipt, clearing, and deposit funds represent amounts on deposit with Treasury that have no budget status at September 30, 2009 and 2008.

- Borrowing authority is in budgetary status for use by FEMA for NFIP purposes and community disaster loans, but transfers have not yet been made to the Fund Balance with Treasury account for these purposes.
- Budgetary resources have investments included; however, the money has been moved from the Fund Balance with Treasury asset account to Investments.
- Receivable transfers of currently invested balances increase the budget authority at the time the transfer is realized; however, obligations may be incurred before the actual transfer of funds.
- Imprest funds represent monies 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.
- Sport Fish Restoration Boating Trust Fund (SFRBTF) is a Treasury-managed fund. This fund receives revenues transferred from custodial activities of the Treasury, which are deposited in a Treasury account (see Note 22).

4. Cash and Other Monetary Assets

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

	2009 (Unaudited)	2008 (Unaudited)
Cash	$56	$63
Seized Monetary Instruments	1	4
Total Cash and Other Monetary Assets	**$57**	**$67**

DHS cash includes cash held by others, including the net balance maintained by insurance companies for flood insurance premiums received from policyholders, less amounts paid for insured losses; imprest funds; and undeposited cash, which represent fees collected but not yet deposited. Seized Monetary Instruments are held until disposition. As of September 30, 2009 and 2008, restricted non-entity cash and other monetary assets is $10 million and $15 million, respectively (unaudited).

5. Investments, Net

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

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

Investments at September 30, 2008, consisted of the following (in millions) (unaudited):

Type of Investment:	Amortization Method	Cost	Amortized (Premium) Discount	Interest Receivable	Investments, Net	Market Value Disclosure
Intragovernmental Securities:						
Oil Spill Liability Trust Fund	Effective interest method	$1,124	$31	$ -	$1,155	N/A
SFRBTF	Effective interest method	1,948	(2)	-	1,946	N/A
Total Nonmarketable		3,072	29	-	3,101	N/A
Nonmarketable, Market-Based	Straight-line method	2	-	-	2	2
Total Investments, Net		**$3,074**	**$29**	**$ -**	**$3,103**	**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. Because Treasury and DHS are both parts of the Federal Government, these assets and liabilities offset each other from the standpoint of the Federal Government as a whole. For this reason, these funds do not represent an asset or a liability in the U.S. Government-wide financial statements.

Treasury securities provide the U.S. Coast Guard with authority to draw upon the Treasury to make future benefit payments or other expenditures.

6. Accounts Receivable, Net

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

	2009 (Unaudited)	2008 (Unaudited)
Intragovernmental	**$369**	**$310**
With the Public:		
Accounts Receivable	664	737
Allowance for Doubtful Accounts	(215)	(249)
	449	**488**
Accounts Receivable, Net	**$818**	**$798**

Intragovernmental accounts receivable results from reimbursable work performed by the Department. Accounts receivable with the public consist of amounts due for reimbursable services and user fees.

7. Taxes, Duties, and Trade Receivables, Net

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

As of September 30, 2009 (Unaudited):

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

As of September 30, 2008 (Unaudited):

Receivables Category	Gross Receivables	Allowance	Total Net Receivables
Duties	$1,842	$(128)	$1,714
Excise Taxes	99	(6)	93
User Fees	144	(4)	140
Fines/Penalties	942	(887)	55
Antidumping and Countervailing Duties	364	(288)	76
Total Taxes, Duties, and Trade Receivables, Net	**$3,391**	**$(1,313)**	**$2,078**

When a violation of import/export law is discovered, a fine or penalty is established. CBP assesses a liquidated damage or penalty for these cases to the maximum extent of the law. After receiving the notice of assessment, the importer or surety has a period of time to either file a petition requesting a review of the assessment or pay the assessed amount. Once a petition is received, CBP investigates the circumstances as required by its mitigation guidelines and directives. Until this process has been completed, CBP records an allowance on fines and penalties of approximately 90 percent (94 percent at September 30, 2008) 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 two types of direct loans, State Share and Community Disaster loans, both of which are administered by FEMA.

- State Share Loans: FEMA may lend or advance to a State or an eligible applicant the portion of assistance for which the applicant is responsible under cost-sharing provisions of the Stafford Act. For 1992 and beyond, the State Share Loans are obligated from the Disaster Assistance Direct Loan Financing Account.
- Community Disaster Loans (CDLs): Loans may be authorized to local governments that have suffered a substantial loss of tax and other revenues as a result of a major disaster and have demonstrated a need for financial assistance in order to perform their municipal operating functions.

The loans are made at the current Treasury rate for a term of five years and cannot exceed 25 percent of the annual operating budget of the local government for the fiscal year in which the major disaster occurred. The exception is the Special CDL for Hurricanes Katrina and Rita, where the interest rate on the loan is less than the Treasury rate, and the amount of the loan cannot exceed 50 percent of the annual operating budget of the local government for the fiscal year in which the major disaster occurred. In addition, in accordance with recent Stafford Act amendments (P.L. 109-88), CDLs may exceed $5 million and shall not be cancelled. Since the 2006 Cohort is still disbursing, P.L. 110-28 amended the *Community Disaster Loan Act of 2005* (P.L. 109-88) by striking, "Provided further, that notwithstanding section 471(c)(1) of the *Stafford Act*, such loans may not be cancelled." The balance remains in the programming account to cover costs of undisbursed loans for the 2006 Cohort. Disbursements are tracked by cohort as determined by the date of obligation rather than disbursement.

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

	2009 (Unaudited)	2008 (Unaudited)
	Loans Receivable, Net	Loans Receivable, Net
Community Disaster Loans	**$55**	**$21**

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):

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

At September 30, 2008 (Unaudited):	Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
Community Disaster Loans	**$952**	**$56**	**$(987)**	**$21**

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

	2009 (Unaudited)	2008 (Unaudited)
Community Disaster Loans	**$89**	**$161**

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

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

Community Disaster Loans	Interest Differential	Defaults and Other	Total
2009 (Unaudited)	$14	$73	**$87**
2008 (Unaudited)	$37	$124	**$161**

Total Direct Loan Subsidy Expense

	2009 (Unaudited)	2008 (Unaudited)
Community Disaster Loans	**$87**	**$161**

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

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

	2009 (Unaudited)	2008 (Unaudited)
	Community Disaster Loans	Community Disaster Loans
Interest Subsidy Cost	5.04%	5.01%
Default Costs	- %	- %
Other	88.90%	88.28%

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

	2009 (Unaudited)	2008 (Unaudited)
Beginning balance of the subsidy cost allowance	$987	$822
Add subsidy expense for direct loans disbursed during the reporting years by component:		
Interest rate differential costs	14	37
Other subsidy costs	73	124
Adjustments:		
Subsidy allowance amortization	-	4
Ending balance of the subsidy cost allowance before reestimates	1,074	987
Add subsidy reestimate by component		
Technical/default reestimate	(5)	-
Ending balance of the subsidy cost allowance	**$1,069**	**$987**

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

	2009 (Unaudited)	2008 (Unaudited)
Community Disaster Loans	**$0.8**	**$0.5**

9. Inventory and Related Property, Net

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

	2009 (Unaudited)	2008 (Unaudited)
Operating Materials and Supplies (OM&S)		
Items Held for Use	$380	$323
Items Held for Future Use	39	32
Excess, Obsolete and Unserviceable Items	56	132
Less: Allowance for Losses	(55)	(123)
Total OM&S, Net	**420**	**364**
Inventory		
Inventory Purchased for Resale	79	89
Less: Allowance for Losses	(2)	(5)
Total Inventory, Net	**77**	**84**
Stockpile Materials Held in Reserve	**65**	**70**
Total Inventory and Related Property, Net	**$562**	**$518**

10. Seized and Forfeited Property

Prohibited seized property item counts as of September 30 and seizure and forfeiture activity for FY 2009 and 2008 are as follows:

Seizure Activity						
Fiscal Year Ended September 30, 2009 (Unaudited)						
Seized Property Category:	Beginning Balance	New Seizures	Remissions	New Forfeitures	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	1,037	1,062,594	-	(1,065,252)	2,784	1,163
Cocaine	215	26,012	-	(26,428)	375	174
Heroin	8	1,556	-	(1,558)	(1)	5
Ecstasy	33	1,147	-	(1,146)	-	34
Steroids	145	326	-	(364)	(10)	97
Firearms and Explosives (in number of items)	873	1,651	(303)	(784)	(58)	1,379
Counterfeit Currency (US/Foreign, in number of items)	3,676,346	1,574,547	-	-	(1,051,967)	4,198,926
Pornography (in number of items)	43	74	(3)	(58)	-	56
Forfeiture Activity						
Fiscal Year Ended September 30, 2009 (Unaudited)						
Forfeited Property Category:	Beginning Balance	New Forfeitures	Transfers	Destroyed	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	116,600	1,065,252	(1,833)	(525,453)	(528,514)	126,052
Cocaine	35,374	26,428	(212)	(24,057)	(18,496)	19,037
Heroin	7,066	1,558	(48)	(1,374)	(4,932)	2,270
Ecstasy	1,575	1,146	-	(1,145)	(159)	1,417
Steroids	42	364	-	(368)	1	39
Firearms and Explosives (in number of items)	408	784	(773)	(7)	-	412
Pornography (in number of items)	27	58	-	(70)	1	16

Seizure Activity						
Fiscal Year Ended September 30, 2008 (Unaudited)						
Seized Property Category:	Beginning Balance	New Seizures	Remissions	New Forfeitures	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	3,254	691,151	-	(694,570)	1,202	1,037
Cocaine	186	19,924	-	(19,876)	(19)	215
Heroin	20	5,866	-	(5,878)	-	8
Ecstasy	33	1,114	-	(1,145)	31	33
Steroids	136	393	(10)	(378)	4	145
Firearms and Explosives (in number of items)	1,130	1,444	(870)	(742)	(89)	873
Counterfeit Currency (US/Foreign, in number of items)	3,998,370	1,375,522	-	-	(1,697,546)	3,676,346
Pornography (in number of items)	76	96	(5)	(87)	(37)	43

Forfeiture Activity						
Fiscal Year Ended September 30, 2008 (Unaudited)						
Forfeited Property Category:	Beginning Balance	New Forfeitures	Transfers	Destroyed	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	172,395	694,570	(1,943)	(508,918)	(239,504)	116,600
Cocaine	21,564	19,876	(281)	(20,803)	15,018	35,374
Heroin	6,592	5,878	(11)	(1,790)	(3,603)	7,066
Ecstasy	1,867	1,145	(100)	(1,231)	(106)	1,575
Steroids	13	378	-	(355)	6	42
Firearms and Explosives (in number of items)	348	742	(732)	(8)	58	408
Pornography (in number of items)	29	87	-	(112)	23	27

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

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

11. General Property, Plant, and Equipment, Net

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

As of September 30, 2009 (Unaudited):	Service Life	Gross Cost	Accumulated Depreciation/ Amortization	Total Net Book Value
Land and Land Rights	N/A	$177	N/A	$177
Improvements to Land	2-40 yrs	1,255	90	1,165
Construction in Progress	N/A	5,964	N/A	5,964
Buildings, Other Structures and Facilities	6-40 yrs	4,817	2,341	2,476
Equipment:				
Automated Data Processing Equipment	5 yrs	419	273	146
Aircraft	12-35 yrs	3,478	1,828	1,650
Vessels	5-74 yrs	5,255	2,643	2,612
Vehicles	3-8 yrs	826	538	288
Other Equipment	2-30 yrs	5,043	3,261	1,782
Assets Under Capital Lease	2-20 yrs	79	32	47
Leasehold Improvements	2-50 yrs	620	182	438
Internal Use Software	2-7 yrs	1,671	1,380	291
Internal Use Software - in Development	N/A	510	N/A	510
Total General Property, Plant, and Equipment, Net		**$30,114**	**$12,568**	**$17,546**

As of September 30, 2008 (Unaudited and Restated):	Service Life	Gross Cost	Accumulated Depreciation/ Amortization	Total Net Book Value
Land and Land Rights	N/A	$131	N/A	$131
Improvements to Land	3-50 yrs	415	86	329
Construction in Progress	N/A	4,547	N/A	4,547
Buildings, Other Structures and Facilities	2-50 yrs	4,592	2,176	2,416
Equipment:				
Automated Data Processing Equipment	3-5 yrs	373	243	130
Aircraft	10-35 yrs	3,153	1,674	1,479
Vessels	5-65 yrs	5,234	2,499	2,735
Vehicles	3-8 yrs	530	403	127
Other Equipment	2-30 yrs	4,966	3,159	1,807
Assets Under Capital Lease	2-20 yrs	78	28	50
Leasehold Improvements	3-50 yrs	420	131	289
Internal Use Software	2-10 yrs	1,473	1,251	222
Internal Use Software - in Development	N/A	324	N/A	324
Total General Property, Plant, and Equipment, Net		**$26,236**	**$11,650**	**$14,586**

12. Stewardship Property, Plant, and Equipment

DHS's Stewardship PP&E is comprised of U.S. Coast Guard, CBP, USCIS, and FEMA heritage assets located in the United States, including the Commonwealth of Puerto Rico. Physical unit information related to heritage assets as of and for the year ended September 30, 2009 consisted of the following (in number of units):

2009 (Unaudited)	Beginning Balance (Restated)	Additions	Withdrawals	Total
Collection-type Assets				
USCG	19,607	261	(100)	19,768
CBP	2	-	-	2
USCIS	5	-	-	5
Non-collection-type Assets				
USCG	60	-	-	60
Multi-use Heritage Assets				
USCG	796	-	(12)	784
CBP	4	-	-	4
FEMA	1	-	-	1
Total Stewardship Property, Plant and Equipment	**20,475**	**261**	**(112)**	**20,624**

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

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

- Artifacts include ship's equipment (sextants, bells, binnacles, etc.); decommissioned aids-to-navigation and communication equipment (buoy bells, lighthouse lenses, lanterns, etc.); personal-use items (uniforms and related accessories); and ordnance (cannons, rifles, and lyle guns).
- Artwork consists of the U.S. Coast Guard's collection of World War II combat art as well as modern art depicting both historical and modern U.S. Coast Guard activities.

- Display models are mostly of U.S. Coast Guard vessels and aircraft. These are often builders' models acquired by the U.S. Coast Guard as part of the contracts with the ship or aircraft builders.

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

The U.S. Coast Guard does not acquire or retain heritage buildings and structures without an operational use. Most real property, even if designated as historical, is acquired for operational use and is transferred to other Government agencies or public entities when no longer required for operations. Of the U.S. Coast Guard buildings and structures designated as heritage assets, including memorials, recreational areas, and other historical areas, more than two-thirds are multi-use heritage assets.

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

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

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.

All multi-use heritage assets are reflected on the Balance Sheet as general PP&E and are depreciated over their useful life. Deferred maintenance and condition information for heritage assets and general PP&E are presented in the required supplementary information.

The Department has adopted the full provisions of SFFAS No. 29, *Heritage Assets and Stewardship Land*. For FY 2009, all heritage asset information, with the exception of condition information, is presented in the notes to the financial statements. In FY 2008, heritage asset additions and withdrawals and condition information were disclosed as required supplementary information.

13. Other Assets

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

	2009 (Unaudited)	2008 (Unaudited)
Intragovernmental:		
Advances and Prepayments	$2,688	$2,852
Due from Treasury	-	151
Total Intragovernmental	**2,688**	**3,003**
Public:		
Advances and Prepayments	591	649
Total Public	**591**	**649**
Total Other Assets	**$3,279**	**$3,652**

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

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

14. Liabilities Not Covered by Budgetary Resources

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

	2009 (Unaudited)	2008 (Unaudited) (Restated)
Intragovernmental:		
Debt (Note 15)	$18,525	$17,110
Accrued FECA Liability (Note 18)	370	361
Other	73	57
Total Intragovernmental	18,968	17,528
Public:		
Federal Employee and Veterans' Benefits:		
Actuarial FECA Liability (Note 16)	1,826	1,796
Military Service and Other Retirement Benefits (Note 16)	39,187	34,434
Environmental and Disposal Liabilities (Note 17)	985	994
Other:		
Accrued Payroll and Benefits (Note 18)	1,065	972
Insurance Liabilities (Note 20)	508	5,531
Contingent Legal Liabilities (Note 21)	242	280
Capital Lease Liability (Note 19)	71	89
Other	6	-
Total Public	43,890	44,096
Total Liabilities Not Covered by Budgetary Resources	62,858	61,624
Liabilities Covered by Budgetary Resources or Non-Entity Assets	13,276	13,532
Total Liabilities	**$76,134**	**$75,156**

The Department anticipates that the liabilities listed above will be funded from future budgetary resources when required.

15. Debt

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

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

Fiscal year ended September 30, 2008 (Unaudited)	Beginning Balance	Net Borrowing/ Repayment	Ending Balance
Debt to the Treasury General Fund:			
Debt for the NFIP	$17,902	$(183)	$17,719
Debt for Credit Reform	251	(251)	-
Total Debt to the Treasury General Fund	$18,153	$(434)	$17,719
Total Debt	**$18,153**	**$(434)**	**$17,719**

DHS's intragovernmental debt is owed to Treasury's Bureau of Public Debt (BPD) and consists of borrowings to finance claims under NFIP and borrowings to finance FEMA's credit reform programs (Disaster Assistance Direct Loan Program).

NFIP loans from Treasury are typically for a three-year term. In September 2009, FEMA repaid an outstanding loan of $16.9 billion and re-entered into a new loan totaling $16.5 billion for a one year term. Debt for the NFIP increased due to new interest and Hurricanes Gustav and Ike borrowings of $1.988 billion net of interest payments and loan repayment of $707 million. Interest rates are obtained from the BPD and range by cohort year from 0.13 percent to 4.75 percent (unaudited) as of September 30, 2009, and from 1.88 percent to 4.88 percent (unaudited) as of September 30, 2008. Interest is paid semi-annually on October 1 and April 1. Interest is accrued based on the loan balances reported by BPD. Principal repayments are required only at maturity but are permitted any time during the term of the loan. Flood premiums from policy holders and map collection fees are intended to repay loan principal and interest payments due to Treasury; however, due to the size of the debt incurred for damages sustained for Hurricanes Katrina and Rita, premiums received are only sufficient to cover the interest payments. Congress will need to enact legislation to provide funding to repay the Treasury Department or to forgive the debt.

Under Credit Reform, the unsubsidized portion of direct loans is borrowed from the Treasury. The repayment terms of FEMA's borrowing from Treasury are based on the life of each cohort of direct loans. Proceeds from collections of principal and interest from the borrowers are used to repay the Treasury. In addition, an annual reestimate is performed to determine any change from the original subsidy rate. If an upward reestimate is determined to be necessary, these funds are available through permanent indefinite authority, which is to be approved by OMB. Once these funds are appropriated, the original borrowings are repaid to Treasury. The weighted average interest rates for FY 2009 and FY 2008 were 4.75 percent and 5.09 percent (unaudited), respectively.

16. Federal Employee and Veterans' Benefits

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

	2009 (Unaudited)	2008 (Unaudited)
U.S. Coast Guard Military Retirement and Healthcare Benefits	$35,343	$30,661
U.S. Coast Guard Post-Employment Military Travel Benefits	69	82
USSS DC Pension Plan Benefits	3,770	3,686
Actuarial FECA Liability	1,826	1,796
Other	5	5
Total Federal Employee and Veterans' Benefits	**$41,013**	**$36,230**

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

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

Defined Benefit Plan:	2009 (Unaudited)	2008 (Unaudited)
Normal Cost	$731	$682
Interest on the Liability	1,584	1,510
Actuarial Losses/(Gains)	642	(501)
Actuarial Assumption Change	707	-
Total Defined Benefit Plan Expense	**$3,664**	**$1,691**
Post-retirement Healthcare:		
Normal Cost	$333	$173
Interest on the Liability	395	275
Other Actuarial (Gains)/Losses	1,507	185
Total Post-retirement Healthcare Expense	**2,235**	**633**
Total MRS Expense	**$5,899**	**$2,324**

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

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

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

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

- life expectancy and expected future service are based upon the DOD decrement (mortality, disability, withdrawal, and retirement) tables, as adjusted to reflect actual U.S. Coast Guard experience;
- cost of living increases are 3.0 percent annually; and
- annual rate of investment return is 5.75 percent.

In FY 2009, the U.S. Coast Guard performed an experience study. As a result, two assumptions regarding the term of active duty and disability rates were changed and the actuarial liability as of September 30, 2009, increased by approximately $5 billion.

B. District of Columbia Police and Fireman's Retirement System for U.S. Secret Service Employees

Special agents and other USSS personnel in certain job series hired as civilians before January 1, 1984, are eligible to transfer to the District of Columbia Police and Fireman's Retirement System (DC Pension Plan) after completion of ten years of Secret Service employment and ten years of protection-related experience. All uniformed USSS officers who were hired before January 1, 1984, are automatically covered under this retirement system. Participants in the DC Pension Plan make contributions of 7 percent of base pay with no matching contribution made by USSS. Annuitants of this plan receive benefit payments directly from the DC Pension Plan. USSS reimburses the District of Columbia for the difference between benefits provided to the annuitants and payroll contributions received from current employees. This liability is presented as a component of the liability for military service and other retirement benefits in the accompanying Balance Sheet. SFFAS No. 5 requires the administrative entity (administrator) to report the actuarial liability. However, USSS adopted the provisions of SFFAS No. 5 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, 2009, are:

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

Total expenses related to the DC Pension Plan for the fiscal years ended September 30, 2009 and 2008, were $237 million and $225 million, respectively (unaudited).

C. Actuarial FECA Liability

The actuarial FECA liability represents the estimated liability for future workers' compensation and includes the expected liability for death, disability, medical, and miscellaneous costs for approved cases. Future workers' compensation estimates for the future cost of approved compensation cases, which are generated from an application of actuarial procedures developed by DOL, were approximately $1,826 million and $1,795 million at September 30, 2009 and 2008, respectively (unaudited).

17. Environmental and Disposal Liabilities

Environmental and disposal liabilities at September 30, 2009 and 2008, are $1,011 million and $1,028 million, respectively (unaudited and restated). The Department is responsible for remediating its sites with environmental contamination and is party to various administrative proceedings, legal actions, and tort claims that may result in settlements or decisions adverse to the Federal Government. The source of remediation requirements to determine the environmental liability is based on compliance with Federal, state, or local environmental laws and regulations.

The major Federal laws covering environmental response, cleanup, and monitoring are the *Comprehensive Environmental Response, Compensation and Liability Act (P.L. 96-510)* and the *Resource Conservation and Recovery Act (P.L. 94-580)*.

The U.S. Coast Guard completed a study of its lighthouses in FY 2009, identifying from various historical lists approximately 1,500 lighthouses with potential liability. Based on this study, the U.S. Coast Guard created a cost methodology for estimating cleanup cost for various categories of lighthouse environmental liability. A total of 1,539 lighthouses were confirmed and recorded as a probable environmental and disposal liability of $792 million (unaudited) for FY 2009. In addition, the U.S. Coast Guard restated the FY 2008 lighthouse environmental liability in the amount of $733 million (unaudited). For additional information, please see Note 32, Restatements.

In accordance with the *Consolidated Security, Disaster Assistance, and Continuing Appropriations Act, 2009* (P.L. 110-329), the Secretary of Homeland Security has directed the administrator of GSA to sell through public sale all real and related personal property and transportation assets that support the Plum Island Animal Disease Center operations. The probable environmental remediation cost of the center is recognized as $8 million (unaudited) for S&T. In addition, the Facility Closure and Transition Study indicates a reasonably possible range of liability of approximately $8 million to $30 million (unaudited).

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

The Department has an unrecognized environmental liability of $93 million (unaudited) as of September 30, 2009, and $89 million (unaudited) for September 30, 2008, for U.S. Coast Guard vessels that have a reasonable possibility of being converted into marine artificial reefs; however, decisions on these conversions have not occurred. The preparation process includes the removal of all grease and buoyant material that might be harmful to the marine environment.

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

18. Other Liabilities

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

Fiscal year ended September 30, 2009 (Unaudited)	Current	Non-Current	Total
Intragovernmental:			
Due to the General Fund (Note 2)	$1,969	$ -	$1,969
Accrued FECA Liability	76	294	370
Advances from Others	447	-	447
Employer Benefits Contributions and Payroll Taxes	190	1	191
Other Intragovernmental Liabilities	17	65	82
Total Intragovernmental Other Liabilities	**$2,699**	**$360**	**$3,059**
Public:			
Accrued Payroll and Benefits (See B. below)	$1,936	$ -	$1,936
Deferred Revenue and Advances from Others (See B. below)	1,405	1,224	2,629
Unliquidated Antidumping and Countervailing Duties (Notes 2, 3, and 7)	106	-	106
Insurance Liabilities (Note 20)	175	333	508
Refunds and Drawbacks (Note 2) (See B. below)	126	-	126
Contingent Legal Liabilities (Note 21)	469	120	589
Capital Lease Liability (Note 19)	23	48	71
Other	1,158	7	1,165
Total Other Liabilities with the Public	**$5,398**	**$1,732**	**$7,130**
Total Other Liabilities	**$8,097**	**$2,092**	**$10,189**

Fiscal year ended September 30, 2008 (Unaudited and Restated)	Current	Non-Current	Total
Intragovernmental:			
Due to the General Fund (Note 2)	$2,397	$ -	$2,397
Accrued FECA Liability	137	224	361
Advances from Others	138	-	138
Employer Benefits Contributions and Payroll Taxes	149	1	150
Other Intragovernmental Liabilities	106	-	106
Total Intragovernmental Other Liabilities	**$2,927**	**$225**	**$3,152**

Public:			
Accrued Payroll and Benefits (See B. below)	$1,736	$51	$1,787
Deferred Revenue and Advances from Others (See B. below)	1,931	1,149	3,080
Unliquidated Antidumping and Countervailing Duties (Notes 2, 3 and 7)	161	-	161
Insurance Liabilities (Note 20)	1,844	3,687	5,531
Refunds and Drawbacks (Note 2) (See B. below)	130	-	130
Contingent Legal Liabilities (Note 21)	232	142	374
Capital Lease Liability (Note 19)	19	70	89
Other	970	1	971
Total Other Liabilities with the Public	**$7,023**	**$5,100**	**$12,123**
Total Other Liabilities	**$9,950**	**$5,325**	**$15,275**

A. Intragovernmental Other Liabilities

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

Workers' Compensation. Claims incurred for the benefit of Department employees under FECA are administered by DOL and are ultimately paid by the Department. The accrued FECA liability represents money owed for current claims. Reimbursement to DOL for payments made occurs approximately two years subsequent to the actual disbursement. Budgetary resources for this intragovernmental liability are made available to the Department as part of its annual appropriation from Congress in the year in which the reimbursement takes place. Workers' compensation expense was $161 million and $159 million, respectively (unaudited), for the fiscal years ended September 30, 2009 and 2008.

B. Other Liabilities with the Public

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

	2009 (Unaudited)	2008 (Unaudited)
Accrued Funded Payroll and Benefits	$841	$776
Accrued Unfunded Leave	1,047	947
Unfunded Employment Related Liabilities	18	25
Other	30	39
Total Accrued Payroll and Benefits	**$1,936**	**$1,787**

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

	2009 (Unaudited)	2008 (Unaudited)
USCIS Application Fees	$781	$1,343
FEMA Unexpired NFIP Premium	1,837	1,723
Advances from Others	11	14
Total Deferred Revenue	**$2,629**	**$3,080**

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 that are recognized over the term of the period of insurance coverage. The decrease in application fees is partly due to economic conditions and a reduction in receipts and applications in FY 2009 compared to FY 2008, which allowed USCIS to adjudicate more applications during FY 2009.

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

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

19. Leases

A. Operating Leases

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

As of September 30, 2009, estimated future minimum lease commitments under operating leases, some of which are cancelable, for equipment and GSA controlled leases were as follows (in millions) (unaudited):

	Land and Buildings	Vehicles and Equipment	Total
FY 2010	$473	$34	$507
FY 2011	484	37	521
FY 2012	495	41	536
FY 2013	472	42	514
FY 2014	447	42	489
After FY 2014	1,006	202	1,208
Total Future Minimum Lease Payments	**$3,377**	**$398**	**$3,775**

The estimated future lease payments for operating leases, some of which are cancelable, are based on lease contract terms considering payments made during the year ended September 30, 2009.

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 were as follows (in millions):

	2009 (Unaudited)	2008 (Unaudited)
Land and Buildings	$69	$69
Vehicles and Equipment	10	10
Software	152	152
Accumulated Amortization	(160)	(142)
Assets under Capital Lease, Net	**$71**	**$89**

As of September 30, 2009, estimated future minimum lease payments under capital leases, which were all non-GSA, were as follows (in millions) (unaudited):

	Land and Buildings	Software	Total
FY 2010	$6	$18	$24
FY 2011	6	-	6
FY 2012	6	-	6
FY 2013	6	-	6
FY 2014	6	-	6
After FY 2014	52	-	52
Total Future Minimum Lease Payments	82	18	100
Less: Imputed Interest and Executory Costs	28	1	29
Total Capital Lease Liability	**$54**	**$17**	**$71**

20. Insurance Liabilities

Insurance liabilities for the periods ended September 30, 2009 and 2008, were $508 million and $5,531 million, respectively (unaudited), and consist of primarily NFIP insurance liabilities.

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

	2009 (Unaudited)	2008 (Unaudited)
Beginning Balance	$5,531	$1,508
Change in Incurred Losses	(1,825)	4,942
Less: Amounts Paid During Current Period	(3,198)	(919)
Total Insurance Liability	**$508**	**$5,531**

The NFIP insurance liability, the majority of the insurance liability reported, represents an estimate of NFIP based on the loss and loss adjustment expense factors inherent in the NFIP insurance underwriting operations experience and expectations. Estimation factors used by the insurance underwriting operations reflect current case basis estimates and give effect to estimates of trends in claim severity and frequency. These estimates are periodically reviewed, and adjustments, reflected in current operations, are made as deemed necessary. The difference relates to a significant decrease in the amount of actuarial claims loss and lost adjustment expense at the close of FY 2009.

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).

21. Commitments and Contingent Liabilities

A. Legal Contingent Liabilities and Subsequent Events

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.

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, 2009, was $589 million (unaudited), of which $347 million (unaudited) was funded. This increase in recorded contingent liabilities is the result of a change in the Department's assessment of claims for which the possibility of loss could not be determined in the prior year. Asserted and pending legal claims for which loss was reasonably possible is estimated to range from $444 million (unaudited) to $10,870 million (unaudited) at September 30, 2009.

The estimated contingent liability recorded in the accompanying financial statements included with other liabilities for all probable and estimable litigation-related claims at September 30, 2008, was $374 million (unaudited), of which $94 million (unaudited) was funded.

Both the probable and reasonably possible claims are litigation related to the *Federal Tort Claims Act (P.L. 79-601)*, Oil Spill Liability Trust Fund, and various customs laws and regulations.

There are also other legal actions pending where the ultimate resolution of the legal actions, for which the possibility of loss could not be determined, may materially affect the Department's financial position or results. As of September 30, 2009, 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.

After September 30, 2009, three new claims assessed as reasonably possible arose, that resulted in the Department determining a $489 million potential upper range of loss.

B. Duty and Trade Refunds

There are various trade-related matters that fall under the jurisdiction of other Federal agencies, such as the U.S. 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, 2009 and 2008, 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, 2009 and 2008, CBP had 16 aircraft loaned from DOD with a replacement value of up to $25 million (unaudited) per aircraft. As of September 30, 2009 and 2008, the U.S. Coast Guard had three vessels loaned from DOD with a replacement value of $36 million (unaudited).

D. Other Contractual Arrangements

In addition to future lease commitments disclosed in Note 19, the Department is committed under contractual agreements for goods and services that have been ordered but not yet received (undelivered orders) at fiscal year-end. Aggregate undelivered orders for all Department activities are disclosed in Note 30. In accordance with the *National Defense Authorization Act for Fiscal Year 1991 (P.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, 2009, DHS estimates total payments related to cancelled appropriations to be $107 million (unaudited), of which $32 million (unaudited) for contractual arrangements may require future funding. As of September 30, 2008, DHS estimates $44 million (unaudited) in obligations related to cancelled appropriations for which the Department has a contractual obligation for payment, as well as an estimated $41 million (unaudited) for contractual arrangements which may require future funding.

TSA entered into a number of *Letters of Intent for Modifications to Airport Facilities* with eleven major airports in which TSA may reimburse the airports for 75 percent (estimated total of $1,357 million (unaudited)) of the cost to modify the facilities for security purposes. These Letters of Intent would not obligate TSA until funds have been appropriated and obligated. TSA has received $200 million (unaudited) in each FY 2009 and FY 2008 under this program. These funds are available for payment to the airports upon approval by TSA of an invoice for the modification costs incurred. As of September 30, 2009, TSA has received invoices or documentation for costs incurred totaling $842 million (unaudited) related to these agreements. TSA has accrued $40 million (unaudited) for the invoices or documentation received but not paid.

22. Earmarked Funds

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

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

	Customs User Fees	**Sport Fish Restoration Boating Trust Fund**	**Immigration Examination Fees**	**National Flood Insurance Program**	**All Other Earmarked Funds**	**Total Earmarked Funds**
Balance Sheet as of September 30, 2009						
ASSETS						
Fund Balance with Treasury	$732	$1	$1,479	$362	$1,453	$4,027
Investments, Net	-	1,985	-	-	1,432	3,417
Taxes Receivable	65	-	-	-	-	65
Other	99	10	124	563	460	1,256
Total Assets	**$896**	**$1,996**	**$1,603**	**$925**	**$3,345**	**$8,765**
LIABILITIES						
Other Liabilities	$85	$1,291	$1,197	$21,313	$386	$24,272
Total Liabilities	**$85**	**$1,291**	**$1,197**	**$21,313**	**$386**	**$24,272**

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	All Other Earmarked Funds	Total Earmarked Funds
NET POSITION						
Cumulative Results of Operations	$811	$705	$406	$(20,388)	$2,959	$(15,507)
Total Liabilities and Net Position	**$896**	**$1,996**	**$1,603**	**$925**	**$3,345**	**$8,765**

Statement of Net Cost for the Year Ended September 30, 2009

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	All Other Earmarked Funds	Total Earmarked Funds
Gross Program Costs	$399	$ -	$2,378	$(224)	$1,434	$3,987
Less: Earned Revenues	-	-	(2,707)	(2,900)	(472)	(6,079)
Net Cost of Operations	**$399**	**$ -**	**$(329)**	**$(3,124)**	**$962**	**$(2,092)**

Statement of Changes in Net Position for the Year Ended September 30, 2009

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	All Other Earmarked Funds	Total Earmarked Funds
Net Position Beginning of Period	$847	$768	$17	$(23,648)	$2,657	$(19,359)
Net Cost of Operations	(399)	-	329	3,124	(962)	2,092
Non-exchange Revenue	1,619	658	-	134	1,115	3,526
Other	(1,256)	(721)	60	2	149	(1,766)
Change in Net Position	(36)	(63)	389	3,260	302	3,852
Net Position, End of Period	**$811**	**$705**	**$406**	**$(20,388)**	**$2,959**	**$(15,507)**

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	All Other Earmarked Funds	Total Earmarked Funds
Balance Sheet as of September 30, 2008 (Restated)						
ASSETS						
Fund Balance with Treasury	$768	$9	$1,716	$829	$1,515	$4,837
Investments, Net	-	1,945	-	-	1,158	3,103
Taxes Receivables	75	-	-	-	-	75
Other	104	20	17	536	359	1,036
Total Assets	**$947**	**$1,974**	**$1,733**	**$1,365**	**$3,032**	**$9,051**
LIABILITIES						
Other Liabilities	$100	$1,206	$1,716	$25,013	$375	$28,410
Total Liabilities	**$100**	**$1,206**	**$1,716**	**$25,013**	**$375**	**$28,410**

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	All Other Earmarked Funds	Total Earmarked Funds
NET POSITION						
Cumulative Results of Operations	$847	$768	$17	$(23,648)	$2,657	$(19,359)
Total Liabilities and Net Position	**$947**	**$1,974**	**$1,733**	**$1,365**	**$3,032**	**$9,051**

Statement of Net Cost for the Year Ended September 30, 2008 (Restated)

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	All Other Earmarked Funds	Total Earmarked Funds
Gross Program Costs	$376	$ -	$2,145	$6,671	$1,381	$10,573
Less: Earned Revenues	-	-	(2,227)	(2,921)	(656)	(5,804)
Net Cost of Operations	**$376**	**$ -**	**$(82)**	**$3,750**	**$725**	**$4,769**

Statement of Changes in Net Position for the Year Ended September 30, 2008 (Restated)

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	All Other Earmarked Funds	Total Earmarked Funds
Net Position Beginning of Period	$788	$771	$(18)	$(19,899)	$2,107	$(16,251)
Net Cost of Operations	(376)	-	82	(3,750)	(725)	(4,769)
Non-exchange Revenue	1,925	710	-	-	1,188	3,823
Other	(1,490)	(713)	(47)	1	87	(2,162)
Change in Net Position	59	(3)	35	(3,749)	550	(3,108)
Net Position, End of Period	**$847**	**$768**	**$17**	**$(23,648)**	**$2,657**	**$(19,359)**

Customs User Fees

In April 1986, the President signed the *Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) (P.L. 99-272)*, which authorized CBP to collect user fees for certain services. The law initially established processing fees for air and sea passengers, commercial trucks, rail cars, private vessels and aircraft, commercial vessels, dutiable mail packages, and CBP broker permits. An additional fee category for processing barges and bulk carriers for Canada and Mexico, contained in tax reform legislation, was added later that year.

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

The *Customs and Trade Act of 1990* amended the COBRA legislation to provide for the hiring of inspectional personnel, the purchasing of equipment, and the covering of related expenses with any surplus monies available after overtime and excess pre-clearance costs are satisfied. Expenditures from the surplus can only be used to enhance the service provided to those functions for which fees are collected.

The fees for certain customs services are provided by 19 USC § 58c. The authority to use these funds is contained in the annual DHS Appropriations Act.

Sport Fish Restoration 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 (P.L. 98-369)*. Two funds were created under this act, the Boat 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 boat safety and conservation of U.S. recreational waters.

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

The most recent reauthorization of SFRBTF and expenditure of Boat Safety funds for the National Recreational Boating Safety Program was enacted in 2005 in the *Safe, Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) (P.L. 109-59)* and the *Sportfishing and Recreational Boating Safety Amendments Act of 2005 (P.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) (P.L. 82-414, Section 286(m)) provides for the collection of fees at a level that will ensure recovery of the full costs of providing adjudication and naturalization services, including the costs of providing similar services without charge to asylum applicants and other immigrants. The INA also states that the fees may recover administrative costs. This revenue remains available to provide immigration and naturalization benefits and allows the collection, safeguarding, and accounting for fees.

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

National Flood Insurance Program

The National Flood Insurance Program (NFIP) was established by the *National Flood Insurance Act of 1968 (P.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 (P.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 (P.L. 103-325)* reinforced the objective of using insurance as the preferred mechanism for disaster assistance by expanding mandatory flood insurance purchase requirements and by effecting a prohibition on further flood disaster assistance for any property where flood insurance, after having been mandated as a condition for receiving disaster assistance, is not mandated.

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

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

This program is an insurance program for which the Department pays claims to policyholders whose houses have been flooded. The WYO companies that participate in the program have authority to use Departmental funds (revenue and other financing sources) to respond to the obligations of the policyholders. Congress has mandated that the NFIP funds are to only be used to pay claims caused by flooding.

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

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, Emergency Preparedness and Response, Department of Homeland Security
- 70X5089: U.S. Customs and Border Protection, Land Border Inspection Fees, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70_5087: U.S. Customs and Border Protection, Immigration User Fees, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5126: Breach Bond/Detention Fund, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5378: Student and Exchange Visitor Program, Border and Transportation Security, Department of Homeland Security; 110 Stat. 3009-706, Sec. (e)(4)(B)

- 70X5382: Immigration User Fee Account, BICE, Department of Homeland Security; 116 Stat. 2135
- 70X5385: Aviation Security Capital Fund, Transportation Security Administration, Department of Homeland Security; 117 Stat. 2567(h)(1)
- 70_5389: H-1B and L Fraud Prevention and Detection Account, U.S. Citizenship and Immigration Service, Department of Homeland Security; 8 U.S.C. § 1356(s)
- 70X5390: Unclaimed Checkpoint Money, Transportation Security Administration, Department of Homeland Security; 118 Stat. 1317-1318, Sec.515(a)
- 70X5398: H-1B and L Fraud Prevention and Detection, U.S. Immigration and Customs Enforcement, Department of Homeland Security; P.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); P.L. 107-296, Sec. 476c
- 70X5545: Airport Checkpoint Screening Fund, Transportation Security Administration, Department of Homeland Security; P.L. 110-161
- 70_5694: User Fees, Small Airports, U.S. Customs Service, Department of Homeland Security; 116 Stat. 2135
- 70X8149: Boat Safety, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8244: Gifts and Donations, Department Management, Department of Homeland Security; 116 Stat. 2135 (FEMA REPORTED)
- 70X8312: Oil Spill Liability Trust Fund, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70_8314: Trust Fund Share of Expenses, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8349: Oil Spill Recovery, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8533: General Gift Fund, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8870: Harbor Maintenance Fee Collection, U.S. Customs Service, Department of Homeland Security; 116 Stat. 2135
- 70X8185: Oil Spill Liability Trust Fund; 103 Stat. 2363, 2364
- 70_5106: H-1 B Nonimmigrant Petitioner Account, Department of Homeland Security; 116 Stat. 2135
- 70X8360: Gifts and Bequests, Federal Law Enforcement Training Center, Department of Homeland Security; 116 Stat. 2135
- 70X8420: Surcharge Collections, Sales of Commissary Stores, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8428: Coast Guard Cadet Fund, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X5543: International Registered Traveler Program Fund, U.S. Customs and Border Protection, Department of Homeland Security; 121 Stat. 2091-2092

23. Intragovernmental Costs and Exchange Revenue

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

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
U.S. Customs and Border Protection			
Gross Cost	$2,876	$7,796	$10,672
Less Earned Revenue	(45)	(121)	(166)
Net Cost	**2,831**	**7,675**	**10,506**
U.S. Coast Guard			
Gross Cost	845	12,987	13,832
Less Earned Revenue	(187)	(245)	(432)
Net Cost	**658**	**12,742**	**13,400**
U.S. Citizenship and Immigration Services			
Gross Cost	640	1,789	2,429
Less Earned Revenue	(8)	(2,688)	(2,696)
Net Cost	**632**	**(899)**	**(267)**
Federal Emergency Management Agency			
Gross Cost	1,866	12,882	14,748
Less Earned Revenue	(259)	(2,934)	(3,193)
Net Cost	**1,607**	**9,948**	**11,555**
Federal Law Enforcement Training Center			
Gross Cost	54	395	449
Less Earned Revenue	(35)	(1)	(36)
Net Cost	**19**	**394**	**413**
National Protection and Programs Directorate			
Gross Cost	346	539	885
Less Earned Revenue	-	-	-
Net Cost	**346**	**539**	**885**
U.S. Immigration and Customs Enforcement			
Gross Cost	1,374	4,946	6,320
Less Earned Revenue	(834)	(154)	(988)
Net Cost	**540**	**4,792**	**5,332**
Office of Health Affairs			
Gross Cost	355	59	414
Less Earned Revenue	-	-	-
Net Cost	**355**	**59**	**414**

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
Departmental Operations and Other			
Gross Cost	$570	$1,206	$1,776
Less Earned Revenue	(2)	-	(2)
Net Cost	**568**	**1,206**	**1,774**
U.S. Secret Service			
Gross Cost	450	1,368	1,818
Less Earned Revenue	(16)	-	(16)
Net Cost	**434**	**1,368**	**1,802**
Science and Technology Directorate			
Gross Cost	528	440	968
Less Earned Revenue	(3)	(1)	(4)
Net Cost	**525**	**439**	**964**
Transportation Security Administration			
Gross Cost	1,157	5,875	7,032
Less Earned Revenue	(1)	(2,242)	(2,243)
Net Cost	**1,156**	**3,633**	**4,789**
Total Department of Homeland Security			
Gross Cost	11,061	50,282	61,343
Less Earned Revenue	(1,390)	(8,386)	(9,776)
Net Cost	**$9,671**	**$41,896**	**$51,567**

For the year ended September 30, 2008 (in millions) (Unaudited and Restated)

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
U.S. Customs and Border Protection			
Gross Cost	$2,463	$7,320	$9,783
Less Earned Revenue	(55)	(105)	(160)
Net Cost	**2,408**	**7,215**	**9,623**
U.S. Coast Guard			
Gross Cost	702	8,814	9,516
Less Earned Revenue	(203)	(306)	(509)
Net Cost	**499**	**8,508**	**9,007**
U.S. Citizenship and Immigration Services			
Gross Cost	660	1,531	2,191
Less Earned Revenue	(5)	(2,210)	(2,215)
Net Cost	**655**	**(679)**	**(24)**
Federal Emergency Management Agency			
Gross Cost	1,597	16,903	18,500
Less Earned Revenue	(80)	(2,947)	(3,027)
Net Cost	**1,517**	**13,956**	**15,473**
Federal Law Enforcement Training Center			
Gross Cost	32	419	451
Less Earned Revenue	(38)	(2)	(40)
Net Cost	**(6)**	**417**	**411**
National Protection and Programs Directorate			
Gross Cost	337	488	825
Less Earned Revenue	(1)	-	(1)
Net Cost	**336**	**488**	**824**
U.S. Immigration and Customs Enforcement			
Gross Cost	1,315	4,133	5,448
Less Earned Revenue	(822)	(106)	(928)
Net Cost	**493**	**4,027**	**4,520**
Office of Health Affairs			
Gross Cost	119	38	157
Less Earned Revenue	-	-	-
Net Cost	**119**	**38**	**157**

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
Departmental Operations and Other			
Gross Cost	$380	$936	$1,316
Less Earned Revenue	(1)	-	(1)
Net Cost	**379**	**936**	**1,315**
U.S. Secret Service			
Gross Cost	427	1,320	1,747
Less Earned Revenue	(11)	-	(11)
Net Cost	**416**	**1,320**	**1,736**
Science and Technology Directorate			
Gross Cost	444	330	774
Less Earned Revenue	(6)	-	(6)
Net Cost	**438**	**330**	**768**
Transportation Security Administration			
Gross Cost	1,230	5,388	6,618
Less Earned Revenue	(1)	(2,384)	(2,385)
Net Cost	**1,229**	**3,004**	**4,233**
Total Department of Homeland Security			
Gross Cost	9,706	47,620	57,326
Less Earned Revenue	(1,223)	(8,060)	(9,283)
Net Cost	**$8,483**	**$39,560**	**$48,043**

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

24. Suborganization Costs by DHS Goals

Operating costs are summarized in the Statement of Net Cost by responsibility segment, as applicable to the reporting period. The net cost of operations is the gross (i.e., total) cost incurred by the Department, less any exchange (i.e., earned) revenue. A responsibility segment is the Component that carries out a mission or major line of activity, and whose managers report directly to Departmental management.

The suborganization costs by DHS goals are presented to integrate performance and financial information, as required by the *President's Management Agenda* and the *Government Performance and Results Act (P.L. 103-62).* As such, the FY 2009 net costs are allocated to Departmental strategic goals (*Fiscal Year 2008-2013 Strategic Plan*) for all Components. However, due to a complex cost management system and the late issuance of the current Departmental strategic goals in September 2008, CBP did not have sufficient time to reprogram its system at the end of FY 2008. Therefore, the FY 2008 net cost information for CBP was presented in the FY 2008 Annual Financial Report based on the Secretary's two-year goals (which had been in effect for FY 2007), and has not been reclassified to be consistent with the current year presentation based on the new strategic goals.

Net Costs of Department Sub-organizations by Strategic Goals (in millions)
For the Year Ended September 30, 2009 (Unaudited)

	Protect our Nation from Dangerous People	Protect our Nation from Dangerous Goods	Protect Critical Infrastructure	Strengthen Our Nation's Preparedness and Emergency Response Capabilities	Strengthen and Unify DHS Operations and Management	TOTAL
U.S. Customs and Border Protection	$5,793	$4,707	$6	$ -	$ -	**$10,506**
U.S. Coast Guard	2,445	1,815	7,150	1,990	-	**13,400**
U.S. Citizenship and Immigration Services	(267)	-	-	-	-	**(267)**
Federal Emergency Management Agency	-	-	175	11,380	-	**11,555**
Federal Law Enforcement Training Center	-	-	-	413	-	**413**
National Protection and Programs Directorate	310	-	551	24	-	**885**
U.S. Immigration and Customs Enforcement	5,007	-	325	-	-	**5,332**
Office of Health Affairs	-	331	-	83	-	**414**
Departmental Operations and Other	-	308	-	-	1,466	**1,774**
U.S. Secret Service	-	-	1,802	-	-	**1,802**
Science and Technology Directorate	50	487	125	302	-	**964**
Transportation Security Administration	2,772	994	1,023	-	-	**4,789**
TOTAL Department	**$16,110**	**$8,642**	**$11,157**	**$14,192**	**$1,466**	**$51,567**

Net Costs of Department Sub-organizations by Strategic Goals (in millions)
For the Year Ended September 30, 2008 (Unaudited) (Restated)

	Protect our Nation from Dangerous People	Protect our Nation from Dangerous Goods	Protect Critical Infrastructure	Strengthen Our Nation's Preparedness and Emergency Response Capabilities	Strengthen and Unify DHS Operations and Management	TOTAL
U.S. Customs and Border Protection	$9,623	$ -	$ -	$ -	$ -	**$9,623**
U.S. Coast Guard	1,581	1,154	4,894	1,378	-	**9,007**
U.S. Citizenship and Immigration Services	(24)	-	-	-	-	**(24)**
Federal Emergency Management Agency	-	-	6	15,467	-	**15,473**
Federal Law Enforcement Training Center	-	-	-	411	-	**411**
National Protection and Programs Directorate	243	-	554	27	-	**824**
U.S. Immigration and Customs Enforcement	4,224	-	296	-	-	**4,520**
Office of Health Affairs	-	126	-	31	-	**157**
Departmental Operations and Other	-	257	-	-	1,058	**1,315**
U.S. Secret Service	-	-	1,736	-	-	**1,736**
Science and Technology Directorate	40	430	85	213	-	**768**
Transportation Security Administration	3,184	862	187	-	-	**4,233**
TOTAL Department	**$18,871**	**$2,829**	**$7,758**	**$17,527**	**$1,058**	**$48,043**

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

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

Year Ended September 30, 2009 (Unaudited):	**Apportionment Category A**	**Apportionment Category B**	**Exempt from Apportionment**	**Total**
Obligations Incurred - Direct	$32,668	$33,739	$1,294	$67,701
Obligations Incurred - Reimbursable	3,303	914	10	4,227
Total Obligations Incurred	**$35,971**	**$34,653**	**$1,304**	**$71,928**

Year Ended September 30, 2008 (Unaudited) (Restated):	**Apportionment Category A**	**Apportionment Category B**	**Exempt from Apportionment**	**Total**
Obligations Incurred - Direct	$32,576	$23,172	$1,000	$56,748
Obligations Incurred - Reimbursable	3,631	5,018	10	8,659
Total Obligations Incurred	**$36,207**	**$28,190**	**$1,010**	**$65,407**

The increase in direct obligations incurred was the result of obligation activity against increased funding because of Hurricanes Gustav and Ike. The decrease in reimbursable obligations incurred was a result of a reclassification in NFIP accounts from direct to reimbursable during FY 2008 which did not occur in FY 2009.

26. Available Borrowing Authority

At the beginning of FY 2009, the Department, through FEMA's NFIP, had available borrowing authority of $3,415 million (unaudited). During FY 2009, FEMA received $51 million (unaudited) in new borrowing authority, used $1,992 million (unaudited) in borrowing authority, and had a decrease of $47 million (unaudited) in indefinite borrowing authority, which leaves a balance of $1,427 million (unaudited). For FY 2008, FEMA had a beginning balance of $3,465 million (unaudited) in borrowing authority. During FY 2008, FEMA used $50 million (unaudited), leaving a balance of $3,415 million (unaudited). DADLP annually requests borrowing authority to cover the principal amount of direct loans not to exceed $25 million less the subsidy due from the program account.

27. Permanent Indefinite Appropriations

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

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

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

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

28. Legal Arrangements Affecting the Use of Unobligated Balances

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

Included in the cumulative results of operations for special funds is $1 billion (unaudited) at September 30, 2009, and $1.1 billion (unaudited) at September 30, 2008, that represents the Department's authority to assess and collect user fees relating to merchandise and passenger processing; to assess and collect fees associated with services performed at certain small airports or other facilities; to retain amounts needed to offset costs associated with collecting duties; and taxes and fees for the Government of Puerto Rico. These special fund balances are restricted by law in their use to offset specific costs incurred by the Department. Part of the passenger fees in the User Fees Account, totaling approximately $784 million (unaudited) and $735 million (unaudited) at September 30, 2009 and 2008, respectively, is restricted by law in its use to offset specific costs incurred by the Department and are available to the extent provided in Department appropriation acts.

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

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

The table below documents the material differences between the FY 2008 Statement of Budgetary Resources (SBR) and the actual amounts reported for FY 2008 in the Budget of the U.S. Government. Since the FY 2009 financial statements will be reported prior to the release of the Budget of the U.S. Government, DHS is reporting for FY 2008 only. Typically, the Budget of the U.S. Government with the FY 2009 actual data is published in February of the subsequent year. Once published, the FY 2009 actual data will be available on the OMB website at: www.whitehouse.gov/omb.

	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
FY 2008 Actual Balances per the FY 2010 President's Budget (in millions) (Unaudited)	**$84,960**	**$64,122**	**$6,048**	**$46,725**
Reconciling Items:				
Accounts that are expired that are not included in Budget of the United States.	1,346	62	-	-
Distributed Offsetting Receipts not included in the Budget of the United States.	-	-	-	(6,048)
Refunds and drawbacks not included in the Budget of the United States.	970	265	-	264
Byrd Program (Continued Dumping and Subsidy Offset) not included in the Budget of the United States.	969	969	-	969
Biodefense Countermeasure Program included in the Budget of the United States.	(1,436)	(5)	-	(356)
Miscellaneous Differences	33	(6)	-	3
Per the 2008 SBR (Unaudited) (Restated)	**$86,842**	**$65,407**	**$6,048**	**$41,557**

30. Undelivered Orders, Unpaid, End of Period

An unpaid undelivered order exists when a valid obligation has occurred and funds have been reserved but the goods or services have not been delivered. Undelivered orders for the periods ended September 30, 2009 and 2008, were $41,621 million (unaudited) and $41,775 million (unaudited and restated), respectively.

31. Custodial Revenues

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

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

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

- **Excise taxes:** amounts collected on imported distilled spirits, wines, and tobacco products.

- **User fees:** amounts designed to maintain U.S. harbors and to defray the cost of other miscellaneous service programs. User fees include application fees collected from employers sponsoring nonimmigrant petitions.

- **Fines and penalties:** amounts collected for violations of laws and regulations.

- **Refunds:** overpayments of duties, taxes, fees, and interest to an importer/exporter for which the importer/exporter needs to reimburse the payer. 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, 2009 and 2008 (in millions) (unaudited):

2009 Tax Disbursements

	Tax Year				
	2009	2008	2007	2006	Prior Years
Customs duties	$755	$176	$71	$42	$323
Total nonexchange revenue refunded	755	176	71	42	323
Exchange revenue refunded	-	-	-	-	-
Total tax refunds and drawbacks disbursed	**$755**	**$176**	**$71**	**$42**	**$323**

2008 Tax Disbursements

	Tax Year				
	2008	2007	2006	2005	Prior Years
Customs duties	$815	$162	$54	$27	$238
Total nonexchange revenue refunded	815	162	54	27	238
Exchange revenue refunded	-	-	- -	-	
Total tax refunds and drawbacks disbursed	**$815**	**$162**	**$54**	**$27**	**$238**

The disbursements include interest payments of $85 million and $34 million for the fiscal years ended September 30, 2009 and 2008, respectively (unaudited).

The disbursement totals for refunds include antidumping and countervailing duties collected that are refunded pursuant to rulings by the U.S. 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.

The total amounts of antidumping and countervailing duties vary from year to year depending on decisions from DOC. Antidumping and countervailing duty refunds (included in total refunds presented above) and associated interest refunded for the fiscal years ended September 30, 2009 and 2008, consisted of the following (in millions):

	2009 (Unaudited)	2008 (Unaudited)
Antidumping and Countervailing Duty Refunds	$29	$16
Interest	1	1
Total Antidumping and Countervailing Duty Refunds	**$30**	**$17**

32. Restatements

A. USCG Restatement (Unaudited)

Property, Plant, and Equipment. The Department restated the FY 2008 financial statements to correct errors in property, plant, and equipment for property accounted for using incorrect acquisition values, labor costs, and accumulated depreciation balances. Correction of these errors required adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Budgetary Resources and the Statement of Custodial Activity, as follows:

A.1 – Decrease property, plant, and equipment by net value of $69 million;
A.2 – Increase operating expense by $8 million;
A.3 – Decrease cumulative results of operations – other funds and net position by $69 million;
A.4 – Decrease beginning balance FY 2008 cumulative results of operations by $105 million; and
A.5 – Increase earned revenue by $44 million.

Environmental Liabilities. The Department restated the FY 2008 financial statements to correct errors in cleanup costs for additional lighthouses identified in a U.S. Coast Guard lighthouse study completed in FY 2009. Correction of these errors required adjustments to the Balance Sheet and Statement of Changes in Net Position and related footnotes as follows:

A.6 – Increase environmental liabilities by $733 million;
A.7 – Decrease cumulative results of operations – other funds and net position by $733 million; and
A.8 – Decrease beginning balance FY 2008 cumulative results of operations by $733 million.

B. USCIS Restatement (Unaudited)

Internal Use Software. USCIS was not in compliance with SFFAS No. 10, *Accounting for Internal Use Software* and DHS Financial Management Policy Manual, Section 3.1, Property, Plant, and Equipment, because of the following errors in USCIS balances and transactions:

- USCIS had expensed instead of capitalized costs for the development of internal use software;
- USCIS had not properly identified and accounted for the implementation of internal use software; and
- USCIS had not properly amortized the internal use software in service because it was not properly identified.

USCIS conducted an analysis of all software development projects, including the reporting of internal use software developed by the former Immigration and Naturalization Service and still used by USCIS, and corrected the account balances.

Leasehold Improvements. USCIS conducted a detailed review of improvements made to USCIS lease spaces based on GSA policy and the Financial Accounting Standards Board guidance on capital leases. As a result of this review, it was determined that certain leasehold improvements were inappropriately capitalized instead of expensed. Additionally, the period of amortization for leasehold improvements were adjusted to the life of the lease instead of a set number of years to comply with Departmental guidance.

Personal Property and Equipment. USCIS conducted a detailed review of all equipment on hand to ensure all capital equipment was recorded for the appropriate value and acquisition dates.

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

B.1 – Decrease property, plant, and equipment by a net value of $22 million;
B.2 – Increase operating expenses by $7 million;
B.3 – Decrease cumulative results of operation – earmarked and net position by $22 million; and
B.4 – Decrease beginning balance FY 2008 cumulative results of operations by $15 million

C. FLETC Restatement (Unaudited)

Environmental Disposal Liabilities. The Department restated the FY 2008 financial statements to correct errors in environmental and disposal liability balances. The understatement of environmental and disposal liability was caused by the change in estimate methodology and a revision of the number of sites requiring remediation. Correction of these estimates required adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Custodial Activity, as follows:

C.1 – Increase environmental disposal liability by $7 million;
C.2 – Decrease cumulative results of operation – other funds and net position by $7 million; and
C.3 – Decrease beginning balance FY 2008 cumulative results of operations by $7 million.

Budgetary Resources. The Department restated the FY 2008 financial statements to correct errors in Budgetary Resources balance due to the elimination of the balances of a one-year fund and to carry forward the balances of the reimbursable agreements of no-year funds. Correction of these errors required adjustments to the Statement of Budgetary Resources and related footnotes, as follows:

C.4 – Increase in unfilled customer orders without advance from Federal sources by $7 million;
C.5 – Decrease in unobligated balance apportioned by $2 million;
C.6 – Decrease in obligations incurred reimbursable by $5 million;
C.7 – Increase in unobligated balance not available by $35 million:
C.8 – Increase in beginning balance unobligated balance brought forward by $35 million;
C.9 – Increase uncollected customer payments from Federal sources, brought forward by $32 million;
C.10 – Increase uncollected customer payments from Federal sources by $24 million;
C.11 – Increase change in uncollected customer payments from Federal sources by $9 million;
C.12 – Decrease obligated balance, net of period unpaid obligations by $9 million;

C.13 – Decrease obligated balance, net unpaid obligations brought forward by $5 million; and
C.14 – Decrease obligations incurred, net by $9 million.

D. ICE Restatement (Unaudited)

Internal Use Software. As a result of an analysis conducted to determine compliance with SFFAS No. 10, Accounting for Internal Use Software and DHS Financial Management Policy Manual, Section 3.1, Property, Plant and Equipment, the Department restated the FY 2008 financial statements to correct the following errors in internal use software balances and transactions:

- The development of internal use software was being expensed in error instead of being capitalized;
- ICE had not properly identified and accounted for the implementation of internal use software; and
- ICE had not properly amortized the internal use software in service because it was not properly identified.

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

D.1 – Decrease property, plant, and equipment by net value of $41 million;
D.2 – Decrease operating expenses by $10 million;
D.3 – Decrease cumulative results of operation – other funds and net position by $41 million; and
D.4 – Decrease beginning balance FY 2008 cumulative results of operations by $51 million.

Personal Property, and Equipment. The Department restated the FY 2008 financial statements for changes in the capitalization threshold. The capitalization thresholds were changed for Equipment from $200 thousand to $50 thousand and vehicles from $200 thousand to all vehicles regardless of cost. Changes in the capitalization thresholds are considered changes in accounting principle and required adjustments to the principal financial statements and related footnotes, except for the Statement of Budgetary Resources and the Statement of Custodial Activity. DHS retroactively applied the change to FY 2008 in order to present financial statements, as follows:

D.5 – Increase property, plant, and equipment by net value of $100 million;
D.6 – Decrease operating expenses by $27 million;
D.7 – Increase cumulative results of operations – other funds and net position by $100 million; and
D.8 – Increase beginning balance FY 2008 cumulative results of operations by $73 million.

E. NPPD Restatement (Unaudited)

Personal Property and Equipment. As a result of a physical inventory conducted at a contractor's facility, the Department restated the FY 2008 financial statements to record computer hardware equipment that was acquired prior to FY 2008 but not reported in the financial statements. This error required correcting adjustments to each of the principal financial statements and related footnotes, except for the Statement of Budgetary Resources and the Statement of Custodial Activity, as follows:

E.1 – Increase property, plant, and equipment by a net value of $163 million;
E.2 – Decrease operating expenses by $47 million;
E.3 – Increase cumulative results of operations – other funds and net position by $163 million; and
E.4 – Increase beginning balance FY 2008 cumulative results of operations by $116 million.

F. S&T Restatement (Unaudited)

Internal Use Software. As a result of an analysis conducted to determine compliance with SFFAS No. 10, *Accounting for Internal Use Software* and DHS Financial Management Policy Manual, Section 3.1, Property, Plant, and Equipment, the Department restated the FY 2008 financial statements to correct the following errors in internal use software balances and transactions:

- The development of internal use software was being expensed in error instead of being capitalized;
- S&T had not properly identified and accounted for the implementation of internal use software; and
- S&T had not properly amortized the internal use software in service because it was not properly identified.

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

F.1 – Increase property, plant, and equipment by a net value of $11 million;
F.2 – Decrease operating expenses by $2 million;
F.3 – Increase cumulative results of operation – other funds and net position by $11 million; and
F.4 – Increase beginning balance FY 2008 cumulative results of operations by $11 million.

G. TSA Restatement (Unaudited)

Accounts Payable. The Department restated the FY 2008 financial statements to correct the Accounts Payable balances as a result of over-accruing for TSA's canine cooperative agreements at the end of the fiscal year. This error required correcting adjustments to each of the principal financial statements and related footnotes, except for the Statement of Custodial Activity, as follows:

G.1 – Decrease non-governmental accounts payable by $12 million;
G.2 – Increase unexpended appropriations – other funds by $12 million;
G.3 – Decrease appropriations used by $12 million; and
G.4 – Decrease operating expenses by $12 million.

Personal Property and Equipment. The Department restated the FY 2008 financial statements to correct capital asset balances and transactions, as described below:

- The capitalization threshold was lowered from $50 thousand to $25 thousand, following the results of TSA's FY 2008 financial statement audit, causing an understatement of capitalized assets; and
- TSA erroneously double counted assets that became inactive between October 2007 and December 2007.

These modifications and corrections to capital assets required adjustments to each of the principal financial statements and related footnotes, except the Statement of Budgetary Resources and the Statement of Custodial Activity, as follows:

G.5 – Increase property, plant, and equipment by a net value of $95 million;
G.6 – Increase cumulative results of operations – other funds and net position by $95 million;
G.7 – Increase operating expenses by $3 million;
G.8 – Increase beginning balance FY 2008 cumulative results of operations by $85 million; and,
G.9 – Decrease budgetary financing sources – other by $13 million.

Internal Use Software. During FY 2009, TSA performed a subsequent analysis of the internal use software that was recorded in FY 2008. This analysis revealed that TSA had overstated its internal use software, including software in development. The correction of this error required adjustments to each of the principal financial statements and related footnotes, except the Statement of Budgetary Resources and the Statement of Custodial Activity, as follows:

G.10 – Decrease property plant and equipment by a net value of $119 million;
G.11 – Decrease cumulative results of operation – other funds and net position by $119 million;
G.12 – Increase operating expenses by $1 million; and
G.13 – Decrease beginning balance FY 2008 cumulative results of operations by $119 million.

Explosive Detection Systems (EDS). During FY 2009, TSA performed a subsequent analysis of the other direct costs associated with networking EDS which were capitalized in FY 2008. This analysis revealed that TSA had overstated its EDS balance regarding other direct costs. The correction of this error required adjustments to each of the principal financial statements and related footnotes, except the Statement of Budgetary Resources and the Statement of Custodial Activity, as follows:

G.14 – Decrease property, plant and equipment by a net value of $32 million;
G.15 – Decrease cumulative results of operation – other funds and net position by $32 million;
G.16 – Increase operating expenses by $4 million; and
G.17 – Decrease beginning balance FY 2008 cumulative results of operations by $28 million.

H. Other Restatements (Unaudited)

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

H.1 – Increase operating expenses by $4 million;
H.2 – Increase non-governmental accounts payable by $3 million;
H.3 – Decrease unexpended appropriations-other funds by $1 million;
H.4 – Increase appropriations used by $1 million;
H.5 – Increase obligations incurred, net by $4 million;
H.6 – Decrease cumulative results of operations - other funds and net position by $2 million;
H.7 – Increase unobligated balance not available by $2 million;
H.8 – Increase unobligated balance brought forward by $2 million;
H.9 – Decrease obligated balance, net unpaid obligations brought forward by $2 million;
H.10 – Decrease obligated balance, net end of period unpaid obligations by $ 2 million;
H.11 – Increase intragovernmental accounts payable by $10 million;
H.12 – Decrease cumulative results of operations by $10 million;
H.13 – Decrease beginning balance FY 2008 cumulative results of operations by $10 million.
H.14 – Decrease property, plant, and equipment by net value of $1 million;
H.15 – Decrease cumulative results of operations – other funds and net position by $1 million; and
H.16 – Decrease beginning balance FY 2008 cumulative results of operations by $1 million.

Budgetary Adjustments. The Department adjusted the FY 2008 financial statements to correct errors in the Budgetary Resources balances at the Department due to receiving a correction after the AFR was published. A correction in Budgetary Resources was recorded in the CBP financial statements but was not received in time to be recorded in the published Department FY 2008 AFR; thus requiring adjustments to the Statement of Budgetary Resources and related footnotes, as follows:

H.17 – Decrease obligations incurred – direct by $77 million;
H.18 – Increase unobligated balance not available by $77 million;
H.19 – Decrease obligations incurred, net by $77 million; and
H.20 – Decrease obligated balance, net, end of period, unpaid obligations by $77 million.

Stewardship Property, Plant and Equipment. During FY 2009, CBP and USCIS identified additional collection-type heritage assets that were not reported during FY 2008. This resulted in a difference between the FY 2009 beginning balance and the FY 2008 ending balance in Note 12, Stewardship Property, Plant, and Equipment.

BALANCE SHEET, in millions	**Original 2008**	**Effects of Restatements**	**Restated 2008**	**Description Reference**
ASSETS				
Intragovernmental				
Fund Balance with Treasury	$63,157	$ -	$63,157	
Investments, Net	3,103	-	3,103	
Accounts Receivable	310	-	310	
Other		-		
Advances and Prepayments	2,852	-	2,852	
Due from Treasury	151	-	151	
Total Intragovernmental	**$69,573**	**$ -**	**$69,573**	
Cash and Other Monetary Assets	67	-	67	
Accounts Receivable, Net	488	-	488	
Taxes, Duties, and Trade Receivables, Net	2,078	-	2,078	
Direct Loans, Net	21	-	21	
Inventory and Related Property, Net	518	-	518	
General Property, Plant and Equipment, Net	14,501	85	14,586	A.1, B.1, D.1, D.5, E.1, F.1, G.5, G.10, G.14, H.14
Other				
Advances and Prepayments	649	-	649	
TOTAL ASSETS	**$87,895**	**$85**	**$87,980**	**A, B, D, E, F, G, H**
LIABILITIES				
Intragovernmental				
Accounts Payable	$1,989	$10	$1,999	H.11
Debt	17,719	-	17,719	
Other				
Due to the General Fund	2,397	-	2,397	
Accrued FECA Liability	361	-	361	
Other	394	-	394	
Total Intragovernmental	**$22,860**	**$10**	**$22,870**	**H**
Accounts Payable	2,914	(9)	2,905	G.1, H.2
Federal Employee and Veteran Benefits	36,230	-	36,230	
Environmental and Disposal Liabilities	288	740	1,028	A.6, C.1
Other				
Accrued Payroll	1,787	-	1,787	
Deferred Revenue and Advances from Others	3,080	-	3,080	
Unliquidated Antidumping and Countervailing Duties	161	-	161	
Insurance Liabilities	5,531	-	5,531	
Refunds and Drawbacks	130	-	130	
Other	1,434	-	1,434	
Total Liabilities	**$74,415**	**$741**	**$75,156**	**A, C, G, H**

BALANCE SHEET, in millions	Original 2008	Effects of Restatements	Restated 2008	Description Reference
Net Position				
Unexpended Appropriations – Other Funds	$55,228	$11	$55,239	G.2, H.3
Cumulative Results of Operations – Earmarked Funds	(19,337)	(22)	(19,359)	B.3
Cumulative Results of Operations – Other Funds	(22,411)	(645)	(23,056)	A.3, A.7, C.2, D.3, D.7, E.3, F.3, G.6, G.11, G.15, H.6, H.12, H.15
Total Net Position	**$13,480**	**$(656)**	**$ 12,824**	**A, B, C, D, E, F, G, H**
TOTAL LIABILITIES AND NET POSITION	**$87,895**	**$85**	**$87,980**	

STATEMENT OF NET COST, in millions	Original 2008	Effects of Restatements	Restated 2008	Description Reference
Directorates and Other Components				
U.S. Customs and Border Protection				
Gross Cost	$9,783	$ -	$9,783	
Less Earned Revenue	(160)	-	(160)	
Net Cost	**9,623**	**-**	**9,623**	
U.S. Coast Guard				
Gross Cost	9,508	8	9,516	A.2
Less Earned Revenue	(465)	(44)	(509)	A.5
Net Cost	**9,043**	**(36)**	**9,007**	
U.S. Citizenship and Immigration Services				
Gross Cost	2,184	7	2,191	B.2
Less Earned Revenue	(2,215)	-	(2,215)	
Net Cost	**(31)**	**7**	**(24)**	
Federal Emergency Management Agency				
Gross Cost	18,500	-	18,500	
Less Earned Revenue	(3,027)	-	(3,027)	
Net Cost	**15,473**	**-**	**15,473**	
Federal Law Enforcement Training Center				
Gross Cost	447	4	451	H.1
Less Earned Revenue	(40)	-	(40)	
Net Cost	**407**	**4**	**411**	
National Protection and Preparedness Directorate				
Gross Cost	872	(47)	825	E.2
Less Earned Revenue	(1)	-	(1)	
Net Cost	**871**	**(47)**	**824**	
U.S. Immigration and Customs Enforcement				
Gross Cost	5,485	(37)	5,448	D.2, D.6
Less Earned Revenue	(928)	-	(928)	
Net Cost	**4,557**	**(37)**	**4,520**	

STATEMENT OF NET COST, in millions	Original 2008	Effects of Restatements	Restated 2008	Description Reference
Office of Health Affairs				
Gross Cost	157	-	157	
Less Earned Revenue	-	-	-	
Net Cost	**157**	**-**	**157**	
Departmental Operations and Other				
Gross Cost	1,316	-	1,316	
Less Earned Revenue	(1)	-	(1)	
Net Cost	**1,315**	**-**	**1,315**	
U.S. Secret Service				
Gross Cost	1,747	-	1,747	
Less Earned Revenue	(11)	-	(11)	
Net Cost	**1,736**	**-**	**1,736**	
Science and Technology				
Gross Cost	776	(2)	774	F.2
Less Earned Revenue	(6)	-	(6)	
Net Cost	**770**	**(2)**	**768**	
Transportation Security Administration				
Gross Cost	6,622	(4)	6,618	G.4, G.7, G.12, G.16
Less Earned Revenue	(2,385)	-	(2,385)	
Net Cost	**4,237**	**(4)**	**4,233**	
NET COST OF OPERATIONS	**$48,158**	**$(115)**	**$48,043**	**A, B, D, E, F, G, H**

STATEMENT OF CHANGES IN NET POSITION, in millions	**Original 2008**	**Effects of Restatements**	**Restated 2008**	**Description Reference**
Cumulative Results of Operations				
Beginning Balances	$(38,883)	-	$(38,883)	
Adjustments:				
Correction of Errors	-	(857)	(857)	A.4, A.8, B.4, C.3, D.4, E.4, F.4, G.8, G.13, G.17, H.13, H.16
Other	-	73	73	D.8
Beginning Balance, as adjusted	$(38,883)	(784)	$(39,667)	
Budgetary Financing Sources:				
Appropriations Used	41,062	(11)	41,051	G.3, H.4
Non-Exchange Revenue	3,829	-	3,829	
Donations and Forfeitures of Cash and Cash Equivalents	2	-	2	
Transfers in/out without Reimbursement	(269)	-	(269)	
Other	(38)	13	(25)	G.9
Other Financing Sources (Non-Exchange):				
Donations and Forfeitures of Property	14	-	14	
Transfers in/out Reimbursement	18	-	18	
Imputed Financing	738	-	738	
Other	(63)	-	(63)	
Total Financing Sources	45,293	2	45,295	
Net Cost of Operations	(48,158)	115	(48,043)	A.2, A.5, B.2, D.2, D.6, E.2, F.2, G.4, G.7, G.12, G.16, H1
Net Change	(2,865)	117	(2,748)	**A, B, C, D, E, F, G, H**
Cumulative Results of Operations	**(41,748)**	**(667)**	**(42,415)**	
Unexpended Appropriations:				
Beginning Balances	47,342	-	47,342	
Budgetary Financing Sources:				
Appropriations Received	50,253	-	50,253	
Appropriations transferred in/out	(683)	-	(683)	
Other Adjustments	(622)	-	(622)	
Appropriations Used	(41,062)	11	(41,051)	G.3, H.4
Total Budgetary Financing Sources	7,886	11	7,897	
Total Unexpended Appropriations	**55,228**	**11**	**55,239**	**G, H**
NET POSITION	**$13,480**	**$(656)**	**$12,824**	

STATEMENT OF BUDGETARY RESOURCES, in millions	**Original 2008**		**Effects of Restatements**		**Restated 2008**		
	Budgetary	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Description Reference**
BUDGETARY RESOURCES							
Unobligated Balance, Brought Forward, October 1	$17,214	$131	$37	$ -	$ 17,251	$131	C.8, H.8
Recoveries of Prior Year Unpaid Obligations	3,824	-	-	-	3,824	-	
Budget Authority:							
Appropriations	57,653	-	-	-	57,653	-	
Spending Authority from Offsetting Collections:							
Earned:							
Collected	9,450	172	-	-	9,450	172	
Change in Receivable from Federal Sources	(19)	-	-	-	(19)	-	
Change in Unfilled Customer Orders:							
Advances Received	84	-	-	-	84	-	
Without Advance from Federal Sources	(350)	(37)	(7)	-	(357)	(37)	C.4
Expenditure transfers from Trust Funds	48	-	-	-	48	-	
Subtotal	66,866	135	(7)	-	66,859	135	
Non-expenditure Transfers, Net; Anticipated and Actual	(210)	-	-	-	(210)	-	
Temporarily Not Available Pursuant to Public Law	(14)	-	-	-	(14)	-	
Permanently Not Available	(883)	(251)	-	-	(883)	(251)	
TOTAL BUDGETARY RESOURCES	**$86,797**	**$15**	**$30**	**$ -**	**$86,827**	**$15**	**C, H**

	Original 2008		Effects of Restatements		Restated 2008		
STATEMENT OF BUDGETARY RESOURCES, in millions	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Description Reference**
STATUS OF BUDGETARY RESOURCES							
Obligations Incurred:							
Direct	$56,814	$11	$(77)	$ -	$56,737	$11	H.17
Reimbursable	8,664	-	(5)	-	8,659	-	C.6
Subtotal	65,478	11	(82)	-	65,396	11	
Unobligated Balance:							
Apportioned	7,224	4	(2)	-	7,222	4	C.5
Exempt from Apportionment	91	-	-	-	91	-	
Subtotal	7,315	4	(2)	-	7,313	4	
Unobligated Balance Not Available	14,004	-		-	14,118	-	C.7, H.7, H.18
TOTAL STATUS OF BUDGETARY RESOURCES	**$86,797**	**$15**	**$30**	**$ -**	**$86,827**	**$15**	**C, H**

114

STATEMENT OF BUDGETARY RESOURCES, in millions	Original 2008		Effects of Restatements		Restated 2008		
	Budgetary	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Description Reference**
CHANGE IN OBLIGATED BALANCE							
Obligated Balance, Net							
Unpaid Obligations Brought Forward, October 1	$42,753	$480	$ (7)	$ -	$42,746	$480	C.13, H.9
Less: Uncollected Customer Payments from Federal Sources, brought forward, October 1	(2,770)	(361)	(32)	-	(2,802)	(361)	C.9
Total Unpaid Obligated Balance, Net	39,983	119	(39)	-	39,944	119	
Obligations Incurred, Net	65,478	11	(82)	-	65,396	11	C.14, H.5, H.19
Less: Gross Outlays	(57,191)	(168)	-	-	(57,191)	(168)	
Obligated Balance Transferred, Net							
Actual Transfers, Unpaid Obligations	(25)	-	-	-	(25)	-	
Total Unpaid Obligated Balance Transferred, Net	(25)	-	-	-	(25)	-	
Recoveries of Prior Year Unpaid Obligations, Actual	(3,824)	-	-	-	(3,824)	-	
Change in Uncollected Customer Payments from Federal Sources	367	38	9	-	376	38	C.11
Obligated balance, Net End of Period							
Unpaid obligations	47,191	323	(88)	-	47,103	323	C.12, H.10, H.20
Less: Uncollected customer payments from Federal Sources	(2,403)	(323)	(24)	-	(2,427)	(323)	C.10
Total, unpaid obligated balance, net end of period	**$44,788**	**$ -**	**$(112)**	**$ -**	**$44,676**	**$ -**	**C, H**

	Original 2008		Effects of Restatements		Restated 2008		
STATEMENT OF BUDGETARY RESOURCES, in millions	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Description Reference**
NET OUTLAYS							
Gross Outlays	$57,191	$168	$ -	$ -	$57,191	$168	
Less: Offsetting Collections	(9,582)	(172)	-	-	(9,582)	(172)	
Less: Distributed Offsetting Collections	(6,048)	-	-	-	(6,048)	-	
NET OUTLAYS	**$41,561**	**$(4)**	**$ -**	**$ -**	**$41,561**	**$(4)**	

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

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

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

The reconciliations of net cost of operations to budget for FY 2009 and FY 2008 are as follows:

	2009 (Unaudited)	2008 (Unaudited) (Restated)
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred (Note 25)	$71,928	$65,407
Less: Spending Authority from Offsetting Collections and Recoveries	(13,825)	(13,165)
Obligations Net of Offsetting Collections and Recoveries	58,103	52,242
Less: Offsetting Receipts	(5,213)	(6,048)
Net Obligations	52,890	46,194
Other Resources		
Donations and Forfeiture of Property	4	14
Transfers In (Out) Without Reimbursement	11	18
Imputed Financing from Costs Absorbed by Others	766	738
Other	(5)	(63)
Net Other Resources Used to Finance Activities	776	707
Total Resources Used to Finance Activities	**$53,666**	**$46,901**

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	$(436)	$4,793
Resources that Fund Expenses Recognized in Prior Periods	5,373	(347)
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	88	172
Other	(2,172)	(2,862)
Resources that Finance the Acquisition of Assets	5,143	4,035
Other Resources or Adjustments to Net Obligated Resources that Do Not Affect Net Cost of Operations	1,436	1,747
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	9,432	7,538
TOTAL RESOURCES USED TO FINANCE THE NET COST OF OPERATIONS	**$44,234**	**$39,363**

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	$100	$105
Increase in Environmental and Disposal Liability	-	759
Increase in Exchange Revenue Receivable from the Public	1	-
Upward/Downward reestimates of credit subsidy expense	(5)	-
Other		
Increase in Insurance Liabilities	-	92
Increase in Actuarial Pension Liability	2,755	729
Increase in Actuarial Health Insurance Liability	2,051	447
Other	324	4,450
Total Components of Net Cost of Operations that Will Require or Generate Resources in Future Periods	5,226	6,582
Components not Requiring or Generating Resources		
Depreciation and Amortization	1,539	1,464
Revaluation of Assets or Liabilities	177	(7)
Other	391	641
Total Components of Net Cost of Operations that Will Not Require or Generate Resources	2,107	2,098
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	**7,333**	**8,680**
NET COST OF OPERATIONS	**$51,567**	**$48,043**

Required Supplementary Information (Unaudited)

Stewardship Investments

Stewardship investments are substantial investments made by the Federal Government for the benefit of the Nation. When incurred, stewardship investments are treated as expenses in calculating net cost, but they are separately reported as Required Supplementary Stewardship Information (RSSI) to highlight the extent of investments that are made for long-term benefit. The Department's expenditures (including carryover funds expended in FY 2009) in Human Capital, Research and Development, and Non-Federal Physical Property are shown below:

Summary of Stewardship Investments (in millions) (unaudited)

	FY 2009	FY 2008	FY 2007	FY 2006	FY 2005
Research and Development	$852	$880	$1,115	$1,144	$975
Human Capital	88	78	89	29	21
Non-Federal Physical Property	375	204	394	(118)	394
Total	$1,315	$1,162	$1,598	$1,055	$1,390

1. Investments in Research and Development

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

<u>TSA</u>

TSA funds applied research projects and grants to develop advance security technology equipment and systems. Projects include partnerships with George Mason University, the Regional Maritime Security Coalition, and the Federal Aviation Administration. These applied research projects include human factors research intended to enhance screening officers capabilities, improve person-machine performance, and increase human system effectiveness, including ongoing certification testing of explosive detection systems (EDS) and explosives trace detection (ETD) technology as well as infrastructure protection research related to using biometrics for passenger access controls and tracking.

Operation Safe Commerce is a pilot program that brings together private business, ports, and local, state, and Federal representatives to analyze current security procedures for cargo entering the country. The new technologies look at improving security during the process of stuffing and deconsolidating containers, physically securing and monitoring containers as they are transported through the supply chain, and exchanging timely and reliable communication.

U.S. Coast Guard

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

- Determine the most effective Unmanned Aerial System (UAS) to operate off the National Security Cutter (NSC). Provide U.S. Coast Guard leadership with the information, traceable to NSC mission needs, to support a UAS major acquisition program. Report on the capability that will provide the most value for the lowest risk to meet NSC mission needs.
- Develop a means to certify a shipboard system to insure aquatic nuisance species (ANS) have been eradicated before entering U.S. waters.
- Further develop the at-sea biometrics system that can leverage a unique, identifiable human characteristic to identify individuals encountered at sea. Partner with and leverage the databases of other government agencies.
- Identify and prioritize gaps in port security and provide support for Countermeasures Strategy (CS) development to the U.S. Coast Guard. Identify critical needs across both prevention and response phases of operations relative to threat vectors from explosives in the (surface) maritime environment.

Significant accomplishments in development:

- Testing small Unmanned Aerial Vehicles for greater surveillance capabilities: Developed a Modeling and Simulation (M&S) capability that can be used during a field exercise to produce a visualization tool for post-test event analysis and future event planning.
- Developing and evaluating at-sea biometrics system prototype for migrant identification: Developed proof-of-concept portable biometric collections system that could be used in a maritime environment. Implemented and operated this standalone biometric system and delivered standard operating procedures, training package, and equipment to the U.S. Coast Guard operational entity.
- Developed specific tools that model the survivability of distressed mariners in a variety of conditions and that can be incorporated into search and rescue (SAR) planning software to provide clear and understandable operational SAR guidance and decision support tools for decision makers.
- Developed a Sensor Visualization and Analysis Tool to visualize and assess a variety of surveillance/search concepts of operations and provide guidance on setting up sensors for the best coverage in key tactical situations.

The following major new applications developments are ongoing:

- Develop and evaluate the most promising capabilities and techniques for recovering heavy viscous oil on the ocean floor and integrate those capabilities and techniques with heavy oil detection systems.
- Explore the USCG's needs with regard to alternative energy systems and the extent these systems are currently used throughout the USCG. Baseline the carbon footprint of selected USCG afloat assets. Investigate potential "green" technology projects for powering USCG afloat assets and the technologies that have the potential for providing renewable energy while lowering the carbon footprint.
- Investigate potential advanced technologies used in surface vessel construction. Complete a survey of material properties, construction methods, and other factors contributing to total

life cycle costs for three principal materials used in small boat construction and identify the most promising systems to meet the design requirements of a notional cutter boat. Develop a plan for correcting shipboard HVAC deficiencies by identifying technologies used in industrial HVAC systems that have potential for shipboard application.
- Develop the life cycle cost estimate (LCCE) and aggregate information needed for the Mounted Automatic Weapon (MAW) resource proposal. Fully identify, aggregate, and catalogue the extensive body of MAW research and analysis in a manner which makes the information accessible to requirements development study teams.
- Investigate and develop modeling approaches that provide more efficacy in board-based decision support for current and future acquisition activities.

Significant accomplishments in research:

- Conducted testing of the two heavy oil detection systems selected. Reported on the preliminary results of the detection phase of this project in the presentation "Research Efforts for Detection and Recovery of Submerged Oil" at Interspill 2009 in Marseille, France. A similar presentation was also given to the Delaware River and Bay Oil Spill Advisory Committee (DRBOSAC) at Sector Philadelphia. The USCG is currently the only organization making substantial progress in developing this technology, drawing substantial interest from vendors and advisors.
- Conducted final testing of heavy oil detection systems. Determined that two of the three technologies evaluated appeared to make searching underwater more effective and provided recommendations for further development of those technologies into operational systems.
- Compiled a knowledge base of Arctic and Antarctic technology and activities—including those by government, industry, and foreign entities. This supports establishing requirements for, and the acquisition of, appropriate USCG capabilities to support evolving Arctic missions and to gain a working knowledge of Arctic and Antarctic operations, participate in exercises and conferences, and develop a repository of information on Arctic and Antarctic operations.
- Completed Market Research and Analysis and identified twenty potential projects which were subsequently narrowed to five best candidate technologies to meet current and future mission requirements on inland and intracoastal waterways. Developed a technology development strategy for the five candidate projects to provide more technical insight into how the projects might be executed. Completed the Inland Waterways Maritime Security System (IWMSS) Technology Development and Demonstration (T&D) Plan.

S&T

The S&T Directorate improves homeland security by providing our customers, the operating components of DHS, and state, local, tribal, and territorial emergency responders and officials with state-of-the-art technology that helps them to accomplish their missions.

The S&T Directorate directs, funds, and conducts Research, Development, Test & Evaluation (RDT&E), and enables the procurement of technology and systems to prevent, protect against, and respond to terrorist threats and natural disasters. The S&T Directorate collaborates and coordinates with Federal, state, and local government and private sector entities to conduct its activities. It establishes an efficient system to transfer homeland security developments and technologies to the operational elements of the Department to enhance their ability to execute all missions, now and in the future, and to meet the high priority homeland security RDT&E needs of the Nation.

The S&T Directorate leads the homeland security research enterprise outside of DHS by remaining proactively engaged with universities, research institutions, government laboratories, and private industry that conduct R&D in areas important to addressing our customers' homeland security requirements. The S&T Directorate makes research investments in many areas to support the Department's missions to defend against chemical and biological threats; protect infrastructure and transportation systems from explosives; determine the motivation and intent behind terrorist attacks; prepare the nation to respond to large and small scale events; and protect the critical systems that run our financial and electrical power systems. The S&T Directorate also develops new standards, educates the next-generation workforce, and conducts testing and evaluation activities to further increase the security of the nation.

Significant Accomplishments in Development:

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

2. Investments in Human Capital

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

<u>FEMA</u>

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

- The National Fire Academy has been developed by FEMA to promote the professional development of the fire and emergency response community and its allied professionals. Also, to supplement and support state and local fire service training programs, the National Fire Academy develops and delivers educational and training courses having a national focus.

- The Emergency Management Institute (EMI) serves as the national focal point for the development and delivery of emergency management training to enhance the capabilities of Federal, state, local, and tribal government officials, volunteer organizations, and the public and private sectors to minimize the impact of disasters on the American public. EMI curricula are structured to meet the needs of this diverse audience with an emphasis on how the various elements work together in emergencies to save lives and protect property.

TSA

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

3. Investments in Non-Federal Physical Property

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

TSA

Airport Improvement Program. To help facilitate 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 so expensive, the LOI is used to offset the physical modification costs incurred by commercial service airports for the modifications. TSA issued eight LOIs in FY 2007 and another three agreements in FY 2008.

Airport Renovation Program. Another funding mechanism employed by TSA are Other Transaction Agreements (OTA) that exist for one year and establish the respective cost-sharing obligations and other responsibilities of the TSA and the specific entity (Board, Port, or Authority) related not only to the installation of integrated and non-integrated EDS and ETD equipment, but also to the improvements to be made to the existing systems in the baggage handling area. TSA entered into OTAs with 27 airports in FY 2007 and another 15 in FY 2008. All work will be completed in order to achieve compliance with the Aviation and Transportation Security Act (ATSA) Public Law 107-71, November 19, 2001.

American Recovery and Reinvestment Act. TSA entered into Other Transaction Agreements with 29 airports. These agreements are funded by the American Recovery and Reinvestment Act. In FY 2009, TSA obligated $421 million: $371 million for electronic baggage screening program; $29.8 million for closed circuit television cameras; and $19.7 million for Advanced Surveillance Program.

Air Cargo. On Aug. 3, 2007, President Bush signed into law the Implementing Recommendations of the 9/11 Commission Act of 2007 (9/11 Act), P.L. 110-53 (2007). The 9/11 Act requires 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 Other Transaction Agreements with 47 Freight Forwarders totaling $36.8 million.

Port Security Grant Program. This program provided 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. TSA has not had any programmatic or administrative responsibilities for this grant program since FY 2004.

Intercity Bus Security Program. This program provides funds to improve security for operators of fixed route intercity and charter bus services. TSA awards grants based on the users of funds outlined in section 1532(b) of the 9/11 Act. Funding priorities reflect the Department's overall investment strategy, including risk-based funding and regional security cooperation. Funding priorities are collaboratively developed with transit security partners based on threat, vulnerabilities, and transit system assessment results. Priority is given to projects that can be implemented quickly and have a high return on investment. By developing clear funding priorities and a scoring methodology that reflects those priorities and risks, TSA is able to ensure that grant dollars are spent appropriately.

Required Supplementary Stewardship Information (Unaudited)

1. Deferred Maintenance

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

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

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

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

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

Deferred maintenance as of September 30, 2009, on general property, plant, and equipment and heritage assets was estimated to range from $1,065 million (unaudited) to $1,295 million (unaudited) and the condition of these assets range 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 2008, the Department reported estimated deferred maintenance ranging from $1,062 million (unaudited) to $1,296 million (unaudited) on general property, plant, and equipment and heritage assets with a range of poor to good condition. These amounts represent maintenance on vehicles, vessels, and buildings and structures owned by the Department that was not performed when it should have been, or was scheduled to be performed but was delayed for a future period.

A summary of deferred maintenance, by asset class, at September 30, 2009, is presented below (in millions) (unaudited):

	Low estimate	High estimate	Asset Condition
Building & Structures	$757	$908	Good to Poor
Equipment (vehicles and vessels)	140	179	Fair
Equipment (Other)	162	199	Good to Fair
Heritage assets	6	9	Fair
Total	**$1,065**	**$1,295**	

2. Statement of Budgetary Resources

The principal Statement of Budgetary Resources combines the availability, status, and outlays of the Department's budgetary resources during FY 2009 and FY 2008. Presented on the following pages is the disaggregation of this combined information by DHS Components, which represent the responsibility segments that carry out the Department's missions

2. Statement of Budgetary Resources

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

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
BUDGETARY RESOURCES													
Unobligated Balance, Brought Forward, October 1	$2,549	$1,792	$971	$13,573	$140	$771	$10	$305	$297	$63	$174	$790	**$21,435**
Recoveries of Prior Year Obligations	371	167	77	3,055	12	246	6	91	49	-	55	151	**4,280**
Budget Authority:													
Appropriations	13,186	9,864	2,353	7,778	333	5,334	2,332	1,790	1,158	1,750	934	6,027	**52,839**
Borrowing Authority	-	-	-	51	-	-	-	-	-	-	-	-	**51**
Spending Authority from Offsetting Collections:													
Earned:													
Collected	1,598	486	29	3,568	141	1,144	33	542	5	23	40	2,020	**9,629**
Change in Receivable from Federal Sources	11	9	35	26	10	41	(1)	(8)	-	(1)	3	(1)	**124**
Change in Unfilled Customer Orders:													
Advance Received	-	3	-	282	-	(1)	-	(2)	-	(1)	(1)	-	**280**
Without Advance from Federal Sources	(92)	(24)	(4)	(467)	(12)	(68)	5	97	(2)	(4)	37	(2)	**(536)**
Anticipated for Rest of Year, without advances	-	-	-	-	-	-	-	-	-	-	-	-	-
Previously Unavailable	-	-	-	-	-	-	-	-	-	-	-	-	-
Expenditure Transfers from Trust Funds	3	45	-	-	-	-	-	-	-	-	-	-	**48**
Subtotal	14,706	10,383	2,413	11,238	472	6,450	2,369	2,419	1,161	1,767	1,013	8,044	**62,435**
Nonexpenditure Transfers, Net; Anticipated and Actual	321	246	(17)	(26)	-	11	(2,176)	35	30	-	-	-	**(1,576)**
Temporarily Not Available Pursuant to Public Law	-	-	-	(4)	-	-	-	-	-	-	-	-	**(4)**
Permanently Not Available	(279)	(249)	(9)	(594)	(4)	(13)	-	(47)	(7)	(11)	(14)	(32)	**(1,259)**
TOTAL BUDGETARY RESOURCES	**$17,668**	**$12,339**	**$3,435**	**$27,242**	**$620**	**$7,465**	**$209**	**$2,803**	**$1,530**	**$1,819**	**$1,228**	**$8,953**	**$85,311**
STATUS OF BUDGETARY RESOURCES													
Obligations Incurred:													
Direct	13,075	9,859	2,528	22,958	289	5,476	131	1,861	1,290	1,661	971	7,602	**67,701**
Reimbursable	1,527	486	21	83	176	1,188	39	601	1	17	85	3	**4,227**
Subtotal	14,602	10,345	2,549	23,041	465	6,664	170	2,462	1,291	1,678	1,056	7,605	**71,928**
Unobligated Balance:													
Apportioned	64	1,565	422	3,251	134	429	36	238	184	53	166	1,164	**7,706**
Exempt from Apportionment	-	2	-	3	-	-	-	-	-	-	-	-	**5**
Subtotal	64	1,567	422	3,254	134	429	36	238	184	53	166	1,164	**7,711**
Unobligated Balance Not Available	3,002	427	464	947	21	372	3	103	55	88	6	184	**5,672**
TOTAL STATUS OF BUDGETARY RESOURCES	**$17,668**	**$12,339**	**$3,435**	**$27,242**	**$620**	**$7,465**	**$209**	**$2,803**	**$1,530**	**$1,819**	**$1,228**	**$8,953**	**$85,311**

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

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
CHANGE IN OBLIGATED BALANCES													
Obligated Balance, Net													
Unpaid Obligations Brought Forward, October 1	$5,378	$3,887	$1,049	$26,796	$161	$2,406	$758	$1,612	$980	$346	$1,107	$2,946	**$47,426**
Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(280)	(193)	(16)	(1,357)	(128)	(416)	(5)	(272)	(3)	(14)	(52)	(14)	**(2,750)**
Total Unpaid Obligated Balance, Net	5,098	3,694	1,033	25,439	33	1,990	753	1,340	977	332	1,055	2,932	**44,676**
Obligations Incurred, Net	14,602	10,345	2,549	23,041	465	6,664	170	2,462	1,291	1,678	1,056	7,605	**71,928**
Gross Outlays	(15,041)	(10,081)	(2,550)	(20,168)	(435)	(6,405)	(430)	(2,163)	(1,026)	(1,729)	(1,072)	(6,891)	**(67,991)**
Obligated Balance Transferred, Net	-	-	-	(25)	-	-	-	-	-	-	-	-	**(25)**
Recoveries of Prior Year Unpaid Obligations	(371)	(167)	(77)	(3,055)	(12)	(246)	(6)	(91)	(49)	-	(55)	(151)	**(4,280)**
Change in Uncollected Customer Payments from Federal Sources	81	16	(31)	441	1	26	(5)	(88)	3	6	(40)	3	**413**
Obligated Balance, Net End of Period													
Unpaid Obligations	4,569	3,985	971	26,588	178	2,419	491	1,820	1,197	295	1,036	3,509	**47,058**
Uncollected Customer Payments from Federal Sources	(200)	(178)	(47)	(915)	(126)	(390)	(9)	(360)	(1)	(8)	(92)	(11)	**(2,337)**
Total, Unpaid Obligated Balance, Net, End of Period	4,369	3,807	924	25,673	52	2,029	482	1,460	1,196	287	944	3,498	**44,721**
NET OUTLAYS													
Net Outlays													
Gross Outlays	15,041	10,081	2,550	20,168	435	6,405	430	2,163	1,026	1,729	1,072	6,891	**67,991**
Offsetting Collections	(1,601)	(534)	(30)	(3,849)	(141)	(1,143)	(33)	(540)	(4)	(23)	(39)	(2,020)	**(9,957)**
Distributed Offsetting Receipts	(2,281)	(26)	(2,485)	(5)	-	(154)	-	(11)	-	-	-	(251)	**(5,213)**
Net Outlays	**$11,159**	**$9,521**	**$35**	**$16,314**	**$294**	**$5,108**	**$397**	**$1,612**	**$1,022**	**$1,706**	**$1,033**	**$4,620**	**$52,821**

Schedule of FY 2008 Budgetary Resources by Responsibility Segments (in millions) (unaudited and restated) (page 1 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
BUDGETARY RESOURCES													
Unobligated Balance, Brought Forward, October 1	$2,896	$1,666	$846	$8,482	$116	$498	$925	$433	$377	$82	$296	$765	**$17,382**
Recoveries of Prior Year Obligations	485	117	51	2,757	20	191	2	37	15	-	34	115	**3,824**
Budget Authority:													
Appropriations	11,973	9,032	2,555	18,720	289	4,993	116	1,456	1,177	1,612	829	4,901	**57,653**
Spending Authority from Offsetting Collections:													
Earned:													
Collected	1,612	525	33	3,670	179	1,123	28	445	12	28	33	1,934	**9,622**
Change in Receivable from Federal Sources	(6)	-	(3)	(23)	(8)	7	4	19	-	(7)	(1)	(1)	**(19)**
Change in Unfilled Customer Orders:													
Advance Received	-	(2)	1	49	-	1	-	42	(1)	(4)	1	(3)	**84**
Without Advance From Federal Sources	(34)	(21)	6	(281)	(30)	(21)	1	-	2	1	19	(36)	**(394)**
Previously Unavailable	-	-	-	-	-	-	-	-	-	-	-	-	-
Expenditure Transfers from Trust Funds	3	45	-	-	-	-	-	-	-	-	-	-	**48**
Subtotal	13,548	9,579	2,592	22,135	430	6,103	149	1,962	1,190	1,630	881	6,795	**66,994**
Nonexpenditure Transfers, Net; Anticipated and Actual	334	356	(8)	(24)	9	29	(915)	8	(6)	18	-	(11)	**(210)**
Temporarily Not Available Pursuant to Public Law	-	(14)	-	-	-	-	-	-	-	-	-	-	**(14)**
Permanently Not Available	(87)	(325)	(11)	(584)	(6)	(22)	-	(42)	(15)	(32)	-	(10)	**(1,134)**
TOTAL BUDGETARY RESOURCES	**$17,176**	**$11,379**	**$3,470**	**$32,766**	**$569**	**$6,799**	**$161**	**$2,398**	**$1,561**	**$1,698**	**$1,211**	**$7,654**	**$86,842**
STATUS OF BUDGETARY RESOURCES													
Obligations Incurred:													
Direct	$12,863	$9,052	$2,470	$14,757	$284	$4,909	$118	$1,573	$1,258	$1,616	$989	$6,859	**$56,748**
Reimbursable	1,764	535	29	4,436	146	1,119	33	520	5	19	48	5	**8,659**
Subtotal	14,627	9,587	2,499	19,193	430	6,028	151	2,093	1,263	1,635	1,037	6,864	**65,407**
Unobligated Balance:													
Apportioned	8	835	536	4,193	81	357	10	255	128	15	166	642	**7,226**
Exempt from Apportionment	-	89	-	2	(1)	-	-	1	-	-	-	-	**91**
Subtotal	8	924	536	4,195	80	357	10	256	128	15	166	642	**7,317**
Unobligated Balance Not Available	2,541	868	435	9,378	59	414	-	49	170	48	8	148	**14,118**
TOTAL STATUS OF BUDGETARY RESOURCES	**$17,176**	**$11,379**	**$3,470**	**$32,766**	**$569**	**$6,799**	**$161**	**$2,398**	**$1,561**	**$1,698**	**$1,211**	**$7,654**	**$86,842**

Schedule of FY 2008 Budgetary Resources by Responsibility Segments (in millions) (unaudited and restated) (page 2 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
CHANGE IN OBLIGATED BALANCES													
Obligated Balance, Net													
Unpaid Obligations brought forward, Oct 1	$4,069	$3,812	$698	$25,285	$216	$2,176	$914	$1,297	$697	$333	$1,097	$2,632	**$43,226**
Uncollected customer payments from federal sources, brought forward, Oct 1	(321)	(214)	(13)	(1,661)	(166)	(431)	-	(253)	(2)	(19)	(34)	(49)	**(3,163)**
Total unpaid obligated balance, net	3,748	3,598	685	23,624	50	1,745	914	1,044	695	314	1,063	2,583	**40,063**
Obligations incurred, net	14,627	9,587	2,499	19,193	430	6,028	151	2,093	1,263	1,635	1,037	6,864	**65,407**
Gross Outlays	(12,833)	(9,394)	(2,096)	(14,900)	(468)	(5,607)	(306)	(1,741)	(965)	(1,622)	(993)	(6,434)	**(57,359)**
Obligated balance transferred, net	-	-	-	(25)	-	-	-	-	-	-	-	-	**(25)**
Recoveries of Prior Year Unpaid Obligations	(485)	(117)	(51)	(2,757)	(20)	(191)	(2)	(37)	(15)	-	(34)	(115)	**(3,824)**
Change in uncollected customer payments from Federal Sources	41	21	(2)	304	39	15	(4)	(19)	(2)	5	(18)	34	**414**
Obligated balance, net end of Period													
Unpaid Obligations	5,378	3,888	1,051	26,796	159	2,406	758	1,612	979	346	1,107	2,946	**47,246**
Uncollected customer payments from Federal Sources	(280)	(193)	(16)	(1,357)	(128)	(416)	(5)	(272)	(3)	(14)	(52)	(14)	**(2,750)**
Total, unpaid obligated balance, net, end of period	5,098	3,695	1,035	25,439	31	1,990	753	1,340	976	332	1,055	2,932	**44,676**
NET OUTLAYS													
Net Outlays													
Gross Outlays	12,833	9,394	2,096	14,900	468	5,607	306	1,741	965	1,622	993	6,434	**57,359**
Offsetting collections	(1,614)	(568)	(33)	(3,719)	(180)	(1,125)	(28)	(487)	(11)	(24)	(34)	(1,931)	**(9,754)**
Distributed offsetting receipts	(2,797)	(5)	(2,625)	37	-	(153)	-	(2)	-	(1)	-	(502)	**(6,048)**
Net Outlays	**$8,422**	**$8,821**	**$(562)**	**$11,218**	**$288**	**$4,329**	**$278**	**$1,252**	**$954**	**$1,597**	**$959**	**$4,001**	**$41,557**

3. Statement of Custodial Activity

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

CBP reviews selected documents to ensure all duties, taxes, and fees owed to the Federal Government are paid and all regulations are followed. If CBP believes 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 a 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 2009 and FY 2008, CBP had legal right to collect $1.9 billion and $2.1 billion of receivables, respectively (unaudited). There was an additional $2.2 billion and $2 billion representing records still in the protest phase for FY 2009 and FY 2008, respectively (unaudited). CBP recognized as write-offs $397 million and $311 million, respectively (unaudited), of assessments that the Department had statutory authority to collect at September 30, 2009 and 2008, but has no future collection potential. Most of this amount represents fines, penalties, and interest.

4. Risk Assumed Information

The Department has performed an analysis of the contingencies associated with the unearned premium reserve for the NFIP. The underlying calculation estimates the amount of subsidy in the total rates, removes the expense load, and applies the results to the unearned premium reserve. The range is designed to straddle the resulting estimate of unpaid expected losses by $600 to $650 million (unaudited).

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

Independent Auditors' Report

Office of Inspector General

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

Homeland Security

NOV 1 3 2009

MEMORANDUM FOR: The Honorable Janet Napolitano
Secretary

Richard L. Skinner

FROM: Richard L. Skinner
Inspector General

SUBJECT: *Independent Auditor's Report on DHS' FY 2009 Financial Statements and Internal Control over Financial Reporting*

The attached report presents the results of the Department of Homeland Security's (DHS) financial statement audits for fiscal years (FY) 2009 and 2008 and the results of an examination of internal control over financial reporting of the balance sheet as of September 30, 2009, and the statement of custodial activity for FY 2009. 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 2009 *Annual Financial Report*. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the integrated audit.

Generally, the department continued to show modest improvement in financial reporting during FY 2009, but still has much work to do. Many of DHS' challenges in financial management and reporting can be attributed to the original stand-up of a complex executive branch agency without adequate organizational expertise in financial management and accounting. Consequently, for the sixth year, KPMG was unable to express an opinion on the department's balance sheet and statement of custodial activity. Additionally, KPMG was unable to perform procedures necessary to form an opinion on DHS' internal control over financial reporting of the FY 2009 balance sheet and statement of custodial activity.

Summary

KPMG was unable to express an opinion on the department's balance sheets as of September 30, 2009 and 2008, and the related statements of custodial activity for the years then ended. DHS was unable to represent that certain financial statement balances were correct and was unable to provide sufficient evidence to support its financial statements. Additionally, KPMG was unable to perform the examination procedures necessary to form an opinion on DHS' internal control over financial reporting of the balance sheet as of September 30, 2009, and the statement of custodial activity for the year then ended.

The FY 2009 Independent Auditor's Report discusses six significant deficiencies considered to be material weaknesses, two other significant deficiencies in internal control, and five instances of non-compliance with laws and regulations, as follows:

Significant Deficiencies That Are Considered To Be Material Weaknesses

A. Financial Management and Reporting
B. Information Technology Controls and System Functionality
C. Fund Balance with Treasury
D. Property, Plant, and Equipment and Operating Materials and Supplies
E. Actuarial and Other Liabilities
F. Budgetary Accounting

Other Significant Deficiencies

G. Entity-Level Controls
H. Custodial Revenue and Drawback

Non-compliance with Laws and Regulations

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

Moving DHS' Financial Management Forward

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

- The department lacks a sufficient number of accounting and financial management personnel with core technical competencies to ensure that its financial statements are presented accurately and in compliance with generally accepted accounting principals;
- DHS' accounting and financial reporting infrastructure, including policies, procedures, processes, and internal controls, have not received investments in proportion to the department's rapid growth in new programs and operations, and changes in mission since the department's inception;

- 2 -

- Field and operational personnel do not always share responsibilities for, or are not held accountable for, matters that affect financial management, including adhering to accounting policies and procedures and performing key internal control functions in support of financial reporting; and
- The department's financial information technology system infrastructure is aging and has limited functionality, which is hindering the department's ability to implement efficient corrective actions and produce reliable financial statements that can be audited.

In FY 2009, the department reduced the number of conditions leading to the independent auditor's disclaimer of opinion on DHS' financial statements from three to two. As a result, FEMA no longer contributes to the disclaimer conditions. However, the department was unable to represent that its financial statements as of, and for the year ended, September 30, 2009, were presented in conformity with U.S. generally accepted accounting principles due to conditions existing in FY 2008 that remained at the U.S. Coast Guard (Coast Guard) and the Transportation Security Administration (TSA) in FY 2009. The Coast Guard was unable to provide sufficient evidence to support any of the account balances presented in the balance sheet. Additionally, TSA was unable to provide sufficient evidence to support the general property, plant, and equipment balance. Collectively, these conditions contributed to the auditors' inability to render an opinion. Although the department was able to reduce the number of instances of noncompliance with laws and regulations from eight to five, all six material weakness conditions remained in FY 2009.

The Coast Guard began FY 2009 with a focus on entity-level controls, and the military portion of the fund balance with Treasury. During FY 2009, the Coast Guard made initial steps toward improvements to procedural, control, and personnel by chartering the Senior Management Council and revising its Financial Strategy for Transformation and Audit Readiness (FSTAR). To update FSTAR, the Coast Guard performed an in-depth root cause analysis that identified 17 areas for improvement. However, the Coast Guard was unable to fully remediate prior year control weaknesses and the auditor again reported that the Coast Guard contributed to all six material weaknesses and the significant deficiency regarding entity-level controls.

During FY 2009, the DHS made modest progress in remediating weaknesses and remains committed to focusing on remediation efforts at the Coast Guard, TSA, and the Federal Emergency Management Agency (FEMA). However all six material weakness conditions existing in FY 2008 were repeated in FY 2009. Additionally, except for property, plant, and equipment weakness conditions at the U.S. Customs and Border Protection (CBP) and information technology controls and financial systems functionality weakness conditions at FEMA and U.S. Immigration and Customs Enforcement (ICE), the department sustained progress made in FY 2008 throughout FY 2009.

*****

- 3 -

KPMG is responsible for the attached independent auditor's report dated November 13, 2009, and the conclusions expressed in the report. We do not express opinions on financial statements or internal control or conclusions on compliance with laws and regulations.

Consistent with our responsibility under the *Inspector General Act*, we are providing copies of this report to appropriate congressional committees with oversight and appropriation responsibilities over the department. In addition, we will post a copy of the report on our public website.

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

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

Attachment

Department of Homeland Security
Office of Inspector General

Independent Auditor's Report on DHS' FY 2009 Financial Statements and Internal Control over Financial Reporting

OIG-10-11

November 2009

Office of Inspector General

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

Homeland Security

NOV 1 3 2009

Preface

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

The attached report presents the results of the DHS financial statements audits for fiscal years (FY) 2009 and 2008 and the results of an examination of internal control over financial reporting of the balance sheet as of September 30, 2009, and the statement of custodial activity for FY 2009. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the audits. The contract required that KPMG perform its audits according to generally accepted government auditing standards and guidance from the Office of Management and Budget and the Government Accountability Office. KPMG was unable to provide an opinion on DHS' balance sheets as of September 30, 2009 and 2008, or on DHS' internal control over financial reporting of the FY 2009 balance sheet and statement of custodial activity. The FY 2009 auditor's report discusses six material weaknesses, two significant deficiencies in internal control, and five instances of noncompliance with laws and regulations. KPMG is responsible for the attached draft auditor's report and the conclusions expressed in the report. We do not express opinions on DHS' financial statements or provide conclusions on compliance with laws and regulations.

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

Richard L. Skinner

Richard L. Skinner
Inspector General

U.S. DEPARTMENT OF HOMELAND SECURITY

Excerpts from the DHS Annual Financial Report

Table of Contents

KPMG LLP
2001 M Street, NW
Washington, DC 20036

INDEPENDENT AUDITORS' REPORT

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

We were engaged to audit the accompanying balance sheets of the U.S. Department of Homeland Security (DHS or Department) as of September 30, 2009 and 2008, and the related statements of custodial activity for the years then ended (referred to herein as "financial statements"). We were also engaged to examine the Department's internal control over financial reporting of the balance sheet as of September 30, 2009, and statement of custodial activity for the year then ended. In connection with our audit engagement, we also considered DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on the balance sheet as of September 30, 2009 and the related statement of custodial activity for the year ended. We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources, for the years ended September 30, 2009 and 2008 (referred to herein as "other fiscal year [FY] 2009 and 2008 financial statements"), or to examine internal control over financial reporting over the other FY 2009 financial statements.

Summary

As stated in our report on the financial statements, the scope of our work was not sufficient to express an opinion on the DHS balance sheets as of September 30, 2009 and 2008, or the related statements of custodial activity for the years then ended.

As stated in our report on internal control over financial reporting, we were unable to perform procedures necessary to form an opinion on DHS' internal control over financial reporting of the FY 2009 balance sheet and statement of custodial activity.

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

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

Significant deficiencies have been identified in the following areas:

- Other Entity Level Controls
- Custodial Revenue and Drawback.

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

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

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

Other deficiencies in internal control, potentially including additional material weaknesses and significant deficiencies, and other instances of non-compliance may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DHS' balance sheets as of September 30, 2009 and 2008, and the related statements of custodial activity for the years then ended, had we been able to perform all procedures necessary to express an opinion on DHS' internal control over financial reporting of the balance sheet as of September 30, 2009, and statement of custodial activity for the year then ended, and had we been engaged to audit the other FY 2009 and 2008 financial statements, and to examine internal control over financial reporting of the other FY 2009 financial statements.

The following sections discuss the reasons why we are unable to express an opinion on the accompanying DHS financial statements; why we were unable to express an opinion on internal control over financial reporting of the balance sheet as of September 30, 2009, and statement of custodial activity for the year then ended; our tests of DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements and other matters; and management's and our responsibilities.

Report on the Financial Statements

We were engaged to audit the accompanying balance sheets of the U.S. Department of Homeland Security as of September 30, 2009 and 2008, and the related statements of custodial activity for the years then ended. These financial statements are the responsibility of DHS management.

The Coast Guard was unable to provide sufficient evidential matter that support transactions and certain balance sheet accounts including fund balance with Treasury, accounts receivable, inventory and related property, general property, plant and equipment including heritage assets and stewardship land, actuarially-derived liabilities, environmental and other liabilities, and net position, as reported in the accompanying DHS balance sheets as of September 30, 2009 and 2008. The total assets of the Coast Guard, as reported in the accompanying DHS balance sheets, were $18.8 billion and $17.4 billion, or 22 and 20 percent of total DHS consolidated assets as of September 30, 2009 and 2008, respectively.

The Transportation Security Administration (TSA) was unable to provide sufficient evidential matter that supports certain general property, plant, and equipment balances and related effects on net position, as reported in the accompanying DHS balance sheets as of September 30, 2009 and 2008. The TSA general property, plant, and equipment balances reported in the accompanying DHS balance sheets were $997 million and $932 million as of September 30, 2009 and 2008, respectively, or 6 percent of DHS' consolidated general property, plant, and equipment in both years.

We were unable to obtain certain representations from DHS management regarding consistency with U.S. generally accepted accounting principles, with respect to the presentation of the accompanying DHS balance sheets as of September 30, 2009 and 2008, and the related statements of custodial activity for the years then ended.

It was impractical to extend our procedures sufficiently to determine the extent, if any, to which the DHS balance sheets as of September 30, 2009 and 2008, and the related statements of custodial activity for the years then ended, may have been affected by the matters discussed in the three preceding paragraphs. Accordingly, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements and the related notes thereto.

We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the years ended September 30, 2009 and 2008, and accordingly, we do not express an opinion on these other FY 2009 and 2008 financial statements.

As discussed in Note 32, DHS restated its FY 2008 financial statements to correct multiple errors identified by TSA, Coast Guard, United States Customs and Border Protection, United States Immigration and Customs Enforcement, NPPD, United States Citizenship and Immigration Services, Federal Law Enforcement Training Center, and the Science and Technology Directorate, that required adjustment of balances previously reported in DHS' FY 2008 financial statements. Because of the matters discussed in the second and third paragraphs of the report on the financial statements regarding our audits at the Coast Guard and TSA, we were unable to audit the

KPMG

restatements identified by the Coast Guard and TSA, and accordingly, we have not concluded on the appropriateness of this accounting treatment or the restatement of the DHS balance sheet as of September 30, 2008.

The information in the Management's Discussion and Analysis (MD&A), Required Supplementary Stewardship Information (RSSI), and Required Supplementary Information (RSI) sections of the DHS FY 2009 AFR is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We were unable to complete limited procedures over MD&A, RSSI, and RSI as prescribed by professional standards because of the limitations on the scope of our audit described in the previous paragraphs of this section of our report. Certain information presented in the MD&A, RSSI, and RSI is based on other FY 2009 and 2008 financial statements on which we have not expressed an opinion. We did not audit the MD&A, RSSI, and RSI, and accordingly, we express no opinion on it. However, we noted that DHS did not include summary performance information that is aligned with its FY 2009 strategic goals and other information, within the MD&A section of the FY 2009 AFR, as required by OMB Circular No. A-136, *Financial Reporting Requirements*, as amended. DHS is currently performing a quadrennial review for the purpose of developing an updated strategic plan around new priorities established by the Secretary.

The information in the Other Accompanying Information section of DHS' FY 2009 AFR is presented for purposes of additional analysis, and are not a required part of the financial statements. This information has not been subjected to auditing procedures, and accordingly, we express no opinion on it.

Report on Internal Control over Financial Reporting

We were engaged to examine the Department's internal control over financial reporting of the balance sheet as of September 30, 2009, and statement of custodial activity for the year then ended, based on the criteria established in OMB Circular No. A-123, *Management's Responsibility for Internal Control*, 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 Secretary's Assurance Statement on pages 26-27 of the DHS FY 2009 AFR. We were not engaged to examine and report on internal control over financial reporting at the DHS component level.

The Coast Guard was unable to provide documentation of key processes, risk assessments, or evidence supporting the existence of internal controls, and management acknowledges that pervasive material weaknesses exist in key financial processes, and is therefore unable to make an assertion on the effectiveness of internal control over financial reporting. In addition, as discussed in the second paragraph of our report on the financial statements above, the Coast Guard was unable to provide evidential matter that support transactions and account balances that are material to DHS' financial statements. Accordingly, we were unable to perform the examination procedures necessary to form an opinion on DHS' internal control over financial reporting of the balance sheet as of September 30, 2009, and statement of custodial activity for the year then ended. It was impractical to extend our procedures sufficiently to determine the extent, if any, to which the FY 2009 balance sheet and statement of custodial activity may have been affected by these circumstances.

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 material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, 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. If one or more material weaknesses exist, an entity's internal control over financial reporting cannot be considered effective. Material weaknesses in internal control over financial reporting have been identified in the following areas:

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

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

A control deficiency 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 significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. Our consideration of internal control was for the purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in DHS' internal control that might be significant deficiencies. However, in accordance with *Government Auditing Standards*, we are required to report significant deficiencies in internal control identified during our examination. Significant deficiencies have been identified in the following areas:

- Other Entity Level Controls
- Custodial Revenue and Drawback.

Exhibit III presents significant deficiencies at the consolidated level.

Because of the limitation on the scope of our examination described in the second paragraph of this report, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the effectiveness of DHS' internal control over financial reporting of the balance sheet as of September 30, 2009, and related statement of custodial activity for the year then ended. We were not engaged to examine internal controls over financial reporting of the accompanying statements of net cost, changes in net position, and budgetary resources, for the year ended September 30, 2009. Additional deficiencies in internal control over financial reporting, potentially including additional material weaknesses and significant deficiencies, may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DHS' internal control over financial reporting of the FY 2009 balance sheet and statement of custodial activity, and had we been engaged to audit the other FY 2009 and 2008 financial statements, and to examine internal control over financial reporting over the other FY 2009 financial statements.

A summary of the status of FY 2008 material weaknesses and significant deficiencies is included as Exhibit V. We also noted certain additional deficiencies involving internal control over financial reporting and its operation that we will report to the management of DHS in a separate letter.

Report on Compliance and Other Matters

In connection with our engagement to audit of the balance sheet of DHS as of September 30, 2009, and statement of custodial activity for the year then ended, we performed tests of DHS' 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 balance sheet amounts as of September 30, 2009, and the related statement of custodial activity for the year then ended, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, as amended, including the provisions referred to in Section 803(a) of FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to DHS. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our engagement, and accordingly, we do not express such an opinion.

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

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

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

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

As discussed in our reports on the financial statements and internal control over financial reporting, the scope of our work was not sufficient to express an opinion on the balance sheets as of September 30, 2009 and 2008, and the related statements of custodial activity for the years then ended, or to express an opinion on the effectiveness of internal control over financial reporting of the balance sheet as of September 30, 2009 and the related statement of custodial activity for the year then ended. Accordingly, other instances of noncompliance with laws, regulations, contracts, and grant agreements may have been identified and reported, had we been able to perform all procedures necessary to complete our audit of the financial statements and examination of internal control over financial reporting of the balance sheet as of September 30, 2009 and the related statements of custodial activity for the year then ended, and had we been engaged to audit the other FY 2009 and 2008 financial statements and to examine internal control over financial reporting over the other FY 2009 financial statements. In addition, because of the matters discussed in the second paragraph of our report on the financial statements, we were unable to complete tests of compliance over the Prompt Payment Act and Titles 10, 14, 31 (as related to the *Anti-deficiency Act*), and 37 of the United States Code at the Coast Guard.

Other Matters: Management of the NPPD, FEMA, USSS, and Coast Guard have initiated reviews of certain collections, classification and use of funds, expenditures and/or obligations recorded that may identify a violation of the *Anti-deficiency Act*, or other violations of appropriation law in FY 2009 or in previous years.

Management's Response to Internal Control and Compliance Findings

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

Restricted Use

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

KPMG LLP

November 13, 2009

5

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

Our report on internal control over financial reporting and compliance and other matters is presented in accordance with *Government Auditing Standards,* issued by the Comptroller General of the United States. The internal control weaknesses and findings related to compliance with certain laws, regulations, contracts, and grant agreements presented herein were identified during our engagement to audit the Department's the balance sheet as of September 30, 2009, and statement of custodial activity for the year then ended (financial statements), and to examine internal control over financial reporting of those financial statements. We were not engaged to audit the Department's fiscal year (FY) 2009 statements of net cost, changes in net position, and budgetary resources (referred to as other FY 2009 financial statements), or to examine internal controls over financial reporting of the other FY 2009 financial statements. Our findings and the status of prior year findings are presented in five exhibits:

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

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

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

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

Exhibit V The status of our findings reported in FY 2008.

As stated in our Independent Auditors' Report, the scope of our work was not sufficient to enable us to express an opinion on the effectiveness of DHS' internal control over financial reporting of the balance sheet as of September 30, 2009, and related statement of custodial activity for the year then ended. In addition, the scope of our work was not sufficient to express an opinion on the financial statements that we were engaged to audit; consequently, additional deficiencies in internal control over financial reporting, potentially including additional material weaknesses and significant deficiencies, may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DHS' internal control over financial reporting of the financial statements, and had we been engaged to audit the other FY 2009 financial statements, and to examine internal control over financial reporting of the other FY 2009 financial statements.

The determination of which findings rise to the level of a material weakness is based on an evaluation of how deficiencies identified in all components, considered in aggregate, may affect the DHS balance sheet as of September 30, 2009, or the related statement of custodial activity for the year then ended.

We have also performed follow-up procedures on findings identified in previous engagements to audit the DHS financial statements. All of the significant deficiencies identified and reported in Exhibit I for the Coast Guard are repeated from our FY 2008 and FY 2007 report, and include updates for new findings resulting from our 2009 procedures. To provide trend information for the DHS Civilian Components, Exhibit II contains a Trend Table next to the heading of each finding, except Comment **II-B**, *IT Controls and Financial System Functionality*. The Trend Tables in Exhibit II depict the severity and current status of findings by component that has contributed to that finding from FY 2007 through FY 2009.

i.1

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

A summary of our findings in FY 2009 and FY 2008 are presented in the Tables below:

Table 1 Presents a summary of our internal control findings, by component, for FY 2009.
Table 2 Presents a summary of our internal control findings, by component, for FY 2008.

We have reported six material weaknesses and two significant deficiencies at the Department level in FY 2009, shown in Table 1.

TABLE 1 - SUMMARIZED DHS FY 2009 INTERNAL CONTROL FINDINGS

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

TABLE 2 - SUMMARIZED DHS FY 2008 INTERNAL CONTROL FINDINGS

	Comment / Financial Statement Area	DHS Consol.	CG	CBP	USCIS	FEMA	FLETC	ICE	NPPD	S&T	TSA
			Military	Civilian							
Material Weaknesses:			Exhibit I	Exhibit II							
A	Financial Reporting	MW									
B	IT General and App. Controls	MW									
C	Fund Balance with Treasury	MW									
D	Capital Assets and Supplies	MW									
E	Actuarial and Other Liabilities	MW									
F	Budgetary Accounting	MW									
Significant Deficiencies:			Exhibit III								
G	Entity-Level Controls	SD									
H	Custodial Revenue and Drawback	SD									
I	Deferred Revenue	SD									

	Control deficiency findings are more severe
	Control deficiency findings are less severe
MW	Material weakness at the Department level exists when all findings are aggregated
SD	Significant deficiency at the Department level exists when all findings are aggregated

All components of DHS, as defined in Note 1A – *Reporting Entity*, to the financial statements, were included in the scope of our engagement to audit the consolidated balance sheet of DHS as of September 30, 2009, and the related statement of custodial activity for the year then ended, and to examine internal control over financial reporting of those financial statements Accordingly, our engagement to audit and examine internal control considered significant account balances, transactions, and accounting processes of other DHS components not listed above. Control deficiencies identified in other DHS components that are not identified in the table above did not individually, or when combined with other component findings, contribute to a significant deficiency at the DHS consolidated financial statement level.

i.2

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

I-A Financial Management and Reporting

Background: In fiscal year (FY) 2009, we were engaged to perform an examination of internal controls over financial reporting. The auditors' objective in an examination of internal control is to form an opinion on the effectiveness of internal control. When planning our examination, we gave appropriate emphasis to testing entity-level controls, such as management's risk assessment and monitoring processes, and other control environment elements that exist throughout the Department of Homeland Security (DHS or Department). Four Department-wide control environment conditions were identified through our examination procedures that have a pervasive influence on the control environment and effectiveness of control activities at the United States Coast Guard (Coast Guard). This Exhibit should be read in conjunction with the Department-wide conditions and recommendations described in Comment **II-A**, *Financial Management and Reporting*.

In previous years, we reported that the Coast Guard had several internal control deficiencies that led to a material weakness in financial reporting. In response, the Coast Guard developed its *Financial Strategy for Transformation and Audit Readiness* (FSTAR), which is a comprehensive plan to identify and correct conditions that are causing control deficiencies, which in some cases prevent the Coast Guard from preparing auditable financial statements. The Coast Guard did make progress in FY 2009 by completing its planned corrective actions over pension liabilities, allowing management to make assertions on completeness and accuracy on more than $25 billion of accrued liabilities, which represents more than 50 percent of DHS' total liabilities. In addition, the Coast Guard sustained financial reporting assertions attained in the previous fiscal year over investments representing more than $3 billion or the majority of the Department's balance for this line item, while also sustaining financial reporting assertions for contingent legal liabilities and *Federal Employees' Compensation Act* (FECA)-related line items. The FSTAR calls for substantially more activity in FY 2010; consequently, many of the financial reporting deficiencies we reported in the past remain uncorrected at September 30, 2009.

Conditions:

1. In FY 2009, we identified certain entity-level control weaknesses that may interfere with the timely completion of corrective actions planned for FY 2010 and beyond. The Coast Guard:
   - Does not have sufficient financial management personnel to identify and address control weaknesses, and to develop and implement effective policies, procedures, and internal controls to ensure that data supporting financial statement assertions are complete and accurate, and that transactions are accounted for consistent with GAAP;
   - Has not fully implemented an on-going Coast Guard-wide risk assessment by financial, IT, and program personnel;
   - Has not developed and/or fully implemented information and communication processes and controls relevant to financial reporting; and
   - Has not fully implemented adequate monitoring controls over headquarters, areas/districts, and units with significant financial activity.
2. Does not have properly designed, implemented, and effective policies, procedures, processes, and controls surrounding its financial reporting process, as necessary to:
   - Support beginning balances, year-end close-out, and the cumulative results of operations analysis in its general ledgers individually and/or in the aggregate;
   - Ensure that transactions and accounting events at Coast Guard headquarters, areas/districts, and units are appropriately supported and accounted for in its general ledgers;
   - Ensure financial statement disclosures submitted for incorporation in the DHS financial statements are accurate and complete;

I.1

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

- Ascertain that intragovernmental activities and balances are identified and differences, especially with agencies outside DHS, are being resolved in a timely manner in coordination with the Department's Office of Financial Management (OFM);

Cause/Effect: The Coast Guard has not developed and implemented an effective general ledger system. The Core Accounting System (CAS), Aircraft Logistics Management Information System (ALMIS), and Naval Engineering Supply Support System (NESSS) general ledgers do not comply with the requirements of the *Federal Financial Management Improvement Act of 1996* (FFMIA). The general ledgers do not allow for compliance with the United States Standard General Ledger (USSGL) at the transaction level, and period-end and opening balances are not supported by transactional detail in the three general ledgers. The conditions described below in Comment **I-B**, *Information Technology Controls and Financial System Functionality* contribute to the financial reporting control deficiencies, and make correction more difficult. In addition, the Coast Guard was unable to provide reasonable assurance that internal controls over financial reporting are operating effectively and has acknowledged that pervasive material weaknesses exist in key financial processes. Consequently, the Coast Guard can not be reasonably certain that its financial statements are reliable, or assert to the completeness, existence, accuracy, valuation, rights and obligations, or presentation of their financial data related to their balances of fund balance with Treasury, accounts receivable, inventory and related property, general property, plant, and equipment, including heritage assets and stewardship land, actuarially-derived liabilities, environmental and other liabilities, and net position as reported in the Department's balance sheets as of September 30, 2009 and 2008.

Criteria: FFMIA Section 803(a) requires that Federal financial management systems substantially comply with (1) applicable Federal accounting standards, (2) Federal financial management system requirements, and (3) the 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.

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

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

The Treasury *Federal Intragovernmental Transactions Accounting Policies Guide,* dated August 6, 2009, and OMB Circular No. A-136, *Financial Reporting Requirements,* as revised, require Federal CFO Act and non-CFO Act entities identified in the Treasury Financial Manual (TFM) 2009, Vol. I, Part 2, Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government,* to perform quarterly reconciliations of intragovernmental activity/balances. TFM, Section 4706, *Intragovernmental Requirements,* provides guidance on OMB Circular No. A-136 requirements for reporting agencies to reconcile and confirm intragovernmental activity and balances quarterly for specific reciprocal groupings. TFM Bulletin 2007-03, *Intragovernmental Business Rules*, also provides standardized guidance to Federal agencies for reconciling and recording intragovernmental activities.

Recommendations: We recommend that the Coast Guard:

1. Continue the implementation of the FSTAR as planned;

2. Conduct a human resource needs assessment and financial organizational assessment to identify gaps in skill sets, hire or realign personnel to fill the gaps, and assign personnel with responsibilities that best match their expertise, and consider updating the financial organizational structure based on the human resources needs assessment;

3. Improve entity-level controls by fully implementing a formal risk assessment process, evaluating and updating processes used to communicate policies and ensure that all transactions are recorded completely and accurately, and improve monitor controls over financial data supporting the general ledger and financial statements;

4. Implement accounting and financial reporting processes including an integrated general ledger system that is FFMIA compliant; and

5. Establish new or improve existing policies, procedures, and related internal controls to ensure that:

    a. The year-end close-out process, reconciliations, and financial data and account analysis procedures are supported by documentation, including evidence of effective management review and approval, and beginning balances in the following year are determined to be reliable and auditable;

    b. All accounting transactions and balances are properly reflected in the financial statements consistent with GAAP;

    c. Financial statement disclosures submitted for incorporation in the DHS financial statements are accurate and complete; and

    d. All intragovernmental activity and balances are accurately reflected in the financial statements, and differences are resolved in a timely manner in coordination with the Department's OFM.

I-B Information Technology Controls and Financial System Functionality

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

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

In FY 2009, our IT audit work identified 20 IT findings, of which 11 were repeat findings from the prior year and 9 were new findings. In addition, we determined that the Coast Guard remediated 9 IT findings identified in previous years. Specifically, the Coast Guard took actions to improve aspects of its ITGC by strengthening access controls around key programs and data, and in its entity-wide security program.

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

Related to IT Controls:

Condition: We noted that the Coast Guard's core financial system configuration management process controls are not operating effectively and continue to present risks to DHS financial data confidentiality, integrity, and availability. Financial data in the general ledger may be compromised by automated and manual changes that are not adequately controlled. For example, the Coast Guard uses an IT scripting process to make updates to its core general ledger software as necessary to process financial data. However, the Coast Guard has not (a) fully developed testing standards to guide staff in the development and functional testing of IT scripts, (b) documented policies and procedures over testing plans that must be performed, and (c) ensured that all necessary approvals are obtained prior to implementation.

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

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

Related to financial system functionality:

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

1. As noted above, the Coast Guard's core financial system configuration management process is not operating effectively due to inadequate controls over IT scripts. The IT script process was instituted as a solution primarily to compensate for system functionality and data quality issues;
2. Annual financial system account recertifications are not being performed due to limitations;
3. Financial system audit logs are not readily generated and reviewed, as some of the financial systems are lacking this capability;
4. Aspects of DHS-required system password requirements are not implemented because some financial systems cannot support the policy;
5. Production versions of operational financial systems are outdated, no longer supported by the vendor, and do not provide the necessary core functional capabilities (e.g., general ledger capabilities);
6. 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:
   - Tracking of costs to support weighted average pricing for operating materials and supplies;
   - Maintaining data needed to support the calculation of accounting payable and provide detailed listings of accounts payable, which may reduce the resources spent by Coast Guard personnel in manually preparing the accounts payable accrual;
   - Ensuring proper segregation of duties such as automating the procurement process to ensure that only individuals who have proper contract authority can approve transactions;
   - Tracking detail transactions associated with intragovernmental business and eliminate the need for default codes such as Trading Partner Identification Number that cannot be easily researched; and
   - Ensuring that undelivered obligations are properly accounted for upon receipt of goods or services.

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

Criteria: The *Federal Information Security Management Act* (FISMA), passed as part of the *E-Gov Act of 2002*, mandates that Federal entities maintain IT security programs in accordance with standards prescribed by the Secretary of Commerce.

OMB Circular No. A-130, *Management of Federal Information Resources,* describes specific essential criteria for maintaining effective general IT controls.

FFMIA sets forth legislation prescribing policies and standards for Executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems. The purposes of FFMIA are to (1) provide for consistency of accounting by an agency from one fiscal year to the next, and uniform accounting standards throughout the Federal Government, (2) require Federal financial management systems to support full disclosure of Federal financial data, including the full costs of Federal programs and activities, (3) increase the accountability and credibility of federal financial management, (4) improve performance, productivity, and efficiency of Federal Government financial management, and (5) establish financial management systems to support controlling the cost of Federal Government.

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

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

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

I-C Fund Balance with Treasury

Background: Fund Balance with Treasury (FBWT) at the Coast Guard totaled approximately $5.5 billion, or approximately 9.7 percent of total DHS FBWT, at September 30, 2009. The majority of these funds represented appropriated amounts that were obligated, but not yet disbursed, as of September 30, 2009. In FY 2008, we reported a material weakness in internal control over FBWT at the Coast Guard. In FY 2009, the Coast Guard corrected some FBWT control deficiencies and revised its remediation plan to include additional corrective actions that are scheduled to occur after FY 2009. Consequently, most of the conditions stated below are repeated from our FY 2008 report.

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

- Did not properly design FBWT monthly activity reconciliations and/or could not provide detail transaction lists for amounts reported to Treasury for at least three of the six Coast Guard Agency Location Codes;
- Recorded adjustments to the general ledger FBWT accounts or activity reports submitted to Treasury, including adjustments to agree Coast Guard balances to Treasury amounts, that were unsupported;
- Does not have an effective process for clearing suspense account transactions related to FBWT due to over-reliance on vendor-provided data. The Coast Guard lacks documented and effective policies and procedures and internal controls necessary to support the completeness, existence, and

accuracy of suspense account transactions. In addition, certain issues persist with industrial service orders (ISOs) and credit cards that preclude a complete and accurate population of suspense detail; and

- Was unable to provide military payroll data to support the summary payroll transactions processed through the Coast Guard's FBWT. In addition, the Coast Guard lacked formal policies and procedures for processing and documenting all military and civilian payroll transactions.

Cause/Effect: The Coast Guard had not designed and implemented accounting processes, including a financial system that complies with federal financial system requirements, as defined in OMB Circular No. A-127, *Financial Management Systems*, and the requirements of the *Joint Financial Management Improvement Program* (JFMIP), now administered by the FSIO, to fully support the FY 2009 FBWT activity and balance as of September 30, 2009. Failure to implement timely and effective reconciliation processes could increase the risk of undetected errors and/or violations of appropriation laws, including instances of undiscovered *Anti-deficiency Act* violations or fraud, abuse, and mismanagement of funds, which could lead to inaccurate financial reporting and affect DHS' ability to effectively monitor its budget status.

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

Per *Fund Balance with Treasury Reconciliation Procedures, a Supplement to I TFM 2-5100*, Section V, "Federal agencies must reconcile their SGL 1010 account and any related subaccounts […] on a monthly basis (at minimum). […] Federal agencies must […] resolve all differences between the balances reported on their G/L FBwT accounts and balances reported on the FMS 6653, 6654 and 6655 [now the *Government-wide Accounting* system (GWA)]." In addition, "An agency may not arbitrarily adjust its FBWT account. Only after clearly establishing the causes of errors and properly documenting those errors, should an agency adjust its FBWT account balance. If an agency must make material adjustments, the agency must maintain supporting documentation. This will allow correct interpretation of the error and its corresponding adjustment."

Section 803(a) of FFMIA requires that Federal financial management systems comply with (1) applicable Federal accounting standards, (2) Federal financial management system requirements, and (3) the 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.

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

Recommendations: We recommend that the Coast Guard establish policies, procedures, and internal controls to ensure that FBWT transactions are recorded accurately and completely, and in a timely manner, and that all supporting documentation is maintained for all recorded transactions. These policies and procedures should allow the Coast Guard to:

1. Perform complete and timely FBWT reconciliations using the Treasury Government-wide Accounting tools;
2. Better manage its suspense accounts to include researching and clearing items carried in suspense clearing accounts in a timely manner during the year, and maintaining proper supporting documentation in clearing suspense activity; and
3. Maintain payroll data supporting payroll transactions processed through FBWT and have access to complete documentation, if needed.

I-D Property, Plant, and Equipment and Operating Materials and Supplies

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

Background: The Coast Guard maintains approximately 52 percent of all DHS property, plant, and equipment (PP&E), including a large fleet of boats and vessels. Many of the Coast Guard's assets are constructed over a multi-year period, have long useful lives, and undergo extensive routine servicing that may increase their value or extend their useful lives. In FY 2009, the Coast Guard continued to revise corrective action plans as documented in FSTAR to address the PP&E process and control deficiencies, and execute remediation efforts. However, many of the FSTAR procedures are scheduled to occur over a multi-year timeframe. Consequently, many of the conditions cited below have been repeated from our FY 2008 report.

Operating Materials and Supplies (OM&S) are maintained by the Coast Guard in significant quantities and consist of tangible personal property to be consumed in normal operations to service marine equipment, aircraft, and other operating equipment. The majority of the Coast Guard's OM&S is physically located at either two Inventory Control Points (ICPs) or in the field. The Coast Guard's policy requires regularly scheduled physical counts of OM&S, which are important to the proper valuation of OM&S and its safekeeping. The conditions cited below for OM&S have been repeated from our FY 2008 report.

DHS' Stewardship PP&E consists of 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. The majority of DHS' stewardship PP&E is maintained by the Coast Guard, and consists of both collection type heritage assets, such as artwork and display models, and non-collection-type heritage assets, such as lighthouses, sunken vessels, and buildings.

Conditions: The Coast Guard has not:

Regarding PP&E:

- Established its opening PP&E balances necessary to prepare a balance sheet as of September 30, 2009. In cases where original acquisition documentation has not been maintained, the Coast Guard has not developed and documented methodologies and assumptions to support the value of PP&E;
- Implemented appropriate controls and related processes to accurately, consistently, and timely record additions to PP&E and construction in process (CIP), transfers from other agencies, disposals in its fixed asset system, and valuation and classification of repairable PP&E;
- Implemented accurate and complete asset identification, system mapping, and tagging processes that include sufficient detail, e.g., serial number, to clearly differentiate and accurately track physical assets to those recorded in the fixed asset system; and
- Properly accounted for some improvements and impairments to buildings and structures, capital leases, and selected useful lives for depreciation purposes, consistent with GAAP.

Regarding OM&S:

- Implemented policies, procedures, and internal controls to support the completeness, accuracy, existence, valuation, and presentation assertions related to the FY 2009 OM&S and related account balances;
- Fully designed and implemented policies, procedures, and internal controls over physical counts of OM&S at field units to remediate conditions identified in previous years; and
- Established processes and controls to fully support the calculated value of certain types of OM&S to approximate historical cost.

Regarding stewardship PP&E:

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

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

Coast Guard management deferred correction of most OM&S weaknesses reported in previous years, and acknowledged that the conditions we reported in prior years remained throughout FY 2009. Lack of comprehensive and effective policies and controls over the performance of physical counts, and appropriate support for valuation, may result in errors in the physical inventory process or inventory discrepancies that could result in financial statement misstatements.

The Coast Guard did not consider the new stewardship property reporting standards until late in the year, and did not have sufficient time to design and implement procedures to accumulate data needed for financial reporting purposes before the completion of the FY 2009 DHS AFR.

Criteria: SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, provides the general requirements for recording and depreciating property, plant and equipment. SFFAS No. 6 was recently amended by SFFAS No. 35, which clarifies that "reasonable estimates of original transaction data historical cost may be used to value general PP&E […] Reasonable estimates may be used upon initial capitalization as entities implement general PP&E accounting for the first time, as well as by those entities who previously implemented general PP&E accounting."

The Federal Accounting Standards Advisory Board (FASAB)'s Federal Financial Accounting Standards Interpretation No. 7, dated March 16, 2007, defines "items held for remanufacture" as items "in the process of (or awaiting) inspection, disassembly, evaluation, cleaning, rebuilding, refurbishing and/or restoration to serviceable or technologically updated/upgraded condition. Items held for remanufacture may consist of: Direct materials, (including repairable parts or subassemblies […]) and Work-in-process (including labor costs) related to the process of major overhaul, where products are restored to 'good-as-new' condition and/or improved/upgraded condition. 'Items held for remanufacture' share characteristics with 'items held for repair' and items in the process of production and may be aggregated with either class. Management should use judgment to determine a reasonable, consistent, and cost-effective manner to classify processes as 'repair' or 'remanufacture'."

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

FFMIA Section 803(a) requires each agency to implement and maintain a system that complies substantially with Federal financial management system requirements. OMB Circular No. A-127 prescribes the standards for federal agencies' financial management systems. That Circular requires an agency's system design to have certain characteristics that include consistent "internal controls over data entry, transaction processing, and reporting throughout the system to ensure the validity of information and protection of Federal Government resources."

According to GAO *Standards*, assets at risk of loss or unauthorized use should be periodically counted and compared to control records. Policies and procedures should be in place for this process. The FSIO publication, *Inventory, Supplies, and Materials System Requirements*, states "the general requirements for control of inventory, supplies, and materials consist of the processes of receipt and inspection, storing, and item in transit." Specifically, the "placement into inventory process" requires that an "agency's inventory, supplies, and materials system must identify the intended location of the item and track its movement from the point of initial receipt to its final destination." SFFAS No. 3, *Accounting for Inventory and Related Property*, states OM&S shall be valued on the basis of historical cost.

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

Recommendations: We recommend that the Coast Guard:

Regarding PP&E:

1. Adopt the provisions of SFFAS No. 35, which provides alternatives to the Coast Guard to value general property, plant, and equipment to establish its opening balances for balance sheet presentation;
2. Implement appropriate controls and related processes to accurately and timely record additions to PP&E and CIP, transfers from other agencies, improvements, impairments, capital leases, depreciable lives, disposals in its fixed asset system, and valuation and classification of repairable PP&E;
3. Ensure that appropriate supporting documentation is maintained and readily available for audit; and
4. Implement processes and controls to record an identifying number in the fixed asset system at the time of asset purchase to facilitate identification and tracking; and ensure that the status of assets is accurately tracked in the subsidiary ledger.

Regarding OM&S:

5. Update OM&S physical count policies, procedures, and controls, and provide training to personnel responsible for conducting physical inventories at field units, and include key elements of an effective physical inventory in the policies;
6. Consider adopting an inventory control system for OM&S as a method of tracking usage and maintaining a perpetual inventory of OM&S on hand; and
7. Establish processes and controls to support the calculated value of OM&S to ensure accounting is consistent with GAAP.

Regarding stewardship PP&E:

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

I-E Actuarial and Other Liabilities

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

The Coast Guard estimates accounts payable by adjusting the prior year revised accounts payable accrual estimate by the percentage change in budgetary authority for the current fiscal year. The revised prior year estimate is calculated by analyzing actual payments made subsequent to September 30 of the prior year to determine a range within which the accrual should fall, and using the mid-point of that range. The calculation is based on the results of a statistical sample of subsequent disbursements and actual or average amounts paid.

The Coast Guard's environmental liabilities consist of two main types: shore facilities and vessels. Shore facilities include any facilities or property other than ships, (e.g., buildings, fuel tanks, lighthouses, small arms firing ranges (SAFRs), etc.)

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

Conditions: We noted the following internal control weaknesses related to actuarial and other liabilities. The Coast Guard has not:

Regarding medical and post-employment benefits:

- Implemented effective policies, procedures, and controls to ensure the completeness and accuracy of medical cost data and post-employment travel claims provided to, and used by, the actuary for the calculation of the medical and post-employment benefit liabilities. Reconciliations between subsidiary and general ledger amounts for medical expenditures are not effective;
- Implemented controls to prevent overpayments for medical services; and
- Implemented effective processes to account for military personnel data changes, including changes in leave balances and payroll corrections, in the appropriate reporting periods, and consequently the completeness and accuracy of leave and payroll accruals as well as data used for actuarial projections is not always reliable;

Regarding accounts payable estimates:

- Validated its methodology used to estimate accounts payable, e.g., the reliability of data, assumptions, and criteria used to calculate and subsequently validate the estimate for financial reporting;

Regarding environmental liabilities:

- Fully supported the completeness, existence, and accuracy assertions of the data utilized in developing the estimate for the FY 2009 environmental liability account balance; and
- Fully developed, documented, and implemented the policies and procedures in developing, preparing, and recording the environmental liability estimates related to shore facilities, and has not approved policies and procedures for the review of the environmental liability estimate related to vessels.

Cause/Effect: Much of the data required by the actuary comes from personnel and payroll systems that are outside of the Coast Guard's accounting organization and are managed by the Coast Guard's Pay and Personnel Center (PPC). Inaccurate medical costs submitted to the Coast Guard actuary could result in a misstatement of the actuarial medical liability and related expenses.

The Coast Guard has not yet developed comprehensive policies and procedures or corrective action plans to address the conditions above, and consequently, management is unable to assert to the accuracy and completeness of the accounts payable and payroll accruals recorded as of September 30, 2009.

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

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

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

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

Recommendations: We recommend that the Coast Guard:

Regarding actuarial liabilities:

1. Implement effective policies, procedures, and controls to ensure the completeness and accuracy of medical cost data and post-employment travel claims provided to, and used by, the actuary for the calculation of the medical and post-employment benefit liabilities;
2. Perform a periodic reconciliation between the medical expenditures recorded in the subsidiary ledger and those recorded in the CAS, and address differences before data is provided to the actuary. This reconciliation should be performed for all significant sources of medical actuarial data, including TriCare and DoD Military Treatment Facilities (MTFs). In addition, this reconciliation should be reviewed by someone other than the preparer to ensure accuracy; and
3. Implement effective processes to account for military personnel data changes, including changes in leave balances and payroll corrections, and to ensure that updates are recorded in the proper accounting period;

Regarding accounts payable:

4. Analyze and make appropriate improvements to the methodology used to estimate accounts payable and support all assumptions and criteria with appropriate documentation to develop and subsequently validate the estimate for financial reporting;

Regarding environmental liabilities:

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

I-F Budgetary Accounting

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

Conditions: We noted the following internal control weaknesses related to budgetary accounting, many of which were repeated from our FY 2008 report. The Coast Guard has not:

- Fully implemented policies, procedures, and internal controls over the Coast Guard's process for validation and verification of undelivered order (UDO) balances that are operating effectively. Recorded obligations and UDO balances were not always complete, valid, accurate, and proper approvals and supporting documentation are not always maintained;

- Finalized and implemented policies and procedures to monitor unobligated commitment activity in CAS throughout the fiscal year. Currently, the Coast Guard performs only a year-end review to reverse commitments that are now longer valid;
- Designed and implemented effective procedures, processes, and internal controls to verify the completeness and accuracy of the year-end obligation "pipeline", which are obligations executed on or before September 30 but not recorded in the Coast Guard's CAS, and to record all executed obligations. These deficiencies affected the completeness, existence, and accuracy of the year-end "pipeline" adjustment that was made to record obligations executed before year end; and
- Established adequate internal controls to ensure that procurement transactions are processed only by individuals who have the appropriate warrant authority, e.g., those with expired warrant authority are unable to process transactions.

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

Criteria: According to the Office of Federal Financial Management's *Core Financial System Requirements*, dated January 2006, an agency's core financial management system must ensure that an agency does not obligate or disburse funds in excess of those appropriated or authorized, and "the Budgetary Resource Management Function must support agency policies on internal funds allocation methods and controls." The *Federal Acquisition Regulation* (FAR) Section 1.602 addresses the authorities and responsibilities granted to contracting officers. Treasury's USSGL guidance at TFM S2 09-02 (dated August 2009) specifies the accounting entries related to budgetary transactions.

FFMIA Section 803(a) requires that each Agency implement and maintain a system that complies substantially with Federal financial management system requirements. OMB Circular No. A-127 sets forth the standards for federal financial management systems.

Recommendations: We recommend that the Coast Guard:

1. Improve policies, procedures, and the design and effectiveness of controls related to processing obligation transactions, including periodic review and validation of UDOs. Emphasize to all fund managers the need to perform effective reviews of open obligations, obtain proper approvals, and retain supporting documentation;
2. Finalize policies and procedures to periodically review commitments, and make appropriate adjustments in the financial system;
3. Improve procedures, processes, and internal controls to verify the completeness and accuracy of the year-end obligation "pipeline" adjustment to record all executed obligations for financial reporting; and
4. Establish automated system controls to ensure that procurement transactions can be processed only by those with appropriate/valid warrant authority.

Independent Auditors' Report
Exhibit II – Material Weaknesses – DHS Civilian Components

II-A Financial Management and Reporting

Department-wide Entity-Level Controls affecting Financial Reporting:

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

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

- The Department lacks a sufficient number of accounting and financial management personnel with the core technical competencies to ensure that its financial statements are prepared accurately and in compliance with generally accepted accounting principles;
- DHS' accounting and financial reporting infrastructure, including policies, procedures, processes, and internal controls, have not received investments in proportion to the Department's rapid growth in new programs and operations, and changes in mission since the Department's inception;
- Field and operational personnel do not always share responsibilities for, or are not held accountable for, financial management matters that affect the financial statements, including adhering to accounting policies and procedures and performing key internal control functions in support of financial reporting; and
- The Department's financial Information Technology (IT) system infrastructure is aging and has limited functionality, which is hindering the Department's ability to implement efficient corrective actions and produce reliable financial statements that can be audited.

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

1. Analyze the structures of essential financial management offices and skill sets of key financial management personnel in significant components of DHS to improve core competencies and strengthen internal controls;
2. Expand the annual risk assessment to identify weaknesses in accounting and financial reporting, including accounting systems, processes, and infrastructure, where problems are likely to occur due to changing operations and programs;
3. Use the results of the risk assessment to allocate resources and invest in infrastructure to mitigate risks and to ensure that expenditures for new programs and initiatives are properly accounted for and accurately reflected in the financial statements;
4. Improve information and communications related to roles and responsibilities of field and operational personnel for their compliance with existing policies and procedures in support of effective internal controls, financial reporting, and fiscal management; and

5. Continue the assessment of the Department's financial IT system infrastructure, with the objective of improving the effectiveness of IT controls and IT functionality in support of timely and accurate financial reporting. In the interim, implement compensating controls designed to help ensure completeness, accuracy, authorization, and validity of financial transactions reported in the financial statements.

Financial Management and Reporting (TSA, FEMA and CBP):

	2009	2008	2007
DHS-HQ	N/A	C	(red)
TSA	(red)	(red)	(yellow)
FEMA	(red)	(red)	(red)
CBP	(yellow)	N/A	N/A

Key – Trend Table	
C	Deficiencies are corrected
(yellow)	Deficiencies are less severe*
(red)	Deficiencies are more severe*
* See Introduction	

Background: The Transportation Security Administration (TSA) has had difficulty establishing baseline accounting policies, procedures, and processes, with well-designed and effective internal controls. In FY 2009, TSA made some progress in reconciling its balance sheet accounts and addressed some matters that have led to misstatements in the financial statements in previous years. However, this progress was achieved only through the exceptional efforts of a few people in the Office of Financial Management (OFM) – a situation that is unsustainable in the long-run. Entity-level control weaknesses reported in FY 2008 continued to exist in FY 2009 and had a more acute effect on TSA's financial reporting processes, causing us to elevate some conditions to a material weakness.

The Federal Emergency Management Agency (FEMA)'s accounting and financial reporting processes must support multi-faceted operations such as temporary assistance funds, disaster relief loans, national flood insurance programs, stockpiles of essential supplies, mission assignments to other federal agencies for restoration and reconstruction, and grants to state and local governments. While FEMA has taken positive steps in FY 2009 to correct control deficiencies that we have reported in the past, financial reporting control deficiencies continued to exist throughout the year.

In recent years, U.S. Customs and Border Protection (CBP)'s operations and capital expenditures have increased substantially, particularly along the southwest border states. However, CBP has not invested in an accounting and financial reporting infrastructure in proportion to its growth in mission. The accounting system, processes, and staffing levels that existed several years ago are absorbing an increased workload, creating an environment where financial statement errors are more likely to occur, especially in areas that are new to CBP, such as construction of the virtual and physical fence along the southwest border.

Conditions:

1. TSA:

- Does not have a sufficient number of accounting personnel who possess the technical accounting proficiencies necessary to:
  - Support and perform essential accounting and financial reporting functions;
  - Ensure appropriate segregation of duties, and to supervise and review accounting processes throughout the agency;
  - Ensure that material financial reporting issues are identified on a timely basis; and
  - Ensure that significant events and transactions are properly accounted for and financial statements and related disclosures are presented in conformity with generally accepted accounting principles (GAAP);
- Has weaknesses in communication, training, supervision and/or coordination with personnel outside of OFM, that contribute to control weaknesses in processes dependent on operations;

Independent Auditors' Report
Exhibit II – Material Weaknesses – DHS Civilian Components

- Has not maintained adequate documentation of its accounting processes, internal controls, transactions, and significant events to support management's assertions related to key processes and financial statement balances and disclosures;
- Has conducted an annual risk assessment; however, the risk assessment did not identify all matters that could have a material impact on the financial statements, and did not result in an effective internal control structure for the entire year;
- Is not fully compliant with the United States Government Standard General Ledger (USSGL) requirements at the transaction level. For example, TSA did not record property-related adjustments into the applicable general ledger accounts at the appropriate fund account symbol to provide an audit trail at the transaction level. In addition, proprietary to budgetary account imbalances were created due to advance adjustments recorded without the corresponding budgetary effects; and
- Is unable to fully identify and present its intragovernmental balances and transactions by trading partner.

2. FEMA:

- Does not have adequate processes and controls to ensure that all adjustments are fully researched, substantiated, documented, and/or appropriately reviewed prior to preparation and submission of financial data to the Department. For example, FEMA performs manual adjustments to correct attributes for certain financial activity, primarily related to the former Office of Grants and Training. These adjustments are not fully substantiated;
- Has financial reporting processes that produce numerous differences and abnormal balances that must be researched and resolved before the IT system will allow transmission of financial data to the Department. A substantial number of material manual adjustments are necessary to resolve these differences. FEMA does not have a policy that requires timely research to identify and correct the source of the differences to prevent recurring failed edit checks and abnormal balances;
- Lacks sufficient staff to ensure proper segregation of the preparation, recording, review, and approval of adjustments prior to submission of financial information to the Department;
- Has developed a complex process to record flood insurance financial information obtained from the third-party service provider into its general ledger, which increases the likelihood of error in the flood related balances; and
- Does not have adequate internal controls in place to ensure that apportionments are recorded timely and accurately, and did not properly investigate an abnormal balance identified in USSGL account 4510 at year-end. As a result, FEMA initially understated apportionments and overstated unapportioned authority at September 30, 2009, by approximately $579 million.

3. CBP:

- Has not developed and effectively communicated policies and procedures to properly account for and timely report significant new activities that occur outside of the Office of Finance;
- Has not added sufficient resources or infrastructure within the Office of Finance or in the operating divisions to supplement its current accounting and financial reporting personnel, and consequently, has been unable to adequately monitor inputs and operational activities to ensure proper and timely accounting and reporting consideration; and
- Does not have an annual risk assessment and/or focus group process that maintained its effectiveness to timely identify and address new accounting standards, and/or the application of existing standards to new operations, that may have a material impact on financial reporting throughout the year.

II. 3

Independent Auditors' Report
Exhibit II – Material Weaknesses – DHS Civilian Components

Cause/Effect: TSA has devoted substantial resources to the development of its initial balance sheet. This effort involves many one-time efforts that will not need to be repeated in future years. At times, the effort has also commanded more resources than TSA was able to provide. Financial reporting and management control deficiencies are caused primarily by a lack of personnel who have the necessary technical accounting skills to perform essential financial reporting functions, including the development and implementation of processes to ensure that all relevant financial statement assertions are considered when preparing financial statements. In some cases, the adjustments were recorded without appropriate supporting analysis and documentation. In addition, accounting personnel did not consider all relevant assertions, such as completeness, or consider relevant technical accounting standards before representing to the auditor that balances were correct. Consequently, we discovered numerous errors in FY 2009, including differences between subsidiary records and the general ledger, unrecorded liabilities, misclassified assets, and various over and understatements of other balance sheet account balances.

FEMA's IT systems are outdated and have limited capacity for modification. (See comment **II-B**, *Information Technology Controls and Financial System Functionality.*) Consequently, FEMA must rely more heavily on manual analyses and adjustments to accurately prepare financial statements. With accelerated time-frames for reporting, particularly at year-end, the likelihood that a material error will occur increases. Because of timing differences and the complexities of the National Flood Insurance Program (NFIP), the determination of the appropriate related proprietary and budgetary accounting is inherently difficult, and because of resource constraints, the legacy process to record all NFIP entries into the general ledger has not been recently re-evaluated for efficiency and effectiveness. As a result, there is an increased risk that errors will be made when recording the adjustments, and FEMA was not in full compliance with the USSGL until an on-top adjustment was recorded at year-end.

CBP has not made sufficient investments in its accounting and financial reporting infrastructure, including human resources, and has not identified and established policies and procedures to account for substantial new operations. In addition, CBP does not have a formalized, continuous, and comprehensive communication process to identify the need for and implement new accounting processes that are important to financial reporting. Consequently, CBP and the external auditor have identified several errors in the financial statements, some of which related to the prior year.

Criteria: OMB Circular No. A-123 defines internal control and provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal control. In particular, management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. The documentation for internal control, all transactions, and other significant events should be readily available for examination. Further, relevant, reliable, and timely information should be communicated to relevant personnel at all levels within an organization. It is also crucial that an agency communicate with outside organizations. In addition, the Circular states that management should identify both internal and external risks, and analyze those risks for their potential effect on the entity.

The *Federal Financial Managers Improvement Act of 1996* (FFMIA) Section 803(a) requires all Chief Financial Officer (CFO) Act agencies to implement financial management systems that comply with three essential requirements: Federal financial management systems requirements, Federal accounting standards, and USSGL at the transaction level.

OMB Circular No. A-11, *Instructions on Budget Execution*, Appendix H, requires that an agency's accounting systems provide for recording all financial transactions affecting apportionments, and for preparing and reconciling financial reports that display cumulative obligations, the remaining unobligated balance by appropriation and allotment, and cumulative obligations by budget activity and object class.

OMB Circular No. A-50, *Audit Follow-Up*, states that corrective action taken by management on resolved findings and recommendations is essential to improving the effectiveness and efficiency of Government operations. Each agency shall establish systems to assure the prompt and proper resolution and implementation of audit recommendations. These systems shall provide for a complete record of action taken on both monetary and nonmonetary findings and recommendations.

Statement of Federal Financial Accounting Concepts No. 1, *Objectives of Federal Financial Reporting*, states that financial reporting "should help report users make relevant comparisons among similar federal reporting units, such as comparisons of the costs of specific functions or activities. Comparability implies that differences among financial reports should be caused by substantive differences in the underlying transactions or organizations rather than by the mere selection of different alternatives in accounting procedures or practices."

The Treasury *Federal Intragovernmental Transactions Accounting Policies Guide,* dated August 6, 2009, and OMB Circular No. A-136, *Financial Reporting Requirements,* as revised, require Federal CFO Act and non-CFO Act entities identified in the Treasury Financial Manual (TFM) 2009, Vol. I, Part 2, Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government,* to perform quarterly reconciliations of intragovernmental activity/balances. TFM, Section 4706, *Intragovernmental Requirements,* provides guidance on OMB Circular No. A-136 requirement for reporting agencies to reconcile and confirm intragovernmental activity and balances quarterly for specific reciprocal groupings. TFM Bulletin 2007-03, *Intragovernmental Business Rules*, also provides guidance to Federal agencies for standardizing the processing and recording of intragovernmental activities.

Recommendations: We recommend that:

1. TSA:

   a. Perform a review of its financial and accounting infrastructure and human resource needs, including job responsibilities, functions, and defined tasks and skill sets needed to support essential accounting and financial reporting functions throughout the agency. This may involve restructuring and hiring additional personnel to fill identified gaps, re-align personnel to fill the gaps, and properly utilize and assign personnel with responsibilities that best match their expertise;

   b. Adopt procedures to ensure that relevant financial reporting issues are identified on a timely basis and to ensure that events and transactions are properly accounted for, and financial statements and related disclosures are presented in conformity with GAAP;

   c. Improve communication, training, supervision and/or coordination with personnel outside of the Office of Financial Management to ensure that necessary transactional inputs and information are received accurately and timely;

   d. Ensure that the annual risk assessment process is considered in updating accounting processes and implementing internal controls;

   e. Work with its accounting service provider to ensure that the proper trading partner code is recorded for each intragovernmental transaction. Until such time, TSA should continue to perform its manual process for the identification and reporting of intragovernmental activities and balances; and

   f. Develop policies and procedures to ensure compliance with the USSGL requirements at the transaction level. Specifically, the procedures should ensure that adjustments to the general ledger system are recorded at the appropriate fund account symbol and include the correct budgetary and proprietary entries.

2. FEMA:

   a. Update its current processes and controls to ensure that manual adjustments are fully researched, substantiated, documented, and/or appropriately reviewed prior to preparation and submission of financial data to the Department;

   b. Determine the cause of edit check variances in the general ledger submission to the Department, and implement corrective actions to correct the source of the error and eliminate the need for correcting manual adjustment in future periods;

c. Complete the merger of the two instances of its financial system, and make necessary changes to the merged system to alleviate recurring issues with attributes and financial data submissions to the Department;

d. Continue to dedicate sufficient resources to the financial reporting process to ensure that proper segregation of the preparation, recording, review, and approval of adjustments made to the general ledger;

e. Re-evaluate the current NFIP adjustment process, and issue Standard Operating Procedures (SOPs) specifically designed for the recording of NFIP financial statement information into the FEMA general ledger in a more simplified manner; and

f. Develop and implement policies and procedures to properly record, review, reconcile, and investigate abnormal balances in the budgetary status accounts to strengthen the administrative control of funds.

3. CBP:

a. Develop and timely communicate policies and procedures to ensure that key financial reporting issues are addressed before significant new operations are undertaken;

b. Conduct a human resource and finance organizational assessment to identify accounting and finance infrastructure improvements that should be made to ensure that the Office of Finance and operational units have the resources to establish necessary policies, procedures and controls in operational units, and to ensure effective monitoring of transactions and events that affect financial reporting; and

c. Enhance the annual risk assessment and/or focus group process to ensure continued effectiveness and relevance in identifying new accounting standards, and/or the application of existing standards to new operations timely.

II-B Information Technology Controls and Financial System Functionality

Background: IT general and application controls are essential for achieving effective and reliable reporting of financial and performance data. IT general controls are tested using the objectives defined by the 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 business continuity. In addition to IT general controls, financial systems contain application controls, which are the structure, policies, and procedures that apply to the use, operability, interface, edit, and monitoring controls of a financial application.

During FY 2009, DHS civilian components made progress in strengthening their IT general controls, which resulted in the closure of more than 60 percent of the IT control findings we had reported in FY 2008. However, because of new findings, the number of Department-wide IT control deficiencies increased when compared to the prior year.

During FY 2009, we also considered the effects of financial system functionality while testing IT general and application controls and other internal controls over financial reporting. Many of the financial systems in use at DHS components were inherited from the legacy agencies and have not been substantially updated since the Department's inception. Additionally, DHS has had limited Department-wide financial system development and improvement activities. Consequently, ongoing financial system functionality limitations are contributing to the Department's challenges of addressing systemic internal control weaknesses, strengthening the overall control environment, and preparing auditable financial statements.

Conditions: Our findings related to IT controls and financial systems functionality follow:

Related to IT controls:

The IT general control FISCAM areas that continue to present risks to DHS financial data confidentiality, integrity, and availability include:

- *Access controls* – Key DHS financial systems and applications have access control weaknesses, including: weaknesses in security documentation and approvals; lack of recertification for user accounts on an annual basis; inconsistent disabling of user account accesses upon termination; inadequate or weak system passwords; workstations, servers, or network devices without necessary software patches; lack of sufficient workstation inactivity time-outs; out of date anti-virus software; and insufficient audit logging. In addition we identified the following instances where DHS policy was not adhered to:
  - While performing physical access testing, we identified the following unsecured items: Government credit cards; financial system user IDs and passwords; computer laptops; and issued badges; and
  - We identified instances where DHS employees did not follow IT policy when asked to provide their system user names and passwords to an auditor.
- *Configuration management* – We identified configuration management processes that are not fully defined, followed, or effective, including:
  - Instances where changes made to financial systems were not always properly approved, tested, or documented in accordance with the required System Change Request (SCR) process; and
  - Instances where policies and procedures regarding change controls were not in place to prevent users from having concurrent access to financial system development, test, and production environments, or for restricting access to application system software and system support files.
- *Security management* – We identified security management practices that do not fully and effectively ensure that financial systems are certified, accredited, and authorized for operation prior to implementation; and that all operational financial systems are accounted for in DHS' system inventory and monitored for compliance with security requirements in *Federal Information Security Management Act* (FISMA). Additionally, we noted that security and technical requirements for financial systems have not been considered and planned for in an integrated fashion during systems development and acquisition initiatives.

These control findings, including significant deficiencies that do not rise to the level of a material weakness, are described in greater detail in a separate *Limited Official Use* letter provided to DHS management.

Related to financial system functionality:

We noted that financial system functionality limitations are contributing to control deficiencies reported in Exhibits II and III, and are inhibiting progress on corrective actions in several DHS components. Each of the Departmental material weaknesses can be linked in part to a lack of financial system functionality.

Systemic conditions related to financial system functionality include:

- The need to physically segregate key accounting functions because financial systems cannot enforce automated segregation of duties;
- Financial system audit logs that are not readily generated and reviewed because some financial systems cannot offer the necessary functionality;
- DHS-required system passwords that are not being used because some financial systems cannot support the policy;
- Financial systems that do not provide flexible, user-friendly functionality to access financial data for ad hoc analysis or to track operational information that is supportive of financial data; and
- Production versions of operational financial systems that are outdated, no longer supported by the vendor, and do not provide the necessary core functional capabilities (e.g., general ledger

capabilities). Because the systems are outdated and no longer supported by the vendors, system updates and enhancements are challenging if not impossible.

Cause/Effect: A contributing cause to repeated IT control findings is that DHS lacks an effective component-wide prioritization of financial system weaknesses, including the development of a stable centralized financial system platform for the Department. The time and resources needed to implement corrective actions necessary to mitigate these weaknesses could take several years.

The conditions supporting our findings collectively limit DHS' ability to ensure that critical financial and operational data is kept secure and is maintained in a manner to ensure confidentiality, integrity, and availability. Many of these weaknesses, especially those in the area of access and configuration management controls, may result in material errors in DHS' financial data that are not detected in a timely manner and in the normal course of business. In addition, as a result of the presence of IT control weaknesses and financial system functionality weaknesses, there is increased reliance on other mitigating manual controls to be operating effectively at all times. Because mitigating controls often require more manually performed procedures, there is an increased risk of human error that could materially affect the financial statements.

Criteria: FISMA, passed as part of the *E-Gov Act of 2002,* mandates that Federal entities maintain IT security programs in accordance with guidelines that refer to the guidance published by the National Institute of Standards and Technology (NIST). In addition, OMB Circular No. A-130, *Management of Federal Information Resources,* describes specific essential criteria for maintaining effective general IT controls. Further, FFMIA sets forth legislation prescribing policies and standards for Executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems. The purposes of FFMIA are to: (1) provide for consistency of accounting by an agency from one fiscal year to the next, and uniform accounting standards throughout the Federal Government; (2) require Federal financial management systems to support full disclosure of Federal financial data, including the full costs of Federal programs and activities; (3) increase the accountability and credibility of federal financial management; (4) improve performance, productivity and efficiency of Federal Government financial management; and (5) establish financial management systems to support controlling the cost of Federal Government. FFMIA requirements are complemented by Financial System Integration Office (FSIO) requirements, which set forth core financial management functionality required by Federal financial systems. Finally, DHS' *Sensitive Systems Policy, 4300A*, documents policies and procedures adopted by DHS intended to improve the security and operation of all DHS IT systems.

Recommendations: We recommend that the DHS Office of the Chief Information Officer, in coordination with OCFO, make necessary improvements to the Department's financial management systems. Specific recommendations are provided in a separate *Limited Official Use* letter provided to DHS management.

II-C Not Used

II-D Property, Plant, and Equipment (TSA, CBP, USCIS, NPPD, and ICE)

	2009	2008	2007
CBP			N/A
FEMA	C		
TSA			
US-Visit*	N/A	C	
USCIS		N/A	N/A
ICE		N/A	N/A
NPPD		N/A	N/A

* US-Visit merged into NPPD in 2007

See page II-2 for table explanation

Background: TSA manages passenger and baggage X-ray, explosives detection, and other equipment as part of its mission. This equipment, which is in every major U.S. airport, is owned and maintained by TSA. The costs required to procure, ship, temporarily store, install, operate, and maintain this equipment are substantial and consume a large portion of TSA's annual operating budget. Unique accounting processes and systems are necessary to track the status and accumulate costs, and to accurately value, account for, and depreciate the equipment. In FY 2008, in response to auditor inquiries, TSA initiated various reviews of its Property, Plant, and Equipment (PP&E) and identified errors in its accounting for equipment used in airports that required a number of restatements and current year corrections. These conditions continued into FY 2009 and prevented TSA from asserting that its PP&E balances at September 30, 2009, are fairly stated prior to the completion of the DHS FY 2009 Annual Financial Report (AFR).

CBP has acquired substantial new technology, facilities, and other assets in recent years through purchase and construction. Since FY 2004, CBP's PP&E has increased from $1.5 billion to $5.2 billion as of September 30, 2009, an increase of nearly 250 percent. One of the largest components of this growth is the Secure Border Initiative (SBI), which is a comprehensive multi-year plan to secure America's borders and reduce illegal migration. SBI includes two main components: the Facilities Management and Engineering (FM&E) Tactical Infrastructure (TI) and the SBI Network (SBInet). To properly account for this level and complexity of capital expenditure, CBP has had to implement new accounting policies, procedures, and processes, and apply technical accounting standards not previously used by CBP, such as full-costing of construction projects.

The U.S. Citizenship and Immigration Services (USCIS) is the government agency that oversees lawful immigration into the United States. It carries out this mission at over 75 service centers and district offices located throughout the United States and its territories. All of these locations are leased through the General Services Administration. Due to increased application volume over the past several years, many of these locations have had significant recent leasehold improvements.

The National Protection and Programs Directorate (NPPD) is responsible for the United States Visitor and Immigrant Status Indicator Technology (US-VISIT) program, which provides biometric identification and analysis services that enable DHS to ensure the integrity of the U.S. immigration system while protecting the privacy of international visitors. The US-VISIT program has been under development since the inception of DHS in 2003.

The U.S. Immigration and Customs Enforcement (ICE)'s mission is to protect the security of the American people and homeland by vigilantly enforcing the nation's immigration and customs laws. To enforce these laws, ICE has invested heavily in software development to analyze data to allow it to achieve its mission.

In FY 2009, FEMA substantially corrected its control deficiencies over internal use software that were reported in FY 2008.

Conditions: We noted the following internal control weaknesses related to property, plant, and equipment:

1. TSA:

   - Does not have documented policies and procedures in place to properly account for, monitor, and report:
     - Internal use software balances, including the application of Statement of Federal Financial Accounting Standards (SFFAS) No. 10, *Accounting for Internal Use Software*, identification and allocation of direct and indirect costs to long-term projects, and capitalization of multiple unit and/or multi-year installations;
     - Other direct costs incurred to transport, store, and install screening equipment at airports;
     - Idle or impaired assets consistent with applicable accounting standards, or to ensure that disposed assets are properly accounted for in the financial statements; and
     - Purchased assets that are under the capitalization threshold, such as peripheral equipment and bulk purchases;
   - Does not have documented policies and procedures in place to ensure that:
     - Assets are recorded, depreciated, and disposed of on a timely basis;
     - The subsidiary ledger is reconciled on a regular basis and net book value is correct and supported on an asset-by-asset basis; and
     - Heritage assets are properly identified, tracked, and reported;

- Does not always adhere to its policy requiring timely updates to the capital asset subsidiary ledger after assets are transferred between locations.

2. CBP:

- Does not have adequate accounting policies, procedures, processes, and controls to properly account for new equipment purchases and transfers, construction, or to properly identify and allocate indirect costs to construction projects, or to ensure that depreciation is properly computed and recorded, in a timely manner. For example, CBP:
  - Inappropriately expensed certain equipment purchases in previous years that required correction in FY 2009, including transactions related to SBInet;
  - Did not transfer assets from construction-in-process (CIP) to in-use assets in a timely manner;
  - Did not consistently record CIP related to the FM&E TI fence construction per the observed percentage of completion (POC);
  - Did not establish and apply an appropriate depreciable life to the newly constructed FM&E TI steel fence in a timely manner; and
  - Did not record some asset disposals in accordance with its policy;
- Did not properly perform and/or document several physical annual inventories related to real and personal property.

3. USCIS did not have adequate policies and procedures and related internal controls throughout the year to ensure that:

- Leasehold improvements at its facilities are accurately accounted for in the general ledger. During FY 2009, USCIS identified a gross adjustment of approximately $44 million in leasehold improvements that had not been properly recorded in previous years, resulting in a restatement of its financial statements to correct the error; and
- Internal use software and software in development projects are properly accounted for in accordance applicable accounting standards. USCIS recorded a restatement to its FY 2008 financial statements to properly present the gross cost of its capitalized internal use software totaling $290 million.

4. NPPD did not have adequate policies and procedures and related internal controls throughout the year to ensure that hardware purchased by its contractors and held at contractor sites was properly titled to DHS and was accurately and timely recorded in the general ledger. As a result, NPPD restated its FY 2008 financial statements to record $225 million of equipment, gross, that was acquired in previous years and currently located at a contractor site.

5. ICE did not have policies and procedures throughout the year to properly account for internal use software and software in development in accordance with the applicable accounting standards. As a result, ICE recorded an adjustment totaling $12 million, gross, to restate its FY 2008 financial statements to correct this error.

Cause/Effect: TSA devoted substantial time and resources in FY 2009, including contractor assistance, in an attempt to retroactively correct and restate opening balance sheet values and to properly account for PP&E prospectively. Management was not able to fully complete the work prior to completion of the DHS FY 2009 AFR. In some cases, TSA was dependent on input and feedback from the auditor for interpretation and application of accounting standards and recommendations to resolve difficult accounting issues related to the development of its opening balance sheet. This deficiency is also related to the conditions described in Comment **II-A**, *Financial Management and Reporting*.

CBP's substantial growth, especially in the purchase and construction of capital assets, has required greater capacity of human and system resources, including resources outside of the Office of Finance. As a result, accounting for new operations, such as the construction of the FM&E TI fence, are not considered in a timely manner, causing errors or misapplication of GAAP in financial reporting. These financial statement errors and/or inconsistencies with GAAP may go undetected, in some cases until subsequent years or until questioned by an auditor. Also, CBP financial systems functionality to track and account for assets in various stages of completion and deployment is limited, causing the need for greater manual involvement to accurately report assets. This deficiency is also related to the conditions described in Comment **II-A**, *Financial Management and Reporting*, and Comment **II-B**, *Information Technology Controls and Financial System Functionality.*

USCIS and ICE are obtaining "stand-alone" audits of their September 30, 2009 balance sheets. In previous years, these components prepared financial statements using a DHS consolidated level of materiality. In preparation for the stand-alone audits, both components performed reviews of their significant accounting principles and various financial reporting policies and procedures. Through these reviews, USCIS and ICE identified several discrepancies between existing policies and procedures and those required to comply with GAAP. Corrective actions were taken to properly state the account balances for financial statement reporting purposes, and updated policies and procedures were issued.

Since NPPD's accounting service provider is ICE, the accounting policy review performed by ICE included policies that impact NPPD and other components serviced by ICE during FY 2009. The lack of policies, procedures, and adequate accounting processes over DHS equipment at contractor sites was identified by ICE during its review of policies related to PP&E accounting.

Criteria: SFFAS No. 10 provides requirements for the capitalization and reporting of internal use software development costs. According to paragraph 16, the capitalizable cost should include "….the full cost (direct and indirect cost) incurred during the software development stage." Per SFFAS No. 10, paragraphs 18-20, "For COTS [Commercial off-the-shelf] software, capitalized cost should include the amount paid to the vendor for the software. For contractor-developed software, capitalized cost should include the amount paid to a contractor to design, program, install, and implement the software. Material internal cost incurred by the federal entity to implement the COTS or contractor-developed software and otherwise make it ready for use should be capitalized […] Costs incurred after final acceptance testing has been successfully completed should be expensed."

SFFAS No. 6, *Accounting for Property, Plant, and Equipment,* paragraph 17, states, "Property, plant, and equipment consists of tangible assets, including land, that meet the following criteria: they have estimated useful lives of 2 years or more; they are not intended for sale in the ordinary course of operations; and they have been acquired or constructed with the intention of being used, or being available for use by the entity." Per paragraph 26, "All general PP&E shall be recorded at cost. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use." Paragraph 34 requires, "In the case of constructed PP&E, the PP&E shall be recorded as construction work in progress until it is placed in service, at which time the balance shall be transferred to general PP&E." Per paragraph 35, "Depreciation expense is calculated through the systematic and rational allocation of the cost of general PP&E, less its estimated salvage/residual value, over the estimated useful life of the general PP&E. Depreciation expense shall be recognized on all general PP&E, except land and land rights of unlimited duration."

GAO's *Standards for Internal Control in the Federal Government (Standards)* requires that internal control and all transactions and other significant events be clearly documented and readily available for examination. The Joint Financial Management Improvement Program (JFMIP), *Property Management Systems Requirements,* state that the agency's property management system must create a skeletal property record or have another mechanism for capturing information on property in transit from the providing entity (e.g., vendor, donator, lender, grantor, etc.).

Recommendations: We recommend that:

1. TSA:

   a. Develop and implement policies and procedures to properly account for, monitor, and report internal use software balances; other direct costs incurred to transport, store, and install screening equipment at airports; idle, impaired, and disposed assets; and assets and bulk purchases that are under the capitalization threshold, consistent with applicable accounting standards;

II. 11

Independent Auditors' Report
Exhibit II – Material Weaknesses – DHS Civilian Components

b. Improve training and communication to ensure that TSA's policies regarding updates to the capital asset subsidiary ledger after assets are transferred between locations are consistently followed;

c. Develop policies and procedures to ensure assets are properly recorded, depreciated, disposed, and reconciled to the general ledger on a timely basis; and

d. Develop policies and procedures to ensure heritage assets are properly identified, tracked, and reported.

2. CBP:

a. Develop, document, and communicate policies and procedures for classifying, recording, and reviewing all capital transactions, particularly for new construction, to ensure that the financial statements are materially correct and presented in accordance with GAAP. Consideration should be given to the adequacy of policies to account for CIP, including methodologies to apply overhead charges, and establishing an appropriate useful life for annual depreciation charges;

b. Emphasize the need to record asset disposals in accordance with established policy;

c. Consider adding supervision and monitoring controls to ensure that all intended corrective actions are effective and functioning properly;

d. Establish and implement a standardized process that is integrated with its financial system of record in order to facilitate the timely recording of new assets placed into service; and

e. Reinforce guidance for the performance and documentation of PP&E inventories.

3. USCIS continue to adhere to its newly developed and implemented policies and procedures to properly account for and report leasehold improvements made to its facilities, and to properly account for and report internal use software balances in accordance with applicable accounting standards.

4. NPPD continue to adhere to its newly developed and implemented policies and procedures and related internal controls to ensure that property purchased by its contractors and held at contractor sites are properly titled to DHS and are accurately and timely recorded in the general ledger.

5. ICE continue to adhere to its newly developed and implemented policies and procedure to properly account for and report internal use software balances in accordance with applicable accounting standards.

II-E Actuarial and Other Liabilities (FEMA and TSA)

	2009	2008	2007
FEMA			
G&T*	N/A	NA	
FLETC	C		N/A
ICE	C		N/A
S&T	C		N/A
TSA		C	

* G&T merged with FEMA in 2007

See page II-2 for table explanation

Background: FEMA is recognized as the primary grant-making component of DHS, managing multiple Federal disaster and non-disaster grant programs.

TSA has numerous types of accounts payable and accrued liabilities that affect its balance sheet, including the Other Transactions Agreement (OTA) and Letters of Intent (LOI) programs. The OTA and LOI programs have grown substantially in recent years and function similar to grants, whereby TSA provides funding to airport recipients for various security improvements and construction. For this reason, TSA must estimate its accrued liability for expenditures incurred but not reported by OTA and LOI recipients when preparing financial statements. The OTA activity significantly increased in FY 2009, requiring TSA to develop new accounting processes to support this function.

In FY 2009, the Immigration and Customs Enforcement (ICE), the Science and Technology Directorate (S&T), and the Federal Law Enforcement Training Center (FLETC) corrected the previously reported deficiencies in the environmental liabilities process.

II. 12

Conditions: We noted the following internal control weaknesses related to other liabilities at FEMA and TSA:

1. FEMA does not have sufficient policies and procedures in place to fully comply with the *Single Audit Act Amendments of 1996* (*Single Audit Act*) and related OMB Circular No. A-133, *Audits of States, Local Governments, and Nonprofit Organizations* (OMB Circular A-133) (see Comment **IV-K**, *Single Audit Act Amendments of 1996*).

2. TSA:

   - Has not developed policies and procedures to accurately estimate its OTA accrued liability at year-end. The OTA liability was substantially understated in the draft financial statements until questioned by the auditor, which prompted TSA to consider the need for an accrual related to the incurred but unreported expenditures. This resulted in identification of an additional liability of approximately $50 million that was recorded at year-end;

   - Does not have documented policies and procedures to ensure that accounts payable accruals are complete and accurate, controls over the procurement process are effective, and documentation supporting transactions are available for audit. For example, we noted that:

     - Controls including supervisory reviews are not always effective in indentifying material errors in accounts payable and related accruals;
     - The accounts payable sub-ledger is not routinely reconciled to the accounts payable general Leger (CAS). Specifically, it was noted that TSA was unable to provide a detail of open invoices as of the balance sheet date;
     - Invoices are not always coded correctly as either expense or capitalizable expenditures;
     - Evidence supporting the procurement and receipt of goods, and review and approval of transactions was not always available for audit;
     - Controls to ensure the completeness of the data provided from contracting officers used to calculate the accounts payable accruals were not always operating effectively;
     - Controls to ensure amounts recorded as part of system accounts payable are excluded from the accrual calculations were not always operating effectively; and
     - Controls to ensure the accuracy of queries used to calculate the accounts payable accruals were not always operating effectively;

   - Does not perform an independent analysis of vendor confirmation data for which the LOI accrual is based to determine the accuracy of the confirmations. Further, TSA does not have documented policies and procedures in place to ensure that unconfirmed balances are properly stated.

Cause/Effect: FEMA has not implemented policies and procedures over its grant program in order ensure compliance with the *Single Audit Act* and OMB Circular A-133.

TSA's risk assessment process at the transaction level is not fully developed or implemented to identify points at which a significant error could occur. As a result, accounts payable and unexpended appropriations may not be properly stated in the financial statements. In addition, when the OTA activity became material in FY 2009, TSA did not have adequate risk assessment processes to identify OTAs as a significant new process, requiring management to perform additional procedures to estimate the accrued liability. This deficiency is also related to the conditions described in Comment **II-A**, *Financial Management and Reporting*.

Criteria: OMB Circular No. A-123 states, "Management is responsible for developing and maintaining effective internal control. Effective internal control provides assurance that significant weaknesses in the design or operation of internal control, that could adversely affect the agency's ability to meet its objectives, would be prevented or detected in a timely manner. Management should identify internal and external risks that may prevent the organization from meeting its objectives. When identifying risks, management should take into account relevant interactions within the organization as well as with outside organizations."

The *Single Audit Act*, Section 7502 (f)(1)(B) states, "Each Federal agency which provides Federal awards to a recipient shall review the audit of a recipient as necessary to determine whether prompt and appropriate corrective action has been taken with respect to audit findings, as defined by the Director, pertaining to Federal awards provided to the recipient by the Federal agency."

OMB Circular No. A-133, Subpart D, provides for the responsibilities of federal agencies and pass-through entities for audits of states, local governments, and non-profit organizations.

Recommendations: We recommend that:

1. FEMA implement policies and procedures to ensure full compliance with the *Single Audit Act* and the related OMB Circular No. A-133.
2. TSA:
   a. Develop policies and procedures to accurately estimate its OTA accrued liability at year-end; and
   b. Develop and document policies and procedures to ensure that accounts payable accruals are complete and accurate, controls over the procurement process are designed and operating effectively, and documentation supporting transactions is available for audit.

II-F Budgetary Accounting (FEMA and CBP)

	2009	2008	2007
CBP			N/A
FEMA			
TSA	N/A	C	

See page II-2 for table explanation

Background: Budgetary accounts are a category of general ledger accounts where transactions related to the receipt, obligation, and disbursement of appropriations and other authorities to obligate and spend agency resources are recorded. DHS has over 350 separate Treasury account fund symbols (TAFS) combined, each with separate budgetary accounts that must be maintained in accordance with OMB and Treasury guidance. The TAFS cover a broad spectrum of budget authority, including annual, multi-year, and no-year appropriations, and several revolving, special, and trust funds. Accounting for budgetary transactions in a timely and accurate manner is essential to managing the funds of the Department and preventing overspending of allotted budgets.

In FY 2009, FEMA improved its processes and internal controls over the mission assignment obligation and monitoring process; however, some control deficiencies remain.

CBP has implemented policies and procedures requiring the timely review and deobligation of funds when the contracts have expired or are complete. However, CBP has not been effective in adhering to its policy or in monitoring compliance. CBP has not made substantial progress in correcting the deficiencies we reported in FY 2008, and they are repeated below.

Conditions: We noted the following internal control weaknesses related to budgetary accounting at FEMA and CBP:

1. FEMA:
   - Did not consistently and effectively monitor the status of its obligations as part of its normal operations to ensure timely deobligation when appropriate. We noted that approximately 10 percent of all undelivered order (UDO) samples tested for mission assignments and Grants and Training obligations were past their projected end dates by more than 90 days;
   - Could not readily provide all supporting documentation for UDOs, other than mission assignments and grants, that were tested at June 30, 2009 and September 30, 2009. We noted that for certain portions of the population, significant effort was required to coordinate and identify the responsible parties, to access certain files, or to provide information in a form that clearly supported the balances reported in the financial statements.

2. CBP is not enforcing its policies and procedures (Directive 1220-011B and 1220-011C) to monitor and deobligate or close-out its obligations in a timely manner. We noted that CBP did not properly deobligate inactive undelivered orders for approximately 50 of the 64 items we tested as of June 2009. However, many of these obligations were subsequently deobligated during the open obligation review conducted in the fourth quarter by CBP.

Cause/Effect: FEMA did not always receive timely progress reports from Other Federal Agencies (OFAs) that included sufficient cost and billing data, or a timely response to validation requests of open mission assignments. FEMA's administrative functions are geographically separated from programmatic operations which make locating UDO documentation difficult. Without supporting documentation, FEMA is unable to support the validity of UDO balances.

CBP did not properly monitor all open obligations, and consequently, government funds may be committed and not made available to CBP for other Federal expenditures for longer periods of time than necessary. In addition, CBP's financial statements will not properly reflect the status of obligation.

Criteria: FEMA's SOP for *Processing Mission Assignment and Interagency Payments for Fund Code 06*, updated April 2007, establishes the process for mission assignment closeouts. If no activity has been recorded within the last 90 days, the Disaster Finance Branch initiates the closeout process with the region or headquarters.

FEMA Form 90-129, *Mission Assignment Agreement,* states that the OFA is responsible for submitting a Mission Assignment Monthly Progress Report to FEMA to include cost data when mission assignments take more than 60 days to complete, including billing.

According to GAO *Standards,* "transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records." Further, "control activities help to ensure that all transactions are completely and accurately recorded." In addition, "internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination […] All documentation and records should be properly managed and maintained."

CBP Directive 1220-011B states that financial plan holders will review Systems, Applications, and Products (SAP) reports each quarter to reconcile their obligations to supporting records.

CBP Directive 1220-011C states that a semi-annual review of specific populations of obligations must be performed and the status for each record identified to assure that only valid obligations remain open.

Recommendations: We recommend that:

1. FEMA:
    a. Consistently monitor the status of its obligations as part of the normal business process by:
        i) Ensuring that all mission assignments are reviewed and deobligated timely when authorized by the OFAs or when the OFAs have not responded in a reasonable period of time related to a mission assignment with no recent activity; and
        ii) Researching and resolving the status of aged obligations inherited from the former Office of Grants and Training;
    b. Continue to improve procedures for storing and locating documentation supporting UDO information, including points of contact, so that supporting information is readily available for management review and audit purposes.
2. CBP:
    a. Implement improved procedures to ensure full compliance with CBP Directives 1220-011B and 1220-011C to ensure that obligations are being reconciled to supporting documentation on a quarterly basis and reviewed for validity on a semi-annual basis.

III-G Other Entity-Level Controls (USCG, FEMA, and TSA)

Background: In the past two years, the Department of Homeland Security (DHS or the Department) has undertaken and completed several steps designed to strengthen its entity and process level internal controls, and thereby improve the reliability of financial reporting. These steps are documented in the *Internal Control over Financial Reporting Playbook* released in March 2009, and in component level Mission Action Plans (MAPs) finalized early in fiscal year (FY) 2009. The Department continued its Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control,* assessment in FY 2009.

The comments below should be read in conjunction with Comments **I-B** and **II-B**, *Information Technology Controls and Financial System Functionality,* which describe entity-level control weaknesses related to Department and Component IT systems. Entity-level control deficiencies related to the United States Coast Guard (Coast Guard), the Federal Emergency Management Agency (FEMA), U.S. Customs and Border Protection (CBP), and the Transportation Security Administration (TSA) are presented in Comments **I-A** and **II-A**, *Financial Management and Reporting,* respectively, related to financial management.

The Coast Guard updated its MAPs and *Financial Strategy for Transformation and Audit Readiness* (FSTAR) in FY 2009. The FSTAR is a comprehensive plan to identify and correct the root causes of control deficiencies.

FEMA achieved its MAPs to eliminate the account balance qualifications identified in the Independent Auditors' Report (IAR) in FY 2008. FEMA also made continued progress toward correction of its entity-level control deficiencies in FY 2009. While progress has been made, some entity-level control deficiencies identified at FEMA in previous years continued during FY 2009, and are repeated below.

Conditions: We noted the following internal control weaknesses related to other entity-level controls:

1. Coast Guard:

   - Has not developed adequate policies, procedures, or controls associated with training and continual education courses associated with personnel with financial duties;
   - Does not have standardized job descriptions at a level of detail that includes identification and definition of tasks required to accomplish particular assignments that have financial duties filled by military personnel;
   - Does not have policies that are operating effectively for hiring and evaluating financial employees, as management does not maintain adequate documentation for certain hiring requirements and periodic performance evaluations;
   - Has not developed adequate controls with the Standards of Ethical Conduct to a) ensure that recent changes in the Coast Guard environment are included, and b) track and monitor compliance, including document retention for the investigation of any violation and corrective actions taken to ensure proper filing and review of the Confidential Disclosure Reports and ethics training requirements; and
   - Has not fully implemented a Coast Guard-wide formal policy to appropriately address intervention of management override of internal controls.

2. FEMA:

   - Has not developed sufficiently effective methods of communication to ensure that significant financial-related system development and acquisition projects involve all relevant stakeholders, including the Office of the Chief Financial Officer (OCFO), to ensure the projects meet organizational mission needs and functional and technical requirements;
   - Has not developed sufficiently effective methods of communication to ensure that significant accounting changes made by its flood insurance contractor are reviewed and approved by the OCFO prior to implementation;

Independent Auditors' Report
Exhibit III – Significant Deficiencies – All DHS Components

- Has not completed the placement of sufficient financial and accounting resources related to mission assignments, which contributes to certain issues in the accounting for these agreements. In a sample of 505 mission assignment payments selected for testwork as of June 30, 2009, we noted that approximately 35 percent of the payments were not properly reviewed and approved in accordance with FEMA policy;
- Has not completed its documentation and/or update of formal policies and procedures (including desk manuals) for several of the roles, responsibilities, processes, and functions performed within FEMA. For example, in FY 2009, we noted that improvements are needed in the formal documentation of policies and procedures related to *Anti-deficiency Act* compliance and policies for monitoring and responding to OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* reports, Office of Inspector General (OIG) reports, and Government Accountability Office (GAO) report findings and recommendations;
- Has identified the Risk Management and Compliance Branch's primary function as the implementation of policies and procedures to close findings issued as a result of multiple external audits. Its mission does not fully support internal control monitoring to assess the overall quality and performance of operations on a continual basis;
- Has not committed sufficient resources to ensure that personnel attend required ethics training; and
- Has not developed sufficient policies and procedures to properly designate position sensitivity for positions that use, develop, or operate IT systems; track the status of background investigations; and maintain related documentation.

3. TSA has not implemented an agency-wide formal policy to appropriately address intervention of management override of internal controls.

Cause/Effect: Coast Guard management has acknowledged that longstanding procedural, control personnel, IT and cultural issues have impeded progress toward installing an effective financial management structure. Coast Guard has developed and is in the process of a multi-year MAP that addresses entity-level controls.

In FY 2009, FEMA devoted substantial resources to developing its accounts payable accrual methodology, evaluating its capitalized internal use software, and developing certain policies and procedures. Consequently, FEMA devoted comparatively less attention to improving the underlying accounting processes and correcting other control deficiencies in FY 2009. Decentralized and informal background investigation processes present potential risks to FEMA's operations and IT systems.

TSA's Internal Control Group is still in the process of documenting and testing baseline controls. In the past, TSA assumed that compliance with policies and procedures and performance of control procedures was implicit in every person's job description. Therefore, the need for a policy to appropriately address intervention of management override of controls without appropriate approvals was not identified until TSA fully implemented the provisions of OMB Circular No. A-123 in connection with the external financial statement audit.

In its FY 2009 representations made to the Secretary pursuant to the *DHS Financial Accountability Act*, Coast Guard and FEMA stated that they cannot provide reasonable assurance that internal control over financial reporting are operating effectively.

Criteria: OMB Circular No. A-123, as revised, states that internal controls are the organization, policies, and procedures that agencies use to help program and financial managers achieve results and safeguard the integrity of their programs.

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

III.2

The GAO *Standards* identify the control environment as one of the five key elements of control, which emphasizes the importance of conscientiousness in management's operating philosophy and commitment to internal control. These standards cover controls such as human capital practices, supervisory reviews, policies, procedures, monitoring, and segregation of duties.

DHS 4300A *Sensitive Systems Policy Directive*, Version 6.1.1, and DHS 4300A *Sensitive Systems Handbook*, Version 6.1.1, set forth requirements related to background investigations for federal employees and contractors requiring access to DHS systems.

Recommendations: We recommend that:

1. Coast Guard:
    a. Review and enhance, if necessary, the entity level planned actions on its FSTAR to include steps to fully assess entity level controls, develop effective corrective actions, and implement improved financial processes and systems.
2. FEMA:
    a. Develop and implement agency-wide communication protocols to ensure that significant financial-related system development and acquisition projects involve all relevant stakeholders, including the OCFO;
    b. Develop and implement communication protocols with its flood insurance contractor to ensure that all significant accounting changes are reviewed and approved by the OCFO prior to implementation;
    c. Ensure sufficient financial and accounting resources are in place to address weaknesses related to mission assignment accounting;
    d. Ensure that formal policies and procedures (including desk manuals) are documented and current for all significant roles, responsibilities, processes, and functions performed within FEMA;
    e. Expand the mission and staffing of the Risk Management and Compliance Branch to perform internal control monitoring to assess the overall quality and performance of operations on a continual basis;
    f. Complete development and implementation of procedures and dedicate resources to provide, track compliance with, and monitor the annual and new hire ethics training requirements; and
    g. Develop and implement policies and procedures to properly designate position sensitivity for all positions that use, develop, or operate IT systems; track the status and completion of background investigations; and maintain related documentation.
3. TSA:
    a. Develop explicit policies that appropriately address intervention of management override of controls.

III-H Custodial Revenue and Drawback

Background: CBP collects approximately $26.4 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, and are subsequently exported from the United States or destroyed prior to entering the commerce of the United States.

Our findings on the Entry Process include In-bond, Bonded Warehouse, Foreign Trade Zones, and the Compliance Measurement Program (CM). In-bond entries occur when merchandise is transported through one port; however, the merchandise generally does not officially enter U.S. commerce until it reaches the intended port of destination. Bonded Warehouses (BWH) 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.

CM is the primary method by which CBP measures risk in the areas of cargo security, trade compliance, and revenue collection. CBP utilizes the CM program to measure the effectiveness of its control mechanisms deployed, and its execution in collecting revenues rightfully due to the U.S. Department of the Treasury.

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

Related to drawback:

- The Automated Commercial System (ACS) lacks automated controls to detect and prevent excessive drawback claims and overpayments, necessitating inefficient manual processes that do not effectively compensate for these automated controls;
- ACS lacks controls to prevent the overpayment of drawback claims at the summary line level;
- Drawback review policies do not require drawback specialists to review all, or a statistically valid sample, of prior drawback claims against the underlying consumption entries (UCE) to determine whether, in the aggregate, an excessive amount was claimed;
- Drawback review policy and procedures allow drawback specialists, with supervisory approval, to judgmentally decrease the number of ACS selected UCEs randomly selected for review, thus decreasing the review's effectiveness. Further, CBP implemented a sampling methodology for selecting UCEs; however, this methodology is not considered to be statistically valid;
- The period for document retention related to a drawback claim is only three years from the date of payment. However, there are several situations that could extend the life of the drawback claim well beyond three years.

Related to the Entry Process:

- CBP is unable to determine the status of the in-bond shipments and lacks policies and procedures throughout the year that require monitoring the results of in-bond audits and require the review of overdue immediate transportation in-bonds or air in-bonds. The requirement for ports to review overdue immediate transportation in-bonds was not implemented until February 2009;
- CBP does not perform an analysis to ensure there is not a potentially significant loss of revenue through the in-bond process, as a result of goods entering the commerce of the U.S. without formal entry;
- CM oversight guidelines do not provide complete coverage over the CM program. The ports are not following a consistent set of procedures when performing CM reviews, and there are weaknesses in the oversight and monitoring of the CM program; and
- Current BWH and FTZ Compliance Review Manuals lack specific guidance for ports to determine the appropriate risk assessment of a BWH or FTZ. In addition, headquarters review of the BWHs and FTZs assessment results does not provide CBP with objective data related to the effectiveness of compliance reviews, common discrepancies found and the risks associated with those discrepancies, and techniques for mitigating risks.

Cause/Effect: IT system functionality and outdated IT systems contribute to the weaknesses identified above. For example, CBP is unable to determine the status of the in-bond shipments with the information available within ACS, and CBP does not have the ability to run an oversight report to determine if ports have completed all required audits. For drawback, much of the process is manual until planned IT system functionality improvements are made, placing an added burden on limited resources.

The inability to effectively monitor the in-bond process and verify the arrival of in-bond merchandise at the port level can lead to a potential loss in revenue. This potential loss in revenue is due to uncollected duties and fees on in-bond merchandise that has physically entered U.S. commerce without formal entry.

The weaknesses in the CM program could result in CBP incorrectly evaluating the effectiveness of its control environment over the collections of duties, taxes, and fees.

It is possible that BWH/FTZ operators and users may be able to operate BWHs and FTZs that contain merchandise that CBP has no or limited knowledge about.

Criteria: Under FMFIA, management must implement cost-effective controls to safeguard assets and ensure reliable financial reporting. OMB's *Revised Implementation Guidance for FFMIA,* states that financial systems should "routinely provide reliable financial information consistently, accurately, and reported uniformly" to support management of current operations.

The Financial Systems Integration Office (FSIO) publications and OMB Circular No. A-127, *Financial Management Systems,* outline the requirements for Federal financial systems. The Office of Federal Financial Management's *Core Financial System Requirements,* dated January 2006, states that the core financial system must maintain detailed information sufficient to provide audit trails and to support reconciliation and research activities. OMB Circular No. A-127 requires that the design of financial systems should eliminate unnecessary duplication of a transaction entry. Wherever appropriate, data needed by the systems to support financial functions should be entered only once, and other parts of the system should be updated through electronic means consistent with the timing requirements of normal business/transaction cycles.

The *Improper Payments Information Act of 2002* requires agencies to annually review programs and activities and identify any that may be susceptible to significant improper payment. Whenever an agency estimates that improper payments may exceed $10 million, it must also provide a report on what actions are being taken to reduce such payments. In addition to the statutory requirements stated above, CBP's *Drawback Handbook*, dated July 2004, states that management reviews are necessary to maintain a uniform national policy of supervisory review.

Recommendations: We recommend that CBP:

1. *Related to drawback*:
   a. Implement effective internal controls over drawback claims as part of any new system initiatives, including the ability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries and export documentation for which the drawback claim is based, and identify duplicate or excessive drawback claims;
   b. Develop and implement automated controls to prevent overpayment of a drawback claim;
   c. Develop a system or process to eliminate the need for statistical sampling of UCE and prior related drawback claims as drawback claims. In addition, until this system or process is implemented, we recommend that CBP explore other statistical approaches for selecting UCEs and prior related drawback claims under the current ACS environment;
2. *Related to the Entry Process:*
   a. Implement a standard procedure to periodically compile the results of all in-bond audits during the year and develop an analysis function in order to evaluate the importers' compliance with regulations;
   b. Develop or emphasize policies and procedures to monitor the results of in-bond audits at the port level and to require reviews of overdue immediate transportation in-bonds and air in-bonds;
   c. Analyze the in-bond program annually to determine the potential loss of revenue relating to in-bonds;

d. Provide additional detail in the CM guidelines, specifying the use of the monitoring report, data queries, and any other tools to provide complete coverage over the CM program. The guidance should also readdress the timing requirements for the monitoring reports or data queries;

e. Develop standard operating procedures for conducting risk assessments for all BWHs and FTZs. In addition, develop standardized procedures for headquarters or field office oversight to ensure compliance review schedules are being reviewed timely, and provide effective training to ensure that all ports are aware of updates and changes to the program and can consistently execute all requirements presented in the compliance review manuals and handbooks; and

f. Continue the implementation of a national database of BWHs and FTZs and develop procedures to ensure completeness.

Independent Auditors' Report
Exhibit IV – Compliance and Other Matters – All DHS Components

(Exhibits I and II include Comments A– F, and Exhibit III presents Comments G – H)

All of the compliance and other matters described below are repeat conditions from FY 2008.

IV-I *Federal Managers' Financial Integrity Act of 1982* (FMFIA) and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-Up*, as revised

Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, requires agencies and Federal managers to: (1) develop and implement internal controls; (2) assess the adequacy of internal controls; (3) separately assess and document internal control over financial reporting; (4) identify needed improvements; (5) take corresponding corrective action; and (6) report annually on internal controls. During fiscal year (FY) 2009 and 2008, the Department of Homeland Security (DHS or the Department) developed an annual *Internal Control Playbook* to implement corrective actions and support management assurances by performing tests of design and operating effectiveness of entity level controls and other financial accounting and reporting processes. DHS' implementation of OMB Circular No. A-123 facilitates compliance with the *Federal Managers' Financial Integrity Act of 1982* (FMFIA). The *DHS Financial Accountability Act of 2004* requires DHS to submit an annual audit opinion of internal control over financial reporting. The Secretary of DHS has stated in the Secretary's Assurance Statements dated November 13, 2009, as presented in Management's Discussion and Analysis (MD&A) of the Department's 2009 *Annual Financial Report* (AFR), that based on the material weaknesses identified from the OMB Circular A-123 assessment, the Department provides no assurance that internal control over financial reporting was operating effectively as of September 30, 2009.

In addition, OMB Circular No. A-50, as revised, provides guidance for use by executive agencies when considering reports issued by Inspectors General, other executive branch audit organizations, the Government Accountability Office (GAO), and non-Federal auditors, where follow up is necessary. Corrective action taken by management on findings and recommendations is essential to improve the effectiveness and efficiency of government operations, and to support the objectives of sound fiscal management. As described above, the DHS OCFO has developed an extensive corrective action plan that requires each component to develop and execute corrective actions to address all material weaknesses in internal controls. This strategy is documented in the *Internal Control Playbook*. Progress is monitored by the Under Secretary for Management (USM) and the CFO, and regularly reported to OMB and other outside stakeholders, such as Congressional Committees. We noted that each component has complied with the DHS directive to develop corrective actions, and they have been reviewed and approved by the USM and CFO. All DHS components have made progress toward remediation of material internal control weaknesses; however, as shown in Exhibits I, II and III, deficiencies identified in prior years have not been fully corrected in FY 2009.

While we noted the Department overall has taken positive steps toward full compliance with FMFIA, OMB Circular No. A-123, OMB Circular No. A-50, and the *DHS Financial Accountability Act*, the Department has not fully established effective systems, processes, policies, and procedures to ensure that internal controls are operating effectively throughout the Department.

Recommendation: We recommend that the Department continue its corrective actions to address internal control deficiencies, in order to ensure full compliance with FMFIA and its OMB-approved plan for implementation of Circular No. A-123, in future years. We also recommend that DHS continue to follow and complete the actions defined in the *Internal Control Playbook*, to ensure that audit recommendations are resolved timely and corrective action plans addressing all DHS audit findings are developed and implemented together with appropriate supervisory review in FY 2010.

IV-J *Federal Financial Management Improvement Act of 1996* (FFMIA)

FFMIA Section 803(a) requires that agency Federal financial management systems comply with (1) applicable Federal accounting standards; (2) Federal financial management system requirements; and (3) the United States Government Standard General Ledger (USSGL) at the transaction level. FFMIA emphasizes the need for agencies to have systems that can generate timely, reliable, and useful information with which to make informed decisions to ensure ongoing accountability. OMB Circular No. A-123 requires agencies and Federal managers to: (1) develop and implement internal controls; (2) assess the adequacy of internal controls; (3) separately assess and document internal control over financial reporting; (4) identify needed improvements; (5)

take corresponding corrective action; and (6) report annually on internal controls. During FY 2009, DHS OCFO continued with its implementation of OMB Circular No. A-123 by performing tests of design and operating effectiveness on entity level controls and other financial accounting and reporting processes as planned.

While we noted the Department overall has taken positive steps toward full compliance with FFMIA, the Coast Guard, US Customs and Border Protection (CBP), the Federal Emergency Management Agency (FEMA), the Federal Law Enforcement Training Center (FLETC), and TSA did not fully comply with at least one of the requirements of FFMIA. The reasons for noncompliance are reported in Exhibits I, II, and III. The Secretary of DHS has stated in the Secretary's Assurance Statements dated November 13, 2009 that the Department's financial management systems do not substantially conform to government wide requirements mandated by FFMIA. The Department's remedial actions and related timeframes are also presented in that section of the AFR.

An element within FFMIA Federal system requirements is ensuring security over financial management information. This element is addressed further in the *Federal Information Security Management Act of 2002* (FISMA), which was enacted as part of the *E-Government Act of 2002.* FISMA requires the head of each agency to be responsible for (1) providing information security protections commensurate with the risk and magnitude of the harm resulting from unauthorized access, use, disclosure, disruption, modification, or destruction of (i) information collected or maintained and (ii) information systems used or operated; (2) complying with the requirements of the Act and related policies, procedures, standards, and guidelines, including (i) information security standards under the United States Code, Title 40, Section 11331 and (ii) information security standards and guidelines for national security systems; and (3) ensuring that information security management processes are integrated with agency strategic and operational planning processes.

We noted weaknesses in financial systems security, reported by us in Comments **I-B** and **II-B**, *Information Technology Controls and Financial System Functionality*, which impact the Department's ability to fully comply with FISMA.

Recommendation: We recommend that DHS improve its financial management systems to ensure compliance with the FFMIA, and implement the recommendations provided in Exhibits I, II, and III, in FY 2010.

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

FEMA is the only DHS component that has a significant grant making operation. OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* requires agencies awarding grants to ensure they receive grantee reports timely and to follow-up on *Single Audit* findings to ensure that grantees take appropriate and timely action. Although FEMA has adopted procedures to monitor grantees and their audit findings, FEMA did not fully comply with provisions in OMB Circular No. A-133 in FY 2009. We noted that FEMA does not always obtain and review grantee *Single Audit* reports in a timely manner, or follow up on questioned costs and other matters identified in these reports. Because Single Audits typically are performed by other entities outside of DHS, procedures related to these reports are not always entirely within the control of DHS and its components.

Recommendations: We recommend that:

1. FEMA develop procedures to ensure compliance with its policy to obtain and review grantee Single Audit reports in a timely manner, and follow-up on questioned costs and other matters identified in these reports. We also recommend that FEMA perform the following in FY 2010:

    a. Further develop and implement a tracking system to identify each grantee for which a *Single Audit* is required, and the date the audit report is due;

    b. Use the tracking system to ensure audit reports are received timely, and follow-up when reports are overdue; and

    c. Perform reviews of grantee audit reports, issue-related management decisions, and ensure that the grantees take appropriate corrective action, on a timely basis.

Independent Auditors' Report
Exhibit IV – Compliance and Other Matters – All DHS Components

IV-L *Chief Financial Officers Act of 1990*

The *DHS Financial Accountability Act of 2004* made DHS subject to the *Chief Financial Officers Act of 1990*, as amended, which requires DHS to submit to the Congress and OMB audited financial statements annually. DHS' Office of the Inspector General (OIG) has engaged an independent auditor to audit the September 30, 2009 balance sheet and related statement of custodial activity. Other financial statements, including the statements of net cost, changes in net position, and budgetary resources, are not currently auditable. DHS must be able to represent that its balance sheet is fairly stated, and obtain at least a qualified opinion before it is practical to extend the audit to other financial statements.

Recommendation: We recommend that DHS and its components continue to implement the Mission Action Plans described in DHS' *Internal Control Playbook* (see Comment **IV – I**, *Federal Managers' Financial Integrity Act of 1982*, above) to remediate the FY 2009 material weaknesses and significant deficiencies, and improve its policies, procedures, and processes, as necessary, to allow management to assert that all financial statements are fairly stated in compliance with accounting principles generally accepted in the United States, and are ready for an independent audit.

IV-M *Anti-deficiency Act* (ADA)

Various management reviews and OIG investigations are on-going within the Department and its components that may identify ADA violations. FEMA has initiated a preliminary review of certain expenditures occurring in FY 2008, that may have violated the *Anti-deficiency Act.* The Coast Guard management continues to work to resolve two potential ADA violations, one that was determined in FY 2008 related to use of Operation funds to purchase shore assets, and a second identified in FY 2009 related to exceeding its obligation authority in the Acquisition, Construction and Improvement Appropriation. National Protection and Programs Directorate (NPPD) management is continuing their review, initiated in FY 2007, over the classification and use of certain funds that may identify an ADA violation. In addition, NPPD management has continued a review initiated in FY 2008 of certain fees collected for attendance at a DHS-sponsored annual conference that may identify a violation of the ADA. The Congress has asked the Comptroller General to review certain United States Secret Service salaries and expenses that may identify a violation of the ADA.

Recommendations: We recommend that the Department, along with the OIG and the other components, complete the internal reviews currently planned or being performed, and properly report the results in compliance with the ADA, if necessary.

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

Summary of Conditions As Reported in the 2008 DHS Annual Financial Report		Fiscal Year 2009 Status/ Disposition
Material Weaknesses:		
A.	**Financial Reporting**	
A.1	The Coast Guard had not developed and implemented an effective general ledger system. The general ledgers are not compliant with the USSGL. The Coast Guard's financial reporting process was complex and labor-intensive, and required a significant number of "on-top" adjustments. The Coast Guard had deficiencies in its policies, procedures, and controls surrounding its financial reporting process, and did not record all financial transactions to the general ledger systems or have adequate beginning balance and year-end close out procedures. The Coast Guard did not have effective policies and procedures to identify the cause and resolve abnormal balances and account relationship discrepancies, e.g. budgetary to proprietary reconciliations. The Coast Guard did not have a process to track and reconcile intragovernmental transactions with its Federal trading partners, and to determine that Coast Guard intragovernmental balances are complete and accurate.	**Partially Repeated** (Exhibit I-A)
A.2	TSA did not always follow policies and procedures that require supervisory reviews of financial statements and supporting documentation, and reviews performed was not effective in identifying some material errors in the financial statements. TSA placed inappropriate reliance on the audit as a control over financial reporting, and did not have effective procedures over the review of accounting data provided to/from contractors or outside specialists. TSA had not developed and implemented procedures to fully analyze the effects of its accounting policies to ensure full compliance with GAAP. TSA did not fully reconcile its intragovernmental balances with trading partners.	**Repeated** (Exhibit II-A)
A.3	FEMA did not have sufficient experienced financial managers and staff to address non-routine accounting issues timely. In addition, FEMA lacked segregation of duties in financial reporting roles, and consequently did not have sufficient supervisory review processes over all material accounts. FEMA did not fully reconcile its intragovernmental balances with trading partners; in some cases, FEMA could not confirm or support reported balances or identify the reason for the differences.	**Partially Repeated** (Exhibit II-A)
B.	**Information Technology General and Application Controls**	
	DHS and its components had IT and financial system security control weaknesses in access controls, change controls, and service continuity.	**Partially Repeated** (Exhibits I-B and II-B)

V.1

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

Summary of Conditions As Reported in the 2008 DHS Annual Financial Report	Fiscal Year 2009 Status/ Disposition
C. Fund Balance with Treasury (FBwT)	
The Coast Guard did not maintain adequate supporting documentation that validated the accuracy for five of the sixe Agency Location Codes FBwT reconciliations. The Coast Guard did not effectively manage its suspense accounts to include supporting suspense account transactions and producing complete and accurate populations, and did not maintain adequate supporting documentation that validated the accuracy of the FBwT reconciliations and the clearing of suspense items. The Coast Guard was unable to provide validated military and civilian payroll data to support payroll transactions processed through the FBwT account.	**Repeated** (Exhibit I-C)
D. Property, Plant, and Equipment	
D.1 The Coast Guard had not consistently applied policies and procedures to ensure appropriate documentation is maintained to support Property Plant & Equipment (PP&E) acquisitions and their existence, and the methodologies and assumptions, to support the value of PP&E where documentation has not been maintained, has not been developed. The Coast Guard has not implemented appropriate controls to accurately, consistently, and timely record additions to PP&E and construction in process, transfers, disposals, and valuation and classification of repairable PP&E. The Coast Guard has not implemented accurate and complete asset identification, system mapping, and tagging processes for fixed assets, and has not properly accounted for some improvements and impairments to buildings and structures, capital leases, and selected useful lives. For Operating Materials and Supplies (OM&S), the Coast Guard has not implemented policies, procedures, and internal controls to support the assertions related to the OM&S account balances, or fully designed and implemented procedures over physical counts of OM&S. The Coast Guard has not properly identified recorded OM&S, or established processes and controls to fully support the calculated value of certain types of OM&S to approximate historical cost.	**Repeated** (Exhibit I-D)
D.2 FEMA did not have sufficient policies and procedures to routinely account for costs incurred to develop internal use software consistent with GAAP. For example, FEMA did not record estimated or actual amounts for several internal use software programs under development, or alternatively, did not assess that the related capitalizable amounts were immaterial. In addition, FEMA did not have adequate policies and procedures to accurately identify and account for the various stages of software development costs that would enable FEMA to identify the costs that should be capitalized and those that should be expensed as incurred.	**Corrected**

V.2

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

	Summary of Conditions As Reported in the 2008 DHS Annual Financial Report	Fiscal Year 2009 Status/ Disposition
D.3	TSA did not reconcile its PP&E subsidiary ledger to its general ledger consistently and timely throughout the year. TSA had not recorded depreciation on certain equipment using a method consistent with GAAP. TSA did not record PP&E purchases in an account compliant with the USSGL requirements of FFMIA, and improperly capitalized certain advance payments to vendors as construction in progress.	**Repeated** (Exhibit II-D)
D.4	CBP did not adopt adequate policies and procedures to properly account for steel purchases and construction of the U.S. border fence accurately and timely. CBP initially recorded some capital asset purchases as expenses, and several months later, properly reversed and capitalized the assets. In addition, CBP did not have adequate accounting processes and controls to ensure that transfers of assets from construction in process to completed PP&E were recorded in the general ledger timely.	**Repeated** (Exhibit II-D)
E.	**Actuarial and Other Liabilities**	
E.1	The Coast Guard did not have an effective process to ensure the completeness and accuracy of data provided to, and used by, the actuary for the calculation of the Military Retirement System pension, medical, and postemployment benefit liabilities, and reconciliations between subsidiary and general ledgers for medical expenditures were not effective. The Coast Guard did not have an effective process for reconciling military payroll recorded in CAS to detail payroll records. Military personnel data changes are not processed in the appropriate payroll and/or reporting periods, and consequently impact the completeness and accuracy of leave and payroll accruals as well as data used for actuarial projections. The Coast Guard did not have a reliable methodology to estimate accounts payable. The Coast Guard did not support the completeness, existence, and accuracy assertions of the data utilized in developing the environmental liability estimate.	**Partially Repeated** (Exhibit I-E)
E.2	FEMA did not fully implement planned internal controls over its grant accrual, as management made revisions to the accrual methodology through September 2008. FEMA did not work with its contractor actuary on a timely basis to ensure that the materiality standard used in the report was acceptable to management for financial statement reporting purposes, and FEMA did not timely communicate to its auditors the details of significant changes to the methodology used in development of the flood insurance liability. In addition, FEMA did not have sufficient policies and procedures in place to fully comply with the *Single Audit Act Amendments of 1996* and related OMB Circular No. A-133, *Audits of States, Local Governments, and Nonprofit Organizations.*	**Partially Repeated** (Exhibit II-E)
E.3	FLETC, ICE, and S&T had not fully implemented policies and standard operating procedures that will allow management to fully assert that environmental liabilities have been recorded and disclosed in the financial statements in accordance with applicable accounting standards. Each of these components did not have sufficient policies, procedures, and processes in place to fully comply with FASAB Technical Release No. 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government.*	**Corrected**

V.3

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

	Summary of Conditions As Reported in the 2008 DHS Annual Financial Report	Fiscal Year 2009 Status/ Disposition
F	**Budgetary Accounting**	
F.1	The Coast Guard did not have effective policies, procedures and internal controls over Coast Guard's process for validation and verification of UDO balances to ensure that recorded obligations were valid, accurate, recorded timely, and that proper approvals and supporting documentation is maintained. The Coast Guard had not implemented procedures and controls to prevent incurring a commitment/obligation in excess of the apportioned and/or allotted amounts, and did not effectively monitor unobligated commitment activity in its procurement system. The Coast Guard did not have properly designed and implemented procedures, processes, and internal controls to verify the completeness and accuracy of the year-end obligation pipeline adjustment to record all executed obligations. Automated system controls were not effectively used to prevent the processing of procurement transactions by contracting officers with expired warrant authority.	**Repeated** (Exhibit I-F)
F.2	FEMA did not consistently monitor the status of its obligations as part of its normal operations and ensure the timely deobligation of mission assignments. In addition, FEMA could not provide all supporting documentation for the sample of UDOs other than mission assignments and grant UDOs. Responsible parties could not be readily identified, and the files were not accessible or maintained in a form that clearly supported the balances reported in the financial statements.	**Repeated** (Exhibit II-F)
F.3	CBP did not enforce its policies and procedures to monitor and deobligate or close-out its obligations in a timely manner.	**Repeated** (Exhibit II-F)
Other Significant Deficiencies:		
G.	**Entity Level Controls**	
G.1	The Coast Guard had not fully implemented a financial management structure where GAAP is applied and financial statement balances are appropriately supported, financial management oversight functions are well defined, and the financial management infrastructure is appropriately staffed with experienced financial managers and staff. The Coast Guard had not fully implemented an on-going entity-wide risk assessment, and the Coast Guard did not have a process to monitor and control timely completion of the corrective action milestones, and update the status of completion of such milestones.	**Repeated** (Exhibit I-A and III-G)

V.4

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

	Summary of Conditions As Reported in the 2008 DHS Annual Financial Report	Fiscal Year 2009 Status/ Disposition
G.2	FEMA had not provided the CFO with clearly defined and complete authority for all financial accounting policy, processes, and control functions throughout the agency. In addition, FEMA had not effectively communicated the importance of strong financial management and internal controls throughout the agency, and had not developed sufficiently effective methods of communication to ensure that significant financial-related events outside of the OCFO are timely communicated. FEMA had not completed the placement of sufficient financial and accounting resources in its regional offices, and had not documented and/or updated formal policies and procedures for many of the roles, processes, and functions within the agency. FEMA's Internal Controls Branch's mission did not include internal control monitoring on a continual basis, other than to implement policies and procedures to close findings issued as a result of external audits. FEMA had not committed sufficient resources to ensure that personnel attend required ethics training.	**Repeated** (Exhibit III-G)
G.3	TSA lacked a sufficient number of skilled accounting staff in the proper positions in the Financial Statements and Reports Branch, and the organizational structure in financial and accounting was not optimally aligned with its resources. TSA did not adequately direct, supervise, and review the work of contractors retained to prepare materials for the financial statement audit. In addition, TSA had weaknesses in communication, instruction, training, and supervision with personnel outside the Office of Financial Management, and lacked sufficient oversight of financial reporting functions.	**Partially Repeated** (Exhibit II-A and III-G)
H.	**Custodial Revenue and Drawback**	
	The CBP Automated Commercial System (ACS) lacked automated controls to detect and prevent excessive drawback claims and overpayments, necessitating inefficient manual processes that do not effectively compensate for these automated controls. The CBP's drawback review policies did not require drawback specialists to review all or a statistically valid sample of related drawback claims against the underlying consumption entries to determine whether, in the aggregate, an excessive amount was claimed. CBP was unable to determine the status of in-bond shipments with the information available in ACS. CBP did not perform an analysis to determine the potential loss of revenue through the in-bond process. CBP Compliance Measurement oversight guidance did not provide complete coverage over the CM program. There were inconsistencies in the performance of risk assessments of Bonded Warehouses and Foreign Trade Zones, and HQ review of assessment results can take up to six months to compile and analyze.	**Repeated** (Exhibit III-H)

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

Summary of Conditions As Reported in the 2008 DHS Annual Financial Report		Fiscal Year 2009 Status/ Disposition
I.	**Deferred Revenue**	
	There were deficiencies in policies and procedures over the USCIS deferred revenue quality assurance (QA) process. For example, USCIS did not initially use a statistician with experience in developing the type of methodology needed by USCIS for the selection of QA samples. In addition, USCIS did not perform deferred revenue 'floor-to-list' QA procedures over CLAIMS 4 naturalization applications located at Service Centers, and did not have detailed QA instructions that ensure consistent practices for selecting QA samples. USCIS did not have policies describing and requiring follow-up actions to be carried out when results of the QA fall outside the acceptable range specified in the sampling methodology, and personnel performing the QA have a general lack of understanding. USCIS did not have policies and procedures that require correction of the errors once discovered, and there is little formal follow-up to determine the root cause of errors.	**Corrected**
Compliance and Other Matters:		
J.	***Federal Managers' Financial Integrity Act of 1982***	
	The Coast Guard had not fully established effective systems, processes, policies, and procedures to develop and implement internal accounting and administrative controls and conformance of accounting systems. In addition, the National Preparedness Directorate (NPPD), TSA, and FEMA's control assessment processes require improvement to ensure full compliance with FMFIA.	**Repeated** (Exhibit IV-I)
K.	***Federal Financial Management Improvement Act of 1996***	
	We noted that DHS and each significant component did not fully comply with at least one of the requirements of FFMIA. In addition, we noted weaknesses in financial systems security, which impact the Department's ability to fully comply with FISMA.	**Repeated** (Exhibit IV-J)

V.6

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

	Summary of Conditions As Reported in the 2008 DHS Annual Financial Report	Fiscal Year 2009 Status/ Disposition
L.	***Single Audit Act Amendments of 1996*, and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-up*, as revised**	
	DHS and its components did not have procedures in place to fully comply with provisions in OMB Circular No. A-133 that require them to timely obtain and review grantee Single Audit reports and follow up on questioned costs and other matters identified in these reports. DHS and its components did not fully implement corrective action plans to address all material weaknesses and significant deficiencies identified by previous financial statement audits within the time-frames established in OMB Circular No. A-50.	**Repeated** (Exhibit IV-K) (Circular No. A-50 has been combined with Exhibit IV-I)
M.	***Improper Payments Information Act of 2002***	
	FEMA excluded some programs from the scope of the IPIA risk assessment and test work. In addition, FEMA excluded five programs identified as high risk of significant improper payments during the assessment process from testing, and FEMA did not develop Mission Action Plans for five programs identified as high risk if no statistical sampling was performed to validate those risks.	**Corrected**
N.	***Chief Financial Officers Act of 1990***	
	The *DHS Financial Accountability Act of 2004* made DHS subject to the *Chief Financial Officers Act of 1990*, as amended, which requires DHS to submit to the Congress and OMB audited financial statements annually. DHS engaged an independent auditor to audit the September 30, 2008, consolidated balance sheet and statement of custodial activity only.	**Repeated** (Exhibit IV-L)
O.	***Government Performance and Results Act of 1993(GPRA)***	
	DHS' Strategic Plan expired on October 1, 2006 and the Department did not provide an updated Strategic Plan until September 2008. Consequently, the Department was not in compliance with the requirements of GPRA during the majority of FY 2008.	**Corrected**
P.	***The Debt Collection Improvement Act of 1996***	
	DHS did not perform due process in a timely manner to ensure that some eligible debts are forwarded to the Treasury for cross-servicing or the offset program within the timeframes established by DCIA.	**Corrected**

V.7

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

	Summary of Conditions As Reported in the 2008 DHS Annual Financial Report	Fiscal Year 2009 Status/ Disposition
Q.	*Anti-deficiency Act*	
	DHS and FLETC management communicated an ADA violation that occurred at FLETC, where a capital lease dating back to FY 2001 was not fully funded. The DHS Secretary had reported the violation to the President of the United States, the Head of the Senate, the Speaker of the House of Representatives, and the Comptroller General, as required by 31 U.S.C. Section 1351. In addition, various other management reviews and OIG investigations are on-going within the Department and its components that may identify ADA violations.	**Repeated** (Exhibit IV-M)

V.8

Appendix A
Management's Response

Office of the Chief Financial Officer
U.S. Department of Homeland Security
Washington, DC 20528

Homeland Security

November 12, 2009

MEMORANDUM FOR: Richard L. Skinner
Inspector General

FROM: Peggy Sherry P. Sherry
Acting Chief Financial Officer

SUBJECT: Fiscal Year (FY) 2009 Financial and Internal Controls Audit

Thank you for the opportunity to comment on the Independent Public Accountant's audit of our balance sheets, the related statement of custodial activities and internal controls as of September 30, 2009 and 2008. We agree with the Independent Public Accountant's conclusions.

Although the report indicates that DHS still faces serious financial management challenges, the auditor noted the Department's progress in implementing corrective actions and improving the quality and reliability of our financial reporting. Specifically, over the past year, we reduced material weaknesses at FEMA from four to two, and we can now assert to more than 50 percent of the Department's total liabilities. We also achieved full compliance with the *Improper Payments Information Act*, the *Debt Collection Improvement Act*, and the *Government Performance and Results Act*. We completed the Department's multi-year plan to implement OMB Circular No. A-123, *Management's Responsibility for Internal Control*, and we reduced the number of Component conditions that contributed to our material weaknesses in internal controls over financial reporting by more than half since FY 2006. As we increase the number of standalone audits and scrutiny on our account balances, DHS will discover additional opportunities for financial management improvement and will continue to strengthen internal controls and accountability.

The FY 2009 audit results show that our corrective actions are working, and we are already focusing our efforts on the remaining issues before us. Financial management has come a long way at DHS. I continue to be inspired by the extraordinary efforts of our dedicated staff at Headquarters and in the Components to becoming "One DHS," and I am committed to pursuing financial management success.

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 OIG and the Independent Public Accountant.

Appendix B
Report Distribution

Department of Homeland Security

Secretary
Deputy Secretary
Chiefs of Staff for Operations
Deputy Chief of Staff for Policy
Deputy Chiefs of Staff
General Counsel
Executive Secretariat
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
Acting Chief Financial Officer
Chief Information Officer
Chief Security Officer
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 report, please call the Office of Inspector General (OIG) at (202) 254-4199, fax your request to (202) 254-4305, or visit the OIG web site at www.dhs.gov/oig.

OIG HOTLINE

To report alleged fraud, waste, abuse or mismanagement, or any other kind of criminal or noncriminal misconduct relative to department programs or operations:

- Call our Hotline at 1-800-323-8603;
- Fax the complaint directly to us at (202) 254-4292;
- Email us at DHSOIGHOTLINE@dhs.gov; or
- Write to us at:
  DHS Office of Inspector General/MAIL STOP 2600,
  Attention: Office of Investigations - Hotline,
  245 Murray Drive, SW, Building 410,
  Washington, DC 20528.

The OIG seeks to protect the identity of each writer and caller.