



U.S. DEPARTMENT OF HOMELAND SECURITY **OFFICE OF INSPECTOR GENERAL**

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November 14, 2023

FINAL REPORT

Independent Auditors' Report on the Department of Homeland Security's Consolidated Financial Statements for FYs 2023 and 2022 and Internal Control over Financial Reporting





OFFICE OF INSPECTOR GENERAL

U.S. Department of Homeland Security

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

November 14, 2023

MEMORANDUM FOR: The Honorable Alejandro Mayorkas
Secretary

FROM: Department of Homeland Security
Glenn Sklar *Glenn Sklar*
Principal Deputy Inspector General

SUBJECT: *Independent Auditors' Report on the Department of Homeland Security's Consolidated Financial Statements for FYs 2023 and 2022 and Internal Control over Financial Reporting*

The attached report presents the results of an integrated audit of the Department of Homeland Security's consolidated financial statements for fiscal years 2023 and 2022 and internal control over financial reporting as of September 30, 2023. This audit is required by the *Chief Financial Officers Act of 1990*, as amended by the *Department of Homeland Security Financial Accountability Act* (October 16, 2004).

We contracted with the independent public accounting firm KPMG LLP (KPMG) to conduct the audit. The contract required that the audit be performed in accordance with U.S. generally accepted government auditing standards, Office of Management and Budget audit guidance, and the GAO/CIGIE *Financial Audit Manual*.

The Department achieved an unmodified (clean) opinion on all financial statements. However, KPMG issued an adverse opinion on DHS' internal control over financial reporting because of material weaknesses in internal control. KPMG identified material weaknesses in internal control in five areas and significant deficiency in one area. KPMG also reported two instances of noncompliance with laws and regulations.

Below are the areas in which KPMG identified material weaknesses and significant deficiencies, and laws and regulations with which KPMG identified noncompliance.

Material Weaknesses in Internal Control

- Information Technology Controls and Information Systems
- Financial Reporting
- Insurance Liabilities
- Receipt of Goods and Services
- Seized and Forfeited Property Other than Monetary Instruments

Significant Deficiencies in Internal Control

- Grants Management

Noncompliance with Laws and Regulations

- *Federal Managers' Financial Integrity Act of 1982 (FMFIA)*
- *Federal Financial Management Improvement Act of 1996 (FFMIA)*

Moving DHS' Financial Management Forward

This past fiscal year, the Department continued its commitment to identifying areas for improvement, developing and monitoring corrective actions, and establishing and maintaining effective internal control over financial reporting. Looking forward, to sustain a clean opinion on its financial statements and obtain a clean opinion on its internal control over financial reporting, the Department must continue remediation efforts and stay focused.

KPMG is responsible for the attached Independent Auditors' Report dated November 14, 2023, and the conclusions expressed in the report. We do not express opinions on DHS' financial statements or internal control over financial reporting or conclusions on compliance and other matters.

Consistent with our responsibility under the *Inspector General Act of 1978, as amended*, we will provide copies of our report to congressional committees with oversight and appropriation responsibility over the Department of Homeland Security. We will post the report on our website for public dissemination.

Please call me with any questions, or your staff may contact Kristen Bernard, Acting Deputy Inspector General for Audits, at (202) 981-6000.

Attachment



DHS OIG HIGHLIGHTS

Independent Auditors' Report on the Department of Homeland Security's Consolidated Financial Statements for FYs 2023 and 2022 and Internal Control over Financial Reporting

November 14, 2023

Why We Did This Audit

The *Chief Financial Officers Act of 1990* (Public Law 101-576) and the *Department of Homeland Security Financial Accountability Act* (Public Law 108-330) require us to conduct an annual audit of the Department of Homeland Security's consolidated financial statements and internal control over financial reporting.

What We Recommend

KPMG made 24 recommendations that, when implemented, may help improve the Department's internal control.

For Further Information:

Contact our Office of Public Affairs at (202) 981-6000, or email us at:

DHS-OIG.OfficePublicAffairs@oig.dhs.gov.

What We Found

The independent public accounting firm KPMG LLP (KPMG) has issued an unmodified (clean) opinion on DHS' consolidated financial statements. KPMG noted that the financial statements present fairly, in all material respects, DHS' financial position as September 30, 2023 and 2022.

KPMG issued an adverse opinion on DHS' internal control over financial reporting as of September 30, 2023. The report identifies significant deficiencies in internal control in the following six areas, the first five of which are considered material weaknesses:

1. Information Technology Controls and Information Systems
2. Financial Reporting
3. Insurance Liabilities
4. Receipt of Goods and Services
5. Seized and Forfeited Property Other than Monetary Instruments
6. Grants Management

KPMG also identified noncompliance with the following two laws and regulations.

1. Federal Managers' Financial Integrity Act of 1982
2. Federal Financial Management Improvement Act of 1996

Management's Response

DHS concurred with all the recommendations.



OFFICE OF INSPECTOR GENERAL

U.S. Department of Homeland Security

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Independent Auditors' Report

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

Report on the Consolidated Financial Statements and Internal Control over Financial Reporting

Opinions on the Consolidated Financial Statements and Internal Control Over Financial Reporting

We have audited the consolidated financial statements of the U.S. Department of Homeland Security (DHS), which comprise the consolidated balance sheets as of September 30, 2023 and 2022, and the related consolidated statements of net costs, changes in net position, and custodial activity, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements. In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of DHS as of September 30, 2023 and 2022, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended in accordance with U.S. generally accepted accounting principles.

We also have audited DHS's internal control over financial reporting as of September 30, 2023, based on criteria established in the *Standards for Internal Control in the Federal Government*, issued by the Comptroller General of the United States. In our opinion, because of the effect of the material weaknesses described in the Basis for Adverse Opinion on Internal Control over Financial Reporting section on the achievement of the objectives of the control criteria, DHS has not maintained effective internal control over financial reporting as of September 30, 2023, based on criteria established in the *Standards for Internal Control in the Federal Government*, issued by the Comptroller General of the United States.

We considered the material weaknesses described in the Basis for Adverse Opinion on Internal Control Over Financial Reporting section in determining the nature, timing, and extent of audit procedures applied in our audit of the 2023 consolidated financial statements, and the material weaknesses do not affect such report on the consolidated financial statements.

Basis for Opinions

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS), the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 24-01, *Audit Requirements for Federal Financial Statements*. Our responsibilities under those standards and OMB Bulletin No. 24-01 are further described in the Auditors' Responsibilities for the Audits of the Consolidated Financial Statements and Internal Control Over Financial Reporting section of our report. We are required to be independent of DHS and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Basis for Adverse Opinion on Internal Control Over Financial Reporting

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 consolidated financial statements will not be prevented, or detected and corrected, on a timely basis. The following areas of material weaknesses have been identified and included in the accompanying *Management's Report on Internal Controls*



Over Financial Reporting and are further described in the accompanying Exhibits Overview as Exhibits I-A through I-D.

- A. Information Technology Controls and Information Systems
- B. Financial Reporting
- C. Insurance Liabilities
- D. Receipt of Goods and Services

DHS management did not report the material weaknesses related to Exhibit I-E. Seized and Forfeited Property Other than Monetary Instruments, and Entity Level Controls related to the Control Environment, Risk Assessment Process, Information and Communication, and Monitoring Activities, which are further described in Exhibit I, in the accompanying *Management's Report on Internal Controls Over Financial Reporting*, and in its *Statement of Assurance*, included in the Management's Discussion and Analysis section of the accompanying *Agency Financial Report*.

Emphasis of Matter

As discussed in Note 15 to the consolidated financial statements, DHS had intragovernmental debt used to finance the National Flood Insurance Program (NFIP) of approximately \$21 billion as of September 30, 2023 and 2022. The debt and interest payments are financed by the flood premiums from policyholders. Given the current rate structure, DHS will not be able to pay its debt from the premium revenue alone; therefore, DHS does not anticipate repaying the debt. Our opinion is not modified with respect to this matter.

Other Matter – Interactive Data

Management has elected to reference to information on websites or other forms of interactive data outside the *Agency Financial Report* to provide additional information for the users of its consolidated financial statements. Such information is not a required part of the consolidated financial statements or supplementary information required by the Federal Accounting Standards Advisory Board. The information on these websites or the other interactive data has not been subjected to any of our auditing procedures, and accordingly, we do not express an opinion or provide any assurance on it.

Other Matter – Management's Report on Internal Controls Over Financial Reporting

Management's statements regarding challenges faced and areas of improvement, included in the accompanying *Management's Report on Internal Controls Over Financial Reporting*, have not been subjected to any of our auditing procedures, and accordingly, we do not express an opinion or provide any assurance on it.

Responsibilities of Management for the Consolidated Financial Statements and Internal Control Over Financial Reporting

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with U.S. generally accepted accounting principles, and for the design, implementation, and maintenance of effective internal control over financial reporting relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. Management is also responsible for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report on Internal Controls Over Financial Reporting*.



Auditors' Responsibilities for the Audits of the Consolidated Financial Statements and Internal Control Over Financial Reporting

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and about whether effective internal control over financial reporting was maintained in all material respects, and to issue an auditors' report that includes our opinions.

Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit of consolidated financial statements or an audit of internal control over financial reporting conducted in accordance with GAAS, *Government Auditing Standards*, and OMB Bulletin No. 24-01 will always detect a material misstatement or a material weakness when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered to be material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the consolidated financial statements.

In performing an audit of consolidated financial statements and an audit of internal control over financial reporting in accordance with GAAS, *Government Auditing Standards*, and OMB Bulletin No. 24-01, we:

- Exercise professional judgment and maintain professional skepticism throughout the audits.
- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.
- Obtain an understanding of internal control relevant to the consolidated financial statement audit in order to design audit procedures that are appropriate in the circumstances.
- Obtain an understanding of internal control over financial reporting relevant to the audit of internal control over financial reporting, assess the risks that a material weakness exists, and test and evaluate the design and operating effectiveness of internal control over financial reporting based on the assessed risk.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the consolidated financial statement audit.

We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with U.S. generally accepted accounting principles. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the entity are being made only in accordance with authorizations of



management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment 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.

Required Supplementary Information

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis and Required Supplementary Information sections be presented to supplement the basic consolidated financial statements. Such information is the responsibility of management and, although not a part of the basic consolidated financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with GAAS, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audits of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Management is responsible for the other information included in the *Agency Financial Report*. The other information comprises the DHS@20, About this Report, Message from the Secretary, Message from the Acting Chief Financial Officer, Introduction, Other Information, Acronym List, and Acknowledgements sections but does not include the consolidated financial statements and our auditors' report thereon. Our opinion on the consolidated financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the consolidated financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

Other Reporting on Internal Control

In accordance with *Government Auditing Standards*, we are required to report findings of significant deficiencies. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. Our audit of internal control over financial reporting was not designed to identify all deficiencies in internal control that might be significant deficiencies. Given these limitations, significant deficiencies may exist that were not identified. We consider the deficiency described in the accompanying Exhibits Overview as Exhibit II-F to be a significant deficiency.

F. Grants Management

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether DHS's consolidated financial statements as of and for the year ended September 30, 2023 are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could



have a direct and material effect on the consolidated financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 24-01, and which are described in the accompanying Exhibits Overview as Exhibit III-G.

G. Federal Managers' Financial Integrity Act of 1982 (FMFIA)

We also performed tests of DHS's compliance with certain provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). Providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances described in the accompanying Exhibit III-H, in which DHS's financial management systems did not substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and application of the United States Government Standard General Ledger at the transaction level.

DHS's Response to Findings

Government Auditing Standards requires the auditor to perform limited procedures on DHS's response to the findings identified in our audit and described in Appendix A. DHS's response was not subjected to the other auditing procedures applied in the audit of the consolidated financial statements and the audit of internal control over financial reporting and, accordingly, we express no opinion on the response.

Purpose of the Reporting Required by Government Auditing Standards

The purpose of the communication described in the Other Reporting on Internal Control and the Report on Compliance and Other Matters sections is solely to describe the deficiencies we consider to be significant deficiencies and the scope of our testing of compliance and the results of that testing, and not to provide an opinion on compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Washington, D.C.
November 14, 2023

Independent Auditors' Report

Exhibits Overview

The weaknesses in internal control over financial reporting (internal control) existed as of September 30, 2023, and the instances of noncompliance with certain provisions of laws, regulations, contracts, and grant agreements occurred during the year ended September 30, 2023. The determination of which control deficiencies rise to the level of a material weakness or a significant deficiency is based on an evaluation of the impact of control deficiencies identified across DHS (including headquarters and the components), considered individually and in the aggregate, on the DHS consolidated financial statements as of September 30, 2023. The associated weaknesses in entity level controls, as defined by the Government Accountability Office's *Standards for Internal Control in the Federal Government*, issued by the Comptroller General of the United States (Green Book), are also identified in relation to the control activities in the corresponding areas of the following Exhibits.

The findings are presented in three Exhibits:

Exhibit I Material Weaknesses. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's consolidated financial statements will not be prevented, or detected and corrected, on a timely basis. DHS has material weaknesses within each of the following areas:

- A. Information Technology Controls and Information Systems
- B. Financial Reporting
- C. Insurance Liabilities
- D. Receipt of Goods and Services
- E. Seized and Forfeited Property Other than Monetary Instruments

Exhibit II Significant Deficiency. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by DHS management and others in positions of DHS oversight. DHS has a significant deficiency within the following area:

- F. Grants Management

Exhibit III Compliance and Other Matters. The compliance and other matters section includes instances of noncompliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters that are required to be reported under *Government Auditing Standards* or Office of Management and Budget (OMB) Bulletin No. 24-01, *Audit Requirements for Federal Financial Statements*. DHS has instances of noncompliance as follows:

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

Criteria DHS's internal control over financial reporting is based on the criteria established by the Green Book.

Independent Auditors' Report
Exhibit I – Material Weaknesses

I-A Information Technology Controls and Information Systems

Background:

Information technology (IT) systems are comprised of four types of layers of technology – application, database, operating system, and network. Each layer may present risks arising from IT that an entity needs to control in order for automated controls to operate and function effectively, and for the integrity of data and information sources from the entity's IT system to be maintained.

IT general controls (ITGCs) address risks arising from IT in the areas of access to programs and data, program changes, program acquisition and development, and computer operations.

Conditions:

DHS did not achieve objectives and respond to risks arising from IT as required by Green Book principles 11, *Design Activities for the Information System*, and 12, *Implement Control Activities*. Material weaknesses existed in ITGCs and automated controls within information systems used for financial reporting and all business process areas at headquarters and various components across DHS, including the Federal Emergency Management Agency (FEMA), U.S. Immigration and Customs Enforcement (ICE), Transportation Security Administration (TSA), U.S. Coast Guard (USCG), U.S. Customs and Border Protection (CBP), and U.S. Citizenship and Immigration Services (USCIS). These deficiencies include control activities performed by third-party service providers.

Specifically, DHS did not:

- Effectively design, implement, or operate ITGCs in the following areas:

Access to programs and data

- User, service, shared, privileged, and generic (including emergency, temporary, developer, and migrator) accounts were not properly authorized, recertified, and revoked timely.
- The principles of least privilege and segregation of duties were not applied.
- Login events were not monitored or reviewed.

Program changes

- Systems were not properly configured to address ITGC risks.
- System changes were not documented, authorized, or monitored.

Computer Operations

- Assessments and documentation required for a system Authority to Operate (ATO) were not completed or approved.
- Internal manuals were not timely updated for current industry guidance.
- Identified vulnerabilities were not timely remediated.

- Effectively operate application controls that were dependent on effective ITGCs.

Causes:

These deficiencies are a result of material weaknesses in the entity's risk assessment process, information and communication, and monitoring activities as follows:

Green Book principle 7 requires that "Management should identify, analyze, and respond to risks related to achieving the defined objectives." DHS did not effectively implement and operate Green Book principle 7. Specifically, DHS did not:

- fully implement a robust risk assessment to identify and mitigate the risks arising from IT;
- resolve the risks created by historic limitations in the functionality of its information systems; and

Independent Auditors' Report

Exhibit I – Material Weaknesses

- successfully respond to the risk created by implementing manual controls to compensate for risks resulting from decentralized systems and records management processes or utilities with limited automated capabilities.

Green Book principle 14 requires that “Management should internally communicate the necessary quality information to achieve the entity’s objectives.” DHS did not effectively implement and operate Green Book principle 14. Specifically, DHS did not:

- communicate internally to properly authorize, recertify, or revoke access to systems, or to authorize and monitor system changes; and
- timely update and distribute internal manuals based on industry guidance.

Green Book principle 16 requires that “Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.” DHS did not effectively implement and operate Green Book principle 16. Specifically, DHS did not:

- effectively implement a formalized process to monitor the third-party service organizations responsible for maintaining the infrastructure support for various IT systems; and
- effectively monitor the established corrective action plans or track progress towards timely remediation of the deficiencies at third party service providers.

DHS continued to have deficiencies in its design and implementation of controls related to information technology. These deficiencies have persisted since the inception of DHS. As a result, DHS did not remediate identified internal control deficiencies timely as required by Green Book principle 17. Specifically, DHS did not:

- effectively design and implement controls to remediate IT deficiencies and execute corrective actions to address deficiencies that have existed for years in multiple information systems.

Effects:

As a result of the deficiencies described above, automated controls dependent on the ITGCs did not operate and function effectively, and the integrity of DHS’s data and information sources from certain of its IT systems could be impacted. As such, there is a reasonable possibility that material misstatements in each financial statement caption and related note of the consolidated financial statements will not be prevented, or detected and corrected, on a timely basis.

The deficiencies increase the risk of unauthorized access to information systems or data and inappropriate disclosures of sensitive data. Key DHS financial information systems are not compliant with Federal financial management system requirements as defined by FFMA, as reported in Exhibit III-H. In some cases, in response to these deficiencies, DHS intended to utilize manual controls; however, these manual controls often were not properly designed or implemented, or did not operate effectively, as reported in Exhibits I and II.

Recommendations:

We recommend the DHS:

1. Office of the Chief Financial Officer (OCFO), in coordination with the Office of the Chief Information Officer (OCIO), the Office of the Chief Information Security Officer (OCISO), and component IT and financial management, complete a comprehensive risk analysis and develop a mitigation plan to reduce risks related to ITGC and application control deficiencies timely;
2. OCFO, in coordination with the OCIO, the OCISO, and component IT and financial management, design, implement, and communicate effective internal control processes to address the risk of errors due to IT system functionality issues, the inability to rely on information derived from systems, and the inability to rely on application controls until information system deficiencies are remediated;

Independent Auditors' Report
Exhibit I – Material Weaknesses

3. OCISO, the OCIO, and component IT management sufficiently monitor IT vulnerabilities and limitations, and coordinate with the OCFO and component financial management to implement manual controls to mitigate risk until automated controls are adequately designed and implemented;
4. OCFO, in coordination with the OCIO, the OCISO, and component IT and financial management, design and implement an effective internal control process to review service organization risks, evaluate ineffective service organization controls, and design and implement appropriate compensating controls; and
5. OCFO, in coordination with the OCIO, the OCISO, and component IT and financial management, develop, implement, and monitor internal manuals and corrective action plans.

Independent Auditors' Report

Exhibit I – Material Weaknesses

I-B Financial Reporting

Background:

Internal control is a process effected by those charged with governance, management, and other personnel, and is designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with U.S. generally accepted accounting principles. Material weaknesses existed in each of the areas of financial reporting described below.

Conditions:

DHS did not design control activities to achieve internal control objectives and respond to risks as required by Green Book principle 10, *Design Control Activities*, or implement the entity's information systems and related control activities through policies as required by Green Book principles 11, *Design Activities for the Information System*, and 12, *Implement Control Activities*. Material weaknesses were identified in manual controls that were dependent upon information derived from systems, controls over journal entries, compensating service organization controls, and the response to risks presented by financial system migration.

Specifically, DHS did not:

- Effectively design, implement, and/or operate controls in the financial reporting process across DHS in the following areas:

Manual controls dependent upon information derived from systems

- Manual controls dependent upon the accuracy of information included in system generated reports in the financial reporting process and all business processes across DHS.

Journal entries

- Completeness of manual journal entries at USCG.
- Accuracy of manual journal entry amounts and attributes (e.g., general ledger accounts) at CBP and USCG.

Service Organizations

- Risks occurring at service providers were not adequately addressed with appropriate controls at FEMA and USCG.

Response to risks presented by financial system migration

- Risks related to the USCG FY 2022 system implementation were not identified and analyzed, and therefore controls were not designed or implemented to mitigate risks.

Causes:

These deficiencies are a result of material weaknesses in the entity's control environment, risk assessment process, information and communication, and monitoring activities as follows:

Green Book principle 5 requires that "Management should evaluate performance and hold individuals accountable for their internal control responsibilities." DHS did not effectively implement and operate Green Book principle 5. Specifically, DHS did not:

- enforce accountability of personnel responsible for the review of service organizations and the recording of journal entries and certain manual controls.

Green Book principle 7 requires that "Management should identify, analyze, and respond to risks related to achieving the defined objectives." DHS did not effectively implement and operate Green Book principle 7. Specifically, DHS did not:

- sufficiently identify, analyze, and respond to risks related to internal control effected by service providers;

Independent Auditors' Report

Exhibit I – Material Weaknesses

- sufficiently respond to the risk posed by incomplete or inaccurate journal entry supporting documentation;
- fully implement a robust risk assessment to identify and mitigate the risks arising from IT; and
- assess the risks created by IT deficiencies and their impact on other controls, including risks related to inappropriate reliance on information derived from systems.

Green Book principle 9 requires that “Management should identify, analyze, and respond to significant changes that could impact the internal control system.” DHS did not effectively implement and operate Green Book principle 9. Specifically, DHS did not:

- sufficiently identify, analyze, and respond to the changes presented by USCG’s financial system migration.

Green Book principle 13 requires that “Management should use quality information to achieve the entity’s objectives.” DHS did not effectively implement and operate Green Book principle 13. Specifically, DHS did not:

- obtain the appropriate information to support proposed journal entries; and
- process data into quality information that was useable for controls to operate effectively.

Green Book principle 16 requires that “Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results.” DHS did not effectively implement and operate Green Book principle 16. Specifically, DHS did not:

- perform continuous monitoring and testing of IT and financial controls for all significant business processes, including monitoring the activities and controls performed by service organizations;
- sufficiently monitor the status of corrective action plans; and
- establish a baseline for application controls and information used in controls at CBP, USCG, and ICE.

DHS continued to have deficiencies in its design and implementation of controls over Financial Reporting. DHS did not remediate identified internal control deficiencies on a timely basis as required by Green Book principle 17, *Evaluate Issues and Remediate Deficiencies*. Specifically, DHS did not:

- effectively design and implement controls to remediate Financial Reporting deficiencies and execute corrective actions to address deficiencies that have existed for years.

Effects:

As a result of the deficiencies described above, there is a reasonable possibility that material misstatements in each financial statement caption and related note of the consolidated financial statements will not be prevented, or detected and corrected, on a timely basis. Transactions recorded in the new system at USCG resulted in instances of noncompliance with the United States Standard General Ledger (USSGL) at the transaction level. Also, the lack of compensating controls for IT deficiencies resulted in noncompliance with Federal financial management system requirements, as defined by FFMA and reported in Exhibit III-H. The failure to perform continuous monitoring and testing of IT and business process-level controls results in lack of timely remediation of existing deficiencies and noncompliance with FMFIA, as reported in Exhibit III-G.

Recommendations:

In addition to previously listed recommendations, we recommend that DHS:

6. perform an analysis to assess the risks of the migration to a new general ledger system, and implement processes and controls to ensure all necessary journal entries are completely recorded each period;

Independent Auditors' Report
Exhibit I – Material Weaknesses

7. reinforce existing policies, procedures, and established related internal controls, to ensure journal entries are adequately researched, supported, and reviewed for accuracy before recording in the general ledger;
8. enforce accountability for adherence to policies and procedures, and provide the necessary financial reporting oversight;
9. improve the process for identification, analysis, and response over significant changes and updates to risks assessments related to financial reporting, including risks associated with changes to financial systems;
10. align knowledgeable individuals to monitor and evaluate the roles of service organizations, and assess controls at those service organizations; and
11. improve monitoring controls over assessing internal controls and remediating internal control deficiencies timely.

I-C Insurance Liabilities

Background:

DHS's FEMA manages the National Flood Insurance Program (NFIP), a program to provide flood insurance to policyholders through a network of write-your-own (WYO) insurance companies. These insurance companies provide services on behalf of DHS, including underwriting premium policies and processing claims. DHS used the insurance companies' WYO data, along with NFIP loss and loss adjustment expense factors, to estimate its flood insurance liabilities and related future funded costs, including those related to actuarially derived insurance liabilities for claims incurred but not yet reported and losses on remaining coverage as of September 30, 2023. The liability for losses on remaining coverage results from DHS's FY 2023 implementation of a new premium policy rating system referred to as Risk Rating 2.0.

Conditions:

DHS did not design control activities to achieve objectives and respond to risks as required by Green Book principle 10, *Design Control Activities*, or implement the related control activities through policies as required by Green Book principle 12, *Implement Control Activities*. Specifically, at FEMA, DHS did not:

- effectively implement controls over the completeness and accuracy of the underlying data used in the valuation of the flood insurance liabilities;
- effectively design and implement controls over the assumptions, methods, and models used in the valuation of the flood insurance liabilities; and
- effectively implement controls over the retrospective review of the reserve analysis.

Causes:

These deficiencies are a result of material weaknesses in the entity's control environment, risk assessment process, and monitoring activities as follows:

Green Book principle 3 requires that "Management develops and maintains documentation of its internal control system." DHS did not effectively implement and operate Green Book principle 3. Specifically, DHS did not:

- adequately document the determination and appropriateness of the methods, models, and assumptions used in the actuarial insurance liability estimates.

Green Book principle 5 requires that "Management should evaluate performance and hold individuals accountable for their internal control responsibilities." DHS did not effectively implement and operate Green Book principle 5. Specifically, DHS did not:

- enforce accountability of personnel responsible for reviewing the underlying data and the appropriateness of the assumptions, methods, and models used in the actuarial insurance liability estimates.

Green Book principle 9 requires that "Management should identify, analyze, and respond to significant changes that could impact the internal control system." DHS did not effectively implement and operate Green Book principle 9. Specifically, DHS did not:

- properly assess and document the appropriateness of changes to the methods, models, and assumptions for the actuarial insurance liability estimates.

DHS continued to have deficiencies in its design and implementation of controls over insurance liabilities. DHS did not remediate identified internal control deficiencies on a timely basis as required by Green Book principle 17, *Evaluate Issues and Remediate Deficiencies*. Specifically, DHS did not:

- effectively design and implement controls to remediate insurance liability deficiencies at FEMA and execute corrective actions to address deficiencies that have existed for years.

Independent Auditors' Report
Exhibit I – Material Weaknesses

Effects:

As a result of the deficiencies described above, there is a reasonable possibility that material misstatements in the flood insurance liabilities and future funded costs will not be prevented, or detected and corrected, on a timely basis.

Recommendations:

In addition to previously listed recommendations, we recommend that DHS:

12. design and implement controls, and document the performance of the controls, over the determination, changes and appropriateness of the data, methods, models, and assumptions used in the valuation of actuarially derived insurance liabilities; and
13. enforce accountability of personnel responsible for performing controls over actuarially derived insurance liabilities.

Independent Auditors' Report
Exhibit I – Material Weaknesses

I-D Receipt of Goods and Services

Background:

In FY 2022, USCG migrated to a new financial system. The financial system migration resulted in significant changes to existing processes, including changes to the process for recording expenditures incurred. USCG personnel record key data elements for the receipt of goods and services in the financial system and the data elements determine the financial system accounting for the transactions.

Condition:

DHS did not design control activities to achieve objectives and respond to risks as required by Green Book principle 10, *Design Control Activities*, or implement the related control activities through policies as required by Green Book principle 12, *Implement Control Activities*. Specifically, at USCG, DHS did not:

- sufficiently design and implement controls specific to recording the receipt of goods and services to ensure the accuracy of recorded expenditures and the related obligations.

Causes:

The deficiency is a result of material weaknesses in the entity's control environment, risk assessment process, and monitoring activities as follows:

Green Book principle 4 requires that "Management recruits, develops, and retains competent personnel to achieve the entity's objectives." DHS did not effectively implement and operate Green Book principle 4. Specifically, DHS did not:

- have adequate resources to design internal controls that take into consideration the new financial system.

Green Book principle 7 requires that "Management should identify, analyze, and respond to risks related to achieving the defined objectives." DHS did not effectively implement and operate Green Book principle 7. Specifically, DHS did not:

- fully implement a robust risk assessment to identify and mitigate the risks arising from IT; and
- assess the risks created by IT deficiencies and their impact on other controls.

Green Book principle 9 requires that "Management should identify, analyze, and respond to significant changes that could impact the internal control system." DHS did not effectively implement and operate Green Book principle 9. Specifically, DHS did not:

- sufficiently identify, analyze, and respond to the risks arising from USCG's financial system migration.

DHS continued to have deficiencies in its design and implementation of controls over USCG expenditures. DHS did not remediate identified internal control deficiencies on a timely basis as required by Green Book principle 17, *Evaluate Issues and Remediate Deficiencies*. Specifically, DHS did not:

- effectively design and implement controls to remediate deficiencies in the receipt of goods and services at USCG and execute corrective actions to address deficiencies that existed in the prior year.

Effects:

As a result of the deficiency described above, there is a reasonable possibility that material misstatements of gross costs and new obligations and upward adjustments will not be prevented, or detected and corrected, on a timely basis. In addition, the ineffective design of the financial system at USCG resulted in instances of noncompliance with Federal accounting standards, as defined by FFMIA and reported in Exhibit III-H.

Independent Auditors' Report
Exhibit I – Material Weaknesses

Recommendations:

In addition to previously listed recommendations, we recommend that DHS:

14. perform a robust risk assessment related to the financial system migration, and design and implement controls to respond to identified risks; and
15. obtain additional resources to remediate known control deficiencies.

I-E Seized and Forfeited Property Other than Monetary Instruments

Background:

DHS is responsible for recording seized and forfeited property that is in its custody. DHS seizes various items, including prohibited drugs and counterfeit goods. For each seizure, DHS components enter case information, including weights and measures, and disposition status into the seized and forfeited property assets tracking system.

Conditions:

DHS did not design control activities to achieve internal control objectives and respond to risks as required by Green Book principle 10, *Design Control Activities*, or implement control activities through policies as required by Green Book principle 12, *Implement Control Activities*. Specifically, at CBP and ICE, DHS did not:

- effectively design, implement and/or operate controls over the existence, accuracy, and presentation of seized and forfeited asset transactions recorded in the seized and forfeited assets tracking system by CBP and ICE personnel; and
- effectively operate controls over the existence, accuracy, and presentation of seized and forfeited asset transactions held at temporary storage areas.

Causes:

These deficiencies are a result of material weaknesses in the entity's control environment, risk assessment process, information and communication, and monitoring activities as follows:

Green Book principle 5 requires that "Management should evaluate performance and hold individuals accountable for their internal control responsibilities." DHS did not effectively implement and operate Green Book principle 5. Specifically, DHS did not:

- hold all seized and forfeited property temporary storage facilities' personnel accountable for consistently implementing control activities.

Green Book principle 7 requires that "Management should identify, analyze, and respond to risks related to achieving the defined objectives." DHS did not effectively implement and operate Green Book principle 7. Specifically, DHS did not:

- respond to identified risks related to seized and forfeited property information input to and updated in the system of record.

Green Book principle 14 requires that "Management should internally communicate the necessary quality information to achieve the entity's objectives." DHS did not effectively implement and operate Green Book principle 14. Specifically, DHS did not:

- identify the appropriate method to effectively communicate between its components about the processes related to transfers and adjustments of seized and forfeited property.

Green Book principle 15 requires that "Management should externally communicate the necessary quality information to achieve the entity's objectives." DHS did not effectively implement and operate Green Book principle 15. Specifically, DHS did not:

- effectively communicate with third parties to obtain the information necessary for the Seized and Forfeited Property note to the consolidated financial statements.

Green Book principle 16 requires that "Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results." DHS did not effectively implement and operate Green Book principle 16. Specifically, DHS did not:

- effectively monitor seized and forfeited property internal controls.

Independent Auditors' Report
Exhibit I – Material Weaknesses

DHS continued to have deficiencies in its operating effectiveness of controls over seized and forfeited property. DHS did not remediate identified internal control deficiencies on a timely basis as required by Green Book principle 17, *Evaluate Issues and Remediate Deficiencies*. Specifically, DHS did not:

- effectively design and implement controls to remediate deficiencies in seized and forfeited property at CBP and ICE and execute corrective actions to address deficiencies that have existed for years.

Effects:

As a result of the deficiencies described above, there is a reasonable possibility that material misstatements in the seized and forfeited property note to the consolidated financial statements will not be prevented, or detected and corrected, on a timely basis.

Recommendations:

In addition to previously listed recommendations, we recommend that DHS:

16. enhance existing controls to prevent and detect and correct material errors in the seized and forfeited property note to the consolidated financial statements;
17. communicate internally to establish and implement policies related to transfers and adjustments of seized and forfeited property;
18. communicate externally to establish agreement with third parties that receive transfers requiring such parties to provide sufficient data elements to achieve DHS's objectives;
19. monitor the consistent implementation of policies to validate that they achieve DHS's objectives;
20. develop and maintain a complete listing of temporary storage areas that hold seized and forfeited property; and
21. enforce consistent security measures at temporary storage areas that hold seized and forfeited property.

Independent Auditors' Report
Exhibit II – Significant Deficiency

II-F Grants Management

Background:

DHS's FEMA manages multiple Federal disaster and non-disaster grant programs. In FY 2018, DHS began implementation of the process to standardize all grant management activities, which continued through FY 2023. This included coordination among the grant regional offices and central management as well as among the various grant program offices. To monitor the grant recipients' spending of the Federal disaster and non-disaster grants awarded to them, DHS performs site visits of the grant recipients and desk reviews of their submitted Federal Financial Reports.

Condition:

DHS did not fully design control activities to achieve objectives and respond to risks as required by Green Book principle 10, *Design Control Activities*, or implement control activities through policies as required by Green Book principle 12, *Implement Control Activities*. Specifically, at FEMA, DHS did not:

- design and implement effective controls over monitoring of grant recipients.

Causes:

The deficiency is a result of material weaknesses in the entity's control environment, risk assessment process, and monitoring activities as follows:

Green Book principle 5 requires that "Management should evaluate performance and hold individuals accountable for their internal control responsibilities." DHS did not effectively implement and operate Green Book principle 5. Specifically, DHS did not:

- enforce accountability of personnel responsible for monitoring grant recipients.

Green Book principle 7 requires that "Management should identify, analyze, and respond to risks related to achieving the defined objectives." DHS did not effectively implement and operate Green Book principle 7. Specifically, DHS did not:

- establish control thresholds to determine the appropriate scope of grant monitoring site visits and desk reviews to minimize residual risk.

DHS continued to have deficiencies in its design and implementation of controls over grants management. DHS did not remediate identified internal control deficiencies on a timely basis as required by Green Book principle 17, *Evaluate Issues and Remediate Deficiencies*. Specifically, DHS did not:

- effectively design and implement controls to remediate grants management deficiencies at FEMA and execute corrective actions to address deficiencies that have existed for years.

Effects:

As a result of the deficiency described above, there is a reasonable possibility of inaccurate or unauthorized expense reporting by grant recipients and ineffective monitoring of open and closed grants, which may affect the recoverability of grant funds and increases the risk that DHS may not identify corrective actions for grant recipients timely.

Recommendation:

In addition to previously listed recommendations, we recommend that DHS:

22. enforce accountability for the established monitoring control procedures to prevent or detect inaccurate or non-responsive reporting by grant recipients.

Independent Auditors' Report
Exhibit III – Compliance and Other Matters

III-G Federal Managers' Financial Integrity Act of 1982

FMFIA requires agencies to establish effective internal control and information systems, and to continuously evaluate and assess the effectiveness of their internal control. DHS has implemented a multi-year plan to implement OMB Circular No. A-123, *Management's Responsibility for Enterprise Risk Management and Internal Control*, to comply with FMFIA. However, the DHS Secretary's Assurance Statement, dated November 14, 2023, as presented in *Management's Discussion and Analysis* of DHS's FY 2023 Agency Financial Report, acknowledged the existence of control activities demonstrating material weaknesses, and therefore provided modified assurance that internal control over financial reporting was operating effectively as of September 30, 2023. DHS did not perform continuous monitoring and testing of both IT and business process-level controls for all significant areas. DHS did not fully establish effective systems, processes, policies, and testing procedures to ensure that internal controls were operating effectively throughout DHS.

Recommendation:

In addition to previously listed recommendations, we recommend that DHS:

23. implement corrective actions to address internal control deficiencies to ensure compliance with FMFIA, and implement the recommendations provided in Exhibits I and II.

III-H Federal Financial Management Improvement Act of 1996

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 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.

As of September 30, 2023, DHS did not comply with applicable Federal accounting standards in certain instances, Federal financial management system requirements, and application of the USSGL at the transaction level in certain instances, as described in Exhibit I-A, Exhibit I-B, and Exhibit 1-D. The DHS Secretary stated in the *Secretary's Assurance Statement*, dated November 14, 2023, that DHS's financial management systems did not substantially comply with government-wide requirements mandated by FFMIA.

Recommendation:

We recommend that DHS:

24. improve its financial management systems to ensure compliance with FFMIA, and implement the recommendations provided in Exhibits I and II.



OFFICE OF INSPECTOR GENERAL

U.S. Department of Homeland Security

Appendix A Management Comments to the Draft Report

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



Homeland
Security

MEMORANDUM FOR: The Honorable Joseph V. Cuffari
Inspector General

FROM: Stacy Marcott **STACY A** Digitally signed by STACY
A MARCOTT
Date: 2023.11.14
14:43:09 -05'00'
Acting Chief Financial Officer **MARCOTT**

SUBJECT: Fiscal Year 2023 Financial Statement and Internal Control Over
Financial Reporting Audit

Thank you for your audit report on the Department's Financial Statements and Internal Control over Financial Reporting for Fiscal Years (FY) 2023 and 2022. In general, we agree with the Independent Public Accountant's conclusion. We are pleased to have earned an unmodified (clean) opinion on our consolidated financial statements for the eleventh consecutive year.

During the FY 2023 audit, the Independent Public Accountant identified inaccuracies over the recording of non-valued seized and forfeited property that are managed by certain DHS Components. These assets have no financial value, and they are reported as kilograms within our footnote disclosures on the Agency Financial Report. Although we don't fully agree with the characterization of the new material weakness in seized and forfeited property, we recognize that our controls over that process need to be strengthened and will be an area of focus during FY 2024.

The Department continues to prioritize maturing information technology controls and is implementing an aggressive plan to modernize our financial systems. In early FY 2022, the United States Coast Guard migrated to our new Financial Systems Modernization Solution. During FY 2023, we continued our effort to further improve the controls over the system. We have also started migration of FEMA to this platform. Our focus for FY 2024 is to continue modernizing our financial systems while focusing on remediation of our deficiencies in financial reporting and other areas discussed in the auditor's report.

The Department is committed to advancing our controls and remediating known challenges using a multi-year, risk-based approach.

I look forward to our continued partnership and collaboration with the Office of the Inspector General and the Independent Public Accountant in the years ahead.



OFFICE OF INSPECTOR GENERAL

U.S. Department of Homeland Security

Appendix B Report Distribution

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