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DHS FINANCIAL MANAGEMENT

Continued Effort Needed to Address Internal Control and System Challenges

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resources, and custodial activity; and related notes. Further, DHS is required, by the DHS Financial Accountability Act of 2004,[6] to obtain an audit opinion on its internal control over financial reporting.[7] A clean opinion states that in the auditors' opinion, the entity maintained effective internal control over financial reporting.

We have long held that accountability is part of the organizational culture that goes well beyond receiving a clean audit opinion on the financial statements; the underlying premise is that agencies must become more results oriented, cost conscious, and focused on internal control. A disciplined and structured approach to assessing internal control is critical to successfully implement and maintain adequate financial management oversight in the federal government.

My remarks today are primarily based on our September 2013 report on DHS financial management issues.[8] Accordingly, this testimony addresses DHS's progress toward (1) obtaining a clean opinion on its financial statements; (2) obtaining a clean opinion on its internal control over financial reporting; and (3) modernizing its financial systems, including the extent to which DHS's approach for modernizing its current financial systems was consistent with Office of Management and Budget (OMB) requirements. I will also discuss whether DHS followed certain information technology (IT) best practices while implementing its approach. For our report, we reviewed relevant DHS guidance and documents, determined whether DHS followed OMB requirements and certain industry best practices, and interviewed key DHS officials. We updated this statement for new information obtained from DHS since the issuance of our report related to DHS's schedule for completing its financial system modernization efforts. This work was performed in

[6]Pub. L. No. 108-330, § 4(a), 118 Stat. 1275 (Oct. 16, 2004).

[7]The objectives of internal control over financial reporting are to provide reasonable assurance that (1) transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in conformity with U.S. generally accepted accounting principles, and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and (2) transactions are executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements.

[8]GAO, *DHS Financial Management: Additional Efforts Needed to Resolve Deficiencies in Internal Controls and Financial Management Systems*, GAO-13-561 (Washington, D.C.: Sept. 30, 2013).

certain reconciliations and provide evidence supporting certain components of general property, plant, and equipment (PP&E), as well as heritage and stewardship assets that caused DHS's auditors to issue a qualified opinion on its fiscal year 2012 financial statements. DHS has a goal of achieving a clean opinion for fiscal year 2013. However, the auditors' report indicates that DHS continues to rely on compensating controls and complex manual work-arounds to support its financial reporting, rather than sound internal control over financial reporting and effective financial management systems.

Opinion on Internal Control

In regard to DHS's progress on obtaining a clean opinion on internal control over financial reporting, from fiscal years 2005 through 2011, DHS's auditors reported a reduction in the number of material weaknesses in internal control over financial reporting from 10 to 5 and a decrease in the number of control deficiencies contributing to the material weaknesses from 30 to 15.[12] Although the number of auditor-reported material weaknesses in DHS's internal control over financial reporting has decreased since fiscal year 2005, the largest reduction—for fiscal year 2007—was due to a consolidation of weaknesses into fewer, broader categories for reporting purposes.[13] For fiscal year 2012, the most recently completed audit, DHS's auditors reported material weaknesses in five areas related to deficiencies at eight components, including USCG.

[12]A material weakness is a significant deficiency, or a combination of significant deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a control deficiency, or combination of deficiencies, in internal control important enough to merit attention by those charged with governance. 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.

[13]For fiscal year 2007, auditors consolidated certain material weaknesses by combining (1) intragovernmental balances into the financial reporting material weakness, (2) PP&E with the operating materials and supplies material weakness and reporting the combination as capital assets and supplies, and (3) actuarial liabilities with the legal and other liabilities and reporting the combination as actuarial and other liabilities. The auditors noted that DHS had made progress during fiscal year 2007 in remediating the deficiency related to intragovernmental balances. USCG was the only DHS component that contributed to the fiscal year 2006 material weaknesses in operating materials and supplies and actuarial liabilities, but the auditors did not report that USCG had made progress during fiscal year 2007 in remediating the deficiencies within operating materials and supplies and actuarial liabilities.

been fully implemented. DHS has implemented certain IT recommended best practices that reflect key areas of effective program management, such as conducting an analysis of alternatives, establishing a governance structure, developing financial management systems baseline business process requirements, and developing a description of its current financial management environment. However, DHS had not fully incorporated other IT best practices, including developing a description of how its components' financial management systems will operate in the future—called a detailed target state—or a description of how components will transition to a new financial management environment—called a department-level transition plan.[15]

To help DHS deploy component-level integrated financial management systems, we made two recommendations to DHS regarding the need to follow best practices related to its target state and transition plan. After reviewing the draft report, DHS generally agreed with our recommendations and described actions already taken to address them. However, we believe that further action is needed to address these recommendations. Specifically, DHS has not developed other important details for its target state, such as department-level operational needs and characteristics, including the systems' availability, data flow, expandability, and interoperability. In addition, its transition strategy is missing needed elements of a transition plan, such as milestones and time frames for implementing new systems as well as the optimal sequencing of activities. Without a detailed target state and department-level transition plan, DHS has an increased risk of, among other things, investing in and implementing systems that do not provide the desired capabilities and inefficiently using resources during its financial management system modernization efforts.

With regard to the status of DHS's efforts to complete actions necessary to achieve removal from our high-risk list, in a September 2010 letter to DHS, we identified, and DHS subsequently agreed to achieve, 31 actions and outcomes, including 9 related to financial management, that are

[15]We also had two other findings and recommendations in our report related to IT best practices and the need for DHS, at the time of our review, to update its standard operating procedures and include specific procedures for (1) revising milestone dates and providing written confirmation of completed activities reflected in its integrated master schedule and (2) performing key elements of a lessons learned process. After DHS received our draft report for comment, DHS finalized its procedures to resolve these issues, and we agreed that DHS had completed actions to address these two recommendations.