MAKING FINANCIAL MANAGEMENT A PRIORITY AT THE DEPARTMENT OF HOMELAND SECURITY

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT EFFICIENCY AND FINANCIAL MANAGEMENT

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

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MAKING FINANCIAL MANAGEMENT A PRIORITY AT THE DEPARTMENT OF HOMELAND SECURITY

WEDNESDAY, MARCH 10, 2004

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY AND FINANCIAL MANAGEMENT,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2247, Rayburn House Office Building, Hon. Todd R. Platts (chairman of the subcommittee) presiding.

Present: Representatives Platts and Towns.

Staff present: Mike Hettinger, staff director; Dan Daly, counsel; Larry Brady and Tabetha Mueller, professional staff members; Amy Laudeman, legislative assistant; Sarah D'Orsie, clerk; Adam Bordes, minority professional staff member; and Jean Gosa, minority assistant clerk.

Mr. PLATTS. This hearing of the Subcommittee on Government Efficiency and Financial Management will come to order.

In the interest of time management, we are going to skip formally presenting opening statements, my own and the ranking member, Mr. Towns, who will be here shortly. We will submit those for the record.

I would quickly say that having just marked the 1-year anniversary of the Department of Homeland Security, we appreciate both of our witnesses being here and the important roles you play in the Department, on behalf of the Department personnel and certainly all American citizens. Having just concluded the audit of your first year financial statements, we also appreciate your participation in this timely hearing.

[The prepared statement of Hon. Todd Russell Platts follows:]

ONE HUNDRED EIGHTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT REFORM

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Opening Statement

Todd Russell Platts
March 10th, 2003

Just over one year ago, the Department of Homeland Security was established in response to the most devastating attack on the homeland in our Nation's history. The ability to protect our citizens from terrorism is a national priority, and DHS has risen to the challenge.

The establishment of DHS did not add new responsibilities or increase the size of government; rather it reorganized and reprioritized functions, sharpening our focus and increasing effectiveness. One of the primary reasons for the creation of the Department was to streamline processes and realize efficiencies – in short, to spend less on overhead and more on protecting America. In this light, sound financial management must be priority.

Six months ago, the Subcommittee heard from witnesses representing the Office of Management and Budget, the General Accounting Office, the DHS Office of the Inspector General, and the Office of the Chief Financial Officer. At that time, the challenges facing the Department's financial management seemed nearly insurmountable. DHS inherited 18 serious problems or "material weaknesses" identified in previous audits of legacy agencies. The transfer had taken place five months into the fiscal year, and some of the component agencies had never been audited on a stand-alone basis. Despite these known challenges, we were encouraged by what we heard. The Department was proceeding with plans to submit its financial statements to audit, forgoing an optional waiver of the requirement, and had begun work on a new systems initiative. Despite the fact that the financial team faced serious challenges, they had chosen an aggressive plan of action.

We've seen changes during these six months, including the appointment of a new Chief Financial Officer and the recess appointment of the Inspector General, both of whom will testify here today. Most important, we now have the findings of the audit – a baseline for the future. The auditor was able to issue a qualified opinion on two of the six statements. The four remaining statements received a disclaimer of opinion. The most important aspect of the audit, however, is information gained in the process. This information, if used effectively, will help DHS integrate its systems, establish effective controls, and function effectively as a single entity.

Last summer, I, along with full Committee Chairman Tom Davis, Ranking Member Towns, full Committee Ranking Member Waxman, and Vice Chair Blackburn introduced H.R. 2886, *The Department of Homeland Security Financial Accountability Act*, which would apply the provisions of the Chief Financial Officers Act to DHS. This legislation has passed the full Government Reform Committee and awaits action on the House floor.

Continued oversight and passage of H.R. 2886 are essential steps toward ensuring that DHS establishes sound business practices, enabling the Federal government to take advantage of the efficiencies and use resources effectively to protect America.

Today the Subcommittee will hear from Inspector General, Clark Kent Ervin, and the Department's Chief Financial Officer, Andrew Maner Thank you for agreeing to testify today. I look forward to hearing from each of you.

Mr. PLATTS. I think we will swear both of you in, and if any of your staff who may be guiding you or giving advice as part of the testimony will stand and take the oath as well, then we will get into your opening statements.

[Witnesses sworn.]

Mr. PLATTS. We are pleased to have the Inspector General of the Department with us. We appreciate your participation and your service to our fellow citizens at the Department. We appreciate as well having our Chief Financial Officer for the Department. Andy, thank you for being here also.

I am going to dispense with a brief bio on each of you in the interest of time if that is all right. I think we will go right into your testimony, Mr. Ervin, and then proceed to yours, Mr. Maner.

STATEMENT OF CLARK KENT ERVIN, INSPECTOR GENERAL, DEPARTMENT OF HOMELAND SECURITY; AND ANDREW MANER, CHIEF FINANCIAL OFFICER, DEPARTMENT OF HOMELAND SECURITY

Mr. ERVIN. Thank you very much, Mr. Chairman, and members of the committee, for the opportunity to be here this afternoon to discuss the fiscal year 2003 financial statement audit at the Department of Homeland Security and to provide an update on how DHS is addressing the inherent challenges involved in realigning its financial operations and addressing its financial system weaknesses. In that regard, we include financial accounting, contract management, grants management and information technology issues.

With regard to the 2003 financial statement audit, when we provided testimony to this subcommittee some 6 months ago on September 10, 2003, we discussed the financial management challenges then facing DHS. One of the larger challenges of course preparing the auditable financial statements for the Department. At that time, the fiscal year 2003 financial statement audit was already underway but the outcome was unclear. The good news under the circumstances is that the Department received a qualified opinion on its consolidated balance sheet and statement of custodial activity as you know. I say good news because with just a few very specific exceptions, we can be reasonably assured that DHS has fairly presented its assets and liabilities as of September 30, 2003 and the custodial revenues it collected over the first 7 months of operation. Those are key pieces of information needed for good stewardship and they provide an essential financial baseline for the new organization going forward.

Regarding the other statements which we call collectively activity statements, the auditors were unable to complete their procedures and thus unable to provide an opinion for reasons that I explain in my prepared statement for the record.

DHS is to be congratulated on producing its first set of financial statements for audit and for accepting the challenge last April when the Department was just establishing itself. Not only do we have a baseline for the Department's assets and liabilities but the process itself has been invaluable by providing focus on good financial management practices going forward.

With regard to audit challenges for 2004, OMB has accelerated the reporting deadline for audited financial statements and the performance and accountability report to November 15. Two major keys to success are the commitment to do so starting at the top of the organization and a detailed plan to get there. Mr. Maner has assured us that this commitment has been made and in the next week we understand that his office, Bureau financial staff, and the auditors will be holding a 2-day strategy session to plan for this.

DHS also will have to deal with problems it was unable to overcome this past year. For example, as you know, weaknesses in inventory and valuation procedures at the Coast Guard for OM&S, operating materials and supplies, must be corrected and the Office of the Chief Financial Officer must address gaps in its staffing, create standard operating procedures that will guide the bureaus and support timely and accurate reporting, and establish clear organizational roles and responsibilities.

With regard to contracts management, a major challenge for DHS is the identification and management of its procurements. Although the Department inherited procurement responsibility for 22 incoming organizations, only 7 procurement shops came into the Department. The remaining 15 components are receiving procurement services from organizations outside the Department, limiting the Department's ability to apply effective and consistent oversight to its procurements.

Under these circumstances, the Department has struggled even to prepare a detailed and accurate listing of its procurements. DHS needs to begin integrating the procurement functions of its component organizations to ensure that good management controls are consistently applied.

Also, some bureaus have large, complex and high cost procurements underway that need to be closely managed. By that, I mean the $5 billion ACE project and CBP, Coast Guard's Deepwater Project, $17 billion, taking two to three decades to complete and the U.S. visit system providing electronic entry and exit system at land, sea and airports of entry will too be a multibillion dollar program over the next 10 years. We will be reviewing all of these projects very actively.

With regard to grants management, DHS inherited a variety of grant programs that provide money for disaster preparedness and response and prevention. Significant shortcomings have been identified in many of these programs in the past and the potential for overlap and duplicate funding has grown as the number of grant programs has grown.

Furthermore, DHS program managers need to develop meaningful performance measures to determine whether the grant programs have actually enhanced State and local capabilities to respond to terrorist attacks and natural disasters. DHS has made significant strides in this area particularly in consolidating the preparedness grant programs. However, problems remain and means must be found to ensure that the first responder funds are being used effectively and getting to those who need them in a timely fashion.

IG believes that progress has been slow because DHS may have underestimated the problem of consolidating the grant management systems. About 63 fiscal year 2002 grants and more than 83 fiscal year 2003 grants were integrated into DHS and yet the Grants Policy and Oversight Office was staffed by only one full-time person for much of the past year. The problem is receiving attention in fiscal year 2004 and we will continue to monitor the Department's progress.

Finally, in the area of systems integration, DHS organizational elements have over 100 disparate, redundant and non-integrated systems used to support a range of administrative functions such as accounting, acquisition, budgeting and procurement. Because of the lack of standardization and systems interoperability in the current environment, many of these activities are tedious, manual and burdensome. To address these issues, DHS has established the eMerge2 program and we are actively monitoring that process. We understand it is scheduled for implementation by September 2006 and our understanding is the Department is on schedule for that. We will monitor it closely with regard to both cost, timeliness and most importantly, effectiveness.

Mr. Chairman, that concludes my prepared statement and I would be delighted to take questions when the time for that comes.

[The prepared statement of Mr. Ervin follows:]

STATEMENT OF CLARK KENT ERVIN

INSPECTOR GENERAL

U. S. DEPARTMENT OF HOMELAND SECURITY

BEFORE THE

COMMITTEE ON GOVERNMENT REFORM

SUBCOMMITTEE ON GOVERNMENT EFFICIENCY

AND FINANCIAL MANAGEMENT

U. S. HOUSE OF REPRESENTATIVES

MARCH 10, 2004

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to be here today to discuss the FY 2003 financial statement audit at the Department of Homeland Security (DHS) and to provide an update on how DHS is addressing the inherent challenges involved in realigning its financial operations and addressing its financial systems weaknesses. In that regard, we include financial accounting, contract management, grants management, and information technology.

Overview

Since the department's organization one year ago, it has made notable progress in the integration of legacy agencies and the development of department-wide functions. Through our work in the various bureaus and offices within the department, we have seen the roots of this new organization begin to take hold. This is happening because of the commitment and hard work of many dedicated civil servants. Still, there is much to be done.

When we provided testimony to this subcommittee six months ago on September 10, 2003, we discussed the financial management challenges facing DHS. One of the larger challenges was preparing auditable financial statements for the department. At that time, the FY 2003 financial statement audit was already well under way, but the outcome was hardly clear. Getting an unqualified opinion was the goal, albeit a very optimistic one, but the realities were that the mid-year creation of the department and its dispersed accounting providers proved too much to overcome in such a short period of time. The good news, however, is that the department did receive a qualified opinion on its consolidated balance sheet and statement of custodial activity.

I say "good news" because, with just a few very specific exceptions, we can be reasonably assured that DHS has fairly presented its assets and liabilities as of September 30, 2003, and the custodial revenues it collected over its first seven months of operations. Those are key pieces of information needed for good stewardship, and they provide an essential financial baseline for the new organization going forward. Regarding the other statements – the consolidated statements of net cost and changes in net position, the combined statement of budgetary resources, and the consolidated statement of financing - the auditors were unable to complete their procedures and thus unable to provide an opinion, for reasons I soon will explain.

DHS is to be congratulated on producing its first set of financial statements for audit and for fully accepting this challenge last April 2003 when the department was just establishing itself. Not only do we have a baseline for the department's assets and liabilities, the process itself has been invaluable in providing focus on good financial management practices. We now know where the major financial reporting weaknesses in this new organization lie, and DHS can begin to address them.

Summary of Auditors' Opinion

The Office of Inspector General (OIG) contracted with the independent public accounting firm, KPMG LLP, to audit DHS' financial statements as of September 30, 2003, and for the seven months then ended, as required by the Accountability of Tax Dollars Act of 2002. As noted above, KPMG gave a qualified opinion on the consolidated balance sheet and statement of custodial activity.

The qualification on the balance sheet and statement of custodial activity related to: (1) the lack of sufficient documentation provided prior to the completion of KPMG's audit procedures to support $2.9 billion in property, plant, and equipment at the U.S. Coast Guard (Coast Guard); (2) KPMG's inability to observe sufficient physical counts of operating materials and supplies (OM&S) at Coast Guard or otherwise verify the valuation of OM&S reported in the amount of $497 million; and (3) the lack of sufficient, actuarial documentation provided prior to the completion of KPMG's audit procedures to support retirement benefits recorded at $3.3 billion at the U.S. Secret Service (Secret Service), and post-employment benefits recorded at $201 million at the Coast Guard. However, the Coast Guard's financial statements had never been audited at the level of detail required at DHS, where Coast Guard became a larger bureau relative to its executive department. It is not uncommon for a large established agency such as the Coast Guard to require additional time to get its processes and systems in place to facilitate a financial statement audit performed at this level of detail. Similarly, even the $3.3 billion in retirement benefits at the Secret Service would not likely have been material at Treasury, where total liabilities reach almost $7 trillion. The Secret Service has obtained an actuarial report on its retirement benefits' liability, and believes it has recorded the correct amount. Coast Guard likewise has done the same for its post-employment benefits liability.

KPMG was unable to provide an opinion on the consolidated statements of net cost and changes in net position, the combined statement of budgetary resources, and the consolidated statement of financing – referred to as "activity statements" - for several reasons. First, several "legacy" agencies (agencies from which component entities or functions were transferred to DHS) submitted accounting and financial information over which DHS had limited control. Consequently, the auditors were unable to complete procedures relating to revenue, costs, and related budgetary transactions reported by the legacy agencies to DHS. In addition, KPMG was unable to complete audit procedures over certain revenues, costs and related budgetary transactions, prior to the completion of the audit.

Summary of Material Weaknesses and Reportable Conditions

KPMG reported 14 reportable conditions, seven of which were considered to be material weaknesses. "Reportable conditions" are significant deficiencies in internal controls that could adversely affect the department's ability to record, process, summarize, and report financial data. "Material weaknesses" are reportable conditions in which internal controls do not reduce to a relatively low level the risk of material misstatements in the financial statements.[1]

The following is a brief synopsis of each material weakness. Detailed descriptions of these weaknesses, their causes, and KPMG's recommendations can be found in the *Independent Auditors' Report* that is included as part of DHS' FY 2003 *Performance and Accountability* Report.

Reportable Conditions That Are Considered To Be Material Weaknesses

A. Financial Management and Personnel: DHS' Office of the Chief Financial Officer (OCFO) needs to establish financial reporting roles and responsibilities, assess critical needs, and establish standard operating procedures (SOPs) for the department. These conditions were not unexpected for a newly created organization, especially one as large and complex as DHS. The Coast Guard and the Strategic National Stockpile had weaknesses in financial oversight that have led to reporting problems, as discussed below.

B. Financial Reporting: Key controls to ensure reporting integrity were not in place, and inefficiencies made the process more error prone. At the Coast Guard, the financial reporting process was complex and labor-intensive. Several DHS bureaus lacked clearly documented procedures, making them vulnerable to the loss of key people.

C. Financial Systems Functionality and Technology: The auditors found weaknesses across DHS in its entity-wide security program management and in controls over system access, application software development, system software, segregation of duties, and service continuity. Many bureau systems lacked certain functionality to support the financial reporting requirements.

D. Property, Plant, and Equipment (PP&E): The Coast Guard was unable to support the recorded value of $2.9 billion in PP&E due to insufficient documentation provided prior to the completion of KPMG's audit procedures, including documentation to support its estimation methodology. The Transportation Security Administration (TSA) lacked a comprehensive property management system and adequate policies and procedures to ensure the accuracy of its PP&E records.

E. Operating Materials and Supplies (OM&S): Internal controls over physical counts of OM&S were not effective at the Coast Guard. As a result, KPMG was unable to verify the recorded value of $497 million in OM&S. The Coast Guard also had not recently reviewed

[1] More specifically, under standards issued by the American Institute of Certified Public Accountants, reportable conditions are "matters coming to the auditors' attention relating to significant deficiencies in the design or operation of internal controls that, in the auditors' judgment, could adversely affect the department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

its OM&S capitalization policy, leading to a material adjustment to its records when an analysis was performed.

F. Actuarial Liabilities: The Secret Service did not record the pension liability for certain of its employees and retirees, and when corrected, the auditors had insufficient time to audit the amount recorded. The Coast Guard also was unable to provide, prior to the completion of KPMG's audit procedures, sufficient documentation to support the recorded value of $201 million in post-service benefit liabilities.

G. Transfers of Funds, Assets, and Liabilities to DHS: DHS lacked controls to verify that monthly financial reports and transferred balances from legacy agencies were accurate and complete.

Other Reportable Conditions

H. Drawback Claims on Duties, Taxes, and Fees: The Bureau of Customs and Border Protection's (CBP) accounting system lacked automated controls to detect and prevent excessive drawback claims and payments.

I. Import Entry In-bond: CBP did not have a reliable process of monitoring the movement of "in-bond" shipments -- i.e., merchandise traveling through the U.S. that is not subject to duties, taxes, and fees until it reaches a port of destination. CBP lacked an effective compliance measurement program to compute an estimate of underpayment of related duties, taxes, and fees.

J. Acceptance and Adjudication of Immigration and Naturalization Applications: The Bureau of Citizenship and Immigration Services' (CIS) process for tracking and reporting the status of applications and related information was inconsistent and inefficient. Also, CIS did not perform cycle counts of its work in process that would facilitate the accurate calculation of deferred revenue and reporting of related operational information.

K. Fund Balance with Treasury (FBWT): The Coast Guard did not perform required reconciliations for FBWT accounts and lacked written SOPs to guide the process, primarily as the result of a new financial system that substantially increased the number of reconciling differences.

L. Intra-governmental Balances: Several large DHS bureaus had not developed and adopted effective SOPs or established systems to track, confirm, and reconcile intra-governmental balances and transactions with their trading partners.

M. Strategic National Stockpile (SNS): The SNS accounting process was fragmented and disconnected, largely due to operational challenges caused by the laws governing the SNS. A $485 million upwards adjustment had to be made to value the SNS in DHS' records properly.

N. Accounts Payable and Undelivered Orders: CIS and the Bureau of Immigration and Customs Enforcement (ICE), TSA, and the Coast Guard had weaknesses in their processes for accruing accounts payable and /or reporting accurate balances for undelivered orders.

Other Matters

The material weaknesses and reportable conditions cited above were identified considering their materiality to DHS' financial reporting as a whole. There are other matters significant to individual bureaus that did not rise to the level of material weakness or reportable condition at the DHS consolidated level. KPMG informally communicated these issues to financial management officials during the course of the audit. We plan to summarize these findings in a more formal document; however, with the commencement of the FY 2004 audit upon us, these issues will immediately carry forward into the ongoing audit.

Status of Prior Year Material Weaknesses

DHS inherited 18 material weaknesses from the former Customs Service, the former Immigration and Naturalization Service, the Federal Emergency Management Agency (FEMA), and TSA. KPMG determined that nine of the material weaknesses were corrected or partially corrected. The remaining weaknesses were consolidated into the seven DHS material weaknesses or reclassified to a reportable condition or other matter for management's attention. A reconciliation of the 18 material weaknesses to their current status is found in the *Independent Auditors' Report* that is included as part of DHS' FY 2003 *Performance and Accountability Report.*

Compliance with Laws and Regulations

For agencies subject to the Chief Financial Officers' Act (CFO Act), the Federal Financial Management Improvement Act (FFMIA) requires financial statement auditors to report on compliance with it. DHS is not subject to the CFO Act, and, consequently, FFMIA; therefore, KPMG did not directly report on DHS' compliance with FFMIA. However, KPMG did report significant deficiencies in the three key areas of FFMIA: financial management systems, the application of federal accounting standards, and the recording of financial transactions at the U.S. standard general ledger level. Based on these deficiencies, if DHS were subject to FFMIA, OIG would have concluded that DHS was not in substantial compliance with FFMIA. Specific areas of non-compliance are described within the material weaknesses and reportable conditions already cited.

DHS has not yet implemented procedures to ensure accuracy and completeness in its reporting process for the Federal Managers' Financial Integrity Act (FMFIA). FMFIA, as implemented by OMB Circular A-123, *Management Accountability and Control,* requires agencies to report on an annual basis material weaknesses in their controls and plans to correct those weaknesses. KPMG noted that DHS did not report some material weaknesses identified in the *Independent Auditors' Report*, nor corrective actions plans for many of the material weaknesses. KPMG also noted some timeliness and consistency issues between the bureaus and DHS headquarters.

KPMG found weaknesses across DHS in its entity-wide information security program management and in controls over system access, application software development, system software, segregation of duties, and service continuity. These weaknesses represent instances of non-compliance with the Federal Information Security Management Act, which requires agencies to provide information security for their systems. Because of the importance of system security, I am providing more details on these findings later in this testimony.

KPMG also noted that certain cost-share analyses and follow-up were not performed when the percentage of cost share funds paid/unpaid was greater than 20 percent. This is required under OMB Circular A-133, subpart D – *Federal Agencies and Pass-Through Entities* and Appendix B, *Compliance Supplement.*

Corrective Action Plans

Because DHS is not subject to FFMIA, it is not required to submit an FFMIA mandated remediation plan to OMB. However, OMB is requiring all agencies to summarize corrective action plans for all material weaknesses, not just FFMIA related non-compliance, in their performance and accountability reports. Given the short time since DHS received our audit report, DHS officials have not had sufficient time to respond to us formally with corrective action plans. Many of these weaknesses will not be fully addressed until the department and its bureaus implement information technology (IT) system solutions. OIG will be working closely with DHS officials to ensure that remedial actions are timely and complete.

Audit Process and Challenges

Now that I have discussed the audit results for DHS, I would like to share some background on how this audit was performed, challenges encountered, and challenges for the upcoming year.

Methodology

We required that KPMG perform the audit according to the General Accounting Office's (GAO) *Auditing Standards* (referred to as the "yellow book") and use *GAO's Financial Audit Manual* (FAM) as the basis for their audit procedures. The FAM requires auditors to identify key internal controls that may materially affect the financial statements and assess whether they are adequate – both in design and in operation. If the auditor finds the internal controls to be reliable, they can reduce the amount of balance and transaction testing. As a result, KPMG looked at processes related to financial reporting, such as revenue collection, disbursement of funds, PP&E, fund balance with Treasury, claims, and payroll, among others. KPMG reviewed these processes at the individual bureaus where they were significant to DHS as a whole. It was this review of key internal controls over financial reporting that led to the identification of material weaknesses and reportable conditions cited earlier.

Audit Challenges For 2003

The challenges of this audit were several. First, the mid-year and mid-quarter creation of DHS made it difficult to get good cut-off balances as of March 1, 2003; that is, beginning balances for DHS. Beginning balances are needed to audit, successfully, activity over a period of time. Many DHS bureaus had to reconstruct their balance sheets as of March 1, 2003, which was outside of their normal reporting periods. The bureaus mostly succeeded in this task; however, in the case of the Coast Guard, difficulties in conducting the audit, as described in the next paragraphs, caused KPMG to run out of time to complete its audit procedures in this area. This was a contributing factor to KPMG's inability to opine on the DHS' consolidated statement of net cost and changes in net position, combined statement of budgetary resources, and consolidated statement of financing. One of the results of this beginning balance work, though, is that it helped the bureaus and programs ensure a more complete and accurate documentation of the transfer of assets, liabilities, and budgetary authorities into DHS, which were then compared for consistency with transfers out by the legacy agencies.

Second, the Coast Guard is proportionally a larger bureau within DHS compared to the Department of Transportation, its legacy department. This brought with it proportionally more scrutiny during our audit, something for which it was not fully prepared. Its financial reporting processes were inefficient and complex. Also, because the Coast Guard had never received an audit opinion on its own financial statements (although its financial information received audit coverage specific to its legacy department's financial statement audit), auditing standards required KPMG to test certain Coast Guard balances related to prior years. The Coast Guard had not maintained certain documentation needed to support the valuation of PP&E in the net amount of $2.9 billion out of total net balance of $9.1 billion at the DHS consolidated level. Some of the $2.9 billion related to PP&E acquired prior to 1995, just when departments were starting to implement reform legislation requiring audited financial statements. Nevertheless, auditing standards required us to seek objective evidence, including estimates using documented and acceptable methodologies, to support this balance. KPMG qualified its opinion on the balance sheet for the $2.9 billion, in part, because the Coast Guard could not timely provide sufficient documentation.

The Coast Guard also had significant weaknesses related to OM&S. The Coast Guard maintains OM&S primarily as inventory to support its fleet of ships and aircraft. Because of poor controls at field sites over physical counts (procedures that verify the existence and completeness of inventory), KPMG could not validate the valuation of $497 million out of $1.2 billion net OM&S, inventory, and stockpile balance at the DHS consolidated level. Auditing standards require auditors to observe physical counts of inventories as part of their validation procedures. KPMG attempts to observe inventory procedures were made difficult in some cases because of ships being out to sea, or the Coast Guard being unable to resolve differences between the physical counts and the accounting records.

Third, financial reporting at the consolidated level in particular was a challenge. Although the large bureaus came into DHS with financial reporting mechanisms in place, those processes had to be created at the consolidated level. DHS was fortunate to be able to use the

Department of the Treasury's *Treasury Information Executive Repository* (TIER), a data warehouse that collects DHS bureaus' financial information, interfaces with other software, and prepares DHS consolidated and individual bureau financial statements. Difficulties in using TIER, however, have prevented DHS from preparing timely and accurate periodic consolidated financial statements. Most bureau financial systems are not electronically interfaced with TIER, and bureaus have had to configure their systems and processes to meet TIER submission requirements. As a result, errors continue to occur. TIER is a temporary system solution until a permanent financial reporting system architecture for DHS can be developed and implemented.

The Office of the Chief Financial Officer (OCFO) is responsible for the preparation of consolidated financial statements using TIER. The OCFO operates with relatively few finance personnel, who principally serve to coordinate financial management policy and consolidate financial information submitted by the bureaus. The OCFO has not yet established a hierarchy of financial reporting authority, or an entity-wide financial management organization chart that clearly defines roles and responsibilities and assists with the identification of critical human resources needed to ensure that all financial management responsibilities are assigned. The OCFO has not yet developed SOPs that will result in consolidated financial reports that are consistent, timely, accurate, and in compliance with federal accounting standards. These conditions were not unexpected for a newly created organization, especially one as large and complex as DHS. Nevertheless, the problems associated with TIER, the lack of clear DHS-wide organizational roles and responsibilities and SOPs, and the insufficient number of qualified personnel or contractors at the OCFO will continue to make complying with financial reporting requirements difficult.

Audit Challenges for 2004

For FY 2004, OMB has accelerated the reporting deadline for audited financial statements and the *Performance and Accountability Report* to November 15. Two major keys to success, learned from other departments that have already met this date, are the commitment to do so, starting at the top of the organization, and a detailed plan to get there. DHS' Chief Financial Officer (CFO) has assured us that this commitment has been made. In mid-March, the OCFO, bureau financial staff, and the auditors will hold a two-day planning session to map out a strategy.

DHS also will have to deal with problems that it was unable to overcome this year. Coast Guard must still obtain sufficient support for $2.9 billion in PP&E. Weaknesses in inventory procedures at the Coast Guard for OM&S must be corrected to allow for an accurate physical count at year-end. Also, accounts payable and undelivered orders--only a reportable condition this year--and other accrual type accounts will take on paramount importance. Reliable estimation techniques or other procedures will need to be developed at several bureaus to report accruals at a date much earlier than was achieved in 2003. The OCFO must address gaps in its staffing, create SOPs that will guide the bureaus and support timely and accurate reporting, and establish clear organizational roles and responsibilities.

Also, H.R. 2886, if passed, would require DHS to include in its FY 2004 performance and accountability report an assertion on internal controls over financial reporting. Management's assertion as to the adequacy of internal controls, supported by adequate documentation, testing, and reporting, is essential to a successful audit on internal controls over financial reporting. H.R. 2886 would require the auditors to provide an opinion on internal controls over financial reporting at DHS starting with the FY 2005 reporting period.

Contracts Management

A major challenge for DHS is the identification and management of its procurements (the "procurement universe"). Although the department inherited procurement responsibility for 22 incoming organizations, only 7 procurement shops came into DHS. The remaining 15 components are receiving procurement services from organizations outside of the department, limiting the department's ability to apply effective and consistent oversight to its procurements. In addition, the Chief Procurement Officer has not been granted the authority to realign existing procurement resources to meet the procurement service needs of all 22 components better. Under these circumstances, the department has struggled to prepare a detailed and accurate listing of its procurement universe. The data the department has received to date has come from 22 different sources and has not been independently validated. Although efforts are under way to bring all department procurements under the umbrella of one comprehensive reporting system, data for fiscal years 2003 and 2004 have not been reported in detail sufficient to manage the procurement universe.

DHS needs to begin integrating the procurement functions of its component organizations to ensure that good management controls are consistently applied. Several of the incoming procurement organizations have lacked important management controls. For example, during its first year of operation, the Transportation Security Administration (TSA) relied extensively on contractors to accomplish its mission, while providing little contract oversight. Contracts were written without clearly defined deliverables, and on occasion, contractors themselves were permitted to determine need and to define deliverables. As a result, the cost of those initial contracts ballooned. TSA is in the process of devising policies and procedures that require adequate procurement planning, contract structure, and contract oversight. Also, the Federal Emergency Management Agency (FEMA) has just recently discovered that it has not been reporting or tracking procurements let by its disaster field offices.

Some bureaus have large, complex, and high-cost procurement programs under way that need to be closely managed. For example, CBP's Automated Commercial Environment (ACE) system project will cost $5 billion, and the Coast Guard's Deepwater Capability Replacement Project will cost $17 billion and take two to three decades to complete. Further, in early 2004, the department will award a contract for the development of the United States Visitor and Immigrant Status Indication Technology System (US-VISIT). US-VISIT is an automated system for tracking and controlling the entry and exit of all aliens by air, land, and sea ports of entry. It is anticipated that US-VISIT will be a multi-billion dollar program implemented over the next ten years. DHS OIG will be reviewing these major procurements on an ongoing basis.

Grants Management

DHS inherited a variety of grant programs that provide money for disaster preparedness and response and prevention. Significant shortcomings had been identified in many of these programs in the past, and the potential for overlap and duplicate funding has grown as the number of grant programs has grown. For example, DHS OIG's report on the Assistance to Firefighters Grant Program (OIG-ISP-01-03, September 2003) pointed out that many items authorized for purchase under the program are also authorized for purchase under the State Homeland Security Grant Program. In addition, preparedness grant programs were located in different DHS directorates, creating challenges related to inter-departmental coordination, performance accountability, and fiscal accountability. Furthermore, DHS program managers need to develop meaningful performance measures to determine whether the grant programs have actually enhanced state and local capabilities to respond to terrorist attacks and natural disasters.

DHS has made significant strides in this area, particularly in consolidating the preparedness grant programs. However, problems remain, and means must be found to ensure that first responder funds are being used effectively and getting to those who need them in a timely manner.

Consolidation of Preparedness Grants

DHS has initiated consolidation of the two principal offices responsible for administering the grant awarding process for emergency responders and state/local coordination: the Office of Domestic Preparedness, and the Office of State and Local Government Coordination. This consolidation addresses the need to tie all DHS terrorism preparedness programs together into a cohesive overall national preparedness program. OIG applauds this effort.

The department is also in the process of creating a Grants Management Council (Council). It is intended to be a group of senior DHS managers who provide advice on issues regarding the department's grants. The Council will identify innovative approaches to promote effective business practices that ensure the timely delivery and proper stewardship of federal assistance funds. The first meeting was held in February 2004. OIG supports this effort and will participate in an advisory role.

DHS Grants Management System

DHS is faced with developing an effective, integrated grants management and accounting system. The Department is still a long way from accomplishing that objective. Grants managed by the Science and Technology Directorate (S&T), Office of Domestic Preparedness (ODP) (fire only), ICE, and the Information Assurance and Infrastructure Protection Directorate (IAIP) are processed under MOUs with FEMA. ODP (except for fire) grants are processed by the Department of Justice; TSA aviation grants are processed by the Federal Aviation Administration, port security grants by the Department of Transportation;

and S&T grants and contracts with Oak Ridge National Laboratories are processed by the Department of Energy.

The DHS Grants Policy and Oversight Office has been inventorying DHS grants, collecting the regulations and relevant laws for each, and identifying awarding offices, servicing offices, grants management systems, and administrative staff. This office was also spearheading the e-grants initiative until the DHS Resource Management Transformation Office took over that responsibility in September 2003.

OIG believes that progress has been slow because DHS may have underestimated the problem of consolidating the grant management systems. About 63 FY 2002 grants and more than 83 FY 2003 grants were integrated into DHS, yet the Grants Policy and Oversight Office was staffed by only one full-time person for much of the past year. The problem is receiving additional attention and funding in FY04. OIG will continue to monitor DHS' progress.

Systems Integration

DHS organizational elements have over 100 disparate, redundant, and non-integrated systems used to support a range of administrative functions, such as accounting, acquisition, budgeting, and procurement. Because of the lack of standardization and systems interoperability in the current environment, many of these activities are tedious, manual, and burdensome. To address these issues, DHS has established the eMerge[2] program (electronically managing enterprise resources for government effectiveness and efficiency), scheduled for implementation by September 2006. Program goals include implementing DHS-wide enterprise solutions to increase efficiency and effectiveness significantly while optimizing investments. Based upon recent OIG discussions with management officials, the program is on schedule in the design and acquisition phase, requirements have been identified, and a request for proposals has been issued for enterprise-wide solutions to meet mission requirements.

Further, the CIO must ensure that individual technology investments are aligned with an overarching, department-wide framework for IT. To this end, the CIO has a stated goal of implementing "one network, one infrastructure" by December 2005. To establish the network, the CIO has set up an Enterprise Infrastructure Board that meets periodically to discuss strategies for connecting DHS networks, which include local area networks, metropolitan area networks, and wide area networks. The Enterprise Infrastructure Board is comprised of a number of project teams, such as the Network Security Board, which is tasked with implementing an initiative to institute the firewalls, routers, switches, and other technologies needed to secure the DHS networks. DHS is enhancing ICE's backbone to create the department-wide network that establishes data communications between all of its organizational elements.

With release of the first version of an enterprise architecture in September 2003, the CIO has also made progress toward the goal of one DHS infrastructure. In December 2003, enterprise architecture officials in the CIO's office told OIG that the department had not yet issued a request for proposal to implement the enterprise architecture. Version 1 of the document outlines a very general transition strategy, but it must be detailed further for the architecture to be implemented. Work is currently under way on version 2 of the enterprise architecture. One of the objectives of the DHS enterprise architecture team is to make the transition strategy in version 2 more detailed and easier to implement.

Information Technology Controls

A key aspect of the financial statement audit was the assessment of DHS IT general controls, as IT systems significantly facilitate DHS' financial processing activities and maintain important financial data. Controls over IT and related financial systems are essential elements of financial reporting integrity. Effective general controls in an IT and financial systems environment are typically defined in seven key control areas: entity-wide security program planning and management, access control, application software development and change control, system software, segregation of duties, service continuity, and system functionality. In addition to reliable controls, federal financial management system functionality is important to program monitoring, increasing accountability of financial and program managers, providing better information for decision-making, and increasing the efficiency and effectiveness of services provided by the federal government.

KPMG found weaknesses at each bureau across all IT general control areas. Collectively, these weaknesses limited DHS' ability to ensure that critical financial and operational data is maintained in such a manner to ensure confidentiality, integrity, and availability. In addition, these weaknesses negatively affected the internal controls over DHS financial reporting and its operation, and KPMG considered them to collectively represent a material weakness, as mentioned earlier.

The challenge of merging numerous entities into DHS is a key contributing factor to these weaknesses. These various entities have had their own IT functions, controls, and processes. DHS has taken some steps to begin addressing these issues, such as implementing the *Information Technology Security Program Publication*, which contains many requirements for maintaining a DHS-wide information security program. In addition, DHS is currently designing a department-wide IT architecture, as mentioned above. Until the architecture is complete and the related IT infrastructure, controls, and processes are implemented, DHS' IT control environment will continue to primarily consist of the IT processes and controls in place at the entities that were consolidated into DHS.

We believe that to address these weaknesses DHS needs to design and implement DHS-wide policies and procedures related to IT controls, and to ensure that the policies and procedures are enforced through the performance of periodic control assessments and audits. Focus should be made on implementing and enforcing a DHS-wide security certification and accreditation (C&A) program, and IT training for administrators and users. Many of the technical issues identified during this review, such as weak technical security controls and the lack of contingency planning strategies, can be addressed through an effective C&A and training programs.

Conclusion

Mr. Chairman, this concludes my prepared statement. Please be assured that our office will continue to place a high priority on these issues. Again, I appreciate your time and attention and welcome any questions you or members of the Subcommittee might have.

Mr. PLATTS. Mr. Ervin, thank you for your oral testimony here today as well as the extensive written testimony you shared with us. That was very helpful as we prepared for today's hearing.

Mr. Maner, I will turn to you next and thank you for your service. As we shared notes as dads of young children who are putting in a lot of hours, you and me and not our young children, I appreciate your service to our Nation as well.

Mr. MANER. Thank you, Mr. Chairman and members of the subcommittee, for the opportunity to be here and discuss the progress of DHS in the area of financial management. Let me also say thank you to the Congress and specifically this subcommittee for its continued interest, commitment and assistance to us in this area. I think we all agree that this area is critical to our overall future mission success of DHS.

While I was only appointed as CFO in January, I have been part of DHS since its inception serving at U.S. Customs and later at CBP as its Chief of Staff as well as its Director of Transition Management, managing the largest reorganization within DHS. Adding this to my business education and experience in the private sector, I think has given me the benefit of seeing the DHS successes and many challenges it faces from different angles.

I am keenly aware of the importance of sound financial management practices to the overall successful management and the importance and impact decisions made at the Department level have on Bureau operations and vice versa. I am personally driven daily by the need to provide a base for financial management goals, practices and systems that will aid the Department for decades to come and am energized by the opportunity to help lead DHS in this endeavor.

Last week, as you mentioned, we celebrated our 1 year anniversary. I think all of us at the Department are very proud of the progress that we have made in the past 12 months. Specifically in my office, I am very encouraged by the accomplishments of last year but more so the goals we have created for ourselves this year. We have made tremendous headway in unifying and strengthening the Department's financial management, accounting, budgeting, strategic planning, performance measurement processes and systems, all the while dealing with the enormous challenges involved in standing up the third largest department in Government.

In September of last year, my predecessor, Bruce Carnes, testified before you on a similar subject and I am pleased to report that in many of the areas you spoke, much progress has been made, either projects have been completed or are well underway in implementation.

In the past year, we streamlined the number of financial management service providers in the Department from 19 to 10. We are implementing a consolidated bank card program that is reducing the significant number of bank card programs for purchase, travel and fleet throughout the Department down to about three. We developed and delivered to Congress on time our President's 2005 budget and accompanying CJ's. We instituted and recently collected preliminary data for the Department's 5 year budget and planning process which is known as the FYHSP which will be coming to the Hill at a later date. We subjected ourselves to and completed an audit of our consolidated fiscal year 2003 financial statements. We submitted our first strategic plan to Congress and continued the work in perfecting a robust investment review and joint requirements process.

We have made great strides in our attempt to build one resource management system known as eMerge2 which will link all these initiatives and processes in the future. Most importantly, all this has been accomplished with little or no negative impact mission operations.

While we have much to be proud of, much remains to be done and we have big goals in 2004. We will continue to focus on the people, processes and systems in the areas of financial management systems and programs analysis and evaluation. The year 2003 was the year for the vision and design of our processes; 2004 is the year to operationalize and improve them.

In 2003, one of our greatest accomplishments was that only 2 months after our creation, DHS took on the challenge of subjecting ourselves to the rigors of a consolidated financial statement audit. More noteworthy was the ability to pass the scrutiny of an audit to the extent necessary to support a qualified opinion on our September 30 balance sheet. The 2003 audit was paramount for the Department to have a basis for improvement in 2004. Although the audit identified 7 material weaknesses, this was a substantial improvement over the 18 material weaknesses that were inherited from our component agencies. This means that nine material weaknesses were either corrected or partially corrected. The rest were consolidated into seven. Nevertheless, we are committed to resolving these remaining weaknesses in 2004 and have set forth an aggressive plan to do so. Within 30 days, corrective actions will be developed by each bureau and submitted to my office. We will also implement a DHS-wide tracking system to monitor the corrective action status. Starting next month, we will closely monitor the status of corrective actions through quarterly clean action plan meetings with each bureau or entity that has substantial or outstanding weaknesses.

Additionally, we have taken steps early in the year, as my counterpart said, including an all hands offsite meeting next week with all the components to get ready for our November 15 close.

Good financial management is not just about accounting though. Essential to sound financial management is a robust financial management system. When DHS was created, we inherited over 100 resource management systems, few of which were integrated and many of which had limited functionality. To address this problem, the Department has undertaken a resource transformation initiative entitled eMerge2 that will consolidate and integrate our budgeting, accounting, reporting, cost management, asset management and acquisitions and grants functions. As eMerge2 is implemented over the next few years, it will greatly enhance our visibility oversight and accountability. The year 2004 will be a watershed year for eMerge2 as we move to assess requirements, prioritize and schedule the rollout and procure and pilot a solution.

In closing, I would like to thank the committee again for the opportunity to appear before you today and assure you the Department and I are committed to achieving the goals we have established. We have already made good progress under challenging circumstances and I commend the experience and dedicated staff with whom I work. Now with a strong, growing and motivated staff, coupled with the continued support of DHS, OMB and Congress, I am confident we will realize even greater progress this our second year.

That concludes my statement and I would be happy to answer questions.

[The prepared statement of Mr. Maner follows:]

Statement of Andrew B. Maner
Chief Financial Officer
Department of Homeland Security
Before the House Government Reform Committee
Subcommittee on Government Efficiency and Financial Management
March 10, 2004

Thank you Mr. Chairman, for the opportunity to be here and discuss the Department of Homeland Security's progress in the area of financial management. I would also like to thank Congress, and specifically this subcommittee, for its commitment to assisting DHS in this critical area.

While I have only been in my job as Chief Financial Officer for 2 months, I have been part of DHS since its inception; serving at U.S. Customs as its Chief of Staff since early 2002. Adding this experience to my previous business education and experience in the private sector, I am keenly aware of the importance of sound financial management practices to overall successful management and the importance decisions made at the department level have on bureau operations and visa versa. I am driven daily by the need to provide a base of financial management goals, practices and systems that will aid the Department for decades to come and am energized by the opportunity to assist our leadership in this endeavor.

Last week at DHS we celebrated the one-year anniversary of the Department. All of us at the Department are very proud of the progress we have made in these past twelve months. Specifically, in the Office of the CFO, I am very encouraged by the accomplishments of last year and the goals for this year. While dealing with the enormous challenges involved in standing up the 3rd largest Department, we have still managed to make tremendous headway in unifying and strengthening the Department's financial management, accounting, budgeting, strategic planning, and performance measurement processes and systems.

In the past year, we streamlined the number of financial management service providers in the Department from nineteen to ten. We are implementing a consolidated bankcard program that is reducing the significant number of bankcard programs for purchase, travel, and fleet throughout the Department among the 22 legacy entities to three. We developed and delivered to Congress on time, the Department's FY 2005 President's Budget and accompanying Congressional Justifications. We instituted and recently collected preliminary data for the Department's five-year budget and planning program. We subjected ourselves to and successfully completed an audit of our consolidated FY 2003 financial statements. We have also made strides in our attempt to build one financial system for the Department. We submitted our Department's first Strategic Plan and we continued to work in perfecting a robust investment review and joint requirements process. Most importantly, all of this has been accomplished with no negative impact on mission operations.

While we have much to be proud of, much remains to be done. Like my predecessor, Bruce Carnes, who should be commended for the outstanding leadership and vision he provided the Department at a key time, I am committed to four overall management goals:

- Increase efficiency and effectiveness by producing financial data that is timely, reliable, and useful to decision makers;
- Strengthen accountability by ensuring that internal controls are in place across the Department and appropriate oversight reviews are conducted;
- Manage costs by consolidating functions, systems, and processes and by instituting best business practices; and
- Achieve results through the use of rigorous planning, measurement and evaluation processes.

To carry out these goals, we will focus on the people, processes, and systems in the areas of financial management, financial systems, and programs, analysis and evaluation. I would like to take this opportunity with you here today to tell you where we are and where we are going in our drive towards achieving these goals and in making DHS the model of management excellence.

Financial Management

One of our greatest accomplishments is that only two months after its creation, DHS took on the tremendous challenge of subjecting ourselves to the rigors of a consolidated financial statement audit. The challenges were complicated by the obstacles in coordinating the efforts of 19 separate and distinct accounting offices and the unfamiliarity of several bureaus in facing audits for the first time. The Office of the Chief Financial Officer designed and implemented the methodologies and controls necessary to produce consolidated statements. In the span of two months, the Department was able to submit quarterly financial statements to OMB. This demonstrated an ability to comply with the full gauntlet of requirements outlined by OMB for consolidated financial statements. The Department successfully completed the audit and submitted the Performance and Accountability Report (PAR) to OMB. More noteworthy was the ability to pass the scrutiny of audit to the extent necessary to support a qualified opinion on the September 30 balance sheet. The 2003 audit was paramount for the Department to have a basis for improvement in 2004. Although the audit identified seven material weaknesses, this was a substantial improvement over the 18 material weaknesses that were inherited from the DHS components' legacy agencies. This means that nine material weaknesses were either corrected or partially corrected. The rest were consolidated into seven. Nevertheless, we are committed to resolving these remaining weaknesses and have set forth an aggressive plan to do so. By March 31, 2004, corrective actions will be developed by each applicable bureau/office and submitted to the OCFO. We will implement a DHS-wide tracking system to monitor the corrective action status. And, commencing April 2004, we will monitor the status of corrective actions through quarterly Clean Action Plan (CAP) meetings with each bureau or entity that has outstanding material weaknesses.

I am also confident that DHS is taking the proper steps now to submit its FY 2004 PAR, including audited financial statements, by the accelerated due date of November 15, 2004. This year's effort will benefit from the methodologies developed and lessons learned from the first year audit. Many bureaus that faced audits for the first time in FY 2003 have made major strides in upgrading their systems and training their staff in dealing with the rigors of the audit. We have also centralized and automated many of the consolidated monthly reporting requirements. This will yield substantial economies of scale and will free up bureau accounting personnel for other PAR activities.

Financial Systems

Essential to sound financial management is a sound and robust financial management system. When DHS was created, we inherited over 100 resource management systems from the 22 agencies that were merged to create DHS. Few of these systems are integrated, several are outdated and many have limited functionality. To address this problem, the Department has undertaken a resource transformation initiative entitled ***eMerge***^{2}. The goal of ***eMerge***^{2}, which stands for *"electronically Managing enterprise resources for government effectiveness and efficiency"*, is to improve resource management and enable the bureaus to move "Back Office" effectiveness and efficiency to "Front Line" Operations. ***eMerge***^{2} is a business-focused program that seeks to consolidate and integrate the Department's budget, accounting and reporting, cost management, asset management, and acquisitions and grants functions. Once procured and developed, the solution will be rolled out in several phases focusing first on those organizations most in need of improved basic financial management services. ***eMerge***^{2} is currently in the midst of an exhaustive requirements definition and design phase, which is expected to evolve into a solutions acquisition phase this summer. As ***eMerge***^{2} is implemented over the next few years, it will greatly enhance Departmental visibility, oversight and accountability of component operations and financial management.

Programs, Analysis and Evaluation

Sensible financial management requires informed financial and management decisions. To ensure policy decisions are made based on sound rationale, such as a program's contribution to our strategic goals and measurable results, DHS has put in place a comprehensive planning, evaluation, and investment review process.

At the core of this process is the Future Years Homeland Security Program FYHSP. Section 874 of the Homeland Security Act of 2002, requires the Department to prepare the FYHSP. The FYHSP will ensure current and out year program requirements are properly planned, identified, aligned with DHS goals and priorities and have measurable meaningful performance outcomes. The Department's first FYHSP will be provided to Congress this spring.

In addition, the Department's first high-level Strategic Plan was released in February. This Strategic Plan sets forth the vision and mission statements, core values, guiding principles and strategic goals and objectives that provide the framework to guide the actions that make up the daily operations of the Department. The Department's FY 2005 budget request is tied to the strategic plan and provides annual performance measures for each agency.

Holding managers accountable for achieving established goals and results is integral to DHS's financial management and planning. Towards this end, the performance budget forges a strong link between resources and performance, shows what is being accomplished with the money being spent, and establishes accountability for the levels of performance achieved. The Program Assessment Rating Tool (PART) complements the performance budget by providing the Department an objective means of assessing the value and contribution of individual programs to achieving the Department's objectives. It also provides a tool for assessing how the program is being managed.

In the past year, an Investment Review Board (IRB) and Joint Requirements Council (JRC) were established and their structures refined to ensure the proper identification, prioritization and evaluation of cross-cutting investment opportunities both within and outside the Department and to ensure optimal allocation of resources. Specifically, the IRB and JRC review major capital investments to:

- Integrate Departmental priorities, resource planning, investment control, budgeting, acquisition, and investment management to ensure resources are wisely used.
- Ensure that spending directly supports and furthers DHS's mission and provides optimal benefits and capabilities to stakeholders and customers.
- Identify poorly performing programs and investments so corrective actions can be taken.
- Identify duplicative efforts for consolidation and mission alignment when it makes good sense or when economies of scale can be achieved.

H.R. 2886, Department of Homeland Security Financial Accountability Act

Like many others, I appreciate and applaud the objectives of H.R. 2886, the "Department of Homeland Security Financial Accountability Act" and the companion Senate bill, S. 1567. As the CFO of DHS, I commend all relevant efforts by the executive and legislative branches to make our controls tighter and to provide financial managers better tools to complete our mission more efficiently and effectively.

That said, I do believe that much of what is contemplated in the legislation may not be critical or necessary to DHS at this juncture. The current design and mandate of my position and the office that I manage, some of which was set out in the Homeland Security Act, is working very effectively and I believe should be given time to work. I also believe that this legislation will not alter the way in which I perform my job, nor will it provide me any tools, reporting structures, or authorities that I do not have today. Today, DHS complies with the provisions of the Chief Financial Officers Act of 1990 and will continue to do so.

One provision I would like to discuss specifically, which the House is considering and the Senate included in S 1567, is one that would require an audit of the Department's internal controls beginning in 2005. There are several factors that lead me to believe that this should not be mandated in this legislation at this time. They include:

- Such an audit would be costly in dollars and staff time and would not bring the level of benefits to the agency that it might be intended to provide.
- DHS still receives financial management and payroll services from several external sources that would not be included in such an internal controls audit. Examples include: much of DHS payroll services are provided by the National

Finance Center; the Bureau of Public Debt provides financial management for the DHS Inspector General; and the Department of Justice provides financial management for the Office of Domestic Preparedness.

- DHS continues to realign its resources into an organization structure that will efficiently utilize its resources. Examples include: major components of the Directorate for Border and Transportation Security and the U.S. Citizenship and Immigration Services are reconfiguring the assets and personnel of legacy Immigration and Naturalization Service and the U.S. Customs Service; the Federal Air Marshals are in the process of transferring assets and personnel from the Transportation Security Administration into ICE; and the Department is requesting approval to transfer the Strategic National Stockpile back to HHS.
- The current audit of financial statements includes testing of internal controls to the extent necessary to support an audit opinion on the statements. The financial statement testing will identify material weakness in internal controls and other reportable conditions related to financial reporting. I believe consideration should be given to postponing the effective date of this Act until after a cost benefit analysis is conducted to determine if the benefits of an audit of internal controls is justified by the extra costs incurred to conduct the audit.

Closing

In closing, I would like to thank the Committee again for the opportunity to appear before you here today and assure you that the Department and I are committed to achieving the goals we have established. We have already made great progress under challenging circumstances. Now, with a strong, growing and motivated staff and the continued support of DHS leadership, OMB and Congress, I am confident we will realize even greater progress in this, our second year of the Department.

I would now be happy to answer any questions you may have.

Mr. PLATTS. Thank you, Mr. Maner.

I would like to recognize we have been joined by our ranking member, Mr. Towns, from New York. Thanks for being with us.

I submitted opening statements for the record, if you would like to do the same?

Mr. TOWNS. Yes.

[The prepared statement of Hon. Edolphus Towns follows:]

Statement of Congressman Ed Towns
Subcommittee on Government Efficiency and Financial Management

March 10, 2004

Thank you Mr. Chairman for holding this hearing today on ways in which we can improve the financial management of the Department of Homeland Security. I am hopeful that today's witnesses can shed some light on progress being made towards that goal.

Although still in its infancy and only beginning to meld 22 disparate agencies into one organization, DHS has the same responsibilities as other agencies to prevent waste, fraud, and abuse, while ensuring financial accountability to both Congress and the American people. Meeting these goals requires establishing systems, processes, and controls that will preserve effective financial management throughout all of its legacy agencies. This must remain a top priority for DHS due to the many financial management problems displayed at these agencies over the years.

The first annual audit of DHS should be viewed as a blueprint for the Congress to determine the inefficiencies and mismanagement that is present throughout the component agencies of the Department. While the Department received a disclaimer for its financial audit during 2003, it provided us an opportunity to identify areas of lax fiscal and operations management, particularly at agencies such as the Coast Guard and the new Transportation Security Administration. In addition, we now have a better understanding of deficiencies due to the lack of established roles and responsibilities for sound financial management, personnel practices, and secure information technology systems, especially in a new organization of nearly 180,000 employees.

We should also commend DHS for adhering to the requirements of the CFO Act by submitting to an annual audit. It does not escape me that the next logical step in bringing responsible fiscal and operational management to DHS is by bringing them under the CFO Act umbrella through legislation passed by this Subcommittee last September. This new cabinet Department combined various agencies of different missions, has one of the largest budgets in the federal government, and provides our nation with the domestic security that is necessary for the many services we depend upon daily. To exempt its CFO from the requirements faced by other federal CFOs is shortsighted in both theory and in practice. The Congress ought to move quickly in remedying this oversight.

Mr. Chairman, this concludes my statement. I look forward to hearing from our witnesses on these and other matters.

Mr. PLATTS. We will get right into questions and hopefully will have 25 to 30 minutes and see where we are if the bells go off at that point for votes and play it by ear as that happens.

I would like to start Mr. Maner with you. We have talked previously and this committee has been working with your predecessor, Bruce Carnes, and others at the Department on the issue of the structure of DHS as it relates to the Chief Financial Officers Act and how financial management is being prioritized at the Department.

Congress in various ways in the 1980's and into the 1990's, said that the executive branch agencies were not making good financial management practices a priority in the Congress' eyes, so put a structure in statute to ensure better focus on these important issues on the expenditure of tax dollars.

When we created the Department in the final version the Department was not brought under the CFO Act. I appreciate your statement in your testimony that today DHS complies with the provisions of the Chief Financial Officers Act of 1990 and will continue to do so. Mr. Carnes said the same when he testified before us 6 months ago but as I pursued with him, you actually are not following the CFO Act in all the requirements of it and that relates to the structure of it. I would like to explore some aspects of that.

The reason I am focusing on it today and will continue to focus on it really goes to your second paragraph, and I commend your approach, where your daily efforts are about ensuring a base of financial management goals, practices and systems that will aid the Department for decades to come. To me that is what Congress sought to do through statute, that for decades to come all departments and agencies of this magnitude had a structure in place. That is what my bill which would bring the Department under the CFO Act seeks to do.

As an example, start with the structure of your office and how it relates to the Secretary. One of the things Congress said they thought was important was direct communications from the CFO to the Secretary so there is no opportunity for miscommunication, lack of information, that the ultimate decisionmaker, the Secretary, has everything they need to ensure good financial practices.

I don't believe you report directly to the Secretary. You report to Under Secretary Hale, I believe?

Mr. MANER. That is right.

Mr. PLATTS. Why do you feel comfortable saying that you are complying with the CFO Act if you really aren't reporting directly to the Secretary as the act requires?

Mr. MANER. Again, I guess there is reporting on an org chart and then there is reporting in reality and I guess like my predecessor, I have only been in the job about 60 days but I have really unfettered access to the Secretary. Using a number of things in my office that we have done to date, first the 2005 budget, then the audit, now the FYHSP, I enjoy unfettered access to the Secretary and that is something he and I have discussed. So in terms of access and his commitment to financial management, I feel we are in compliance, but you are right, by definition of the CFO Act, we are not there directly. I do report through Under Secretary Hale. This was a structure that was laid out as you said in the legislation that created the Department. It is a structure that is working. It is a structure that allows me to work with Under Secretary Hale and she has all of the chiefs reporting to her, the Chief Procurement Officer and some of the other Chiefs. That makes for a tight grouping as well to be with my peers, the Chief Procurement Officer and others. So that has worked well.

Mr. PLATTS. I will say up front, having had the privilege of serving with Secretary Ridge in his position as Governor, I have absolute great respect. His record of public service both in uniform as a decorated veteran and in State and Federal Government, a prior Member of Congress, Governor and back here as Secretary, is remarkable. He and his family have sacrificed tremendously for the good of all American citizens. I don't doubt, and I think much of what he and you and others at the Department are doing are good faith efforts at good financial accountability, but there is a difference between unfettered access and reporting day in and day out or week in and week out directly to him. Saying I can go to him if I need to versus my daily or weekly, my periodic updates are directly to him, I believe from your answer I am taking that your regular updates are to the Under Secretary as far as updates on where things stand with the audit. You are not giving that same regular, periodic update to the Secretary but to the Under Secretary. Is that right?

Mr. MANER. That is correct.

Mr. PLATTS. That is contrary I believe to what the Congress intended. They wanted the Secretary to regularly hear directly from the CFO. That is the intent of the CFO Act. When they passed the Integrity Act in 1982 and tried to reform the management practices, Congress decided we didn't get it right and came back 8 years later and said, we are going to get it right and for every Cabinet level department but the Department of Homeland Security, we require it. That is but one example. The fact that you are not required and not fulfilling the requirements of the Federal Financial Management Improvement Act. You are not doing that and that is a requirement of the CFO Act, so again it seems inappropriate to say that you are complying with the CFO Act if that is an important part of it.

Can you give an explanation of why you feel comfortable saying you are in full compliance?

Mr. MANER. Again, I agree with your point and while I meet daily, many times daily with the Under Secretary, like any Secretary, he has demands on his time and when we have an issue we believe he needs to hear, know about and be updated on, we go and see him about that and enjoy that access.

Mr. PLATTS. My hope is with passage of the bill that as Congress sought to ensure that level of interaction between you and the Secretary as opposed to you and the Under Secretary, it becomes the norm. I think it also diminishes the perceived focus on financial management because of the position you hold not being a Senate-confirmed position. In the hierarchy of Washington, it is viewed as the level of authority you are given. I appreciate your vast private sector experience and the public experience you brought from Customs, but it is seen from a different level than a Senate-confirmed appointee as far as the hierarchy and the weight we are giving to your role.

I raise that to start because I think for us to have a frank discussion I am very comfortable with you and anyone from the Department saying we believe we fulfilling the intent of the CFO Act. But when Mr. Carnes testified 6 months ago and you today, I am not comfortable with saying we are complying with the act when in fact you are not. We should acknowledge that and move forward and have a more frank discussion.

I have more specifics but I want to give Mr. Towns a chance to jump and we will go from there.

Mr. TOWNS. Thank you very much, Mr. Chairman.

This question I would like to ask both of you to respond. Can you tell us what specific actions you have taken to address the inadequate controls over security screener contracts at the Transportation Security Agency in the past year? Apparently inadequate monitoring of contracts allowed contractors to charge TSA up to 97 percent more than the contractors charged air carriers prior to Federalization. Do you know how much money was lost through this overcharging and whether the Department has made an attempt to recover the funds?

Mr. ERVIN. I would be happy to start, sir. We are very much involved, the Office of Inspector General, in looking at the NCS Pearson contract. At this point we don't have an exact dollar figure with regard to what the potential overcharge might be but we do know that based on the audit work that has been done, both by the Office of Inspector General and by DCAA, the Defense Contracting Auditing Agency with which we are working very closely, the range started at $100 million and now we are up to around $700 million or so.

The problem there is the contract was not definitized, which is to say that the terms of the contract were not set before it was let. There wasn't due oversight on TSA's part with regard to that contract and so in partnership with DCAA or working with DCAA, we are trying right now to sort out all this and figure out what the terms were, and figure out what the costs were.

Mr. MANER. Congressman Towns, I have not much more to add on that. We are very aware of the issue and we have met with TSA from my angle which is the financial angle about various weaknesses, both material and management controls, this being one of those that was identified. We spoke of it as recently as 2 days ago but I can't provide you any further update on that. From a procurement standpoint, I would want to have procurement expertise in the room as well.

Mr. TOWNS. So you don't have any idea in terms of how much money we are talking about?

Mr. MANER. We don't have any idea at this time.

Mr. TOWNS. Mr. Maner, one of the challenges identified in creating a coherent financial management system for the Department of Homeland Security is developing a centralized blueprint of financial management for all of the component agencies under DHS. Can you update us on the progress being made in integrating the 22 agency components into the cohesive and operational financial management system? What are the major financial management issues that remain from the integration of DHS?

Mr. MANER. First of all, in order to stand up a cohesive financial management structure, we have to develop and implement and document standard operating procedures for our component parts and agencies. In our first year, as we developed and went through our audit and certain aspects of it, we were doing things for the first time, we were issuing guidance, direction of how we wanted to do things for the very first time. In the fact we have completed our audit, we are now moving into the area of documenting a lot of these policies and procedures. The first thing we want to do is document so that these policies can outlast people that come and are steadfast. That is probably the first area in which we have tried to focus.

The second area that we tried to focus is on financial systems. I think any agency head, any CEO in the private sector realizes that in order to have true financial management, you need to have visibility into your financials, your grants data base, your procurements and you need to have one system or one suite of systems that does not. The second area we have given great focus is systems and eMerge2 is underway to move to a consolidated resource management system which encompasses all the way from budget to cost accounting to procurement and grants management and asset management. That is a medium and long term goal that we have undertaken.

However, in the short term, we also need to find quick wins so we are not just waiting 2 years from now for this system to roll out. We have closed down or consolidated a number of accounting offices, thereby consolidating the number of systems we use. We are also developing and starting a data warehouse so that before the system is rolled out we at least have one visual end to all of our information.

To answer your question, first is to set out standard operating procedures for our entities. They all came from different levels of rigor in financial management, different levels of systems, so we want to level the playing field and second, turn to the systems. Those are the two primary focuses at this time.

Mr. TOWNS. How long do you think it is going to take, approximately?

Mr. MANER. To get to a standard set of practices and systems?

Mr. TOWNS. Yes.

Mr. MANER. I think on the systems side, it will take us probably into 2006–2007 to have a really standard system where we have all of our agencies. However, because we have certain agencies and components that are already doing a lot of good things, we want to set the vision for them and start to meet it. Completion, frankly, I don't think you are ever complete with financial management but on the systems side, probably 2006 or 2007.

Mr. TOWNS. Thank you, Mr. Chairman.

Mr. PLATTS. Mr. Maner, as I pointed out in your opening statements and in your statements to Mr. Towns, you actually helped make the case of what I am trying to do through statute. Your statement was you are trying to put "policies that outlast people as they come and go and replace policies with statutory requirements.” That is exactly what we are trying to do, so it is not based on who is or is not there but good sound financial management. I think that is what my predecessors wanted and again, that is what we are trying to do.

In the Inspector General’s testimony relating to the structure, and I would ask you about this appreciating you have been in your role for roughly 60 days but the Department is now a year old. The Inspector General in talking about the structure said, “The Office of Chief Financial Officer has not yet established a hierarchy of financial reporting authority or an entity-wide financial management organization chart that clearly defines roles and responsibilities and assists with identification of critical human resources needed to ensure that all financial management responsibilities are assigned. The OCFO has not yet developed standard operating procedures that will result in consolidated financial reports that are consistent, timely, accurate and in compliance with Federal accounting standards.” It goes on to say, “These conditions were not unexpected for a newly created organization, especially one as large and complex as DHS.”

I agree, not unexpected and challenges that are significant but given that we are now a year into it, where do we stand. Are we still without SOPs, without a Department-wide financial management infrastructure and the hierarchy being delineated? Early on I believe that would be understandable but a year in, because both of those issues really go to that foundation you start with as you then build a good financial management system, having that hierarchy delineated and having the SOPs in place. Could you tell us where we stand today?

Mr. MANER. Mr. Chairman, I think that we are on a journey as we talked about toward perfecting our financial management practices and we want to continually make steps to get there. One thing I would point out is that the Department is new, is a year old and many of the entities within the Department are as old as 214 years, so there are big portions of the Department that are not new and not in a startup mode as relates to financial accountability and management.

In terms of a lot of our work, we have some components that are doing great work and have done great work and are working on material weaknesses and the only thing we need to “guide and put out” are our SOPs on how to deal with the new department. Customs knew how to deal with Treasury, the old INS knew how to deal with Justice, so that is our role. We will be putting that out this spring on how to deal with us from an audit and financial management standpoint.

We are not starting from scratch and I think that is important to note. However, over time and with our use of bodies like the CFO Council that I chair within Homeland, we are working through all of our issues which relate to financial management and accounting, the eMerge2 project and financial systems, so we have had a great track record of getting together, solving problems, getting together to listen to how our bureaus do things so that we are not starting from scratch. We have a lot of very good practices within Homeland Security that I want to make sure we don’t just throw out. I have asked our managers to be careful and be thorough but we do need to get our SOPs out, especially if we expect to do things like an early close for November 15.

Mr. PLATTS. It would seem the fact that you are not starting from scratch, it is all the more important to have an entity-wide hierarchy in place because you have all these CFOs and the component entities that are coming from different departments, reporting to different people in a different way, all the more you would want to have that up front so that you have uniformity.

As we saw with the Federal Government's financial statements in total, because of one particular component, DOD, we can't get a clean opinion on the big picture. When you bring that down to the department level, unless all your entities are working on the same page and understand who has the responsibility and authority within the Department across the board, it is going to be that much harder to get to the goal line of a good reporting process in place.

To me the things you said are all the more reason why up front and not 12 months later we are still talking about trying to get there. We should have gotten there first and then moved forward. Some of that goes to your predecessor and Mr. Carnes isn't here to answer why he didn't prioritize that and you would have inherited that already in place.

Mr. MANER. Mr. Chairman, I don't want to lead on that we are not considering that a priority. Again, we inherited a lot of agencies at different places in their financial management. What I mean by that is we have startup organizations, IAIP, SNT, who are going up a learning curve. We have some agencies that pieces of them came over from Justice and we have others that came over in total. So we have different people at different phases of the spectrum.

We have had to give our attention to those at different levels, so I think we have done a good job of bringing them together. The Department is still considering more rigorous capitalization plans where maybe there needs to be a more formalized reporting chain for various financial management people through the Office of the CFO and we are looking at that but that hasn't hampered me. I can't speak for my predecessor. These are attentive bureaus who want to solve problems, who judge themselves on how they are doing financial management, Coast Guard, Customs take it very seriously. So I don't want to lead on that structure is not important.

Mr. PLATTS. Let me ask you specifically how it is working for you. The CFOs and the component entities, are they reporting directly to you and through you to the Under Secretary, are they also able to report directly to the Under Secretary regarding issues you are trying to implement?

Mr. MANER. The financial people within the bureaus?

Mr. PLATTS. Yes.

Mr. MANER. We have had a relationship to date where I chaired and my predecessor chaired the CFO Council which would be usually the CFO of an agency.

Mr. PLATTS. Was it also to the Under Secretary? It is a delineated authority down to you, you to Under Secretary Hale?

Mr. MANER. There is no organization chart at present that lays out the reporting structure. Right now a CFO of a bureau reports to their bureau head or their assigned person and we consider it to be a dotted line to me but it is not formalized.

Mr. PLATTS. Mr. Ervin, that is where maybe I bring you in. That seems to be one of the concerns you raised, that it is not formalized, that there is uncertainty about the reporting line of authority and who has what authority regarding the financial hierarchy as well as the SOPs. If you could expand on your written testimony in those two specific concerns you raised and whether you believe that getting the standard SOPs and hierarchy in place, the sooner the better, how critical that is or isn't to the big picture?

Mr. ERVIN. Absolutely, Mr. Chairman. I would be happy to expand on that. There are a number of things to be said, so let me start.

I think it is absolutely critical that the organization chart be formalized to make it clear who does what and who reports to whom. With regard to the Office of the Chief Financial Officer, the staffing of that office so as to oversee the overall financial services enterprise, for want of a better term, is also very important.

There are relatively few, fewer than 10 as we understand it, accountants in the Office of the Chief Financial Officer to oversee the process of consolidating this financial information from 10 different accounting service providers, 4 of which are outside the Department. That leaves little if any time for the people in the office of Chief Financial Officer to oversee the data that comes in, to develop analytical procedures, to test for data integrity. Also to develop the expertise in-house, it is necessary to oversee the reporting complexities in an entity as large and as complex as DHS. That is one thing in addition to the organization chart. The standard operating procedures which both you and Mr. Maner mentioned, it is absolutely critical that those be formalized as quickly as possible, particularly given the accelerated reporting schedule. We understand the Department is considering whether contractors should be brought in either to do that or to help supplement the process of doing it. It doesn't matter to us whether it is contractors or full-time personnel, those standard operating procedures absolutely must be formalized.

Further, the whole issue of control. Mr. Maner, to be fair to him as he said and as you know, has been on board only for 2 months or so and he is in the process, as he tells us, of developing relationships with the various component CFOs and obviously relationships are very important. I don't doubt for a second that there is cooperation from those component CFOs but ultimately as he acknowledged, they report to the head of their respective bureaus and not to him.

We think that direct organizational chart reporting where he has the power to hire and fire, he writes the performance evaluations, he determines budget, all of that is very, very important in order to ensure and to institutionalize making sure the CFO at the organizational level, at the top level has what he needs.

By the way, I would say this whole control issue, this organizational control issue, the information technology issues are very important on their own and also with regard to financial integrity, the CIO of the Department is not in control of the various component CIOs, that is likewise the case and that is also true in the procurement area. The Chief Procurement Officer is not in charge in all of the component procurement offices. There are 22 different procurement systems, 15 of those remain outside the Department, only 7 of them are within the Department. The 7 within the Department are managed at the component level, so the Department's Chief Procurement Officer does not have the power to reallocate resources among those 7 units to deploy them where he thinks it is necessary for the good of the organization.

This brief, those are the concerns we have about all of those issues, all of which are interconnected, needless to say.

Mr. PLATTS. Based on your knowledge of other departments and agencies, what would be the norm as far as having that authority over the component entity CFOs? Is this more the exception that currently there is not a delineation, that the Department CFO has that authority to hire and fire and they report directly to him versus through their entity? That may be something out of the scope of your knowledge.

Mr. ERVIN. I would like to get back to you on that if I may. I have only limited experience outside HHS. I was the Inspector General at the State Department. My understanding is that at the State Department, the CFO did have much more control over the various component parts than was the case at DHS. As to the rest of government, I would like to get back to you on that.

Mr. PLATTS. If you could followup with the committee, that would be great.

Your assessment in reading between the lines of just 10 accountants in the Office of Chief Financial Officers led me to believe that your assessment is that there is not the number of financial expertise to both oversee, evaluate and actually critique what is received versus simply compile what is received?

Mr. ERVIN. Precisely.

Mr. PLATTS. Is that your concern? They have the people to put it together but are unable to really assess it in form and fashion?

Mr. ERVIN. That is exactly right. To be precise, I really mean fewer than 10, somewhere between 1 and 10 and there is disagreement about exactly how many people can be characterized as accountants but certainly fewer than 10.

Mr. PLATTS. Mr. Maner, your comments on that and the ability of your office from the staffing you have been given and the type of staffing, the expertise of the staffing, to truly have the knowledge base to look at what you are receiving and really try to ensure the integrity of what is compiled as opposed to just putting it together to pass on?

Mr. MANER. Staffing is always a big question at DHS. I don't think anyone contemplated creating a department with thousands of people in the 500 series because we have accountants in the bureaus. In terms of my own staff, I feel very good with what they were able to do this year in sort of taking us through the consolidated audit coaching, the bureaus that needed coaching, working and training people on the new systems they would be using. I am confident in how we did last year. I always worry about burning out staff and making sure we have enough staff to make sure we are coaching and being strategic about action plans.

That said, the only thing I would add is this year we are very excited because we are going to have to do a lot less of that, we don't have to train people on tiers and all these other things, so we can always use more people but I feel pretty good about where we are.

Mr. PLATTS. I appreciate the efforts of everyone at the Department given the largest transformation in 50 years. I don't want to demean the good faith efforts of all staff there, including those in your office. Again, do they have the knowledge base and expertise to be able to do what we are asking them to do? It sounds like you basically are saying that although you may not have that financial expertise, because that expertise exists at the component level, you are trusting of what you have been given as opposed to have that same level of expertise in your office.

Given that you are now overseeing entities that brought 18 material weaknesses almost overwhelmingly related to internal controls, if I were you I would want my own people there verifying what those entities that had those 18 material deficiencies sending to me as opposed to relying on them to put my reputation on the line. At this point it sounds like you really are relying on those component entities to give you credible information and not really assess it. Is that an accurate statement?

Mr. MANER. First of all, you get data from the components, you work with your auditor and you are getting information. It is what you do with that information. We are getting information about how we are doing from plenty of sources. It is now how do we spend that into SOPs moving forward.

Mr. PLATTS. But it is not just getting the information but being able to assess the integrity of the information and not just what you do with it but how credible it is.

Mr, MANER. The only thing I would add is that my comfort level varies within the Department. Within the startups, they need more attention.

Mr. PLATTS. Depending on what component is sending you the information?

Mr. MANER. Sure. Some components have been through standalone audits for a long time and very comfortable with the process, are very comfortable with their integrity. You are absolutely right, this is all on my watch and it is my integrity at stake.

Mr. PLATTS. Are you considering taking the Inspector General's recommendation that you have direct authority over hiring and firing those component entity CFOs and requiring them to report directly to you instead of to their entity heads? Is that something currently being reviewed within the Department?

Mr. MANER. It is currently being contemplated at all parts of DHS, so in procurement, IT, CFO and all these things. I have inputted my beliefs on that process. While I and the Department want to do that at once, doesn't want to do it one way for CFO and wants to be very comprehensive when it does it. The only part that I have been mindful of, and I feel extremely gratified and granted I have only been here 2 months, I did see it from the other side when I was at the Bureau, at the support I get from the bureau level CFOs. I get all information in a timely manner that allows me to make great use of it.

I also am mindful that I want the Bureau CFO to have an intimate relationship with his or her bureau head and don't want to take them away from the intimacy of knowing the insides of that part. It is a very fine balance.

Mr. PLATTS. I would agree but I think it also would be helpful if that component head knows their financial books are going to go right to the CFO of the Department and eventually to the Secretary through the Under Secretary, that they are going to focus on that report, that aspect of the entity a little more than if it comes to them and what they pass on is up to him or her. The advantage of having that for certain oversight is something I hope you weigh.

If I could ask you to followup with the committee on two aspects of this discussion. One, is that you share with us once that determination is made of what changes are going to be made specifically relating to your authority over component CFOs and whether you have authority over hiring and firing and them reporting directly to you as well as to their component heads.

Also on the SOPs, give an estimated timeframe for when you will have those SOPs in place and once they are in place, that they be shared with us.

I would turn to the ranking member. I hope you didn't mind my kidding about our long tenure. As a new chairman, I hope to hold on to it for at least a little while.

Mr. Towns.

Mr. TOWNS. Thank you.

Mr. Ervin, the independent auditor's report describes several discrepancies in documentation of certain property plans, equipment and operating materials and other material weaknesses in the financial reporting mechanism of the U.S. Coast Guard. Can you bring us up to date as to what is going on with that?

Mr. ERVIN. Yes, I would be happy to.

With regard to PP&E, property, plant and equipment at the Coast Guard, there weren't procedures in place to ensure that documentation was received in time before the audit had to be completed to support $2.9 billion in PP&E at the Coast Guard. I want to be clear about that. That is not to say that $2.9 billion of property was missing; the property was there and indeed the documentation was ultimately produced. It just wasn't produced in a timely enough fashion such that it could be factored into the financial statement audit. We understand that the documentation has been submitted and that should not be a problem going forward.

With regard to OM&S, operating materials and supplies at the Coast Guard, the figure there was $497 million, almost $1 billion. There the problem was the procedure calls for two things, a review of the record as to exactly what the inventory is and also an observation of what the inventory is. With regard to observing the inventory, that was difficult because sometimes the ships were out to sea, for example, and in those instances where there was inventory to observe and check against the documentation, there were discrepancies and those discrepancies couldn't be reconciled or at least they couldn't be reconciled in a timely fashion. Go forward, that issue likewise needs to be taken care of if these problems are not to recur in 2004. That is it in a nutshell.

Mr. TOWNS. Mr. Maner, I sort of regret asking this question because you have only been around 60 days but do you really feel you have the material and staff to really make what we are asking you to do a reality?

Mr. MANER. I believe that in Homeland there is the staff and the expertise to do and put forth, manage and perfect financial management practices and systems. Yes, I believe that expertise exists within the Department. That said, as we have discussed with the chairman, we have to put out SOPs that say how we want to do these things. Yes, I do believe the expertise exists.

Mr. TOWNS. Is there anything on this side you think we need to do? Let us reverse our roles. You are the member.

Mr. MANER. That is quite a role reversal.

Mr. PLATTS. Besides shelving 2886.

Mr. TOWNS. I think that is it, that is very important. [Laughter.]

Mr. MANER. I have had conversations with a lot of people who have asked my opinion as I have moved from bureau to the Department and I think people should look at what Homeland has done in the past year, not just on the mission side, I think those are well documented but I think we should look at what we have done on what I will call the mission support side in our office. We have in place now and are utilizing a very robust investment review process, yes, modeled after DOD. We have done our audit, we are making progress. I take very seriously dollars that are misspent or anything that comes into my purview but we need some patience in terms of what we are trying to do.

We want to put in our SOPs but we want people to remember at the same time we have very well run, well constructed bureaus within our department. We are not starting from scratch so we do ask for patience. We have almost 300 GAO audits going, we have several hundred issues with the IG now. We are testifying a lot, we have reports to Congress and we should do all this but we are working very hard and have the staff to make great progress this year.

Mr. TOWNS. I grant you it is a huge task, there is no question about it. We all agree. Yet sometimes I wonder if you really have the necessary tools to be able to do what we are asking. I wonder about that.

Mr. Ervin, your testimony mentions the creation of a Grants Management Council intended to provide advice on issues specifically related to the Departments grants. Can you characterize for us the efforts that will be made through the Council to improve the disbursements and stewardship of first responders grants or the emergency terrorism preparedness and the award process?

Mr. ERVIN. With regard to the Grants Management Council, the Department is to be commended for establishing the Council. As we understand, the first meeting of the Council took place last month in February. We attended that meeting. We are a part of that process as an observer to give our input and recommendations for the Department to accept or reject as it sees fit. The concept of it is a good one and that is to provide some department level oversight over the grants award process to promote efficiency and integrity and economy, and also to develop some metrics by which, as I said in my prepared testimony, a determination can be made as to how the money that is being spent is used and whether the country is more prepared, the recipients are more prepared as a result of those expenditures. That in a nutshell is the concept behind the Council and that is a good concept. We will continue to participate in that process and oversee it.

We ultimately hope there will also be a grants management system, a financial system, that will support the Council and support the grant process. There are a number of things that such a system should have as a part of it, namely complete and accurate funds control and several other things I could elaborate on.

With regard to the State and local grants which you also asked about, I should tell you that we have completed an audit of this very newsworthy issue of how well the Department has done in getting these first responder grants out to States and localities. That draft report is with the Department for review. Our practice is to give the Department 30 days for comment. In this instance because it is such a topic of interest to the Congress and the American people, we are hope we will receive the Department's comments sooner than that but at the latest we expect to issue that report in April.

I can tell you that generally the audit finds a good story for the Department. The Department has done, generally speaking, a good job of getting the money out to the States and localities. We find largely the hangup is at the State and local level. The States, in certain instances, have not disbursed the money quickly, sometimes for good reasons because the States want to ensure that there is a procedure in place to justify the expenditure of the money at the local level and to make sure not every locality in a given State gets the same amount of money or is given an amount of money for the same purposes. They are rather complex procedures obtaining between the States and localities in certain instances, so there are a number of reasons for that, but on the whole, the Department has done a good job of getting the money out.

I would be happy to give you some specifics on that if you have one more moment.

Mr. TOWNS. Mr. Chairman.

Mr. PLATTS. Sure.

Mr. ERVIN. We have a breakout of what we are finding there. We looked at these States in particular: California, Texas, New York, Florida, Illinois, Pennsylvania, Ohio, Michigan, New Jersey, Georgia and Massachusetts. As of November 2003, Pennsylvania had drawn down relatively little of the awarded funds but it obligated almost all of the funds. Ohio had drawn down almost half but had obligated almost all. New York, your State, had drawn down almost nothing but obligated less than half. There are different stories with regard to the various States but again, the Department has done a pretty good of getting the money out.

Mr. TOWNS. Can I get a copy of that?

Mr. ERVIN. Yes, I would be happy to give you a copy of what I just gave you. With regard to the draft report itself, as I say, it is with the Department for comment.

Mr. TOWNS. Actually, just that part there.

Mr. ERVIN. Absolutely.

Mr. TOWNS. Because you mentioned New York.

Mr. PLATTS. And Pennsylvania. Probably not by chance.

Did you have others?

Mr. TOWNS. No.

Mr. PLATTS. We are estimating the first vote in about 15 minutes which will give us about 30 more minutes. We will see where we are, if we can get through and not have you wait, but time will tell here.

Mr. Maner, I want to followup on the staffing. You talked about your confidence that the Department has the personnel and expertise. I wanted to make that more specific with respect to your office. Does the CFO Office have the staffing numbers and expertise that you need to be able to truly make an informed assessment of what you are provided by all the component entities when you are compiling and forwarding it? It may exist elsewhere in the Department but do you have what you need to do what you are charged with?

Mr. MANER. I do have what I need at present to do what I am charged with. I think as we evolve, we will probably need to grow in the Office of the CFO. I feel comfortable about our staffing right now. We are just starting to get to our authorized level and I think we have done some pretty good things with that number of people.

Someone in my position always has a greater vision for where you want to take financial management. I know you asked me not to focus on that but I will use resources in the components to help us get there. In DHS, you can't sit in the ivory tower, so we have been very good at using what we call details, some short term, some long term, on our eMerge2 project which is a huge not only systems project but it is going to be our process. So it is not only developing our process but our system. We might have 200 or so people over there. That is a mix of contractors, detailees and full-time staff. I like that blend. I think you get a lot from that blend.

Your specific question was about my staffing and I feel decent about where it is right this very minute.

Mr. PLATTS. So currently you are not requesting any additional staff? You don't have any pending requests for additional staff?

Mr. MANER. I don't at this moment.

Mr. PLATTS. I appreciate the economy of scale using resources that are maybe being under utilized in a component. My concern is ultimately your office is responsible not just to compile but to attest to the accuracy of what is going to be audited. The importance of your people responding to you, especially since the component CFOs don't answer to you, are not hired and fired by you, that their independence is more at issue because they answer to somebody else. I appreciate that you are looking at that. In a similar way the IG is independent within your department, you are independent to attesting to the accuracy of the material the component entities are submitting to you.

Turning to the issue of internal controls, reading from a statement is what I understand is referred to as the Green Book, the GAO Standards for Internal Controls, "A good internal control environment requires that the agency's organizational structure clearly define key areas of authority and responsibility and establish appropriate lines of reporting. The environment is also affected by the manner in which the agency delegates authority and responsibility throughout the agency.'' In the words of the Green Book, having a delineation of authority is something that is critical to good financial practice, especially regarding internal controls.

Given that all material deficiencies identified relate to internal controls, it seems we come back to the issue of delineation of hierarchy and authority be the top priority. We have to get that in place. I start there in reiterating what we already talked about a bit but the option of that delineation existing today.

Mr. Maner, if you could give us an update on how your department is trying to comply with the Integrity Act requirements relating to attesting to the internal controls of the Department?

Mr. MANER. I would start by recognizing that internal controls, as you suggest, are what you can look at more than just in audit to see how you are doing and where your assets are and how well you are controlling your assets. For us we have to focus first and foremost on our SOPs for how we are going to learn about and correct our weaknesses, many of which are as you suggest at internal controls.

We are going to focus on trying to correct all our material weaknesses and reportable conditions this year. How do you do that? First, you have to obtain the commitment from the places where these material weaknesses are at the highest level to correct these. That we have done. I have already had some meetings as recent as yesterday about some of these problems to learn how the Bureau has been briefed, are we working on plans to correct these deficiencies and internal controls. For us, we are very focused on a rigorous approach to solving these problems.

Mr. PLATTS. In complying with the Integrity Act which relates to the accuracy of your internal controls or appropriateness of those controls, the auditor found 14 reportable conditions relating to internal controls, 7 of which were considered material weaknesses, yet your Integrity Act report didn't identify any of those. There seems to be an inconsistency for which I would appreciate your explanation.

Mr. MANER. Our report as I understand, as I have read it, was one of the very first things that I approved, has been signed by the Secretary and it actually did recognize most of what the auditor found in terms of our internal controls, if I read it correctly. In terms of our compliance, I think last year we had a very difficult situation in doing a mid-year startup, in taking on some of the challenges we did. That said, we were comfortable in the work my office did in signing a report that did represent internal controls.

I do want to make the point that as I have read it, I believe most, maybe two that our auditor found were not in our report.

Mr. PLATTS. In your expressing objection to requiring an audit opinion on internal controls, you talked about the excessive costs and staff required. Do you have an estimate of what that cost in dollars and staffing time would be in saying it would be excessive?

Mr. MANER. I have very limited data, as do a lot of people around the Government. As best we can tell from working with the IG and our auditor, it does seem to be about 30 percent above and beyond.

That is sort of the average number I have heard above and beyond the cost of our audit.

Mr. PLATTS. So instead of $10 million, perhaps $13 million?

Mr. MANER. Yes.

Mr. PLATTS. Doesn't it seem that would be a wise investment? Mr. Towns gave the example of the TSA contracts and if we were doing audits of internal controls, we may have more quickly and better understood those problems before the huge loss of dollars. A related example, not necessarily dollars paid out to somebody outside the Government but OSHA has reported that the Transportation Security Administration had a 20 percent injury and illness rate for 2003. I believe that rate is 26 percent for the first quarter of 2004. The average across the Federal Government is 3.7, 20 percent versus 3.7 for illness and injury of its employees. On lost time, the Department had 9 percent of the TSA workers actually have lost time because of being sick or hurt versus a 1.7 percent average governmentwide. Those numbers tell us that there is a way above average illness and injury incident at TSA in lost time, way above average.

In both of those cases, Mr. Towns' example and the contracts, lost time at TSA, both would seem to make a pretty strong argument that an audit of internal controls, why do we have that and how do we fix and would save a lot of dollars as opposed to costing $3 million. Your thoughts?

Mr. MANER. I don't mean to imply and hope my statement didn't imply that an audit of internal controls is a bad use of dollars. I don't mean to imply that. Anyone from the private sector or public sector knows it is a very useful tool in managing your agency and knowing your weaknesses. I would never want the record to reflect that.

That said, there is a lot of work and talk going on in the Government right now about the subject of mandating audits on internal controls, there are folks at OMB studying this issue, doing cost benefits that I am learning about. I learn something new about that each week.

I am saying to have the timing right of doing this audit on internal controls, I read once that the Social Security Administration does this and this was their cost and I just caution people that is one agency with one set of internal controls and we are not one set of internal controls, we are multiple, perhaps seven or eight.

Yes, we need to do this. It is a question of time. Homeland is not currently in its final structure. The fans are still moving out of TSA into ICE, CVP and ICE have not fully completed their restructuring. I think there is a time and place for this audit. That is all I wanted to reflect, that now didn't seem to be the time for that.

Mr. PLATTS. Paraphrasing, you think an audit of your internal controls will be a good and worthy investment but it is a question of when, not if?

Mr. MANER. I would love to have some data from an independent body or someone that tells me the cost benefit of it within the Government. I know of it more from the private sector and I think people are doing that now, so yes, it is a question of time.

Mr. PLATTS. Kind of which came first, the chicken or the egg, because I am not a CPA, my background is not in this area and I have worked hard in the last 13 months to get myself up to speed to be able to fulfill my responsibilities as Chair but my understanding is having sound internal controls is one of the most important foundation items in your financial management system. So every year that we don't do them, we are farther along in developing a system that maybe is not based on a good knowledge base because of the internal controls not being as good as they need to be and our understanding of those not being what it needs to be.

In my layman's understanding of internal controls and auditing, it would be the sooner the better because that allows us to go forward. I would welcome your opinion on the wisdom of auditing internal controls by an outside entity and would you recommend doing that now versus waiting for another year or more? When I say now, I mean the 2005 fiscal year with us already being well into 2004.

Mr. MANER. I can confirm, based on our understanding, that the issue of cost benefit is in fact being studied in the Government now. The PCIE, for example, the President's Council on Integrity and Efficiency, the Consortium of US Presidentially appointed Inspectors General are studying that issue and likewise the CFO Council is consulting with a number of agencies like Social Security Administration which Mr. Maner mentioned and FDIC and GSA, so we should know soon what that cost benefit analysis is.

Once the cost is determined, then we will have that data. Clearly during the course of the financial statement audit obviously certain material weaknesses were unearthed. The question is what additional ones might be unearthed and at what additional cost. We will have that information soon.

At a minimum, I think it is fair to say that having an opinion at the appropriate time, and I think sooner rather than later, on internal controls and also with regard to this management assertion, I think that could be helpful if it does nothing other than focus management's attention on internal controls, on reviewing them, on evaluating them, on assessing what the Department is doing with regard to that and indeed, as I said, during the course of that process still more internal control weaknesses might be unearthed.

Mr. PLATTS. I am one who certainly believes in holding ourselves to the same standards we are requiring of the private sector. In Sarbanes-Oxley, we said to the private companies, you have to do audits of internal controls and they are working through that to meet whatever the challenges are in making that happen. It seems somewhat hypocritical if we are saying to the private sector, you need to do it but we are resisting it. Making an informed decision I think is wise and may be that 30 percent will be way off. Maybe it is 500 percent and it gets more questionable.

In your department specifically, the examples we are seeing with the TSA contracts with the lost time, there is a lot of money that relates to the internal control issue that seems could likely be saved and diminish those losses if we are more informed with our internal control process.

Mr. Ervin mentioned the CFO Council. Do you participate in the CFO Council?

Mr. MANER. I do, yes.

Mr. PLATTS. I am glad to hear that. I wasn't sure. That being statutorily created by the CFO Act, I am glad to know that you are an active participant.

Mr. MANER. In fact, it has come into play very quickly in my tenure in that they have done under Ms. Springer's guidance a lot recently on the early close, helping to educate, using people who have done it in the past to help educate those of us who have not.

Mr. PLATTS. For the November 15th deadline?

Mr. MANER. Exactly. It has been very helpful.

Mr. PLATTS. Finally on the internal controls, it seems in complying with the Integrity Act, you should be a long way toward having your internal controls in place for a good audit. As you are looking at that cost benefit, it seems that is something you want to weigh by what you are required to do under that act, you are a long way there. I hope that is being factored into that assessment of cost benefit.

Mr. MANER. I agree with you.

Mr. PLATTS. Mr. Towns.

Mr. TOWNS. One question. I can't leave without asking this. I feel that excluding the CFO of a department with so many operational components really would be short-sighted on our part if we did. If all the other CFOs in the executive branch are confirmed, can you explain or convince me why you shouldn't be?

Mr. MANER. I believe that confirmation and some of the other items are very important processes within government. I just don't want you, the Congress or the American people to think that we need that legislation to make us uphold to the portions of the CFO Act that are very important or to consider financial management as an important and critical piece of running a department.

Whether or not Senate confirmation is a good or a bad thing, I won't debate. It is certainly a lengthy process.

Mr. TOWNS. I agree with that.

Mr. MANER. We certainly just want to make sure that someone like myself or someone who follows me is at work and not waiting for confirmation which in Homeland has taken some time. I would leave it at that. I don't think anything more needs to be said but I just don't want people to think that would lead to us caring more, paying more attention to financial management. It is one of the driving goals of the Department to excel in this arena already.

Mr. TOWNS. I think the chairman said it well already, it is not really about you, it is in terms of the future. I served in the Congress with Secretary Ridge and have great respect for him. I think he is a very capable person. I think the issue here is that putting a structure in place that we know in moving forward would be there to do the kind of things that need to be done. That is my concern. I say it without reservation because I feel pretty strongly about it and knowing the Secretary as I do, him and I played basketball together, so we know each other, and I think he is a very competent and capable person. It is nothing to do with any of that or you. I just think it is important to put this in place so years and years to come, we will know it is working and working properly.

On that note, Mr. Chairman, I yield back.

Mr. PLATTS. Thank you.

Given his size, I assume the Secretary was a good inside player. [Laughter.]

I am a guy who stays out on the perimeter and tries to shoot over the big guys.

Mr. Maner, Mr. Towns gave a good summary. It is not about you or the Secretary but about the process. Unfortunately, history told Congress that when left to their own decisions, previous departments and agency administrators didn't prioritize financial management as high as needed and that is why the Integrity Act, that is why the CFO Act and the Management Improvement Act were all adopted.

I appreciate your ability to be with us today and your sitting here to testify and say you want to stand by and make a commitment on your successors or 5 years from now, their successors efforts, whoever it may be. That is what it is really about. It is about institutionalizing good management practices, having a commitment from the individual that the process requires good management as opposed to the people requiring it as well. We want both. The benefit I think is to have both.

A specific question on one of the component entities is INS, BCIS, CIS, I am not sure, there are a number of acronyms, but one of the serious material weaknesses inherited regarded INS and their processing applications and recording revenue and the fact they had to shut down for 2 weeks at the end of the previous fiscal year mainly to count where they were. The 2003 audit listed this as a reportable condition. If both of you could address where you believe we are on that specific aspect of the audit report?

Mr. ERVIN. Our recommendation, Mr. Chairman, has been so as to avoid this for 2004, that CIS undertake to do what is called cycle counts which as I am sure you know is simply a process of having various field locations do the process of comparing the applications they have in process on their system and the actual number of applications, do that for a few field locations during the course of the year and see if there are discrepancies. If there are discrepancies early on, then work out procedures to resolve those discrepancies as opposed to as you say waiting until the end when the heavy hand of the financial statement audit is upon us to shut down the entire system.

We understand that the Department is considering cycle counts. It may be that cycle counts are underway. If they are not underway, we urge that they get underway because we think that is a very good system that could be put in place now, at least to lessen the likelihood that a year of shut down would have to occur again.

Mr. PLATTS. Would an analogy be with the quarterly financial reports, trying throughout the year to stay ahead of the process instead of at the end?

Mr. ERVIN. Precisely because the longer there are these discrepancies between the count and the inventory and the actual physical applications, the bigger the problem and the harder it is to resolve at the end, needless to say.

Mr. PLATTS. Mr. Maner, your view on where you are and how you are trying to address that reportable condition?

Mr. MANER. I have not had my meeting with CIS to know specifically about the corrective action planned that is in place. As I understand from briefings with my staff, they have seen some obvious improvement in the situation, largely due to systems improvements. As it was told to me, I think they have quite a ways to go, so I would have to get back to you on that.

Mr. PLATTS. If you could followup and give us that assessment. I raise that specifically because at my office in the district we process a lot of INS work and one of the challenges we find is their inability to manage the volume they are dealing with. It really has kind of a snowball effect because they are getting further behind on processing the initial application, then having to issue interim work authorizations and things related that are temporary which then takes more staff time and gets worse and worse. It is something we are looking at which maybe relates more to the government efficiency side of our subcommittee more than the financial management but it certainly is something that is going to impact the financial management because if you have to again shut down for 2 weeks, that is having a financial impact as well as an efficiency impact. Your taking a look and followup would be great.

As I read your testimony, I made all sorts of notes and I just want to followup with you. I think through the questions we touched on pretty much everything I had. It is probably good timing with the bells going off and the votes. I am glad that worked out because I always feel bad if we hold you and your staffs here while we are voting and take up more of your day.

I would conclude with my sincere thanks to both of you for your participation here today and your testimony and especially for the work you are doing day in and day out, you and your staffs.

Mr. Maner, some of my questions are maybe more pointed at where you are and why aren't you doing this, it is a year gone now, a year for the Department, 60 days for you but as the chairman and given the oversight responsibility the committee has, I feel obliged to pursue the issues that are raised and to stay with them as we will. I do appreciate the effort and the good faith effort you are making in a challenging environment.

I hope that within the Department you will give consideration to and advocate for the administration better embracing what we are trying to do with the legislation which to me your good actions make the case of why we want to make it permanent. You will work with us as partners in achieving the ultimate goal of good financial management and good efficiency in the operation of the Department as we go forward.

I thank you for your efforts and your testimony. We will keep the record open for 2 weeks for some of the followup materials we asked for and appreciate your participation as well as all in the audience today being here.

This hearing stands adjourned.

[Whereupon, at 3:30 p.m., the subcommittee was adjourned, to reconvene at the call of the Chair.]

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