

Independent Auditors' Report on U.S. Customs and Border Protection's FY 2014 Financial Statements





HIGHLIGHTS

Independent Auditors' Report on U.S. Customs and Border Protection's FY 2014 Financial Statements

April 21, 2015

Why We Did This

The Federal Government has a fundamental responsibility to be an effective steward of taxpayers' dollars. Sound financial practices and related management operations, reliable financial systems, and effective internal control are essential for reliable, timely financial information that supports management decision-making needed to achieve Customs and Border Protection's (CBP) mission.

What We Recommend

KPMG LLP made 18 recommendations to help improve internal control over financial reporting and increase the reliability of financial systems and operations. These recommendations address the four significant deficiencies identified in the report.

For Further Information:

Contact our Office of Public Affairs at (202) 254-4100, or email us at DHS-OIG.OfficePublicAffairs@oig.dhs.gov

What We Found

The independent public accounting firm, KPMG LLP, has issued an unmodified (clean) opinion on CBP's fiscal year 2014 consolidated financial statements. In the independent auditors' opinion, the financial statements present fairly, in all material respects, the financial position of CBP as of September 30, 2014.

The report identifies four significant deficiencies in internal control, one of which KPMG LLP considers to be a material weakness in the area of drawback duties, taxes, and fees. The other three significant deficiencies in internal control were identified in the areas of property, plant, and equipment; entry process (including the in-bond program, bonded warehouse and foreign trade zones, entry reports, bond sufficiency, and classification of custodial liabilities); and information technology.

CBP's Response

CBP concurred with the one material weakness and the three significant deficiencies identified in the report and indicated that management will continue to work to resolve all identified weaknesses.



OFFICE OF INSPECTOR GENERAL

Department of Homeland Security

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

APR 21 2015

MEMORANDUM FOR: Jaye M. Williams
Chief Financial Officer
U.S. Customs and Border Protection

FROM: Mark Bell 
Assistant Inspector General for Audits

SUBJECT: *Independent Auditors' Report on U.S. Customs and
Border Protection's FY 2014 Financial Statements*

Attached for your action is our final report, *Independent Auditors' Report on U.S. Customs and Border Protection's FY 2014 Financial Statements*. We have incorporated the formal comments from U.S. Customs and Border Protection (CBP) in the final report.

The report presents the results of CBP's consolidated financial statements audits for fiscal years (FY) 2014 and 2013. We contracted with the independent public accounting firm KPMG LLP to perform the audits. KPMG LLP concluded that CBP's consolidated financial statements as of and for the years ended September 30, 2014, and September 30, 2013, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

The independent auditors' report also contains observations and 18 recommendations related to internal control weaknesses that are considered significant deficiencies and are required to be reported in the financial statements audit report. Your office concurred with the four significant deficiencies in internal control presented below, the first of which is considered to be a material weakness:



OFFICE OF INSPECTOR GENERAL

Department of Homeland Security

Significant Deficiencies in Internal Control

- A. Drawback of Duties, Taxes, and Fees
- B. Property, Plant, and Equipment
- C. Entry Process
 - 1. In-Bond Program
 - 2. Bonded Warehouse and Foreign Trade Zones
 - 3. Entry Reports
 - 4. Bond Sufficiency
 - 5. Classification of Custodial Liabilities
- D. Information Technology

KPMG LLP (KPMG) is responsible for the attached independent auditors' report dated April 1, 2015, and the conclusions expressed in the report. To ensure the quality of the audit work performed, we evaluated KPMG's qualifications and independence, reviewed the approach and planning of the audit, monitored the progress of the audit at key points, reviewed and accepted KPMG's audit report, and performed other procedures that we deemed necessary. Additionally, we provided oversight of the audit of financial statements and certain accounts and activities conducted at CBP. Our review disclosed no instances where KPMG did not comply, in all material respects, with generally accepted governments auditing standards.

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

Please call me with any questions, or your staff may contact Paul Wood, Acting Deputy Assistant Inspector General for Audits, at (202) 254-4100.

Attachment



OFFICE OF INSPECTOR GENERAL

Department of Homeland Security

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KPMG LLP
Suite 12000
1801 K Street, NW
Washington, DC 20006

Independent Auditors' Report

Inspector General
U.S. Department of Homeland Security:

Commissioner
U.S. Customs and Border Protection:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the U.S. Customs and Border Protection (CBP), which comprise the consolidated balance sheets as of September 30, 2014 and 2013, and the related consolidated statements of net cost, changes in net position, and custodial activity, and combined statements of budgetary resources for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 14-02 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion on the Financial Statements

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of CBP as of September 30, 2014 and 2013, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Required Supplementary Information

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

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The Commissioner's Message, Performance Section, Message from the Chief Financial Officer, Other Information, and Acronyms as reflected in CBP's *Fiscal Year 2014 Performance and Accountability Report* are presented for purposes of additional analysis and are not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by Government Auditing Standards

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements as of and for the year ended September 30, 2014, we considered CBP's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of CBP's internal control. Accordingly, we do not express an opinion on the effectiveness of CBP's internal control. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying exhibits we identified certain deficiencies in internal control that we consider to be a material weakness and significant deficiencies.



A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described in Exhibit I to be a material weakness.

A. Drawback of Duties, Taxes, and Fees

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in Exhibit II to be significant deficiencies.

- B. Property, Plant, and Equipment
- C. Entry Process
- D. Information Technology

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CBP's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 14-02. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests of compliance disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 14-02.

CBP's Responses to Findings

CBP's responses to the findings identified in our audit are described in Management's Response to the Independent Auditors' Report. CBP's responses were not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the responses.

Purpose of the Other Reporting Required by Government Auditing Standards

The purpose of the communication described in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of CBP's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Washington, D.C.
April 1, 2015

Material Weakness

A. Drawback of Duties, Taxes, and Fees

Background:

U.S. Customs and Border Protection (CBP) performs an important revenue collection function for the U.S. Department of the Treasury. In fiscal year (FY) 2014, CBP collected approximately \$39.0 billion in import duties, taxes, and fees on merchandise arriving in the U.S. from foreign countries. Receipts of import duties and related refunds are presented in the statement of custodial activity in CBP's consolidated financial statements.

Refunds occur when a claimant has paid duties, taxes, fees, and interest in excess of the amount due. As a result, a refund check is issued. CBP issues a variety of types of refunds, including baggage declaration refunds, refunds of cash deposits in lieu of surety, mail refunds, and administrative refunds of formal entry collections. One week prior to the processing of a refund for payment, the refund appears on the *B41, Preliminary Check Proof Listing Report*. A separate individual from the reviewer of the refund request reviews and verifies the *B41, Preliminary Check Proof Listing Report* to verify that the refund payment is properly supported.

Drawback, which is a particular type of refund, is the remittance, in whole or in part, of duties, taxes, or fees previously paid by an importer. Drawback typically occurs when the imported goods, on which duties, taxes, or fees have been previously paid, are subsequently exported from the United States or destroyed prior to entering the commerce of the United States. Depending on the type of drawback claim, the claimant has up to eight years from the date of importation to file for drawback. The responsibility for maintaining documentation to support drawback claims remains with the brokers and claimants.

CBP offers accelerated payment privileges to qualifying claimants, and in turn the claimants are required to maintain 100 percent bond coverage through either a continuous or single transaction bond. In years past, CBP's system has been incapable of properly accounting for bond sufficiency of claims that involve a continuous bond. Therefore, the Drawback Specialists responsible for reviewing the accelerated payment claims are required to verify that sufficient bond coverage remains on the bond in order to accelerate the claim.

The conditions cited below have existed for several years; however, CBP's planned remediation for these conditions is dependent upon funding for IT systems modernization and new system implementation. In FY 2014, CBP continued its efforts to review and reassess the drawback process as a whole.

Conditions:

We identified the following weaknesses in internal control over refund and drawback of duties, taxes, and fees paid by the importer:

- CBP lacks effective controls to prevent, or detect and correct excessive drawback claims. Currently, the drawback module provides information to ensure that the total amount of all drawback claims against a given import entry does not exceed 100 percent of the total amount of duties, taxes, and fees collected, at the entry summary level. However, the amount paid for drawback claims against a given import entry should not exceed 99 percent of the duties, taxes, and fees collected at the individual line item level and the entry summary level. In addition, export information is not linked to the drawback module and therefore, electronic comparisons of export data cannot be performed.
- The drawback system does not allow for an automated review of all prior drawback claims against a selected import entry to determine whether an excessive amount has been claimed against the underlying consumption entry sheets. A manual review of all prior claims against a selected import entry is not feasible. Therefore, CBP utilizes a validity control review process to select and trace the

EXHIBIT I

highest dollar invoice item on the highest dollar consumption entry sheet for claims over \$50,000. However, this approach is not statistical. In addition, drawback review policy and procedures allow the Drawback Specialist, with supervisor approval, to judgmentally decrease the number of consumption entry sheets reviewed for certain claims. This methodology is also not statistical and CBP's Drawback Handbook does not include procedures for statistically projecting errors across the population.

- The length of document retention of a drawback claim, per the Code of Federal Regulations, is three years from the date of payment. However, there are several situations that could extend the life of the drawback claim beyond three years from the date of payment.
- The system does not properly account for bond sufficiency of claims that involve a continuous bond. Specifically, the automated control that prevents a claimant from exceeding the bond amount on file does not operate effectively. The control is designed to accumulate all open accelerated payments against a continuous bond to ensure that the bond is sufficient. However, the system does not always track open accelerated payments against continuous bonds. Additionally, manual procedures are not in place to ensure the sufficiency of continuous bonds. In FY 2012, CBP began developing a script that indicates the bond number, claimants listed on the bond, anniversary date of the bond, bond value, and a list of all drawback payments applied against the bond. However, the script has not been fully tested and developed to allow for it to be implemented and released into production within the system.
- CBP did not maintain sufficient documentation to evidence review of the *B41, Preliminary Check Proof Listing Report*. For example, at one port only the first page was retained. Therefore, it was impossible to verify the refund amount to the B41 report. At another port, the first page was not retained, therefore proper review of the B41 report could not be determined.

Cause/Effect:

The current drawback system does not provide the necessary functionality to prevent overpayment of drawback claims. CBP plans to replace the current drawback system with a new system in FY 2015. However, CBP does not currently have sufficient resources to effectively perform compensating manual controls over drawback claims until such implementation of the new automated system occurs.

There is a high inherent risk of fraudulent claims or claims made in error, which increases the risk for erroneous payments. Since all, or a statistically valid sample, of drawback claims are not reviewed against a selected import entry, the possibility exists that the related drawback claims, in aggregate, could exceed the amount of duty and tax collected on the underlying consumption entry sheet at the individual line item level. Thus, an import entry could be over-claimed by submitting multiple claims for the same item and the error would not be detected.

The length of the drawback claim lifecycle often extends beyond the statutorily mandated document retention period, which can only be changed by Congressional legislation. Therefore, CBP management may not be able to obtain sufficient, competent evidence to determine whether the recorded drawback claims exist and are complete and accurate.

Since the current drawback system is scheduled for replacement, CBP has not allocated funding to complete development of the bond script within the current system. The use of manual control procedures to track bonds is not an efficient and effective means of ensuring the sufficiency of continuous bonds. Therefore, if a claimant claims an incorrect amount of drawback via accelerated payment and the claimant is paid without sufficient bond coverage on file, CBP may not be able to recollect the overpayment from the surety, as the bond will be insufficient.

EXHIBIT I

CBP did not consistently adhere to policies and procedures over the review of the *B41, Preliminary Check Proof Listing Report*. Failure to consistently adhere to the policies and procedures for reviewing the report may result in CBP not identifying inaccurate or unsupported refunds, resulting in the potential misstatement of the Taxes, Duties, and Trade Receivables, Net balance.

Criteria:

Presented in *Index of Financial Reporting and Internal Control Criteria*, Exhibit III.

Recommendations:

We recommend that CBP:

1. Continue with the implementation of drawback functionality in the new system as scheduled.
2. Dedicate sufficient resources to effectively perform compensating manual controls over drawback claims, including implementation of a statistical method for identifying potential revenue loss until CBP systems can be updated to implement an automated solution.
3. Continue to pursue Congressional action in order to have the statutory requirement set by Congress changed.
4. Include requirements to automate bond sufficiency for drawback in the development of drawback functionality in the new system. Additionally, until such time as the automated functionality is operating in the new system, CBP should develop manual control procedures to track the sufficiency of continuous bonds.
5. Institute a periodic monitoring control to ensure accurate and timely reconciliations are performed, including the redistribution of relevant directives to personnel that communicate the required steps for completing the reconciliations.

Significant Deficiencies

B. Property, Plant, and Equipment

Background:

U.S. Customs and Border Protection (CBP) acquired new equipment, facilities, and other assets through purchase and construction in FY 2014. The increase in assets is primarily due to construction of new facilities and software. This was offset by the depreciation of assets previously placed-in-service.

Condition:

CBP continued to have weaknesses in its processes for tracking and reporting property, plant, and equipment (PP&E) balances. Specifically, CBP did not:

- Adhere to policies and procedures to timely and accurately record certain construction-in-progress (CIP) settlement transactions, resulting in misclassification of assets between CIP, completed assets, accumulated depreciation, and depreciation expense.
- Have adequate controls in place to verify that the correct amount was settled from CIP to completed assets.
- Produce an auditable population of CIP projects as of April 30, 2014, and had to conduct further analysis of CIP projects in order to provide an auditable population at fiscal year-end.
- Have adequate controls in place to timely and accurately record the acquisition of new assets to the general ledger in accordance with policies and procedures.
- Have adequate controls in place to detect and correct for errors when certain assets recorded in the general ledger no longer existed.
- Adhere to policies and procedures to timely record certain asset retirements. Additionally, some assets were retired prior to receiving proper approval in accordance with policies.

Criteria:

Presented in *Index of Financial Reporting and Internal Control Criteria*, Exhibit III.

Cause/Effect:

Due to the decentralized nature of CBP's PP&E, CBP's policies are heavily reliant upon individuals in local field offices to submit timely and accurate information. CBP personnel do not consistently adhere to policies and procedures to ensure that transactions are recorded in a timely manner and for the correct amount. CBP management has not implemented appropriate monitoring controls to ensure compliance with stated policies and procedures by CBP personnel.

However, CBP is at an increased risk of errors and misstatements due to the untimely recording of asset retirement transactions and the disposal of assets without proper authorization. In addition, disposal of physical assets prior to approval increases the risk of misappropriation of assets.

CBP's PP&E and related depreciation balances were misstated during the fiscal year due to untimely or inaccurate PP&E entries. At year-end, CBP's General PP&E, CIP, Accumulated Depreciation, and Prior Period Adjustments Due to Corrections of Errors contained uncorrected factual and projected misstatements.

Recommendations:

We recommend that CBP:

1. Distribute and reinforce policies and procedures to local field offices to ensure that completed assets are transferred from CIP to general PP&E in a timely manner.
2. Strengthen monitoring controls to ensure accountability at the project manager level for timely asset creation and settlement, as well as compliance with stated policies and procedures. Additionally, monitoring controls should include processes to identify projects that are nearing completion or have not had recent activity, as these have a higher risk of no longer being valid CIP projects.
3. Educate field personnel, including project managers and supervisors on the importance of following policies and procedures to ensure that asset additions are recorded in a timely manner.
4. Modify policies and procedures to require formal authorization and documentation of all asset retirements, emphasize the importance of timely reporting asset retirement transactions, and develop and implement monitoring controls to ensure compliance with stated policies and procedures for asset retirements.

C. Entry Process

1. In-Bond Program

Background:

An in-bond entry allows for the movement of cargo through the United States without payment of duty or appraisal prior to entry into either domestic commerce or exportation to a foreign country. The cargo may enter U.S. commerce after it arrives at the destination port and an entry is filed, may be entered into a bonded warehouse (BW) for storage, or may be admitted into a Foreign Trade Zone (FTZ).

To assist with in-bond oversight functions, CBP implemented the In-Bond Compliance Module in September 2012. CBP conducts audits and examinations to assist in protecting custodial revenues related to in-bond entries of goods. CBP performs audits by reviewing entry documents or documents that show proof of subsequent export to ensure proper accounting of all merchandise has occurred. Examinations are conducted by physical inspection of the merchandise to ensure the commodity matches the entry documentation. At the end of each audit or examination, the findings, conclusions, and corrective actions recommended or taken are documented. These results assist CBP in assessing the risk of bonded carriers.

We identified control deficiencies over the in-bond process from FY 2006 through FY 2013. CBP developed an “NFR Analysis and Remediation Strategy” in response to these prior year findings, with full implementation planned for the fourth quarter of FY 2014. We confirmed that a revised policy was developed by CBP and implemented on April 1, 2014. Additionally, CBP Management stated that a memo was issued on October 2, 2014, which directed ports to implement oversight plans for in-bond, including the ports’ procedures and processes when conducting in-bond examinations and audits. These plans were due November 19, 2014, and therefore they were not considered during the FY 2014 audit.

Condition:

The following weaknesses in internal control over compliance exams and audits were identified:

- Revised policies and procedures over the in-bond process were not implemented until April 1, 2014. Therefore, prior year weaknesses continued to exist through the first half of FY 2014. Additionally, port personnel did not have a clear understanding of how to operate the newly implemented compliance module, which led to inconsistent implementation across ports.

EXHIBIT II

- Complete and accurate listings of the completed in-bond compliance exams, audits, and the underlying individual audit/exam results cannot be reliably generated from the system.

Criteria:

Presented in *Index of Financial Reporting and Internal Control Criteria*, Exhibit III.

Cause/Effect:

CBP did not effectively communicate the revised policy across the organization and did not provide sufficient training to port personnel prior to the implementation of the revised policy. Additionally, system functionality issues continue to result in report discrepancies. The system also lacks sufficient document retention capability to support the in-bond compliance exam and audit function at the port level. Further, port personnel are not required to maintain supporting documentation to evidence performance of required in-bond compliance exams and audits outside of the system.

The in-bond monitoring process supports CBP's efforts to protect custodial revenues. The inability to effectively monitor the in-bond process could result in missed opportunities for CBP to assess fines and penalties and collect the associated revenues.

Recommendations:

We recommend that CBP implement additional training at port locations over in-bond tracking and compliance, as well as develop a process to ensure effective oversight of the in-bond process. Additionally, we recommend that CBP implement policies and procedures that resolve the insufficient document retention capability of the system.

2. Bonded Warehouse and Foreign Trade Zones

Background:

Bonded Warehouses (BW) are facilities under CBP's supervision used to store merchandise that has not made entry into U.S. commerce. The merchandise stored in such warehouses is secured by the bond on the warehouse. Merchandise is entered into the BW by the submission of the CBP Form 7501, *Entry Summary with Continuation Sheets*, and can be stored in the bonded facility for up to five years.

Foreign Trade Zones (FTZs) are secure areas under CBP supervision that are legally considered to be outside the commerce of the United States. Authority for establishing these facilities is granted by the FTZ Board under the FTZ Act of 1934, as amended (19 U.S.C. 81a through 81u). Foreign and domestic merchandise may be admitted into zones for operations not otherwise prohibited by law, including storage, exhibition, assembly, manufacturing, and processing. Merchandise is admitted into an FTZ using CBP Form 214, *Application for Foreign-Trade Zone Admission and/or Status Designation*.

The monitoring of BW and FTZ operations is based on the performance of risk assessments and compliance reviews by CBP officers in the field. CBP conducts a quarterly survey of ports that have BWs and FTZs, the results of which are submitted to CBP Headquarters for compilation and analysis. Headquarters uses the survey results to assist in CBP's determination on the effectiveness of the BW and FTZ programs. CBP developed national databases in order to maintain a centralized repository of profiles of bonded facilities, including BW and FTZ sites.

EXHIBIT II

Condition:

The following weaknesses in internal control over the BW and FTZ programs were identified:

- A reconciliation of the codes assigned within the system to the compliance review schedule maintained by each port was not fully implemented during FY 2014.
- CBP was unable to provide documentation to evidence the completion of compliance reviews to support the assessed risk level for certain BW and FTZ reviews.
- CBP improperly recorded the risk level of an FTZ based on the compliance review that was conducted.

Criteria:

Presented in *Index of Financial Reporting and Internal Control Criteria*, Exhibit III.

Cause/Effect:

CBP had not completed its review of system codes to ensure the completeness and accuracy of data maintained within the system. Therefore, the results of any reconciliations performed, would not be reliable. In addition, CBP personnel did not consistently adhere to BW and FTZ policies and procedures in relation to the completion of compliance reviews.

These weaknesses in internal control increase the likelihood that CBP is not in compliance with Title 19 of the Code of Federal Regulations. Further, improper monitoring of BWs or FTZs creates a risk that imported goods awaiting entry into commerce may not be secure, and could result in a loss of revenue or error to the Taxes, Duties, and Trade Receivables, Net balance.

Recommendations:

We recommend that CBP:

1. Complete the process of reconciling codes for bonded facilities.
2. Implement additional training at ports and/or additional oversight controls to ensure risk assessments for BWs and FTZs are consistently performed in accordance with required guidelines.

3. Entry Reports

Background:

CBP personnel process and review certain entry edit/exception reports, including the following:

- The *B06, Weekly List of Rejected/Cancelled Entries Report*, denotes entries that were either cancelled or placed in rejected status.
- The *B07, Weekly List of Unpaid/Rejected Entries*, denotes entries in rejected status and entries for which duty, taxes, and fees have not been collected, or if collected, not properly posted to the entry.
- The *B08, Weekly Late Report: Entry Releases with No Follow-Up Summaries*, is a cumulative listing of entry releases with no processing errors or follow-up entry summary on file.
- The *B84, Weekly Budget Clearing Account (BCA) and Suspense Item Report*, is a cumulative listing of collections that are an intentional posting to a suspense account or collections in an error condition.

EXHIBIT II

Condition:

CBP personnel did not consistently complete and review reports in accordance with the directives requirements. Specifically, a lack of segregation of duties was identified over the review process for certain reports as the individuals who performed the transactions were also responsible for reviewing the reports of those transactions. In addition, some entry exception/edit reports selected did not include evidence that the actions taken to resolve the exceptions or to verify the edits were performed timely or at all.

Criteria:

Presented in *Index of Financial Reporting and Internal Control Criteria*, Exhibit III.

Cause/Effect:

CBP port personnel did not consistently adhere to the policies and procedures in place to ensure entry edit/exception reports were resolved properly. CBP does not have adequate controls in place to enforce the segregation of duties over the processing, review, and verification of entry edit/exception reports at the ports.

Failure to consistently adhere to existing policies and procedures for review and verification of entry edit/exception reports may cause CBP not to identify improperly cancelled or deleted entries, unpaid duties, late entry summaries, or duties held in suspense accounts, resulting in a potential misstatement to the Taxes, Duties, and Trade Receivables, Net balance.

Recommendation:

We recommend that CBP redistribute to all ports of entry the relevant directives communicating the steps for completing report reconciliations. Additionally, we recommend that CBP institute a quarterly monitoring control by local port of entry management to ensure the timely completion of reconciliations.

4. Bond Sufficiency

Background:

CBP requires bonds from parties that import merchandise into the United States. These bonds are contracts to secure payment of duties, taxes, and fees in the event that an importer fails to fulfill their financial obligations. The assessment of liquidated damages against a bond serves to promote compliance with laws and regulations.

The two primary types of customs bonds are continuous bonds and single transaction bonds (STBs). A continuous bond is typically obtained by importers that have a large number of entries across several ports of entry. The bond has a term of one year and is automatically renewed each year until it is terminated by the surety or the principal. An STB serves as collateral for a specific entry or transaction.

Condition:

The following weaknesses in internal control over STBs were identified:

- CBP was unable to provide documentation to support the review of two STBs that were submitted electronically.
- The execution date and transaction date of an STB occurred after the date of entry per the entry summary form. Therefore, the STB was invalid.

Criteria:

Presented in *Index of Financial Reporting and Internal Control Criteria*, Exhibit IV.

Cause/Effect:

CBP did not consistently adhere to policies and procedures for the review of STBs. Failure to adhere to existing policies and procedures for the review of STBs may cause CBP not to collect all revenue owed, resulting in an inability to identify all trade receivables.

Recommendation:

We recommend that CBP implement a centralized approach to monitoring STBs.

5. Classification of Custodial Liabilities

Background:

CBP is authorized to collect duties and taxes for Puerto Rico and to recover CBP's cost of services from the collections. CBP recorded the net duties and taxes that are due to Puerto Rico, as well as amounts potentially payable to an importer that are under protest, as accounts payable. However, these amounts met the definition of custodial liabilities.

Condition:

The internal control over the review of manual journal entries recorded for amounts to be paid to Puerto Rico was not operating effectively, as the liabilities were improperly recorded as Accounts Payable rather than Custodial Liabilities.

Criteria:

Presented in *Index of Financial Reporting and Internal Control Criteria*, Exhibit III.

Cause/Effect:

CBP's review of the manual journal entries did not ensure appropriate posting logic was used, based on applicable guidance per Statement of Federal Financial Accounting Standard (SFFAS) No. 7, *Accounting for Revenue and Other Financing Sources*, and the United States Standard General Ledger (USSGL) with respect to accounting for Puerto Rico transactions. The aggregate impact of the three misclassifications is an overstatement of Accounts Payable and an understatement of Custodial Liabilities.

Recommendation:

We recommend that CBP correct the posting logic applied in preparing journal entries related to amounts payable to Puerto Rico, such that amounts owed are recorded to SGL 2980, Custodial Liability, rather than SGL 2110, Accounts Payable.

D. Information Technology

Background:

Controls over information technology (IT) and related financial systems are essential elements of financial reporting integrity. Effective IT controls in an IT financial systems environment can be defined in five key general control areas (security management, access control, configuration management, segregation of duties, and contingency planning) and four key application control areas (application level general controls, business process controls, interface controls, and data management system controls). In addition to reliable general and application controls, financial management system functionality is important to program monitoring, increasing accountability of financial and program managers, providing better information for

EXHIBIT II

decision-making, and increasing the efficiency and effectiveness of services provided by the Federal government.

Condition:

CBP took corrective actions to address prior year IT control deficiencies, and successfully closed 12 of 18 deficiencies that were followed up on in FY2014. For example, CBP made improvements to password parameters, audit log reviews and maintenance of evidence, recertification of user access, provisioning of user access, removing separated personnel in a timely manner, enforcing segregation of duties, and performing backups.

However, during FY 2014, new and continuing general IT control weaknesses were identified that could potentially impact CBP's financial and custodial data. The most significant weaknesses related to controls over system functionality, access, segregation of duties, and configuration management. Collectively, the general IT control weaknesses limit CBP's ability to support assertions that critical financial and operational data confidentiality, integrity, and availability are maintained. CBP's current system of record for entries imported into the U.S. does not fully support CBP's custodial revenue and drawback processes.

Due to the sensitive nature of these issues, we will issue a separate, restricted distribution report that discusses the general IT control and functionality deficiencies in greater detail.

Criteria:

The criteria will be presented in a separate, restricted distribution report that discusses the general IT control and functionality deficiencies in greater detail.

Cause/Effect:

Funding for IT development and implementation, as well as for IT support staff has been reduced in recent years. This has prolonged implementation of systems that would replace or enhance current systems, and has had an impact on providing IT support resources. In addition, transition to different system development methodologies has led to inconsistent IT control practices and documentation. Further, due to the presence of IT control and financial system functionality weaknesses, there is additional pressure on the manual, mitigating processes and controls.

Recommendation:

We recommend that CBP improve the IT general and application controls over its financial systems to ensure adequate security, protection, and functionality of the information systems.

EXHIBIT III

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

Criteria	Reference	Report Exhibit
2014 Code of Federal Regulations (CFR)	Title 19, Volume 1, Section 18.2 (d), Section 18.6 (b), and Section 18.8(b)	II-C-1
	Title 19, Volume 1, Section 19.4 (a) and Section 146.3 (a)	II-C-2
	Title 19, Volume 1, Section 111.23 (a)(1)-(2)	I-A
	Title 19, Volume 1, Section 111.25	
	Title 19, Volume 1, Section 113.13 (c)	
	Title 19, Volume 1, Section 113.65 (a)(3)-(4),(b)	
	Title 19, Volume 2, Section 163.4 (a)-(b)	
	Title 19, Volume 2, Section 191.15	
	Title 19, Volume 2, Part 191.38 (a)	
	Title 19, Volume 2, Section 191.51 (b)(1)	
	Title 19, Volume 2, Section 191.92 (d)	
	Title 19, Volume 1, Section 113.13 (c)	II-C-4
	Title 19, Volume 1, Section 113.15	
	Title 19, Volume 1, Section 113.26	

EXHIBIT III

Criteria	Reference	Report Exhibit
CBP Directive 3510-005, <i>Bond Sufficiency</i>	Section 2; Section 3	II-C-4
CBP Directive 3710-004B, <i>Refund of Miscellaneous Collections</i>	Section 2.2; Section 5.7.1	I-A
CBP Directive 5320-028D, <i>Commitment, Obligation, Expenditure, and Payment Procedures for Goods and Services</i>	Section 7.5.1	II-B
CBP Directive 5610-004B, <i>Resolving Certain ACS Exception and Error Reports</i>	Section 5.1.2; Section 5.4.2; Section 5.5.2; Section 5.6.2; Section 5.11.2	II-C-3
CBP Directive 5610-006A, <i>Entry Deletion and Entry or Entry Summary Cancellation</i>	Section 6.6.1	II-C-3
CBP FY 2014 Personal Property Inventory Instructions	Introduction	II-B
CBP Handbook (HB) 3500-09, <i>Compliance Review Handbook for Bonded Warehouses</i>	Foreword; Chapter 3	II-C-2
CBP HB 3500-10, <i>Compliance Review Handbook for Foreign Trade Zones</i>	Chapter 3	II-C-2
CBP HB 3500-11, <i>Bonded Warehouse Manual for Customs and Border Protection Officers and Bonded Warehouse Proprietors</i>	Part 1.1	II-C-2
CBP HB 3700-01B, <i>Drawback Handbook</i>	Chapter 5	I-A
CBP HB 5200-13B, <i>Personal Property and Asset Management Handbook</i>	Chapter 8	II-B
Federal Accounting Standards Advisory Board (FASAB) Statement of Federal Financial Accounting Standards (SFFAS) No. 6, <i>Accounting for Property, Plant, and Equipment</i>	Chapter 2, Paragraphs 26, 34, 38, and 39	II-B
FASAB SFFAS No. 7, <i>Accounting for Revenue and Other Financing Sources</i>	Appendix B, Paragraphs 245, 289, 290, and 291	II-C-5
FASAB Federal Financial Accounting Technical Release (TR) No. 14	Paragraph 10	II-B

EXHIBIT III

Criteria	Reference	Report Exhibit
The Federal Manager's Financial Integrity Act (FMFIA) of 1982	Section 2 (d)(1)(A)	I-A, II-B
Office of Management and Budget (OMB) Circular No. A-123, Management's Responsibility for Internal Control	Section I	I-A, II-C-3, II-C-4
	Policy, paragraph 3; Section I, paragraph 2; Section IV, paragraph 1	I-A
	Section II. Standards	I-A, II-B, II-C-3
	Purpose, paragraph 1	II-C-5
U.S. Customs Service HB 2100-05A, <i>Records Control Handbook</i>	Introduction and Background	II-C-4
United States Standard General Ledger (USSGL)	Account Definitions for SGL 2110, Accounts Payable, and SGL 2980, Custodial Liability	II-C-5



OFFICE OF INSPECTOR GENERAL
Department of Homeland Security

Appendix A Management Comments to the Report

1331 Pennsylvania Avenue NW
Washington, DC 20229



**U.S. Customs and
Border Protection**

MAR 24 2015

MEMORANDUM FOR: Mark Bell
Acting Assistant Inspector General for Audits
U.S. Department of Homeland Security

FROM: Jaye M. Williams
Chief Financial Officer

SUBJECT: Management Response to Independent Auditor's Report on CBP's
FY 2014 Consolidated Financial Statements

On behalf of U.S. Customs and Border Protection (CBP), I am responding to the Independent Auditor's Report on CBP's Fiscal Year (FY) 2014 Consolidated Financial Statements, which will be included in our FY 2014 Performance and Accountability Report.

I accept the independent public accounting firm's (KPMG LLP), unmodified opinion on CBP's FY 2014 Consolidated Financial Statements, which concluded that CBP's consolidated financial statements are fairly presented in all material respects in conformity with generally accepted accounting principles.

CBP has reviewed and concurs with the one material weakness and the three significant deficiencies identified in the report. Mission Action Plans (MAPs) outlining CBP's strategy to correct these conditions have been provided to the U.S. Department of Homeland Security, Office of Financial Management. CBP will continue to work to resolve all auditor identified weaknesses. CBP non-concurs with two Financial Management Comment Notice of Finding and Recommendation (NFR): NFR 14-21 *Omission of Rotable Parts Accounting Policy from Non-GAAP Analysis* and NFR 14-27 *Error in Performance of 9/30 Payroll Accrual Look-Back Analysis*.

CBP appreciates the opportunity to review this year's audit report and looks forward to continuing our professional auditing relationship with your office. If you have any questions or would like additional information, please contact me at (202) 344-2364, or a member of your staff may contact Judy Starling, Acting Executive Director, Financial Operations Directorate, at (317) 614-4531.



OFFICE OF INSPECTOR GENERAL

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Appendix B Report Distribution

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