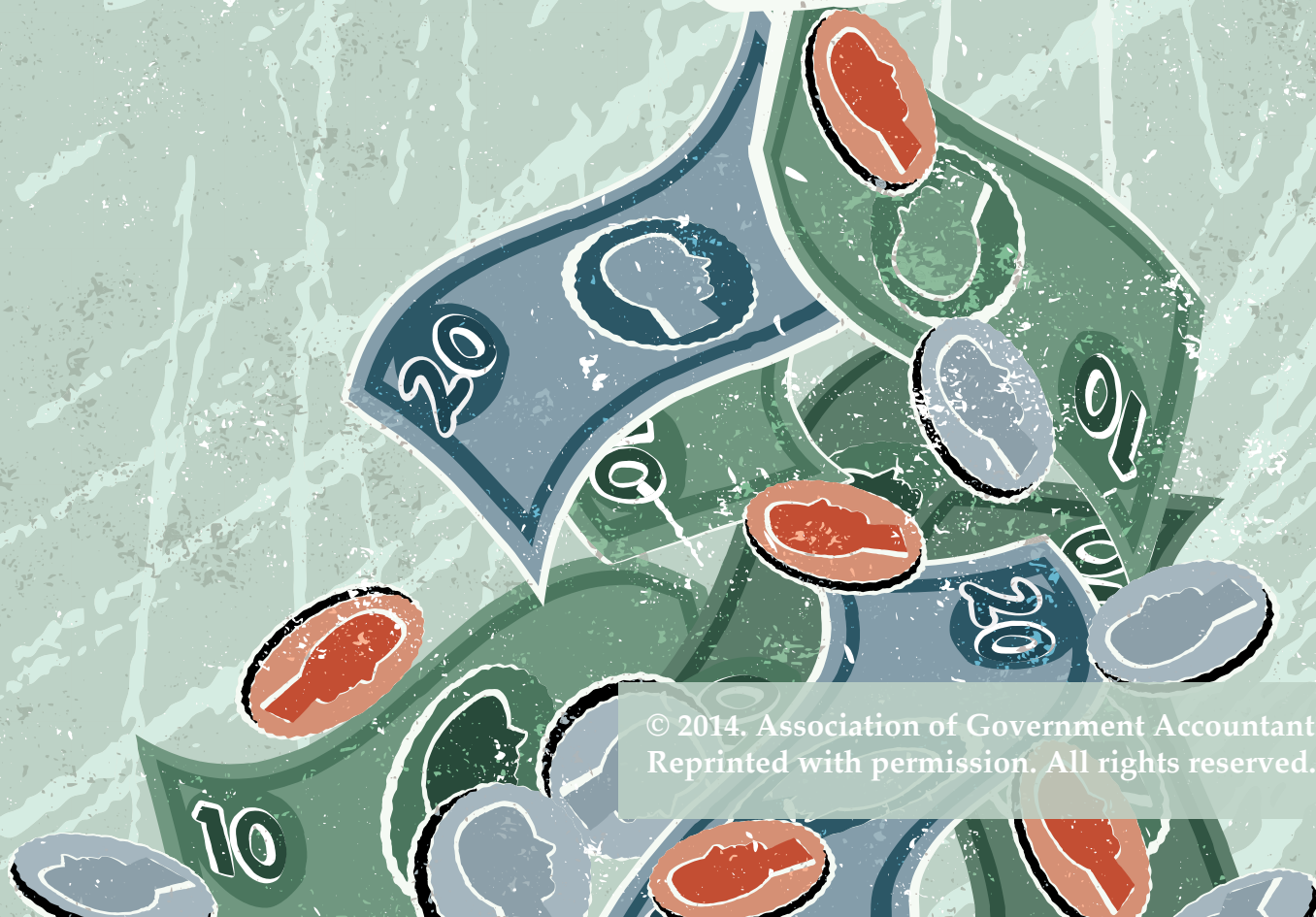


Journal

OF GOVERNMENT FINANCIAL MANAGEMENT SUMMER 2014 VOL. 63, NO. 2

Improper Payments



© 2014, Association of Government Accountants.
Reprinted with permission. All rights reserved.



12



Federal Improper Payments: An Overview

By: Elizabeth Owens and Carol M. Jessup, Ph.D., CPA, CFE

The federal government began earnestly addressing improper payments in 2009, culminating with the Improper Payments Elimination and Recovery Act of 2010. These actions yielded a 'Do Not Pay' list for government use and a transparent website for the public (www.paymentaccuracy.gov). An improper payment rate reduction to 3.53% during FY 2013 resulted.

18



Are You Combat Ready to Win the War Against Improper Payments?

By: Danny Werfel, JD, MPP; and Jeffrey C. Steinhoff, CGFM, CPA, CFE, CGMA

Let's celebrate the 35-percent drop in the rate of improper payments, while committing to appreciably 'up' our game, given the remaining \$100 billion annually. We explore pivotal questions regarding combat readiness and provide context on how the fight against improper payments can yield lower error rates through transformational change.



24



An Emphasis on Payment Integrity: Key Practices to Sustain and Renew Your Commitment to Ending Improper Payments

By: Wendy Morton-Huddleston, CGFM, PMP; and Calandra Dixon, PMP

Offices of Inspectors General reported agency compliance results in reducing and recapturing improper payments for the first time in 2012 under the Improper Payments Elimination and Recovery Act. With trends analysis, CFOs have an opportunity to evaluate their agency results and improve program performance and sustainability.



Denotes articles eligible for CPE hours through AGA's CPE Online Program. This issue of the *Journal* is worth 3 CPE hours, through the CPE Online Program. Visit www.agacgfm.org/cpeonline for more information.

32



We are Here to Help: Redefining External Auditors' Role

By: Geoffrey Frank, MPA, CGFM; and Rich Rasa, CGFM

External auditors, while 'here to help,' are wary of compromising their independence. A new model, now used in grant making agencies, could go a long way toward redefining the external auditors' role in facilitating actions to reduce improper payments and improve program performance, while also effectively maintaining their independence.

38



DHS: The Road to a 'Clean' Opinion

By: David Norquist; Peggy Sherry, CPA; Larry Bedker, CGFM, CPA; and Scot Janssen, CPA

On December 11, 2013, the U.S. Department of Homeland Security (DHS) received a 'clean' opinion on its financial statements. The effort to achieve this milestone spanned two administrations and involved hundreds of people and thousands of changes to processes, systems, and controls. This is the story of that journey

48



Taking a Proactive Approach to Improper Payments

By: Ray Kalustyan

Every day, government agencies make billions of dollars in payments to a staggering number of vendors and citizens; unfortunately, some payments shouldn't have been made. To detect, mitigate and prevent improper payments, government agencies increasingly turn to diagnostic assessments and data management technology.



Departments

- 4 From the Editor
- 8 Letter to the Editor
- 8 AGA Calendar
- 10 Standards Watch
- 54 Inside the Huddle
- 56 Controller's Corner
- 58 Ethics Q&A
- 60 Final Entry: Meet AGA's New President



DHS: THE ROAD TO A

**Clean Opinion
Straight Ahead**



**Financial
Management
Foundation**



'CLEAN' OPINION

**By: David Norquist; Peggy Sherry, CPA;
Larry Bedker, CGFM, CPA; and Scot Janssen, CPA**

On December 11, 2013, the U.S. Department of Homeland Security (DHS) received an unmodified or 'clean' opinion on its financial statements. The effort to achieve this milestone spanned two administrations and involved hundreds of people and thousands of changes to processes, systems, and controls. This is the story of that journey.

**Internal Controls
and Risk
Framework**

**Audit Scope:
Balance Sheet
First**

**Innovative Strategies
for Hard-to-Audit Areas**

CLEAN OPINION

**Working Around
the Financial
Systems**

The Beginning

The formation of DHS was the largest reorganization in the federal government since the creation of the U.S. Department of Defense (DoD) and involved merging 22 federal organizations. Created in response to the terrorist attacks of 9/11, DHS's mission is broad and includes protecting the country from terrorism, securing the borders, responding to natural disasters, law enforcement responsibilities, immigration administration and enforcement, ensuring smooth travel and commerce, protecting the waterways, and cyber security. The importance and breadth of this mission meant that there was rarely a quiet time at DHS.

Each of these events not only commanded leadership attention, but engaged the financial management community in preparing budget requests, tracking obligations, responding to congressional inquiries, and monitoring internal controls to detect or prevent improper payments.

U.S. Department of Homeland Security

- 3rd largest federal agency
- \$60 billion in total budget authority
- \$18 billion in procurements
- \$13 billion in fee collections
- More than 230,000 personnel

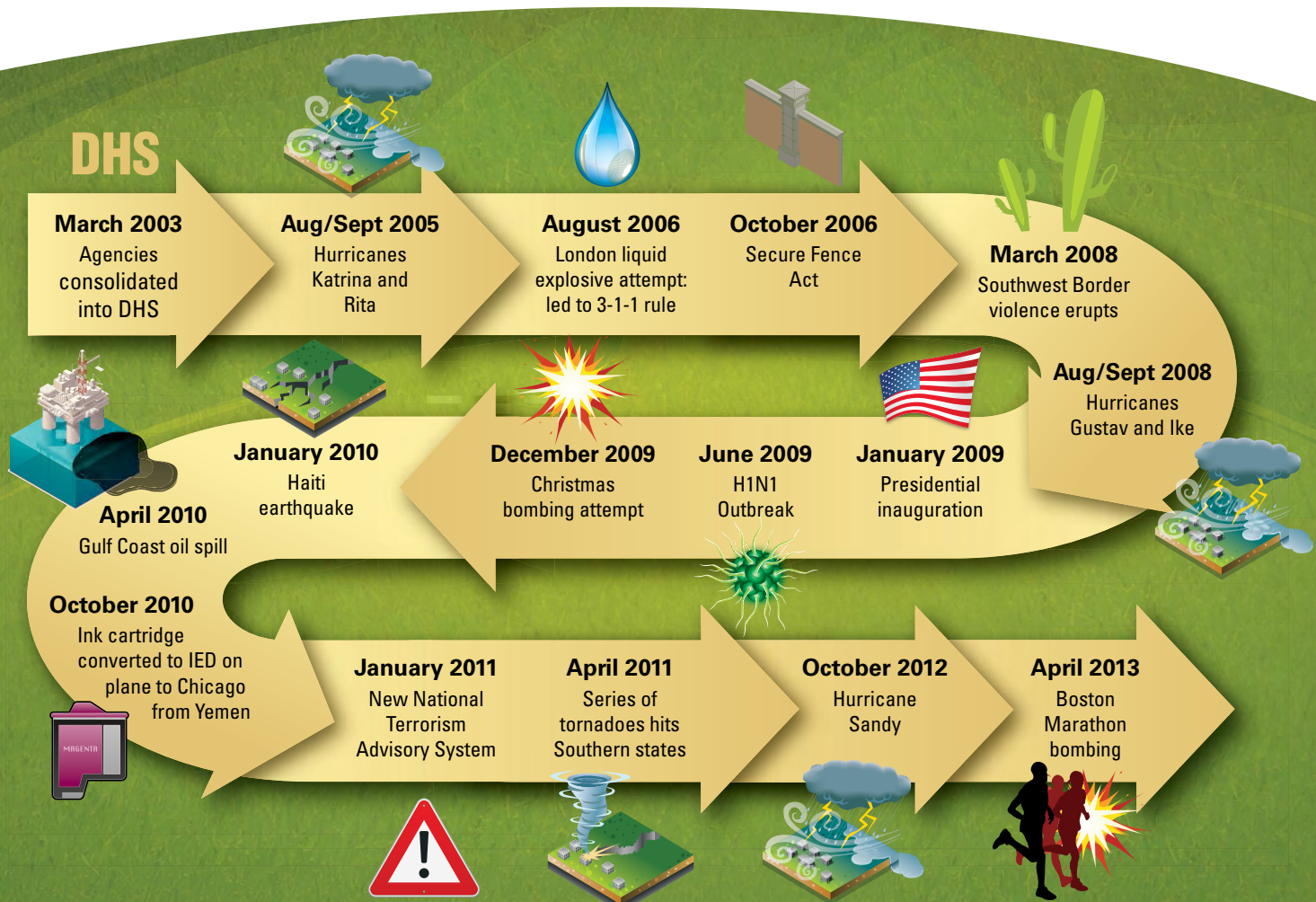
The Challenge

In 2004 Congress passed the DHS Financial Accountability Act, which incorporated this new agency into a series of existing financial management laws and required DHS to get a clean opinion on its financial statements and its internal controls over financial reporting. The challenge was daunting. According to the Congressional Research Service, "Some of the agencies transferred to DHS came with known serious financial management problems. For example, four of the major agencies

transferred... had a total of 18 material weaknesses in internal control reported by auditors for fiscal year (FY) 2002."¹ In addition, the organizations that make up DHS (called Components²) came from eight different parent agencies,³ so their financial management practices, policies, processes and accounting systems were different.

During its first three years, enormous efforts were devoted to implementing basic processes, such as budgeting, cross-servicing agreements, and mission and program development. DHS experienced business and operational issues that are common to a start-up enterprise, limiting the resources that could be dedicated to financial statement audits.

By 2006, DHS's financial management community was in position to shift from focusing on standing up the organization to strengthening the processes and internal controls required for timely and accurate financial data. The financial management community developed



a comprehensive strategy and built support for its implementation within DHS, the Office of Management and Budget (OMB), and Congress. DHS's Secretary made obtaining an opinion on the financial statements a top priority. This supportive 'tone-at-the-top' was critical to institutionalizing a culture shift in DHS's quest for a clean audit opinion.

DHS's Strategy

DHS's strategy for obtaining a clean audit opinion included:

- 1 Developing a strong financial management foundation.
- 2 Establishing an internal control and risk management framework.
- 3 Focusing on the balance sheet first.
- 4 Working around financial systems limitations.
- 5 Employing innovative strategies for hard-to-audit areas.
- 6 Providing strong and consistent leadership support.

Financial Management Foundation

An important first step was to create a strong financial management foundation. This involved targeted recruiting for key positions, developing policies and processes for financial reporting, and providing consistent training for everyone involved in the audit. DHS developed centralized metrics and review processes to ensure the reporting and audit requirements were being followed consistently by Components. The Office of Financial Management under the Chief Financial Officer (CFO) was staffed with additional capacity to respond quickly when a Component needed help with an accounting or auditing issue.

Internal Controls and Risk Framework

Another critical step was to obtain a clear understanding of the depth and breadth of DHS's financial management problems. In this area, the Inspector General (IG) and external auditor became a source of support and information. From the beginning, DHS was audited by an independent public accounting firm who provided DHS with an audit report (which has exceeded

50 pages) of detailed findings. The report was written to maximize the informational benefit of audit findings, root causes and detailed remediation recommendations. DHS's IG was committed to the Department's success. For example, it designed the audit as a 'time and materials' contract which allowed for greater flexibility in the nature and extent of procedures performed and made it possible to produce detailed and relevant findings. In addition, the IG included an easy-to-follow table that identified which Components contributed to each material weakness, as shown in **Figure 1**. This meant that the audit report became a consistent scorecard used to measure progress within the Department.

Focus on Controls

Beginning in 2006, DHS established an internal control framework to assess and strengthen internal controls. For each material weakness identified by the audit, DHS developed corrective action plans. DHS documented its approach in the *Internal Controls Playbook* and included a detailed, multi-year approach to strengthening internal controls. The playbook had two tracks: track one was a plain explanation of each corrective action;

Figure 1. DHS 2006 Independent Auditors' Report Component Conditions Supporting Material Weaknesses^{4,5}

Material Weaknesses	DHS Components									
	OCFO	USCG	TSA	FEMA	CBP	ICE	G&T	US VISIT	FLETC	MGT
Financial Management & Oversight	⬢	⬢								
Financial Reporting	⬢	⬢	⬢							
Financial Systems Security	⬢	⬢	⬢	⬢	⬢	⬢	⬢	⬢	⬢	⬢
Fund Balance with Treasury		⬢								
Property, Plant & Equipment		⬢	⬢					⬢		
Operating Materials & Supplies		⬢								
Legal and Other Liabilities	⬢	⬢	⬢	⬢			⬢			
Actuarial Liabilities		⬢								
Budgetary Accounting		⬢	⬢	⬢		⬢		⬢		⬢
Intragovernmental Balances	⬢									

Figure 2. Audit Readiness Risk Assessment Table

Primary Impact Area	Audit Risk	Component			
		1	2	3	4
Statement of Net Cost	Challenges due to complex cost allocation to 4 or more strategic goals	■	■	■	■
	Proper accounting of reimbursable agreements, including unfilled customer orders	□	□	□	■
	Budgetary posting logic for systems limitations	■	■	■	■
Statement of Budgetary Resources	Ability to provide transaction-level detail to support balances	■	□	□	□
	Inability to record receipt of goods and services; potential understatement of delivered orders unpaid (systems and processes)	□	■	■	□
	Proper classification of and completeness over fee-related revenue	□	□	□	■
	Insurance adjustments to actuarial estimate; agreement between DHS actuaries and external audit actuaries	■	□	□	□
Balance Sheet	PP&E audit readiness for personal property, real property, and/or internal use software	□	□	■	□
	Inability to determine environmental liabilities and cleanup costs, potential impact undetermined	■	■	■	■
Other Risks	Audit-readiness deliverables and management commitment	□	■	■	□

LEGEND	■ High Risk – Level of effort to remediate is high and area is material	■ Medium Risk – Risks exist but effective mitigation strategies are in place	■ Low Risk – Risks exist but they have been mitigated or are not material	□ No known risks have been identified
---------------	---	--	---	---------------------------------------

and, track two outlined a schedule of internal control assessments (test of design, followed by a test of operating effectiveness) for areas where the auditor had not identified a weakness.

OMB assisted by accepting a multi-year A-123 plan that focused on remediation, instead of testing controls known to be deficient. DHS established a Senior Assessment Team and a Senior Management Council that monitored A-123 testing and audit

results, and directed resources to address internal control weaknesses.

Focus on Risk

Another strategy was to focus on areas that were materially important to achieving audit success. For financial statements undergoing audit for the first time, DHS developed audit-readiness risk assessments to identify areas that could cause audit failure (**figure 2**). DHS then developed and implemented action plans to address those high-risk areas and established policies, processes, and structures to help ensure consistent operations across DHS. This strategy

allowed DHS to mitigate any risk of new material weaknesses or audit qualifications and to sustain prior-year successes.

DHS held regular risk management meetings to monitor audit readiness and to ensure corrective action plans addressed control deficiency root causes, provided sufficient resources, and identified critical path milestones to eliminate control weaknesses. DHS also continued to conduct internal control assessments over business processes that affected the remaining financial statements and developed corrective action plans for weaknesses identified during A-123 testing. This process allowed DHS to remediate immediate issues affecting auditability, and to re-engineer business processes to ensure sustainable success in the long term.

EXPERIENCE

We serve the Federal Government exclusively.

Count on Kearney for your agency's accounting needs.

What makes Kearney better? In a word - experience. The fact is, we've served Federal agencies like yours exclusively for over 20 years. Additionally, we've supported all Cabinet-level agencies, 23 of the 24 CFO Act agencies, and over 30 independent agencies as well. Don't take chances with your vital directives. Rely on the experience of Kearney for your accounting needs.

- *Financial Reporting and Accounting Support Services*
- *Financial and Performance Audit Services*
- *Internal Controls/A-123*
- *Program Management*
- *Financial Services*
- *Advisory Services*

**KEARNEY &
COMPANY**

www. Kearneyco.com

Audit Scope: Balance Sheet First

Perhaps the most important decision DHS made around audit scope was to focus on the balance sheet first. The balance sheet is the anchor for all other financial statements, and the system of internal control. It is the only financial statement that shows one day in time. All other financial statements are activity-based and cover a period of time, with the balance sheet as the starting point. DHS needed audited beginning of the year balances (i.e., an audited balance sheet) before activity-based financial statements could be audited.

Within the balance sheet, DHS focused first on Fund Balance with Treasury (FBWT), since nearly every

financial transaction eventually involves cash. Eliminating control weaknesses around cash gave DHS an internal control anchor that served as a foundation to expand control remediation into nearly every financial statement balance.

This balance sheet emphasis greatly expedited DHS's audit success with the activity statements, such as the statement of net cost. In fact, the Department was able to move from a 'balance sheet only' to a 'full-scope' (all statements) audit in one year, with no impact to the opinion or additional material weaknesses, after completing the balance sheet audit.

DHS also stopped performing stand-alone Component audits,

except for CBP, and instead approached the audit as a consolidated corporate challenge, using shared strategies and resources to address issues material to the reliability of the DHS consolidated financial statements.

Working Around the Financial Systems

DHS's financial systems are still largely operating on the same legacy software and platforms the Department inherited in 2003. Some systems are no longer supported by vendors and cannot be modified to fix issues

or improve controls. Others cannot produce audit-ready evidence, or take excessively long to obtain files of auditable transactions. For a number of reasons, DHS has been hindered in its efforts to modernize the systems. Rather than forgoing the opinion until it replaced its systems, DHS developed innovative techniques to work around these limitations to obtain audit evidence for material accounts. For example, because the U.S. Coast Guard's general ledger could not support an audit of FBWT, it developed an ancillary system that provided transactional-level support that was auditable. The Department worked closely with the auditors as it developed its approach to ensure the information available could be audited.

Innovative Strategies for Hard-to-Audit Areas

Property, Plant and Equipment (PP&E), particularly at the U.S. Coast

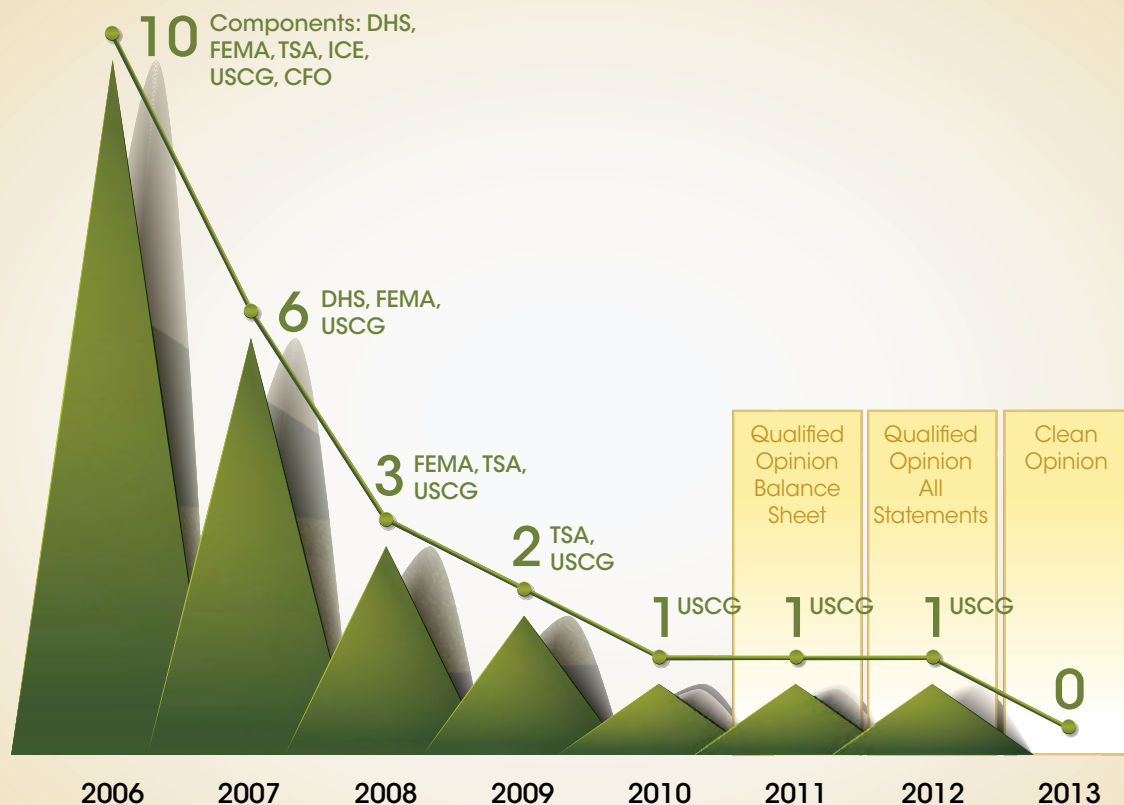
Guard (Coast Guard), was a difficult area to audit. In fact, DHS may have had a clean opinion in 2010 if PP&E had been auditable then. DHS is a highly capital-intensive agency, with equipment spread throughout the United States. For example, the U.S. Customs and Border Protection (CBP) has the southwestern border fence and extensive equipment deployed at points of entry, the U.S. Transportation Security Administration (TSA) has security equipment in over 400 airports, and the U.S. Federal Emergency Management Agency (FEMA) stockpiles disaster relief supplies. The Coast Guard has vessels, aircraft, real property (with environmental liabilities) and operating materials and supplies, as well as a wide range of heritage assets (light houses) that pose unique audit challenges.

Preparing for the audit of PP&E at the Coast Guard was particularly complex and required innovative approaches. Many of these assets were acquired decades ago, at a time

when historical cost records were not required. To address this, DHS used the flexibilities afforded by the Statement of Federal Financial Accounting Standards (SFFAS) No. 35, *Estimating the Historical Cost of General Property, Plant, and Equipment*, to develop methodologies that created auditable evidence. DHS worked closely with the auditors to ensure they understood the estimating process, including methodology, assumptions and data used.

DHS faced a major challenge auditing Coast Guard real property due to the lack of complete and consistent records. Coast Guard engaged a number of experts to develop innovative processes, such as using GPS to identify locations and using engineering studies to develop cost estimates. DHS communicated regularly with its auditors to ensure these non-traditional approaches would provide adequate support that would allow the audit procedures to be performed.

Figure 3. DHS Financial Statement Audit Disclaimer Conditions



The Endgame

The road to the clean opinion was not easy. DHS had its share of disappointments and sometimes needed to backtrack and rework. Progress would reveal previously hidden problems as new areas became ready for audit. In addition, the Department was more vulnerable to setbacks because of its heavy reliance on manual controls and vulnerability to turnover in personnel with system or process knowledge. Managing expectations and strong leadership support were essential to maintaining commitment, high morale and focus.

In fact, leadership support was a critical success factor to finally obtaining its first opinion. DHS is a complex agency with many important missions, yet DHS leadership made a firm commitment to obtain the opinion. This support was evidenced in annual commitment letters, signed by DHS senior leaders, that identified areas to be remediated for the audit. The Secretary visibly committed to obtaining an unmodified audit opinion, and reinforced this expectation during leadership meetings and in public messages expressing support for the audit. Coast Guard leadership similarly reinforced this message. The Vice Commandant held monthly meetings with Coast Guard leadership and the Department to review audit status and provide support where needed. The meetings were an open, honest dialogue about potential problems, road blocks and solutions.

The leadership message was clear — obtaining the opinion was the responsibility of everyone in the organization, not just those in the CFO offices. Also of great importance, DHS leadership consistently ensured funding for audit remediation and the financial statement audit. Ultimately, this leadership commitment is what propelled DHS over the finish line.

The Results

As shown in Figure 3, from 2006 to 2013, the Department reduced the number of audit opinion qualifications from ten to zero, remediated hundreds of control deficiencies, and as a result, the audit report improved every year. In 2012, the Department received a qualified opinion and a clean opinion in 2013 on all its financial statements.

Key Takeaways

- ◆ **Don't fight the audit.** The audit process produces a wealth of information that helped DHS better understand its problems and develop effective corrective action plans.
- ◆ **Look for the problems you don't know exist.** Performing risk assessments and testing your own controls is the only way to stay ahead of the audit. It is important for messaging as well — everyone should understand that uncovering and fixing problems is part of making progress.
- ◆ **Not everything is material.** Evaluate and document what is material and immaterial so you don't waste resources. Focus on risk areas and material accounts and processes that lead to auditability.
- ◆ **Take time to identify the root cause.** Find and fix the root cause so you don't chase the symptoms.
- ◆ **Don't wait for the perfect plan.** Once you find the root cause of any problem, fix what you can and shrink the size and scope of the issue. You will get to write another corrective action plan next year for what you didn't get to. All plans must say who will do what by when; if they don't, they aren't plans.
- ◆ **Leadership commitment counts.** Testing controls and the audit process requires a commitment of resources. Leadership must see this as an important investment.
- ◆ **Have enough people with the right experience.** Possessing the right skills and sharing those skill sets at critical points really matters. It helps to have staff and consultants who have been auditors and are good communicators.
- ◆ **Expect more from your audit.** DHS's external financial statement auditors 'audited through the disclaimer.' They didn't simply turn-in

their report and walk away; DHS met with them all year long. They helped DHS think 'outside the box' and define options to resolve problems. They reported issues in a way that was more helpful to DHS.

◆ **Find a way to measure progress.** DHS used the chart of material weaknesses issued by the IG to show progress to Congress, OMB, and DHS leadership and to encourage and motivate the DHS staff.

◆ **Promote constant, open communications.** Foster a collaborative relationship with the auditors. Work with them to develop various dashboards, metrics and other reporting mechanisms to receive valuable, real-time feedback you can use to expedite corrective actions. If a potential issue was developing, DHS always followed the 'proper order of confession' by informing the auditor immediately after DHS leadership.

Conclusion

Achieving this milestone was only possible due to the hard work and dedication of the entire DHS financial management community. We sincerely thank them for their efforts to build a foundation of sustainable practices that will support DHS operations for years to come. ▮

Endnotes

1. Congressional Research Service, CRS Report for Congress: Homeland Security Financial Accountability Act: History and Recent Developments: November 15, 2004, page CRS-2.

2. The largest components of DHS include the U.S. Coast Guard, Transportation and Security Administration (TSA), Federal Emergency Management Agency (FEMA), Customs and Border Protection (CBP), Immigration and Customs Enforcement (ICE), U.S. Citizenship and Immigration Services (CIS), the Federal Law Enforcement Training Center (FLETC), and the US Secret Service (USSS).

3. Federal agencies that contributed to the creation of DHS included the U.S. Departments of the Treasury, Justice, Transportation, Agriculture, Defense, Health and Human Services, Energy, and the General Services Administration.

4. DHS OIG, Independent Auditors' Report on DHS' FY 2006 Financial Statements: November 2006, page I.1.

5. In addition to the organizations mentioned in end note two, acronyms in this table include the Office of the CFO (OCFO), Office of Grants and Training (G&T), U.S. Visitor and Immigration Status Indicator Technology (US-VISIT), and Headquarters Management (MGMT).

The opinions expressed within this article are those of the authors, and do not necessarily reflect those of their employers.

This article is dedicated to the memory of our friend and co-worker, Bill Mason.



Partner with Kearney & Company, P.C.

David Norquist served as the first Senate-confirmed CFO of DHS from 2006–2008. He has 20 years of Federal financial management experience and is currently a



is currently the Deputy Commissioner for Operations Support at the IRS.

Peggy Sherry, CPA, served in DHS from 2007–2013, starting as the Director of the Office of Financial Management and later, the DCFO and then CFO. She



Services. He joined DHS in 2008 as the Director of the Office of Financial Management and retired from DHS in 2014.

Larry Bedker, CGFM, CPA, spent 29 years in federal financial management at the General Services Administration and the Department of Health and Human



DHS from 2003–2013.

Scot Janssen, CPA, is a partner at KPMG LLP. He has more than 30 years of financial statement audit experience, and served as the lead audit partner at

