



Financial Strategy for Transformation and Audit Readiness (FSTAR)

Fiscal Year 2011 Report to Congress

First Half

August 24, 2011



Homeland
Security

United States Coast Guard

Message from the Commandant

August 24, 2011

I am pleased to present the following report, "Financial Strategy for Transformation and Audit Readiness (FSTAR)," covering the first half of Fiscal Year (FY) 2011. The report has been prepared by the United States Coast Guard.

This document has been compiled pursuant to language in House Report 111-157, which accompanies the *FY 2010 Department of Homeland Security (DHS) Appropriations Act* (P.L. 111-83). The Coast Guard will continue to provide reports on the status of its audit readiness every 6 months.

This report includes the results of the Coast Guard's effort during the first 6 months of FY 2011. In line with Secretary Napolitano's commitment to demonstrate continued stewardship and accountability over financial management, the Coast Guard is concentrating efforts this year on assisting DHS in obtaining an audit opinion on the Department's Consolidated Balance Sheet and Statement of Custodial Activity for FY 2011.



Pursuant to congressional requirements, this report is being provided to the following Members of Congress:

The Honorable Robert B. Aderholt
Chairman, House Appropriations Subcommittee on Homeland Security

The Honorable David E. Price
Ranking Member, House Appropriations Subcommittee on Homeland Security

The Honorable Mary L. Landrieu
Chairman, Senate Appropriations Subcommittee on Homeland Security

The Honorable Daniel Coats
Ranking Member, Senate Appropriations Subcommittee on Homeland Security

I am happy to answer any further questions you may have. Please do not hesitate to contact me at (202) 372-4411 or the Department's Deputy Chief Financial Officer, Peggy Sherry, at (202) 447-5751.

Sincerely,

A handwritten signature in blue ink, appearing to read "R. J. Papp, Jr.", written over the printed name.

R. J. Papp, Jr.
Admiral, U.S. Coast Guard
Commandant

Executive Summary

On November 28, 2008, the Coast Guard submitted the first FSTAR to the House and Senate Appropriations Subcommittees on Homeland Security, as directed in the *FY 2009 DHS Appropriations Act* (P.L. 110-329). This version of FSTAR included the substantive revisions of the Coast Guard's detailed corrective action plans for audit remediation. The Office of the Inspector General evaluated it, and a DHS independent public accounting firm audited it during the spring of 2009: audit number OIG-09-073. House Report 111-157 accompanying the *FY 2010 DHS Appropriations Act* (P.L. 111-83) included language requiring the Coast Guard to submit a report to Congress on the status of FSTAR remediation efforts semi-annually, with the first report due 6 months after passage of the legislation. The Coast Guard submitted the first semi-annual report in April 2010.

The objective of FSTAR was to focus the Coast Guard remediation efforts on financial statement line items with the greatest impact on DHS's ability to obtain a qualified opinion on its Consolidated Balance Sheet and Statement of Custodial Activity without changing major financial systems.

Three years into the execution of FSTAR, the Coast Guard has made substantive progress in strengthening internal controls, improving financial management processes, and remediating many longstanding Notices of Findings and Recommendations (NFRs) and reportable conditions. This report on audit readiness outlines the Coast Guard's achievements during the first two quarters of FY 2011. The Coast Guard will continue to provide semi-annual audit readiness reports to the House and Senate Appropriations Subcommittees on Homeland Security in accordance with the direction provided in P.L. 111-83.



Financial Strategy for Transformation and Audit Readiness (FSTAR)

Table of Contents

I.	Legislative Language	1
II.	Background	2
III.	Overview of First Half FY 2011 Accomplishments	4
IV.	Challenges to a Clean Audit	12
V.	FSTAR Plans for Second Half FY 2011	14
VI.	Sustainment Plans Beyond 2011	18
VII.	Conclusion	19
VIII.	Acronyms	20

I. Legislative Language

This document was prepared pursuant to language in House Report 111-157 accompanying the *FY 2010 DHS Appropriations Act* (P.L. 111-83), which states:

FINANCIAL MANAGEMENT

The Coast Guard's ongoing struggle with internal financial controls is a persistent area of concern. The Committee notes that the Coast Guard lags behind all other DHS components in terms of addressing material weaknesses in these systems, and it is the single largest holder of un-auditable balances in the Department of Homeland Security, according to the IG. At the Committee's direction, in December 2008 the Coast Guard produced an extensive financial management improvement plan for fiscal years 2009 and 2010. The Financial Strategy for Transformation and Audit Readiness (FSTAR) plan should help lead the Coast Guard and DHS out of the financial wilderness. The Committee therefore directs the Coast Guard to provide a report on the progress of this initiative no later than six months after the date of enactment of this Act, and every six months thereafter. This report should include an assessment of the performance of the Coast Guard against the milestones outlined in the FSTAR plan, identification of any remaining major roadblocks to achieving a clean audit, and an outline of proposals on how to remove those roadblocks.

II. Background

On November 28, 2008, the Coast Guard transmitted FSTAR to the Chairmen and Ranking Members of both the House and Senate Subcommittees on Homeland Security, Committees on Appropriations. FSTAR outlined the Coast Guard strategy for audit readiness and identified what the Coast Guard would accomplish during FY 2009 and FY 2010. The current report provides an update on the Coast Guard's accomplishments during the first half of FY 2011. These updated plans incorporate the new financial management resources provided to the Coast Guard by Congress in P.L. 111-83.

In addition to maintaining prior audit successes, the Coast Guard is focused on asserting to the following additional line items in FY 2011: Fund Balance with Treasury (FBwT), Accounts Payable, Accounts Receivable and Net Position. Part III of this report describes the audit remediation progress the Coast Guard made in the first 6 months of FY 2011 as compared to what it planned in the FY 2010 FSTAR report (dated February 7, 2011). Part IV of this report describes the challenges to receiving an audit opinion and the corresponding mitigation strategies. Part V of this report describes the Coast Guard's additional planned activities and milestones for FY 2011 in support of the DHS goal of obtaining a qualified opinion on its Consolidated Balance Sheet and Statement of Custodial Activity at September 30, 2011. Part VI of this report describes the Coast Guard's audit readiness sustainment initiatives for financial management areas that it previously remediated.

The Coast Guard Audit Readiness Strategy

During 2008, the Coast Guard leadership chartered the Audit Readiness Planning Team (ARPT) to develop a strategy for audit readiness that included detailed corrective action plans. The team was composed of the Coast Guard military and civilian personnel and personnel from the DHS Office of the Chief Financial Officer (OCFO). ARPT also received contractor support from a public accounting firm. During this time, FSTAR continued to evolve.

From 2008 through 2010, the Coast Guard's FSTAR strategy focused on the corrective actions necessary for DHS to obtain an opinion on its Consolidated Balance Sheet and Statement of Custodial Activity. These corrective actions are detailed in the Coast Guard's Mission Action Plans (MAPs). MAPs provide a detailed risk-based approach to improving financial processes and removing material weaknesses. These MAPs were originally organized into two primary tracks. Track 1 areas addressed the line items on the Coast Guard Balance Sheet that were financially material to DHS's Consolidated Balance Sheet, were not constrained by current financial systems limitations, and involved the highest risk to DHS. These identified line items neither required major changes to the current financial, asset, and procurement information systems nor impeded the Coast Guard's ability to execute remediation activities. Track 2 areas were line items that did not meet the definition of Track 1. As Track 2 areas became critical to audit success and/or impediments to their remediation were overcome, they were moved to Track 1.

In addition, the Coast Guard identified additional tasks and milestones that were necessary to remediate all known audit-related findings and conditions. These milestones were included in the MAPs.

Because of increased audit scrutiny in FY 2011, the Coast Guard had to expand beyond the original two-track approach to deal with all material Balance Sheet line items. As a result, there are a total of 12 primary focus MAPs in FY 2011. These primary focus areas now include assets and liabilities covered by financial and information systems that will require compensating controls be put in place to support these balances.

In order to achieve its FY 2011 audit goals, the Coast Guard is currently focused on the following 12 areas:

1. Fund Balance with Treasury
2. Military Payroll
3. Civilian Payroll
4. Accounts Payable
5. Accounts Receivable
6. PP&E: Capitalized Personal Property
7. Environmental Liabilities
8. PP&E: Acquisition, Construction, and Improvements (AC&I) Construction in Progress (CIP)
9. Federal Employee and Veteran Benefits/Actuarial Medical Liability (AML)/Actuarial Pension Liability (APL)
10. Inventory and Related Material (Operating Materials & Supplies and Repairable Spares [OM&S])
11. Budgetary Resource Management /Statement of Budgetary Resources
12. Information Technology (IT)

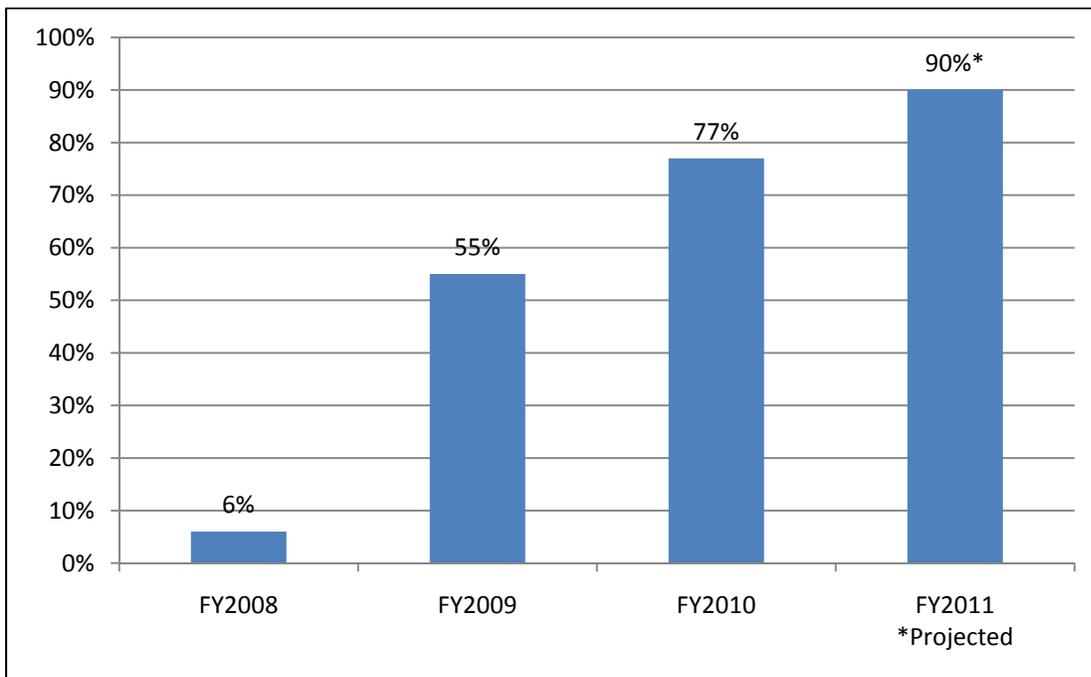
The Coast Guard developed this audit readiness plan to accomplish strategic near-term remediation tasks that will have a material effect toward obtaining an opinion on the DHS Consolidated Balance Sheet and Statement of Custodial Activity while preparing for its migration to a new financial system. The Coast Guard developed this strategy in consultation with the DHS OCFO to ensure that remediation plans directly align with the needs of DHS. This close coordination between DHS and the Coast Guard will continue during the execution of FSTAR and this year's update of the plan.

The Coast Guard will continue to maintain detailed, 2-year corrective action plans (i.e., MAPs) for each audit remediation area. These MAPs are updated each year to reflect the accomplishments of the prior year, illustrate any action items carried over from the previous year, and incorporate new steps to address any additional issues/risks identified by the Coast Guard, the DHS OCFO, or external auditors.

III. Overview of First Half FY 2011 Accomplishments

In response to Secretary Napolitano’s call for DHS to obtain an audit opinion in FY 2011, the Coast Guard is aggressively implementing its plans for correcting financial management and performance deficiencies related to the annual consolidated financial audit. Primary focus areas increased to 12 in FY 2011 and are being executed by multiple remediation teams chartered by the Vice Commandant of the Coast Guard. These teams are composed of Coast Guard financial managers as well as subject matter experts for the business processes under review. The teams have successfully executed MAP remediation efforts. Since the implementation of FSTAR in 2008, they have, to date, produced a nine-fold increase in total assets and liabilities that the Coast Guard is able to support on the Balance Sheet through documentary evidence, data validation, updated processes, and improved internal controls.

Percentage of Value of the Coast Guard Assets & Liabilities Supported



In addition to the quantifiable progress made in remediating specific line items on the Balance Sheet (highlighted in the above chart), the Coast Guard is making meaningful progress in re-engineering the business processes necessary to migrate to a new system solution, remediating deficiencies in existing Coast Guard IT systems, and improving entity level controls (ELCs).

The Coast Guard’s current financial system does not comply with the requirements of the *Federal Financial Management Improvement Act*, the Office of Federal Financial Management, or the U.S. Standard General Ledger (USSGL). This condition has limited progress toward audit readiness for several material line items in the past. To overcome this limitation, compensating controls have been put in place to support areas of audit emphasis. In particular this year, the Coast Guard is addressing areas within FBwT and Net Position. To compensate for these

systemic deficiencies, the Coast Guard is employing computer-assisted audit techniques that allow visibility into transactional data to support the entire population of the Coast Guard accounting activity.

Fund Balance with Treasury (FBwT)

Of critical importance this year is the remediation effort in FBwT. The FBwT line reflects the Coast Guard's general ledger account balance with the Department of the Treasury and is the net effect of all collections and disbursements. It represents the aggregate amount with which the Coast Guard is authorized to make expenditures and pay liabilities. As such, it ties together many other line items reported in the financial statements and is essential to the Department obtaining a qualified audit opinion on the Consolidated Balance Sheet and the Statement of Custodial Activity.

At the end of the second quarter of FY 2011, the Coast Guard delivered all material FBwT reconciliations (\$6.5B) for the first six months of FY 11 to the auditors. In addition, all FY 2010 transactions have been analyzed and corrected to support the beginning balances for these accounts as of October 1, 2010. The Coast Guard relied on computer-assisted audit techniques to test and analyze the entire population of data, and is conducting additional analysis to test transactions and overcome system limitations.

Non-Payroll Agency Location Codes (ALCs)

Agency Location Codes are assigned to Government agencies by Treasury; they are used to identify accounting stations within the agency. To address the three major non-payroll FBwT ALCs in FY 2011, the Coast Guard has combined elements of the existing FBwT MAP with those of the general ledger and financial reporting MAPs. Because the ALCs for Core Accounting System, Surface Forces Logistics Center, and Aviation Logistics Center also represent the three major general ledger systems, this alignment is natural. To support transaction level detail for FBwT, the Coast Guard developed the full population of transactions of all three general ledgers using computer-assisted audit techniques. This has allowed the Coast Guard to:

- Map how the full population of detailed transactions is posted and ensure that it is being done in compliance with generally accepted accounting principles (GAAP) and with USSGL requirements;
- Identify and validate any manual or system adjustments that modify the transactions within the general ledger;
- Identify, quantify, and correct any errors or mispostings; and
- Establish repeatable exception reports that can be used to identify and correct issues as identified by these procedures.

In addition, the Coast Guard is working to ensure that every transaction can be supported by sufficient and appropriate documentary evidence. To accomplish this, the Coast Guard examined each type of transaction that is posted to the three general ledgers and determined the nature and type of documentation necessary to support them for audit purposes. The location of

these documents has also been established to facilitate the audit process. A documentation matrix of this information has been created and disseminated Coast Guard-wide. Outreach and training have been provided, using the chain of command as well as identifying headquarters and field units responsible for generating financial transactions. This was done to familiarize them with audit requirements and with ways to use the documentation matrix to support audit queries. Also, a communications strategy has been adopted to increase the awareness of the importance of the audit and the need for timely and complete responses to auditors' requests.

Military Payroll

In FY 2011, the Coast Guard will again assert to the auditability of the balance of the FBwT military payroll line item. Although this area represents approximately \$200 million on the Balance Sheet at year end, more than \$4.0 billion in transactions (for active, reserve, and annuitants) flow through military payroll every year, thus representing sufficient risk to warrant aggressive remediation attention. In FY 2010, the independent auditors subjected three ALCs that process military active/reserve and retiree/annuitant payrolls to a more in-depth evaluation during the financial statement audit than in prior years. These increased audit efforts revealed discrepancies in payroll and leave accruals. The subsequent remediation efforts resulted in the Coast Guard successfully modifying its procedures for accounting for military payroll accruals, and will lead to an assertion as to the compliance of military payroll with GAAP for FY 2011.

During the first and second quarters of FY 2011, the Coast Guard:

- Completed remediation efforts involving the 100-percent recertification of member data, validating the data and correcting as needed;
- Assisted the Servicing Personnel Offices (SPOs) through self-assessment tools;
- Corrected errors in military human resources (HR) data; and
- Conducted tests on the new military payroll process.

Civilian Payroll

In FY 2011, the Coast Guard will again assert to the correctness of the FBwT civilian payroll line item. Similar to military payroll, the year-end balance of this line item is small, but more than \$800 million in transactions flowed through this process last year. The Coast Guard still has work to complete regarding civilian HR internal controls. The effort to remediate FBwT civilian payroll will capitalize on many of the lessons learned and best practices from other DHS Components using the same civilian pay service provider, the U.S. Department of Agriculture's National Finance Center (NFC). The following lists the Coast Guard's achievements for this account in the first half of FY 2011:

- Identified control gaps in the civilian payroll process by initiating an internal control gap analysis, and
- Conducted internal control assessment planning.

Accounts Payable

During the first half of FY 2011, the Coast Guard completed an in-depth analysis of the Accounts Payable line item. As of September 30, 2010, about 66 percent of the Accounts Payable balance of \$2.2 billion (before eliminations) consisted of the Oil Spill Liability Trust Fund (OSLTF) and Sports Fish Restoration and Boating Trust Fund (SFRBTF) Accounts Payable. To support the assertion of the Trust Funds' Accounts Payable balances, the Coast Guard performed tests of design and operating effectiveness over internal controls, examined the Statement of Auditing Standards (SAS) 70 report over controls at the Treasury Department's Bureau of Public Debt, and reconciled the Accounts Payable balance by rolling forward the balances from previous years.

The Coast Guard also made progress toward remediating and asserting to the balances of the remaining Accounts Payable. During the first 6 months of FY 2011, the Coast Guard:

- Performed testing of internal controls;
- Implemented compensating controls to support the Accounts Payable balance;
- Determined standard Accounts Payable documentation support and communicated through training to Key Process Owners (KPOs);
- Released interim Accounts Payable policy; and
- Enhanced vendor maintenance to improve controls over payments and accurate vendor information.

Accounts Receivable

During the first and second quarters of FY 2011, the Coast Guard finalized plans to assert to the trust fund transfer Accounts Receivable balances of \$170 million and \$139 million due from the OSLTF and SFRBTF, respectively, as of September 30, 2010, and will execute those plans in the second half of FY 2011. These balances make up 63 percent of the Coast Guard's Accounts Receivable balance, which was \$495 million as of September 30, 2010 (before eliminations). To support the Trust Fund Accounts Receivable balances, the Coast Guard performed tests of design and tests of operating effectiveness over internal controls, examined the SAS 70 (attestation [AT] Section 801) report over controls at the Treasury Department's Bureau of Public Debt, and reconciled the receivable balance by rolling forward the balances from previous years. The Coast Guard made progress toward remediating and asserting to the balances of the remaining Accounts Receivable. During the first 6 months of FY 2011, the Coast Guard:

- Established standard documentation support required for Accounts Receivable balances;
- Implemented compensating controls over intragovernmental receivables and updated related policies and procedures;
- Determined that the allowance for doubtful accounts did not meet the Coast Guard policy and implemented improvements to the procedures; and
- Released the updated Accounts Receivable policy.

PP&E: Capitalized Personal Property

In the prior fiscal year, the Coast Guard conducted several 100-percent physical inventories of capitalized personal property and developed and implemented alternate valuation procedures in support of the completeness, existence, and valuation audit assertions. These efforts focused on vessels, aircraft, and small boats. As of September 30, 2010, these assets represent roughly \$5.6 billion, or nearly half, of the PP&E line item. Efforts in FY 2011 are focused on sustaining the completeness, existence, and valuation audit assertions of capitalized personal property and on establishing a baseline inventory count of real property. The Coast Guard accomplished the following during the first half of FY 2011:

- Completed tests of operating effectiveness of internal controls related to the physical inventory count procedures for personal property;
- Conducted a second quarter Coast Guard-wide (encompassing more than 1,100 geographically disbursed units) physical inventory of vessels, aircraft, small boats, and approximately 100 leases related to recruiting offices. Results include:
 - 99 percent of the units reporting within the 7-day count phase;
 - 100 percent of all units reporting within 11 days; and
 - 100 percent of units' inventory packages being accepted in 18 days, which was 8 days faster than in September 2010.
- Established the real property classification process guide (95 percent complete) for the management of real property and established standard reporting attributes for the Shore Asset Management System and the Oracle Fixed Asset System;
- Conducted 30 field site visits to gather information on the current status of inventory completeness; and
- Developed a uniform design of placards to mark real property across all units.

Environmental Liabilities

Shore facilities, vessels, and boats comprise the Environmental and Disposal Liabilities line item. Environmental liabilities were estimated at \$974 million as of September 30, 2010. To prepare for asserting to this line item in FY 2012, to date in FY 2011, the Coast Guard has:

- Created the initial process flow for the entire environmental liabilities process; and
- Surveyed field offices to support individual units' initial identification of potential environmental liabilities.

PP&E: AC&I CIP

During FY 2010, the Coast Guard cleaned up or validated 60% of the AC&I Construction in Progress. In the first half of FY 2011, the Coast Guard continued efforts and reduced the CIP balance by removing and capitalizing approximately \$291 million of "in-use" assets and expense items, thereby reducing the overall CIP balance to \$2.3 billion, the lowest amount since 2006. The Coast Guard has focused its efforts on standardizing project establishment meetings and periodic project reviews, resulting in more accurate and timely CIP information. Thus far in FY 2011, the Coast Guard has:

- Completed the capitalization of more than \$291 million of delivered assets by executing cost-effective valuation methodologies for each asset;
- Conducted the tests of design of key internal controls associated with CIP life-cycle events to assess the adequacy of associated policy and procedures; and
- Drafted CIP policies to fill policy gaps associated with capital and operating leases, internal use software, real property operating leases, real property, and the use of operating expense funding for CIP life-cycle events.

Federal Employee and Veteran Benefits/AML/APL

In FY 2011, the Coast Guard will again assert to the balance for Federal Employee and Veteran Benefits Actuarial Liability, which is the largest single line item on both the Coast Guard and consolidated DHS Balance Sheet (representing \$42.5 billion as of September 30, 2010).

Actuarial Medical Liability

In FY 2011, the Coast Guard will again assert to the balance of Actuarial Medical Liability. During the first and second quarters of FY 2011, the Coast Guard's remediation plans for AML continued to be very aggressive. The Coast Guard's remediation actions required close coordination with and cooperation from the Department of Defense (DOD) and the various Military Treatment Facilities (MTFs) where Coast Guard personnel and their dependents receive care. The Coast Guard completed the following milestones in the first half of FY 2011:

- Tested controls over updated procedures in place to validate the eligibility of Coast Guard employees, retirees, and their dependents;
- Initiated a medical coding audit to test whether the Coast Guard received the medical services for which it was billed;
- Verified that TRICARE Management Activity will provide SAS 70 reports for service organizations performing controls for military health insurance costs;
- Drafted a written desk guide to provide guidance to the medical liability KPOs by outlining the tasks requiring completion to assert to the year-end balance;
- Performed an invoice reconciliation procedure to determine the accuracy of MTF invoices received for FY 2010 and FY 2011; and
- Developed and implemented MTF invoice data validation procedures to test the eligibility and the accuracy of other pertinent invoice data before payment.

Actuarial Pension Liability

In 2011, the Coast Guard will continue to assert to the balance of the APL line item. At \$33.7 billion, APL was the single largest line item on the Coast Guard's balance sheet on September 30, 2010, comprising three quarters of the Coast Guard's total liabilities and more than a third of the DHS total liabilities. The Coast Guard's ability to support the accuracy of this line item is essential to achieving the DHS goal of obtaining a qualified opinion on its Consolidated Balance Sheet. In FY 2011, the Coast Guard accomplished the following milestones:

- Posted corrections of the outstanding items reported as errors during a military personnel 100-percent HR data verification to Coast Guard official Personnel Data Record, and
- Developed requirements and quality assurance criteria for a new actuarial services contract in FY 2011.

Inventory and Related Material

Last year, the Coast Guard asserted to the correctness of the \$211 million OM&S inventory and the related line item as of September 30, 2010, and will continue to do so in FY 2011. Thus far in FY 2011, the Coast Guard has corrected the non-material items identified during the FY 2010 audit and internal reviews and is focusing on sustainment and improvement efforts over OM&S key internal controls. In addition, the Coast Guard has increased focus on preparing Repairable Spares for audit.

Financial and Mixed Financial Systems

The majority of the previously described areas address individual line items on the balance sheet. In addition to the remediation work in those areas, the Coast Guard completed a great deal of work focused on business process reengineering. This included other steps necessary to fully remediate its material weaknesses in internal controls while preparing for migration to a new financial management system. The following are some of the Coast Guard's key activities:

- *The Coast Guard Finance Center (FINCEN) Business Process Reengineering effort*
This continuous effort documents the existing financial accounting processes (e.g., payables, receivables, and financial reporting) and mixed financial processes (e.g., acquisition, fixed assets, and inventory) as the Coast Guard executes them in its current financial system. The Coast Guard compared the current processes against the financial system requirements provided by the Office of Management and Budget (OMB) and the Financial Systems Integration Office and reported the known gaps. On the basis of the gaps identified, corrective action plans were developed.
- *IT Security*
During FY 2011, the Coast Guard's efforts on IT issues have focused on the remediation of outstanding IT NFRs from the FY 2010 financial statement audit. This is being accomplished using a Systems Maintenance Agent to provide for the near-term sustainability of CAS at FINCEN and conducting a variety of activities related to preparing for the establishment of a new financial management systems environment. The Coast Guard has established a development environment and an associated change control process to test potential software changes to the CAS suite that will bring the Coast Guard closer to audit compliance.

Other

Investments and Contingent Legal Liabilities

In 2011, the Coast Guard continued to assert to the \$3.4 billion investments balance and the \$141.9 million Contingent Legal Liabilities balance. The continued efforts in these areas successfully remediated the prior material weaknesses in the Coast Guard's internal controls.

Entity Level Controls

The Coast Guard continues to make great strides toward improving the overall control environment across the organization, and Coast Guard leadership has increased the importance of and focus on financial management. The addition of the DHS Chief Financial Officer (CFO) to the Coast Guard Executive Management Council – Internal Control and Audit Readiness Board has been vital in continuing to align the efforts of the Coast Guard with DHS audit remediation priorities. The Coast Guard is highly focused on audit remediation and implementing the FSTAR to help the Department obtain an opinion. Active commitment of the Coast Guard leadership is the cornerstone to remediating entity level control weaknesses and supports the Coast Guard's commitment to sound financial management. The Coast Guard accomplished the following critical path milestones relating to entity level controls in FY 2011

- Developed and implemented a management control assessment process to determine the reliability of the Coast Guard's internal controls over financial reporting. This process is aligned with OMB Circular A-123 and DHS internal control assessment guidance;
- Put in place a comprehensive Management Control Plan under CFO signature;
- Provided training related to OMB Circular A-123 and the Federal Information Systems Controls Audit Manual to the Internal Control Division;
- Identified control issues and compliance gaps for corrective action and audit remediation; and
- Institutionalized the Coast Guard Financial Management Accounting Oversight Board to adjudicate accounting issues and/or changes in line with GAAP and overarching standards as promulgated by the Federal Accounting Standards Advisory Board, OMB, and other standards-setting entities.

IV. Challenges to a Clean Audit

The Coast Guard continues to work closely with the Department to mitigate ongoing challenges detailed in the FY 2010 report that include:

Coast Guard Core Accounting System – The Coast Guard financial system does not comply with the *Federal Financial Management Improvement Act*, Office of Federal Financial Management, and USSGL requirements. This noncompliance of the basic systems for financial management limits progress toward audit readiness for multiple material line items.

Mitigation Strategy: Within the constraints of the current system, the Coast Guard has taken action to improve compliance with USSGL in its different general ledger systems. It is currently implementing procedures for better control over an improvement in vendor data and intra-governmental reporting. The Coast Guard has made significant progress on IT general control deficiencies; these efforts will continue in the second half of FY 2011. In addition, the Coast Guard is conducting an evaluation of application controls over its general ledger system to initiate remediation action as needed. The Coast Guard is developing mitigating and compensating methodologies, where able, to overcome system limitations.

Standardized Policy Implementation – Given the widely distributed nature of the Coast Guard's workforce, it is challenging for the Coast Guard to establish standard policy enforcement across the organization.

Mitigation Strategy: The Coast Guard Executive Management Council has chartered an Internal Controls and Audit Readiness Board, chaired by the Vice Commandant, to provide executive leadership of the audit readiness process and ensure both process owners and financial managers execute standardized policy and practices. In addition, the Coast Guard is implementing a management control program to oversee compliance with applicable policy and internal controls.

Change Management – Resolving existing material weaknesses will require changes in various Coast Guard processes. Overcoming the natural resistance to change and precluding remediation processes from reverting to their previous state requires aggressive leadership, clear policies and guidance, and constant reinforcement.

Mitigation Strategy: The Coast Guard Internal Controls and Audit Readiness Board serves as the venue where resistance to change is addressed by executive leadership. The Internal Controls Division, also acting as a dedicated change management team, is in place to support the FSTAR execution teams by integrating internal control assessment and related change management activities into the execution of the MAPs. As the Coast Guard remediates processes, it is developing internal controls and monitoring systems to sustain efforts and ensure progress is not lost because of an inability to adapt or lack of knowledge.

Data Integrity at MTFs – Invoices presented to the Coast Guard by the DOD Military medical treatment facilities lack sufficient detail for audit compliance.

Mitigation Strategy: Because DOD procedures and internal controls have not changed sufficiently since FY 2010, the Coast Guard will continue to conduct eligibility verifications and a claims audit in FY 2011. Coast Guard leadership will work closely with DOD leadership in both the medical and comptroller organizations to provide detailed medical invoices electronically to the Coast Guard. Detailed invoices will provide the Coast Guard with the information necessary to validate the accuracy of DOD medical bills at the time of payment. This effort will determine the impact of the errors and will allow the Coast Guard to adjust the actuarial accrual model to account for known errors and produce an auditable balance.

Support for Valuation, Completeness, and Existence of Real Property – The Coast Guard owns and leases more than 12,000 real property assets, some in remote locales with potentially complex historical ownership chains of custody. Some purchases can date back hundreds of years, and much historical acquisition cost documentation is typically not readily available.

Mitigation Strategy: The Coast Guard has worked closely with the FASAB to develop alternative valuation methodologies for use with vessels, aircraft, and small boats. The Coast Guard will continue this engagement with FASAB to develop a cost-effective means of supporting the value for legacy real property that meets audit standards in a manner consistent with good stewardship. The physical inventory procedure, which was developed and implemented to support vessels, aircraft, and small boats during FY 2010, will be refined to include real property to support the “existence” assertion for these assets.

Support for Valuation of Inventory and Related Material – The Coast Guard owns a wide variety of repairable spares classified as PP&E, as well as OM&S items dating back many years, which support older surface assets in particular. Historic acquisition/payment documentation for newer purchases is readily available, although many of the older items lack such supporting documentation

Mitigation Strategy: The Coast Guard tested the availability of supporting documentation for OM&S. The Coast Guard pulled two statistically representative samples for the ALC and SFLC, respectively. The sample items that it could not validate were valued alternatively to support the cost. The Coast Guard then made a projection over the whole population to support valuation. The Coast Guard will apply a similar approach for PP&E Repairable spares in the second half of FY 2011 and will continue to remediate remaining conditions for both categories of items.

V. FSTAR Plans for Second Half FY 2011

The Coast Guard's goal by the end of FY 2011 is to support more than 90 percent of the dollar value on its Balance Sheet by asserting to Fund Balance with Treasury, Accounts Payable, Accounts Receivable, Actuarial Liabilities, segments of Property, Plant & Equipment, and Net Position. To achieve this, the Coast Guard has focused on implementing Mission Action Plans in 12 focus areas. The following lists the Coast Guard's Second Half FY 2011 plans for each of the focus areas.

FBwT

Non-Payroll

By the end of FY 2011, the Coast Guard will have reconciled all seven of its FBwT accounts. Beginning balances as of September 30, 2010, will be fully supported through the use of computer-assisted audit techniques. Monthly reconciliations completed during FY 2011 will be supported at the detail transaction level. With the development of computer-assisted audit techniques, the tracing and validation of transactions will become a repeatable process that will ensure USSGL-compliant postings and supportable topside adjustments. In other areas, the Coast Guard will rely heavily on best practices from other DHS Components for process improvements in areas such as reconciliation of civilian payroll and leave accruals.

Military Payroll

The Coast Guard will perform self-assessments on personnel data records held in the field at SPOs by the start of the second half of FY 2011, which will highlight the decisive nature of controls (specifically segregation of duties and records retention). A KPO turnover plan relating to payroll processes and internal controls will be developed in the second half of FY 2011, but the transfer of KPO responsibilities at the strategic and operational levels depends on identification of resources in conjunction with the KPO transfer.

Civilian Payroll

The Coast Guard will focus its efforts in the second half of FY 2011 on planning to rollout WebTA to 35 percent of the employees by the end of the fiscal year. The Coast Guard will also perform substantive analytical procedures on the civilian payroll balance and will review the SAS 70 (AT Section 801) report on the NFC. The critical achievements that the Coast Guard plans on executing for this account in the second half of FY 2011 are:

- Implementing process improvements;
- Continuing to update process documentation and develop policies; and
- Completing tests of design and effectiveness over internal controls.

Accounts Payable

The Coast Guard will continue to support its assertion of the Accounts Payable balances in the second half of FY 2011 through evaluation of the Trust Fund SAS 70 (AT Section 801) and testing controls over the FINCEN subsequent disbursement process, promulgating Accounts Payable procedures based on the Financial Resource Management Manual – Procedures, and completing remediation efforts for Deepwater Horizon Incident deficiencies.

Accounts Receivable

The Coast Guard will focus the second half of FY 2011 on continuing its remediation efforts on federal reimbursable Accounts Receivable. These efforts will include promulgating revised procedures, implementing training of program managers, developing, testing, and implementing a SharePoint site to track the reimbursable agreement activity flow and maintain agreements, and implementing and conducting training on the standard Interagency Agreement.

PP&E: Capitalized Personal Property

During FY 2011, the Coast Guard will continue to build on the FY 2010 success achieved in supporting the completeness, existence, and valuation of its vessels, aircraft, and small boat assets. The Coast Guard will use the lessons learned in these areas to expand into real property, vehicles, and major electronic systems. These efforts are extremely complex and involve some real property assets that have been in the Coast Guard's inventory since the early 1800s.

Environmental Liabilities

Environmental liabilities depend entirely on the capitalized property efforts. In FY 2011, the Coast Guard will refine the estimated liabilities associated with real property, such as lighthouses, buildings, land, and structures. This effort is dependent on the development of a complete inventory of Coast Guard real property assets. Furthermore, the Coast Guard will continue the development of systematic and repeatable procedures for the assessment and valuation of environmental liabilities.

PP&E: AC&I CIP

During FY 2011, the Coast Guard will complete the capitalization of all legacy "in-use" capital assets. Furthermore, the Coast Guard will strengthen and improve the processes used to evaluate all "active" CIP projects to ensure timely recording of capitalizable assets and accurate reporting of CIP project balances. The Coast Guard anticipates auditors will begin testing of the CIP balance in the third quarter of FY 2011.

Federal Employee and Veteran Benefits/AML/APL

The Coast Guard will focus the second half of FY 2011 on efforts to continue to improve the integrity of the data provided to the actuary for the medical liability calculation. The Coast Guard will test age-based tables for purchased care and will perform testing of active vs. retired

and Medicare Eligible Retiree Health Care Fund. Additionally, the Coast Guard will perform a medical coding test to determine the accuracy of medical cost data feeding the actuarial model. The decision on how to sustain billing processes going forward will progress through negotiations with DOD with the objective of implementing a per-capita billing system. The Coast Guard would receive one large invoice from DOD, and the Coast Guard members would be able to receive medical services from any DOD clinic, which would greatly simplify the billing process.

Inventory and Related Material OM&S and Repairable Spares

In FY 2011, the Coast Guard will mainly focus on assessing internal controls and performing test of design and test of operating effectiveness for OM&S and Repairable Spares valuation and physical inventory counts. The Coast Guard will do this to remediate compliance gaps identified in the prior year and to ensure proper controls are in place for sustainability. For PP&E Repairable Spares, the Coast Guard will conduct remediation and testing necessary to support assertions for this component of PP&E by the end of FY 2011. The Coast Guard will also focus on updating policies and procedures for better valuation and physical inventory processes.

Budgetary Resource Management/Statement of Budgetary Resources

A new area of focus for 2011 is the Statement of Budgetary Resources, which is inextricably linked to FBwT. In FY 2010, the Coast Guard performed a root-cause analysis to determine the fundamental reasons for *Anti-Deficiency Act* risks. In FY 2011, the Coast Guard plans to continue efforts to implement corrective action to remediate these issues as well as improve policies and procedures over the budgetary resource process. Additionally, the Coast Guard will implement business process improvements over undelivered orders, commitments, and obligations to support those balances. If necessary, the Coast Guard will determine the magnitude and direction of any errors using computer-assisted audit techniques.

IT Governance & IT Controls

In FY 2011, the Coast Guard will continue efforts to remediate remaining IT NFRs and further mature its Systems Maintenance effort for CAS, to include completion of system documentation. In view of the audit and related compliance challenges and the performance limitation of its current financial management systems environment, the Coast Guard must transition to a new financial, asset, and procurement management system in the near term. The objectives of this transition will include:

- Conversion of impacted systems to a USSGL-compliant accounting line structure, establishing a more highly integrated general ledger;
- Elimination of custom/commercial off-the-shelf solutions that present many of its audit and performance challenges; and
- Implementation of more-robust analytic capabilities.

The Coast Guard plans significant efforts for FY 2011 related to governance processes, including the furtherance of the C4IT [Command, Control, Communications, Computers, and Information Technology] Governance.

Financial and Mixed Financial Systems

The Coast Guard will continue to focus on preparations for migration to a new financial management system. The Coast Guard has established a Program Management Office (PMO), reporting to the Deputy CFO, to lead this effort under the guidance of an executive steering committee consisting of executives from the IT, Human Capital, Finance, Logistics, and Acquisition directorates. The PMO will leverage the OMB Circular A-123 documentation effort previously discussed to update system architecture requirements to prepare for the migration to a new system. The PMO will work with the various Coast Guard process owners to develop migration strategies that will comply with the requirements of a new system without disrupting or having a negative impact on Coast Guard operational effectiveness. In addition, the Coast Guard will continue to aggressively remediate control deficiencies associated with its financial and mixed financial IT systems.

Other

ELC

In the remainder of FY 2011, the Coast Guard will implement its Management Control Program as a comprehensive internal controls plan that includes a robust risk management strategy. Incorporating a risk management strategy allows the Coast Guard to anticipate, identify, assess, and respond to key financial management risks affecting the organization. Additionally, the Management Control Program will incorporate elements of change management that will prepare and support the organization during audit remediation and readiness. The Coast Guard Management Control Program will be in complete alignment with OMB Circular A-123 guidance, as well as with DHS policy and industry leading practices.

VI. Sustainment Plans Beyond 2011

A key challenge in achieving and maintaining audit readiness is the sustainment of the newly implemented internal controls and GAAP-compliant process changes introduced by various process owners. To ensure personnel continue to follow the process improvements enacted during audit preparations, the Coast Guard developed and implemented oversight, control, and monitoring activities to measure and evaluate effectiveness. These sustainment activities and the overarching agency-wide management control program will position the Coast Guard for success in future financial audits and continuing improvements in its overall financial management.

VII. Conclusion

Although facing significant challenges, the Coast Guard is committed to asserting to the correctness of its balance sheet line items and is doing everything possible to support the Department in obtaining an opinion on the Consolidated Balance Sheet and Statement of Custodial Activity in FY 2011. The Coast Guard has designed an aggressive plan to improve its financial management through continuous implementation of FSTAR. In addition, the Coast Guard is expanding its remediative activities, and will continue to implement the FSTAR to be ready for audit of all financial statements in the near future.

VIII. Acronyms

AC&I	Acquisition, Construction, and Improvements
ALC	Agency Location Code
AML	Actuarial Medical Liability
AP	Accounts Payable
APL	Actuarial Pension Liability
AR	Accounts Receivable
ARPT	Audit Readiness Planning Team
AT	Attestation
CAS	Core Accounting System
CFO	Chief Financial Officer
CIP	Construction in Progress
DHS	Department of Homeland Security
DOD	Department of Defense
ELC	Entity Level Control
FBwT	Fund Balance with Treasury
FINCEN	Finance Center
FSTAR	Financial Strategy for Transformation and Audit Readiness
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
HR	Human Resources
ICP	Inventory Control Point
IT	Information Technology
KPO	Key Process Owner
MAP	Mission Action Plan
MTF	Military Treatment Facility
NFC	National Finance Center
NFR	Notice of Findings and Recommendations
OCFO	Office of the Chief Financial Officer
OM&S	Operating Materials & Supplies
OMB	Office of Management and Budget

OSLTF	Oil Spill Liability Trust Fund
PMO	Program Management Office
PP&E	Property, Plant, and Equipment
SAS	Statement of Auditing Standards
SFLC	Surface Forces Logistics Center
SFRBTF	Sport Fish Restoration and Boating Trust Fund
SPO	Servicing Personnel Office
USSGL	U.S. Standard General Ledger