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**U. S. DEPARTMENT OF JUSTICE**
**ANNUAL FINANCIAL STATEMENT**
**FISCAL YEAR 2002**

**OFFICE OF THE INSPECTOR GENERAL**
**COMMENTARY AND SUMMARY**

This audit report contains the Annual Financial Statement of the U.S. Department of Justice (Department) for the fiscal year ended September 30, 2002. Under the direction of the Office of the Inspector General (OIG), PricewaterhouseCoopers LLP performed the consolidated Department audit and five of the ten component audits. Two other independent public accounting firms performed the remaining five component audits, upon which PricewaterhouseCoopers LLP relied on when issuing the report on the consolidated financial statements.

The Department received an unqualified opinion on its FY 2002 financial statements. The Department had obtained its first unqualified opinion in FY 2001, and it maintained its unqualified opinion in FY 2002. This reflects continued progress in the Department's financial statements, and the Department deserves credit for this result.

However, it is important to note that similar to prior years, the Department had to expend tremendous cost and efforts in preparing its financial statements for FY 2002. The Department lacks sufficient automated systems to readily support ongoing accounting operations and financial statement preparation. Many tasks were performed manually at the end of the year rather than being performed throughout the fiscal year. For example, in order to determine deferred revenue, the Immigration and Naturalization Service (INS) again had to manually count approximately five million immigration applications at the end of the year. In addition, most components' management systems are not integrated with their financial accounting systems, requiring manual reconciliations between the two systems to support amounts reported on the financial statements. These significant, costly, and time-intensive manual efforts will continue to be necessary for the Department and its components to produce financial statements until automated, integrated processes and systems are implemented that readily produce the necessary information.

The OIG's concern about these conditions is increased by the Office of Management and Budget's requirements for quarterly financial statements and accelerated reporting dates. Beginning with FY 2003, quarterly financial statements are due 45 days after the close of the quarter, and for FY 2004, the Performance & Accountability Report is due 2½ months earlier than in FY 2002 (by November 15, 2004). Consequently, these requirements, coupled with the Department's reliance on manual processes at the end of the year, may significantly impair the Department's and its components' ability to routinely and timely prepare financial statements.

With regard to the FY 2002 consolidated report on internal controls, three material weaknesses previously reported in FYs 1999 through 2001 were combined into two material weaknesses for FY 2002. Overall, however, the Department's components showed improvement by reducing the number of material weaknesses and reportable conditions. In FY 2002, the components had a total of 9 material weaknesses (versus 13 in FY 2001) and 10 reportable conditions (versus 12 in FY 2001). The most notable improvement occurred in the Drug Enforcement Administration, which eliminated their four material weaknesses from the previous year. The table on page 177 compares the FY 2002 and the FY 2001 audit results for the Department consolidated audit as well as for the ten individual component audits.

The first Department material weakness resulted because of weaknesses in financial accounting and reporting at nine of the ten Department components. These weaknesses include (1) not recording financial transactions (assets, liabilities, revenue, property, and inventories in particular) in accordance with generally accepted accounting principles; (2) financial management systems not being configured to support financial statement preparation and on-going financial management; and (3) not having effective financial statement preparation processes to ensure financial statements were completed timely and in conformance with the Department's requirements. Additional issues relating to the preparation of the Department's consolidated financial statements and with reconciling intra-departmental and intra-governmental transactions were also noted. The second material weakness resulted from weaknesses in eight of ten components' financial management systems' general and application controls.

In the FY 2002 consolidated report on compliance with laws and regulations, the auditors identified five Department components that were not compliant with the Federal Financial Management Improvement Act of 1996 (FFMIA), which requires compliance with Federal financial management systems requirements, applicable Federal accounting standards, and the United States standard general ledger at the transaction level. The five non-compliant components were the Federal Bureau of Investigations (FBI); INS; Federal Prison Industries, Inc. (FPI); Offices, Boards and Divisions; and the Working Capital Fund. The FBI, INS and FPI were also not compliant with FFMIA in FY 2001.

While the Department continues to gradually improve its financial management, it will face many challenges in the next few years, including the integration and disposition of functions and entities related to the establishment of the Department of Homeland Security, the selection and implementation of a Department-wide unified financial system, and the accelerated due dates for audited financial statements. To continue improving financial management, the Department must concentrate on standardizing and integrating financial processes and systems to more efficiently support accounting operations, preparation of financial statements, and audit processes. Additionally the Department must be willing to dedicate the appropriate staff and resources to these efforts.

| Comparison of FY 2002 and FY 2001 Audit Results | | | | | | |
|---|---|---|---|---|---|---|
| **Reporting Entity** | **Auditors' Opinion On Financial Statements** | | **Number of Material Weaknesses[1]** | | **Number of Reportable Conditions[2]** | |
| | **2002** | **2001** | **2002** | **2001** | **2002** | **2001** |
| Consolidated Department of Justice | Unqualified[3] | Unqualified | 2 | 3 | 0 | 0 |
| Offices, Boards and Divisions | Unqualified | Unqualified | 1 | 0 | 1 | 2 |
| Assets Forfeiture Fund and Seized Asset Deposit Fund | Unqualified | Unqualified | 0 | 0 | 1 | 0 |
| Federal Bureau of Investigation | Unqualified | Unqualified | 3 | 3 | 0 | 1 |
| Drug Enforcement Administration | Unqualified | Unqualified | 0 | 4 | 2 | 1 |
| Office of Justice Programs | Unqualified | Unqualified | 0 | 0 | 1 | 3 |
| Immigration and Naturalization Service | Unqualified | Unqualified | 3 | 3 | 0 | 1 |
| U.S. Marshals Service | Unqualified | Unqualified | 0 | 1 | 2 | 2 |
| Federal Bureau of Prisons | Unqualified | Unqualified | 0 | 0 | 2 | 0 |
| Federal Prison Industries, Inc. | Unqualified | Unqualified | 1 | 2 | 1 | 2 |
| Working Capital Fund | Unqualified | Unqualified | 1 | 0 | 0 | 0 |
| | | ***Component Totals*** | 9 | 13 | 10 | 12 |

[1] A material weakness is a reportable condition (see below) in which the design or operation of the internal control does not reduce to a relatively low level the risk that error, fraud, or noncompliance in amounts that would be material in relation to the principal statements or to performance measures may occur and not be detected within a timely period by employees in the normal course of their assigned duties.

[2] A reportable condition includes matters coming to the auditor's attention that, in the auditor's judgment, should be communicated because they represent significant deficiencies in the design or operation of internal controls that could adversely affect the entity's ability to properly report financial data.

[3] Unqualified opinion -- An auditor's report that states the financial statements present fairly, in all material respects, the financial position and results of operations of the reporting entity, in conformity with generally accepted accounting principles.