U. S. DEPARTMENT OF JUSTICE
ANNUAL FINANCIAL STATEMENT
FISCAL YEAR 2005

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 (FY) ended September 30, 2005. Under the direction of the Office of the Inspector General (OIG), KPMG LLP performed the consolidated Department audit and 7 of the 10 component audits. Two other independent public accounting firms performed the remaining three component audits, upon which KPMG LLP relied when issuing its report on the consolidated financial statements. For FY 2004, KPMG LLP also performed the consolidated Department audit, and 6 of the 10 component audits.

The Department received an unqualified opinion on its FY 2005 and 2004 financial statements. The Department had previously received a disclaimer on the FY 2004 financial statements due to a disclaimer on the FY 2004 financial statements of the Office of Justice Programs (OJP). However, during FY 2005 OJP restated its FY 2004 and FY 2003 financial statements. Re-audits were performed, and OJP obtained unqualified opinions on its FY 2004 and FY 2003 financial statements (OIG Reports #05-36 and 05-38), as well as its FY 2005 financial statements. Another component, the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) previously received a qualified opinion on its FY 2004 financial statements. During the FY 2005 audit, the ATF was able to provide sufficient supporting documentation for its FY 2004 accounts payable accrual, and it too obtained unqualified opinions on its FY 2005 and FY 2004 financial statements. The other eight components received unqualified opinions on both their FY 2005 and 2004 financial statements.

At the consolidated level, the Department has two material weaknesses, compared to two material weaknesses and one reportable condition in FY 2004. Both of this year's material weaknesses are repeat issues from last year, although the elements of the two findings varied from last year. The first material weakness is a financial one and includes many serious issues at the component level, including the U.S. Marshals Service's (USMS) internal control framework and management and recording of real property; OJP's grant advance and payable estimation processes and also its financial reporting, monitoring, analysis, and documentation; the controls over the ATF's accounts payable accrual; and financial reporting and property issues at the Federal Bureau of Investigation (FBI). The second material weakness related to information systems, which was elevated from a reportable condition last year. This change not only reflects new and continued deficiencies being reported in 8 of the 10 components, but it also reflects weaknesses in the DOJ consolidated information system general controls environment that provides general control support for several DOJ components' financial applications. The third material weakness from last year was eliminated because of OJP's progress in correcting its grant accounting and monitoring policies and procedures related to data quality, monitoring, and the methodology utilized to calculate its grant accrual and advance amounts. As a result of the progress made, the risk was sufficiently reduced to the point that the remaining issues no longer required separate reporting but could be included within the above financial material weakness.

At the component level, the total number of material weaknesses was unchanged from 10 in FY 2004. However, the number of reportable conditions decreased significantly from 13 in FY 2004 to 8 this year. It should also be noted that two components, the Drug Enforcement Administration and the Federal Prison Industries, Inc., had no material weaknesses, reportable conditions, or compliance issues. The table at the end of this discussion compares the FY 2005 and the FY 2004 audit results for the Department's consolidated audit as well as for the 10 individual component audits.

One overall concern of the OIG is that the Department still lacks sufficient automated systems to readily support ongoing accounting operations and financial statement preparation. Inadequate, outdated, and, in some cases non-integrated financial management systems do not provide for certain automated financial transaction processing activities to support management's need for timely and accurate financial information. There is also a shortage of trained financial management personnel available to perform certain internal control functions related to the financial reporting process. This inhibits both Department and component management's ability to assess financial reporting risk; design, communicate, and implement appropriate control activities; and monitor the financial reporting process. Many tasks still must be performed manually at interim periods and at year end, requiring extensive efforts on the part of financial and audit personnel. 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 throughout the year.

In addition, these weaknesses place added importance on the financial analysis and analytical review aspects of the quality assurance procedures at the end of each quarter, and particularly at the end of the fiscal year, to detect and correct misstatements in the financial statements. The limited amount of time available to the components' staffs at the end of each financial reporting period for performing financial analyses and analytical reviews increases the risk that errors existing in the components' financial statements will not be detected and corrected prior to final issuance. Absent improvements in their financial management, accounting, and internal control practices, components will continue to be challenged in preparing timely and accurate financial statements in accordance with generally accepted accounting principles. We encourage the Department to continue its current efforts to obtain funding to implement a unified financial management system, supported by consistent, standardized business practices across the Department.

In the FY 2005 consolidated report on compliance and other matters, the auditors identified four Department components that were not in compliance 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 four non-compliant components were the ATF, the FBI, OJP, and the USMS. The same four components were also non-compliant with FFMIA in FY 2004. For FY 2005, the OJP was not in compliance with the Inspector General Act of 1978 (as amended), *Prompt Management Decisions and Implementation of Audit Recommendations*. This was a repeat issue. Additionally for FY 2005, the USMS was not in compliance with the Prompt Payment Act; the Improper Payments Information Act; the Federal Managers' Financial Integrity Act; and OMB Circular A-11, *Preparation, Submission and Execution of the Budget*. All were new issues for the USMS except for the Prompt Payment Act issue, which was a repeat issue. The USMS auditors also noted they were unable to fully test USMS's compliance with the Anti-Deficiency Act.

The OIG reviewed KPMG LLP's report on the consolidated financial statements and related documentation and made necessary inquiries of its representatives. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on the Department's financial statements, conclusions about the effectiveness of internal control, or conclusions on compliance with laws and regulations. KPMG LLP is responsible for the attached auditor's report dated November 11, 2005, and the conclusions expressed in the report. However, our review, while still ongoing, disclosed no instances where KPMG LLP did not comply, in all material respects, with generally accepted government auditing standards.

Comparison of FY 2005 and FY 2004 Audit Results						
Reporting Entity	Auditors' Opinion On Financial Statements		Number of Material Weaknesses[1]		Number of Reportable Conditions[2]	
	2005	2004	2005	2004	2005	2004
Consolidated Department of Justice	Unqualified[3]	Unqualified[4]	2	2	0	1
Offices, Boards and Divisions	Unqualified	Unqualified	0	0	1	2
Assets Forfeiture Fund and Seized Asset Deposit Fund	Unqualified	Unqualified	0	0	1	1
Federal Bureau of Investigation	Unqualified	Unqualified	2	2	1	1
Drug Enforcement Administration	Unqualified	Unqualified	0	0	0	1
Office of Justice Programs	Unqualified	Unqualified[4]	3	5	1	1
U.S. Marshals Service	Unqualified	Unqualified	3	2	1	2
Federal Bureau of Prisons	Unqualified	Unqualified	0	0	1	1
Federal Prison Industries, Inc.	Unqualified	Unqualified	0	0	0	1
Working Capital Fund	Unqualified	Unqualified	0	0	2	2
Bureau of Alcohol, Tobacco, Firearms and Explosives	Unqualified	Unqualified[5]	2	1	0	1
Component Totals			10	10	8	13

[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.

[4] Originally issued as a disclaimer of opinion – An auditor's report that states that the auditor does not express an opinion on the financial statements. The opinion was reissued in FY 2005 to an unqualified opinion, after a re-audit was performed of OJP's FY 2004 financial statements.

[5] Originally issued as a qualified opinion – An auditor's report that states "except for" matters identified in the report, 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. The opinion was reissued in FY 2005 to an unqualified opinion, after additional test work was performed on ATF's accounts payable accrual.