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Independent Auditors' Report on Internal Control over Financial Reporting

Inspector General
U.S. Department of Justice

United States Attorney General
U.S. Department of Justice

We have audited the consolidated balance sheets of the U.S. Department of Justice (Department) as of September 30, 2008 and 2007, and the related consolidated statements of net cost and changes in net position and the combined statements of budgetary resources and custodial activity (hereinafter referred to as the "consolidated financial statements") for the years then ended, and have issued our report thereon dated November 12, 2008. We did not audit the financial statements of the U.S. Marshals Service as of and for the years ended September 30, 2008 and 2007. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our report, insofar as it related to the amounts included for the U.S. Marshals Service, was based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

As stated above, we did not audit the fiscal year 2008 financial statements of the U.S. Marshals Service. Those financial statements were audited by other auditors whose report thereon, including the other auditors' *Independent Auditors' Report on Internal Control*, has been furnished to us. Accordingly, our report on the Department's internal control over financial reporting, insofar as it relates to that component, is based solely on the report and findings of the other auditors.

The Department's management is responsible for establishing and maintaining effective internal control. In planning and performing our fiscal year 2008 audit, we considered the Department's internal control over financial reporting by obtaining an understanding of the Department's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements. To achieve this purpose, we did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to express an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Department's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Department's consolidated financial statements that is more than inconsequential will not be prevented or detected by the Department's internal control. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Department's internal control.

In our fiscal year 2008 audit, we noted, and the report of the other auditors identified, certain matters described in Exhibits I and II that we and the other auditors consider to be significant deficiencies in internal control over financial reporting. However, we believe that none of the deficiencies described in Exhibits I and II is a material weakness. Exhibit I is an overview of the significant deficiencies identified in the Department's component auditors' *Independent Auditors' Reports on Internal Control Over Financial Reporting*, and includes an explanation of how these component-level significant deficiencies are reported at the Department level. Exhibit II provides the details of the Department-wide significant deficiencies. Exhibit III presents the status of prior years' Department-wide recommendations.

The Department's responses to the findings identified in our audit are presented in Exhibit II. We did not audit the Department's responses, and accordingly, we express no opinion on them.

This report is intended solely for the information and use of the management of the U.S. Department of Justice, the U.S. Department of Justice Office of the Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 12, 2008

EXHIBIT I

OVERVIEW OF SIGNIFICANT DEFICIENCIES

The following table summarizes the 14 significant deficiencies identified by the Department's component auditors during fiscal year 2008. The component auditors also considered one of these significant deficiencies to be a material weakness. We analyzed the component-level material weakness and significant deficiencies to determine their effect on the Department's internal control over financial reporting and concluded that they comprise two Department-wide significant deficiencies.

Department Significant Deficiencies Noted During Fiscal Year 2008		DOJ	OBDS	AFF	FBI	DEA	OJP	ATF	USMS (1)	BOP	FPI
Improvements are needed in the Department's component financial systems' general and application controls.		S		S			S		S	S	S
Improvements are needed in the components' internal controls to provide reasonable assurance that transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with generally accepted accounting principles.		S	S	S S S	S		S	S	M S		
Total Material Weaknesses Reported by Components' Auditors	FY 2008	1	0	0	0	0	0	0	1	0	0
	FY 2007	4	0	0	1	0	0	1	2	0	0
Total Significant Deficiencies Reported by Components' Auditors	FY 2008	13	1	4	1	0	2	1	2	1	1
	FY 2007	14	3	3	0	1	3	1	1	1	1

Offices, Boards and Divisions (OBDs); Assets Forfeiture Fund and Seized Asset Deposit Fund (AFF); Federal Bureau of Investigation (FBI); Drug Enforcement Administration (DEA); Office of Justice Programs (OJP); Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF); United States Marshals Service (USMS); Federal Bureau of Prisons (BOP); and Federal Prison Industries, Inc. (FPI).

Legend:
(1) USMS's financial statements were audited by other auditors.

M – Material weakness
S – Significant deficiency

In Exhibit II we discuss in detail the Department-wide significant deficiencies noted above.

EXHIBIT II

SIGNIFICANT DEFICIENCIES

IMPROVEMENTS ARE NEEDED IN THE DEPARTMENT'S COMPONENT FINANCIAL MANAGEMENT SYSTEMS' GENERAL AND APPLICATION CONTROLS.

While the Department has made significant progress in addressing previously-reported material weaknesses and significant deficiencies, the component entities' auditors continue to identify opportunities for improvement in the general and application controls designed and implemented to protect the integrity of information systems data. Although the corrective actions taken by the Department and its component entities over the past year have resolved prior-year deficiencies at four of the Department's nine component entities, component auditors continue to report significant deficiencies at five of the Department's component entities. Accordingly, additional corrective actions are needed to resolve this Department-wide significant deficiency.

In performing procedures on the components' financial management information systems, we and the other auditors considered the Government Accountability Office's *Federal Information System Controls Audit Manual*; the Department's Order No. 2640.2E, *Information Technology Security*; OMB Circular No. A-130, *Management of Federal Information Resources*; and technical publications issued by the National Institute of Standards and Technology (NIST).

In support of the Department's fiscal year 2008 consolidated financial statement audit, we performed a review of the DOJ information system (IS) general controls environment that provides general control support for several DOJ components' financial applications. The Department's OSS has primary responsibility over the IS general controls environment and the following services: (1) Technology Assessment and Planning Services, (2) Customer Services, (3) Infrastructure Services, and (4) Security and Business Continuity Services. We conducted our general controls environment review for the fiscal year ended September 30, 2008.

The following table depicts the IS general and application control weaknesses identified by the auditors related to five of the Department's nine component entities for fiscal year 2008. Following the table, we present brief summaries of the specific conditions reported by the components' auditors.

General & Application Control Weaknesses[1]	AFF	OJP	USMS	BOP	FPI
Access Controls		X	X	X	X
Application Software Development and Change Controls/System Development Life Cycle (SDLC)		X	X		
Segregation of Duties					X
System Software	X		X	X	X

[1] This table summarizes the IS control weaknesses reported in the component auditors' *Independent Auditors' Reports on Internal Control Over Financial Reporting*. For the AFF, OJP, USMS, BOP, and FPI, the component auditors reported an IS-related significant deficiency.

AFF – Improvements have been made to address the prior-year weaknesses in the area of change controls. However, weaknesses continue to exist in the Consolidated Asset Tracking System's (CATS) system software.

OJP – Improvements have been made to address all of the prior-year weaknesses. However, new weaknesses were identified in the areas of application change controls and access controls for certain financial applications.

USMS – Significant improvements have been made; however, opportunities for further improvements continue to exist within the IS environment. Prior year issues remain open and new issues were identified during fiscal year 2008. Specifically, weaknesses were noted in application change controls, system software, and access controls.

BOP – Access controls and system software weaknesses continue to exist in controlling access to financially-significant systems.

FPI – Improvements have been made to address the prior year weakness in application change controls. However, weaknesses in the IS and SAP general controls environment continue to exist in the areas of access controls, segregation of duties, and system software.

The weaknesses identified by the component auditors in the components' general and application controls increase the risk that programs and data processed on the components' information systems are not adequately protected from unauthorized access or service disruption.

Recommendation

We recommend the Department:

1. Require the components to submit and implement corrective action plans that address the weaknesses identified above. The corrective action plans should focus on correcting deficiencies in access controls, application change controls, segregation of duties, and system software weaknesses discussed in the component auditors' reports on internal control over financial reporting. The corrective action plans should also include a timeline that establishes when major events must be completed. The Department's CIO should monitor the components' efforts to correct deficiencies, hold them accountable for meeting the action plan timelines, and ensure the corrective actions are implemented adequately to address the noted deficiencies. *(Updated)*

Management Response:

DOJ management concurs. The Department's Office of the Chief Information Officer (OCIO), working with the Chief Financial Officer and component program managers as well as their respective CIOs, have made substantial progress in eliminating prior year significant deficiencies in Operation Services Staff (OSS), Federal Bureau of Investigation (FBI), Drug Enforcement Administration (DEA) and Alcohol, Tobacco and Firearms (ATF). For the remaining components with significant deficiencies, the Department's CIO will ensure that robust corrective action plans are developed to address the weaknesses identified. These plans will be validated and monitored by the Department's OCIO to ensure corrective actions are institutionalized and program improvements are made. In addition, the Department's OCIO will ensure that all weaknesses identified in prior year audits are addressed and that enhancements in policies, processes, and work flow are implemented to provide the best possible support for successful financial audits. The corrective action plans are a subset of the Department's overall capital Plans of Actions and Milestones and are available to the Office of the Inspector General and reported to OMB in the Department's quarterly Federal Information Security Management Act (FISMA) Reports.

IMPROVEMENTS ARE NEEDED IN THE COMPONENTS' INTERNAL CONTROLS TO PROVIDE REASONABLE ASSURANCE THAT TRANSACTIONS ARE PROPERLY RECORDED, PROCESSED, AND SUMMARIZED TO PERMIT THE PREPARATION OF FINANCIAL STATEMENTS IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES.

The Department and its component entities have made significant progress in addressing previously-reported material weaknesses and significant deficiencies in internal control. However, several of the component entities' auditors continue to report significant deficiencies in internal controls that inhibit the preparation of financial statements in accordance with generally accepted accounting principles. Further improvement is needed in the component entities' internal controls designed to provide reasonable assurance that transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with generally accepted accounting principles.

The following component entity-level significant deficiencies comprise this Department-wide significant deficiency.

Funds Management Controls. The USMS does not have adequate financial and compliance controls to ensure that obligation transactions are executed and recorded in accordance with laws and regulations and the related open obligation balances are accurate and complete. While the USMS management implemented a new obligation review and certification process during fiscal year 2008, the process was evolving during the year and was not fully effective. The component auditors identified accounting errors and instances of noncompliance with accounting standards; OMB Circular No. A-11, *Preparation, Submission and Execution of the Budget*, and the United States Standard General Ledger (USSGL), as follows:

Undelivered Orders

- As a result of their year-end test work, component auditors identified accounting errors related to the proper classification between undelivered orders and accounts payable for certain transactions and related balances. Included in the errors identified by the component auditors were (1) an overstatement of undelivered orders, with a corresponding understatement of accounts payable, in connection with projects for which the work completed to date was not properly recognized as an accounts payable, (2) a one-time year-end obligation for performance awards that should have been recorded as an accounts payable, with a corresponding reduction to undelivered orders, and (3) invalid undelivered orders for which an accounts payable should have been recorded (for goods or services received) or for which the balances were only partially de-obligated in error. The USMS's policies require that obligation balances be carefully monitored for accuracy and that quarterly reviews of outstanding obligation balances be performed to determine whether the balances are still valid and supported by adequate documentation. However, as a result of these accounting errors, the USMS's undelivered orders balance was overstated by a likely amount of $48.7 million as of September 30, 2008. The component auditors identified similar accounting errors in their interim test work related to the USMS's quarterly undelivered orders balances.

- Procedures for reviewing and certifying undelivered orders and accounts payable before the monthly Financial Management System (FMS) closing process and as part of the quarterly obligation certification process were ineffective. As a result, the component auditors identified $4.3 million of undelivered orders that should have been classified as accounts payable before FMS was closed. In addition to correcting this error, the USMS corrected an additional $4.7 million error related to district office undelivered orders that originated in the Standard Tracking, Accounting, and Reporting System rather than the FMS.

Delivered Orders – Obligations Unpaid (Budgetary Accounts Payable). In their year-end testing of accounts payable, the component auditors identified accounting errors related to the USMS's accounts payable accrual estimates. As a result of these accounting errors, the USMS's accounts payable balance was overstated by a likely amount of $17.6 million as of September 30, 2008. These errors were not identified during the supervisory review process.

Unauthorized Commitments. The component auditors noted that the USMS made unauthorized commitments during the fiscal year in connection with projects related to the purchase, installation, and preventive maintenance and service of security equipment; a facilities lease; and a database software and licensing and maintenance agreement. The USMS processed 20 ratifications authorizing payments totaling $9.0 million for these and other unauthorized commitments. The Federal Acquisition Regulation prohibits contracts from being entered into unless the contracting officer ensures that all requirements of law, executive orders, regulations, and other applicable procedures have been satisfied. Unauthorized commitments could result in Anti-Deficiency Act violations if there is not sufficient funding to cover such unauthorized commitments.

Accounts Payable. Component auditors noted that ATF demonstrated significant improvement in implementing policies and procedures developed in response to their recommendations made to address a material weakness that was first identified during the fiscal year 2004 audit. While errors were identified by the component auditors in their interim testing of the accounts payable balances, the errors were not as significant as in prior years and did not resurface at year-end.

In its interim internal control testing of accounts payable transactions and related balances, component auditors noted the following:

- As of March 31, 2008, the obligated balances for 2 out of 73 (2.7%) undelivered orders were not recorded accurately.
- As of March 31, 2008, the accounts payable amounts for 4 out of 19 (21.1%) balances reviewed were not calculated accurately, resulting in a likely overstatement of $2.0 million.
- As of June 30, 2008, the obligated balance for 1 out of 75 (1.3%) undelivered orders was not recorded accurately.
- As of June 30, 2008, the accounts payable amount for 1 out of 20 (5.0%) balances reviewed was not calculated accurately, resulting in a likely overstatement of $1.9 million.

Component auditors identified no errors in their testing of undelivered orders and accounts payable balances as of September 30, 2008. As a result of the improvement made, component auditors downgraded the prior-year material weakness to a significant deficiency in fiscal year 2008. ATF management should strive to sustain the effects of the internal control improvements made to provide reasonable assurance that the errors identified in the component auditors' interim test work do not recur and have a material effect on the accuracy of the accounts payable balance.

Grant Advances and Obligations. Component auditors noted that improvements were needed in OJP's grant advance estimation and grant de-obligation processes, as follows:

Grant Advance Estimation Process. During their testing of the OJP's fiscal year 2008 grant accrual methodology, component auditors observed overstatements in the estimated advance amounts. In addition, component auditors noted as a result of their review of OJP's "look-back" analysis that the variance between the estimated advances and actual advances (based on reviews of the subsequently-submitted SF-269s, *Financial Status Reports*) increased significantly from September 30, 2007 to March 31, 2008. For the quarters ended September 30, 2007, December 31, 2007, and March 31, 2008, the variances were 4%, 14%, and 22%, respectively.

OJP's *Policies and Procedure for Validating the Estimated Grant Accrual* provides guidance related to the periodic review, analysis, and validation of the grant accrual amounts posted to the general ledger. This policy states that OJP should determine that estimates are calculated and presented both fairly and reasonably for the financial statements and, when discrepancies occur, OJP should perform a more in-depth analysis. OJP management should validate the approach each quarter based on receipt of additional SF-269 data and revise the methodology, as appropriate. Management's current judgment about the adequacy of the grant accrual is a critical component of the methodology. Accrual results should be reviewed by the Office of the Comptroller and documentation of the review maintained.

The increase in the rate of variance for the three quarters mentioned above can be attributed to a significant change in the composition of OJP's block grant portfolio over the past few years. While OJP made revisions to its grant accrual methodology at the beginning of the fiscal year to address the changes that have occurred in its grant portfolio, the revised grant accrual methodology did not result in reasonably accurate grant advance estimates. As a result, the advance balance was overstated by a likely amount of $40.0 million as of March 31, 2008. While this condition remained unresolved as of June 30, 2008, OJP made revisions to its grant advance estimation methodology that resulted in reasonable estimates of the grant advance balance as of September 30, 2008.

Grant De-obligations. In testing undelivered orders (UDO) balances, component auditors noted that although improvements had been made to OJP's grant closeout process, additional progress is needed in the timely de-obligation and closeout of grants. Specifically, the component auditors identified approximately 1,200 out of 17,800 grants as of March 31, 2008, and 1,000 out of 18,300 grants as of June 30, 2008, had not been fiscally closed out and/or funds de-obligated within 180 days from the grant end date. From September 30, 2007, to September 30, 2008, OJP made progress by reducing the number of open grants pending closeout from approximately 1,600 to approximately 770. However, the issue of grants pending closeout continues to be a concern due to the backlog of open grants with expired end dates.

OJP's grant closeout policy, *Financial Closeout of OJP Grants*, provides for the closing out of grants to finalize the programmatic and financial activities on grants and to comply with Federal government grant administration requirements. Grantees are required to submit all closeout documents and complete all closeout requirements within 90 days after the end date of the grant. The grant closeout policy affords the program office 120 days after a grant's end date or submission of the final SF-269 to send a grant closeout package to the Office of Comptroller. The Office of Comptroller must complete closeouts within 180 days after the end date of the grant. If a grantee fails to provide the program office with the information needed for a standard closeout within 120 days of the end date of the grant, an administrative closeout is required.

In their review of expired grants with unliquidated balances, component auditors noted that the undelivered orders balance was overstated in OJP's financial statements by likely amounts of $73.3 million and $63.3 million for the fiscal quarters ended March 31 and June 30, 2008, respectively. Based on an analysis of historical data, OJP made adjustments of $62.4 million and $40.6 million to the undelivered orders balances as of March 31 and June 30, 2008, respectively. As a result of these adjustments, the amount of the overstatement of OJP's undelivered orders balances was reduced to approximately $10.9 million and $22.7 million as of March 31 and June 30, 2008, respectively. OJP's March 31, 2008 and June 30, 2008 UDO balances were approximately $2.9 billion and $3.1 billion, respectively.

At September 30, 2008, there were approximately $53.4 million of outstanding award balances related to grants that had been expired for six months or more. Of this amount, OJP recorded an accrued expenditure for $11.6 million and de-obligated $29.7 million. The remaining balance of expired grant UDOs was approximately $12.1 million.

Obligations and Disbursements. Component auditors noted that improvements are needed in the AFF's internal controls related to the processing and recording of obligations and related disbursements. In conducting interim and year-end tests of internal controls, undelivered orders, and accounts payable balances; component auditors identified various valuation and classification errors, including: (1) obligated balances that were not liquidated after receipt of the final invoice, (2) transactions recorded as undelivered orders after the related services were received, (3) obligations recorded as delivered prior to receipt of the services, (4) obligations not liquidated due to the duplicate recording of the obligations, (5) an obligation classified as delivered-unpaid after payment for the services was made, and (6) a disbursement recorded as a disbursement refund as opposed to a revenue receipt. These valuation errors had an absolute dollar value of approximately $6.0 million as of the interim or year-end balance sheet dates.

These valuation and classification errors occurred because the Asset Forfeiture Program participating agencies did not ensure the timely reclassification of previously created undelivered orders balances to delivered-unpaid status before initiating the disbursement of funds through the Intra-Governmental Payment and Collection system, which resulted in the undelivered orders balances not being reduced upon receipt of the related services. In addition, participating agencies did not perform adequate periodic reviews of open obligations to ensure their continued validity and the accuracy of the recorded amounts.

Seized and Forfeited Property. Component auditors noted that the AFF's internal controls are in need of improvement with respect to: (1) seized and forfeited property management, and (2) the deletion of property records from the asset tracking system, as described below.

Internal Controls Related to Status and Valuation. In conducting tests of transactions recorded in the Consolidated Asset Tracking System (CATS) as of June 30 and August 31, 2008, component auditors observed various status and valuation errors, including: (1) seized property under-valuations and over-valuations, (2) forfeited property under-valuations and over-valuations, (3) a seized property item recorded as on-hand that should have been classified as disposed of. These status and valuation errors had an absolute dollar value of approximately $4.8 million as of June 30 and August 31, 2008, combined, while the undelivered orders balance was overstated by $200 thousand as of September 30, 2008.

In addition to the errors noted in the recording of valued items, component auditors also noted that 9 out of 345 (2.6%) non-valued items tested were recorded as on-hand but should have been classified as disposed of. These errors, if not detected and corrected, would result in inaccurate reporting of the number of non-valued items on-hand in the notes to the AFF's financial statements.

Internal Controls Related to the Deletion of Records from CATS. In conducting tests related to the deletion of property records from CATS, component auditors noted that 4 out of 45 (8.9%) Drug Enforcement Administration records were not properly authorized prior to their removal from CATS. If not properly authorized, such deletions could result in misstatements in the notes to the AFF's financial statements.

SFFAS No. 3, *Accounting for Inventory and Related Property,* states that seized and forfeited property should be properly classified as of the financial reporting date. Seized property other than monetary instruments shall be disclosed in the footnotes and its value accounted for in the agency's property management records until the property is forfeited, returned, or otherwise liquidated.

Financial Accounting and Reporting Quality-Control and Assurance. The USMS implemented several new quality control procedures during fiscal years 2008 and 2007 that enhanced its ability to prepare interim and final financial statements within prescribed timeframes and with more accuracy. However, improvements are still needed. The USMS's management review of controls over the accuracy and completeness of the underlying accounting data were ineffective in ensuring that all transactions were recorded, processed, summarized, and reported in accordance with the United States Standard General Ledger (USSGL); OMB Circular No. A-136, *Financial Reporting Requirements*; and federal accounting standards. This control deficiency has been reported in the USMS's *Independent Auditors' Report on Internal Control* for the past eight years.

The USMS's Office of Finance employs a core group of personnel and contractors to perform the financial statement preparation and quality-control and assurance functions. Although there has been recent continuity among this core group, the environment is still fragile due to heavy reliance on a few key individuals and the limited time for completing year-end reporting. The component auditors noted that improvements are still needed in the following areas.

Financial Statement Preparation. Based on their review of the USMS's interim and year-end financial statements, the component auditors identified the following misstatements that were not detected during the USMS's quality control review:

- Errors were made in the September 30, 2008, financial statement footnotes, including: (1) the improper classification of a $4.5 million General Services Administration lease as non-federal capitalized property, (2) a $3.7 million understatement of Resources that Finance the Acquisition of Assets that resulted from the improper write-off of a capital lease that expired during the year, and (3) a $5.1 million unexplained difference in the reconciliation of net costs to the budget.

- Errors were made in the June 30, 2008, financial statements, including: (1) a $6.3 million overstatement of Intragovernmental Gross Costs and a corresponding understatement of Gross Costs with the Public, (2) a $24.5 million understatement of "All Other Funds" revenue and costs in the Net Cost of Operations by Sub-organization footnote, and (3) federal and non-federal capitalized property were overstated by $1.1 million and understated by $1.1 million, respectively, in the General Property, Plant and Equipment footnote.

General Ledger Account Balances Review and Validation. Component auditors noted that the USMS's September 30, 2008, and June 30, 2008, trial balances included several improper or abnormal balances and account relationship anomalies that resulted from transaction-level posting errors. The following errors identified by the component auditors were not detected by the USMS during its financial reporting process:

- The September 30, 2008, trial balance contained a $3.1 million abnormal debit balance in the Disbursements in Transit account because the USMS did not properly record a September 2008 construction-related payment.

- A journal entry resulting in the reclassification of obligations between undelivered orders and accounts payable was intended to have the effect of increasing accounts receivable in connection with certain of the USMS's reimbursable activity. This misclassification resulted in a $4.7 understatement of accounts receivable and a corresponding overstatement of unfilled customer orders without advance.

- The June 30, 2008, trial balance contained a $5.0 million abnormal debit balance in the Accrued Payroll Benefits account because National Finance Center payroll entries to record payment of tax liabilities were posted to the Accrued Payroll Benefits account, while the liability was accrued in the Other Liabilities account.

- The USMS made errors in posting elimination entries for its intra-fund activity as of June 30, 2008, including a $6.1 million reposting (as opposed to the intended reversal) of a June 30, 2008 elimination entry amount resulting from the reversal of an intra-fund accounts receivable having been posted using the wrong standard accounting event code.

- The USMS understated accounts payable and operating expenses by $7.8 million for a particular trading partner on the June 30, 2008 "Intragovernmental Activity and Balances Form" as a result of an error made when manually calculating the amount of these balances attributable to this trading partner.

Verification of Audit Deliverables. A data download of undelivered orders as of September 30, 2008, submitted for audit testing included a balance that differed from the corresponding trial balance amount by approximately $6.4 million. The data download did not include any data comprising the amount recorded in the trial balance for X-year funds for budget fiscal years prior to 2003. This exclusion was not identified as part of the reconciliation process because a pivot table used in the reconciliation also excluded the relevant data.

Ineffective financial reporting controls, including review and validation of general ledger account balances and the verification of data downloads provided to the auditors for use in their test procedures can have an adverse effect on the reliability of data included in the USMS's and the Department's financial statements and result in audit opinion modifications and the identification of significant internal control deficiencies.

The Financial Reporting Environment. Component auditors noted deficiencies in the AFF's internal controls related to data uploads made into the Financial Management Information System 2 (FMIS2) and the related reconciliation of amounts recorded in the general ledger. Specifically, the component auditors identified differences between the subsidiary ledger detail files uploaded from the USMS and the balances recorded in the AFF's general ledger (FMIS2) used for financial reporting, as follows:

- The Non-exchange Revenue subsidiary balance for the year ended September 30, 2008, exceeded the balance recorded in FMIS2 by approximately $4.4 million. This variance was approximately $1.6 million and $7.7 million as of June 30, 2008, and March 31, 2008, respectively.

- The Undelivered Orders subsidiary balance for the year ended September 30, 2008, exceeded the balance recorded in FMIS2 by approximately $300 thousand. This variance was approximately $1.0 million and $2.0 million as of June 30, 2008, and March 31, 2008, respectively.

- The Delivered-Unpaid subsidiary balance for the year ended September 30, 2008, exceeded the balance recorded in FMIS2 by approximately $700 thousand. This variance was approximately $300 thousand and $200 thousand as of June 30, 2008, and March 31, 2008, respectively.

- The Delivered-Paid subsidiary balance for the year ended September 30, 2008, was approximately $200 thousand less than the balance recorded in FMIS2. This same subsidiary balance exceeded the balance recorded in FMIS2 by approximately $800 thousand and $600 thousand as of June 30, 2008, and March 31, 2008, respectively.

These differences occurred because of inadequate controls over the timely upload and subsequent reconciliation of financial data from the USMS's financial systems into FMIS2. The failure to identify and correct such reconciliation differences can result in the misstatement of related financial statement account balances. OMB Circular No. A-123, *Management's Responsibility for Internal Control*, calls for the periodic review and reconciliation of data as part of management's continuous monitoring of internal control.

The Financial Reporting Process. Component auditors noted several areas in which the FBI lacks sufficient controls over its financial reporting process. Specifically, component auditors noted insufficient quality assurance controls over financial statements and footnotes at year-end. During their review of the draft fiscal year 2008 financial statements, they noted discrepancies between the principal statements and footnotes, instances in which the financial statements did not conform to DOJ financial statement requirements and preparation instructions, errors within the presented footnotes, and oversights in version control of the financial statement template.

Component auditors also noted that formal policies and procedures (including desk manuals) are either outdated or incomplete for many of the roles, responsibilities, processes, and functions performed within the FBI's Finance Division. For example, they noted that improvements are needed in the formal documentation of the preparation and review of the quarterly financial statements and footnotes, as well as the reconciliation and review of Fund Balance with Treasury amounts.

According to OMB Circular No. A-123, *Management's Responsibility for Internal Control*, meeting the accelerated financial statement reporting due date provides incentive for agencies to have added discipline and effective internal control to routinely produce reliable financial information. Deficiencies in internal control need to be mitigated to ensure timely and accurate financial information.

The FBI's current legacy accounting system, the Financial Management System (FMS), is over 25 years old. It was not designed for today's demands for real-time financial information, nor was it designed for Federal budgeting and accounting purposes. Many of the financial reporting issues identified resulted from system limitations in the legacy accounting system. The FBI has developed extensive manual accounting processes and methods to compensate for the limited capabilities of its financial management system in order to maintain the integrity of the FBI's financial records and statements.

The FBI is scheduled to implement a Department financial management system, the Unified Financial Management System (UFMS), which is anticipated to deliver substantially improved reporting and accounting capability for all components within DOJ.

Preparation, Review, and Approval of Journal Entries. Component auditors noted deficiencies in both the design and operation of controls related to the preparation, review, and approval of journal entries recorded in the OBDs' financial management system and as "on-top" adjustments within its financial statement preparation database. These journal entries are used to process a high volume and material dollar amount of routine and non-routine entries each fiscal quarter.

Component auditors also noted that an additional compensating corrective action, which would have helped detect journal entry errors, and which was agreed to in response to a fiscal year 2007 audit finding, was not consistently performed during fiscal year 2008. Many of the journal entry-related errors identified in fiscal years 2007 and 2008 would have been detected by a fund-level quarterly budgetary-to-proprietary account relationship analysis and an analysis of abnormal account balances. Component auditors did not receive documentary evidence that such a review was consistently performed in fiscal year 2008.

Specifically, component auditors noted the following errors:

- The OBDs included two cancelled Treasury Account Symbols in the Fund Balance with Treasury (FBWT) line item reported on the September 30, 2008, balance sheet. The OBDs did not make the appropriate proprietary entry to cancel the appropriations, which resulted in an $18.5 million misstatement in FBWT (overstated) and unexpended appropriations (overstated). This entry was subsequently corrected by JMD.

- Within the Journal Module used to post both routine and non-routine journal entries, the incorrect posting of a non-routine journal entry resulted in a $1.6 million overstatement of delivered orders, unexpended appropriations, expended appropriations, and an understatement of allotments – realized resources. Component auditors also identified Journal Module entries that did not include evidence of appropriate review or adequate supporting documentation.

Although component auditors noted improvement in the segregation of duties related to the processing of journal entries, they noted deficiencies in the recording of journal entries in the general ledger and the lack of abnormal account balance review. Specifically, they identified errors in the recording of four journal entries at year-end that were not detected and corrected as a result of the review-and-approval control designed for this purpose. Among the errors identified were journal entries affecting contingent liabilities, expired appropriations, unexpended appropriations, undelivered orders, and delivered orders. The erroneous journal entries of significant amounts were subsequently corrected by management.

It is the policy of OBDs' management that control should be exercised over journal entries through high-level management review of the closing trial balance and the budgetary and proprietary financial statements, as opposed to through the review and approval of every journal entry individually. These management review controls failed to detect and correct the deficiencies and errors noted above. Moreover, it was not evident to the component auditors that such deficiencies and errors would have been detected and corrected prior to the financial statements having been issued had they not been detected as part of the external audit process.

In summary, certain components' internal controls do not provide reasonable assurance that financial transactions are properly recorded, processed, summarized, and documented to permit the preparation of financial statements in accordance with generally accepted accounting principles. Improvements are still needed in the components' day-to-day adherence to standardized accounting policies, as set forth in the Department's *Financial Statement Requirements and Preparation Guide*, to provide for accuracy and consistency in the component entities' and the Department's financial statements.

Recommendations:

We recommend the Department:

2. Monitor the corrective actions taken by the USMS to improve the condition of its funds management controls, in response to the specific recommendations made in the component auditor's *Independent Auditors' Report on Internal Control* issued in connection with the audit of the USMS's financial statements as of and for the year ended September 30, 2008. *(Updated)*

Management Response:

DOJ management concurs. The Justice Management Division (JMD) will continue to work with the USMS to document and improve processes related to external reporting to include financial statement preparation and re-evaluate their business processes and financial activities associated with accounts payable and undelivered orders. In FY 2009, the USMS's Office of Finance will continue to coordinate with relevant offices, internal and external, to ensure that advance reconciliations and analyses are performed at least quarterly and discrepancies resolved timely. Further, designated individuals will ensure corrective actions are in place to reduce or eliminate audit concerns as well as identify and incorporate sustaining best practices. The Management and Budget Divisions will work with the Office of Compliance Review to provide training and other information or data necessary so independent reviews of open obligations can routinely be conducted to identify risks and recommend corrective actions to ensure compliance with accounting standards and regulations. In addition, the JMD Finance Staff will assist in the reviews, by pulling samples and reviewing internal processes and reviews for obligations, procurements and JPATS activities.

3. Assess the adequacy and completeness of the Department's accounting and financial reporting policies in the areas of: (a) accounts payable; (b) grant advances and obligations; (c) obligations and disbursements; (d) seized and forfeited property; (e) financial accounting and reporting and related quality assurance processes; and (f) preparation, review, and approval of journal entries. Based on the results of this assessment, determine the need to issue new guidance and/or reiterate to components the existing policies for those areas in which the components' auditors identified significant deficiencies related to the recording of transactions and the preparation of financial statements in accordance with generally accepted accounting principles. Monitor the components' adherence to the Department's accounting and financial reporting policies and procedures throughout the year. *(Updated)*

Management Response:

DOJ management concurs. The OJP will continue its efforts to reduce the number of grants that are 180 days or more past their end dates and are pending close out. Procedures were implemented in FY 2008 to include formalizing inter-office coordination and tracking, availability of reports within the OJP, increased customer involvement, and integrating the closeout process into OJP's daily business environment which resulted in closing over 7,000 grants. As of September 30, 2008, the OJP devised new procedures for estimating the grant accrual for grants with expired end dates. These estimation techniques will be further refined in FY 2009.

The OJP also began using the FMIS2+ as their official accounting system in FY 2008. Posting logic was reviewed, updated, or added to comply with the USSGL. FMIS2+ posting logic will continue to be reviewed and updated in FY 2009 to include transaction-driven entries for standard activity like upwards and downwards adjustments. This should reduce the number of journal entries required. Corrective actions will be taken to address any deficiencies to include descriptions of the activity, documentation, tightened controls on entries requiring supervisory or secondary approval, and independent reviews each quarter. JMD will also incorporate into their quarterly financial reporting controls the performance of fund code level account relationship analyses. This will include a reconciliation of expended and unexpended appropriations to the relevant proprietary and budgetary accounts for all material funds.

JMD will continue to work with various financial and property management offices, to ensure all property is accounted for accurately, to include real, accountable, seized and forfeited.

Management believes that the adequacy and completeness of existing practices and procedures are sufficient and that errors are primarily related to individuals needing to be more diligent in their period end review of transactions. Management also believes that there are adequate compensating controls to prevent material misstatements from occurring.

4. Continue efforts to implement a Department-wide integrated financial management system that is in compliance with the United States Government Standard General Ledger, conforms to the financial management systems requirements established by the Financial Systems Integration Office (formerly the Joint Financial Management Improvement Program), and can accommodate the requirements of applicable Federal accounting standards. *(Repeat)*

Management Response:

DOJ management concurs. The Unified Financial Management System (UFMS) initiative is a keystone to the Department's financial systems improvement planning for the future. UFMS is replacing the Department's multiple core financial management and procurement system with an integrated Commercial Off-The-Shelf (COTS) solution, Momentum, provided by CGI Federal Inc. Implementation of the UFMS will improve financial management and procurement operations through streamlining and standardizing business processes and procedures across all components. Progress in FY 2008 regarding the Department's implementation of its Unified Financial Management System included: Asset Forfeiture Program pilot project went live in November 2007; DEA completed requirements, design, and configuration phases and plan to go live December 2008; FBI continued work on preparation for UFMS and assessing the UFMS Contract writing tool; and ATF has begun to plan for its UFMS implementation.

EXHIBIT III

STATUS OF PRIOR YEARS' RECOMMENDATIONS

As required by *Government Auditing Standards* issued by the Comptroller General of the United States, and by OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, we have reviewed the status of prior years' findings and recommendations. The following table provides our assessment of the progress DOJ has made in correcting the significant deficiencies identified during this audit. We also provide the Office of the Inspector General report number where the deficiency remains open, the fiscal year it was identified, our recommendation for improvement, and the status of the deficiency as of the end of fiscal year 2008:

Report	Significant Deficiency	Recommendation	Status
Annual Financial Statement Fiscal Year 2007 Report No. 08-01	Improvements are needed in the Department's component financial management systems' general and application controls	**Recommendation No. 1:** Require the components' and the OSS's Chief Information Officers (CIO) to submit and implement corrective action plans that address the weaknesses identified. The corrective action plans should focus on correcting deficiencies in entity-wide security, access controls, application software development and change controls/SDLC, and system software weaknesses discussed in the component auditors' reports on internal control and the general controls environment limited-distribution reports. The corrective action plans should also include a timeline that establishes when major events must be completed, and the Department's CIO should monitor components' efforts to correct deficiencies, hold them accountable for meeting the action plan timelines, and ensure the corrective actions are implemented adequately to address the noted deficiencies.	In Process (Updated by FY 2008 Recommendation No. 1)
	Improvements are needed in the components' internal controls to provide reasonable assurance that transactions are properly recorded, processed, and summarized to permit the	**Recommendation No. 2:** Monitor the corrective actions taken by the USMS to improve the condition of its financial statement quality control and quality assurance processes and funds management controls, in response to the specific recommendations made in the component auditor's *Independent Auditors' Report on Internal Control* issued in connection with the audit of the USMS's financial statements as of and for the year ended September 30, 2007.	In Process (Updated by FY 2008 Recommendation No. 2)

Report	Significant Deficiency	Recommendation	Status
	preparation of financial statements in accordance with generally accepted accounting principles	**Recommendation No. 3:** Monitor the corrective actions taken by ATF to improve the condition of its accounts payable process, in response to the specific recommendations made in the component auditor's *Independent Auditors' Report on Internal Control* issued in connection with the audit of the ATF's financial statements as of and for the year ended September 30, 2007.	In Process (Updated by FY 2008 Recommendation No. 3)
		Recommendation No. 4: Assess the adequacy and completeness of the Department's accounting and financial reporting policies and procedures in the areas of: (a) grant advances and the grant-related accounts payable estimation methodology, (b) budgetary accounting for grant obligations, (c) budgetary and proprietary accounting related to the status of obligations and disbursements, (d) status, valuation, and completeness of seized and forfeited property, and (e) preparation, review, and approval of journal entries. Based on the results of this assessment, determine the need to issue new guidance and/or reiterate to components the existing policies for those areas in which the components' auditors identified internal control weaknesses related to the recording of transactions and the reporting of financial results. Monitor the components' adherence to the Department's accounting and financial reporting policies and procedures throughout the year.	In Process (Updated by FY 2008 Recommendation No. 3)
		Recommendation No. 5: Continue efforts to implement a Department-wide integrated financial management system that is in compliance with the United States Government Standard General Ledger, conforms to the financial management systems requirements established by the Financial Systems Integration Office (formerly the Joint Financial Management Improvement Program), and can accommodate the requirements of applicable Federal accounting standards.	In Process (FY 2008 Recommendation No. 4)