U. S. DEPARTMENT OF JUSTICE
ANNUAL FINANCIAL STATEMENT
FISCAL YEAR 2004

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, 2004. Under the direction of the Office of the Inspector General (OIG), KPMG LLP performed the consolidated Department audit and six of the ten component audits. Two other independent public accounting firms performed the remaining four component audits, upon which KPMG LLP relied when issuing the report on the consolidated financial statements. For FY 2003, PricewaterhouseCoopers LLP performed the consolidated Department audit and five of the eleven component audits, with two other firms performing the remaining six component audits. For the Office of Justice Programs (OJP), KPMG LLP performed the FY 2003 audit and PricewaterhouseCoopers LLP performed the FY 2004 audit.

The Department received a disclaimer of opinion on its FY 2004 financial statements. The consolidated disclaimer was caused by a disclaimer on the financial statements of the OJP. Another component, the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) received a qualified opinion on its FY 2004 financial statements, but this had no affect on the consolidated disclaimer. The other eight components received unqualified opinions on their FY 2004 financial statements.

It is important to note that despite the disclaimer of opinion at the consolidated level, many parts of the Department made significant progress regarding its financial statements. Three components corrected material weaknesses reported last year. Eight components produced financial information much more quickly this year and obtained unqualified opinions. The Department also made good progress in improving the quality of interim period financial statements. Processes were changed as needed and more were identified for improvement next year.

However, the auditors for OJP in FY 2004 could not perform the necessary testing to obtain an opinion in the required timeframe because they were unable to rely upon OJP's financial and information technology controls. The auditors found significant issues with OJP's information technology controls that caused them to conclude they could not be relied upon in FY 2004. As a result, the only way to successfully complete the audit would have been to perform substantive testing of account balances, since system-produced data could not be relied upon, but there was not time to do this type of testing at year end. In addition, the auditors found significant issues with OJP's overall control environment, grant accounting and monitoring, documentation and support for adjusting entries, and the financial reporting process to ensure compliance with generally accepted accounting principles. Many of these issues – including the overall control environment, grant accounting and monitoring issues, and documentation issues – remain unresolved as of November 15, 2004. Overall, the auditors for OJP reported six reportable conditions, five of which were also considered to be material weaknesses.

The auditors for ATF were able to perform the necessary testing to obtain an opinion in the required timeframe, with the exception of the accounts payable accrual at year end. The auditors found significant issues with the ATF's determination of the accounts payable accrual. The ATF attempted to quickly validate this data, but subsequent testing by the auditors still found material errors. Given the Office of Management and Budget (OMB) reporting deadlines, there was insufficient time to either increase the number of transactions tested or revalidate the data to ensure the accrual was correct. Consequently, the auditors for ATF reported a material weakness on ATF's process for recording accounts payable.

The Department previously received an unqualified opinion on its FY 2003 financial statements.

However, during the FY 2004 audit of the OJP, sufficient uncertainty was raised as to the FY 2003 audit opinion of the OJP to cause KPMG LLP, the auditors of OJP for FY 2003, to subsequently withdraw their opinion regarding OJP and reissue it as a disclaimer. KPMG LLP concluded that additional procedures needed to be performed for FY 2003 to resolve these uncertainties but noted they were restricted from performing such procedures. The restriction to which this refers, and the only restriction on KPMG performing these additional procedures, was that there was insufficient time to perform these additional procedures before November 15, 2004, the due date mandated by the OMB for all federal agencies' Performance and Accountability Reports. The Department has and will continue to provide complete access to KPMG in order for them to perform these additional procedures and eventually resolve these uncertainties. The uncertainties regarding OJP also caused PricewaterhouseCoopers LLP, the consolidated auditors for FY 2003, to withdraw their FY 2003 opinion on the Department's financial statements and reissue it as a disclaimer of opinion. In both instances, there simply was not sufficient time to perform additional procedures to resolve the uncertainties raised during the FY 2004 audit of the OJP prior to the OMB November 15 due date.

Due dates for the financial statement audits were moved up this year to November 15 by the OMB, a reduction of approximately two and a half months from prior year due dates. As a result, it was critical that the components maintain quality financial information throughout the year in order for auditors to test financial controls and determine that they are effective and can be relied upon to produce correct numbers for financial statements. It was also critical that the auditors be able to rely upon the information technology controls for financial systems from which the financial statements are produced. There no longer is sufficient time between fiscal year end and issuance of audit reports to do extensive clean-up or updating of financial data. There also is not time to validate financial data if audit testing reveals problems during the latter stages of the audit.

At the consolidated level, the Department has two material weaknesses and one reportable condition, up from one material weakness and one reportable condition in FY 2003. One financial material weakness and the information technology reportable condition reported this year are both repeat issues, although elements of the two findings varied from last year. The other financial material weakness is new and involved issues related to data quality, monitoring, and the methodology utilized to calculate OJP's grant accrual and advance. The financial material weakness continues to include many serious issues at the component level, including the OJP issues, the accounts payable accrual at ATF, separation of duties issues at the U.S. Marshals Service (USMS), and financial reporting and property issues at the Federal Bureau of Investigation (FBI).

At the component level, the number of material weaknesses increased from 9 in FY 2003 to 10 this year, and the number of reportable conditions rose from 10 in FY 2003 to 13 this year. The following table compares the FY 2004 and the FY 2003 audit results for the Department consolidated audit as well as for the 10 individual component audits. The consolidated report on internal control includes both the ATF and the Immigration and Naturalization Service (INS) for FY 2003. The INS was transferred to the Department of Homeland Security on March 1, 2003, and the ATF was transferred into the Department of Justice on January 24, 2003, from the Department of the Treasury, pursuant to the Homeland Security Act of 2002, Public Law 107-296.

However, the Department still lacks sufficient automated systems to readily support ongoing accounting operations and financial statement preparation. Many tasks still must be performed manually at interim periods and year-end, requiring extensive efforts on the part of financial and audit personnel. 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 throughout the year. We encourage the Department to continue its current efforts to implement a unified financial management system, supported by consistent, standardized business practices across the Department.

In the FY 2004 consolidated report on compliance and other matters, the auditors identified four

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 four non-compliant components were the ATF; the FBI; OJP, and the USMS. In addition, the FBI, the INS, the Offices, Boards and Divisions, the Working Capital Fund and the USMS were not compliant with FFMIA in FY 2003. In FY 2004, the USMS and OJP were also cited for noncompliance with the Prompt Payment Act and OJP was cited for noncompliance with the Improper Payments Information Act.

To improve 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 dedicate the appropriate staff and resources to these efforts.

The OIG reviewed KPMG LLP's report 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 12, 2004, 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 2004 and FY 2003 Audit Results						
Reporting Entity	Auditors' Opinion On Financial Statements		Number of Material Weaknesses[1]		Number of Reportable Conditions[2]	
	2004	2003	2004	2003	2004	2003
Consolidated Department of Justice	Disclaimer[3]	Disclaimer	2	1	1	1
Offices, Boards and Divisions	Unqualified[4]	Unqualified	0	1	2	1
Assets Forfeiture Fund and Seized Asset Deposit Fund	Unqualified	Unqualified	0	1	1	0
Federal Bureau of Investigation	Unqualified	Unqualified	2	2	1	0
Drug Enforcement Administration	Unqualified	Unqualified	0	0	1	2
Office of Justice Programs	Disclaimer	Disclaimer	5	0	1	1
Immigration and Naturalization Service[5]	N/A	Unqualified	N/A	3	N/A	1
U.S. Marshals Service	Unqualified	Unqualified	2	1	2	1
Federal Bureau of Prisons	Unqualified	Unqualified	0	0	1	2
Federal Prison Industries, Inc.	Unqualified	Unqualified	0	0	1	1
Working Capital Fund	Unqualified	Unqualified	0	1	2	0
Bureau of Alcohol, Tobacco, Firearms and Explosives[5]	Qualified[6]	Unqualified	1	0	1	1
		Component Totals	10	9	13	10

[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] Disclaimer of Opinion – An auditor's report that states that the auditor does not express an opinion on the financial statements.

[4] 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.

[5] Pursuant to the Homeland Security Act of 2002, Public Law 107-296, the Immigration and Naturalization Service transferred to the Department of Homeland Security on March 1, 2003. Additionally, the Bureau of Alcohol, Tobacco, Firearms and Explosives transferred from the Department of the Treasury into the Department of Justice on January 24, 2003.

[6] 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.

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