KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Internal Control

Inspector General
U.S. Department of Justice

Acting 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, 2007 and 2006, 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 9, 2007. We did not audit the financial statements of the U.S. Marshals Service as of and for the year ended September 30, 2007, or the financial statements of the U.S. Marshals Service, the Federal Bureau of Prisons, and the Federal Prison Industries as of and for the year ended September 30, 2006. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our report, insofar as it related to the amounts included for those components, was based solely on the reports of the other auditors. As discussed in Note 1 to the consolidated financial statements, beginning in fiscal year 2007 the activities and balances of the Department's Working Capital Fund, previously reported as a separate entity, have been included in the financial statements of the Offices, Boards and Divisions for fiscal years 2007 and 2006. As discussed in Note 26 to the consolidated financial statements, the Department changed its method of reporting the reconciliation of budgetary resources obligated to the net cost of operations in fiscal year 2007.

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 2007 financial statements of the U.S. Marshals Service. Those financial statements were audited by other auditors whose reports thereon, including the other auditors' *Independent Auditors' Report on Internal Control*, have 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.

INTERNAL CONTROL OVER FINANCIAL REPORTING

The Department's management is responsible for establishing and maintaining effective internal control. In planning and performing our fiscal year 2007 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. We limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 07-04. 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 of this section 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 over financial reporting. 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 2007 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. 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*, 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.

INTERNAL CONTROL OVER PERFORMANCE MEASURES

As required by OMB Bulletin No. 07-04 in our fiscal year 2007 audit, with respect to internal control related to performance measures determined by management to be key and reported in the *Management's Discussion and Analysis* and *Performance* sections, we and the other auditors obtained an understanding of the design of internal controls relating to the existence and completeness assertions and determined whether these internal controls had been placed in operation. We and the other auditors limited our testing to those controls necessary to report deficiencies in the design of internal control over key performance measures in accordance with OMB Bulletin 07-04. However, our and the other auditors' procedures were not designed to provide an opinion on internal control over reported performance measures and, accordingly, we do not provide an opinion thereon. In our fiscal year 2007 audit, we and the other auditors noted no deficiencies involving the design of the internal control over the existence and completeness assertions related to key performance measures.

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 9, 2007

EXHIBIT I

OVERVIEW OF SIGNIFICANT DEFICIENCIES

The following table summarizes the 18 significant deficiencies identified by the Department's component auditors during fiscal year 2007. The component auditors also considered 4 of these significant deficiencies to be material weaknesses. We analyzed these component-level material weaknesses 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[1] Noted During Fiscal Year 2007		DOJ	OBDs	AFF	FBI	DEA	OJP	ATF	USMS[2]	BOP	FPI	WCF[3]
Improvements are needed in the Department's component financial systems' general and application controls.[4]		S	S	S	M	S	S	S	S	S	S	n/a
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	M	M M			n/a
Total Material Weaknesses Reported by Components' Auditors	FY 2007	4	0	0	1	0	0	1	2	0	0	n/a
	FY 2006	7	0	0	1	0	2	2	2	0	0	0
Total Significant Deficiencies Reported by Components' Auditors	FY 2007	14	3	3	0	1	3	1	1	1	1	n/a
	FY 2006	7	1	2	0	0	1	0	0	1	0	2

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); Federal Prison Industries, (FPI); and Working Capital Fund (WCF).

Legend:
(1) Effective for fiscal year 2007, the term "reportable condition" was changed to "significant deficiency" and new definitions of material weakness and significant deficiency were introduced in auditing standards generally accepted in the United States, *Government Auditing Standards*, and OMB Bulletin No. 07-04.
(2) USMS's financial statements were audited by other auditors.
(3) Beginning in fiscal year 2007 the activities and balances of the Working Capital Fund are included in the OBDs' financial statements.
(4) Includes the Department's Operations Services Staff (OSS), a component of the Office of the Chief Information Officer (OCIO), Justice Management Division (JMD), which has primary responsibility over the information system general controls environment that provides general control support for several DOJ components' financial applications. See related finding in Exhibit II.

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, the component entities' auditors continue to identify weaknesses in the general and application controls designed and implemented to protect the integrity of information systems data. However, as a result of the corrective actions taken by the Department and the component entities over the past year, this Department-wide internal control finding has been reduced from a material weakness to a significant deficiency.

In performing procedures on the components' financial management information systems, we and other component auditors considered the Government Accountability Office's (GAO) *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). The FBI's auditors reviewed the FBI's information system (IS) general controls environment and reported their detailed findings to the OIG in a separate limited distribution report.

In support of the Department's fiscal year 2007 consolidated financial statement audit, we performed a review of the DOJ 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, 2007, and reported our detailed findings to the OIG in a separate limited distribution report.

The following table depicts the IS general and application control weaknesses identified by the auditors on the DOJ IS general controls environment and the nine Department reporting components for fiscal year 2007. Following the table, we present brief summaries of the specific conditions reported by the components' auditors.

General & Application Control Weaknesses[(1)]	OBDs [(2)]	AFF [(2)]	FBI	DEA	OJP	ATF	USMS	BOP [(2)]	FPI
Entity-wide Security					X				
Access Controls			X	X	X	X	X	X	X
Application Software Development and Change Controls/System Development Life Cycle (SDLC)		X			X		X		X
Service Continuity									
Segregation of Duties									
System Software	X	X	X		X		X	X	X
Application Controls									

(1) This table summarizes the IS control weaknesses reported in the component auditors' *Independent Auditors' Reports on Internal Control*. For the FBI, the component auditors reported an IS-related material weakness. For OBDs, AFF, DEA, OJP, ATF, USMS, BOP and FPI, the component auditors reported an IS-related significant deficiency.
(2) The OSS IS general controls environment weakness identified in the area of system software impacts the OBDs, AFF, and BOP IS controls environments.

OBDs – Weaknesses in the area of system software were identified in the JMD/OSS IS general controls environment. JMD/OSS has primary responsibility over the IS general controls environment that provides general control support for the OBDs' financial application, FMIS2. JMD implemented corrective actions on all previous and current vulnerabilities prior to the end of the fiscal year.

AFF – Weaknesses were also identified in the Consolidated Asset Tracking System's (CATS) change controls and system software. In addition, the weaknesses identified in the JMD/OSS IS general controls environment impact AFF because AFF uses FMIS2 as its accounting system.

FBI – Weaknesses were identified in the IS general controls environment in the areas of access controls and system software. Based on the results of the IS environment testing and failure of related IS general controls, specific application controls were not tested during the fiscal year 2007 audit. The FBI implemented corrective actions to eliminate the weaknesses, which were validated during the course of the audit.

OJP – Improvement has been made to address many of the prior-year weaknesses. However, weaknesses continued to exist and new weaknesses were identified in the areas of entity-wide security, access controls, system software, and change control procedures for applications.

ATF – A weakness was identified in the IS general controls environment in the area of access controls.

USMS – Significant improvement has been made, however areas for improvement continue to exist within the USMS IS environment. Issues remain open from prior years and new issues were identified during fiscal year 2007. Specifically, weaknesses were noted in application change controls, system software, and access controls.

BOP – Weaknesses continue to exist in controlling access to financially significant systems. Access controls and system software weaknesses were identified. In addition, the weaknesses identified in the JMD/OSS IS general controls environment impact BOP because BOP uses the FMIS2 accounting system.

FPI – Weaknesses in the IS general controls environment exist in the areas of access control, application change controls, and system software.

DEA – Weaknesses in the IS general network control environment exist in the area of access controls.

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

Recommendation

We recommend the Department:

1. Require the components' and the OSS's Chief Information Officers (CIO) to submit and implement corrective action plans that address the weaknesses identified above. 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. *(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, will develop corrective action plans 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.

While the Department and its component entities have made progress in addressing previously-reported reportable conditions, the component entities' auditors continue to identify weaknesses in the financial management systems, internal controls, and financial reporting processes that inhibit the component entities' ability to prepare financial statements in accordance with generally accepted accounting principles. Component entities' financial management systems and related internal controls continue to be in need of improvement 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.

Specifically, the component auditors noted the following deficiencies in the component entities' financial management systems, internal controls, and financial reporting processes (the effects of which were adjusted in the components' financial statements, as appropriate) that comprise the Department-wide significant deficiency.

Financial Accounting and Reporting Quality-Control and Assurance. The USMS implemented several new quality control procedures during the year that enhanced its ability to prepare interim and final financial statements within prescribed timeframes, and, in some respects, more accurately. However, improvements are still needed. The USMS management-review 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 7 years.

The USMS's Office of Finance (OF) employs a core group of personnel and contractors to perform the financial statement preparation and quality-control and assurance functions. The expertise within this core group is still evolving, as members enhance their knowledge and understanding of the USMS's business processes, accounting systems, and financial accounting and reporting requirements. However, 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 financial statements, the component auditors noted the following deficiencies:

- The USMS did not comply with the Department's *Financial Statement Requirements and Preparation Guide* when submitting its interim financial statements. The USMS reported June 30, 2006, financial data as opposed to the required September 30, 2006, data. This error was not detected by the management quality assurance process.

- The USMS made an error in updating its electronic application used to prepare the financial statements. This resulted in a $7.4 million overstatement and equivalent understatement of Unobligated Obligations – Not Available and Unobligated Balances – Available, respectively, in the Statement of Budgetary Resources as of and for the period ended June 30, 2007. The USMS detected this error after the interim financial statements were issued to the Department's finance office.

- The USMS implemented procedures to perform general ledger edit checks on interim financial data but failed to resolve large differences related to one general ledger account edit check. Further research would have disclosed that inclusion of an inappropriate general ledger account in the edit check was the reason for the difference.

General Ledger Account Balances Review and Validation. Component auditors noted that the USMS's June 30, 2007, trial balance included several improper or abnormal balances and account relationship anomalies that resulted from transaction-level posting errors. These errors were not detected by the USMS during its financial reporting process, resulting in significant misstatements in the interim financial statements, including:

- A $21 million understatement in accrued payroll resulting from a reclassification error.

- A $19.1 million abnormal debit balance in accounts payable due to the improper posting of a payroll accrual.

- A $9.8 million collection was erroneously included in accounts receivable resulting in an overstatement of accounts receivable and revenue and an understatement of unfilled customer orders.

- A $7.8 million abnormal credit balance in operating expenses resulting from the use of an incorrect document type for the posting of a refund.

Verification of Audit Deliverables. A data download of undelivered orders as of June 30, 2007, submitted for audit testing included a balance that differed from the corresponding trial balance amount by approximately $167 million. The USMS did not validate the accuracy and completeness of the data before providing it for the component auditors' use. Upon further review, OF personnel determined that certain transaction types were missing from the data download provided to the component auditors.

Upward and Downward Adjustments. The USMS's accounting system does not systematically record upward and downward adjustments in accordance with USSGL posting logic, causing OF personnel to have to manually research adjustments and prepare journal voucher to reclassify accounting transactions to the USSGL accounts established for such adjustments. The process used by the USMS for reclassification entries is not USSGL compliant because it nets upward and downward adjustments at the fund, budget fiscal year, and document-type level. Such adjustments should not be netted because they artificially affect budgetary resources available and obligations incurred.

Noncompliance with the USSGL and the Department's and OMB's financial reporting requirements can have a negative impact on the preparation of the USMS's and the Department's financial statements, resulting in the possibility of significant control deficiencies, if not material weaknesses, that could have adverse effects on the audit opinions.

Funds Management Controls. The USMS does not have adequate financial and compliance controls at district, headquarters, and Justice Prisoner & Alien Transportation System (JPATS) offices to ensure that obligation transactions are executed and recorded in accordance with laws and regulations and related open obligation balances are accurate and complete. The component auditors' interim and year-end testing disclosed accounting errors and instances of noncompliance with accounting standards; OMB Circular No. A-11, *Preparation, Submission and Execution of the Budget*; and the USSGL, as follows:

Undelivered Orders. In their interim and year-end testing, component auditors noted:

- District offices did not always establish obligations for approved medical treatment prior to medical services being performed. Two district offices did not record obligations until after the re-priced medical invoices were received. District offices do not have procedures in place to accurately estimate the cost of medical services, which can vary significantly between the amounts invoiced by service providers and the amounts actually paid under Medicare guidelines (the re-priced medical invoice).

- Procedures for reviewing undelivered orders at year end need to be enhanced to ensure that amounts are valid. For example, component auditors noted that $3 million set aside for FY 2006 and FY 2007 rent purposes remained in undelivered orders at September 30, 2007, whereas these amounts should have been accrued as an accounts payable if additional rental billings were anticipated. Otherwise, the amounts should have been de-obligated. Also, District Office and Headquarters supervisory review procedures over month-end closing processes are not adequate to ensure that orders that have been delivered but not yet paid are properly recorded as accounts payable at month end. The component auditors noted obligations totaling $2.9 million included in undelivered orders even though the associated costs had been incurred and should have been recorded as accounts payable.

Accounts Payable (Proprietary) and Delivered Orders – Obligations (Budgetary). In their interim and year-end testing, component auditors noted:

- JPATS made unauthorized commitments under two existing aircraft leases without executing modifications to the lease agreements. The USMS subsequently ratified the unauthorized commitments and payments totaling $3.9 million that were made related to the aircraft lease contracts. In addition, JPATS erroneously established duplicate accounts payable accruals related to these transactions causing accounts payable to be overstated.

- JPATS erroneously accrued $5.0 million as an accounts payable as of September 30, 2007, for new aircraft leases even though the leases had been terminated earlier in the year, resulting in an overstatement of accounts payable.

- The component auditors noted that Headquarters recorded invalid accounts payable totaling $2.2 million as of June 30, 2007.

- One District Office erroneously recorded an accounts payable transaction in the amount of $8.8 million when the transaction should have been recorded in the amount of $841 thousand. This error was not detected in the District Office's month-end closing process, although it was detected by Headquarters as part of its quality control review of related obligations.

The misstatements in District Office and Headquarters undelivered orders and accounts payable resulted primarily from inadequate procedures for reviewing the status of open obligations at month end and year end. Procedures to ensure that recorded accounts payable represent valid and accurate liabilities, orders that have been delivered but not paid and that recorded undelivered orders represent valid obligations are lacking.

The misstatements in JPATS undelivered orders and accounts payable resulted primarily from a lack of communication and coordination between JPATS procurement, budget, and finance staffs concerning the status of contract obligations and liabilities. JPATS' finance office personnel not having been actively involved in the posting of year-end liabilities may also have contributed to the resulting misstatements.

Accounts Payable. Improvements are needed in the ATF's process for recording accounts payable. ATF uses a "receiver" process to indicate that goods and services have been received and are approved for payment. Despite modifications made by ATF to its existing policies and procedures and training provided to purchasing agents involved in the process, the component auditors identified errors in the receiver process controls as well as errors in the recording of transactions related to undelivered orders and the recording of accounts payable. Such errors impacted the amounts reported for net costs of operations and obligations incurred. Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*, requires that entities recognize a liability for unpaid amounts once the entity accepts title to the goods received. If invoices are not available when the financial statements are prepared, the amounts owed should be estimated.

The above errors occurred primarily because: (1) purchasing agents did not always identify purchases when the goods and services had been received and accepted, (2) ATF personnel did not perform reviews of the supporting documentation to verify receipt and acceptance of goods and services, and (3) supporting documentation for processed receivers was not always reviewed to ensure that receiver information was accurate and complete. This condition, which was identified as a material weakness in ATF's 2006, 2005, and 2004 *Independent Auditors' Reports on Internal Control*, continued to exist in 2007 although ATF took steps to address the problem. In conclusion, ATF continues to experience difficulty in recording accounts payable transactions through the receiver process and in the recording of adjustment estimates, which can result in misstatement of the accounts payable balances in the financial statements.

Grant Advance and Payable Estimation Process. During the component auditors' testing of the controls over OJP's grant accrual process, they noted significant improvement from the prior year. However, they determined that further improvements are needed in OJP's process to estimate quarterly accrual amounts. Specifically, as a result of their March 31 and June 30, 2007, interim test procedures the component auditors noted that the accrual methodology overstated the estimated expenditure amount and related accounts payable for grants with expired dates.

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 is to perform a more in-depth analysis. The resulting accrual should be reviewed by the Office of the Comptroller and documentation of the review maintained.

Although the grant accrual process was designed to identify errors in the accrual methodology, it is primarily focused on grantees that have submitted current-period financial status reports. OJP did not have sufficient processes or controls in place to effectively analyze potential errors in the grant accrual calculation relating to those grantees that had not submitted current-period financial status reports (SF-269), specifically grants for which the performance period had expired. In addition, throughout FY 2007 OJP had a backlog of grants pending closeout that adversely affected the accuracy of the quarterly accounts payable estimation.

As a result of the conditions described above, OJP's accounts payable balances were overstated by likely amounts of $41.7 million and $21 million as of March 31 and June 30, 2007, respectively. As a result of these misstatements, OJP revised its year-end grant expense accrual methodology in consideration of expired grants.

Grant Deobligations. In testing undelivered orders balances, component auditors noted a need for improvement in OJP's deobligation and close-out process for grant-related undelivered orders. Specifically, the undelivered orders balances of certain grants were not de-obligated within 180 days of OJP receiving the final SF-269 from the grantee or within 180 days from the grant end date. Of 449 grants tested at the June 30, 2007, interim audit period, component auditors identified 91 grants that either had a final SF-269 submitted or were past their performance period end date. Of these 91 grants, 58 were either not fiscally or programmatically closed out or de-obligated within 180 days after the grant completion end date and 28 grants had outstanding undelivered orders balances that should have been de-obligated prior to the end of the quarter.

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. 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 then has 60 days after receipt of the closeout package to close the grant and de-obligate the remaining funds.

In their analysis 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 $125.6 million and $100.5 million for the fiscal quarters ended March 31 and June 30, 2007, respectively. Component auditors also noted that there were grants with outstanding award balances of approximately $67.1 million related to grants that had been expired for 180 days or more as of September 30, 2007. Of this amount, OJP had accrued expenditures of approximately $23.3 million and had de-obligated approximately $18.7 million. The $25.1 million balance was recorded as undelivered orders.

Although improvement was noted throughout the year, grants requiring close-out continue to exist as a result of OJP's program managers' failure to: (1) consistently close out grants in accordance with existing policy, or (2) adequately document justification for delays. Specifically, grant managers did not properly monitor certain grants for which a final SF-269 had been submitted or for which the grant end date had passed. There was also insufficient communication between the program offices and the Office of the Chief Financial Officer to ensure that closed out grants were timely de-obligated.

Status of Obligations. The results of the component auditors' tests of a sample of open obligations indicated that managers across the OBDs did not perform a sufficient review of their open obligation balances to ensure their proper classification as either undelivered orders or accounts payable. In their sample of 975 obligations as of March 31 and June 30, 2007, component auditors noted 53 obligation balances that were not properly classified. The absolute value of the errors identified was $20.3 million and $13.8 million for undelivered orders and accounts payable, respectively. Although a compensating control detected 17 of the errors noted, the remaining errors resulted in a most-likely extrapolated misstatement of $13.9 million and $11.6 million in undelivered orders and accounts payable, respectively, as of June 30, 2007. Errors of a similar nature were noted in a smaller sample of year-end open obligations.

The OBDs policies and procedures bulletin, *Accounting for Financial Obligations Within the OBDs*, recommends that obligating organizations perform reviews of open obligations on a monthly basis and requires that reviews be conducted no less frequently than quarterly. The purpose of the review is to determine the validity of open obligation accruals, that balances are properly classified as either delivered or undelivered orders, and that obligation amounts are reasonably estimated. The condition described above increases the risk of misstated undelivered orders and accounts payable balances in OBDs' financial statements.

Obligations and Disbursements. In performing interim and year-end tests of obligations and disbursements, the AFF's component auditors identified various obligation status and valuation errors, including: (1) items erroneously classified as delivered-unpaid prior to actual delivery of services, (2) items erroneously recorded as undelivered when services had actually been delivered, (3) items not de-obligated after receipt of final invoices, (4) an item not de-obligated upon determination that the obligation was no longer warranted,

(5) overstated obligation balances, and (6) understated obligation balances. These status and valuation errors had an absolute dollar value of approximately $3.8 million.

OMB Circular No. A-123, *Management's Responsibility for Internal Control*, requires that transactions be promptly recorded, properly classified, and accounted for in order to prepare timely accounts and reliable financial and other reports. The documentation for transactions, management controls, and other significant events must be clear and readily available for examination.

Ineffective internal controls over the recording of obligations and subsequent de-obligations may result in misstatements of the related financial statement balances.

Seized and Forfeited Property. The AFF's component auditors noted that internal controls were in need of reinforcement with respect to: (1) seized and forfeited property management, and (2) the reconciliation of property seized for forfeiture between the ATF's property management system and its case management system, as described below.

Internal Controls Related to Status and Valuation. In conducting tests of transactions recorded in the Consolidated Asset Tracking System (CATS) and the Forfeited and Seized Asset Tracking System (FASTRAK) as of June 30, August 31, and September 30, 2007, component auditors observed various status and valuation errors, including: (1) a seized property item, a seized cash not-on-deposit item, and a forfeited property item that should not have been recorded in CATS, (2) seized property items not properly classified as "returned-to-owner" or otherwise disposed of, (3) a forfeited property item that was not accrued as revenue, (4) seized property undervaluations and overvaluations, (5) a forfeited property undervaluation, and (6) a seized property currency item misclassified as personal property. These status and valuation errors had an absolute dollar value of approximately $12 million.

Internal Controls Over Reconciliation of Property Seized for Forfeiture Between FASTRAK and NForce Need Reinforcement. In conducting tests of transactions recorded in FASTRAK (the property management system used by ATF to record seized and forfeited property related to AFF) as of June 30, 2007, component auditors identified certain property items that were designated as "seized for forfeiture" in NForce (ATF's case management system) that were not recorded as such in FASTRAK. Upon further investigation, it was determined that ATF headquarters had declined to pursue forfeiture proceedings and notified the affected field office but the field office failed to update NForce to change the classification from "seized for forfeiture" to "seized for evidence."

The failure to record and adjust the status of seized and forfeited property in NForce, FASTRAK, and the underlying physical property inventory logs and to reconcile the status of property between these systems and the seized property in ATF's physical possession can result in: (1) the untimely forfeiture of seizures subject to timely notice requirements, (2) misstatements in the custody control records, and the mechanisms that identify property as "seized for forfeiture," "seized for evidence," or both, and (3) failure to dispose of property in a timely manner.

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.

In summary, certain components' financial management systems and related internal controls do not provide an adequate level of 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 also still needed in the components' day-to-day adherence to the standardized accounting policies and procedures, as set forth in the Department's *Financial Statement Requirements and Preparation Guide*, to ensure accuracy and consistency in the Department's consolidated financial statements.

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 quarter.

Specifically, component auditors noted errors in the OBDs' recording of journal entries in the financial management system, as follows:

- Within the financial management system's "generic" module used to post primarily routine journal entries, certain entries made using a particular transaction code omitted a suffix needed to ensure that the appropriate accounts were debited and credited, resulting in errors totaling $36.5 million in the affected general ledger account balances. These errors were not detected by the review-and-approval control designed for this purpose.

- Within the financial management system's "journal" module used to post both routine and non-routine journal entries, the incorrect posting of a non-routine journal entry resulted in a $57.2 million understatement of both total budgetary resources and total status of budgetary resources in the Statement of Budgetary Resources. The OBDs' standard operating procedures require the review and approval of non-routine journal entries posted within this journal module. The subject journal entry was judged to be routine; consequently, it was not reviewed and approved prior to its posting.

Component auditors also noted deficiencies in the OBDs' recording of journal entries in the financial statement preparation database, as follows:

- At June 30, 2007, the journal entry log was approved and signed by the same individual who prepared two of the journal entries included in the log. Consequently, the manual segregation of duties requirements for this activity were not observed. This same deficiency was noted at September 30, 2007, where the journal entry log was approved and signed by the same individual who prepared two of the journal entries included in the log. In addition, the September 30, 2007 journal entry control log was found to be incomplete in that two reclassification journal entries were excluded from the signed version of the log used in preparation of the September 30, 2007 draft financial statements.

- Errors identified in the recording of eight journal entries 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, accounts receivable related to a reimbursable agreement, the elimination of intra-entity accounts receivable and accounts payable, the classification of custodial liabilities, and the correction of errors between the first and second drafts of the year-end financial statements.

It is the policy of OBDs' management that control 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.

Recommendations:

We recommend the Department:

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. *(Updated)*

Management Response:

DOJ Management Concurs. The 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 2008, 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 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.

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. *(Updated)*

Management Response:

DOJ Management Concurs. The JMD will continue to work with the ATF to review the validity of open obligations through aging analyses and other analytics and further refine the accrual methodology that was used in FY 2007. This will include analyzing the accrual process each quarter and reevaluating the category types (commercial rent obligations, intergovernmental transactions, etc.) used to determine the accrual process, validating of vendor estimates used to accrue commercial activity through review of subsequent invoices and/or ATF program manager or Contracting Officer Technical Representative concurrence, and subsequent disbursement testing. These processes will be documented and policies and procedures updated as appropriate. The ATF will also continue to conduct quarterly open obligation reviews.

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. *(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 2007 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, 2007, 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 2008.

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 2008, 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.

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. *(Updated)*

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. Implementation efforts are already underway with a pilot project at the Asset Forfeiture Management Staff, scheduled to go live in November 2007. DEA's implementation, currently in the Development and Configuration phase, is scheduled to go live in October 2008. FBI is engaged in a planning phase with a full implementation schedule ready for release in early FY 2008.

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 the DOJ has made in correcting the reportable conditions identified during these audits. We also provide the OIG report number where the condition remains open, the fiscal year it was identified, our recommendation for improvement, and the status of the condition as of the end of fiscal year 2007.

Report	Reportable Condition	Recommendation	Status
Annual Financial Statement Fiscal Year 2006 Report No. 07-02	Improvements are needed in the Department's and components' financial systems general and application controls.	**Recommendation No. 1:** Require the components' and the OSS's Chief Information Officers (CIO) to submit corrective action plans that address the identified weaknesses. The corrective action plans should focus on correcting deficiencies in entity-wide security, access controls, application software development and change controls/SDLC, service continuity, segregation of duties, system software, and other specific application control weaknesses discussed in the component auditors' reports on internal control and the general controls environment limited-distribution report. 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 2007 Recommendation No. 1)

Report	Reportable Condition	Recommendation	Status
	Improvements are needed in the components' internal control to provide reasonable assurance that transactions are properly recorded and summarized to permit the preparation of financial statements in accordance with generally accepted accounting principles.	**Recommendation No. 2:** 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) accounts payable (and proper consideration of receipt and acceptance of goods and services), (c) budgetary accounting for grant and non-grant obligations, (d) RA-related accrual accounting, and (e) status, valuation, and completeness of seized and forfeited property. 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 2007 Recommendations No. 3 and 4)
		Recommendation No. 3: 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. Proceed with implementation of a financial statement consolidation package to automate the compilation of the Department-wide financial statements.	In Process (Updated by FY 2007 Recommendation No. 5)
		Recommendation No. 4: Monitor the corrective actions taken by the USMS to improve the condition of its financial statement quality control and quality assurance processes, in response to the specific recommendations made in the component auditor's *Independent Auditor's 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, 2006.	In Process (Updated by FY 2007 Recommendation No. 2)