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Independent Auditors' Report on Internal Control

United States Attorney General
U. S. Department of Justice

Inspector General
U. S. Department of Justice

We have audited the consolidated balance sheets of the U.S. Department of Justice (the Department) as of September 30, 2006 and 2005, and the related consolidated statements of net cost, changes in net position, and financing, 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 10, 2006. That report indicated that we did not audit the financial statements of the following components of the Department: the U.S. Marshals Service; the Federal Bureau of Prisons; and the Federal Prison Industries, Inc. 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 18 to the consolidated financial statements, the Department changed its method of reporting earmarked funds to adopt the provisions of the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 27, *Identifying and Reporting Earmarked Funds*, effective October 1, 2005.

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. 06-03, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 06-03 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

As noted above, we did not audit the financial statements of the U.S. Marshals Service; the Federal Bureau of Prisons; and the Federal Prison Industries, Inc. Those financial statements were audited by other auditors whose reports thereon, including the other auditors' *Independent Auditors' Reports 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 these components, is based solely on the reports 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 2006 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 in order to determine 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. 06-03. 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 provide assurance on the Department's internal control over financial reporting. Consequently, we do not provide an opinion thereon.

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions by management in the consolidated financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud, in amounts that would be material in relation to the consolidated financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in any internal control, misstatements due to error or fraud may nevertheless occur and not be detected.

In our fiscal year 2006 audit, we noted, and the reports of the other auditors identified, certain matters, described in Exhibits I, II, and III, involving internal control over financial reporting and its operation that we and the other auditors consider to be reportable conditions. Exhibit I is an overview of the reportable conditions (including material weaknesses) identified in the Department's component auditors' *Independent Auditors' Reports on Internal Control*, and includes an explanation of how we treated these component-level reportable conditions at the Department level. Exhibit II provides the details of the Department-wide reportable condition that we believe to be a material weakness. Exhibit III presents the other Department-wide reportable condition. Exhibit IV presents the status of prior years' Department-wide reportable conditions.

INTERNAL CONTROLS OVER REQUIRED SUPPLEMENTARY STEWARDSHIP INFORMATION AND PERFORMANCE MEASURES

Under OMB Bulletin No. 06-03, the definition of material weakness is extended to other controls as follows. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud, in amounts that would be material in relation to the Required Supplementary Stewardship Information or material to a performance measure or aggregation of related performance measures, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in any internal control, misstatements due to error or fraud may nevertheless occur and not be detected.

Our consideration of the internal control over Required Supplementary Stewardship Information and the design and operation of internal control over the existence and completeness assertions related to key performance measures would not necessarily disclose all matters involving the internal control and its operation related to Required Supplementary Stewardship Information or the design and operation of the internal control over the existence and completeness assertions related to key performance measures that might be reportable conditions.

As required by OMB Bulletin No. 06-03, in our fiscal year 2006 audit, we and the other auditors considered the Department's internal control over the Required Supplementary Stewardship Information by obtaining an understanding of the Department's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. We and the other auditors limited our testing to those controls necessary to test and report on the internal control over the Required Supplementary Stewardship Information in accordance with OMB Bulletin No. 06-03. However, our and the other auditors' procedures were not designed to provide an opinion on internal control over the Required Supplementary Stewardship Information, and, accordingly, we do not provide an opinion thereon. In our fiscal year 2006 audit, we and the other auditors noted no matters involving the internal control and its operation related to Required Supplementary Stewardship Information that we considered to be material weaknesses as defined above.

As further required by OMB Bulletin No. 06-03, in our fiscal year 2006 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 of the Department's *Fiscal Year 2006 Performance and Accountability Report*, 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 controls had been placed in operation. We and the other auditors limited our testing to those controls necessary to test and report on the internal control over key performance measures in accordance with OMB Bulletin No. 06-03. 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 2006 audit, we and the other auditors noted no matters involving the design and operation of the internal control over the existence and completeness assertions related to key performance measures that we considered to be material weaknesses as defined above.

We noted certain additional matters that we reported to the management of the Department in a separate letter dated November 10, 2006.

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, the OMB, the 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 10, 2006

Exhibit I

OVERVIEW OF REPORTABLE CONDITIONS (INCLUDING MATERIAL WEAKNESSES)

The following table summarizes the 14 reportable conditions identified by the Department's component auditors. The component auditors also considered 7 of these reportable conditions to be material weaknesses. We analyzed these component-level material weaknesses and reportable conditions to determine their effect on the Department's internal control over financial reporting and concluded that they comprise two Department-wide reportable conditions, one of which we also consider to be a material weakness.

Department Reportable Conditions Noted During Fiscal Year 2006		DOJ	OBDs	AFF	FBI	DEA	OJP	ATF	USMS[1]	BOP[1]	FPI[1]	WCF
Improvements are needed in the Department's and components' financial systems general and application controls.[2]		M	R	R	M		M	M	M	R		R
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.		R		R			M R	M	M			R
Total Material Weaknesses Reported by Components' Auditors	FY2006	7	0	0	1	0	2	2	2	0	0	0
	FY2005	10	0	0	2	0	3	2	3	0	0	0
Total Reportable Conditions Reported by Components' Auditors	FY2006	7	1	2	0	0	1	0	0	1	0	2
	FY2005	8	1	1	1	0	1	0	1	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[1] (USMS); Federal Bureau of Prisons[1] (BOP); Federal Prison Industries, Inc.[1] (FPI); and Working Capital Fund (WCF).

Legend:
[1] Department's components whose financial statements were audited by other auditors.
[2] 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 consolidated information system general controls environment. See related finding in Exhibit II.

M – Material weakness
R – Reportable condition

In Exhibit II and Exhibit III, respectively, we discuss in detail the Department-wide material weakness and reportable condition noted above.

Exhibit II

MATERIAL WEAKNESS

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

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 2006 consolidated financial statement audit, we performed a review of the DOJ consolidated IS general controls environment that provides general control support for several DOJ components' financial applications. The Department's OSS has primary responsibility over the consolidated 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, 2006, 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 consolidated IS general controls environment and the 10 Department reporting components for fiscal year 2006. 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	WCF [2]
Entity-wide Security	X				X	X				X
Access Controls		X	X		X	X	X	X		
Application Software Development and Change Controls/System Development Life Cycle (SDLC)		X	X		X	X				
Service Continuity			X		X					
Segregation of Duties					X	X	X			
System Software	X	X			X	X	X			X
Application Controls	X				X	X	X			X

[1] This table summarizes the IS control weaknesses reported in the component auditors' *Independent Auditors' Reports on Internal Control*. For FBI, OJP, ATF, and USMS, the component auditors reported an IS-related material weakness. For OBDs, AFF, BOP, and WCF, the component auditors reported an IS-related reportable condition.

[2] The OSS IS controls environment weakness identified in the areas of security program, access controls, and system software impacts the OBDs, AFF, BOP, and WCF IS controls environments.

OBDs – Weaknesses were identified in the Financial Management Information System's (FMIS2) security program, system software, and application controls.

AFF – The FMIS2 weaknesses identified at OBDs also impact AFF's financial management information systems because AFF uses FMIS2 as its accounting system. Weaknesses were also identified in the Consolidated Asset Tracking System's (CATS) logical access controls, change controls, and system software.

FBI – Weaknesses were identified in the IS general controls environment in the areas of logical access controls, change controls, and service continuity. 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 2006 audit.

OJP – Weaknesses were identified in the overall entity-wide security program, access controls, system software development and change control procedures for applications, system software, segregation of duties, and service continuity. Many of these weaknesses had not been corrected from prior years.

ATF – Weaknesses continue to exist in entity-wide security program, access controls, system software, and application change controls. In addition, weaknesses were identified in ATF's segregation of duties. Significant vulnerabilities not fully corrected from prior years remained in the controls over financial network operating systems, access controls over various financial and operational databases, and operating system level weaknesses on servers and databases that impact the processing of financial data.

USMS – Weaknesses in the general network control environment continue to exist in the areas of segregation of duties, access controls, and system software for the general support systems.

BOP – Weaknesses continue to exist in controlling access to financially significant systems. Many of these weaknesses existed in prior years. In addition, the FMIS2 weaknesses identified at OBDs also apply to BOP because BOP uses the FMIS2 accounting system.

WCF – The FMIS2 weaknesses identified at OBDs also impact WCF's financial management information systems because WCF uses FMIS2 as its accounting system.

The weaknesses identified by 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 that the Department:

1. Require the components' and the OSS's Chief Information Officers (CIO) to submit 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, 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. (Updated)

Management Response:

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 proactive corrective action plans. These plans will be validated by the Department's OCIO. This validation will address weaknesses identified and will institutionalize corrective actions to ensure program improvements are made in four of the Bureaus having IT material weaknesses. 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.

Exhibit III

REPORTABLE CONDITION

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 has made significant progress in addressing previously-reported material weaknesses, 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. 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 reportable condition.

Financial Management Systems, Internal Controls, and Financial Reporting

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).

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, as described below.

Accuracy and Completeness of Grant Advance and Payable Amounts. The component auditors noted that improvements are still needed to ensure the accuracy and completeness of OJP's grant advance and payable amounts, as well as the underlying assumptions in the estimation process. During the year, OJP made corrections to its grant accrual calculations as a result of errors identified through its review process, for which improvements had been made to better identify errors by using "look-back" and excess cash analysis procedures. While OJP identified errors as a result of its improved review process prior to preparation of the year-end financial statements, the errors were discovered subsequent to issuance of the year's first three fiscal quarters' financial statements. Most of the errors identified by OJP related to a lack of analysis of new grant programs prior to developing the grant accrual estimate. By not identifying the impact of new grant programs until after the issuance of its financial statements, OJP is at risk of misstating the grant advance and accounts payable balances.

In addition to the errors identified by OJP, as noted above, the component auditors identified certain errors relating to the grant accrual as a result of their test work, suggesting that OJP's look-back analysis and adjustment factor calculations needed further refinement. Specifically, the component auditors noted that the adjustment factor improperly included non-block grants in an advanced position, whereas it should only include the portion of the accrual relating to accounts payable. And, as a result of their year-end confirmation process, the component auditors also noted errors relating to the amount of estimated expenditures that OJP used as the basis for its accounts payable estimate. These errors resulted from the grantees' submitting inaccurate estimates to OJP that were not identified by OJP in its follow-up procedures. In addition to these errors, the component auditors identified errors directly related to the data files used by OJP to calculate its March 31 and June 30, 2006 quarterly grant accruals.

The errors identified by the component auditors occurred while OJP was still in the process of formalizing the current year's grant accrual process. As such, OJP did not have sufficient controls in place to ensure the completeness and accuracy of the grant data files during the first three quarters of the year, nor did OJP perform sufficient analyses to ensure the accuracy of the look-back and adjustment factor calculation processes as of that time. As a result, the accounts payable balance was understated by approximately $72 million and $60 million as of March 31 and June 30, 2006, respectively. OJP did correct the majority of these errors before fiscal year-end, leaving the accounts payable balance overstated by a known amount of approximately $9 million as of September 30, 2006.

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 results of that analysis should be reviewed by the Office of the Comptroller and documentation of the review maintained.

Grant Monitoring Procedures. In reviewing OJP's grant monitoring procedures, component auditors noted that OJP did not follow up and resolve certain site visit findings within the required time frames. Specifically, OJP did not submit to the grantee a follow-up letter within 30 working days of completion of the site visit for 23 of the 25 site visit reports reviewed. The average number of days to complete the follow-up letter was approximately 94 days. In addition, one report was not approved by the External Oversight Division (EOD) Director prior to finalization and submission of the follow-up letter. Component auditors also noted that OJP did not select its site visit sample statistically from the complete population of grants, which would have allowed OJP to statistically project any error rates identified to the entire population of grants. Rather, OJP used a combination of risk-based and random sampling techniques over the population of grants

Accounts Payable. Improvements are needed in 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. As a result of the component auditors' interim and year-end test work, they 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. They also identified errors in their tests of undelivered orders related to ATF's new headquarters facility. Identification of errors specific to the new headquarters facility caused ATF to reassess the status of the facility-related undelivered orders, which resulted in a $10.4 million adjustment to the undelivered orders and accounts payable balances. 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, (3) supporting documentation for processed receivers was not always reviewed to ensure that receiver information entered was accurate and complete, and (4) ATF did not conduct a thorough quarterly review of the documentation and status of the headquarters facility project. This condition, which was identified as a material weakness in ATF's 2005 and 2004 *Independent Auditors' Reports on Internal Control,* continued to exist in 2006 although ATF took steps to address the problem. In conclusion, ATF continues to experience difficulty in recording accounts payable transactions, which can result in misstatement of the accounts payable balances in the financial statements.

Financial Statement Quality-Control and Assurance. The USMS's interim and year-end financial statements contained excessive errors and omissions that were identified by the component auditors and the Office of the Inspector General, as follows:

- The June 30, 2006 financial statements were misstated, including Fund Balance with Treasury misclassifications; accounts payable and accounts receivable balances were overstated due to the failure to eliminate certain intra-fund activity; construction work-in-progress was overstated due to a misinterpretation of the Department's capitalization policy; accounts payable and accrued payroll were misstated by an offsetting amount due to the misclassification of the related accrual; the budgetary account for reimbursements collected did not agree to the supporting schedule because certain revenue and receivable activity had not been posted to the general ledger; and, there was an unreconciled difference in the Statement of Financing due to improper accounting entries related to capitalized property transactions.

- The September 30, 2006 financial statements were misstated, including distributed offsetting receipts were overstated due to improper entries affecting Fund Balance with Treasury and certain budget clearing accounts; unfilled customer orders without advance and anticipated resources were overstated due to a misunderstanding of how to post year-end reimbursable activity and balances; there was an unreconciled difference in the Statement of Financing due to improper accounting entries related to capitalized property transactions; and unobligated balances available were overstated.

OMB Circular No. A-127, *Financial Management Systems*, requires that (1) reports produced by the systems that provide financial information shall provide financial data that can be traced directly to the Standard General Ledger (SGL) accounts, and (2) transaction detail supporting SGL accounts be available in the financial management systems and directly traceable to specific SGL account codes. The USMS completed this year's financial reporting cycle in a difficult and challenging environment, including the replacement of the previous year's key financial reporting personnel with new personnel; processes underlying the financial statement preparation process were not documented, thus inhibiting the transfer of institutional knowledge to newly-appointed personnel; the USMS's financial systems were not in compliance with the Federal Financial Management Improvement Act of 1996; and the USMS's quality control over interim and final financial statements was both limited and ineffective. A component entity's failure to comply with OMB's financial statement reporting requirements could affect the Department's consolidated financial statements in such a way so as to adversely affect the Department's audit opinion or result in Department-level internal control findings.

Grant Deobligations. In testing undelivered orders transactions, component auditors noted a general lack of timeliness and the need for improvement in OJP's deobligation and close-out process for grant-related undelivered orders. In reviewing OJP's grant close-out process, component auditors noted that grant managers did not consistently ensure that the undelivered orders balances on closed grants were deobligated in a timely manner (within 180 days of the grant's end date and/or submission of the final SF-269). In their analysis of expired grants with unliquidated balances, component auditors noted certain grants that were not deobligated within 1 year of the grant termination date. As a result, the undelivered orders balance was overstated in OJP's financial statements by likely amounts of $48 million and $19 million for the fiscal quarters ended March 31 and June 30, 2006, respectively. Although improvement was noted during the third and fourth quarters, grants pending 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. Failure to deobligate funds timely prevents budget authority related to the grants pending close-out from being made available for new grants.

Accrual Accounting Functions. During their interim test work of intragovernmental reimbursable agreements (RAs), component auditors identified errors in the WCF's accrual processes related to revenue earned for goods and services provided but not yet billed. The component auditors identified a net revenue overstatement of $13.2 million in the WCF's March 31, 2006 financial statements and a net revenue understatement of $12.2 million in the WCF's June 30, 2006 financial statements. These errors were caused by staff involved in the revenue calculation and reporting process inaccurately calculating earned revenue or failing to record unbilled revenue in the financial management system. As a result of improvements made in the WCF's control environment, errors noted in the component auditors' year-end test work were reduced to $3.3 million. Quarterly revenue estimation is required to ensure that the WCF's quarterly financial statements are prepared in accordance with generally accepted accounting principles. SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*, requires that agencies recognize revenue at the time goods or services are provided to the public or another Government entity and that it is measured at the price likely to be received.

Seized and Forfeited Property. The AFF's component auditors identified weaknesses related to the status, valuation, and completeness of seized and forfeited property, 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 September 30, 2006, component auditors observed: (1) items not properly classified as "returned-to-owner" or otherwise disposed of, (2) seized property overvaluations, (3) forfeited property overvaluations, (4) seized property items that should have been designated as forfeited, and (5) seized property items designated as forfeited that should have been designated as seized. These status and valuation errors amounted to approximately $5.1 million.

Internal Controls Related to the Completeness of Seized and Forfeited Property. In conducting their inventory test procedures, component auditors noted seized property items designated as "seized-for-forfeiture" in ATF's case management system that were not designated as such in ATF's seized property management system, thus causing the auditors to question their possible omission from the AFF/SADF's financial statements. Upon further research, it was determined that ATF headquarters had decided not to pursue a forfeiture action for the seized property items. However, because ATF does not have sufficient controls in place to ensure that all property seized for forfeiture is classified consistently and contemporaneously in the ATF's property storage inventory locations, the field office was not aware of the need to change the status in the case management system from "seized-for-forfeiture" to "seized-for-evidence." As a result, the seized property was omitted from ATF's property management system and not included in its financial statements.

The failure to record, reconcile, and adjust the case management system, property management system, and underlying inventory control logs in a timely and consistent manner can result in forfeitures not being made timely; custody control records not properly reflecting the property's status as seized-for-evidence, seized-for-forfeiture, or both; and property disposals being made that are not consistent with the Department's seized property disposition policies. 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. Absent improvements in their financial management, internal control, and financial reporting practices, the components will continue to be challenged to prepare accurate financial statements in accordance with generally accepted accounting principles.

Recommendations

We recommend that the Department:

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. (Updated)

   Management Response:

   DOJ management concurs with the recommendation. JMD will continue to reinforce existing, and develop new, accounting policy and procedures requiring application of component revenue accrual methodologies and calculations. Additionally, JMD will work with particular components to re-evaluate their business processes and financial activities associated with accounts payables and undelivered orders. This will include a review and validation of accounts payable methodologies on a quarterly basis, to include accruals related to real property additions. JMD will work with various financial and property management offices, to ensure all property is accounted for accurately, to include real, accountable, seized and forfeited. Grant accrual methodologies will continue to be refined and any variances addressed. In addition, a review of all existing grant types will be conducted to further address any accrual differences that can be identified specific to a program.

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. (Updated)

   Management Response:

   DOJ management concurs with this recommendation. The Attorney General identified a unified core financial system as a major goal for the Department. The certified software program and integration and implementation contractor has been selected, with implementation beginning for two financial statement components in FY 2008. JMD will continue to work with the contractors to ensure processes meet the requirements of applicable federal accounting standards and that external reports can be automated as appropriate.

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. (Updated)

Management Response:

DOJ Management concurs with this recommendation. JMD will continue to work with the USMS to document and improve processes related to external reporting to include financial statement preparation.

Exhibit IV

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. 06-03, A*udit 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 Department has made in correcting the reportable conditions identified during these audits. We also provide the Office of the Inspector General (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 2006.

Report	Reportable Condition	Recommendation	Status
FY 2003 Department of Justice Annual Financial Statement, Report No. 04-13.	Fundamental changes are needed in the components' internal controls to ensure financial information can be provided timely to manage the Department's programs and to prepare its financial statements within the accelerated reporting deadlines of the OMB. *(Material Weakness)*	No. 1: Improve the Department-wide internal control program and include timely monitoring of financial controls by management. Communicate this to the components in the Department's *Financial Statement Requirement and Preparation Guide*. Senior leadership of the Department must support this effort and assign direct responsibility for the implementation of the internal control program to senior leaders at each component.	In process (Updated by FY 2006 Recommendation No. 2)
		No. 3: Proceed with the rapid implementation of the Department's Unified Financial Management System Project. The core financial system should include, but not be limited to, applications that support: (a) funds control (e.g., budget execution); (b) obligation accounting and control; (c) cash management; (d) inventory and property management; (e) the standard general ledger; (f) financial statement preparation, consolidation and reporting; and (g) customer/vendor recognition, including, intragovernmental trading partners. To the extent possible, the financial management system should be able to provide real-time financial data and provide flexibility in meeting external reporting requirements. As part of this effort, the Department should continue its development of a consolidation tool that will automate the current labor-intensive consolidation process, including, performance and accountability reporting, and the reconciliation of intragovernmental and intra-	In process (Updated by FY 2006 Recommendation No. 3)

Report	Reportable Condition	Recommendation	Status
		departmental transactions. Finally, a standard schedule of transaction codes should be developed and implemented in the system that describes the accounting transactions and the standard general ledger accounts to be used (both proprietary and budgetary). During the development of the transaction schedule, we strongly encourage the use of the Department of the Treasury's *Treasury Financial Manual*, Section III, which provides a detailed list of budgetary and proprietary transactions and the U.S. Government Standard General Ledger accounts affected.	
		No. 4: Ensure components have allocated sufficient resources to support the financial management and reporting process. Develop training for components' program and finance staff on the responsibilities for internal control and financial management. Include a detailed discussion on the Department's consolidated accounting and reporting requirements and emphasize that components' financial statements are segments of the Department's consolidated financial statements.	Completed
FY 2005 Department of Justice Annual Financial Statement, Report No. 06-04.	Fundamental changes are needed in the components' internal controls to ensure financial information can be provided timely to manage the Department's programs and to prepare its financial statements within the accelerated reporting deadlines of the OMB. *(Material Weakness)*	No. 1: Monitor the corrective actions taken by the USMS to improve the condition of its overall internal control framework, in response to the specific recommendations made in the other auditors' *Independent Auditors' Reports on Internal Control over Financial Reporting* issued in connection with the audit of the USMS's financial statements as of and for the year ended September 30, 2005.	In Process (Updated by FY 2006 Recommendation No. 4)
		No. 3: Assess the adequacy and completeness of the Department's accounting and financial reporting policies and procedures in the areas of: (a) accounts payable (and proper consideration of receipt and acceptance of goods and services), (b) grant advances and the grant-related accounts payable estimation methodology, (c) budgetary accounting for grant and non-grant obligations, (d) property management (e.g., real property, construction	In Process (Updated by FY 2006 Recommendation No. 2)

		work-in-progress, the charging of construction costs to the proper budgetary resource, software-in-progress, leasehold improvements, and subsidiary property records), and (e) RA-related accrual accounting. 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.	
	Improvements are Needed in the Department's Component Financial Management Systems' General and Application Controls. (*Material Weakness)*	No. 5: Require the components' and the OSS's Chief Information Officers (CIO) to submit corrective action plans that address the weaknesses identified above. The 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 include a timeline that establishes when major events must be completed, and the Department's CIO should monitor components' efforts to correct deficiencies and hold them accountable for meeting the action plan timelines.	In Process (Updated by FY 2006 Recommendation No. 1)