ASSETS FORFEITURE FUND AND SEIZED ASSET DEPOSIT FUND ANNUAL FINANCIAL STATEMENT FISCAL YEAR 2007

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ASSETS FORFEITURE FUND
AND
SEIZED ASSET DEPOSIT FUND
ANNUAL FINANCIAL STATEMENT
FISCAL YEAR 2007

OFFICE OF THE INSPECTOR GENERAL COMMENTARY AND SUMMARY

The Assets Forfeiture Fund and Seized Asset Deposit Fund (AFF/SADF) is a reporting entity within the U.S. Department of Justice (DOJ). The AFF/SADF were created to serve as repositories for funds seized by participating agencies and the sale proceeds from forfeited property. The proceeds deposited in the AFF are used to cover certain operating costs of the DOJ Asset Forfeiture Program (AFP). These include equitable sharing payments to state, local, and foreign governments; joint law enforcement operations; contract services in support of the program; and satisfaction of innocent third party claims. Operational expenses do not include the salaries and administrative expenses of AFP participants incurred while conducting investigations leading to seizure and forfeiture, and these expenses are not reported in the AFF/SADF financial statements.

This audit report contains the financial statements of the AFF/SADF for the fiscal years (FY) ended September 30, 2007, and 2006. Under the direction of the Office of the Inspector General (OIG), the FY 2007 audit was performed by KPMG LLP (KPMG). The audit resulted in an unqualified opinion on the FY 2007 financial statements. An unqualified opinion means that the financial statements present fairly, in all material respects, the financial position and results of operations of the entity in conformity with accounting principles generally accepted in the United States. For FY 2006, the AFF/SADF, also received an unqualified opinion on its financial statements (OIG Report No. 07-15).

The Independent Auditors' Report on Internal Control identified three significant deficiencies. The first significant deficiency concerns weaknesses in the seized and forfeited property management environment and was previously reported as a reportable condition in FY 2006, and as a management letter comment in FY 2005. The second significant deficiency concerns weaknesses in the procurement management environment. The third significant deficiency concerns weaknesses in the information system controls environment. The auditors reported no compliance issues for the AFF/SADF in FY 2007.

Effective for FY 2007, the term “reportable condition” was changed to the term “significant deficiency,” and new definitions of material weakness and significant deficiency were introduced in auditing standards generally accepted in the United States. See *Government Auditing Standards* and Office of Management and Budget Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*.

The OIG reviewed KPMG’s reports and related documentation and made necessary inquiries of its representatives. Our review, as differentiated from an audit in accordance with U.S. generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on the AFF/SADF’s financial statements, conclusions about the effectiveness of internal control, conclusions on whether the AFF/SADF’s financial management systems substantially complied with the Federal Financial Management Improvement Act, or conclusions on compliance with laws and regulations. KPMG is responsible for the attached auditors’ reports dated October 31, 2007, and the conclusions expressed in the reports. However, our review disclosed no instances where KPMG did not comply, in all material respects, with generally accepted government auditing standards.

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MISSION

The primary mission of the Department of Justice (DOJ or the Department) Asset Forfeiture Program (AFP or the Program) is to prevent and reduce crime by disrupting, damaging, and dismantling criminal organizations through the use of the forfeiture sanction. This is accomplished by means of depriving drug traffickers, racketeers, and other criminal syndicates of their ill-gotten proceeds and instrumentalities of their trade. Components responsible for the administration and financial management of the AFP are charged with lawfully, effectively and efficiently supporting law enforcement authorities in the application of specified forfeiture statutes. The Assets Forfeiture Fund (AFF or the Fund) and Seized Asset Deposit Fund (SADF) together comprise a single financial reporting entity of the DOJ, which includes the specified funds, property seized for forfeiture, and the transactions and program activities of DOJ forfeiture program components and other participating agencies as described more fully herein.

ORGANIZATION STRUCTURE

Table 1 below displays the primary functional activities of the participating agencies in the AFP. For the full names of the participating agencies, see Footnote 1. These agencies investigate or prosecute criminal activity under statutes, such as the Comprehensive Drug Abuse Prevention and Control Act of 1970, the Racketeer Influenced and Corrupt Organizations statute, the Controlled Substances Act, and the Money Laundering Control Act, or provide administrative support services to the Program.

Table 1. Asset Forfeiture Program Participants by Function [1]

Function	AFMLS	AFMS	ATF	DCIS	DEA	DS	EOUSA	FBI	FDA	USDA	USMS	USPS
Investigation			X	X	X	X		X	X	X		X
Litigation	X						X					
Custody of Assets			X		X			X			X	
Management	X	X										

FINANCIAL STRUCTURE

The AFP is comprised of two funds, which are under the management control of AFMS. The AFF is a special fund listed in the U.S. Treasury Federal Account Symbols and Titles Book as 15X5042. The SADF is a deposit fund listed as 15X6874.

[1] The participants include the Asset Forfeiture and Money Laundering Section, Criminal Division (AFMLS); Asset Forfeiture Management Staff, Justice Management Division (AFMS); Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF); Drug Enforcement Administration (DEA); Bureau of Diplomatic Security, Department of State (DS); Executive Office for United States Attorneys (EOUSA); Federal Bureau of Investigation (FBI); Food and Drug Administration (FDA), United States Department of Agriculture (USDA); United States Marshals Service (USMS); and United States Postal Service (USPS). ATF, DEA and FBI have custody of assets in addition to the USMS. In 2007, the Defense Criminal Investigative Service (DCIS) joined the AFP. DCIS is the criminal investigative arm of the Inspector General of the Department of Defense. DCIS devotes investigative resources to terrorism, product substitution, computer crimes, illegal technology transfers, and public corruption.

The AFF was created by the Comprehensive Crime Control Act of 1984 to be the repository of the proceeds of forfeitures under any law enforced and administered by the DOJ (28 U.S.C. 524(c)). All amounts earned on investment of AFF and SADF balances are deposited into the AFF. The interest earned on the AFF balances is the property of the United States (Government). Interest earned on SADF balances is deposited into the AFF pursuant to the statute cited above.

Monies deposited in the AFF are used to cover operating costs of the Program. These include, for example, asset management and disposition expenses; equitable sharing payments to participating state, local, and foreign governments; Automatic Data Processing (ADP) equipment expenses; contract service payments; and payments of innocent third party claims. All salaries and employment related expenses, liabilities, and imputed financing costs of DOJ AFP participants are reported in the financial statements of the participants' reporting entities. Salaries and employment related costs of administrative personnel of the Asset Forfeiture Management Staff (AFMS) and USMS are charged to the AFP as program operating costs. The AFP's operating costs do not include the costs of any participant salaries incurred while conducting investigations leading to seizure and forfeiture.

While the AFF is the repository for forfeited currency and proceeds arising from the sale of forfeited property and also serves as the operating fund for specified program expenditures, the SADF serves as a repository for seized currency and specified deposits.

The SADF was created administratively by the DOJ to ensure control over monies seized by agencies participating in the DOJ's AFP. Public Law (P.L.) 102-140, dated October 28, 1991, provided authority for the investment of SADF balances pending adjudication. Generally, monies in the SADF are not the property of the Government. The SADF holds seized cash, the proceeds of any pre-forfeiture sale of seized property, and forfeited cash not yet transferred to the AFF. Operating businesses under seizure also may be managed through the SADF. Because most funds held in the SADF are not Government property, monies in the SADF cannot be expended. SADF balances are transferred to the AFF upon the successful conclusion of a forfeiture action.

The Fund receives most of its revenue from the forfeiture of cash and other monetary assets and, secondly, from the sale of forfeited property. AFP participants may receive annual allocations by suballotment advice or reimbursement agreement. The Fund's first priority is to cover the business or operational expenses of the AFP. After it is determined that there will be sufficient receipts, allocations may be made for investigative expenses, such as awards for information, purchase of evidence, and equipping of conveyances, and also discretionary expenses, such as storage, protection and destruction of controlled substances.

Limitations on the Use of the Assets Forfeiture Fund

The AFF is defined by statute. Authorities and limitations governing use of the AFF are specified in 28 U.S.C. 524(c). In addition, use of the AFF is controlled by laws and regulations governing the use of public monies and appropriations (e.g., 31 U.S.C. 1341-1353 and 1501-1558, Office of Management and Budget (OMB) Circulars, and provisions of annual appropriation acts). The AFF is further controlled by the *Attorney General's Guidelines on Seized and Forfeited Property* (July 1990), policy memoranda, and statutory interpretations issued by appropriate authorities. Unless otherwise provided by law, restrictions on the use of AFF monies retain those limitations after any monies are made available to a recipient agency. Moreover, monies are available for use only to the extent receipts are available in the AFF.

In Fiscal Year (FY) 2007, monies were available under a permanent indefinite appropriation to finance the following:

(1) The operational costs of the forfeiture program, including handling and disposal of seized and forfeited assets, and the execution of legal forfeiture proceedings to perfect the title of the United States in that property.

(2) The payment of innocent third party claims.

(3) The payment of equitable shares to participating foreign governments and state and local law enforcement agencies.

(4) The costs of ADP equipment and ADP support for the Program.

(5) Contract services in support of the Program.

(6) Training and printing associated with the Program.

(7) Other management expenses of the Program.

(8) Awards for information leading to forfeiture.

(9) Joint Federal, state, and local law enforcement operations.

(10) Investigative expenses leading to seizure.

Resources of the AFF are intended to cover the business expenses of the AFP, with any excess balances available for discretionary purposes, including investigative expenses subject to appropriations limitation (definite authority). Excess unobligated balances identified at the end of a fiscal year may be declared a "Super Surplus" balance. Super Surplus balances may be allocated at the discretion of the Attorney General for ". . . any Federal law enforcement, litigative/prosecutive, and correctional activities or any other authorized purpose of the DOJ" pursuant to 28 U.S.C. 524(c)(8) (E).

Holding and Accounting for Seized and Forfeited Property

The USMS has primary responsibility for holding and maintaining real and tangible personal property seized by participating agencies for disposition. Seized property can be either returned to the owner or forfeited to the Government. Forfeited property is subsequently sold, placed into official use, destroyed, or transferred to another agency. Seized and forfeited property is not considered inventory held for resale in the normal course of business.

ANALYSIS OF FINANCIAL STATEMENTS

Following are brief explanations for the AFF/SADF financial results, position, and condition conveyed in the principal financial statements. There were some unusually large deposits from three cases totaling approximately $842.3 million in FY 2007 that will affect comparisons to prior years. Comparisons were also impacted in FY 2006 by a single case occurring near the end of the year where the AFF/SADF recognized forfeiture income in the amount of $337.5 million pertaining to a major fraud case. The following AFF/SADF financial results reflect the impact of the significant increase in forfeiture income and accrued expenses in the fund balance with Treasury, accounts payable, forfeiture revenue, and budgetary resources.

Balance Sheets

Total assets, which present as of a specific time the amounts of future economic benefits owned or managed by the AFF/SADF, increased in FY 2007 to $3,056.5 million from $2,053.4 million in FY 2006, an increase of 48.8 percent. If seized assets, which are not yet owned by the government are backed out, the adjusted assets of the Fund increased to $1,790.6 million in FY 2007 from $1,256.2 million in FY 2006, an increase of 42.5 percent. This is attributable to an increase in both forfeited and seized assets in FY 2007 from FY 2006, indicating a strong current and future potential stream of assets flowing into the AFF. The AFF/SADF fund balances with the U.S. Treasury were high at the end of FY 2006 due to the large case that occurred at the end of the year. In FY 2007 forfeiture revenue deposited in the AFF throughout the fiscal year from the major fraud cases resulted in another unusually high AFF fund balance with the U.S. Treasury on September 30, 2007.

Total liabilities of the funds increased to $2,322.3 million in FY 2007 from $1,402.3 million in FY 2006, an increase of 65.6 percent. The majority of the change, $925.7 million, in liabilities is due to the increase in seized cash and monetary instruments and accounts payable, most of which is attributable to the major fraud cases explained in the above introductory paragraph to this section. A deposit of $337.5 million from one of the large cases occurred at the end of FY 2006 and another $100 million deposit from the same case was received in FY 2007. Liabilities were created at the same time notifications of the deposits were received. Half of the liabilities was paid to victims in FY 2007 and the other half remained a liability at the end of FY 2007, pending notification from the court to make payment. Current assets exceeded current liabilities by a ratio of 1.75 to 1, which reflects a decrease of .32 from FY 2006. However, the ratio continues to indicate that the AFF will be able to meet its obligations when due. In the calculation of the ratio of current assets to current liabilities, current assets consist of total assets less SADF net investments, seized cash deposited, and seized monetary instruments (see Note 12) while current liabilities include the total of liabilities covered by budgetary resources except for total seized cash and monetary instruments.

For the fiscal year ended September 30, 2007, net position, which is the equity of the U.S. Government in the AFF, increased 12.8 percent compared to FY 2006. The ratio of net position to total assets was 0.24 to 1 in FY 2007, a decrease of 0.08 from FY 2006.

Statements of Net Cost

Net cost of operations, shown by strategic goal, increased to $1,530.3 million in FY 2007 from $974.2 million in FY 2006, an increase of 57.1 percent. Typically, the largest single Fund expense consists of equitable sharing payments; however, the largest category of expense in FY 2007 was payments to third parties as a result of the major fraud cases explained in the introductory paragraph to this section.

Each year, millions of dollars are paid to state and local law enforcement agencies and foreign governments for their participation in seizures that lead to forfeitures. The increase in net costs was due to an increase in mandatory program activities. This was made possible by $1,613.4 million and $1,177.2 million from financing sources in FY 2007 and 2006, respectively, generated in cash and proceeds from the sale of assets deposited into the AFF. To the extent that financing sources do not cover net costs, AFF's carry forward balances are used to support program expenses. The carry forward balances consist primarily of special case funds and monies for operational requirements.

Statements of Changes in Net Position

Net position, an indicator of the Fund's future capability to support ongoing operations, increased to $734.2 million in FY 2007 from $651.1 million in FY 2006, an increase of $83.1 million or 12.8 percent. The Fund's financing sources consist primarily of forfeited cash and other monetary assets and, secondly from the sale of forfeited property. In addition, other factors that influence the AFF net position to a lesser extent include the short-term interest rates that affect nonexchange revenue from investment in Government securities; the nature of seized non-cash properties that must be converted into cash, affecting their rates of disposition; and Super Surplus allocations and transfers of properties placed into official use that consume resources.

The Program invests cash balances from both the AFF and SADF in Government securities. Earnings over a five-year period are presented in Figure 2. Investment interest earnings (i.e., nonexchange revenue) realized for the fiscal year ended September 30, 2007, totaled $111.4 million, which is $51.0 million more than the $60.4 million in investment interest earnings for the fiscal year ended September 30, 2006. FY 2007 investment interest earned is $41.4 million more than the $70.0 million estimated for FY 2007 in the Budget of the United States Government, Fiscal Year 2008--Appendix. The increased earnings are due primarily to the rise in short-term interest rates and to the accumulation of a full year's results from a change in investment strategy implemented in FY 2005 that increased amounts invested and staggered investments over different periods of time. Amounts available for investment are difficult to predict because many factors influence the balance. For example, one significant factor is the level of equitable sharing distributions, associated with uncertainties in the amount and timing of such disbursements, including the time needed for DOJ approval of equitable sharing requests for cases with asset values exceeding $1 million (i.e., extraordinary equitable sharing) and appeals of forfeiture judgments.

Statements of Budgetary Resources

Total budgetary resources increased to $1,982.7 million in FY 2007 from $1,484.7 million in FY 2006, a 33.5 percent increase. The net increase may be attributed primarily to significant increases in forfeiture income received, the majority of which was attributable to nonrecurring activities. From FY 2007 activity, approximately $591.1 million of the increase in forfeiture income will be disbursed to the victims of the major fraud cases. As a result of the cases, the net outlays increased to $940.5 million in FY 2007 from $560.7 million in FY 2006, an increase of 67.7 percent.

The total obligations incurred in FY 2007 were $1,553.9 million, an increase of $494.5 million compared to $1,059.4 million incurred in FY 2006. The FY 2007 obligations increased relative to FY 2006 due to expenses associated with nonrecurring case activity in FY 2006.

The AFF's unobligated balance was $428.9 million as of September 30, 2007, an increase of $3.6 million or 0.9 percent as compared to $425.3 million as of September 30, 2006. The unobligated balance carried forward is retained in the AFF to ensure the availability of sufficient monies in the upcoming fiscal year for authorized purposes. These purposes include program operating expenses as well as pending extraordinary distributions, pending innocent third party payments, uncommitted Super Surplus authority, and other essential items. For example, as of September 30, 2007, pending extraordinary equitable sharing distributions totaled an estimated $140.2 million (comprises 90 assets with values in excess of $1 million for which the forfeiture process, including disposition, has concluded and asset proceeds have been deposited into the Fund).

Table 2. Source of Assets Forfeiture Fund Resources
(Dollars in Thousands)

Source	FY 2007	FY 2006	Change%
Earned Revenue	3,722	1,481	151.3%
Budgetary Financing Sources			
Nonexchange Revenues	111,426	60,350	84.6%
Donations and Forfeitures of Cash and Cash Equivalents	1,409,015	1,009,217	39.6%
Other Financing Sources			
Donations and Forfeitures of Property	106,746	115,687	(7.7%)
Transfers-In/Out Without Reimbursement	(13,777)	(8,020)	(71.8)
Total	**1,617,132**	**1,178,715**	**37.2%**

Table 3. How Assets Forfeiture Fund Resources are Spent
(Dollars in Thousands)

Strategic Goal (SG)	FY 2007	FY 2006	Change %
SG 2: Prevent Crime, Enforce Federal Laws, and Represent the Rights and Interests of the American People			
Total Gross Cost	1,534,041	975,636	
Less: Total Earned Revenue	3,722	1,481	
Total Net Cost of Operations	1,530,319	974,155	57.1%

2007 Financial Highlights

As indicated in Table 3, in FY 2007 the AFF supported Strategic Goal 2 of the Attorney General's Strategic Plan (Plan) for Fiscal Years 2007 – 2012, which includes strategic objective 2.2 - *Reduce the threat, incidence, and prevalence of violent crime.* The new Plan reflects the Department's highest priorities. As of September 2006, the AFF supported Goals 2 (Enforce Federal Laws and Represent the Rights and Interests of the American People) and 3 (Assist State, Local, and Tribal Efforts to Prevent or Reduce Crime and Violence). The AFF's former Goal 3 objectives have been subsumed under Goal 2 of the new Plan.

The AFF has no costs associated with counterterrorism, homeland security, or hurricanes Katrina and Rita.

Strategic Goal 2, Prevent Crime, Enforce Federal Laws, and Represent the Rights and Interests of the American People. Included are expenditures made for case, program, investigative, and other authorized support costs incurred by AFP participants to operate the activities of the Program. The Fund's resources cover the costs of seizing, evaluating, inventorying, maintaining, protecting, advertising, forfeiting, and disposing of property seized for forfeiture. These costs are necessary to support the AFP and fluctuate in direct relation to the forfeiture activity levels of the investigative, prosecutive, litigative and administrative participants of the Fund. For the fiscal year ended September 30, 2007, $1,530.3 million was expended (net of earned revenue) while $974.2 million was expended (net of earned revenue) for the fiscal year ended September 30, 2006. Goal 2 net costs are presented in Figure 1, Financing sources are presented in Figure 2.

Figure 1. AFF Net Costs (Dollars in Millions)

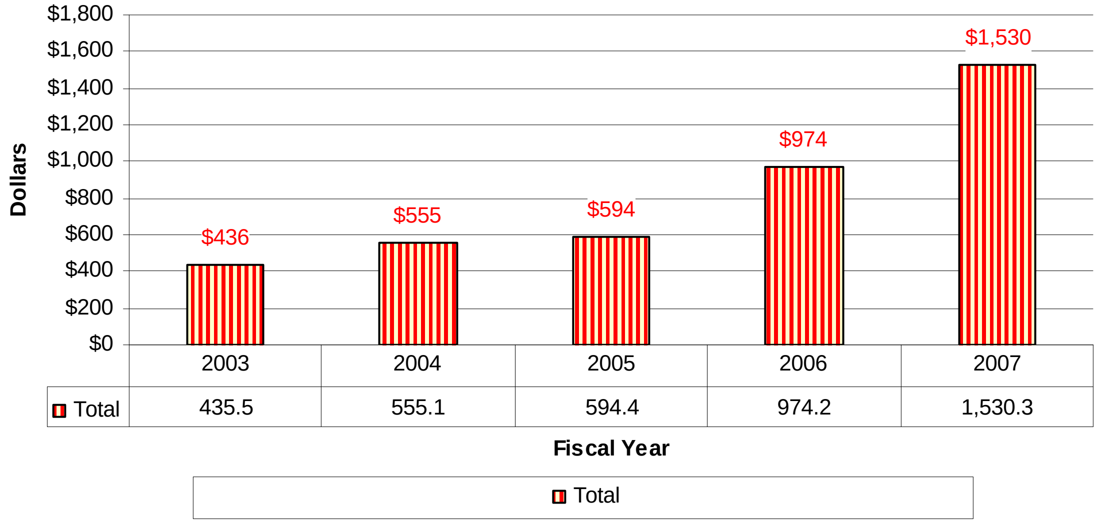
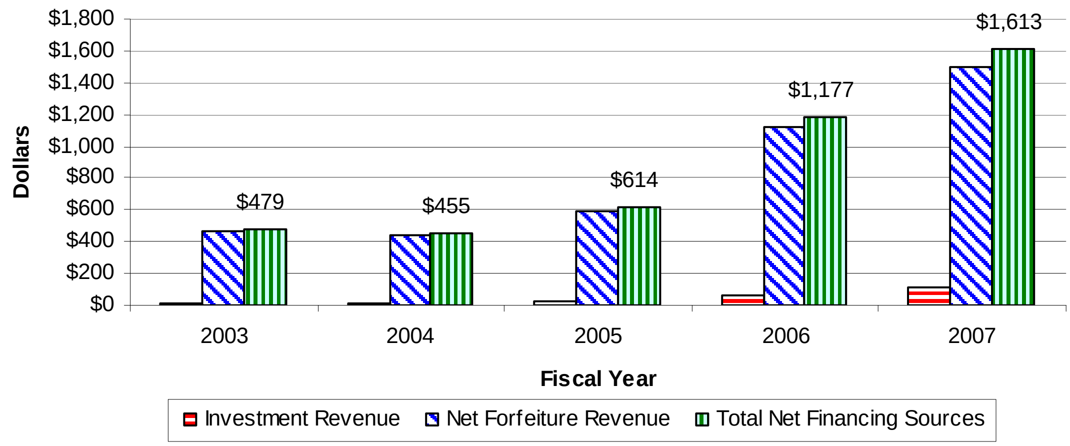


Figure 2. AFF Financing Sources
(Dollars in Millions)



PERFORMANCE INFORMATION

Data Reliability and Validity

The AFP views data reliability and validity as critically important in the planning and assessment of its performance. The Justice Management Division (JMD) maintains standards and practices to ensure that data reported meets the OMB standards for data reliability that are presented in OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget,* Section 230.2 (e).

The financial management of the Fund is supported by the JMD's Financial Management Information System 2 (FMIS2), the USMS' Standardized Tracking and Reporting System (STARS) and Financial Management System (FMS), the AFP's Consolidated Asset Tracking System (CATS), and ATF's Forfeited and Seized Assets Tracking System (FASTRAK). FMIS2 is a computerized, general-purpose accounting and reporting system that supports the financial operations of the DOJ. STARS is the USMS Headquarters financial system. FMS is the USMS field offices' financial management system. CATS is an integrated system that provides services to the asset forfeiture community and serves as a subsidiary system for the financial accounting and reporting of the seized and forfeited property. FASTRAK is an asset tracking and forfeiture status information system used by ATF. Enhancements and refinements are being made to some of these systems that will improve the usefulness of the data supporting the activities of the AFF and SADF.

FY 2007 REPORT ON SELECTED RESULTS

STRATEGIC GOAL 2: Prevent Crime, Enforce Federal Laws, and Represent the Rights and Interests of the American People
100% of the AFF's Net Costs support this Goal.

PROGRAM:
Background/Program Objectives*:* The primary purpose of the AFP is to deter crime by disrupting, damaging, and dismantling criminal organizations through the use of forfeiture sanction. Depriving white collar criminals, drug traffickers, racketeers, and other criminal syndicates of their ill-gotten

proceeds and instrumentalities of their trade not only achieves important law enforcement objectives but also provides an effective means of recovering funds for victim restitution.

Among other important benefits of an aggressive and well-managed forfeiture program is the application of surplus revenues to law enforcement objectives such as enhancing cooperation among Federal, state, and local law enforcement agencies through the equitable sharing of Federal forfeiture proceeds. Pursuant to 21 U.S.C. Sec. 881(e)(1) and 19 U.S.C. Sec. 1616a, as made applicable by 21 U.S.C. Sec. 881(d) and other statutes, the Attorney General has the authority to equitably transfer forfeited property and cash to state and local agencies that directly participate in the law enforcement effort leading to the seizure and forfeiture of property. All property and cash transferred to state and local agencies and any income generated by this property and cash is to be used for law enforcement purposes. As a result, state and local law enforcement programs and capabilities benefit significantly from their cooperative efforts with Federal law enforcement agencies. Among the uses of equitable shares, priority is given to supporting community policing activities, training, and law enforcement operations calculated to result in further seizures and forfeitures.

Performance Measures:

There are no applicable AFP performance measures. No performance measures are indicated because the Fund's program operations are performed by its participants. The Fund is considered to be an enabling/administrative activity where resources are spread across agencies in accordance with full program costing guidance.

Discussion of FY 2007 Results:

Net forfeiture revenues realized by the Fund were $1,515.8 million for the fiscal year ended September 30, 2007. This is the second year since inception of the Fund that it has exceeded $1 billion in deposits. If we remove the effect of the three major fraud cases producing $842.3 million, the deposits still exceeded $750 million in FY 2007. These revenues must cover program operation expenses, which include all costs incurred in support of the AFP. The FY 2007 percentage of program operation expenses to revenues was 69% while in FY 2006 it was 49%. After program operation expenses (as presented in Note 15) are deducted from revenues and financing sources, the remainder represents the results of the year's operations ($1,617.1 million - $1,120.5 million = $496.6 million in FY 2007 and $1,177.2 million – $573.8 million = $603.4 million in FY 2006). This net income is distributed in various ways. It is paid out for equitable sharing; state and local overtime; contracts to identify assets; investigative costs leading to seizures; and investigative expenses after the annual appropriation of funds.

In FY 2007, $981.1 million was returned or is accrued to be returned as third party payments to victim fund groups as a result of the successful prosecution of multiple major fraud cases, such as U.S. v. Rigas ("Adelphia" case), U.S. v. Israel/Marino (Bayou Group), and U.S. v. Bawag Bank. The restitution is for the victims of corporate corruption, including investors who lost billions of dollars. The deposits from these major cases have more than doubled the estimated AFF revenue in FY 2007.

To improve financial performance, the AFF funded a 2006 CATS project that contributes to a 2008 ATF deployment of a new version of the Nforce case management system that will include an interface to the CATS application. This application will enable a single point of data entry for ATF agents and asset forfeiture administrators, thus centralizing tracking for ATF forfeiture activity.

ANALYSIS OF SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

FMFIA Section 2 – Material Weaknesses

For FY 2007 and FY 2006, the independent auditors reported no material weaknesses. Management's self assessment of the AFF/SADF internal controls over financial reporting, conducted in FY 2007 and 2006, as required by the Federal Managers' Financial Integrity Act of 1982 (FMFIA) and OMB Circular No. A-123, *Management Accountability and Control*, identified fragmented financial systems and processes as an operational deficiency that is not currently material but warrants acknowledging as a deficiency that, if not addressed, managed, or corrected, could develop into a program material weakness. To correct this deficiency, forfeiture program components will work with the Unified Financial Management System Project team to implement a Department-wide and program-wide core financial system. The financial system will be integrated with the AFP's seized and forfeited property system (CATS) and ATF seizures and forfeitures will be brought into CATS to provide access across the appropriate components to ensure timely reporting in the audited financial statements. As these systems are implemented, changes in participating agencies' financial accounting procedures will be made to promote uniform procedures for AFF/SADF seized and forfeited property and financial transactions.

Based on the results of the assessment for the year ended September 30, 2007, the JMD management did not identify any Section 2 material weaknesses to report that impact the AFP. The FY 2006 AFF/SADF financial statement audit revealed deficiencies in the seized and forfeited property controls, access controls, and application software development and change controls. AFP management has undertaken steps to further strengthen forfeiture program controls during FY 2007. To address the Department financial systems weaknesses in the long term, the DOJ will adopt a single Unified Financial Management System. Further information may be obtained from the FY 2007 and 2006 U.S. Department of Justice Performance & Accountability Reports.

Internal Control Program

The Attorney General will provide the overall assurance statement on internal controls for the Department. Component responsibilities will be determined by the Department's Senior Assessment Team (SAT).

AFMS is responsible for maintaining internal accounting and administrative controls that are adequate to ensure that: (1) transactions are executed in accordance with applicable budgetary and financial laws and other requirements, consistent with the purposes authorized, and are recorded in accordance with Federal accounting standards; (2) assets are properly safeguarded to deter fraud, waste, and abuse; and (3) management information is adequately supported. AFMS, along with other Fund participants who use FMIS2, monitor their financial transactions on an on-going basis. AFMS also requires participants, who enter Fund transactions into their own financial system, to provide reports of their financial transactions at least quarterly to update the AFF obligation status.

FMFIA Section 4 – Material Nonconformances

For FY 2007 and FY 2006, the Fund reported no material nonconformances of its financial-mixed IT system CATS. See FMFIA Section 2 – Material Weaknesses for discussion of management's self-assessment relative to potential program financial systems and processes deficiencies.

For FY 2007 the Offices, Boards and Divisions (OBD) management participated in the Departmental assessment of internal controls over financial reporting required by Appendix A of OMB Circular No. A-123. A significant number of the AFF/SADF's transactions are processed by the OBDs. Therefore, results of internal control reviews performed over OBD processes and transactions also pertain to the AFF/SADF. Results of the testing of the controls over financial reporting in the OBD's will be consolidated with other Departmental components and reported in the overall Departmental assurance statement. For FY 2007 and FY 2006, DOJ provided qualified assurance that management controls and financial systems met the objectives of Section 4 of FMFIA. The Fund relies upon the Department's JMD/FMIS2 managers for Section 4 compliance on the Department's financial system of record.

Legal Compliance

For FY 2007 and FY 2006 the AFF/SADF was in compliance with the requirements and responsibilities defined in applicable laws and administrative requirements including FMFIA, the Federal Financial Management Improvement Act of 1996 (FFMIA), and relevant OMB Circulars.

Improper Payments

The Improper Payment Information Act (IPIA) requires a risk assessment in all programs to identify those that are susceptible to significant erroneous payments. Significant erroneous payments are defined by the OMB as annual erroneous payments in a program exceeding both 2.5% of program payments and $10 million. For FY 2007 and 2006, the AFF has not identified any program that was susceptible to significant erroneous payments that exceed both 2.5% of program payments and $10 million.

POSSIBLE FUTURE EFFECTS OF EXISTING EVENTS AND CONDITIONS

Financing sources in FY 2007 totaled $1,613.4 million, which are $436.2 million more than the $1,177.2 million reported in FY 2006. It is difficult to project future levels of financing since they are dependent upon many factors, including the development of new cases, uneven flow of cases through the forfeiture process, level of appropriations that Federal law enforcement agencies receive, level of personnel and monetary resources dedicated to the forfeiture program, international cooperation in forfeiture and repatriation matters, Federal court decisions, and evolving forfeiture law.

The DOJ is planning to update its financial management systems through the replacement of the core financial management systems currently operating across the components of DOJ with one core commercial off-the-shelf financial management system certified by the Financial Systems Integration Office, formerly known as the Joint Financial Management Improvement Program. The AFP will be among the first group of components migrating to the Unified Financial Management System.
The Fund is continuing to support the DOJ's goals, some of which are to streamline, eliminate or consolidate duplicative functions; improve communications; improve financial performance; and utilize technology to improve operations. The Fund is already meeting some of these goals with the completion of the Browser-Based CATS (BBC) development project in late 2005 and the development

of an interface between the ATF Nforce and the CATS applications, with implementation set to begin in early FY 2008.

LIMITATIONS OF THE FINANCIAL STATEMENTS

The financial statements have been prepared to report the financial position and results of operations of the AFF/SADF, pursuant to the requirements of 31 U.S.C. 3515(b).

While the statements have been prepared from the books and records of the AFF/SADF in accordance with U.S. generally accepted accounting principles for Federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

The statements should be read with the realization that they are for a component of the U. S. Government, a sovereign entity.

Reports of Independent Auditors

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KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Financial Statements

Inspector General
U.S. Department of Justice

Acting Director
Asset Forfeiture Management Staff
U.S. Department of Justice

We have audited the accompanying consolidated balance sheets of the U.S. Department of Justice Assets Forfeiture Fund (AFF) and Seized Asset Deposit Fund (SADF) as of September 30, 2007 and 2006, and the related consolidated statements of net cost, changes in net position, and combined statements of budgetary resources (hereinafter referred to as "consolidated financial statements") for the years then ended. These consolidated financial statements are the responsibility of the AFF/SADF's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the AFF/SADF's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of Justice Assets Forfeiture Fund and Seized Asset Deposit Fund as of September 30, 2007 and 2006, and its net costs, changes in net position, and budgetary resources for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Notes 21 and 22 to the consolidated financial statements, respectively, the AFF/SADF changed its method of accounting for the recording of the proceeds from the sale of forfeited real property to a preferred method and changed its method of reporting the reconciliation of budgetary resources obligated to the net cost of operations in fiscal year 2007.

The information in the Management's Discussion and Analysis is not a required part of the consolidated financial statements, but is supplementary information required by U.S. generally accepted accounting principles and OMB Circular No. A-136, *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated October 31, 2007, on our consideration of the AFF/SADF's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

KPMG LLP

October 31, 2007

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Internal Control

Inspector General
U.S. Department of Justice

Acting Director
Asset Forfeiture Management Staff
U.S. Department of Justice

We have audited the consolidated balance sheets of the U.S. Department of Justice Assets Forfeiture Fund (AFF) and Seized Asset Deposit Fund (SADF) as of September 30, 2007 and 2006, and the related consolidated statements of net cost, changes in net position, and combined statements of budgetary resources (hereinafter referred to as "consolidated financial statements") for the years then ended, and have issued our report thereon dated October 31, 2007. As discussed in Notes 21 and 22 to the consolidated financial statements, respectively, AFF/SADF changed its method of accounting for the recording of the proceeds from the sale of forfeited real property to a preferred method and 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 Standard*s, 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.

INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of the AFF/SADF is responsible for establishing and maintaining effective internal control. In planning and performing our fiscal year 2007 audit, we considered the AFF/SADF's internal control over financial reporting by obtaining an understanding of the AFF/SADF'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 AFF/SADF's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the AFF/SADF'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 AFF/SADF'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 AFF/SADF's consolidated financial statements that is more than inconsequential will not be prevented or detected by the AFF/SADF'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 AFF/SADF's internal control over financial reporting.

In our fiscal year 2007 audit, we consider the control deficiencies described in Exhibit I to be significant deficiencies in internal control over financial reporting. However, we believe that none of the significant deficiencies described in Exhibit I are material weaknesses. Exhibit II presents the status of prior years' reportable conditions.

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

This report is intended solely for the information and use of the Asset Forfeiture Management Staff, the U.S. Department of Justice's 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

October 31, 2007

EXHIBIT I

SIGNIFICANT DEFICIENCIES

IMPROVEMENTS ARE NEEDED IN THE SEIZED AND FORFEITED PROPERTY MANAGEMENT ENVIRONMENT

<u>Internal controls over seized and forfeited property need reinforcement</u>

During internal control and substantive test work procedures over seized and forfeited property transactions from the Consolidated Asset Tracking System (CATS) and the Forfeited and Seized Asset Tracking System (FASTRAK), we noted the following exceptions:

<u>June 30, 2007, Interim Test Results:</u>

- One out of 209 seized property sample items, valued at $7,853,827, should not have been recorded in CATS.
- One out of 209 seized property sample items, valued at $24,000, should have been classified as returned to owner or otherwise disposed.
- One out of 185 forfeited property sample items was erroneously not included in accrued revenue, resulting in a $10,000 understatement.
- One out of 185 forfeited property sample items was undervalued by $123,200.
- One out of 185 forfeited property sample items, valued at $50,000, should have been classified as seized.
- One out of 55 aged seized property sample items, valued at $500, should have been classified as returned to owner or otherwise disposed.
- Two out of 55 aged seized property sample items were overvalued by a total of $42,655.
- One out of 55 aged seized property sample items was undervalued by $345,000.
- One out of 40 aged forfeited property sample items, valued at $205,985, should not have been recorded in CATS.
- One out of 10 seized cash not on deposit property sample items, valued at $205,985, should not have been recorded in CATS.
- One out of 16 valued existence sample items was overvalued by $50 in FASTRAK.
- One case of cigarettes out of 39 non-valued existence sample items was under-counted by 10 cartons in FASTRAK.
- Three out of 39 non-valued existence sample items should have been classified as disposed in FASTRAK.
- Six out of 148 completeness sample items were not recorded in CATS.

<u>August 31, 2007, Interim Test Results:</u>

- One out of 38 seized property sample items was overvalued by $3,180,731.

<u>September 30, 2007, Final Test Results:</u>

- One out of 60 seized property sample items was improperly classified as personal property instead of as currency.

The Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 3, *Accounting for Inventory and Related Property,* requires that seized property should be classified as seized and forfeited property should be classified as forfeited at each financial reporting date. Furthermore, "seized property other than monetary instruments shall be disclosed in the footnotes… [and the] value of the seized property shall be accounted for in an agency's property management records until the property is forfeited, returned, or otherwise liquidated."

OMB Circular No. A-123, *Management Accountability and 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.

We recommend the Asset Forfeiture Management Staff (AFMS):

1. Enforce procedures to ensure the current property and financial data in the property and financial management systems are updated based on accurate information in a timely manner and within the timeframes established for issuing the AFF/SADF financial statements. *(Repeat)*

Management Response:

Management concurs with the findings and recommendation. The Asset Forfeiture Management Staff will work with the Asset Forfeiture Program (AFP) components to strengthen data entry and period end closing procedures to ensure both the property and accounting systems reflect accurate information within the timeframes established for issuing the financial statements.

Internal controls over reconciliation of property seized for forfeiture between FASTRAK and NForce need reinforcement

During our field site procedures over completeness of AFF/SADF seized and forfeited property in FASTRAK, the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) property management system used for the AFF/SADF's financial reporting as of June 30, 2007, we noted 8 out of 101 completeness property sample items designated as "seized for forfeiture" in NForce, the ATF's case management system, were not designated as "seized for forfeiture" in FASTRAK. ATF headquarters had declined to pursue forfeiture and had subsequently notified the appropriate field office. However, the field office did not make the necessary updates in NForce to change the classification from seized for forfeiture to seized-for-evidence. This problem occurred because the ATF does not have sufficient controls in place to ensure that all property seized for forfeiture is classified consistently and contemporaneously across NForce, FASTRAK, and the property storage inventory locations at each financial reporting date.

Failure to record, reconcile, and adjust NForce, FASTRAK, and the underlying physical property inventory logs promptly, contemporaneously, and consistently with the seized property in ATF's actual possession or control can: (1) preclude forfeiture of seizures where timely notice requirements apply, (2) misstate the custody control records as well as data that designates whether property is seized for forfeiture, seized for evidence, or both, and (3) result in the failure to dispose of property in a timely manner.

The Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standards No. 3, *Accounting for Inventory and Related Property*, requires that seized property should be classified as seized and forfeited property should be classified as forfeited at each financial reporting date. Furthermore, "seized property other than monetary instruments shall be disclosed in the footnotes… [and the] value of the seized property shall be accounted for in an agency's property management records until the property is forfeited, returned, or otherwise liquidated."

We recommend the AFMS:

2. Work with the ATF to develop an adequate methodology that documents the follow up on items that are rejected from the NForce forfeiture "pending file" to ensure that the appropriate corrective action is taken by field personnel in a timely manner. *(Repeat)*

Management Response:

Management concurs with the findings and recommendation. The Asset Forfeiture Management Staff will work with ATF Program management to implement proper controls to ensure that seized for forfeiture property is classified consistently and contemporaneously across NForce, FASTRAK and the property storage inventory locations at each quarterly and annual financial reporting date.

IMPROVEMENTS ARE NEDED IN THE PROCUREMENT MANAGEMENT ENVIRONMENT

Internal controls over obligations and related disbursements need improvement

During our internal control and substantive test work procedures over obligations and related disbursement balances, we noted the following:

June 30, 2007, Interim Testing Results:

- Four out of 180 obligation sample items were erroneously recorded as delivered-unpaid prior to delivery of services, resulting in a $21,532 total variance.
- Four out of 180 obligation sample items were erroneously recorded as undelivered after delivery of services, resulting in a $37,822 total variance.
- Eleven out of 180 obligation sample items, valued at $299,286 in total, were not de-obligated after receipt of final invoices.
- One out of 180 obligation sample items, valued at $250, was not de-obligated upon determination the original obligation was not warranted.
- Two out of 180 obligation sample items were over-obligated by a total of $10,041.
- One out of 180 obligation sample items was under-obligated by $1,170.
- One out of 26 aged obligation sample items was erroneously recorded as delivered-unpaid prior to delivery of services, resulting in a $1,775 variance.
- Three out of 26 aged obligation sample items were not de-obligated after receipt of final invoices resulting in a $131,716 overstatement of obligations.

August 31, 2007, Interim Testing Results:

- One out of 36 obligation sample items was over-obligated by $1,045,449.
- One out of 36 obligation sample items, valued at $259, was not de-obligated after receipt of final invoices.
- One out of 36 obligation sample items did not have documentation to support a contra-payment of $1,733,440.

September 30, 2007, Final Testing Results:

- Two out of 30 obligation sample items were erroneously recorded as undelivered after delivery of services, resulting in a $483,711 variance.
- Two out of 30 obligation sample items, valued at $638, were not de-obligated after receipt of final invoices.

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

OMB Circular No. A-123, *Management Accountability and 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.

We recommend the AFMS:

3. Improve review procedures with the participants, over obligation documents and vouchers, posted amounts, and outstanding obligations to ensure amounts are adjusted or de-obligated in a timely manner and within the timeframes established for issuing the AFF/SADF financial statements. *(New)*

Improvements should include:

- Performing a more effective, complete, and regular review over open obligations and delivered-unpaid (accounts payable) balances.
- Giving special attention to inactive outstanding obligations in excess of 1 year old.

Management Response:

Management concurs with the findings and recommendation. The Asset Forfeiture Management Staff will work with the AFP components to promote more effective, complete, and regular reviews over open obligations and delivered-unpaid balances to ensure the accounting systems reflect accurate information within the timeframes established for issuing the financial statements.

Internal controls over the review of open obligations need improvement

During discussions with the U.S. Marshals Service (USMS) personnel as part of the fiscal year 2007 financial statements audit of the AFF/SADF and our internal control and substantive test work procedures over obligations and related disbursement balances, we noted that USMS field districts do not perform an adequate review over open obligations.

Ineffective review and accounting for open obligations may result in misstatements to related financial statements balances.

OMB Circular No. A-123, *Management's Responsibility for Internal Control*, states that, "monitoring the effectiveness of internal control should occur in the normal course of business. In addition, periodic reviews, reconciliations or comparisons of data should be included as part of the regular assigned duties of personnel. Periodic assessments should be integrated as part of management's continuous monitoring of internal control, which should be ingrained in the agency's operations. If an effective continuous monitoring program is in place, it can level the resources needed to maintain effective internal controls throughout the year."

We recommend the AFMS:

4. Work with the USMS to strengthen procedures requiring field districts perform and document periodic reviews (i.e., bi-weekly or monthly) over open obligations to ensure amounts are adjusted or de-obligated in a timely manner and within the timeframes established for issuing the AFF/SADF financial statements. *(New)*

Improvements should include:

- Performing a more effective, complete, and regular review over open obligations and delivered-unpaid (accounts payable) balances.
- Giving special attention to inactive outstanding obligations in excess of 1 year old.

Management Response:

Management concurs with the findings and recommendation. The Asset Forfeiture Management Staff will work with the USMS Finance and AFP units to promote more effective, complete, and regular reviews over open obligations and delivered-unpaid balances to ensure the accounting systems reflect accurate information within the timeframes established for issuing the financial statements.

Internal controls over the reconciliation of obligation extracts to the financial reporting system need improvement

During our review of obligation and related disbursement extracts from the financial system as of September 30, 2007, we noted variances between the extracts we were provided to select our procurement samples for testing and the related U.S. Standard General Ledger accounts from the Financial Management Information System 2 (FMIS2).

Failure to identify and correct differences arising from the extract reconciliation process and related adjustments to the general ledger may result in a material misstatement to related financial statements balances.

OMB Circular No. A-123, *Management's Responsibility for Internal Control*, states that, "monitoring the effectiveness of internal control should occur in the normal course of business. In addition, periodic reviews, reconciliations or comparisons of data should be included as part of the regular assigned duties of personnel. Periodic assessments should be integrated as part of management's continuous monitoring of internal control, which should be ingrained in the agency's operations. If an effective continuous monitoring program is in place, it can level the resources needed to maintain effective internal controls throughout the year."

We recommend the AFMS:

5. Work with the Justice Management Division (JMD) Finance Staff to perform periodic (i.e., monthly or quarterly) reconciliations between the various extracts/downloads into the FMIS2 and the resultant general ledger accounts and take immediate and resolute action to eliminate the sources of differences. *(New)*

Management Response:

Management concurs with the findings and recommendation. The Asset Forfeiture Management Staff will work with JMD Finance and USMS Finance to assure monthly reconciliations between the various extracts/downloads into the FMIS2 are performed and that differences are promptly resolved.

IMPROVEMENTS ARE NEEDED IN THE INFORMATION SYSTEM CONTROLS ENVIRONMENT

We performed a general information system (IS) and application controls review at the AFF/SADF by: (1) documenting our understanding of the general controls environment, (2) evaluating the effectiveness of IS general and specific application controls at the AFF/SADF, and (3) updating the general controls tests related to the fiscal year 2006 audit. We evaluated the general controls as they apply to the key financial management systems and the application controls associated with these systems. The review was performed using the U.S. Government Accountability Office's (GAO) *Federal Information System Controls Audit Manual* (FISCAM*);* guidance issued by the DOJ Information Technology Security Staff; National Institute of Standards and Technology (NIST), Special Publication (SP) 800-53, *Recommended Security Controls for Federal Information Systems*, and as established by OMB Circular A-130, *Management of Federal Information Resources*.

Control improvements are needed in the DOJ consolidated IS general controls environment

We performed a review of the DOJ consolidated IS general controls environment that provides general control support for several DOJ components' financial applications and identified one overall significant deficiency in the area of system software. We concluded that the IS controls in place for the consolidated IS general controls environment as of September 30, 2007, were adequate to safeguard the programs and data files from unauthorized access and modification, except as noted in the overall significant deficiency.

JMD has primary responsibility over the consolidated IS general controls environment. We verified that JMD immediately implemented corrective actions on all previous and current vulnerabilities prior to the end of the fiscal year, but they were not in effect throughout the audit period. Therefore, this significant deficiency will be addressed to JMD in a separate report. Accordingly, no further action is required.

<u>Administrative account activity is not logged on the Consolidated Asset Tracking System (CATS) production servers</u>

The AFMS is not effectively monitoring administrator accounts with access to the CATS production environment.

DOJ, Information Technology Security (ITS) Standard, *Access Control (AC) Control Family*, version 2.1, dated March 2007. Result reference number AC-02.01-52 states: "Mandatory (operating system) generic accounts, such as 'root' or 'administrator' can only be accessed from a current valid logon that provides an audit path with explicit user identity; except where direct login to mandatory generic accounts is necessary. (NIST 800-53)"

OMB Circular No. A-123, *Internal Control Systems*, states: "access to resources should be limited to authorized individuals and accountability for the custody and use of resources should be assigned and maintained."

Failure to frequently monitor administrative account activity increases the risk that unauthorized modification and disclosure of production data may occur without management's knowledge.

We recommend the AFMS:

6. Implement software to ensure that administrative accounts on production servers are effectively monitored. In addition, the AFMS should establish procedures to review production server logs for unusual activity on a bi-weekly or monthly basis. *(New)*

Management Response:

Management concurs with the findings and recommendation. The Asset Forfeiture Management Staff has implemented modifications to the production server logging programs to capture all administrative account activities. The Asset Forfeiture Management Staff will implement policies and procedures to review the logs on a monthly basis to validate that activities coincide with approved Change Request documents.

<u>Network devices were installed with default configuration settings and protocols that were not compliant with DOJ ITS Standards</u>

The AFMS has not implemented policies and procedures to periodically check for devices installed with default configuration settings and unnecessary services running on their servers. During our vulnerability assessment, we identified the following vulnerabilities:

- The AFF/SADF General Support System devices were installed with default Simple Network Management Protocol (SNMP) configuration settings.
- Unsecured protocols such as File Transfer Protocol (FTP) and Telnet are used to communicate between AFF/SADF CATS devices.

DOJ ITS Standard, *Configuration Management (CM) Control Family,* dated December 2006. Result reference number CM-07.01-01 states: "Prohibited or restricted functions, ports, protocols, and/or service are disabled or deactivated."

DOJ Order No. 2640.2E, *Information Technology Security,* Chapter 2, Section 16, states: "Access controls shall be in place and operational for all Department IT systems to ensure that only authorized personnel can add, change, or remove component devices, dial-up connections, network addresses and protocols, or remove or alter programs."

Periodic reviews of the configuration settings, services, and passwords running on the CATS devices reduce the risk of default configuration installations and unnecessary services operating that can compromise the availability, integrity, and confidentiality of financial data on the network.

We recommend the AFMS:

7. Analyze and revise procedures to require periodic reviews to identify and mitigate vulnerabilities. The procedures should address weaknesses related to configuration settings and communications protocols. *(New)*

Management Response:

Management concurs with the findings and recommendation. The Asset Forfeiture Management Staff will implement policies and procedures to address configuration settings and communication protocol setting weaknesses. The Asset Forfeiture Management Staff will identify weaknesses with annual vulnerability assessment scans.

<u>Inadequate patch management</u>

The AFMS has not isolated resources (devices) to ensure that its systems are appropriately patched prior to network implementation. Current critical vendor security patches were not installed on the following systems and network devices:

- Cisco Routers
- Windows Servers
- Windows Desktops
- Linux Servers

We also noted that the AFMS does not install patches on "server build" systems prior to setting them up on the network.

DOJ, ITS Standard, *System & Information Integrity (SI) Control Family*, version 2.0, dated December 2006. Result reference number SI-02.01-01 states: "The organization identifies information systems affected by recently announced software flaws and potential vulnerabilities resulting from those flaws; installs newly released security relevant patches, service packs, and hot fixes on the information system in a reasonable timeframe in accordance with organizational policy and procedures; and tests information system patches, service packs, and hot fixes for effectiveness and potential side effects before installation. (NIST 800-53)"

Additionally, result reference number SI-02.04-01 states: "The organization i) conducts continuous security assessments to identify vulnerabilities in the information system within its operating environment; ii) tests information system patches, service packs, and hot fixes for effectiveness and potential side effects before installation; and iii) captures all appropriate information pertaining to the discovered flaws, including the cause of the information system flaws, mitigation activities, and lessons learned to identify necessary improvements in the flaw remediation process. (NIST 800-53)"

Finally, result reference number SI-02.07-01 states: "The organization centrally manages the flaw remediation process for information systems and employs a centralized patch management program to assist system administrators in identifying, acquiring, testing, and deploying patches. (NIST 800-53)"

Failure to apply critical vendor security patches exposes system and network devices to new and existing vulnerabilities. This can expose the information system controls environment to security breaches, unauthorized access, service interruptions, and denial of service attacks.

We recommend the AFMS:

8. Ensure that non-production systems or test systems are tested on enclaves that do not interface with production or General Support System data. In addition, the AFMS should analyze and update procedures for implementing new or test systems to ensure appropriate patches are installed timely. *(New)*

Management Response:

Management concurs with the findings and recommendation. The Asset Forfeiture Management Staff will implement policies and procedures to address device patching and connectivity to the General Support System network for new or re-built systems. The Asset Forfeiture Management Staff will design, develop, and implement an isolated test enclave to build, apply patches, and scan devices prior to activation on the production or support networks.

EXHIBIT II

STATUS OF PRIOR YEARS' FINDINGS AND RECOMMENDATIONS

As required by *Government Auditing Standards* issued by the Comptroller General of the United States, and by OMB Bulletin No. 07-04 we have reviewed the status of prior years' findings and recommendations. The following table provides our assessment of the progress the AFF/SADF has made in correcting the reportable conditions identified during these audits. We also provide the Office of the Inspector General 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. 07-15	Weaknesses exist in the seized and forfeited property management environment	**Recommendation No. 1:** Enforce procedures to ensure the current property and/or financial data in the property and/or financial management systems are updated based on accurate information in a timely manner and within the timeframes established for issuing the AFF/SADF financial statements.	In Process (FY 2007 Recommendation No. 1)
		Recommendation No. 2: Develop an adequate methodology that documents the follow-up on items that are rejected from the NForce forfeiture "pending file" to ensure the appropriate corrective action is taken by field personnel in a timely manner.	In Process (FY 2007 Recommendation No. 2)
	Weaknesses exist in the information system controls environment	**Recommendation No. 3:** Implement the appropriate security measures to properly restrict access to the CATS production database, server, and operating systems accounts.	Completed

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Compliance and Other Matters

Inspector General
U.S. Department of Justice

Acting Director
Asset Forfeiture Management Staff
U.S. Department of Justice

We have audited the consolidated balance sheets of the U.S. Department of Justice Assets Forfeiture Fund (AFF) and Seized Asset Deposit Fund (SADF) as of September 30, 2007 and 2006, and the related consolidated statements of net cost, changes in net position, and combined statements of budgetary resources (hereinafter referred to as "consolidated financial statements") for the years then ended, and have issued our report thereon dated October 31, 2007. As discussed in Notes 21 and 22 to the consolidated financial statements, respectively, AFF/SADF changed its method of accounting for the recording of the proceeds from the sale of forfeited real property to a preferred method and 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

The management of the AFF/SADF is responsible for complying with laws, regulations, and contracts applicable to the AFF/SADF. As part of obtaining reasonable assurance about whether the AFF/SADF's consolidated financial statements are free of material misstatement, we performed tests of the AFF/SADF's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including certain provisions referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA). We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to the AFF/SADF. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests of compliance described in the preceding paragraph of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

Under OMB Bulletin No. 07-04 and FFMIA, we are required to report whether the AFF/SADF's financial management systems substantially comply with: (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements.

The results of our tests of FFMIA disclosed no instances in which the AFF/SADF's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

This report is intended solely for the information and use of the Asset Forfeiture Management Staff, the U.S. Department of Justice's 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

October 31, 2007

Principal Financial Statements
And Related Notes

See Independent Auditors' Report on Financial Statements

U.S. Department of Justice
Assets Forfeiture Fund and Seized Asset Deposit Fund
Consolidated Balance Sheets
As of September 30, 2007 and 2006

Dollars in Thousands	2007	2006
ASSETS (Note 2)		
Intragovernmental		
Fund Balance with U.S. Treasury (Note 3)	$ 300,136	$ 411,871
Investments, Net (Note 5)	2,548,567	1,436,744
Accounts Receivable, Net (Note 6)	13,608	8,071
Other Assets (Note 9)	2,228	1,445
Total Intragovernmental	2,864,539	1,858,131
Cash and Monetary Assets (Note 4)	64,206	58,777
Accounts Receivable, Net (Note 6)	1	-
Forfeited Property, Net (Note 7)	124,379	132,409
General Property, Plant and Equipment, Net (Note 8)	3,378	4,118
Advances and Prepayments	-	1
Total Assets	**$ 3,056,503**	**$ 2,053,436**
LIABILITIES (Note 10)		
Intragovernmental		
Accounts Payable	$ 67,016	$ 64,754
Total Intragovernmental	67,016	64,754
Accounts Payable	829,987	372,950
Deferred Revenue	124,379	132,409
Seized Cash and Monetary Instruments (Note 12)	1,265,908	797,201
Contingent Liabilities (Note 13)	35,000	35,000
Total Liabilities	**$ 2,322,290**	**$ 1,402,314**
NET POSITION		
Cumulative Results of Operations - Earmarked Funds (Note 14)	$ 734,213	$ 651,122
Total Net Position	**$ 734,213**	**$ 651,122**
Total Liabilities and Net Position	**$ 3,056,503**	**$ 2,053,436**

The accompanying notes are an integral part of these financial statements.

U.S. Department of Justice
Assets Forfeiture Fund and Seized Asset Deposit Fund
Consolidated Statements of Net Cost
For the Fiscal Years Ended September 30, 2007 and 2006

Dollars in Thousands

		Gross Costs			Less: Earned Revenues			Net Cost of Operations (Note 15)
	FY	**Intra-governmental**	**With the Public**	**Total**	**Intra-governmental**	**With the Public**	**Total**	
Goal 2	**2007**	$ 195,990	$ 1,338,051	$ 1,534,041	$ 3,722	$ -	$ 3,722	$ 1,530,319
	2006	$ 153,393	$ 822,243	$ 975,636	$ 1,481	$ -	$ 1,481	$ 974,155
Total	**2007**	**$ 195,990**	**$ 1,338,051**	**$ 1,534,041**	**$ 3,722**	**$ -**	**$ 3,722**	**$ 1,530,319**
	2006	**$ 153,393**	**$ 822,243**	**$ 975,636**	**$ 1,481**	**$ -**	**$ 1,481**	**$ 974,155**

Goal 2: Prevent Crime, Enforce Federal Laws, and Represent the Rights and Interests of the American People

The accompanying notes are an integral part of these financial statements.

U.S. Department of Justice
Assets Forfeiture Fund and Seized Asset Deposit Fund
Consolidated Statements of Changes in Net Position
For the Fiscal Year Ended September 30, 2007

Dollars in Thousands

	2007		
	Earmarked Funds	**All Other Funds**	**Total**
Cumulative Results of Operations			
Beginning Balances	$ 651,122	$ -	$ 651,122
Budgetary Financing Sources			
Nonexchange Revenues (Note 19)	111,426	-	111,426
Donations and Forfeitures of Cash and Cash Equivalents (Note 20)	1,409,015	-	1,409,015
Other Financing Sources			
Donations and Forfeitures of Property (Note 20)	106,746	-	106,746
Transfers-In/Out Without Reimbursement (Note 18)	(13,777)	-	(13,777)
Total Financing Sources	**1,613,410**	**-**	**1,613,410**
Net Cost of Operations	(1,530,319)	-	(1,530,319)
Net Change	83,091	-	83,091
Cumulative Results of Operations	$ 734,213	$ -	$ 734,213
Net Position	**$ 734,213**	**$ -**	**$ 734,213**

The accompanying notes are an integral part of these financial statements.

U.S. Department of Justice
Assets Forfeiture Fund and Seized Asset Deposit Fund
Consolidated Statements of Changes in Net Position
For the Fiscal Year Ended September 30, 2006

Dollars in Thousands

	2006		
	Earmarked Funds	**All Other Funds**	**Total**
Cumulative Results of Operations			
Beginning Balances	$ 444,912	$ 3,131	$ 448,043
Budgetary Financing Sources			
Nonexchange Revenues (Note 19)	63,481	(3,131)	60,350
Donations and Forfeitures of Cash and Cash Equivalents (Note 20)	1,009,217	-	1,009,217
Other Financing Sources			
Donations and Forfeitures of Property (Note 20)	115,687	-	115,687
Transfers-In/Out Without Reimbursement (Note 18)	(8,020)	-	(8,020)
Total Financing Sources	**1,180,365**	**(3,131)**	**1,177,234**
Net Cost of Operations	(974,155)	-	(974,155)
Net Change	206,210	(3,131)	203,079
Cumulative Results of Operations	$ 651,122	$ -	$ 651,122
Net Position	**$ 651,122**	**$ -**	**$ 651,122**

The accompanying notes are an integral part of these financial statements.

U.S. Department of Justice
Assets Forfeiture Fund and Seized Asset Deposit Fund
Combined Statements of Budgetary Resources
For the Fiscal Years Ended September 30, 2007 and 2006

Dollars in Thousands	2007	2006
Budgetary Resources		
Unobligated Balance, Brought Forward, October 1	$ 425,253	$ 278,978
Recoveries of Prior Year Unpaid Obligations	25,543	24,808
Budget Authority		
Appropriations Received	1,691,056	1,273,744
Spending Authority from Offsetting Collections		
Earned		
Collected	5,072	8,134
Change in Receivable from Federal Sources	5,538	338
Change in Unfilled Customer Orders		
Without Advance from Federal Sources	286	930
Subtotal Budget Authority	1,701,952	1,283,146
Temporarily not Available Pursuant to Public Law	(170,000)	(102,274)
Total Budgetary Resources (Note 16)	**$ 1,982,748**	**$ 1,484,658**
Status of Budgetary Resources		
Obligations Incurred		
Direct	$ 1,550,148	$ 1,057,924
Reimbursable	3,722	1,481
Total Obligations Incurred (Note 16)	1,553,870	1,059,405
Unobligated Balance - Available		
Apportioned	396,962	28,152
Total Unobligated Balance - Available	396,962	28,152
Unobligated Balances not Available	31,916	397,101
Total Status of Budgetary Resources	**$ 1,982,748**	**$ 1,484,658**
Change in Obligated Balance		
Obligated Balance, Net - Brought Forward, October 1		
Unpaid Obligations	$ 580,029	$ 174,645
Less: Uncollected Customer Payments from Federal Sources	9,001	7,733
Total Unpaid Obligated Balance, Net - Brought Forward, October 1	571,028	166,912
Obligations Incurred	1,553,870	1,059,405
Less: Gross Outlays	1,057,026	629,213
Less: Recoveries of Prior Year Unpaid Obligations, Actual	25,543	24,808
Change in Uncollected Customer Payments from Federal Sources	(5,824)	(1,268)
Obligated Balance, Net - End of Period		
Unpaid Obligations	1,051,329	580,029
Less: Uncollected Customer Payments from Federal Sources	14,824	9,001
Total Unpaid Obligated Balance, Net - End of Period	**$ 1,036,505**	**$ 571,028**
Net Outlays		
Gross Outlays	$ 1,057,026	$ 629,213
Less: Offsetting Collections	5,072	8,134
Less: Distributed Offsetting Receipts	111,426	60,350
Net Outlays (Note 16)	**$ 940,528**	**$ 560,729**

The accompanying notes are an integral part of these financial statements.

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

The Assets Forfeiture Fund (AFF or Fund) and Seized Asset Deposit Fund (SADF) together comprise a single financial reporting entity of the Department of Justice (DOJ or Department) which includes the specified funds, property seized for forfeiture, and the transactions and program activities of DOJ forfeiture program components and other participating agencies as described more fully herein.

The primary mission of the DOJ Asset Forfeiture Program (AFP) is to maximize the effectiveness of forfeiture as a deterrent to crime. This is accomplished by means of depriving drug traffickers, racketeers, and other criminal syndicates of their ill-gotten proceeds and instrumentalities of their trade. Components responsible for administration and financial management of the AFP are charged with lawfully, effectively, and efficiently supporting law enforcement authorities in the application of specified forfeiture statutes.

The AFF was created by the Comprehensive Crime Control Act of 1984 to be a repository of proceeds from forfeitures under any law enforced and administered by the DOJ. AFF and SADF funds are managed by the Asset Forfeiture Management Staff (AFMS), Justice Management Division. The SADF was created administratively by the Department to ensure control over monies seized by agencies participating in the Department's AFP.

The AFF and SADF financial reporting entity of the DOJ is not an employer entity under Statement of Federal Financial Accounting Standards (SFFAS) No. 5, "Accounting for Liabilities of the Federal Government." All salaries and employment-related expenses, liabilities, and imputed financing costs of the DOJ AFP participants, including those pertaining to post-employment benefits, are reported in the financial statements of the DOJ's other components. Salaries and employment-related costs of administrative personnel of the AFMS and United States Marshals Service (USMS) are allocated to the AFF and SADF financial reporting entity as program operating costs either through reimbursement agreement or an allocation from DOJ's Working Capital Fund. Such charges to the AFF and SADF do not include the costs of any participant salaries incurred while conducting investigations leading to seizure and forfeiture.

B. Basis of Presentation

These financial statements have been prepared from the books and records of the AFF/SADF in accordance with United States generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) and presentation guidelines in the Office of Management and Budget (OMB) Circular No. A-136, "Financial Reporting Requirements." These financial statements are different from the financial reports prepared pursuant to OMB directives which are used to monitor and control the use of the AFF/SADF budgetary resources.

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

B. Basis of Presentation (continued)

To ensure that the AFF/SADF financial statements are meaningful at the entity level and to enhance reporting consistency within the Department, Other Assets and Other Liabilities as defined by OMB Circular No. A-136 have been disaggregated on the balance sheet. These include Forfeited Property, Net; Advances and Prepayments; Deferred Revenue; Seized Cash and Monetary Instruments; and Contingent Liabilities.

C. Basis of Consolidation

The consolidated/combined financial statements include the accounts of the AFF/SADF. All significant proprietary intra-entity transactions and balances have been eliminated in consolidation. The Statement of Budgetary Resources is a combined statement for FYs 2007 and 2006, and as such, intra-entity transactions have not been eliminated.

D. Basis of Accounting

Transactions are recorded on the accrual and budgetary bases of accounting. Under the accrual basis, revenues are recorded when earned and expenses are recorded when incurred, regardless of when cash is exchanged. Under the budgetary basis, however, funds availability is recorded based upon legal considerations and constraints. As a result, certain line items on the proprietary financial statements may not equal similar line items on the budgetary financial statements.

E. Non-Entity Assets

Non-entity assets consist of seized property and investments of seized cash that are not available to fund the operations of the AFP.

F. Fund Balance with U.S. Treasury and Cash

Generally, the U.S. Treasury processes cash receipts and disbursements for AFF and SADF. The funds in the AFF, a special fund receipt account, are entity assets and are used to finance the operations of the AFP. Seized cash is deposited and accounted for in the SADF, a deposit fund, until a determination has been made as to its disposition. If title passes to the U.S. Government, the forfeited cash is then transferred from the SADF to the AFF. The cash balance in the SADF is a non-entity asset and is not available to finance the AFP activities, but AFP does have statutory authority for the investment of idle cash.

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

G. Investments

The AFF and SADF are authorized by 28 U.S.C. § 524(c) to invest idle funds in excess of its immediate needs in U.S. Treasury Securities. Investments are short-term non-marketable market-based Federal Debt securities issued by the Bureau of Public Debt (BPD) and purchased exclusively through the BPD's Division of Federal Investments. Investments are reported on the Consolidated Balance Sheet at their net value, the face value plus or minus any unamortized premium or discount. Premiums and discounts are amortized over the life of the Treasury security. Amortization is based on the straight-line method over the term of the securities. AFF and SADF intend to hold investments to maturity. Accordingly, no provision is made for unrealized gains or losses on these securities.

H. Accounts Receivable

Accounts receivable mainly consist of amounts due from other Federal agencies for goods or services provided by the AFP. Receivables arising from services provided to other Federal agencies are considered fully collectible. Therefore, no allowance for uncollectible accounts is established.

I. General Property, Plant and Equipment

The General Services Administration (GSA), which charges rent equivalent to the commercial rates for similar properties, provides a building on a reimbursable basis in which the AFMS operate. The Department does not recognize depreciation on buildings provided by the GSA.

Property, plant and equipment consist of leasehold improvements and enhancements to the Consolidated Asset Tracking System (CATS), which meet the SFFAS No. 10 "Accounting for Internal Use Software" definition of "internal use software." Leasehold improvements are capitalized when the initial cost of acquiring the asset is $100 or more, and the asset has an estimated useful life of two or more years. Internal use software is capitalized when developmental phase costs or enhancement costs are $500 or more and the asset has an estimated useful life of two or more years. Internal use software purchases with an acquisition cost of less than $500 are expensed when purchased. Depreciation is calculated using the straight-line method over the useful lives of the assets.

J. Advances and Prepayments

Advances and prepayments include advances to other Federal agencies for any law enforcement, litigative/prosecutive, and correctional activity, or any other authorized purpose of the DOJ and travel advances issued to Federal employees for official travel. Travel advances are limited to meals and

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

J. Advances and Prepayments (continued)

incidental expenses expected to be incurred by employees during official travel. Payments in advance of the receipt of goods and services are recorded as prepaid charges at the time of payment and are recognized as expenses when the goods and services are received. Advances and prepayments involving other federal agencies are classified as Other Assets on the balance sheet.

K. Forfeited and Seized Property

Property is seized in consequence of a violation of public law. Seized property can include monetary instruments, real property, and tangible personal property of others in the actual or constructive possession of the custodial agency. The value of seized property is its estimated fair market value at the time it was seized. Most seized property is held by the USMS from the point of seizure until its disposition. In certain cases, the investigative agency will keep seized property in its custody if the intention is to place the property into official use after forfeiture or to use the property as evidence in a court proceeding.

Forfeited property is property for which title has passed to the U.S. Government. This property is recorded at the estimated fair market value at the time of forfeiture. The value of the property is reduced by estimated liens of record. The amount ultimately realized from the forfeiture and disposition of these assets could differ from the amounts initially reported. Seized and forfeited property on hand with no legal market in the United States is disclosed in item number only with no value reported.

L. Liabilities

Except for contingent liabilities, budgetary resources cover all liabilities of the AFF, since the AFF has no other imputed or unfunded costs. AFF accounts payable represent liabilities to both Federal and non-Federal entities. Deferred revenue represents the value of forfeited property not yet sold or placed into official use. Seized cash and monetary instruments represent liabilities for SADF amounts on deposit pending disposition.

M. Contingencies and Commitments

The AFF is involved in various administrative proceedings, legal actions, and claims that arise in the ordinary course of business. SFFAS No. 5, “Accounting for Liabilities of the Federal Government”, states that a contingent liability should be recognized when a past event or exchange transaction has occurred; a future outflow or other sacrifice of resources is probable; and the future outflow or sacrifice of resources is reasonably measurable. The AFF’s management must determine whether it is probable that a legal claim or other contingency will result in a loss for the AFF, and whether the loss is reasonably measurable. If the loss is probable and estimable, the AFF recognizes an expense and unfunded liability for the estimated amount of the expected loss.

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

N. Interest on Late Payments

Pursuant to the Prompt Payment Act, 31 U.S.C. § 3901-3907, Federal agencies must pay interest on payments for goods or services made to concerns after the due date. The due date is generally 30 days after receipt of a proper invoice or acceptance of the goods or services, whichever is later.

O. Intragovernmental Activity

Intragovernmental costs and exchange revenue represent transactions made between two reporting entities within the Federal government. Costs and earned revenues with the public represent exchange transactions made between the reporting entity and a non-Federal entity. The classification of revenue or cost as “intragovernmental” or “with the public” is defined on a transaction-by-transaction basis. The purpose of this classification is to enable the Federal government to prepare consolidated financial statements, not to match public and intragovernmental revenue with costs incurred to produce public and intragovernmental revenue.

P. Revenues and Other Financing Sources

The funds in the AFF are derived primarily from financing sources and are presented on the Consolidated Statements of Changes in Net Position as both Budgetary and Other Financing Sources. Financing sources consist of (1) interest earned on investments (i.e., nonexchange revenues) and (2) donations and forfeitures, which include forfeited cash, proceeds from the sale of forfeited property (or conversion of deferred revenue to realized revenue through sale), receipt of payments in lieu of property forfeiture, recovery of asset management expenses, and financing sources from judgments. These financing sources are recognized when cash is forfeited, forfeited property is sold, or forfeited property is placed into official use or transferred to another Federal agency. The financing sources from legal judgments are not recognized until the judgment has been enforced.

Deferred revenue is recorded when the property is forfeited. When the property is sold or otherwise disposed, the deferred revenue becomes earned and a financing source is recognized. The AFF recognizes exchange revenue when the United States Attorneys Offices provide services in judicial forfeiture cases brought by agencies participating in the U.S. Department of the Treasury (Treasury), Treasury Forfeiture Fund (TFF). The AFF recognizes exchange revenue on a reimbursement basis and the revenue is presented on the Consolidated Statements of Net Cost as earned revenue. In accordance with 28 U.S.C. 524 and AFMS Memorandums of Understanding, donations and forfeitures available for use by certain Federal agencies are treated as returns of financing sources when disbursed.

The funds in the SADF are held in trust until a determination is made as to their disposition. These funds include seized cash, proceeds from preforfeiture sales of seized property, and income from property under seizure. No revenue recognition is given to cash deposited in the SADF.

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Q. Earmarked Funds

SFFAS No. 27, “Identifying and Reporting Earmarked Funds” defines ‘Earmarked Funds’ as being financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits or purposes, and must be accounted for separately from the Government’s general revenues. The three required criteria for an earmarked fund are:

1. A statute committing the Federal Government to use specifically identified revenues and other financing sources only for designated activities, benefits, or purposes;
2. Explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and
3. A requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguishes the earmarked fund from the Government’s general revenues.

The AFF meets the definition of an Earmarked Fund, but the SADF does not meet the definition of an Earmarked Fund.

R. Tax Exempt Status

As an agency of the Federal Government, AFF is exempt from all income taxes imposed by any governing body whether it be a Federal, state, commonwealth, local, or foreign government.

S. Use of Estimates

The preparation of financial statements requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

T. Reclassifications

The FY 2006 financial statements were reclassified to conform to the FY 2007 Departmental financial statement presentation requirements. The reclassifications had no material effect on total assets, liabilities, net position, change in net position or budgetary resources as previously reported.

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 2. Non-Entity Assets

Non-entity assets are assets held by the AFP that are not available for use by the AFP.

As of September 30, 2007 and 2006

	2007	2006
Intragovernmental		
Investments, Net (Note 5)	$ 1,201,702	$ 738,424
With the Public		
Cash and Monetary Assets	64,206	58,777
Total Non-Entity Assets	1,265,908	797,201
Total Entity Assets	1,790,595	1,256,235
Total Assets	$ 3,056,503	$ 2,053,436

Note 3. Fund Balance with U.S. Treasury

As of September 30, 2007 and 2006

	2007	2006
Fund Balances		
Special Funds	$ 300,136	$ 411,871
Status of Fund Balances		
Unobligated Balance - Available	$ 396,962	$ 28,152
Unobligated Balance - Unavailable	31,916	397,101
Obligated Balance not yet Disbursed	1,036,505	571,028
Other Funds (With)/Without Budgetary Resources	(1,165,247)	(584,410)
Total Status of Fund Balances	$ 300,136	$ 411,871

Other Funds (With)/Without Budgetary Resources primarily represent the AFF investments in short-term securities less amounts Temporarily not Available Pursuant to Public Law.

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 4. Cash and Monetary Assets

Cash consists of seized cash deposited in the SADF. Monetary assets include seized monetary instruments deposited in the SADF, seized cash in DOJ custody but not yet deposited in the SADF, and certain seized cash in the custody of the TFF pending transfer to the DOJ SADF (in connection with the Homeland Security Act provisions which established the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) as a DOJ law enforcement participant in the AFP).

As of September 30, 2007 and 2006	2007	2006
Cash		
Seized Cash Deposited	$ 42,791	$ 51,177
Monetary Assets		
Seized Monetary Instruments	21,415	7,600
Total Cash and Monetary Assets	$ 64,206	$ 58,777

Note 5. Investments, Net

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with AFF. The cash receipts collected from the public for the AFF, an earmarked fund, are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to the AFF as evidence of its receipts. Treasury securities are an asset to the AFF and a liability to the U.S. Treasury. Because the AFF and the U.S. Treasury are both parts of the Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Government-wide financial statements.

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 5. Investments, Net (continued)

Treasury securities provide the AFF with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When the AFF requires redemption of these securities to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

	Face Value	Unamortized Premium (Discount)	Investments, Net	Market Value
As of September 30, 2007				
Intragovernmental				
Non-Marketable Securities				
Market-Based				
AFF	$ 1,349,545	$ (2,680)	$ 1,346,865	$ 1,343,094
SADF	1,212,961	(11,259)	1,201,702	1,206,730
Total	$ 2,562,506	$ (13,939)	$ 2,548,567	$ 2,549,824

	Face Value	Unamortized Premium (Discount)	Investments, Net	Market Value
As of September 30, 2006				
Intragovernmental				
Non-Marketable Securities				
Market-Based				
AFF	$ 700,474	$ (2,154)	$ 698,320	$ 693,993
SADF	749,681	(11,257)	738,424	742,944
Total	$ 1,450,155	$ (13,411)	$ 1,436,744	$ 1,436,937

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 6. Accounts Receivable, Net

Accounts receivable consist mostly of amounts owed to the AFF by the Executive Office for United States Attorneys for services provided to the U.S. Treasury. There is no allowance for uncollectible accounts since accounts receivable from business with Federal entities are considered fully collectible.

As of September 30, 2007 and 2006	2007	2006
Intragovernmental		
Accounts Receivable	$ 13,608	$ 8,071
With the Public		
Accounts Receivable	1	-
Total Accounts Receivable, Net	$ 13,609	$ 8,071

Note 7. Forfeited and Seized Property

Property seized for any purpose other than forfeiture and held by the seizing agency or a custodial agency is reported in the financial statements of the seizing or custodial agency. All property seized for forfeiture, including property with evidentiary value, is reported in the financial statements of the AFF/SADF. Federal Financial Accounting and Auditing Technical Release No. 4, "Reporting on Non-Valued Seized and Forfeited Property," requires disclosure of property that does not have a legal market in the United States or does not have a value to the Federal government. The non-valued property category includes: alcohol, chemicals, drug paraphernalia, gambling devices, pornography, and weapons.

A. Forfeited Property

The following tables show the analysis of changes in and methods of disposition of forfeited property, excluding cash, during the fiscal years ended September 30, 2007 and 2006, respectively.

U.S. Department of Justice
Notes to the Principal Financial Statements
(Dollars in Thousands, Except as Noted)
Analysis of Changes in Forfeited Property -- Fiscal Year Ended September 30, 2007

Forfeited Property Category		Beginning Balance	Adjustments (1)	Forfeited	Disposed (2)	Ending Balance	Liens and Claims	Ending Balance, Net of Liens
Financial Instruments	Number	509	24	285	(757)	61	-	61
	Value	$11,346	($241)	$360,436	($369,418)	$2,123	($14)	$2,109
Real Property	Number	340	2	405	(336)	411	-	411
	Value	$86,527	($212)	$85,988	($81,594)	$90,709	($3,327)	$87,382
Personal Property	Number	3,013	27	5,027	(5,097)	2,970	-	2,970
	Value	$37,960	$312	$58,235	($60,906)	$35,601	($713)	$34,888
Non-Valued	Number	39,777	(3,848)	22,140	(19,856)	38,213	-	38,213
Total	Number	43,639	(3,795)	27,857	(26,046)	41,655	-	41,655
	Value	$135,833	($141)	$504,659	($511,918)	$128,433	($4,054)	$124,379

(1) Adjustments represent changes in the valuation or status of property as a result of fair market appraisals and court orders.

(2) Disposals in the Analysis of Changes table may not agree with disposals on the Methods of Disposition table as a result of partial dispositions.

U.S. Department of Justice
Notes to the Principal Financial Statements
(Dollars in Thousands, Except as Noted)

Methods of Disposition of Forfeited Property -- Fiscal Year Ended September 30, 2007

Forfeited Property Category		Converted Financial Instruments/Property	Destroyed/Donated/ Transferred	Sold/ Liquidated (1)	Official Use/ Transfer for Equitable Sharing	Returned Asset	Variance (2)	Total
Financial Instruments	Number	633	-	123	-	1	-	757
		$14,811	-	354,582	-	$25	-	$369,418
Real Property	Number	-	-	309	-	27	-	336
	Value	-	-	$74,881	-	$6,713	-	$81,594
Personal Property	Number	-	46	4,127	706	218	-	5,097
	Value	-	$22	$52,695	$1,261	$6,928	-	$60,906
Non-Valued Value	Number	-	19,856	-	-	-	-	19,856
Total	Number	633	19,902	4,559	706	246	-	26,046
	Value	$14,811	$22	$482,158	$1,261	$13,666	-	$511,918

(1) The sold/liquidated total dollar value does not agree to Donations and Forfeitures of Property on the Statement of Changes in Net Position and the Statement of Financing because the sold/liquidated amount above represents the assets at their appraised values at forfeiture, and the Donations and Forfeitures of Property on the Statement of Changes in Net Position and the Statement of Financing represents the proceeds realized upon disposition.

(2) Variances can result from differences between the value of the property when seized and the value of the property when disposed.

(3) Disposals on the Analysis of Changes table may not agree with disposals on the Methods of Disposition table as a result of partial dispositions.

U.S. Department of Justice
Notes to the Principal Financial Statements
(Dollars in Thousands, Except as Noted)
Analysis of Changes in Forfeited Property -- Fiscal Year Ended September 30, 2006

Forfeited Property Category		Beginning Balance	Adjustments (1)	Forfeited	Disposed (2)	Ending Balance	Liens and Claims	Ending Balance, Net of Liens
Financial Instruments	Number	211	22	576	(300)	509	-	509
	Value	$2,395	$387	$45,966	($37,402)	$11,346	($12)	$11,334
Real Property	Number	329	5	399	(393)	340	-	340
	Value	$58,615	$42	$110,538	($82,668)	$86,527	($1,662)	$84,865
Personal Property	Number	2,902	(491)	5,017	(4,415)	3,013	-	3,013
	Value	$31,962	($2,280)	$65,459	($57,181)	$37,960	($1,750)	$36,210
Non-Valued	Number	26,288	(3,028)	31,778	(15,261)	39,777	-	39,777
Total	Number	29,730	(3,492)	37,770	(20,369)	43,639	-	43,639
	Value	$92,972	($1,851)	$221,963	($177,251)	$135,833	($3,424)	$132,409

(1) Adjustments represent changes in the valuation or status of property as a result of fair market appraisals and court orders.

(2) Disposals in the Analysis of Changes table may not agree with disposals on the Methods of Disposition table as a result of partial dispositions.

These notes are an integral part of the financial statements

U.S. Department of Justice
Notes to the Principal Financial Statements
(Dollars in Thousands, Except as Noted)
Methods of Disposition of Forfeited Property -- Fiscal Year Ended September 30, 2006

Forfeited Property Category		Converted Financial Instruments/Property	Destroyed/Donated/ Transferred	Sold/ Liquidated (1)	Official Use/ Transfer for Equitable Sharing	Returned Asset	Variance (2)	Total
Financial Instruments	Number	275	-	1	-	24	-	300
	Value	$9,506	-	$112	-	$27,784	-	$37,402
Real Property	Number	-	3	364	11	15	-	393
	Value	-	$147	$79,573	$542	$2,406	-	$82,668
Personal Property	Number	-	478	2,606	1,122	209	-	4,415
	Value	-	$1,083	$27,229	$25,628	$3,241	-	$57,181
Non-Valued	Number	-	13,764	-	422	1,075	-	15,261
Total	Number	275	14,245	2,971	1,555	1,323	-	20,369
	Value	$9,506	$1,230	$106,914	$26,170	$33,431	-	$177,251

(1) The sold/liquidated total dollar value does not agree to Donations and Forfeitures of Property on the Statement of Changes in Net Position and the Statement of Financing because the sold/liquidated amount above represents the assets at their appraised values at forfeiture, and the Donations and Forfeitures of Property on the Statement of Changes in Net Position and the Statement of Financing represents the proceeds realized upon disposition.

(2) Variances can result from differences between the value of the property when seized and the value of the property when disposed.

(3) Disposals on the Analysis of Changes table may not agree with disposals on the Methods of Disposition table as a result of partial dispositions.

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 7. Forfeited and Seized Property (continued)

B. Seized Property

The following tables show the analysis of changes in and methods of disposition of property seized for forfeiture during the fiscal years ended September 30, 2007 and 2006, respectively. In the following tables, Seized Cash and Monetary Instruments includes seized cash in transit as well as pre-forfeiture deposits into the SADF of monetary instruments and depository account balances, proceeds from pre-forfeiture sales, and cash received in lieu of seized property. Financial Instruments include negotiable instruments and restricted depository accounts.

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Analysis of Changes in Seized Property -- Fiscal Year Ended September 30, 2007

Seized Property Category		Beginning Balance	Adjustments (1)	Seized	Disposed (2)	Ending Balance	Liens and Claims	Ending Balance, Net of Liens
Seized Cash and Monetary Instruments	Number	9,361	97	11,943	(11,120)	10,281	-	10,281
	Value	$797,201	$1,305	$1,474,190	($1,006,788)	$1,265,908	($73,882)	$1,192,026
Financial Instruments	Number	258	-	150	(104)	304		304
	Value	$40,881	-	$430,791	($356,426)	$115,246	($3)	$115,243
Real Property	Number	302	3	145	(247)	203		203
	Value	$90,329	($7,218)	$59,602	($65,671)	$77,042	($17,387)	$59,655
Personal Property	Number	5,875	(91)	7,445	(6,655)	6,574	-	6,574
	Value	$105,277	$100	$149,790	($91,543)	$163,624	($16,285)	$147,339
Non-Valued	Number	47,388	638	28,268	(17,304)	58,990	-	58,990
Total	Number	63,184	647	47,951	(35,430)	76,352	-	76,352
	Value	$1,033,688	($5,813)	$2,114,373	($1,520,428)	$1,621,820	($107,557)	$1,514,263

(1) Adjustments represent changes in the valuation or status of property as a result of fair market appraisals and court orders.

(2) Disposals in the Analysis of Changes table may not agree with disposals on the Methods of Disposition table as a result of partial dispositions.

U.S. Department of Justice
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Methods of Disposition of Seized Property -- Fiscal Year Ended September 30, 2007

Seized Property Category		Converted Financial Instruments/Property	Destroyed/Donated/ Transferred	Sold/ Liquidated	Returned Asset	Forfeited (1)	Variance (2)	Total
Seized Cash and Monetary Instruments	Number	43	-	-	696	10,381		11,120
	Value	$2,074	-	-	$53,217	$951,497		$1,006,788
Financial Instruments	Number	-	-	-	21	83		104
	Value	-	-	-	$782	$355,644		$356,426
Real Property	Number	-	-	-	34	213		247
	Value	-	-	-	$10,418	$55,253		$65,671
Personal Property	Number	-	-	-	1,626	5,029		6,655
	Value	-	-	-	$29,840	$61,703		$91,543
Non-Valued	Number	-	-	-	639	16,665		17,304
Total	Number	43	-	-	3,016	32,371		35,430
	Value	$2,074	-	-	$94,257	$1,424,097		$1,520,428

(1) Forfeitures reported on the Analysis of Changes in Forfeited Property may be greater because some assets are not seized until after they are declared forfeited.

(2) Variances can result from differences between the value of the property when seized and the value of the property when disposed.

U.S. Department of Justice
Notes to the Principal Financial Statements
(Dollars in Thousands, Except as Noted)

Analysis of Changes in Seized Property -- Fiscal Year Ended September 30, 2006

Seized Property Category		Beginning Balance	Adjustments (1)	Seized	Disposed (2)	Ending Balance	Liens and Claims	Ending Balance, Net of Liens
Seized Cash and Monetary Instruments	Number	8,956	91	11,029	(10,715)	9,361	-	9,361
	Value	$711,192	$1,336	$726,866	($642,193)	$797,201	($48,890)	$748,311
Financial Instruments	Number	234	(43)	170	(103)	258	-	258
	Value	$24,459	($2,977)	$22,285	($2,886)	$40,881	($2,007)	$38,874
Real Property	Number	294	4	347	(343)	302	-	302
	Value	$81,211	$225	$107,623	($98,730)	$90,329	($21,382)	$68,947
Personal Property	Number	6,144	(314)	6,300	(6,255)	5,875	-	5,875
	Value	$123,419	($5,532)	$86,804	($99,414)	$105,277	($12,751)	$92,526
Non-Valued	Number	48,702	1,690	30,458	(33,462)	47,388	-	47,388
Total	Number	64,330	1,428	48,304	(50,878)	63,184	-	63,184
	Value	$940,281	($6,948)	$943,578	($843,223)	$1,033,688	($85,030)	$948,658

(1) Adjustments represent changes in the valuation or status of property as a result of fair market appraisals and court orders.

(2) Disposals in the Analysis of Changes table may not agree with disposals on the Method of Disposition table as a result of partial dispositions.

U.S. Department of Justice
Notes to the Principal Financial Statements
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Methods of Disposition of Seized Property -- Fiscal Year Ended September 30, 2006

Seized Property Category		Converted Financial Instruments/Property	Destroyed/Donated/ Transferred	Sold/ Liquidated	Returned Asset	Forfeited (1)	Variance (2)	Total
Seized Cash and	Number	20	2	-	547	10,146	-	10,715
Monetary Instruments	Value	$1,105	$17	-	$25,108	$615,963	-	$642,193
Financial Instruments	Number	-	-	-	15	88	-	103
	Value	-	-	-	$545	$2,341	-	$2,886
Real Property	Number	-	-	3	34	306	-	343
	Value	-	-	$1,598	$7,432	$89,700	-	$98,730
Personal Property	Number	-	1	1	1,501	4,752	-	6,255
	Value	-	$2	$24	$42,866	$56,522	-	$99,414
Non-Valued	Number	-	15	-	1,669	31,778	-	33,462
Total	Number	20	18	4	3,766	47,070	-	50,878
	Value	$1,105	$19	$1,622	$75,951	$764,526	-	$843,223

(1) Forfeitures reported on the Analysis of Changes in Forfeited Property may be greater because some assets are not seized until after they are declared forfeited.

(2) Variances can result from differences between the value of the property when seized and the value of the property when disposed.

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 7. Forfeited and Seized Property (continued)

C. Anticipated Equitable Sharing in Future Periods

The statute governing the use of the AFF (28 U.S.C. §524(c)) permits the payment of equitable shares of forfeiture proceeds to participating foreign governments and state and local law enforcement agencies. The statute does not require such sharing and permits the Attorney General wide discretion in determining those transfers. Actual sharing is difficult to predict because many factors influence both the amount and time of disbursement of equitable sharing payments, such as the length of time required to move an asset through the forfeiture process to disposition, the amount of net proceeds available for sharing, the lapse of time for Departmental approval of equitable sharing requests for cases with asset values exceeding $1 million, and appeal of forfeiture judgments. Because of uncertainties surrounding the timing and amount of any equitable sharing payment, an obligation and expense are recorded only when the actual disbursement of the equitable sharing payment is imminent. The anticipated equitable sharing allocation level for FY 2008 is $400 million.

Note 8. General Property, Plant and Equipment, Net

As of September 30, 2007	Acquisition Cost	Accumulated Depreciation	Net Book Value	Service Life
Leasehold Improvements	$ 470	$ (470)	$ -	5 years
Internal Use Software	4,577	(1,199)	3,378	7 years
Total	$ 5,047	$ (1,669)	$ 3,378	
As of September 30, 2006				
Leasehold Improvements	$ 470	$ (384)	$ 86	5 years
Internal Use Software	4,577	(545)	4,032	7 years
Total	$ 5,047	$ (929)	$ 4,118	

Intragovernmental purchases of General Property, Plant and Equipment during FYs 2007 and 2006 were $0 and $470, respectively. Public purchases during FYs 2007 and 2006 were $0 for both years.

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 9. Other Assets

As of September 30, 2007 and 2006

	2007	2006
Intragovernmental		
Advances and Prepayments	$ 2,228	$ 1,445

Note 10. Liabilities not Covered by Budgetary Resources

As of September 30, 2007 and 2006

	2007	2006
Contingent Liabilities (Note 13)	$ 35,000	$ 35,000
Total Liabilities not Covered by Budgetary Resources	35,000	35,000
Total Liabilities Covered by Budgetary Resources	2,287,290	1,367,314
Total Liabilities	$ 2,322,290	$ 1,402,314

Note 11. Leases

The AFF has no capital leases or significant non-cancelable operating leases.

Operating Lease Expense

Lease Type	2007	2006
Cancelable Operating Leases	$ 859	$ 942

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 12. Seized Cash and Monetary Instruments

The Seized Cash and Monetary Instruments represent liabilities for seized assets held by the AFF/SADF pending disposition.

As of September 30, 2007 and 2006

	2007		2006	
Investments, Net (Note 5)	$	1,201,702	$	738,424
Seized Cash Deposited (Note 4)		42,791		51,177
Seized Monetary Instruments (Note 4)		21,415		7,600
Total Seized Cash and Monetary Instruments	$	1,265,908	$	797,201

Note 13. Contingencies and Commitments

The AFF and SADF are party to various administrative proceedings, legal actions, and claims. The balance sheet includes an estimated liability for those legal actions where management and the Chief Counsel consider adverse decisions "probable" and amounts are reasonably estimable. For those legal actions where management and the Chief Counsel consider adverse decisions "reasonably possible" and amounts are reasonably estimable, the information would be disclosed below. However, there are cases where amounts have not been accrued or disclosed below because the amounts of the potential loss cannot be estimated or the likelihood of an unfavorable outcome is less than reasonably possible.

	Accrued Liabilities		Estimated Range of Loss			
			Lower		Upper	
As of September 30, 2007						
Probable	$	35,000	$	35,000	$	35,000
As of September 30, 2006						
Probable	$	35,000	$	35,000	$	35,000

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U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 14. Earmarked Funds

The AFF, an earmarked fund, exists to eliminate economic disincentives to operation of an extensive national asset forfeiture program by providing a stable source of funds to pay costs, not otherwise funded under agency appropriations, to execute forfeiture functions. This is made possible by depositing the proceeds of all forfeitures under any laws enforced or administered by the Department into the Fund, and using those receipts to finance expenses associated with asset forfeiture functions.

The funds in the AFF are derived primarily from financing sources and are presented on the Consolidated Statement of Changes in Net Position as both Budgetary and Other Financing Sources. Financing sources consist of (1) interest earned on Treasury investments (i.e., nonexchange revenues) and (2) non-governmental donations and forfeitures, which include forfeited cash, proceeds from the sale of forfeited property (or conversion of deferred revenue to realized revenue through sale), receipt of payments in lieu of property forfeiture, recovery of asset management expenses, and financing sources from judgments.

The AFF recognizes exchange revenue, on a reimbursement basis, when the United States Attorneys Offices provide services in judicial forfeiture cases brought by agencies participating in the TFF. This revenue is presented on the Consolidated Statement of Net Cost as earned revenue. In accordance with 28 U.S.C. 524 and AFMS Memorandums of Understanding, donations and forfeitures available for use by certain Federal agencies are treated as returns of financing sources when disbursed.

All funds deposited to the AFF are considered "public" monies, i.e., funds belonging to the U.S. government. The monies deposited into the AFF are available to cover all expenditures in support of the AFP that are allowable under the Fund statute created by the Comprehensive Crime Control Act of 1984 (P.L. 98-473, dated October 12, 1984) at 28 U.S.C. 524(c).

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 14. Earmarked Funds (continued)

As of and For the Fiscal Years Ended September 30, 2007 and 2006

	2007	2006
Balance Sheet		
Assets		
Fund Balance with U.S. Treasury	$ 300,135	$ 411,871
Investments, Net	1,346,865	698,320
Other Assets	143,595	146,044
Total Assets	$ 1,790,595	$ 1,256,235
Liabilities		
Accounts Payable	$ 897,003	$ 437,704
Other Liabilities	159,379	167,409
Total Liabilities	$ 1,056,382	$ 605,113
Net Position		
Cumulative Results of Operations	$ 734,213	$ 651,122
Total Net Position	734,213	651,122
Total Liabilities and Net Position	$ 1,790,595	$ 1,256,235
Statement of Net Cost		
Gross Cost of Operations	$ 1,534,041	$ 975,636
Less: Exchange Revenue	3,722	1,481
Net Cost of Operations	$ 1,530,319	$ 974,155
Statements Changes in Net Position		
Net Position Beginning of Period	$ 651,122	$ 444,912
Budgetary Financing Sources	1,520,441	1,072,698
Other Financing Sources	92,969	107,667
Total Financing Sources	1,613,410	1,180,365
Net Cost of Operations	(1,530,319)	(974,155)
Net Change	83,091	206,210
Net Position End of Period	$ 734,213	$ 651,122

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 15. Net Cost of Operations by Suborganization

For the Fiscal Year Ended September 30, 2007		Gross Cost	Less: Earned Revenue	Net Cost (Revenue) of Operations
Goal 2:	Payments to Third Parties	$ 947,895	$ -	$ 947,895
	Asset Management Expenses	39,396	-	39,396
	Special Contract Services	58,994	3,722	55,272
	ADP Equipment	16,552	-	16,552
	Forfeiture Case Prosecution	30,341	-	30,341
	Forfeiture Training and Printing	8,526	-	8,526
	Other Program Management	18,791	-	18,791
	Awards for Information	18,434	-	18,434
	Purchase of Evidence	6,121	-	6,121
	Equipping Conveyances	1,326	-	1,326
	Contracts to Identify Assets	10,484	-	10,484
	Investigative Cost Leading to Seizure	21,693	-	21,693
	Equitable Sharing	295,809	-	295,809
	Joint Law Enforcement Operations	59,679	-	59,679
	Total	$ 1,534,041	$ 3,722	$ 1,530,319

Goal 2: Prevent Crime, Enforce Federal Laws, and Represent the Rights and Interests of the American People

U.S. Department of Justice
Notes to the Financial Statements
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Note 15. Net Cost of Operations by Suborganization

For the Fiscal Year Ended September 30, 2006		Gross Cost	Less: Earned Revenue	Net Cost (Revenue) of Operations
Goal 2:	Payments to Third Parties	$ 419,973	$ -	$ 419,973
	Asset Management Expenses	43,149	-	43,149
	Special Contract Services	58,484	1,481	57,003
	ADP Equipment	9,564	-	9,564
	Forfeiture Case Prosecution	23,310	-	23,310
	Forfeiture Training and Printing	8,177	-	8,177
	Other Program Management	12,664	-	12,664
	Awards for Information	13,402	-	13,402
	Purchase of Evidence	7,159	-	7,159
	Equipping Conveyances	1,688	-	1,688
	Contracts to Identify Assets	5,942	-	5,942
	Investigative Cost Leading to Seizure	4,465	-	4,465
	Equitable Sharing	322,306	-	322,306
	Joint Law Enforcement Operations	45,353	-	45,353
	Total	$ 975,636	$ 1,481	$ 974,155

Goal 2: Prevent Crime, Enforce Federal Laws, and Represent the Rights and Interests of the American People

U.S. Department of Justice
Notes to the Financial Statements
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Note 16. Information Related to the Statement of Budgetary Resources

Apportionment Categories of Obligations Incurred:

	Direct Obligations	Reimbursable Obligations	Total Obligations Incurred
For the Fiscal Year Ended September 30, 2007			
Obligations Apportioned Under			
Category A	$ 21,206	$ -	$ 21,206
Category B	1,528,942	3,722	1,532,664
Total	$ 1,550,148	$ 3,722	$ 1,553,870
For the Fiscal Year Ended September 30, 2006			
Obligations Apportioned Under			
Category A	$ 21,663	$ -	$ 21,663
Category B	1,036,261	1,481	1,037,742
Total	$ 1,057,924	$ 1,481	$ 1,059,405

Apportionment categories are determined in accordance with the guidance provided in Part 4 "Instructions on Budget Execution" of OMB Circular No. A-11, "Preparation, Submission, and Execution of the Budget." Category A represents resources apportioned for calendar quarters. Category B represents resources apportioned for other periods; for activities, projects, and objectives or for a combination thereof.

U.S. Department of Justice
Notes to the Financial Statements
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Note 16. Information Related to the Statement of Budgetary Resources (continued)

Status of Undelivered Orders:

Undelivered Orders (UDOs) represent the amount of goods and/or services ordered, which have not been actually or constructively received. This amount includes any orders which may have been prepaid or advanced but for which delivery or performance has not yet occurred.

As of September 30, 2007 and 2006

	2007	2006
UDO Obligations Unpaid	$ 154,326	$ 142,326
UDO Obligations Prepaid/Advanced	2,228	1,445
Total UDOs	$ 156,554	$ 143,771

Permanent Indefinite Appropriations:

28 U.S.C. 524(c)(1) authorizes the Attorney General to use AFF receipts to pay program operations expenses, equitable sharing to state and local law enforcement agencies who assist in forfeiture cases, and lien holders. This permanent indefinite authority is open-ended as to both its period of availability (amount of time the agency has to spend the funds) and its amount.

Legal Arrangements Affecting Use of Unobligated Balances:

Unobligated balances represent the cumulative amount of budget authority that is not obligated and that remains available for obligation, unless otherwise restricted. Excess unobligated balances identified at the end of a fiscal year may be declared a “Super Surplus” balance. Super Surplus balances may be allocated at the discretion of the Attorney General for any Federal law enforcement, litigative/prosecutive, and correctional activities or any other authorized purpose of the DOJ pursuant to 28 U.S.C. 524(c)(8)(E).

U.S. Department of Justice
Notes to the Financial Statements
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Note 16. Information Related to the Statement of Budgetary Resources (continued)

Statement of Budgetary Resources vs. Budget of the United States Government:

The reconciliation as of September 30, 2007 is not presented, because the submission of the Budget of the United States (Budget) for FY 2009, which presents the execution of the FY 2007 Budget, occurs after publication of these financial statements. The Department of Justice Budget Appendix can be found on the OMB website (http://www.whitehouse.gov/omb/budget) and will be available in early February 2008.

For the Fiscal Year Ended September 30, 2006 (Dollars in millions)	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
Statement of Budgetary Resources (SBR)	$ 1,485	$ 1,059	$ 60	$ 561
Funds not Reported in the Budget				
Forfeiture Activity	(51)	(32)	-	32
Other	-	8	(3)	(3)
Budget of the United States Government	$ 1,434	$ 1,035	$ 57	$ 590

Differences for Funds not Reported in Budget of the U.S. - Forfeiture Activity, primarily represent forfeiture activities which are unavailable until the authority is granted in the subsequent year. These activities represent real estate sales; the sale of forfeited property maintained by the Treasury Executive Office for Asset Forfeiture for the ATF pending transfer to AFF; and accrued revenue. Other differences represent financial statement adjustments, timing differences and other immaterial differences between amounts reported in the AFF's SBR and the Budget of the United States.

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 17. Explanation of Differences Between Liabilities not Covered by Budgetary Resources and Components of Net Cost of Operations Requiring or Generating Resources in Future Periods

Liabilities that are not covered by realized budgetary resources and for which there is not certainty that budgetary authority will be realized, such as the enactment of an appropriation, are considered liabilities not covered by budgetary resources. These liabilities totaling $35,000 and $35,000 on September 30, 2007 and 2006, respectively, are discussed in Note 10, Liabilities not Covered by Budgetary Resources. Decreases in these liabilities result from current year budgetary resources that were used to fund expenses recognized in prior periods. Increases in these liabilities represent unfunded expenses that were recognized in the current period.

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 18. Super Surplus Transfers

Allocation transfers by the AFF include transfers of Super Surplus Allocations and transfers of forfeited property to participating agencies for official use.

Transfers-out of Super Surplus Allocations. 28 U.S.C. § 524(c)(8)(E) provides authority for the Attorney General to use excess end-of-year monies, without fiscal year limitation, in the AFF for any Federal law enforcement, litigative, prosecutorial, and correctional activities, or any other authorized purpose of the DOJ. The Attorney General approved the following allocations during FYs 2007 and 2006 for distribution in subsequent years.

For the Fiscal Years Ended September 30, 2007 and 2006

	2007	2006
ATF	$ 399	$ 1,367
Civil Division	750	750
Criminal Division - Organized Crime Drug Enforcement Task Force	200	2,000
Drug Enforcement Administration	2,450	5,000
Executive Office for U.S. Attorneys	4,000	4,000
National Security Division	8,153	9,062
Office of Justice Programs	-	54
USMS	-	2,750
Total DOJ Allocations	$ 15,952	$ 24,983
1997 Super Surplus	$ 9	$ 9
1998 Super Surplus	-	216
1999 Super Surplus	-	1,110
2004 Super Surplus	-	485
2005 Super Surplus	15,943	23,163
Total Allocations	$ 15,952	$ 24,983

U.S. Department of Justice
Notes to the Financial Statements
(Dollars in Thousands, Except as Noted)

Note 18. Super Surplus Transfers (continued)

As of September 30, 2007, $6,530 in prior years' surpluses were transferred out to participating agencies, $1,108 was owed and $2,228 was advanced to these agencies for super surplus allocations in the current and prior years. As of September 30, 2006, $1,337 was transferred out, $7,332 was owed, and $1,445 was advanced.

Transfers-out of Forfeited Property for Official Use. Property was distributed pursuant to the Attorney General's authority to share forfeiture revenues with agencies that participated in the forfeiture that generated the property, and pursuant to the DOJ's authority to place forfeited property into official use by the Government. As of September 30, 2007 and 2006, respectively, transfers-out of forfeited property for official use totaled $7,246 and $6,683, respectively.

Note 19. Nonexchange Revenues

Nonexchange revenue consists of income from the investment of the AFF and SADF in U.S. Treasury securities. The investment accrual revenue represents the amortization of the discount on marketable bills using the straight-line basis.

For the Fiscal Years Ended September 30, 2007 and 2006

	2007	2006
Income from AFF investments	$ 51,312	$ 25,232
Income from SADF investments	51,290	32,092
Income from AFF/SADF investments accrual	8,824	3,026
Total Investment Income	$ 111,426	$ 60,350

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Note 20. Donations and Forfeitures

Forfeiture income includes forfeited cash, sales of forfeited property, penalties in lieu of forfeiture, recovery of returned asset management costs, judgment collections, and other miscellaneous income. For the fiscal years ended September 30, 2007 and 2006, net forfeiture income attributable to the AFF totaled $1,515,761 and $1,124,904, respectively, after the following payments and returns to agencies participating in seizures that led to forfeiture.

	2007	2006
Payments to individuals or organizations for proceeds from assets forfeited and deposited into the AFF and subsequently returned to them through a settlement agreement or by court order.	$ 4,895	$ 43,302
Return of forfeiture income to the TFF for its participation in seizures that led to forfeiture.	31,105	12,697
Return to the Federal Deposit Insurance Corporation (FDIC) or other Federal financial institutions or regulatory agency for monies recovered under the Federal Institutions Reform, Recovery and Enforcement Act.	-	906
Return of forfeiture income to the U.S. Postal Service for its participation in seizures that led to forfeiture.	250	4,363
Return of forfeiture income to other Federal agencies for their participation in seizures that led to forfeiture.	154	232
BCCI distributions to victims and other permanent court-ordered distributions.	-	1,862
Total Return of Forfeiture Income	$ 36,404	$ 63,362

Note 21. Change In Accounting Principle

In FY 2007, the AFF changed to a preferred method of accounting for the recording of the proceeds from the sale of forfeited real property. This change in accounting principle is based upon new Office of Management and Budget, Circular No. A-136, “Financial Reporting Requirements” to align the SBR with the FACTS II submission. The impact of this change in FY 2007 was approximately $26 million.

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Note 22. Reconciliation of Net Cost of Operations (proprietary) to Budget (formerly the Statement of Financing)

The AFF/SADF changed its method of reporting the reconciliation of the Net Cost of Operations to budgetary resources during FY 2007. Effective FY 2007 and in accordance with OMB Circular A-136, the Statement of Financing is no longer considered a basic statement. In previous years, this reconciliation was accomplished by presenting the Statement of Financing as a basic financial statement.

For the Fiscal Years Ended September 30, 2007 and 2006:

	2007	2006
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred	$ 1,553,870	$ 1,059,405
Less: Spending Authority from Offsetting Collections and Recoveries	36,439	34,210
Obligations Net of Offsetting Collections and Recoveries	1,517,431	1,025,195
Less: Offsetting Receipts	111,426	60,350
Net Obligations	1,406,005	964,845
Other Resources		
Donations and Forfeitures of Property	106,746	115,687
Transfers-In/Out Without Reimbursement	(13,777)	(8,020)
Net Other Resources Used to Finance Activities	92,969	107,667
Total Resources Used to Finance Activities	1,498,974	1,072,512
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but not Yet Provided	(12,497)	(54,048)
Budgetary Offsetting Collections and Receipts That do not Affect Net Cost of Operations	9,438	(51,450)
Resources That Finance the Acquisition of Assets	-	(470)
Other Resources or Adjustments to Net Obligated Resources That do not Affect Net Cost of Operations	7,246	6,683
Total Resources Used to Finance Items not Part of the Net Cost of Operations	4,187	(99,285)
Total Resources Used to Finance the Net Cost of Operations	1,503,161	973,227
Components of Net Cost of Operations That Will not Require or Generate Resources in the Current Period		
Components not Requiring or Generating Resources		
Depreciation and Amortization	740	928
Other	26,418	-
Total Components of Net Cost of Operations That Will not Require or Generate Resources	27,158	928
Total Components of Net Cost of Operations That Will not Require or Generate Resources in the Current Period	27,158	928
Net Cost of Operations	$ 1,530,319	$ 974,155

Appendix

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OFFICE OF THE INSPECTOR GENERAL AUDIT DIVISION ANALYSIS AND SUMMARY OF ACTIONS NECESSARY TO CLOSE THE REPORT

AFF/SADF's management was provided a draft of the Independent Auditors' Report on Internal Control and their comments on the findings and recommendations were considered in preparing this Analysis and Summary of Actions Necessary to Close the Report. Since management concurred with all of the recommendations, this report is being issued resolved. We will continue to review the actions taken during future financial statement audits in order to assess whether the findings have been adequately addressed and recommendations implemented. Depending on the recommendation, it will be closed either when the action requested is completed or subsequent audit testing verifies the adequacy of corrective actions. In the case of a repeat recommendation, the report recommendation will be immediately closed upon report issuance, but will continue to be followed up in the prior report where the recommendation was initially made.

Recommendation Number

1. **Closed.** This is a repeat recommendation. We will continue to monitor AFMS's corrective actions through recommendation No. 1 of OIG Report No. 07-15.

2. **Closed.** This is a repeat recommendation. We will continue to monitor AFMS's corrective actions through recommendation No. 2 of OIG Report No. 07-15.

3. **Resolved.** This recommendation can be closed when subsequent financial statement audit testing verifies that the AFMS has improved review procedures with participants, over obligation documents and vouchers, posted amounts, and outstanding obligations to ensure amounts are adjusted or de-obligated in a timely manner and within the timeframes established for issuing the financial statements.

4. **Resolved.** This recommendation can be closed when subsequent financial statement audit testing verifies that the AFMS, in conjunction with the USMS, strengthened procedures requiring that field districts perform and document periodic

reviews over open obligations to ensure amounts are adjusted or de-obligated in a timely manner and within the timeframes established for issuing the financial statements.

5. **Resolved.** This recommendation can be closed when subsequent financial statement audit testing verifies that the AFMS, in conjunction with the Justice Management Division Finance Staff, perform periodic reconciliations between the various extracts/downloads into the FMIS2 and the resultant general ledger accounts and take immediate and resolute action to eliminate the source of the differences.

6. **Resolved.** This recommendation can be closed when subsequent financial statement audit testing verifies that the AFMS: (1) implemented software to ensure that administrative accounts on production servers are effectively monitored, and (2) established procedures to review production server logs for unusual activity on a bi-weekly or monthly basis.

7. **Resolved.** This recommendation can be closed when subsequent financial statement audit testing verifies that the AFMS analyzed and revised procedures to require periodic reviews to identify and mitigate vulnerabilities including weaknesses related to configuration settings and communications protocols.

8. **Resolved.** This recommendation can be closed when subsequent financial statement audit testing verifies that the AFMS has: (1) ensured that non-production systems or test systems are tested on enclaves that do not interface with production or General Support System data, and (2) analyzed and updated procedures for implementing new or test systems to ensure appropriate patches are installed timely.