

# **U. S. DEPARTMENT OF JUSTICE ANNUAL FINANCIAL STATEMENT FISCAL YEAR 2006**

## **OFFICE OF THE INSPECTOR GENERAL COMMENTARY AND SUMMARY**

This audit report contains the Annual Financial Statement of the U.S. Department of Justice (Department) for the fiscal year (FY) ended September 30, 2006. Under the direction of the Office of the Inspector General (OIG), KPMG LLP performed the consolidated Department audit and 7 of the 10 component audits. Two other independent public accounting firms performed the remaining three component audits, upon which KPMG LLP relied when issuing its report on the consolidated financial statements. For FY 2005, KPMG LLP also performed the consolidated Department audit, and 7 of the 10 component audits.

The Department received an unqualified opinion on its FY 2006 and 2005 financial statements. The Department had previously received an unqualified opinion on the FY 2005 financial statements. At the consolidated level, the Department has made progress in financial management. This year, at the consolidated level, the Department had one material weakness and one reportable condition, compared to two material weaknesses for FY 2005.

The material weakness this year, which is a repeat weakness from last year, is on financial management systems general and application controls. The material weakness contains new and continued deficiencies for 8 of the 10 components, including weaknesses in the Department's consolidated information systems general controls environment that provides general control support for several components' financial applications. However, the Department reduced the prior year material weakness on financial reporting to a reportable condition this year. The reportable condition includes several serious but isolated issues, including Office of Justice Programs' (OJP) grant advance and payable estimation process, the Bureau of Alcohol, Tobacco, Firearms and Explosives' (ATF) accounts payable process, and the U.S. Marshals Service's (USMS) financial statement quality control and assurance.

At the component level, there was also improvement, as evidenced by the reduction in the component material weaknesses from 10 in FY 2005 to 7 this year. In addition, component reportable conditions dropped from 8 in FY 2005 to 7 this year. Two components, the Drug Enforcement Administration and the Federal Prison Industries, Inc., continued to have no material weaknesses, reportable conditions, or compliance issues. The table at the end of this discussion compares the FY 2006 and the FY 2005 audit results for the Department's consolidated audit as well as for the 10 individual component audits.

Yet, while the Department was able to take a significant step forward this year in reducing its financial material weakness to a reportable condition, it still lacks sufficient automated systems to readily support ongoing accounting operations and financial statement preparation. Inadequate, outdated, and, in some cases non-integrated financial management systems do not provide certain automated financial transaction processing activities that are necessary to support management's need for timely and accurate financial information throughout the year. Many tasks still must be performed manually at interim periods and at year end, requiring extensive manual efforts on the part of financial and audit personnel. These significant, costly, and time-intensive manual efforts will continue to be necessary for the Department and its components to produce financial statements until automated, integrated processes and systems are implemented that readily produce the necessary information throughout the year. While the Department is proceeding towards a Unified Financial Management System (UFMS) that it believes will correct many of these issues, implementation has been slow and will not be completed across the Department for at least another 6 years. However, the Department did make sound efforts this year in documenting financial processes, a key step to successfully implementing the new UFMS and also required by the revised Office of Management and Budget Circular A-123.

The financial management systems general and application control issues are the most serious remaining issues for the financial statement audits. Four components continue to have a material weakness and four other components continue to have a reportable condition in this area. These issues are long standing and must be addressed to ensure a secure systems environment for the Department. Many components had issues with access controls, application software development and change controls, and system software. Application controls were found to be weak at five out of nine components tested. Entity-wide security, service continuity, and segregation of duties issues were less widespread across the Department.

In the FY 2006 consolidated report on compliance and other matters, the auditors identified four Department components that were not in compliance with the Federal Financial Management Improvement Act of 1996 (FFMIA), which requires compliance with federal financial management systems requirements, applicable federal accounting standards, and the United States Standard General Ledger at the transaction level. The four non-compliant components were the ATF, the Federal Bureau of Investigation, OJP, and the USMS. The same four components were also non-compliant with FFMIA in FY 2005. For FY 2006, the USMS was also not in compliance with the Prompt Payment Act and OMB Circular A-11, *Preparation, Submission and Execution of the Budget*, both repeat issues from FY 2005.

The OIG reviewed KPMG LLP's report on the consolidated financial statements and related documentation and made necessary inquiries of its representatives. Our review, as differentiated from an audit in accordance with United States generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on the Department's financial statements, conclusions about the effectiveness of internal control, or conclusions on compliance with laws and regulations. KPMG LLP is responsible for the attached auditor's report dated November 10, 2006, and the conclusions expressed in the report. However, our review, while still ongoing, disclosed no instances where KPMG LLP did not comply, in all material respects, with generally accepted government auditing standards.

Comparison of FY 2006 and FY 2005 Audit Results								
Reporting Entity	Auditors' Opinion On Financial Statements		Number of Material Weaknesses <sup>1</sup>				Number of Reportable Conditions <sup>2</sup>	
			Financial		Information Systems			
	2006	2005	2006	2005	2006	2005	2006	2005
Consolidated DOJ	U <sup>3</sup>	U	0	1	1	1	1	0
OBDs	U	U	0	0	0	0	1	1
AFF/SADF	U	U	0	0	0	0	2	1
FBI	U	U	0	1	1	1	0	1
DEA	U	U	0	0	0	0	0	0
OJP	U	U	1	2	1	1	1	1
USMS	U	U	1	2	1	1	0	1
BOP	U	U	0	0	0	0	1	1
FPI	U	U	0	0	0	0	0	0
WCF	U	U	0	0	0	0	2	2
ATF	U	U	1	1	1	1	0	0
<b>Component Totals</b>			3	6	4	4	7	8

Consolidated Department of Justice (Consolidated DOJ); Offices, Boards and Divisions (OBDs); Assets Forfeiture Fund and Seized Asset Deposit Fund (AFF/SADF); Federal Bureau of Investigation (FBI); Drug Enforcement Administration (DEA); Office of Justice Programs (OJP); U.S. Marshals Service (USMS); Federal Bureau of Prisons (BOP); Federal Prisons Industries, Inc. (FPI); Working Capital Fund (WCF); Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF)

<sup>1</sup> A material weakness is a reportable condition (see below) in which the design or operation of the internal control does not reduce to a relatively low level the risk that error, fraud, or noncompliance in amounts that would be material in relation to the principal financial statements or to performance measures may occur and not be detected within a timely period by employees in the normal course of their assigned duties.

<sup>2</sup> A reportable condition includes matters coming to the auditor's attention that, in the auditor's judgment, should be communicated because they represent significant deficiencies in the design or operation of internal controls that could adversely affect the entity's ability to properly report financial data.

<sup>3</sup> Unqualified opinion – An auditor's report that states the financial statements present fairly, in all material respects, the financial position and results of operations of the reporting entity, in conformity with generally accepted accounting principles.

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