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Independent Auditors' Report on Internal Control over Financial Reporting

Inspector General
U.S. Department of Justice

United States Attorney General
U.S. Department of Justice

We have audited the consolidated balance sheets of the U.S. Department of Justice (Department) as of September 30, 2010 and 2009, and the related consolidated statements of net cost and changes in net position and the combined statements of budgetary resources and custodial activity (hereinafter referred to as "consolidated financial statements") for the years then ended, and have issued our report thereon dated November 9, 2010. We did not audit the financial statements of the following components of the Department: the U.S. Marshals Service (USMS); the Federal Prison Industries, Inc. (FPI); and the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) as of and for the year ended September 30, 2010. Additionally, we did not audit the financial statements of the USMS as of and for the year ended September 30, 2009. Those financial statements were audited by other auditors whose reports have been furnished to us, and our report, insofar as it related to the amounts included for those components, was based solely on the reports of the other auditors. As discussed in Note 26 to the consolidated financial statements, the Department changed its method of accounting for temporary rescissions of budgetary authority in fiscal year 2010.

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*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

As stated above, we did not audit the fiscal year 2010 financial statements of the USMS, FPI, and ATF. Those financial statements were audited by other auditors whose reports thereon, including the other auditors' *Independent Auditors' Report on Internal Control over Financial Reporting*, have been furnished to us. Accordingly, our report on the Department's internal control over financial reporting, insofar as it relates to those components, is based solely on the reports and findings of the other auditors.

The Department's management is responsible for establishing and maintaining effective internal control. In planning and performing our fiscal year 2010 audit, we considered the Department's internal control over financial reporting by obtaining an understanding of the Department's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

A deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the fourth paragraph of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. In our fiscal year 2010 audit, we did not, nor did the reports of the other auditors, identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses for the Department, as defined above. However, we noted, and the reports of the other auditors identified, a deficiency in internal control over financial reporting described in Exhibits I and II that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Exhibit I is an overview of the significant deficiencies identified in the Department's component auditors' *Independent Auditors' Reports on Internal Control over Financial Reporting*, and includes an explanation of how these component-level significant deficiencies are reported at the Department level. Exhibit II provides the details of the Department-wide significant deficiency. Exhibit III presents the status of prior years' findings and recommendations.

The Department's responses to the finding identified in our audit are presented in Exhibit II. We did not audit the Department's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the management of the U.S. Department of Justice, the U.S. Department of Justice Office of the Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 9, 2010

EXHIBIT I

OVERVIEW OF SIGNIFICANT DEFICIENCY

The following table summarizes the four significant deficiencies identified by the Department's component auditors during fiscal year 2010. The component auditors considered one of these significant deficiencies to be a material weakness. We analyzed the component-level material weakness and significant deficiencies to determine their effect on the Department's internal control over financial reporting and concluded that they comprise one Department-wide significant deficiency.

Significant Deficiencies Noted During Fiscal Year 2010		DOJ	AFF	OBDS	USMS (1)	OJP	DEA	FBI	ATF (1)	BOP	FPI (1)
Improvements are needed in the Department's component financial systems' general controls.								S			
Improvements are needed in the components' internal controls to provide reasonable assurance that transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles.		S	S		M				S		
Total Material Weaknesses Reported by Components' Auditors	FY 2010	1	0	0	1	0	0	0	0	0	0
	FY 2009	1	0	0	1	0	0	0	0	0	0
Total Significant Deficiencies Reported by Components' Auditors	FY 2010	3	1	0	0	0	0	1	1	0	0
	FY 2009	7	1	1	1	1	1	0	0	1	1

Assets Forfeiture Fund and Seized Asset Deposit Fund (AFF); Offices, Boards and Divisions (OBDs); United States Marshals Service (USMS); Office of Justice Programs (OJP); Drug Enforcement Administration (DEA); Federal Bureau of Investigation (FBI); Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF); Federal Bureau of Prisons (BOP); and Federal Prison Industries, Inc. (FPI).

Legend:
(1) The financial statements of the ATF and the FPI were audited by other auditors in FY 2010, and those of the USMS were audited by other auditors in FYs 2010 and 2009.

M – Material weakness
S – Significant deficiency

In Exhibit II we discuss in detail the Department-wide significant deficiency noted above.

EXHIBIT II

SIGNIFICANT DEFICIENCY

IMPROVEMENTS ARE NEEDED IN THE COMPONENTS' INTERNAL CONTROLS TO PROVIDE REASONABLE ASSURANCE THAT TRANSACTIONS ARE PROPERLY RECORDED, PROCESSED, AND SUMMARIZED TO PERMIT THE PREPARATION OF FINANCIAL STATEMENTS IN ACCORDANCE WITH U.S. GENERALLY ACCEPTED ACCOUNTING PRINCIPLES.

The Department and its component entities have made significant progress in addressing previously reported material weaknesses and significant deficiencies. However, three of the component entities' auditors continue to report a material weakness and significant deficiencies in internal controls that inhibit the preparation of financial statements in accordance with U.S. generally accepted accounting principles. As detailed below, further improvement is needed in the following component entities' internal controls to provide reasonable assurance that transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with U.S. generally accepted accounting principles.

Funds Management Controls. The USMS does not have adequate financial and compliance controls to ensure that obligation transactions are executed and recorded in accordance with laws and regulations and the related undelivered orders and accounts payable balances are accurate and complete. The component auditors identified accounting errors and instances of noncompliance with accounting standards, OMB Circular No. A-11, *Preparation, Submission and Execution of the Budget*, and the United States Standard General Ledger, as follows:

Undelivered Orders (UDOs). As a result of their interim and year-end testing, the component auditors identified errors related to the accuracy of undelivered orders balances. Included in the errors identified by the component auditors were: (1) UDOs that were overstated due to the failure to establish an accounts payable upon receipt of the goods or services, (2) UDOs that were found to be invalid due to accounts payable accruals or deobligations not having been recorded after the period of performance had expired, (3) UDOs that were misstated due to the failure to record approved modification increases or deobligations not having been recorded, (4) UDOs that were misstated because the recorded amounts did not agree with the underlying source documents or unsupported because supporting documentation could not be provided, and (5) UDOs that were misstated due to errors having been made in the calculation of accounts payable accruals. As a result of these accounting errors, the USMS's undelivered orders balances were misstated at quarter-end, as follows:

Sample Population	Likely Misstatement
Headquarters and District Offices (March 31, 2010)	$20.5 million net overstatement
Headquarters (June 30, 2010)	$861 thousand net understatement
Headquarters and District Offices (September 30, 2010)	$18.7 million net overstatement

EXHIBIT II

Delivered Orders – Obligations Unpaid (Accounts Payable). As a result of their interim and year-end testing, the component auditors identified accounting and recordkeeping errors related to the USMS's accounts payable accrual estimates. Included in the errors identified by the component auditors were accounts payable that were incorrect or unsupported due to: (1) the failure to accrue for services received before quarter-end, (2) the accrual methodology failing to take into consideration accruals that were already posted, and (3) lack of supporting documentation . As a result of these accounting errors, the USMS's accounts payable balance was misstated at quarter-end, as follows:

Sample Population	Likely Misstatement
Headquarters and District Offices (March 31, 2010)	$9.9 million net overstatement
Headquarters (June 30, 2010)	$6.3 million net understatement
Headquarters and District Offices (September 30, 2010)	$15.8 million net understatement

Prisoner Medical Obligations and Accounts Payable. The component auditors noted that the USMS does not have consistent procedures or policies in place for estimating and recording medical obligations incurred by the district offices. During the fiscal year, the USMS established Medical Services Procedures that were scheduled to be implemented in July 2010 under a pilot program. These procedures were not implemented at the time the component auditors conducted district office site visits during June and July. Based on discussions with district office personnel during the site visits, the component auditors determined that district offices were applying the same inconsistent procedures that the USMS has used in prior years.

Unauthorized Commitments. The component auditors noted that the USMS made unauthorized commitments during the fiscal year in connection with projects related to security system monitoring, court security officers, guard services, and prisoner medical services and prescriptions. These unauthorized commitments resulted in 16 contract ratifications totaling $2.3 million. In addition, 24 ratifications totaling $2.2 million were in process pending receipt of additional documentation from the program offices. The *Federal Acquisition Regulation* prohibits agencies from entering into contracts unless the contracting officer ensures that all requirements of law, executive orders, regulations, and other applicable procedures have been satisfied. Unauthorized commitments could result in Anti-Deficiency Act violations or other funds management concerns if sufficient funds are not available to cover the unauthorized commitments.

Undelivered Orders and Accounts Payable. ATF's internal controls need improvement to ensure that undelivered orders are valid, accounts payable transactions are calculated correctly, and related account balances are accurate and complete. The component auditors noted that ATF personnel are not adequately reviewing and approving transactions before posting them to the general ledger, validating posted results to ensure data accuracy, or monitoring undelivered orders to determine their validity.

As a result of their interim and year-end testing of undelivered orders and accounts payable balances, the component auditors identified accounting errors and instances of noncompliance with accounting standards, OMB Circular No. A-11, and the United States Standard General Ledger, including: (1) UDOs that were misstated because accruals were calculated improperly, in duplicate, or not at all, (2) capital lease-related UDOs that were overstated because the amount related to the capital lease liability should have been classified as a budgetary accounts payable, (3) capital lease-related accounts payable that were overstated because "receivers" were posted in the accounting system, creating accounts payable that duplicated the capital lease liability that had already been recorded, and (4) UDOs and accounts payable that were incorrectly recorded because vendor accruals were calculated incorrectly.

EXHIBIT II

As a result of these accounting errors, ATF's undelivered orders and accounts payable balances were misstated at quarter-end, as follows**:**

Sample Population	Likely Misstatement
March 31, 2010	Undelivered Orders - $2.0 million net overstatement Accounts Payable - $550 thousand net overstatement
June 30, 2010	Undelivered Orders - $4.3 million net overstatement Accounts Payable - $7 thousand net overstatement
September 30, 2010	Undelivered Orders - $404 thousand understatement Accounts Payable - $2.6 million overstatement

Seized and Forfeited Property. The component auditors noted that the AFF's internal controls are in need of improvement with respect to the: (1) status and valuation of seized and forfeited assets, and (2) deletion of property records from the asset tracking system, as described below.

Internal Controls Related to Status and Valuation. In conducting interim and year-end tests of transactions recorded in the Consolidated Asset Tracking System (CATS), the component auditors identified various valuation and classification errors, including: (1) forfeited property items that were either misclassified or improperly valued, (2) seized property items that were either misclassified or improperly valued, and (3) FIRE assets that were improperly included in the seized asset footnote item count and dollar value disclosures (FIRE assets are assets that have been Frozen, Indicted, Restrained, or Encumbered as part of a federal investigation and are entered into CATS upon receipt of an indictment or temporary restraining order but have not yet been seized by the investigative agency).

As a result of the valuation and classification errors noted above, the seized and forfeited property balances were misstated as follows:

Sample Area		Likely Misstatement
June 30, 2010		
	Seized property (cash and monetary instruments)	$2.3 million net overstatement
	Seized property (non-cash)	$9.9 million net overstatement
August 31, 2010		
	Forfeited property	$6.8 million net overstatement
	Seized property (non-cash)	$7.9 million net overstatement
September 30, 2010		
	Seized property (non-cash)	$5.9 million net overstatement

Internal Controls Related to the Deletion of Records from CATS. In conducting tests related to the deletion of property records from CATS, the component auditors noted that 8 out of 80 records were not supported by evidence of authorization prior to their removal from CATS. If not properly authorized, such deletions could result in misstatements in the notes to the AFF's financial statements. In the cases at hand, there was no financial statement (footnote) effect because valid explanations were provided; however, these explanations were not supported by documentation authorizing the deletion of the records from CATS.

EXHIBIT II

Recommendations:

We recommend the Department:

1. Monitor the corrective actions taken by the USMS to improve the condition of its funds management controls, in response to the specific recommendations made in the component auditor's *Independent Auditors' Report on Internal Control over Financial Reporting* issued in connection with the audit of the USMS's financial statements as of and for the year ended September 30, 2010. *(Updated)*

Management Response:

DOJ management concurs. The Justice Management Division will continue to work with the USMS to document and improve processes related to external reporting to include continued evaluation of their business processes and financial activities associated with accounts payable and undelivered orders. In FY 2011, the USMS' Office of the Chief Financial Officer will continue to coordinate with relevant offices, external and internal, to ensure that advance reconciliations and analyses are performed at least quarterly and discrepancies resolved timely. The Audit Coordination and Remediation (ACR) team will continue to serve as an audit liaison, recommend and implement improvements in the funds management process, and advises the OCFO on remediation strategies. The USMS will continue its training efforts in FY 2011 to ensure staff and contractors understand their responsibilities for timely recording of obligations.

2. Assess the adequacy of the Department's accounting, internal control, and financial reporting policies in the areas of: (1) seized and forfeited property, and (2) undelivered orders/accounts payable. Based on the results of this assessment, determine the need to issue new guidance and/or reiterate to the AFF and ATF the existing policies for those areas in which the components' auditors identified significant deficiencies related to the recording of transactions and the preparation of financial statements in accordance with U.S. generally accepted accounting principles. Monitor the AFF's and ATF's adherence to the Department's accounting and financial reporting policies and procedures throughout the year. *(Updated)*

Management Response:

DOJ management concurs. AFF will continue to work closely with asset forfeiture components to strengthen data entry and period end closing procedures to ensure that property and accounting systems reflect accurate information. In addition, data quality control teams will be used to help validate and review the accuracy of the entries. ATF is establishing stronger oversight to validate and review accounts payable, obligation, and deobligation transactions. Specifically, ATF is enhancing financial management policies and procedures to address the above finding and reiterate all transaction review and documentation requirements.

3. Continue efforts to implement a Department-wide integrated financial management system that is in compliance with the United States Government Standard General Ledger, conforms to the financial management system requirements established by OMB Circular A-127, *Financial Management Systems*, and can accommodate the requirements of applicable federal accounting standards. *(Updated)*

Management Response:

DOJ management concurs. The UFMS initiative is a keystone to the Department's financial systems improvement planning for the future. UFMS is replacing the Department's multiple core financial management and procurement systems with an integrated Commercial-Off-The-Shelf (COTS) solution, Momentum, provided by CGI, Federal Inc. Implementation of the UFMS will improve financial management and procurement operations through streamlining and standardizing business processes and procedures across all components. As of September 2010, UFMS supported more than 2,000 users worldwide, including the DEA (fully implemented), BOP (UFMS Acquisitions), Marshals Service (UFMS Acquisitions), and Asset Forfeiture Program (pilot program). October 2010 the ATF went live on schedule and within budget with a full UFMS implementation. JMD and DOJ senior leadership meets on a regular basis to discuss and address the challenges and risks associated with the implementation of the UFMS across the Department (excluding FPI).

EXHIBIT III

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, *Audit Requirements for Federal Financial Statements*, as amended, we have reviewed the status of prior years' findings and recommendations. The following table provides our assessment of the progress DOJ has made in correcting the previously identified significant deficiencies. We also provide the Office of the Inspector General report number where the deficiency was reported, our recommendation for improvement, and the status of the recommendation as of the end of fiscal year 2010:

Report	Significant Deficiency	Recommendation	Status
Annual Financial Statement Fiscal Year 2007 Report No. 08-01	Improvements are needed in the components' internal controls to provide reasonable assurance that transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with generally accepted accounting principles	**Recommendation No. 5:** Continue efforts to implement a Department-wide integrated financial management system that is in compliance with the United States Government Standard General Ledger, conforms to the financial management systems requirements established by the Financial Systems Integration Office (formerly the Joint Financial Management Improvement Program), and can accommodate the requirements of applicable Federal accounting standards.	In Process (Updated by Fiscal Year 2010 Recommendation No. 3)
Annual Financial Statement Fiscal Year 2009 Report No. 10-05	Improvements are needed in the Department's component financial management systems' general and application controls	**Recommendation No. 1:** Require the components to submit and implement corrective action plans that address the weaknesses identified above. The corrective action plans should focus on correcting the deficiencies in access controls and configuration management discussed in the component auditors' *Independent Auditors' Reports on Internal Control over Financial Reporting*, to the extent that the significant deficiencies had not been remediated prior to the end of the fiscal year. The corrective action plans should also include a timeline that establishes when major events must be completed. The Department's CIO should monitor the components' efforts to correct deficiencies, hold them accountable for meeting the action plan timelines, and ensure the corrective actions are implemented adequately to address the noted deficiencies.	Completed*

EXHIBIT III

Report	Significant Deficiency	Recommendation	Status
Annual Financial Statement Fiscal Year 2009 Report No. 10-05	Improvements are needed in the components' internal controls to provide reasonable assurance that transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with generally accepted accounting principles	**Recommendation No. 2:** Monitor the corrective actions taken by the USMS to improve the condition of its funds management controls, in response to the specific recommendations made in the component auditor's *Independent Auditors' Report on Internal Control over Financial Reporting* issued in connection with the audit of the USMS's financial statements as of and for the year ended September 30, 2009.	In Process (Updated by Fiscal Year 2010 Recommendation No. 1)
		Recommendation No. 3: Assess the adequacy of the Department's accounting, internal control, and financial reporting policies in the areas of: (1) seized and forfeited property, (2) budgetary upward and downward adjustments, (3) deobligation of funds, (4) inventory controls, and (5) consideration of economic factors in the funding analysis journal entry process. Based on the results of this assessment, determine the need to issue new guidance and/or reiterate to components the existing policies for those areas in which the components' auditors identified significant deficiencies related to the recording of transactions and the preparation of financial statements in accordance with generally accepted accounting principles. Monitor the components' adherence to the Department's accounting and financial reporting policies and procedures throughout the year.	In Process (Updated by Fiscal Year 2010 Recommendation No. 2)

**Sufficient progress has been made in addressing this finding and the related recommendation such that the remaining risk of misstatement is inconsequential. Therefore, the condition has been downgraded to a control deficiency.*