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INDEPENDENT AUDITORS' REPORT ON FINANCIAL STATEMENTS

Inspector General
United States Department of Justice

Director
United States Marshals Service
United States Department of Justice

We have audited the accompanying Consolidated Balance Sheets of the United States Marshals Service (USMS), a component of the United States Department of Justice (DOJ), as of September 30, 2010, and 2009, and the related Consolidated Statements of Net Cost, Consolidated Statements of Changes in Net Position, and Combined Statements of Budgetary Resources for the years then ended. These financial statements are the responsibility of the USMS's management. Our responsibility is to express an opinion on these 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,* as amended by OMB Memorandum M-09-33. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the 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 USMS's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used, and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of the USMS as of September 30, 2010, and 2009; and its consolidated net costs, consolidated changes in net position, and combined budgetary resources for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The information in the *Management's Discussion and Analysis* and *Required Supplementary Information* sections is not a required part of the basic consolidated financial statements, but is supplementary information required by U.S. generally accepted accounting principles, or by 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 November 3, 2010, on our consideration of the USMS's internal control over financial reporting and on our tests of compliance with certain provisions of applicable laws and regulations. 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.

COTTON & COMPANY LLP

Catherine L Nocera

Catherine L. Nocera, CPA, CISA
Partner

November 3, 2010
Alexandria, Virginia

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Inspector General
United States Department of Justice

Director
United States Marshals Service
United States Department of Justice

We have audited the Consolidated Balance Sheets of the United States Marshals Service (USMS), a component of the United States Department of Justice (DOJ), as of September 30, 2010, and 2009, and the related Consolidated Statements of Net Cost, Consolidated Statements of Changes in Net Position, and Combined Statements of Budgetary Resources for the years then ended, and issued our report thereon dated November 3, 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 by OMB Memorandum M-09-33.

In planning and performing our audits, we considered the USMS's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the USMS's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the USMS's internal control over financial reporting or on management's assertion on internal control included in *Management's Discussion and Analysis*. We limited our internal control testing to only 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*, such as controls relevant to ensuring efficient operations.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. Therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that, when combined, we consider to be a material weakness.

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 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. We consider the following deficiency in the USMS's internal control over financial reporting to be a material weakness.

The USMS's response to the finding identified in our audit is included after each recommendation. We did not audit the USMS's response and, accordingly, we express no opinion on it.

FUNDS MANAGEMENT CONTROLS NEED IMPROVEMENT (MATERIAL WEAKNESS) (REPEAT)

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 that related undelivered orders and accounts payable balances are accurate and complete. During fiscal year 2009, USMS management implemented procedures to perform quarterly reviews and certifications of headquarters and district office undelivered orders and accounts payable balances. The certification process is still evolving; it was refined throughout fiscal year 2010. During fiscal year 2010, the USMS created the Audit Coordination and Remediation (ACR) team, which serves as the audit liaison, recommends and implements funds management process improvements, and advises the Financial Services Division on remediation strategies. The ACR team developed a Corrective Action Plan (CAP) to address the previously reported material weakness related to undelivered orders and accounts payable. The control procedures outlined in the CAP appear to be well designed and should address the control weaknesses identified during this and prior audits. However, elements of the CAP were implemented throughout fiscal year 2010, and it was not yet fully effective to reduce the sample error rates to an insignificant level.

During interim and year-end testing, we identified the following accounting errors and instances of non-compliance with accounting standards, OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*, the United States Standard General Ledger (USSGL), and other accounting guidance.

A. UNDELIVERED ORDERS

We selected and reviewed four sample populations of undelivered order transactions during interim and year-end testing. We noted significant accounting errors and instances of noncompliance, which resulted in the following known and likely misstatements.

UNDELIVERED ORDERS FISCAL YEAR 2010 TEST RESULTS			
Sample Population	**Number of Errors/ Transactions Tested**	**Known Errors**	**Likely Misstatement[1]**
Headquarters (March 31, 2010)	37/152	$5.8 million net overstatement	$17.9 million net overstatement
District Offices (March 31, 2010)	16/45	$650 thousand net overstatement	$2.6 million net overstatement
Headquarters (June 30, 2010)	25/148	$3.4 million net overstatement	$861 thousand net understatement
Headquarters and District Offices (September 30, 2010)	17/101	$2.9 million net overstatement	$18.7 million net overstatement

[1] Each transaction tested has a unique weight in relation to the total population; therefore, the likely misstatement will not be in linear proportion to the known errors. In addition, a known net understatement may project to a likely net overstatement.

The accounting errors and instances of non-compliance are discussed below.

Headquarters (March 31, 2010)

- Fourteen undelivered order transactions were overstated by $4.2 million because the USMS did not record an accrual for goods and services received as of March 31, 2010.

- Nine undelivered order transactions were overstated by a net $489 thousand because of errors in calculating accounts payable accruals.

- Five undelivered order transactions were understated by a net $141 thousand because approved modification increases or deobligations were not recorded in STARS as of March 31, 2010 and one modification increase was recorded in STARS although it was not approved or valid.

- Seven instances in which the period of performance had expired or the contract was completed prior to the beginning of fiscal year 2010, and remaining undelivered order amounts had not been deobligated. This resulted in a $734 thousand overstatement.

- Two undelivered order transactions were overstated by a net $505 thousand because amounts recorded in STARS did not agree to the underlying source documents. For one transaction, the USMS could not provide supporting documents for the entire amount obligated in STARS, and for the other item, the supporting documentation for the amount paid was less than the amount recorded in STARS.

District Offices (March 31, 2010)

- Nine undelivered order transactions were overstated by a total $606 thousand because the USMS did not record an accrual for goods and services received as of March 31, 2010. Accruals were not posted in some instances, because of limitations with the current purchase card accrual process. The USMS records purchase card accruals based on payment information provided by the bank issuing the purchase cards, which does not capture instances in which the USMS has received goods or services but payment has not been initiated by the vendor providing the goods or services.

- Two undelivered order transactions were overstated by $25 thousand because the same obligation was recorded twice for one item and the obligated amount exceeded the source documents for the other item.

- Two undelivered order transactions were understated by $4 thousand because the full contract value had not been obligated even though the clause referencing "availability of funds" had been removed from the contract. In addition, an accrual for March services was not recorded for one of these transactions.

- One undelivered order transaction was understated because a payment was posted against it in error. The payment should have been posted to the same document number but a different budget fiscal year. The undelivered order balance was not misstated, in total, because of this error.

- Two undelivered order transactions were overstated by $22 thousand. The accounting entries could not be tied to the underlying source documentation.

Headquarters (June 30, 2010)

- Nine undelivered order transactions were overstated by $2.2 million because the USMS did not record an accrual for goods and services received as of June 30, 2010.

- Three undelivered order transactions were overstated by a net $22 thousand because of errors in calculating accounts payable accruals.

- Five undelivered order transactions were overstated by a net $141 thousand because the obligation was not recorded correctly. For one item, the USMS recorded an obligation for the entire revised contract amount rather than only the increase. For another item, the USMS obligated amounts in excess of the original plus modifications. For three items, the entire contract amount had not been obligated in STARS.

- Five undelivered order transactions were overstated by $944 thousand because the period of performance had expired or the contract was completed prior to the beginning of fiscal year 2010, and remaining undelivered order amounts had not been deobligated.

- Three undelivered order transactions were overstated by a net $59 thousand because amounts recorded in STARS did not agree to the underlying source documents. For one transaction, the USMS stated that the transaction was recorded during the STARS conversion process and should be deobligated. For another item, the supporting documentation for obligated amounts and amounts paid did not agree to STARS. For the third transaction, the USMS did not process a refund in STARS.

Headquarters and District Offices (September 30, 2010)

- Seven undelivered order transactions were overstated by $2.9 million because the USMS did not record an accrual for goods and services received as of September 30, 2010. For two transactions, the accrual was not recorded because of the limitation with the USMS's current purchase card accrual process, discussed previously.

- Four undelivered order transactions were overstated by $40 thousand because the obligation was not recorded correctly. For three items, the USMS recorded the obligation based on the requisition amount rather than the purchase order amount. For another item, the recorded obligation was not supported by a valid obligating document.

- Two undelivered order transactions were understated by $361 thousand; the USMS could not provide supporting documentation for the recorded accruals.

- Two undelivered order transactions were overstated by $344 thousand; the period of performance had expired at September 30, 2009 for one item, and the other item was for a canceled construction project. Remaining undelivered order amounts had not been deobligated.

- Two undelivered order transactions were understated by $49 thousand because an error was made when calculating the accrual for one item and an accrual for August services was not reversed after the invoice was paid for the second item.

B. Delivered Orders – Obligations Unpaid (Accounts Payable)

We selected and reviewed four sample populations of accounts payable transactions during interim and year-end testing. We noted significant accounting errors and instances of noncompliance, which resulted in the following known and likely misstatements.

Delivered Orders – Obligations Unpaid
Fiscal Year 2010 Test Results

Sample Population	Number of Errors/Transactions Tested	Known Errors	Likely Misstatement[2]
Headquarters (March 31, 2010)	1/32	$1 million overstatement	$704 thousand overstatement
District Offices (March 31, 2010)	10/57	$12 thousand net overstatement	$9.2 million net overstatement
Headquarters (June 30, 2010)	4/43	$1.1 million net understatement	$6.3 million net understatement
Headquarters and District Offices (September 30, 2010)	18/61	$1.7 million net understatement	$15.8 million net understatement

[2] Each transaction tested has a unique weight in relation to the total population; therefore, the likely misstatement will not be in linear proportion to the known errors. In addition, a known net overstatement may project to a likely net understatement or a known net understatement may project to a likely net overstatement.

The accounting errors and instances of non-compliance are discussed below.

Headquarters (March 31, 2010)

- One accounts payable transaction in which the accrual was overstated by approximately $1 million because the methodology used to calculate the unidentified IPAC accrual did not take into consideration provider-listing accruals that were already posted.

District Offices (March 31, 2010)

- One accounts payable transaction in which the accounts payable was overstated by $14 thousand because the district office accrued the remaining undelivered order balance without regard to the estimated cost of goods or services provided but not paid for.

- Nine accounts payable transactions at one district office in which documentation to support recorded accounts payable balances was not adequate, resulting in understated accounts payable totaling a net $2 thousand. In some instances, explanations for accounts payable accrual estimates could not be provided, and in other instances the USM-268a, *Jail Utilization Report*, or other supporting source documentation was not retained.

Headquarters (June 30, 2010)

- Three accounts payable transactions in which the USMS did not accrue for goods or services received but not yet paid, causing the accounts payable balance to be understated by approximately $1.2 million. For one transaction, the accrual was not recorded because of the limitation with the USMS's current purchase card accrual process, discussed previously.

- One accounts payable transaction in which the accrual was overstated by $74 thousand because the USMS accrued the remaining undelivered order balance rather than calculating the accrual based on its established accrual methodology.

Headquarters and District Offices (September 30, 2010)

- Five accounts payable transactions were understated by $1.5 million because the USMS did not record an accrual for goods and services received as of September 30, 2010. Three items related to court security officer accruals, one related to prisoner housing costs, and one related to information technology support services.

- Five accounts payable transactions were overstated by a net $58 thousand because the USMS erred in calculating its accounts payable accruals. The USMS did not use the USM-268a report, or did not use the correct USM-268a report for two items; erred in applying its accrual methodology for one item; did not reduce its accounts payable accrual by the amount that exceeded the actual July disbursement; and accrued for September services twice.

- Eight accounts payable transactions were not adequately supported by source documentation. Seven items related to prisoner housing accruals, including three items that were accrued based on amounts provided to the district offices by the Office of Budget. The Office of Budget amounts were not supported, but appeared to be calculated based on remaining undelivered order balances for prisoner housing obligations rather than an analysis of services received but not paid for as of year-end. In addition, one item related to court security officer accruals. We used the best information available at the time of our audit to determine an appropriate accounts payable estimate for these transactions; we calculated a net understatement of $289 thousand.

C. Prisoner Medical Obligations and Accounts Payable

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

D. Unauthorized Commitments

The USMS made unauthorized commitments during fiscal year 2010, resulting in 16 contract ratifications authorizing payments totaling about $2.3 million. Unauthorized commitments were made for services including security system monitoring, court security officers, guard services, and prisoner medical services and prescriptions. We reviewed two sample ratifications. For both items, we noted that incumbent contractors provided services beyond the contract performance periods when new contract awards were delayed.

In addition, 24 ratification actions totaling approximately $2.2 million were in process pending receipt of additional information from the program offices. Eleven of these 24 ratification actions had been identified as possible ratifications prior to June 30, 2010. No resolution had been achieved as of year-end. Unauthorized commitments could result in Anti-Deficiency Act violations or other funds management concerns if funds are not sufficient to cover the unauthorized commitments.

Statement of Federal Financial Accounting Standards No. 5, *Accounting for Liabilities of the Federal Government*, paragraphs 22 and 23, state that a liability and the corresponding expense should be recognized during the period when an exchange transaction takes place.

Title 31 U.S.C. §1501(a) states:

> *An amount shall be recorded as an obligation of the United States Government only when supported by documentary evidence of: (1) a binding agreement . . .; (2) a loan agreement . . .; (3) an order required by law to be placed with an agency; (4) an order issued under a law authorizing purchases without advertising . . .; (5) a grant or subsidy payable . . .; (6) a liability that may result from pending litigation; (7) employment or services of persons or expenses of travel under law; (8) services provided by public utilities; or (9) other legal liability of the Government against an available appropriation or fund.*

OMB Circular A-11, *Preparation, Submission, and Execution of the Budget*, states that an obligation is a legally binding agreement that will result in outlays that will occur either immediately or in the future. An obligation is incurred when an order is placed or a contract is signed that requires the Government to make payments to the public or to another Government agency.

The USSGL defines an undelivered order as "the amount of goods and/or services ordered which have not been actually or constructively received."

USMS Directive 5.1, Accounting for Commitments and Obligations, states "no amount shall be recorded as an obligation unless supported by documentary evidence of transactions authorized by law." It also states that "program managers are responsible for the accurate and timely accounting of their workplans' commitments and obligations," and requires program managers to "ensure that a monthly review of their workplan obligation(s) is performed."

OMB Circular A-123, *Management's Responsibility for Internal Control*. Section IIA, Control Environment, states:

> *…management must clearly… uphold the need for personnel to possess and maintain the proper knowledge and skills to perform their assigned duties as well as understand the importance of maintaining effective internal control within the organization.*

OMB Circular A-123, Appendix A, Section IIA*, Objectives of Internal Control over Financial Reporting*, states:

> *Reliability of financial reporting means that management can reasonably make the following assertions: … Documentation for internal control, all transactions, and other significant events is readily available for examination.*

The Federal Acquisition Regulation (FAR), Subpart 1.6, Section 1.601 (a) states: "contracts may be entered into and signed on behalf of the Government only by contracting officers." Additionally, Subpart 1.6, Section 1.602-1 (b) states: "no contract shall be entered into unless the contracting officer ensures that all requirements of law, executive orders, regulations, and all other applicable procedures... have been met."

RECOMMENDATIONS

We recommend the USMS:

1. Enhance the ACR team's efforts to ensure that accruals for goods and services provided but not paid for are properly calculated, recorded timely, and adequately supported, and that undelivered orders are valid. Efforts should include:

- Development and documentation of accrual policies and procedures, including methodologies for specific types of accrual transactions;
- Development and documentation of policies and procedures for conducting periodic reviews of undelivered orders and accounts payable balances and process controls;
- Review, assessment, and recommendations for improving the control environment and control activities;
- Continued training of headquarters and district office personnel;
- Continued emphasis on periodic testing of undelivered orders and accounts payable transactions to identify and correct misstatements; and
- Documentation of control and substantive test results, including completed checklists; evidence of supervisory review and approval for corrective actions; evidence that corrective action was taken; and performance metrics (such as transaction population, sample size, error rate, and corrective actions), so that progress can be measured and resources can be shifted and prioritized accordingly. *(Updated)*

Management Response:

USMS management concurs with this recommendation. In an effort to address current and prior year audit findings and recommendations and strengthen the Agency's overall management of undelivered orders, the USMS's financial management has implemented a number of activities in the second half of FY 2010 and plans to continue these activities in FY 2011.

The USMS has increased the support and visibility of the Audit Coordination and Remediation (ACR) team. The ACR team currently serves as an audit liaison, recommends and implements improvements in the funds management process, and advises the Office of the Chief Financial Officer (OCFO) on remediation strategies. In order to maximize the impact of ACR activities, the team has primarily focused on six material USMS divisions comprised of eight-five percent of the USMS headquarters' budget as of March 31, 2010 - Financial Services Division (FSD), Investigative Operations Division (IOD), Information Technology Division (ITD), Judicial Security Division (JSD), Management Support Division (MSD), and Justice Prisoner and Alien Transportation System (JPATS). Within each of the six aforementioned divisions, the ACR team has documented the procure-to-pay process and the internal control environment. ACR will perform testing on the controls' operating effectiveness, provide recommendations on control improvements, and help to implement business process and control improvements. ACR will address additional divisions and district offices during FY 2011.

The ACR team developed and delivered one-on-one specialized accruals and undelivered orders training to applicable staff within the six program offices (as referenced earlier) on the estimation and recording of accruals and the process of verifying and validating undelivered orders. In addition, USMS will standardize accrual procedures to incorporate appropriate review, approval controls, and estimation needed to prevent and detect inaccurate accrual transactions.

In addition to accrual improvements, the ACR team has developed a Corrective Action Plan (CAP) for the Undelivered Order (UDO) review process. This CAP addresses audit findings on UDOs and has the following key components that the ACR team will execute:

- add guidance on roles and responsibilities for UDO review to USMS Directive 5.1, paragraph c.3 *Monitoring Obligations*;
- update UDO review checklist and monitor results of reviews;
- deliver training on verification and validation of UDOs;
- standardize the UDO review process to incorporate consistent review and approval processes and correct accrual methodologies;
- test whether key controls are working as intended;
- develop a reporting template and tracking tool used to report consistently on results of UDO review; and
- perform periodic tests and evaluations of controls.

This CAP was initiated in 2010 for the six HQ divisions referenced previously. In FY 2011, the CAP will be expanded to encompass additional headquarters divisions and offices, as well as district offices.

USMS management also conducted the UDO Quarterly Review process in September 2010 for 12 headquarters divisions, which included six divisions in addition to those mentioned previously. Experienced USMS staff were trained and supported by ACR staff to conduct a thorough review of their open obligations portfolio. This process will be completed on a quarterly basis in FY 2011 until the existing monthly open obligation review is comparably strengthened.

2. Enhance supervisory review and approval controls, including review of source documentation, calculations, and posting logic for accounts payable, obligations, and deobligation transactions. *(Updated)*

Management Response:

USMS management concurs with this recommendation. The USMS has escalated the open obligation review process to be directly under the purview of the Assistant Directors. On a quarterly basis, financial performance scorecards are completed to monitor and track the progress of the open obligations reporting compliance for all headquarters staff offices and divisions.

USMS management also initiated the UDO Quarterly Review process in June 2010 for the six divisions referenced in management response #1. The USMS extended and enhanced this process through repetition and refinement in quarter 4 and in FY 2011. Experienced USMS staff were trained and supported by ACR staff to conduct a thorough review of their open obligations portfolio. Division staff utilized standardized checklists (e.g., examined period of performance to determine expiration) and other guidance to determine whether an individual UDO was valid and verified amounts were properly recorded. USMS management recognized the further need to formalize development and retention of documentation. Specifically, USMS management recognized the requirement to understand which obligations were examined, which ones required adjustments, and exactly what adjustments were made in order to produce an acceptable audit trail and institutionalize the process as a quarterly detective control. This process will be completed on a quarterly basis until the existing monthly open obligation review is comparably strengthened.

3. Enhance procedures to ensure that obligations are recorded timely after the period of continuing resolution ends, and develop procedures to ensure that appropriate "availability of funds" clauses are included in all agreements that are not fully obligated. *(Updated)*

Management Response:

USMS management concurs with this recommendation. The USMS will continue its training efforts in FY 2011 to ensure staff and contractors understand their responsibilities for timely recording of obligations after a continuing resolution has ended or appropriated funds have been allocated to their workplan. The Financial Services Division will work closely with program offices to ensure that contracts are properly recorded in the financial system, per OMB Circular A-11, and clearly articulate the funds that are available. The Offices of Finance and Budget will work closely with program offices to ensure that all reimbursable agreements are prepared properly to reflect the availability of funds are fully obligated in STARS on a timely basis.

4. Develop procedures to ensure that purchase card accruals are recorded for all goods and services received, regardless of whether the vendor has processed the payment for the goods or services. *(New)*

Management Response:

USMS management concurs with this recommendation. In addition to assessing the control environment around accrued expenses, the ACR team developed a comprehensive CAP for the accrual process. Execution of that CAP began with the development and delivery of an accrual training/working session with each of the six material headquarters divisions during FY 2010. This comprehensive training addressed all aspects of the accrual process, including: what constitutes proper funds control management, the monthly open obligations review, correct reporting of received goods and services, Federal Laws and USMS policy, entry of receiving information in the financial system, and accrual estimation methodologies for various categories of goods and services. The intent of the training is to provide a consistently applied methodology to record accruals and to reinforce that proper oversight and management approvals are essential to prevent errors such as posting of duplicate accruals. In FY 2011, this training will be expanded to encompass remaining headquarters divisions and districts.

5. Review financial management and accounting processes in place at district offices to identify process, knowledge and training gaps affecting the execution of and adherence to the USMS directives and policies; implement corrective action to address the identified gaps; and develop and implement procedures for maintaining source documentation that can be easily retrieved for review and audit purposes. *(New)*

Management Response:

USMS management concurs with this recommendation. The Associate Director for Administration issued a memorandum entitled Fiscal Year 2010 District and Headquarters Closeout Instructions on July 2, 2010, which addressed the review and reconciliation of UDOs to source documents, as well as processing and reconciling receiving reports against accounts payable. This instruction was distributed to all Chief Deputy US Marshals, Assistant Directors, Staff Offices, and Administrative Officers (AOs) throughout the USMS, including all district offices.

Starting in FY 2011, the ACR team will distribute UDO and accrual training materials to district offices. The training will be reinforced through web-enabled technology to address the importance of maintaining adequate supporting documentation for obligation and accounts payable amounts recorded in the general ledger. District training will also stress the importance of retaining supporting documentation for audit review and testing. The ACR team will examine selected district office financial management policies and procedures and perform UDO and Accounts Payable testing in fiscal year 2011 to help verify that transactions are well supported, and maintained by the district offices' leadership. The ACR team will then update the CAP based on gaps noted in this testing.

In addition, the OCFO and ACR team implemented a standardized checklist to be utilized during Quarterly UDO reviews that includes a documentation attribute to provide evidence that transactions were accurately initiated, processed, and recorded; and that adequate trails of supporting documentation exist for transactions. The scope of the quarterly open obligation review will be expanded to include the district offices at the beginning of fiscal year 2011.

6. Fully implement procedures developed during fiscal year 2010 to ensure district office personnel utilize a consistent and reasonable methodology for recording prisoner medical obligations and accruals. *(Updated)*

Management Response:

USMS management concurs with this recommendation. USMS policies and procedures provide clear guidelines on the medical treatment of prisoners. In cases of emergency care and life-threatening situations, USMS follows all policies necessary to ensure that the prisoners are treated in a timely manner. Historically, exceptions to policy occurred during times of emergency care when prisoners required immediate medical attention.

As of July 1, 2010, USMS began employing the services of an independent vendor to oversee the complete prisoner medical process. The new vendor will standardize management of all costs associated with the treatment of prisoners. Through this vendor and through new policy the USMS will continue strengthening controls around the prisoner medical process. USMS plans to continue implementation of the new process throughout all district offices in FY 2011.

7. Coordinate efforts among the Office of Procurement, the Office of Budget, and the program offices to identify all unauthorized commitments and ensure that ratifications are completed in a timely manner. In addition, we recommend that the USMS provide Federal Acquisition Regulation training to appropriate personnel to minimize instances of unauthorized commitments in the future. *(Repeat)*

Management Response:

USMS management concurs with this recommendation. Chief Deputy and Financial Management Training held in March, April, May, July, and August 2010 included a discussion of unauthorized commitments resulting in ratification. In response to FY 2009 audit findings, individuals involved in unauthorized commitments have been notified that all violations will be reported to the Office of Internal Investigations and Employee Relations Division, and may result in personal financial consequences and/or disciplinary action, up to and including removal. In addition, the Office of Procurement is updating USMS Directive 6.1 to include a "Ratification Guide" which provides examples of situations that could lead to unauthorized commitments. Managers whose employees are involved in unauthorized commitments will be asked to provide a corrective action plan; i.e., training or other preventive measures to avoid future violations. Pursuant to DOJ Procurement Guidance Document 10-08, when a Contracting Officer becomes aware of an unauthorized commitment, a descriptive memorandum satisfying FAR 1.602-3(c) with supportive materials will be submitted to an individual with ratification authority within 30 days of such discovery. The ratification official will review the unauthorized commitment and approve or disapprove of the ratification within 60 days.

Copies of all ratifications will be submitted to the Department's Procurement Executive within 30 days of ratification.

* * * *

We provide the current status of open recommendations from prior years in the following Exhibit.

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

COTTON & COMPANY LLP

Catherine L. Nocera, CPA, CISA
Partner

November 3, 2010
Alexandria, Virginia

EXHIBIT

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 by OMB Memorandum M-09-33, we have reviewed the status of prior years' findings and recommendations. The following table provides our assessment of the progress the USMS 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. 08-15	Improvements Needed to Strengthen Information System Controls	**Recommendation No. 9:** Continue with planned efforts to upgrade servers that will allow the USMS to enable auditing at the Informix database level for the FMS.	Completed
Annual Financial Statement Fiscal Year 2008 Report No. 09-13	Funds Management Controls Need Improvement	**Recommendation No. 4:** Coordinate efforts among the Office of Procurement, the Office of Budget, and the program offices to identify all unauthorized commitments and ensure that ratifications are completed in a timely manner. In addition, we recommend that the USMS provide Federal Acquisition Regulation training to appropriate personnel to minimize instances of unauthorized commitments in the future.	In Process (Fiscal Year 2010 Recommendation No. 7)
	Improvements Needed to Strengthen Information System Controls	**Recommendation No. 11:** Fully implement procedures for monitoring the FMS and STARS system and application activities to ensure that reviews are documented; potential issues are identified and investigated; and, if needed, issues are reported to management.	Completed
		Recommendation No. 12: Develop and implement policies and procedures, including roles and responsibilities for the process of monitoring JCON logs; define security events that require monitoring and provide guidance on how these events will be monitored; and document investigations of events which require management follow-up.	Completed

Report	Significant Deficiency	Recommendation	Status
Annual Financial Statement Fiscal Year 2008 Report No. 09-13	Improvements Needed to Strengthen Information System Controls	**Recommendation No. 13:** Ensure individuals responsible for account reviews adhere to the USMS mandated policies and procedures for reviewing accounts and perform more frequent and thorough reviews of inactive administrator and user accounts.	Completed
Annual Financial Statement Fiscal Year 2009 Report No. 10-09	Funds Management Controls Need Improvement	**Recommendation No. 1:** Enhance supervisory review and approval controls, including review of source documentation, calculations, and posting logic for accounts payable, obligations, and deobligation transactions, and ensure that adequate resources are available to properly segregate the supervisory review and approval of, and posting of transactions in STARS.	In Process (Updated by Fiscal Year 2010 Recommendation No. 2)
		Recommendation No. 2: Develop procedures to ensure that obligations are recorded timely after the period of continuing resolution ends, and that obligations for reimbursable agreements with other entities and other contractual documents are fully recorded in STARS on a timely basis.	In Process (Updated by Fiscal Year 2010 Recommendation No. 3)
		Recommendation No. 3: Develop procedures to ensure that accruals for goods and services provided but not paid for are recorded at least quarterly, and that disbursements that are unidentified and recorded in the suspense fund are reclassified and recorded as expenditures at least quarterly.	In Process (Updated by Fiscal Year 2010 Recommendation No. 1)
		Recommendation No. 4: Develop procedures to ensure district office personnel utilize a consistent and reasonable methodology for recording prisoner medical obligations and accruals.	In Process (Updated by Fiscal Year 2010 Recommendation No. 6)
		Recommendation No. 5: Continue to provide training to headquarters' and district offices' finance, budget, and program personnel on the quarterly open obligation review and certification process. This training should include emphasis on assessing the status of each open obligation. In addition, we recommend that the USMS management consider enhancing its certification process with analytical procedures, such as reviews of specific significant obligations (for example GSA rent or aircraft leases), aged undelivered orders in prior budget fiscal years, and obligations with expired periods of performance.	In Process (Updated by Fiscal Year 2010 Recommendation No. 1)

Report	Significant Deficiency	Recommendation	Status
Annual Financial Statement Fiscal Year 2009 Report No. 10-09	Improvements Needed to Strengthen Information System Controls	**Recommendation No. 7:** Implement policies and procedures that require IT resources to be configured on a timely basis to mitigate vulnerabilities that may be present to both external and internal facing interfaces. Additionally, we recommend that the USMS incorporate a formal review process, which includes management's acceptance of risk associated with vulnerabilities identified in the vulnerability scanning program.	Completed

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND OTHER MATTERS

Inspector General
United States Department of Justice

Director
United States Marshals Service
United States Department of Justice

We have audited the Consolidated Balance Sheets of the United States Marshals Service (USMS), a component of the United States Department of Justice (DOJ), as of September 30, 2010, and 2009, and the related Consolidated Statements of Net Cost, Consolidated Statements of Changes in Net Position, and Combined Statements of Budgetary Resources for the years then ended, and have issued our report thereon, dated November 3, 2010. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; 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 by OMB Memorandum M-09-33.

The USMS's management is responsible for complying with laws, regulations, and contract agreements applicable to the USMS. As part of obtaining reasonable assurance about whether the USMS's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contract agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). 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 disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 07-04, as described in the following paragraphs.

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT (FFMIA) (REPEAT)

Under FFMIA, we are required to report whether the USMS's financial management systems substantially comply with federal financial management system requirements, applicable federal accounting standards, and application of the United States 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 disclosed instances in which the USMS financial management systems did not substantially comply with the first and second requirements discussed in the preceding paragraph.

- **Federal Financial Management System Requirements:** The USMS's financial management system, Standardized Tracking, Accounting, and Reporting System (STARS), does not meet federal financial management systems requirements established in OMB Circular No. A-127, *Financial Management Systems*, because STARS lacks integrated subsidiary records to support certain material account balances.

Accordingly, the USMS must rely on manually-prepared subsidiary ledgers and ad-hoc business processes to generate financial reports.

- **Federal Accounting Standards:** We identified significant departures from federal accounting standards promulgated by the Federal Accounting Standards Advisory Board in the areas of undelivered orders and accounts payable, as discussed in our Independent Auditors' Report on Internal Control over Financial Reporting.

The USMS's Chief Financial Officer is responsible for the financial management systems and the Chief Information Officer is responsible for information technology. We make no recommendation corresponding with the first criterion (Federal Financial Management System Requirements) because the USMS has stated that it will be migrating to a DOJ Unified Financial Management System, and costs to correct the FFMIA deficiencies in the current accounting system are not justified. Please refer to our Independent Auditors' Report on Internal Control over Financial Reporting for recommendations related to the second criterion (Federal Accounting Standards).

Management Response:

USMS Management concurs. Please refer to the management responses in the Independent Auditors' Report on Internal Control over Financial Reporting.

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

COTTON & COMPANY LLP

Catherine L. Nocera

Catherine L. Nocera, CPA, CISA
Partner

November 3, 2010
Alexandria, Virginia

U.S. DEPARTMENT OF JUSTICE

UNITED STATES MARSHALS SERVICE

PRINCIPAL FINANCIAL STATEMENTS AND RELATED NOTES

See Independent Auditors' Report on Financial Statements

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U.S. Department of Justice
United States Marshals Service
Consolidated Balance Sheets
As of September 30, 2010 and 2009

Dollars in Thousands		2010		2009
ASSETS (Note 2)				
Intragovernmental				
Fund Balance with U.S. Treasury (Note 3)	$	684,686	$	497,604
Accounts Receivable (Note 4)		149,713		188,213
Other Assets (Note 7)		17,212		3,025
Total Intragovernmental		851,611		688,842
Accounts Receivable (Note 4)		47		146
Inventory and Related Property (Note 5)		2,739		2,150
General Property, Plant and Equipment, Net (Note 6)		257,937		254,273
Advances and Prepayments		17		68
Other Assets (Note 7)		184		184
Total Assets	**$**	**1,112,535**	**$**	**945,663**
LIABILITIES (Note 8)				
Intragovernmental				
Accounts Payable	$	26,177	$	35,165
Accrued Federal Employees' Compensation Act Liabilities		15,725		15,222
Other Liabilities (Note 10)		24,344		20,878
Total Intragovernmental		66,246		71,265
Accounts Payable		406,268		353,922
Actuarial Federal Employees' Compensation Act Liabilities		83,490		81,314
Accrued Payroll and Benefits		30,525		24,728
Accrued Annual and Compensatory Leave Liabilities		42,138		38,931
Contingent Liabilities (Note 11)		17,000		18,250
Capital Lease Liabilities (Note 9)		946		1,831
Total Liabilities	**$**	**646,613**	**$**	**590,241**
NET POSITION				
Unexpended Appropriations	$	328,900	$	222,502
Cumulative Results of Operations		137,022		132,920
Total Net Position	**$**	**465,922**	**$**	**355,422**
Total Liabilities and Net Position	**$**	**1,112,535**	**$**	**945,663**

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

U.S. Department of Justice
United States Marshals Service
Consolidated Statements of Net Cost
For the Fiscal Years Ended September 30, 2010 and 2009

Dollars in Thousands

		Gross Costs			Less: Earned Revenues			Net Cost of
	FY	**Intra-governmental**	**With the Public**	**Total**	**Intra-governmental**	**With the Public**	**Total**	**Operations (Note 12)**
Goal 1:	**2010**	$ 5,159	$ -	$ 5,159	$ -	$ -	$ -	$ 5,159
	2009	$ 5,138	$ -	$ 5,138	$ -	$ -	$ -	$ 5,138
Goal 2:	**2010**	4,872	-	4,872	-	-	-	4,872
	2009	4,129	-	4,129	-	-	-	4,129
Goal 3:	**2010**	523,823	2,492,351	3,016,174	1,511,198	2,905	1,514,103	1,502,071
	2009	467,739	2,324,956	2,792,695	1,468,876	2,589	1,471,465	1,321,230
Total	**2010**	**$ 533,854**	**$ 2,492,351**	**$ 3,026,205**	**$ 1,511,198**	**$ 2,905**	**$ 1,514,103**	**$ 1,512,102**
	2009	**$ 477,006**	**$ 2,324,956**	**$ 2,801,962**	**$ 1,468,876**	**$ 2,589**	**$ 1,471,465**	**$ 1,330,497**

Goal 1 Prevent Terrorism and Promote the Nation's Security

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

Goal 3 Ensure the Fair and Efficient Administration of Justice

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

Consolidated Statements of Changes in Net Position
For the Fiscal Years Ended September 30, 2010 and 2009

Dollars in Thousands	2010	2009
Unexpended Appropriations		
Beginning Balances	**$ 222,502**	**$ 191,625**
Budgetary Financing Sources		
Appropriations Received	1,190,039	964,000
Appropriations Transferred-In/Out	393,936	354,616
Appropriations Used	(1,477,577)	(1,287,739)
Total Budgetary Financing Sources	**106,398**	**30,877**
Unexpended Appropriations	**$ 328,900**	**$ 222,502**
Cumulative Results of Operations		
Beginning Balances	**$ 132,920**	**$ 143,048**
Budgetary Financing Sources		
Appropriations Used	1,477,577	1,287,739
Other Financing Sources		
Transfers-In/Out Without Reimbursement	186	335
Imputed Financing from Costs Absorbed by Others (Note 13)	38,441	32,295
Total Financing Sources	**1,516,204**	**1,320,369**
Net Cost of Operations	**(1,512,102)**	**(1,330,497)**
Net Change	4,102	(10,128)
Cumulative Results of Operations	**$ 137,022**	**$ 132,920**
Net Position	**$ 465,922**	**$ 355,422**

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

U.S. Department of Justice
United States Marshals Service
Combined Statements of Budgetary Resources
For the Fiscal Years Ended September 30, 2010 and 2009

Dollars in Thousands		2010		2009
Budgetary Resources				
Unobligated Balance, Brought Forward, October 1	$	75,661	$	93,320
Recoveries of Prior Year Unpaid Obligations		66,898		61,319
Budget Authority				
Appropriations Received		1,190,039		964,000
Spending Authority from Offsetting Collections				
Earned				
Collected		1,592,758		1,482,381
Change in Receivables from Federal Sources		(39,937)		22,610
Change in Unfilled Customer Orders				
Advance Received		4,475		1,078
Without Advance from Federal Sources		(18,314)		9,393
Subtotal Budget Authority		2,729,021		2,479,462
Nonexpenditure Transfers, Net, Anticipated and Actual		393,936		354,616
Total Budgetary Resources (Note 14)	**$**	**3,265,516**	**$**	**2,988,717**
Status of Budgetary Resources				
Obligations Incurred				
Direct	$	1,569,307	$	1,375,617
Reimbursable		1,562,834		1,537,439
Total Obligations Incurred (Note 14)		3,132,141		2,913,056
Unobligated Balance - Available				
Apportioned		97,391		51,934
Total Unobligated Balance - Available		97,391		51,934
Unobligated Balance not Available		35,984		23,727
Total Status of Budgetary Resources	**$**	**3,265,516**	**$**	**2,988,717**
Change in Obligated Balance				
Obligated Balance, Net - Brought Forward, October 1				
Unpaid Obligations	$	634,587	$	546,861
Less Uncollected Customer Payments from Federal Sources		223,465		191,462
Total Unpaid Obligated Balance, Net - Brought Forward, October 1		411,122		355,399
Obligations Incurred, Net		3,132,141		2,913,056
Less Gross Outlays		2,991,279		2,764,011
Less Recoveries of Prior Year Unpaid Obligations, Actual		66,898		61,319
Change in Uncollected Customer Payments from Federal Sources		58,251		(32,003)
Obligated Balance, Net - End of Period				
Unpaid Obligations		708,551		634,587
Less Uncollected Customer Payments from Federal Sources		165,214		223,465
Total Unpaid Obligated Balance, Net - End of Period	**$**	**543,337**	**$**	**411,122**
Net Outlays				
Gross Outlays	$	2,991,279	$	2,764,011
Less Offsetting Collections		1,597,233		1,483,459
Less Distributed Offsetting Receipts (Note 14)		-		(520)
Total Net Outlays (Note 14)	**$**	**1,394,046**	**$**	**1,281,072**

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

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

The USMS is an entity of the DOJ and functions to facilitate the following DOJ strategic goals as presented in the DOJ Strategic Plan:

"Prevent Terrorism and Promote the Nation's Security"
"Prevent Crime, Enforce Federal Laws, and Represent the Rights and Interests of the American People"
"Ensure the Fair and Efficient Administration of Justice"

The financial statements of the USMS have been prepared to reflect the activity of these core functions from operations in all 94 Districts and Headquarters.

The USMS receives funding needed to support its programs through congressional appropriations. Both annual and multi-year appropriations are used, within statutory limits, for operating and capital expenditures. The USMS appropriations include Salaries and Expenses, Construction, and Violent Crime Reduction. The USMS also receives an appropriation transfer from the AOUSC for court security. The USMS also has a Revolving Fund called the JPATS. The Federal Prisoner Detention program is entirely funded through a reimbursable agreement with the Office of the Federal Detention Trustee.

B. Basis of Presentation

These financial statements have been prepared from the books and records of the USMS in accordance with United States generally accepted accounting principles issued by the Federal Accounting Standards Advisory Board (FASAB) and presentation guidelines in the OMB Circular 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 USMS budgetary resources. To ensure that the USMS 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 A-136 have been disaggregated on the balance sheet. These include Advances and Prepayments, Actuarial Federal Employees' Compensation Act Liabilities, Accrued Federal Employees' Compensation Act Liabilities, Accrued Payroll and Benefits, Accrued Annual and Compensatory Leave Liabilities, Contingent Liabilities, and Capital Lease Liabilities.

Note 1. Summary of Significant Accounting Policies (continued)

C. Basis of Consolidation

The consolidated/combined financial statements include the accounts of the USMS. All significant proprietary intra-entity transactions and balances have been eliminated in consolidation. The Statements of Budgetary Resources is a combined statement for FYs 2010 and 2009, 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 are composed of deposit and suspense funds, which temporarily hold receipts for service of process fees.

F. Fund Balance with U.S. Treasury

FBWT is the aggregate amount of the entity's accounts with the U.S. Treasury for which the entity is authorized to make expenditures and pay liabilities. FBWT also includes Other Fund Types (deposit and suspense funds). These are non-entity assets for which the entity is not authorized to make expenditures and pay liabilities. The Revolving fund is a separate account involving reimbursement for JPATS prisoner movements.

G. Accounts Receivable

The USMS expects an immaterial amount of uncollectible Accounts Receivable based upon data from previous years. Most of the Accounts Receivable are due from other Federal agencies. As a result, an allowance for doubtful accounts was not established. Accounts receivable written off are a result of management’s specific identification of amounts determined to be uncollectible.

Note 1. Summary of Significant Accounting Policies (continued)

H. Inventory and Related Property

Operating inventory includes equipment and supplies used for the repair of airplanes. The USMS utilizes the first-in, first-out (FIFO) method as the basis for valuation of these items.

I. General Property, Plant, and Equipment

Acquisitions of $25 and over ($100 for airplanes and leasehold improvements) are capitalized and depreciated based on the historical cost using the straight-line method over the estimated useful lives of the assets, which range from 5 to 25 years. Other equipment is expensed when purchased or included in inventory if used for the repair of airplanes. Normal repairs and maintenance are expensed as incurred.

Total capital lease obligations are determined by calculating the present value of the lease payments at the inception of the lease. The interest rate used is the nominal discount rate in Appendix C of OMB Circular A-94, "Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs," at the inception of the lease.

J. Advances and Prepayments

Advances and Prepayments consist of: (a) intragovernmental advances provided to Federal Prison Industries, Inc. for the purchase of vehicles and equipment, (b) intragovernmental advances provided to the Federal Aviation Administration for JPATS fuel costs, and (c) travel advances issued to Federal employees for relocation travel costs.

K. Liabilities

Liabilities represent the amount of monies, or other resources, that are likely to be paid by the USMS as the result of a transaction or event that has already occurred. However, no liability can be paid by the USMS absent proper budget authority. Liabilities for which an appropriation has not been enacted are classified as liabilities not covered by budgetary resources, and there is no certainty that corresponding future appropriations will be enacted.

The USMS maintains liabilities with the Department of the U.S. Treasury for deposit and suspense funds, which temporarily hold receipts for service of process fees. These are included as a part of Other Liabilities on the Balance Sheet.

Note 1. Summary of Significant Accounting Policies (continued)

L. Contingencies and Commitments

The USMS is 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. Legal actions where management and the Chief Counsel consider adverse decisions "probable" or "reasonably possible" and the amounts are reasonably estimable are disclosed in Note 11, *Contingencies and Commitments*. However, there are cases where amounts have not been accrued or disclosed because the amounts of the potential loss cannot be estimated or the likelihood of an unfavorable outcome is considered "remote".

M. Annual, Sick, and Other Leave

Accrued Annual and Compensatory Leave Liabilities are expected to be paid from future years' appropriations. Federal employees' annual leave is accrued as it is earned, and the accrual is reduced annually for actual leave taken and increased for leave earned. Each year, the accrued annual leave balance is adjusted to reflect the latest pay rates. Sick leave is expensed as taken.

N. Interest on Late Payments

The USMS on occasion incurs interest penalties on late payments. All such interest penalties are paid to the respective vendor in accordance with the guidelines mandated by the Prompt Payment Act, (P.L. 97-177), as amended.

O. Retirement Plans

With few exceptions, employees hired before January 1, 1984 are covered by the Civil Service Retirement System (CSRS) and employees hired on or after that date are covered by the Federal Employees Retirement System (FERS).

For employees covered by the CSRS, the USMS contributes 7% of the employee's gross pay for normal retirement or 7.5% for hazardous duty retirement. For employees covered by the FERS, the USMS contributes 11.2% of the employee's gross pay for regular employees, and 24.9% of the employee's gross pay for law enforcement officers. All employees are eligible to contribute to the Federal Thrift Savings Plan (TSP). For those employees covered by the FERS, a TSP account is automatically established, and the USMS is required to contribute an additional 1% of gross pay to this account and match employee contributions up to 4% of gross pay. No matching contributions are made to the TSP accounts established by the CSRS employees. The USMS does not report CSRS or FERS assets, accumulated plan benefits, or unfunded liabilities, if any, which may be applicable to its employees. Such reporting is the responsibility of the Office of Personnel Management (OPM).

Note 1. Summary of Significant Accounting Policies (continued)

P. Federal Employee Compensation Benefits

Federal Employees' Compensation Act (FECA) provides income and medical cost protection to cover Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. The total FECA liability consists of an actuarial and an accrued portion as discussed below.

Actuarial Liability: The U.S. Department of Labor (DOL) calculates the liability of the Federal Government for future compensation benefits, which includes the expected liability for death, disability, medical, and other approved costs. The liability is determined using the paid-losses extrapolation method calculated over the next 37-year period. This method utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. The projected annual benefit payments are discounted to present value. The resulting Federal Government liability is then distributed by agency. The Department's portion of this includes the estimated future cost of death benefits, workers' compensation, medical, and miscellaneous cost for approved compensation cases for its employees. The Department's liability is further allocated to the component reporting entities on the basis of actual payments made to the FECA Special Benefits Fund (SBF) for the three prior years as compared to the total Department's payments made over the same period.

The FECA actuarial liability is recorded for reporting purposes only. This liability constitutes an extended future estimate of cost which will not be obligated against budgetary resources until the fiscal year in which the related funds are billed to the USMS. The cost associated with this liability may not be met by the USMS without further appropriation action.

Accrued Liability: The accrued FECA liability owed to the DOL is the difference between the FECA benefits paid by the FECA SBF and the agency's actual cash payments to the FECA SBF. For example, the FECA SBF will pay benefits on behalf of an agency through the current year. However, most agencies' actual cash payments to the FECA SBF for the current fiscal year will reimburse the FECA SBF for benefits paid through a prior fiscal year. The difference between these two amounts is the accrued FECA liability.

Note 1. Summary of Significant Accounting Policies (continued)

Q. 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 the costs incurred to produce public and intragovernmental revenue.

R. Revenues and Other Financing Sources

The USMS receives funding needed to support its programs through appropriations. Appropriations are recognized as a financing source when the funding is appropriated. The USMS also reports revenue earned for services performed on a reimbursable basis with other Federal agencies and components of the DOJ. The revenue for these services is earned when the work is performed. Moreover, the USMS reports appropriations transferred from other Federal entities as a financing source.

S. Earmarked Funds

Statement of Federal Financial Accounting Standards (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 Federal 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 Federal Government's general revenues.

At the USMS, there are no funds that meet the definition of an earmarked fund.

Note 1. Summary of Significant Accounting Policies (continued)

T. Allocation Transfer of Appropriations

The USMS is a party to allocation transfers with another Federal agency as a transferring (parent) entity and/or a receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. Generally, all financial activity related to allocation transfers is reported in the financial statements of the parent entity, from which the underlying authority, appropriations, and budget apportionments are derived.

The USMS receives, as a child entity, allocation transfers of appropriations from the AOUSC. However, per OMB guidance the USMS reports all budgetary and proprietary activity for court security funds transferred from the Judiciary to the USMS. Exceptions to this general rule affecting the USMS include the Funds transferred from The Judicial Branch to the Department of Justice U.S. Marshals Services, for whom the USMS is the child in the allocation transfer but, per OMB guidance, will report all activity relative to these allocation transfers in the Reporting Entity's financial statements.

U. Tax Exempt Status

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

V. Use of Estimates

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

W. Subsequent Events

Subsequent events and transactions occurring after September 30, 2010 through the date of the auditors' opinion have been evaluated for potential recognition or disclosure in the financial statements. The date of the auditors' opinion also represents the date that the financial statements were available to be issued.

Dollars in Thousands, Except as Noted

Note 2. Non-Entity Assets

As of September 30, 2010 and 2009	2010	2009
Intragovernmental		
Fund Balance with U.S. Treasury	$ 7,974	$ 10,818
Total Non-Entity Assets	7,974	10,818
Total Entity Assets	1,104,561	934,845
Total Assets	$ 1,112,535	$ 945,663

Note 3. Fund Balance with U.S. Treasury

As of September 30, 2010 and 2009	2010	2009
Fund Balances		
Revolving Funds	$ 30,803	$ 30,583
General Funds	645,909	456,203
Other Fund Types	7,974	10,818
Total Fund Balances with U.S. Treasury	$ 684,686	$ 497,604
Status of Fund Balances		
Unobligated Balance - Available	$ 97,391	$ 51,934
Unobligated Balance - Unavailable	35,984	23,727
Obligated Balance not yet Disbursed	543,337	411,122
Other Funds (With)/Without Budgetary Resources	7,974	10,821
Total Status of Fund Balances	$ 684,686	$ 497,604

Other Funds (With)/Without Budgetary Resources and Other Fund Types include non-entity assets. Non-entity assets are composed of deposit funds, which temporarily hold receipts for service of process fees.

Dollars in Thousands, Except as Noted

Note 4. Accounts Receivable

As of September 30, 2010 and 2009	2010	2009
Intragovernmental		
Accounts Receivable	$ 149,713	$ 188,213
With the Public		
Accounts Receivable	47	146
Total Accounts Receivable	$ 149,760	$ 188,359

Intragovernmental accounts receivable primarily consists of reimbursable revenue with OFDT.

Note 5. Inventory and Related Property

As of September 30, 2010 and 2009	2010	2009
Operating Materials and Supplies		
Held for Current Use	$ 2,739	$ 2,150

Dollars in Thousands, Except as Noted

Note 6. General Property, Plant and Equipment, Net

As of September 30, 2010

	Acquisition Cost	Accumulated Depreciation	Net Book Value	Useful Life
Construction in Progress	$ 38,419	$ -	$ 38,419	N/A
Buildings, Improvements, and Renovations	3,422	(3,422)	-	12 years
Aircraft	27,327	(11,540)	15,787	7-25 years
Vehicles	27,647	(19,244)	8,403	5-10 years
Equipment	43,460	(22,924)	20,536	5-15 years
Assets Under Capital Lease	10,727	(10,190)	537	20 years
Leasehold Improvements	385,191	(210,936)	174,255	12 years
Total	$ 536,193	$ (278,256)	$ 257,937	

As of September 30, 2009

	Acquisition Cost	Accumulated Depreciation	Net Book Value	Useful Life
Construction in Progress	$ 30,836	$ -	$ 30,836	N/A
Buildings, Improvements, and Renovations	3,422	(3,137)	285	12 years
Aircraft	27,327	(9,795)	17,532	7-25 years
Vehicles	24,521	(17,185)	7,336	5-10 years
Equipment	40,414	(20,905)	19,509	5-15 years
Assets Under Capital Lease	10,727	(9,654)	1,073	20 years
Leasehold Improvements	361,001	(183,299)	177,702	12 years
Total	$ 498,248	$ (243,975)	$ 254,273	

The USMS purchased capitalized property from Federal sources and from the Public in the amounts of $24,187 and $17,798, respectively, for the fiscal year ended September 30, 2010 and $19,234 and $18,436, respectively, for the fiscal year ended September 30, 2009.

The USMS has no restrictions on the use or convertibility of general PP&E.

Dollars in Thousands, Except as Noted

Note 7. Other Assets

As of September 30, 2010 and 2009	2010	2009
Intragovernmental		
Advances and Prepayments	$ 17,212	$ 3,025
Other Assets With the Public	184	184
Total Other Assets	$ 17,396	$ 3,209

Other Assets With the Public is composed of a collection of historical items such as jewelry, badges, and a carpet. The collection was appraised in November 2002 to provide the USMS with a basis for these items.

Note 8. Liabilities not Covered by Budgetary Resources

As of September 30, 2010 and 2009	2010	2009
Intragovernmental		
Accrued FECA Liabilities	$ 15,725	$ 15,222
Other Unfunded Employment Related Liabilities	91	74
Total Intragovernmental	15,816	15,296
With the Public		
Actuarial FECA Liabilities	83,490	81,314
Accrued Annual and Compensatory Leave Liabilities	42,138	38,931
Contingent Liabilities (Note 11)	17,000	18,250
Total With the Public	142,628	138,495
Total Liabilities not Covered by Budgetary Resources	158,444	153,791
Total Liabilities Covered by Budgetary Resources	488,169	436,450
Total Liabilities	$ 646,613	$ 590,241

Liabilities not covered by budgetary resources result from the receipt of goods and services, or the occurrence of eligible events, for which appropriations, revenues, or other financing sources necessary to pay the liabilities have not yet been made available through congressional appropriation.

U.S. DEPARTMENT OF JUSTICE

UNITED STATES MARSHALS SERVICE

APPENDIX

5. **Resolved.** The USMS concurred with our recommendation. This recommendation can be closed when subsequent annual financial statement audit testing verifies that the USMS has reviewed financial management and accounting processes in place at district offices to identify process, knowledge, and training gaps affecting the execution of and adherence to the USMS directives and policies; implemented corrective action to address the identified gaps; and developed and implemented procedures for maintaining source documentation that can be easily retrieved for review and audit purposes.

6. **Resolved.** The USMS concurred with our recommendation. This recommendation can be closed when subsequent annual financial statement audit testing verifies that the USMS has fully implemented procedures developed during fiscal year 2010 to ensure district office personnel utilize a consistent and reasonable methodology for recording prisoner medical obligations and accruals.

7. **Closed.** The status of corrective action related to this recommendation will be tracked through Recommendation No. 4 of the FY 2008 Annual Financial Statement Audit Report (OIG Report No. 09-13).