U.S. Department of Labor Office of Inspector General
Washington, D.C. 20210

ASSISTANT INSPECTOR GENERAL'S REPORT

**TO THE HONORABLE
ELAINE L. CHAO
SECRETARY OF LABOR**

The *Chief Financial Officers Act of 1990* (CFO Act) requires agencies to report annually to Congress on their financial status and any other information needed to fairly present the agencies' financial position and results of operations. To meet the CFO Act reporting requirements, the United States Department of Labor (DOL), a Department of the United States Government, prepares annual financial statements, which we audit.

The objective of our audit is to express an opinion on the fair presentation of DOL's Fiscal Year 2000 principal financial statements. Our objective also is to obtain an understanding of the Department's internal control and test compliance with laws and regulations that could have a direct and material effect on the financial statements.

We have audited the consolidated balance sheet of the DOL as of September 30, 2000, and the consolidated statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the year then ended. These financial statements are the responsibility of the DOL's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial statements contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 01-02, *Audit Requirements for Federal Financial Statements.* These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. 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 audit provides a reasonable basis for our opinion.

RELATIONSHIP TO THE SINGLE AUDIT ACT

The financial statements for the year ended September 30, 2000, include:

- costs for grants, subsidies, and contributions primarily with various state and local governments and nonprofit organizations in the amount of $8.1 billion;

- costs for unemployment benefits incurred by state employment security agencies in the amount of $21.1 billion;

- state employer tax revenue of $19.7 billion;

- net receivables for state unemployment taxes, reimbursable employers and benefit overpayments of $.7 billion; and

- reimbursements from state, local, and nonprofit reimbursable employers in the amount of $1.0 billion, for unemployment benefits paid on their behalf.

Our audit included testing these costs, financing sources, and balances at the Federal level only. Pursuant to a mandate by Congress, the examination of these transactions below the Federal level is primarily performed by various auditors in accordance with the Single Audit Act of 1984, as amended, and OMB Circular A-133. The results of those audits are reported to each Federal agency which provides direct grants, and each Federal agency is responsible for resolving findings for its awards.

OPINION ON FINANCIAL STATEMENTS

In our opinion the financial statements referred to above present fairly, in all material respects, in conformity with generally accepted accounting principles:

- the assets, liabilities, and net position of the Department of Labor as of September 30, 2000; and
- the net cost, changes in net position, budgetary resources, reconciliation of net cost to budgetary resources, and custodial activity for the year ended September 30, 2000.

OTHER ACCOMPANYING INFORMATION

Our audit was conducted for the purpose of forming an opinion on the FY 2000 principal financial statements of the DOL. The accompanying financial information discussed below is not a required part of the principal financial statements:

The required supplementary information (included in the FY 2000 Annual Performance Report and in the Management of DOL's Financial Resources and Required Supplementary Information sections of the Financial Performance Report) and the Required Supplementary Stewardship Information of the Financial Performance Report are required by the Federal Accounting Standards Advisory Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the information. However, we did not audit the information and express no opinion on it.

The information in the appendices of the DOL's Performance and Accountability Report is presented for purposes of additional analysis. Such information has not been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, accordingly, we express no opinion on it.

REPORT ON INTERNAL CONTROL

In planning and performing our audit, we considered the Department's internal control over financial reporting by obtaining an understanding of the Department's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin 01-02. 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 those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. We noted certain matters, discussed in the following paragraphs, involving the internal control and its operations that we consider to be reportable conditions. However, none of the reportable conditions is believed to be a material weakness.

In addition, we considered the DOL's internal control over Required Supplementary Stewardship Information by obtaining an understanding of the agency's internal controls, determining whether they had been placed in operation, assessed control risk, and performed tests of controls as required by OMB Bulletin 01-02. The objective of our audit was not to provide assurance on these internal controls. Accordingly, we do not provide an opinion on such controls.

Finally, with respect to internal control relating to performance measures included in the FY 2000 Annual Performance Report, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions as required by OMB Bulletin 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls. However, we noted certain deficiencies in internal control over reported performance measures, discussed below that, in our judgment, could adversely affect the agency's ability to collect, process, record, and summarize performance information and report performance measures in accordance with management's criteria.

REPORTABLE CONDITIONS

Current Year Reportable Conditions

Unreconciled Differences with Treasury

The Department continues to have unreconciled cash differences between the DOLAR$ general ledger and Treasury. Although the unreconciled differences are not material to the financial statements, they amounted to over $44 million at year-end. The most serious reconciliation problems exist in ETA, where approximately $7.8 billion in grant payments were made through the Department of Health and Human Services' Payment Management System (HHS-PMS). ETA did not perform reconciliations at the appropriation level throughout FY 2000 (where HHS-PMS activity is reported). At year-end, ETA had $13 million of net unreconciled differences at the appropriation level.

In addition, ineffective reconciliation procedures resulted in $31 million of the $44 million year-end cash adjustment related to payroll activity. We also found $10.6 million of suspended payroll transactions that had been outstanding for more than 90 days. Because these amounts have not been identified and cleared, one or more appropriation accounts are misstated.

We recommend that the Chief Financial Officer ensures that: 1) agencies identify and clear differences at the document level at least monthly; 2) reconciliation procedures effectively address departmental funds processed through non-DOL

ALCs (e.g., HHS, USDA, Treasury, etc.); 3) reconciliation worksheets are prepared in compliance with Treasury and OCFO guidance; and 4) the resolution of differences is adequately supported by source documentation.

The Department agrees that cash reconciliations are necessary and must be performed on a monthly, if not daily, basis. The OCFO has formed a task force to address cash reconciliations Department-wide. This task force will ensure that all agencies, including the OCFO, comply with the Treasury directive on reconciling Funds with Treasury balances. Also, the OCFO will work with the grant agencies and HHS to refine the reports to facilitate reconciling the Department's records with HHS' records.

DOLAR$ Grant Transactions Not Reconciled to HHS-PMS

ETA uses the HHS-PMS to process grant payments for the majority of their grants (approximately $7.8 billion in FY 2000). Accordingly, PMS is the initial system of record for grant payment transactions and it is essential that all PMS transactions are accurately recorded in the DOLAR$ general ledger, and that the two systems reconcile.

Our audit disclosed that ETA does not reconcile PMS transactions, by document, to those recorded in DOLAR$. Significant differences exist in obligation and payment amounts recorded on the two systems for ETA's grants.

Other DOL granting agencies performed detailed reconciliations of PMS and DOLAR$ activity during FY 2000, and noted events that caused DOLAR$ to be misstated. For example, they noted PMS transactions that were posted twice in DOLAR$; an entire quarter of costs that was recorded on PMS but not on DOLAR$; selected days of payment activity that were recorded on PMS but not on DOLAR$; PMS system errors which PMS subsequently corrected but were not corrected in DOLAR$; and transactions that suspended during the PMS/DOLAR$ interface that were not properly recorded when cleared from suspense, or remained suspended. These events indicated systemic problems that affect all granting agencies using PMS. Accordingly, it is critical that ETA initiate a reconciliation process for their PMS grants to ensure that each grant document recorded in DOLAR$ accurately reflects a complete record of payments made to the grantee. It is also critical that ETA reconcile grant obligations to ensure that obligational authority released in PMS is accurate and in agreement with DOLAR$.

Differences between PMS and DOLAR$ payment activity can also indicate that DOLAR$ Funds with Treasury accounts are not in balance with the Treasury's TFS 6653. We reported in a separate finding that there are unreconciled differences in the Funds with Treasury account for ETA's appropriations, totaling approximately $13.5 million. These differences were calculated by management but were not identified or corrected to the respective grant documents. Rather, adjustments were recorded to unrelated documents set up specifically for this purpose.

We recommend that the Chief Financial Officer and the Assistant Secretary for Employment and Training ensure that ETA implement policies requiring routine reconciliations of grant transactions recorded in DOLAR$ to those recorded in PMS. We also recommend that the Chief Financial Officer ensures that changes are made to DOLAR$ and/or the Sync Report so that the report provides a more useful and reliable tool for management.

ETA agreed that DOLAR$ and the HHS-PMS system should be in agreement and periodically reconciled to validate that they are in agreement. The OCFO agreed to work with the grant agencies and HHS to refine existing reports as well as develop new reports to facilitate reconciling the Department's records with HHS' records.

ETA Obligations Inappropriately Moved to Subsequent Fiscal Year

We analyzed selected documents which reflected large differences in payment activity between DOLAR$ and PMS grant activity, and noted several 1993 JTPA grants where a portion of the obligation, cost and payment activity had been moved from one fiscal year to the next. According to ETA, these grants were closed (and the funds had expired) prior to the grantee drawing down their final payment. To close the grants, ETA reduced obligations and costs in DOLAR$ to equal the total payments recorded (in DOLAR$) at the time. When the grantee subsequently drew the funds from PMS (on the 1993 grant), ETA set up a 1994 grant obligation in DOLAR$ so that the system would accept the draw down. As a result, PMS reflects the final payment totaling over $4.5 million as an FY 1993 obligation, cost and payment but DOLAR$ reflects this as an FY 1994 obligation, cost and payment.

These practices are not in compliance with appropriation law (U.S.C. Title 31, Chapter 15, Sections 1552 and 1553). Appropriation law allows adjustments to closed years, however, the adjustments must be made to the current year (in this case FY 2000). In addition, adjustments exceeding $4 million require approval from the head of the agency. ETA inappropriately recorded the adjustments to FY 1994 rather than FY 2000 and did not receive the proper approvals. In addition, ETA did not have the proper obligating documentation to support the FY 1994 obligation.

This situation was caused by the fact that grants were not appropriately or timely closed for FY 1993. ETA waited until the funds canceled and adjusted the documents so that the documents were in balance for obligations, costs and payments. These documents reflected more costs than payments, and actual grant costs were reduced in order to balance the grant. Had the closeout process been performed more timely, ETA would have had the time to notify the grantees to draw down the funds so that the grants would be in balance, rather than reducing costs and obligations to an incorrect amount.

We recommend that the Chief Financial Officer and the Assistant Secretary for Employment and Training ensure that ETA establish controls (including written policies and procedures) which will ensure that adjustments to obligations for closed accounts are posted only to current year appropriations and are properly authorized by the head of the agency when the amount of the adjustments exceeds the dollar threshold established in the regulations.

ETA is considering actions to be taken to alleviate this concern. A decision will be made on a course of action to be taken and the action will be implemented during the fourth quarter of FY 2001.

State Unemployment Benefit Payments Understated

ETA did not perform routine and timely reconciliations of state drawdowns reported on ETA form 2112 and drawdowns reported by Treasury. As a result, state advances were overstated and benefit expenses were understated in the Department's fiscal year ended September 30, 1999 financial statements. Net benefit expenses continued to be recorded and used to adjust gross advances during FY 2000. During FY 2000, the OCFO reconciled state reported drawdowns to Treasury reported drawdowns. As a result of this reconciliation, it was found that starting in January 1999, a number of states underreported unemployment benefit payments. During the FY 2000 year end financial statement process, advances and benefit expense balances were adjusted by $288 million and $403 million for FY 1999 and FY 2000, respectively.

In the publication Standards for Internal Control in the Federal Government, the General Accounting Office describes control activities as policies, procedures, techniques, and mechanisms that enforce management's directives. They include a wide range of diverse activities such as approvals, authorizations, verifications, **reconciliations**. . . . [*Emphasis added.*]

Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records. In addition, control activities help to ensure that all transactions are completely and accurately recorded.

We recommend that the Chief Financial Officer and the Assistant Secretary for Employment and Training ensure that: 1) Reconciliations using FMRS and Treasury data are performed timely and include comparisons of drawdowns for state benefits in addition to drawdowns for Federal benefits; 2) ETA monitors the reconciliation process on a quarterly basis and provides the OCFO status reports on the results of the reconciliations; 3) OCFO documents procedures used to verify that state reported data recorded in DOLAR$ through the FMRS is accurate; and 4) OCFO evaluates analytical procedures used to verify state UI advance, accounts payable, and benefit expense data entering DOLAR$.

ETA will issue instructions to the states on proper reporting of benefit payments, monitor and follow up on state reconciliations of FMRS and Treasury data quarterly, provide the OCFO quarterly status reports, and request state reconciliation of all benefits reported. The OCFO will include procedures in their compilation guide to be followed in case the FMRS reconciliation fails which will include analytical procedures to be used to examine the state data.

Prior Year Reportable Conditions

EDP Controls

DOL Needs to Strengthen Controls to Protect Its Information

DOL's systems environment is exposed to various weaknesses in management's procedures for assessing risks, implementing an effective security framework, periodically monitoring its framework, timely resolving issues identified or reported upon, and effectively implementing and maintaining its access controls.

The Department has taken several key steps in strengthening its information systems security architecture during the last year. Specifically, the Department has issued its Critical Infrastructure Protection Plan (CIPP), the DOL Cyber Security Program Plan and the Computer Security Handbook (CSH). The CSH is to provide direction and guidance for the agencies to complete system security plans and risk assessments for those systems identified as critical assets, major applications or general support systems in the Department's CIPP. The Department is working with the agencies to strengthen the Department's information systems architecture by providing training and guidance.

DOL Needs to Fully Implement a Systems Development Life Cycle Methodology

Changes to DOL's systems were not properly controlled in the areas of software change management, software file access and system documentation. The Department has issued its Systems Development Life Cycle (SDLC)

Manual and agencies are updating systems to comply with the manual. The SDLC serves as the mechanism to ensure that developing, modifying, or enhancing systems meet established user requirements and support DOL critical success factors.

DOL Needs to Complete and Fully Test Its Plan(s) for Maintaining Continuity of Operations

DOL has several weaknesses that would impair the Department's ability to effectively respond to a disruption in business operations as a result of a disaster or another event causing an extended service interruption. The general areas where weaknesses were noted are in risk assessments that have not been finalized and contingency planning.

The Department has established a multi-year strategy and program management plan for its Continuity of Operations (COOP). As articulated in the COOP, the Department must have a viable capability that ensures: the emergency delegation of authority; safekeeping of vital resources, facilities, and records; improvisation or emergency acquisition of the resources necessary for business resumption; capability to perform work at alternate work sites until normal operations are resumed; and the ability to be operational at alternate facilities, with or without warning within a specified amount of time after activation.

Additionally, the Department must also have a Continuity of Government (COG) Plan for discharging its role in maintaining the integrity of critical constitutional functions of the Government in the event of a threat to national security. Also, the Department issued guidance to the agencies to address service continuity in its Computer Security Handbook.

Accounting for Grants

Grant accounting has the following deficiencies:

- Transfers of JTPA funds between programs were not monitored by ETA for compliance with the regulations, and were not accounted for in ETA's accounting records.
- We continued to note unsupported adjustments recorded for ETA's grants and contracts.
- We continued to note delinquent grantee cost reporting and untimely recording of costs for ETA's grants and contracts.
- ETA does not have sufficient procedures for identifying and correcting grant accounting errors on a timely basis.
- ETA does not have written grant accounting procedures.
- Grant accruals were not recorded on a periodic basis, rather, they were recorded at year end only.
- OSHA was not consistently reconciling grant transactions processed by PMS.

Management is in the process of completing a new grant cost system that will resolve several of the cost reporting issues and has agreed that there is a need to reconcile PMS and DOLAR$ transactions.

Wage and Hour's Back Wage System

As we have noted for several years, the Wage and Hour Division (WHD) does not maintain sufficient control over information recorded in the back wage subsidiary system (Back Wage Collection and Disbursement System - BCDS), and certain policies and practices exercised by the regional offices preclude the use of this system as a reliable subsidiary for back wages.

In FY 2000, management took steps to improve the financial accounting for back wages with the design and implementation of a new system, the BCDS 2000. Nonetheless, significant misstatements in both accounts receivable and cash balances still existed at year-end.

Management is continuing to add functions, improvements, and oversight to the BCDS 2000 system on a quarterly basis. The effects will be assessed in the FY 2001 audit.

Wage and Hour's Civil Monetary Penalty (CMP) System

In our FY 1993 audit, we recommended that WHD install a CMP tracking system which would function as a subsidiary for CMP activity and related receivable balances.

In FY 2000, we noted improvements in the documentation supporting computed assessments and accounts receivable balances. However, system weaknesses continue to exist in the areas of transaction cutoff, the accounting period close out process and effective controls ensuring that recorded information is accurate, complete and therefore reliable. Furthermore, there has been a lack of effective implementation of applicable accounting standards with respect to the recording of revenues as of the date the claim became valid and enforceable pursuant to SFFAS 7 and the proper recording of interest charges.

Management is in the process of redesigning portions of the CMP system and adding oversight procedures. The effects will be assessed in the FY 2001 audit.

Performance Measures

We previously reported the need for the Unemployment Insurance Service to verify the accuracy of non-Federal entity data reported to DOL and used for performance measurement. A verification process has been piloted and full implementation is planned in FY 2001.

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We noted other matters involving the internal control and its operations that will be reported to the management of DOL in a separate letter.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

The management of the DOL is responsible for complying with laws and regulations applicable to the Department. As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain laws and regulations specified in OMB Bulletin 01-02, including the requirements referred to in the *Federal Financial Management Improvement Act of 1996 (FFMIA)*. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the DOL.

The results of our tests of compliance with the laws and regulations described in the preceding paragraph, exclusive of FFMIA, disclosed instances of noncompliance with the following laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin 01-02, which are described below.

Adjustment to Grant Obligations

Our FY 2000 audit disclosed that ETA reduced FY 1993 grant obligations and moved these funds into FY 1994, which was not in accordance with appropriation law. While appropriation law allows adjustments to closed years, the adjustment must be made to the current year (in this case FY 2000).

Debt Management

ESA is not in substantial compliance with the *Debt Collection Improvement Act of 1996*. Delinquent receivables for Back Wages, Civil Monetary Penalties and the Black Lung Disability Trust Fund were not submitted to Treasury, or were not submitted timely, as required by the Act.

Grant Closeout Process

JTPA grants were not closed out in accordance with applicable regulations and departmental policy. While ETA has improved the grant closeout processes, there is still a large backlog of grants and contracts which need to be closed and the JTPA closeout process remains untimely.

For laws and regulations tested, exclusive of FFMIA, that are required to be reported under *Government Auditing Standards* or OMB Bulletin 01-02, our tests of compliance disclosed no instances of noncompliance other than those mentioned in the preceding paragraph.

COMPLIANCE WITH FFMIA

Under FFMIA, we are required to report whether the Department's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger (SGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803 (a) requirements.

Our FY 1999 audit reported that five subsidiary DOL financial management systems did not substantially comply with one or more of the three requirements discussed in the preceding paragraph.

The results of the current year audit disclosed that two systems remain in noncompliance:

- Wage and Hour's Back Wage system, and
- Wage and Hour's Civil Monetary Penalty (CMP) system.

The Back Wage and CMP systems are not in substantial compliance with the requirements of OMB Circular A-127, and the CMP system is also not in substantial compliance with applicable Federal accounting standards.

Management expects the implementation of a new Back Wage system and the redesign of portions of the CMP system, which should bring the systems into FFMIA compliance, to be completed during FY 2001.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

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This report is intended solely for the information and use of the management of the U.S. Department of Labor, the Office of Management and Budget, and Congress and is not intended to be and should not be used by anyone other than these specified parties.

JOHN J. GETEK
Assistant Inspector General for Audit

February 15, 2001