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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

HUMAN RESOURCES
DIVISION

November 18, 1985

The Honorable Thomas C. Komarek
Assistant Secretary for Administration
and Management
Department of Labor



129981

Dear Mr. Komarek:

Subject: Second-Year Implementation of the Federal
Managers' Financial Integrity Act in the
Department of Labor (GAO/HRD-86-29)

As part of our management review at the Department, we assessed Labor's second-year efforts to evaluate its internal control and accounting systems under the Federal Managers' Financial Integrity Act (FMFIA) of 1982 (31 U.S.C. 3512(b) and (c)). The act is aimed at strengthening management controls and accounting systems, thereby helping to detect and deter fraud, waste, abuse, and mismanagement in federal agencies.

While our management report¹ discussed Labor's implementation of FMFIA, it did not discuss the Department's 1984 year-end report to the President and the Congress. This letter presents our views on Labor's 1984 year-end FMFIA report for you--as the Department's internal control officer--to consider in preparing the 1985 year-end report.

LABOR'S 1984 YEAR-END REPORT

In its 1984 year-end FMFIA report, Labor stated that its systems of internal control, taken as a whole, complied with the requirement to provide reasonable assurance that the act's objectives were achieved within the limits described. Labor cited as its principal limitation that about 90 percent of the Department's funds pass through entities whose operations and accounting systems are not under its operational control. Labor also stated that its accounting systems, taken as a whole, generally conformed to the Comptroller General's requirements.

Labor has established a basic framework under FMFIA for improving internal controls and accounting systems and has identified a number of material weaknesses and necessary system

¹Strong Leadership Needed to Improve Management at the Department of Labor (GAO/HRD-86-12, Oct. 21, 1985).

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improvements. However, at the end of 1984, Labor's program for identifying and correcting weaknesses had not, in our opinion, progressed to the point to support its determination that internal control and accounting systems, as a whole, complied with the act's requirements. Our review of Labor's FMFIA activities disclosed the following conditions that we believe detract from Labor's 1984 statement about the systems' conformance to FMFIA requirements.

--Labor's Unemployment Insurance and Job Training Partnership Act (JTPA) programs were not effectively covered under FMFIA.

--Labor reported significant internal control weaknesses in other programs as unresolved.

Also, we believe Labor did not have a meaningful basis for making an overall assessment of its accounting system conformance with the Comptroller General's requirements.

We recognize that Labor's 1984 year-end report was based on specific language and format provided in December 1982 Office of Management and Budget (OMB) guidance, which allows agencies to conclude they have reasonable assurance that systems comply with the act notwithstanding the disclosure of material weaknesses. However, in our opinion, the OMB reporting format and language do not provide sufficient guidance to the agencies for making judgments on reasonable assurance. This is because the OMB guidance does not address the extent to which material weaknesses and unevaluated systems preclude agencies from reporting that their internal control systems, taken as a whole, comply with the act's requirements.²

In making such judgments, we believe that agencies need to evaluate most of their key systems and, in doing so, consider four factors: (1) the comprehensiveness and quality of the evaluation work performed, (2) the significance of the weaknesses disclosed, (3) the status of corrective actions, and (4) the extent to which accounting systems conform to the Comptroller General's requirements. These factors, collectively, should serve as the foundation for the agency's assessment as to whether its systems of internal control provide reasonable assurance.

²GAO's overall report, Implementation of the Federal Managers' Financial Integrity Act: First Year (GAO/OCG 84-3, Aug. 24, 1984), recommended that OMB clarify and revise its guidance on what should be contained in the year-end reporting statement.

We recognize that management judgment is involved in reaching a conclusion on the adequacy of internal control systems. The size of the organization, diversity of operations, and degree of centralization are among the many factors that agency management must consider in establishing and maintaining systems of internal control. The concept of "reasonable" assurance recognizes that the cost of internal controls should not exceed their benefits. Because benefits and costs are often not precisely quantifiable, many decisions on reasonable assurance will necessarily depend in part on estimates and judgments by management that are reasonable under the circumstances.

Our views regarding how Labor met these factors are discussed below.

UNEMPLOYMENT INSURANCE PROGRAM NOT EFFECTIVELY COVERED BY FMFIA

In fiscal year 1984, Labor's Unemployment Insurance program expended about \$19.1 billion from the Federal Unemployment Trust Fund, over two-thirds of which came from the deposits of state funds and the remainder from federal funds. Paying correct benefit amounts to only entitled individuals is a principal program goal. Under the present system, states are primarily responsible for making correct payments, while Labor oversees state use of administrative funds and state payment systems to ensure effective and efficient operations.

Labor uses several mechanisms to oversee state and local administration of the Unemployment Insurance program. These include quality control/random audits and periodic reporting. Recent reports have identified many problems in the program at both the federal and the state levels. These include Inspector General (IG) reports that disclosed problems with cash management and payment controls and a GAO report on inadequacies in Labor's oversight of state actions to correct problems identified in random audits.³ Due to these problems, Labor began developing a new quality control process designed essentially as an expansion of the random audit program.

Labor's 1984 year-end FMFIA report implied that its new quality control system was completed although it was not scheduled to be implemented until late 1985. Also, the report cited as a material weakness that Labor's IG had found federal employees were receiving unemployment benefits in selected

³An Assessment of Random Audit--A New Department of Labor Program to Improve the Accuracy of Unemployment Insurance Benefit Payments (GAO/HRD-84-26, Mar. 30, 1984).

states and that the IG was investigating potential improprieties and illegalities.

Labor's year-end FMFIA report was incomplete because coverage in the vulnerability assessment for the Unemployment Insurance program did not appropriately consider the adequacy of controls in state unemployment insurance programs. Labor's assessment results showed predominately low vulnerability for the program. Had Labor included an assessment of its oversight of state systems, its assessment of program susceptibility to fraud, waste, and abuse would have more accurately depicted the program's inherent risks.

JOB TRAINING PARTNERSHIP ACT PROGRAM
NOT EFFECTIVELY COVERED UNDER FMFIA

Labor's current monitoring of state fiscal control and administrative systems for JTPA may not be sufficient to (1) ensure that the systems satisfy requirements imposed by both JTPA and Labor and (2) detect internal control problems at the local service delivery level. Under JTPA program requirements, each entity (federal, state, and local) responsible for the allocation of funds and program eligibility is to take action against its subrecipients to eliminate program abuse and misuse of funds. JTPA gives the Secretary of Labor authority to monitor all recipients of federal assistance under the act and requires him to conduct compliance evaluations each fiscal year in several participating states to determine how federal funds distributed under this program are used (29 U.S.C. 1575(b)(1)).

Our report on Labor's management disclosed problems with states' noncompliance in several areas, including financial management, cash management, and monitoring systems. In addition, Labor did not always test transactions at the state or service delivery level to ensure that state fiscal control and administration systems are in place and working effectively. On July 18, 1985, Labor issued revised guidance for 1985 JTPA oversight which requires on-site visits to a sample of service deliverers.

Since states and service deliverers must have fiscal controls that meet certain standards, Labor's FMFIA evaluations should assess whether those controls satisfy specified standards. Labor's 1984 FMFIA assessment rated JTPA low in vulnerability and did not consider appropriate factors, such as those above, affecting vulnerability at the state and local levels.

UNRESOLVED INTERNAL CONTROL WEAKNESSES
WERE REPORTED AS SIGNIFICANT

Labor's year-end report to the President and the Congress identified 13 material program internal control weaknesses, most of which remained unresolved at the end of 1984. Two were identified as resolved to the satisfaction of the Department. The other 11 were Department-wide and organization-specific weaknesses, most of which will require long-term efforts to resolve and that significantly impair internal controls over important Labor missions. The following illustrate some of the reported weaknesses.

- Management of Labor's automated data process (ADP) systems was deficient in several areas, including system security, and certain systems lacked key controls.
- Controls over payments to medical providers under the Federal Employees Compensation Act and the Black Lung program have not been effective, and Labor was developing automated fee schedules and new payment systems to improve accuracy in these programs.
- An IG audit found a number of internal control weaknesses in screening and placement operations for the \$581 million Job Corps program. Eligibility for enrollment could not be verified in 49 percent of the cases sampled, placement performance information was erroneous, and other contractual and administrative activities were inadequate. Improvements are expected to be completed during fiscal year 1986.

Also, the significance of internal control weaknesses to Labor's operations was often not apparent from statements in its year-end report to the President and the Congress. For example, the significance of ADP weaknesses was not apparent because the report does not indicate that the weaknesses can affect Labor's major programs, which are integrated with and dependent on the reliability of its ADP systems. Information to understand the significance of Labor's weaknesses was available from other sources, including knowledgeable Labor officials. Labor's future year-end reports would be more meaningful if they relate the significance of internal control weaknesses to Labor operations.

ACCOUNTING SYSTEMS' COMPLIANCE UNCERTAIN

Labor's principal accounting systems were approved by GAO many years ago, and significant systems updating efforts were underway at the end of 1984. Labor's year-end report states

that a preliminary evaluation of the Department's accounting systems disclosed that, taken as a whole, the systems generally conform to the Comptroller General's principles, standards, and related requirements. Labor's report also cites a number of material weaknesses and long-term projects underway to update major accounting systems. Yet Labor's principal accounting systems were in a state of transition with many material weaknesses remaining to be corrected, and Labor's evaluations did not include tests of systems conformance. We believe, therefore, that Labor did not have a meaningful basis for making an overall assessment of its accounting systems' conformance with Comptroller General requirements.

In fiscal year 1984, the Department received \$34.8 billion in spending authority to perform its mission, most of which was for Employment and Training activities, including the Unemployment Insurance Trust Fund. To control its financial resources, Labor maintains a financial management structure that is dependent on 17 accounting systems. During 1984, Labor reported significant weaknesses in its principal accounting systems, and our review of Labor management activities showed the need for strengthening accounting systems' structures throughout the Department. In that review we found that

- agency fund balance limitations were often exceeded, raising the potential for Anti-Deficiency Act violations;
- financial reports were not always received or used by managers and did not compare actual to planned performance;
- Labor's control over agency financial management improvement projects was ineffective, and its control over Occupational Safety and Health Administration accounts receivable was inadequate; and
- capitalized property needed to be adequately controlled and reported.

In addition, FMFIA accounting system review efforts were minimal. In our first-year FMFIA report (GAO/HRD-84-45, May 3, 1984), we proposed that the Secretary develop a comprehensive approach and related policy and guidance for conducting full accounting system compliance evaluations, including provision for testing manual and automated procedures, processes, and controls and periodically validating the accounting systems inventory. Although the Department concurred with our proposal, effective actions were not taken in 1984. Systems weaknesses existing at the end of 1984 and the lack of testing indicate that Labor's accounting systems should not have been reported

under FMFIA to substantially conform with Comptroller General requirements.

CONCLUSIONS

At the end of 1984, material uncorrected internal control weaknesses existed in Labor's Unemployment Insurance and JTPA programs and in other Labor programs and accounting systems cited in its year-end FMFIA report. In addition, key elements of the Unemployment Insurance and JTPA programs have not been subjected to FMFIA evaluations. In our opinion, these deficiencies preclude a determination that the Department's (1) systems of internal control, taken as a whole, complied with FMFIA requirements and (2) accounting systems, taken as a whole, generally conformed to the Comptroller General's requirements.

We believe that in order to determine whether its internal control systems provide reasonable assurance, Labor needs to collectively consider (1) the comprehensiveness and quality of the evaluation work performed, (2) the significance of the weaknesses disclosed, (3) the status of corrective actions, and (4) the extent to which accounting systems conform to the Comptroller General's requirements. Also, Labor's annual FMFIA report should provide sufficient information to determine the significance of reported internal control weaknesses.

We recognize that Labor stated it had reasonable assurance in accordance with OMB guidelines. However, in our overall report on first-year implementation of FMFIA in the departments and agencies, we recommended that OMB clarify and revise its guidance on what should be contained in the year-end reporting statement. We suggested an approach that would more fully disclose the overall status of controls and material weaknesses. That approach would identify the functions and operations where (1) controls are adequate, (2) controls are not adequate, and (3) controls have not been sufficiently evaluated to know whether they are adequate. We believe such an approach would place the results of Labor's evaluation of internal controls in better perspective and lead to more informative reporting. OMB did not act on our recommendation. This issue will be discussed further in our report on the overall status of the second-year implementation of the act, which is to be issued later this year.

RECOMMENDATIONS

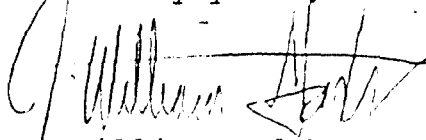
To improve future reporting on internal controls, we recommend that, in future year-end FMFIA reports, Labor disclose

--functions where internal controls are adequate, inadequate, and not yet effectively evaluated and

--the significance of reported internal control weaknesses to Labor operations.

Additional recommendations for improving the quality of Labor's internal controls and accounting systems and FMFIA processes are contained in our report on Labor's management.

Sincerely yours,

A handwritten signature in black ink, appearing to read "J. William Gadsby". The signature is written in a cursive style with a large initial "J" and a long horizontal stroke across the middle.

J. William Gadsby
Associate Director