

U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210*DEPUTY 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 2001 and 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 sheets of DOL as of September 30, 2001 and 2000, and the related consolidated statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the years then ended. These financial statements are the responsibility of 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 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 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 years ended September 30, 2001 and 2000, include:

- costs for grants, subsidies, and contributions primarily with various state and local governments and nonprofit organizations in the amount of \$8.2 billion for FY 2001 and \$8.1 billion for FY 2000;
- costs for unemployment benefits incurred by state employment security agencies in the amount of \$28.6 billion for FY 2001 and \$21.1 billion for FY 2000;
- state employer tax revenue of \$19.9 billion for FY 2001 and \$19.7 billion for FY 2000;

- net receivables for state unemployment taxes, reimbursable employers, and benefit overpayments of \$.9 billion for FY 2001 and \$.7 billion for FY 2000; and
- reimbursements from state, local, and nonprofit reimbursable employers for unemployment benefits paid on their behalf in the amount of \$1.0 billion for FY 2001 and \$1.0 billion for FY 2000.

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 accounting principles generally accepted in the United States of America:

- the assets, liabilities, and net position of the Department of Labor as of September 30, 2001 and 2000; and
- the net cost, changes in net position, budgetary resources, reconciliation of net cost to budgetary resources, and custodial activity for the years ended September 30, 2001 and 2000.

OTHER ACCOMPANYING INFORMATION

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements of DOL taken as a whole. The accompanying financial information discussed below is not a required part of the principal financial statements.

The required supplementary information, included in the Management Discussion and Analysis and FY 2001 Financial Performance Report sections of the Performance and Accountability Report and the Required Supplementary Stewardship Information are required by the Federal Accounting Standards Advisory Board and OMB Bulletin No. 97-01. We have applied 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 Annual Performance Report and the appendices of 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 DOL'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 No. 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. 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 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 No. 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 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 No. 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.

REPORTABLE CONDITIONS

Current Year Reportable Conditions

Unemployment Trust Fund Benefit Overpayments

The Office of Workforce Security (OWS) has two systems which measure benefit overpayments for the UI program. These systems play an important role in detecting and preventing overpayment of UI benefits, and as such are part of management's controls to ensure that UI resources are used consistent with the agency mission and are safeguarded from waste, fraud, and mismanagement.

Each state has a Benefit Payment Control (BPC) system to identify and investigate benefit overpayments. The states reported overpayments for FY 2001 and FY 2000 of approximately \$669 and \$599 million, respectively.

The states also have a Benefits Accuracy Measurement (BAM) unit. The BAM unit uses statistical sampling techniques to determine the accuracy of UI benefit payments and project these sample results to the entire benefit payment universe. BAM management concludes that their projections have a very high degree of accuracy, due to the sampling precision achieved and the care taken to ensure that samples are randomly selected and are tested consistently throughout the country. BAM results are reported each year in the UI Performs annual report.

From FY 1997 to 2000, the BAM data reflect little change in the UI overpayment rates. In fact, the overpayment rate has remained relatively flat since 1989 at about 8.5

percent. These data indicate a lack of significant improvement in the states methods and systems for preventing overpayments.

According to management, the BAM payment accuracy data is a management tool that states can use to identify areas of UI program operations that could be improved, but due to differences in state UI laws, the BAM payment accuracy data are not considered comparable between states. Accordingly, the BAM payment accuracy data are not used by ETA as an indicator to identify the need for corrective action or to measure improvements (or lack thereof) to existing benefit payment systems. Also, the BAM payment accuracy data are not used to identify states that are doing a good job of preventing and detecting overpayments for purposes of developing best practices or sharing successful methodologies.

While the FY 2001 BAM data reflect significantly higher overpayments than those established and reported by the BPC (\$2.3 billion versus \$669 million, respectively), UI management indicated that a significant portion of the \$2.3 billion in overpayments, such as work search issues, can only be cost-effectively monitored/investigated on a sample basis. Although a cost-benefit analysis has not been performed, current BPC procedures do not address such benefit eligibility issues as work search.

Since the overpayment rates reflect little reduction in the payment of erroneous benefits in the past 12 years, and given the recent President's Management Agenda, we believe there is a need for improvement in controls. While management is taking great efforts to measure benefit

overpayments, it is evident that these efforts have not resulted in reduced overpayment rates or improved safeguarding of trust fund assets. The effect of not improving controls over benefit payments and overpayment detection will be the continued loss of significant trust fund resources.

Management has provided information on initiatives being developed to help states reduce or detect erroneous benefit payments.

We recommend that the Chief Financial Officer and the Assistant Secretary for Employment and Training ensure that OWS management:

- 1) develop a written plan to utilize the data produced by the BAM unit as the impetus for improving internal controls over the benefit payment process;
- 2) accelerate efforts to pursue wage and employment information at the state and national levels which will assist ETA in preventing overpayments and detecting overpayments on a timely basis;
- 3) compile BPC overpayment data in categories consistent with those used for the BAM data, in order to identify which types of overpayments are not being detected by the BPC and use the data to prioritize the areas most in need of improvement; and
- 4) perform and document a cost benefit analysis for those overpayments identified as not being detected by the BPC, in order to determine whether or not additional resources should be dedicated in these areas.

Accountable Property

During our audit, we noted several agencies did not have written procedures and systems to identify

and track accountable property (general property, plant, and equipment that does not meet the Department's capitalization threshold).

JFMIP states that property management systems are critical for establishing financial accounting and maintaining physical accountability over property. According to the JFMIP, one category of property which must be tracked includes sensitive or controlled property that is expensed when acquired.

Management concurs with the need to improve controls over accountable property in order to safeguard those assets from loss or theft.

We recommend that the Chief Financial Officer and the Assistant Secretaries for Administration and Management, Employment and Training, and Employment Standards:

- 1) establish written procedures for identifying and tracking all accountable property; and
- 2) develop systems, for identifying and tracking accountable property, which meet JFMIP property management system requirements.

Prior Year Reportable Conditions

IT Controls

DOL has made progress in resolving issues from prior year audits in the areas of controls to protect information, system development life cycle methodology and maintaining continuity of operations. However, DOL continues to face significant risks in these areas that should be addressed.

DOL Continues its Need to Further Strengthen Controls to Protect Its Information

Although DOL has made improvements in its Department wide security programs and practices, we identified 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.

Areas where improvements could be made include:

- entity-wide security programs and associated policies and procedures for developing, implementing and monitoring Local Area Network (LAN), distributed systems, and main-frame environments;
- establishment of a security management structure and clear assignment of responsibilities;
- implementation of effective security-related personnel policies and procedures;
- certification and Accreditation of appropriate general support and major application systems; and
- logical controls over the configuration of security parameters, data files, and software programs.

DOL Continues its Need to Further Enforce its Systems Development Life Cycle Methodology

DOL systems were not properly controlled in the areas of change control policies and procedures, access to software libraries and the

development and updating of critical system documentation. The Department issued *DOL Systems Development and Life Cycle Management Manual* (SDLCM) last year and agencies are in the process of updating systems to comply with the manual. The SDLCM provides the life cycle policies and procedures to be followed by all DOL agencies. The Department's Computer Security Handbook also requires agencies to update their System Security Plans as the system progresses throughout its life cycle.

DOL Continues its Need 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 including identification of alternate data processing and telecommunications facilities, and thorough successful testing of contingency plans.

The Department's Computer Security Handbook provides policy and procedural guidance to DOL agencies regarding contingency planning. The OCIO office recently created a special working group for contingency planning. This working group will include members from each DOL agency and develop detailed templates and procedures for contingency planning applicable to all DOL agencies.

Unreconciled Differences with Treasury

We have previously reported the lack of document-level cash reconciliations

being performed for Departmental Agency Location Codes (ALCs). We also noted a lack of cash reconciliations being performed at the appropriation level for departmental transactions processed through non-DOL ALCs. This lack of timely and effective reconciliations resulted in large cash differences at year end.

In FY 2001, the Department improved its reconciliation procedures at both the ALC and appropriation level. We noted a 22 percent overall decrease in differences at the ALC level from the prior year, and in the current year, transactions processed through non-DOL ALCs were effectively reconciled at year end. However, unreconciled differences related to prior years still exist in ETA.

While ETA management has proposed corrective action plans to address this issue, the prior year differences have not been cleared. We will review ETA's progress in our FY 2002 audit.

In FY 2002, management plans to fully implement the use of an electronic bulk file transfer to submit all departmental SF-224s to Treasury monthly. The effectiveness of this procedure in reducing unreconciled differences will be assessed in the FY 2002 audit.

Accounting for Grants

ETA's grant accounting has the following deficiencies:

- While ETA initiated reconciliations of grant transactions recorded in the Department's general ledger with the HHS Payment Management System, which disburses grant funds, some

adjustments identified in the process were not recorded in the two systems.

- Transfers of WIA funds between programs were not accounted for in ETA's accounting records.
- We continued to note that ETA's grant and contract costs were not recorded timely. In addition, ETA is not following up with grantees who are delinquent in reporting grant costs.
- We continue to note errors in transactions recorded for ETA's grants and contracts. Eleven of the 40 regional office grants had cost or obligation errors, and we noted over 100 cost entries recorded at the national office that were not supported by grantee cost reports and were considered to be errors.
- ETA operates without written grant accounting procedures, both at the regional and National offices.

ETA management believes that they have implemented various improvements over the years to address these audit findings; however, we conclude that the FY 2001 audit results indicate a need for further improvement in each of the areas indicated above.

Wage and Hour's Back Wage System

In FY 2001, ESA implemented a new subsidiary system to account for back wage activities. While the new system provides improved controls over back wages, additional improvements are necessary to ensure that back wage accounts are accurate and up to date. Wage and Hour also needs to improve the processes used to reconcile cash activity recorded in the subsidiary system with that recorded in the general ledger.

ESA management agrees with these findings, and has indicated that they are developing various system improvements and procedural changes which will be implemented throughout FY 2002.

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

In prior audits, we recommended that Wage and Hour implement a new subsidiary system for recording CMP activities, due to certain weaknesses in the existing system. While efforts were made to implement these changes, the revised system was not completed during FY 2001. In addition, we continued to note that new penalty cases and cash receipts were not recorded timely.

Generally, ESA concurs with these findings and has agreed to take additional steps to improve the internal controls over CMP activities.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

The management of 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 No. 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 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 No. 01-02, which are described below.

Grant Closeout Process

While ETA has improved the grant closeout process, improvements are still needed to ensure that grants are identified for closure and are closed on a timely basis, in accordance with 29 CFR 97.50, 29 CFR 95.71, and other applicable regulations and departmental policy. Management concurs and is in the process of developing improved procedures to ensure that grants and contracts are closed timely.

The results of our tests of compliance disclosed no instances of noncompliance with other laws and regulations discussed in the preceding paragraph exclusive of FFMIA that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02.

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.

The results of our tests disclosed no instances in which the agency's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

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
Deputy Inspector General for Audit

January 11, 2002