

ASSISTANT INSPECTOR GENERAL'S REPORT

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 objectives of our audit are to express an opinion on the fair presentation of DOL's Fiscal Years 2002 and 2001 principal financial statements, 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.

Additionally, our objectives included expressing an opinion on DOL's compliance with requirements of the Federal Financial Management Improvement Act of 1996, based on our examination.

We have audited the consolidated balance sheets of DOL as of September 30, 2002 and 2001 and the related consolidated statements of net cost, changes in net position, financing, and custodial activity and the combined statements of budgetary

resources 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 No. 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, 2002 and 2001, include:

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- costs for grants, subsidies, and contributions primarily with various state and local governments and nonprofit organizations in the amount of \$10.0 billion for FY 2002 and \$8.2 billion for FY 2001;
- costs for unemployment benefits incurred by state employment security agencies in the amount of \$50.0 billion for FY 2002 and \$28.6 billion for FY 2001;
- state employer tax revenue of \$19.3 billion for FY 2002 and \$19.9 billion for FY 2001;
- net receivables for state unemployment taxes, reimbursable employers, and benefit overpayments of \$1.0 billion for FY 2002 and \$.9 billion for FY 2001; and
- reimbursements from state, local, and nonprofit reimbursable employers for unemployment benefits paid on their behalf, in the amount of \$1.3 billion for FY 2002 and \$1.0 billion for FY 2001.

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 that 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, 2002 and 2001; 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, 2002 and 2001.

As described in Note 1 (C and D) to the financial statements, the FY 2001 financial statements have been restated to adopt a provision in OMB Bulletin No. 01-09 that requires certain budget authority and other resources allocated to another agency be reported by the transferor; and for an error in the classification within equity of certain funds transferred from the Unemployment Trust Fund to State Unemployment Insurance and Employment Service Operations. The correction of this error for periods prior to FY 2001 has been shown as a prior period adjustment in the statement of changes in net position for FY 2001.

OTHER ACCOMPANYING INFORMATION

Our audit was conducted for the purpose of forming an opinion on the consolidated and combined financial statements of DOL taken as a whole. The accompanying financial information discussed below is

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not a required part of the principal financial statements.

The Required Supplementary Information, included in the Management Discussion and Analysis and FY 2002 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. 01-09. 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 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 and combined 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, 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

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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, assessing control risk, and performing 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

Job Corps Real Property Depreciation

We noted discrepancies in the calculation of depreciation for capitalized ETA Job Corps real property relating to 1998 and prior years. These discrepancies included:

- 13 assets that should have been fully depreciated but continued to have a net book value of \$6 million at April 30, 2002. Depreciation expense continued to be recorded each month.

- 526 assets that should have been fully depreciated at April 30, 2002. These items have no current year depreciation expense but continued to have a net book value of \$57 million.

The assets were fully depreciated as of September 30, 2002, by adjustment. However, Statement of Federal Financial Accounting Standards No. 6, *Accounting for Property, Plant, and Equipment*, requires the calculation of depreciation to be a **systematic and rational allocation** of the cost of general property, plant and equipment over the estimated useful life of the asset. In addition, GAO's *Standards for Internal Control in the Federal Government* require that internal controls should be designed to assure that ongoing monitoring occurs in the course of normal operations. The depreciation calculation for the items noted above was not adequately monitored to ensure a systematic and rational allocation. This weakness in internal control over assets valuation resulted in an overvaluation of property reported in DOL's FY 2001 financial statements.

ETA agreed that there was an oversight on its part, but believes that this is an isolated incident not requiring additional efforts or controls. However, we have concluded that stronger internal controls should be designed to help prevent future oversights.

We recommend that the Chief Financial Officer ensures that property valuations reported by the capitalized assets tracking and reporting system (CATARS) are accurate by developing and documenting internal controls that will include quarterly

reviews of the asset cost, net book value and depreciation expense.

ILAB Excessive Cost Accruals

The Bureau of International Labor Affairs (ILAB) has experienced rapid growth in its appropriations during the last several years, with its funding more than doubling from FY 2000 to FY 2001. This rapid growth has resulted in challenges in accounting methodologies for ILAB. Specifically, we have noted that ILAB does not have a documented accrual methodology for the costs of its grants, and that ILAB does not include subsequent verification of the estimated accruals when actual costs become known. As a result, accrued costs were overstated by approximately \$47 million at September 30, 2002. The cost accrual provisions of Grant Financial System Requirements, issued by the Joint Financial Management Improvement Program (JFMIP), require subsequent verification of estimated accruals.

We recommend that the Chief Financial Officer and the Assistant Secretary for Administration and Management ensure that a formal written accrual methodology is developed that satisfies all JFMIP system requirements. The methodology should include procedures for the subsequent verification of the accrual accuracy, and procedures for adapting the methodology as necessary based on the verification results.

Management concurs with the recommendation made by the OIG. They will review their current methodology and select an accrual method more in line with the specific types of ILAB grants.

Prior Year Reportable Conditions

Information Technology (IT) Controls

While the Department has made progress in strengthening its IT environment in the last 4 years, we noted several areas where the Department can continue to make improvements:

The Department lacks strong logical security controls to secure the Department's data and information.

The Department still lacks strong logical security controls to secure the Department's data and information. In the performance of our internal vulnerability assessment testing of the Department of Labor Accounting and Related Systems (DOLAR\$) for FY 2002, we identified significant vulnerabilities involving general controls and security that resulted in an alert report being issued to DOL's Chief Information Officer and Chief Financial Officer. To address these vulnerabilities, the Department needs to strengthen technical security standards, administrative procedures, enforcement processes, monitoring processes and response/recovery processes.

In response, management stated that while they believe the controls in place during FY 2002 would have prevented a significant compromise of the data in the DOLAR\$ system, they consider any security weakness to be serious. Management has taken additional steps to strengthen these controls.

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Accountable Property

We previously reported that several agencies did not have adequate procedures and systems to track accountable property (general property, plant, and equipment that does not meet the Department's capitalization threshold). During FY 2002, DOL entered into a contract to conduct a preliminary review of current DOL property management operations and property management systems, develop a new property management database and document responsibilities. This remains in the preliminary stages.

Further, in FY 2002, the Department raised its capitalization threshold from \$25,000 to \$50,000, which will substantially decrease the number of items requiring capitalization and tracking in the capitalized property system (CATARS). Because several agencies do not have adequate accountable property systems, items below this new threshold will not be tracked in any system; therefore, the potential risk of loss to the Department increases.

Management has stated that they agree with the need to improve controls over accountable property and are working to develop a Department-wide property system.

Capitalized Assets

We previously reported that management's capitalized asset tracking and reporting procedures are inadequate to ensure that disposals of capitalized assets are reported in a timely and accurate manner, and that assets are adequately safeguarded against loss or theft. To adequately safeguard assets, a physical inventory should be taken

on an annual basis to determine that all of the items in CATARS exist and are in use. A reconciliation should be performed to identify differences between the physical inventory and CATARS. The differences should be researched to determine why they were not located. During our FY 2002 audit, we determined that the Department was not performing reconciliations of CATARS to the physical inventory. Instead, the Department was comparing what was in CATARS to what was found, and removed items from CATARS that could not be found, rather than researching to find out the actual disposition of the missing assets.

Management concurs with the need to develop stronger controls and is working to correct these deficiencies.

Unemployment Insurance Benefit Overpayments

We previously reported certain deficiencies in the internal controls over Unemployment Insurance (UI) benefit payments. We identified that UI overpayment data collected by the Benefit Accuracy Measurement (BAM) data reflect significantly higher overpayments than those established and reported by the states' Benefit Payment Control (BPC) system. In FY 2002, management provided the OIG with a detailed corrective action plan and timeline, as well as descriptions of certain actions already put into place. While we generally concur with the corrective actions described by management, certain actions listed on the final timeline were not fully described in the written plan, and certain decisions regarding the measurement of least-detectable and nonrecoverable overpayments have yet to be finalized.

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ETA agreed with the need to provide a new plan, and recently provided a revised plan that will be reviewed during our FY 2003 audit work.

Accounting for Grants

ETA's grant accounting has the following deficiencies:

- While the number of grants in closeout reflects a steady decrease since FY 2000, our audit disclosed that the ending inventory of grants in closeout at September 30, 2002, does not include certain regional office grants that expired but were not identified for closeout or included in the tracking system. We also noted that the final certification process is not being performed timely.
- Transfers of WIA funds between programs continue to be unaccounted for in ETA's accounting records.
- While ETA has stepped up its efforts to obtain and record delinquent cost reports from its grantees, our FY 2002 audit continued to note delinquent reporting.
- We continued to note data entry errors in our grants testing. Errors were noted at both the regional offices, which are not recorded through the EIMS system, and the national office. For example, at the national level we identified over \$250 million in negative cost entries posted. At the regional offices, we noted errors in various Job Corps contracts selected for testing.

- ETA continues to operate without written grant accounting procedures, both at the regional and National offices.

ETA management has taken certain actions and is continuing to implement improvements to address our audit findings.

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS EXCLUSIVE OF THE FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT OF 1996 (FFMIA)

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 No. 01-02, including the requirements referred to in the *Federal Financial Management Improvement Act of 1996*. 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 no instances of noncompliance with laws and regulations that are required to be reported under *Government Auditing Standards* and OMB Bulletin 01-02.

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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.

REPORT ON COMPLIANCE WITH FFMIA

We have examined DOL's compliance with the requirements of FFMIA as of September 30, 2002. These include implementing and maintaining financial management systems that substantially comply with: (1) financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger (SGL) at the transaction level. Management is responsible for DOL's compliance with these requirements. Our responsibility is to express an opinion on DOL's compliance based on our examination.

Our examination was conducted in accordance with the attestation standards established by the American Institute of Certified Public Accountants; Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Bulletin No. 01-02, Audit Requirements for Federal Financial Statements. These standards include examining on a test basis, evidence about DOL's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on DOL's compliance with specified requirements.

In our opinion, as of September 30, 2002, DOL substantially complied with the requirements of FFMIA, except for applicable Federal accounting standards as described below:

Implementation of Managerial Cost Accounting

The Department of Labor is not in compliance with the requirements for managerial cost accounting contained in Statement of Federal Financial Accounting Standards Number 4 (SFFAS No. 4), *The Managerial Cost Accounting Concepts and Standards for the Federal Government*. Specifically, DOL has not defined outputs for its operating programs nor developed the capability to routinely report the cost of outputs at the operating program and activity levels for use in managing program operations. Additionally, DOL does not use managerial cost information for purposes of performance measurement, planning, budgeting or forecasting.

Noncompliance with requirements for managerial cost accounting persists primarily because DOL has not succeeded in its efforts to implement a functional managerial cost accounting system. System implementation has not been successful because agency and program management responsible for the vast majority of DOL's operating programs have not actively participated in the implementation effort led by the Office of the Chief Financial Officer.

We recommend that the Chief Financial Officer ensures the development of a comprehensive Department-wide managerial cost accounting system implementation plan by June 30, 2003, that

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will be fully operational by January 28, 2006.

In accordance with the provisions and requirements of the Act, the Secretary of Labor has determined that the Department of Labor financial management systems are in substantial compliance with the FFMIA. However, the OIG maintains the position that since costs are not captured and reported at the level required and there is not in place an integrated system that can be used by managers to manage DOL programs on a day-to-day basis, the Department has not implemented managerial cost accounting as required by the standard. Therefore, the OIG's opinion is that the Department is not in substantial compliance in this regard.

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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.

ELLIOT P. LEWIS
Assistant Inspector General for Audit

January 6, 2003