U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210

SEP 21 2006

MEMORANDUM FOR: VICTORIA LIPNIC
Assistant Secretary for Employment Standards

FROM: Elliot P. Lewis
ELLIOT P. LEWIS
Assistant Inspector General for Audit

SUBJECT: FY 2005 Longshore and Harbor Workers' Compensation Act Special Fund Audit
Final Report No.: 22-06-008-04-432

The Office of Inspector General contracted with M.D. Oppenheim & Company, P.C. (MDO), an independent public accounting firm, to audit the financial statements of Longshore and Harbor Workers' Compensation Act (LHWCA) Special Fund as of September 30, 2005, and for the year then ended. The contract required that the audit be conducted in accordance with auditing standards generally accepted in the United States of America, Government Auditing Standards, and Office of Management and Budget audit requirements.

MDO's opinion on the financial statements as of September 30, 2005 is unqualified. MDO's report on compliance with laws and regulations noted no instances of noncompliance. MDO's report on internal control notes a current year reportable condition. 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 of risk that misstatements caused by error or fraud 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. The following reportable condition is considered to be a material weakness:

MDO identified weaknesses in LHWCA's benefit program accounting. The recording of transactions in the general ledger and reconciling accounts was not performed timely, completely, or accurately. Additionally, there was no formal process to reconcile the benefit payment subsidiary system with amounts reported to Treasury and recorded in the general ledger.

MDO is responsible for the attached auditor's report and the conclusions expressed in the report. However, in connection with the contract, we reviewed MDO's report and related documentation and inquired of its representatives. Our review, as differentiated from an audit in accordance with Government Auditing Standards, was not intended to enable us to express, and we do not express, an opinion on LHWCA's financial statements; conclusions about the effectiveness of internal control; or conclusions on LHWCA's compliance with laws and regulations. Our review disclosed no instances where MDO did not comply, in all material respects, with Government Auditing Standards.

If you have any questions, please contact Michael T. McFadden on (202) 693-5164.

We appreciate the cooperation of all the Employment Standards Administration staff involved in this year's audit.

Attachment

cc: Anne Baird-Bridges
Rose Broadwater
Yoko Albayrak
Michael Niss
John Chamberlain

U.S. Department of Labor

Office of Inspector General—Office of Audit

EMPLOYMENT STANDARDS ADMINISTRATION

LONGSHORE AND HARBOR WORKERS' COMPENSATION ACT SPECIAL FUND FINANCIAL STATEMENTS AND INDEPENDENT AUDITORS' REPORT

September 30, 2005 and 2004

This report was prepared by M.D. Oppenheim & Company, P.C., under contract to the U.S. Department of Labor, Office of Inspector General, and by acceptance, it becomes a report of the Office of Inspector General.

Elliot P. Lewis

Assistant Inspector General for Audit

Date Issued: September 21, 2006
Report Number: 22-06-008-04-432

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M.D. OPPENHEIM & COMPANY, P.C.
CERTIFIED PUBLIC ACCOUNTANTS
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Independent Auditors' Report

Ms. Victoria Lipnic, Assistant Secretary
Employment Standards Administration
U.S. Department 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. The Longshore and Harbor Workers' Compensation Act Special Fund (the Fund) is included in the U.S. Department of Labor (DOL) annual financial statements issued to meet the CFO Act reporting requirements. In addition, the Longshore and Harbor Workers' Compensation Act requires that an annual report be made to Congress on the financial status of the Fund.

The objectives of our audits are to express an opinion on the fair presentation of the Fund's financial statements, obtain an understanding of the Fund'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 balance sheets of the Fund as of September 30, 2005 and 2004 and the related statements of net cost, changes in net position, budgetary resources, and financing for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. Those 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 audits provide a reasonable basis for our opinion.

Opinion on Financial Statements

In our opinion the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and net position of the Fund as of September 30, 2005 and 2004; and the net cost, changes in net position, budgetary resources, and reconciliation of net cost to budgetary resources for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Accompanying Information

Our audits were conducted for the purpose of forming an opinion on the Fund's financial statements taken as a whole. The information included in the Management Discussion and Analysis section of the Fund's annual financial statements is not a required part of the principal financial statements. The information is required by the Federal Accounting Standards Advisory Board and OMB Bulletin 01-09. 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.

Report on Internal Control

In planning and performing our audits, we considered the Fund's internal control over financial reporting by obtaining an understanding of the Fund's internal control, determined whether these 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 objectives of our audits were 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 caused by error or fraud 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 a certain matter, discussed in the following paragraphs, involving the internal control and its operations that we consider to be a reportable condition. However, we also believe the reportable condition is a material weakness.

With respect to internal control related to performance measures included in the Management Discussion and Analysis, 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.

Material Weakness

Weaknesses Noted Over LHWCA Accounting

The Employment Standards Administration (ESA) Office of Management, Administration, and Planning (OMAP) performs the accounting for the Longshore and Harbor Workers' Compensation Act Special Fund. These accounting procedures include entering transactions in the DOLAR$ general ledger and reconciling accounts. Many of these transactions are entered in DOLAR$ as monthly summary journal entries from various subsidiary records. In FY 2005, we noted several instances when the accounting for these activities was not performed timely, completely, or accurately. OMB Circular A-127 requires agency financial systems to provide reliable and timely information.

Additionally, ESA did not have a formal process to reconcile the LHWCA benefit payment subsidiary system with amounts reported to Treasury and recorded in the DOLAR$ general ledger. Although the OCFO performs Funds with Treasury reconciliations, the reconciliations are based on amounts recorded in the general ledger and do not include the detailed payment history databases included in the subsidiary system. Without a complete and formal reconciliation process, management cannot ensure that its payment subsidiary systems are in agreement with the actual payments reported and reconciled to Treasury.

These accounting and reconciliation problems arose because there was a significant employee turnover in OMAP, and ESA did not have sufficiently detailed or comprehensive written procedures to enable new staff to perform the required activities in an accurate and timely manner.

We recommend that the Chief Financial Officer and the Assistant Secretary for Employment Standards: ensure that OMAP develops adequate detailed written procedures that address all significant aspects of its accounting and financial management; the OMAP implements a human resource transition/succession plan which includes a description of key positions and detailed written procedures for the duties assigned to the position; and ensure that OMAP and OWCP develop and implement reconciliation procedures for the benefit payment histories and the SF-224, FMS 6653 and the DOLAR$ general ledger. Management generally concurs and has begun taking steps to address these recommendations.

We also noted other matters involving the internal control and its operations that have been reported to the management of DOL in a separate letter dated November 10, 2005.

Report on Compliance with Laws and Regulations

The management of the Fund is responsible for complying with laws and regulations applicable to the Fund. As part of obtaining reasonable assurance about whether the Fund'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 other laws and regulations specified in OMB Bulletin No. 01-02. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to the Fund. Providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

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

This report is intended solely for the information of the management of the Longshore and Harbor Workers' Compensation Act Special Fund and U.S. Department of Labor, the Office of Management and Budget, and the Congress, and is not intended to be and should not be used by anyone other than these specified parties.

M.D. Oppenheim & Company, P.C.

July 10, 2006

U. S. DEPARTMENT OF LABOR
EMPLOYMENT STANDARDS ADMINISTRATION

LONGSHORE AND HARBOR WORKERS' COMPENSATION ACT SPECIAL FUND FINANCIAL STATEMENTS SEPTEMBER 30, 2005 AND 2004

Office of Management, Administration and Planning
Division of Financial Management

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LONGSHORE AND HARBOR WORKERS'
COMPENSATION ACT SPECIAL FUND

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**LONGSHORE AND HARBOR WORKERS'
COMPENSATION ACT SPECIAL FUND**

ACRONYMS

AUP	Agreed Upon Procedures
DCCA	District of Columbia Workmen's Compensation Act Special Fund
DLHWC	Division of Longshore and Harbor Workers' Compensation
DOL	Department of Labor
ESA	Employment Standards Administration
FASAB	Federal Accounting Standards Advisory Board
FMFIA	Federal Managers' Financial Integrity Act
FY	Fiscal Year
JFMIP	Joint Financial Management Improvement Project
LCMS	Longshore Case Management System
LHWCPA	Longshore and Harbor Workers' Compensation Act
OMB	Office of Management and Budget
OWCP	Office of Workers' Compensation Programs
U.S.C.	United States Code

U. S. DEPARTMENT OF LABOR

EMPLOYMENT STANDARDS ADMINISTRATION

Longshore and Harbor Workers' Compensation Act Special Fund

SECTION I

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal Year 2005
Financial Statements

LONGSHORE AND HARBOR WORKERS' COMPENSATION ACT SPECIAL FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS SEPTEMBER 30, 2005

MISSION AND ORGANIZATIONAL STRUCTURE

The Longshore and Harbor Workers' Compensation Act (LHWCA) provides medical benefits, compensation for lost-wages and rehabilitation services for job-related injuries, diseases or death of private-sector workers in certain maritime and related employment. Generally, benefits are paid directly from private funds by an authorized self-insured employer or through an authorized insurance carrier. Cases meeting the requirements of the Longshore and Harbor Workers' Compensation statute are paid from the Fund comprised primarily of employer contributions (assessments) and administered by the DLHWC. In FY 2005, 5,740 workers (customers) received compensation benefits from the Fund.

The reporting entity is the Longshore and Harbor Workers' Compensation Act Special Fund (Fund). Organizationally the Fund is administered by the Employment Standards Administration (ESA), an agency within the United States Department of Labor. Within ESA, the Division of Longshore and Harbor Workers' Compensation (DLHWC) has direct responsibility for administration of the Fund. The Fund supports the program mission by providing compensation, and in certain cases, medical care payments to employees disabled from injuries which occurred on the navigable waters of the United States, or in adjoining areas used for loading, unloading, repairing, or building a vessel. The Fund also extends benefits to dependents if any injury resulted in the employee's death.

Additionally, the Longshore and Harbor Workers' Compensation Act Section 10(h) provides annual wage increase compensation (cost of living adjustments). Fifty percent of this annual wage increase for pre-1972 compensation cases is paid by Federal appropriated funds, and fifty percent is paid by the Fund through the annual assessment. Appropriated funding for 10(h) is not reflected in the accompanying financial statements.

Administrative services for operating the Fund are provided by the ESA through direct Federal Appropriations. Appropriated funding for administrative services is not reflected in the accompanying statements.

FINANCIAL HIGHLIGHTS

The majority of the revenue of the Fund is generated through annual recurring assessments paid by self-insured employers and insurance carriers and totaled $133,565,310 in FY 2005. This compares with assessment revenue of $135,813,028 for FY 2004. During FY 2005 and 2004, substantial recoveries were made for the Fund due to activities involving the application of Agreed Upon Procedures (AUP) on Forms LS-513, Report of Payments (used in the calculation of the annual assessment), and negotiation/collection of past due assessments. Equally important, the AUP activities have uncovered common reporting errors and other record-keeping mistakes which, when discovered, have been eliminated. The on-going AUP program recovered $3,240,708 in FY 2005 and $458,970 in FY 2004 for the Fund. These recoveries have and will continue to reduce carrier assessments.

Investment income for the Fund was $1,006,654 for FY 2005 compared to $420,648 for FY 2004. The average interest rate earned during FY 2005 was 2.48 percent compared to 1.12 percent for FY 2004. The Fund's costs remained relatively stable compared to FY 2004; $130,882,929 for FY 2005 compared to $134,480,081 for FY 2004.

The sources of payments into the Funds include: fines and penalties levied under the Act; payments by employers of $5,000 for each death case where there is no survivor entitled to the benefits; interest payments on Fund investments; and, by far the largest source, payment of annual assessments by self-insured employers and insurance carriers.

LONGSHORE AND HARBOR WORKERS' COMPENSATION ACT SPECIAL FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS SEPTEMBER 30, 2005

FINANCIAL HIGHLIGHTS – Continued

Proceeds of the Special Funds are used for payments under: section 8(f) for second injury claims; section 10(h) for initial and subsequent annual adjustments in compensation for permanent total disability or related death from injuries which occurred prior to the effective date of the 1972 LHWCA amendments; sections 39(c) and 8(g) for the procurement of medical and vocational rehabilitation services for permanently disabled employees and to provide a maintenance allowance to workers undergoing rehabilitation; section 18(b) for compensation to injured workers in cases of employer default; and section 7(e) for the cost of certain medical examinations.

PERFORMANCE GOALS AND RESULTS

The DLHWC supports the Department of Labor's **Strategic Goal 2** - *A Secure Workforce*. This goal broadly promotes the economic security of workers and families. In particular, the DLHWC program supports **Outcome Goal 2.2 –** *To Protect Worker Benefits*. The Department of Labor plays a large role in ensuring that worker benefits are protected and that employers administer benefit programs in an appropriate way. The Longshore program assists in meeting this outcome goal by establishing the long term performance goal of reducing by 12% in six years over the FY 2002 baseline the average time required to resolve disputed issues in Longshore and Harbor Workers' Compensation Program contests cases. The objective of this indicator is to quickly resolve disputes, enabling earlier benefit delivery and reducing litigation costs. Because the Program exceeded it sixth year goal in FY 2004, the performance target was increased to make it substantially more ambitious. The FY 2005 goal was:

> *Reduce by fourteen percent over the FY 2002 baseline the average time required to resolve disputed issues in Longshore and Harbor Worker's Compensation Program contested cases.*

This target was not achieved, with the program result of 254 days as the average number of days to resolve disputed issues, a 3.7% deviation from the target of 245 days. Had the performance target remained unchanged for FY 2005, the result would have been seventeen days below the target of 268 days.

Longshore management has focused on improving mediation skills and timeliness of district office intervention when disputes arose, with added emphasis on the accuracy of dispute tracking data. In FY 2006, these efforts will continue. The performance baseline has been revised to incorporate more challenging disputes, with a new long term goal of improving by 3% over three years from the FY 2005 baseline of 253 days the average time required to resolve claim disputes. The FY 2006 target will be 250 days.

INTERNAL CONTROLS AND SYSTEMS

The Longshore and Harbor Workers' Compensation Division's Branch of Financial Management and Insurance is a very small unit comprised of six employees and one supervisor, all working in very close proximity to each other. Unethical behavior is guarded against by carefully segregated duties, carefully assigned roles which are password protected, and by close supervision. Much of the oversight, evaluation, monitoring, and control and almost all of the supervisory activity is informal, done on a face-to-face basis. Similarly, each of the district offices is in itself a small unit, operating in the same fashion as the Branch of Financial Management and Insurance.

Management communicates all procedural, policy, and operating goals to staff by means of weekly staff meetings, a written procedure manual, frequent e-mail communication, and frequent individual communications regarding changes, problems and issues.

LONGSHORE AND HARBOR WORKERS' COMPENSATION ACT SPECIAL FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS SEPTEMBER 30, 2005

INTERNAL CONTROLS AND SYSTEMS – continued

Statutes provide the formal standards where these are applicable, such as privacy statutes, cash handling procedures and conflict of interest regulations. All codes, statutes, and regulations governing the conduct of Federal employees apply to all Longshore Division employees.

Cases paid by the Special Fund are paid as a result of a formal Compensation Order issued by a District Director or Administrative Law Judge, setting forth precisely what payment is due and to whom the payment is due. Each new case coming in for Special Fund payment is prepared and reviewed by a total of five different employees before payment is made, thus insuring accuracy.

Monthly cash statements, monthly case management reports, quarterly review processes, biweekly payment summaries, the SF-224 report and statement of differences all provide current, reliable, and accurate information.

KNOWN RISKS AND UNCERTANTIES

The Longshore Special Fund is the single largest payer of indemnity payments under the Longshore Act. It pays more than double the next largest payer of benefits. Although there are nearly 600 authorized insurance carriers and self-insured employers, benefit payments are concentrated among a relatively few. For example, the top 10 carriers/self-insurers alone pay almost one-half of total industry payments excluding Special Fund payments.

The Special Fund is assessed one year at a time for current expenses. There are no reserve funds for future Special Fund obligations. It is strictly pay as you go one year at a time, in keeping with the language of section 44 of the Longshore Act.

Taken together, these two factors could indicate future problems if one or more of the largest payers become insolvent and unable to pay their assessment obligations. Temporary collection issues could result, necessitating special, unscheduled assessments or other actions to keep the Special Fund funded for current liabilities.

LIMITATIONS OF THE FINANCIAL STATEMENTS

The following limitations are part of the financial statements:

- The financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of the Chief Financial Officers Act of 1990, U.S.C. 3515 (b).
- While the statements have been prepared from the books and records of the Fund in accordance with the formats prescribed by OMB, the statements are different from the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.
- The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity, that liabilities cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

U. S. DEPARTMENT OF LABOR

EMPLOYMENT STANDARDS ADMINISTRATION

Longshore and Harbor Workers' Compensation Act Special Fund

SECTION II

FINANCIAL STATEMENTS

Fiscal Year 2005 and 2004 Financial Statements

LONGSHORE AND HARBOR WORKERS' COMPENSATION ACT SPECIAL FUND

BALANCE SHEETS
As of September 30, 2005 and 2004

	2005	2004
ASSETS		
Intra-governmental assets		
Funds with U.S. Treasury (Note 2)	$ 13,309,829	$ 465,067
Investments (Note 3)	60,000,000	69,653,321
Total intra-governmental assets	73,309,829	70,118,388
Accounts receivable, net of allowance (Note 4)	1,221,523	1,316,673
Total assets	$ 74,531,352	$ 71,435,061
LIABILITIES AND NET POSITION		
Liabilities		
Accounts Payable	$ 476,567	$ 0
Accrued benefits payable	3,234,327	3,155,032
Deferred revenue	36,583,028	34,164,308
Other liabilities (Note 5)	8,429,029	9,973,788
Total liabilities	48,722,951	47,293,128
Net position		
Cumulative results of operations	25,808,401	24,141,933
Total liabilities and net position	$ 74,531,352	$ 71,435,061

LONGSHORE AND HARBOR WORKERS'
COMPENSATION ACT SPECIAL FUND

STATEMENTS OF NET COST
For the Years Ended September 30, 2005 and 2004

	2005	2004
SPECIAL FUND NET COST OF OPERATIONS		
With the public		
Second injury compensation, Section 8(f)	$ 120,095,708	$ 123,436,824
Wage increase compensation, Section 10(h)	1,976,776	2,091,456
Compensation payment for self-insurer in default, Section 18(b)	4,760,655	4,716,042
Rehabilitation services, Section 39 (c)	2,602,208	2,968,490
Rehabilitation maintenance, Section 8(g)	985	175
Medical services, Section 7(e)	185	8,939
Bankrupt self-insured employers	1,446,412	1,258,155
Net cost of operations	$ 130,882,929	$ 134,480,081

LONGSHORE AND HARBOR WORKERS' COMPENSATION ACT SPECIAL FUND

STATEMENTS OF CHANGES IN NET POSITION
For the Years Ended September 30, 2005 and 2004

	2005	2004
CUMULATIVE RESULTS OF OPERATIONS		
Cumulative results of operations, beginning	$ 24,141,933	$ 24,409,338
Budgetary financing sources:		
Transfers in/out without reimbursement (Note 6)	(2,022,567)	(2,021,000)
Non-exchange revenues:		
Interest	1,006,654	420,648
Assessments	133,565,310	135,813,028
Total non-exchange revenues	134,571,964	136,233,676
Total financing sources	132,549,397	134,212,676
Net cost of operations	(130,882,929)	(134,480,081)
Net position, end of period	$ 25,808,401	$ 24,141,933

LONGSHORE AND HARBOR WORKERS'
COMPENSATION ACT SPECIAL FUND

STATEMENTS OF BUDGETARY RESOURCES
For the Years Ended September 30, 2005 and 2004

	2005	2004
BUDGETARY RESOURCES		
Budgetary authority:		
Appropriations received	$ 135,647,836	$ 141,041,377
Unobligated balance:		
Beginning of period	66,856,569	62,173,892
Temporary not available pursuant to Public Law	(1,122)	(14,995)
Total budgetary resources	$ 202,503,283	$ 203,200,274
STATUS OF BUDGETARY RESOURCES		
Obligations incurred (Note 7)		
Direct	$ 132,905,496	$ 136,343,705
Unobligated balances available		
Apportioned		
Other available - exempt from apportionment	69,597,787	66,856,569
Total status of budgetary resources	$ 202,503,283	$ 203,200,274
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Obligated balance, net, beginning	$ 3,155,032	$ 2,185,301
Obligated balance, net, ending		
Accounts payable	3,710,894	3,155,032
Outlays:		
Disbursements	132,349,634	135,360,785
Net outlays	$ 132,349,634	$ 135,360,785

LONGSHORE AND HARBOR WORKERS'
COMPENSATION ACT SPECIAL FUND

STATEMENTS OF FINANCING
For the Years Ended September 30, 2005 and 2004

	2005	2004
RESOURCES USED TO FINANCE ACTIVITIES		
Budgetary Resources Obligated		
Obligations incurred	$ 132,905,496	$ 136,343,705
Other Resources		
Transfers, net	(2,022,567)	(2,021,000)
Total resources used to finance activities	130,882,929	134,322,705
COMPONENTS OF THE NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD		
Components Not Requiring or Generating Resources		
Revaluation of assets and liabilities	0	366,628
Benefit overpayments	0	(209,252)
Total components of net cost of operations that will not require or generate resources in the current period	0	157,376
Net cost of operations	$ 130,882,929	$ 134,480,081

U. S. DEPARTMENT OF LABOR

EMPLOYMENT STANDARDS ADMINISTRATION

Longshore and Harbor Workers' Compensation Act Special Fund

SECTION III

NOTES TO THE FINANCIAL STATEMENTS

Fiscal Year 2005 and 2004 Financial Statements

LONGSHORE AND HARBOR WORKERS' COMPENSATION ACT SPECIAL FUND

NOTES TO THE FINANCIAL STATEMENTS
For the Years Ended September 30, 2005 and 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies which have been followed by the Fund in preparing the accompanying financial statements are set forth below.

A. Reporting Entity

These financial statements present the financial position, net cost of operations, changes in net position, budgetary resources and financing activities of the Longshore and Harbor Workers' Compensation Act Special Fund (Fund). The Fund is administered by the Employment Standards Administration (ESA) which is an agency within the United States Department of Labor. Within ESA, the Division of Longshore and Harbor Workers' Compensation has direct responsibility for administration of the Fund. The Fund offers compensation, and in certain cases, medical care payments to employees disabled from injuries which occurred on the navigable waters of the United States, or in adjoining areas used for loading, unloading, repairing, or building a vessel. The Fund also extends benefits to dependents if any injury resulted in the employee's death.

Additionally, the Longshore and Harbor Workers' Compensation Act [Section 10(h)] provides annual wage increase compensation (cost of living adjustments). Fifty percent of this annual wage increase for pre-1972 compensation cases is paid by Federal appropriated funds and fifty percent is paid by the Fund through the annual assessment. Appropriated funding for 10(h) is not reflected in the accompanying financial statements.

B. Basis of Accounting and Presentation

These financial statements present the financial position, net cost of operations, changes in net position, budgetary resources and financing activities of the Longshore and Harbor Workers' Compensation Act Special Fund (Fund), in accordance with accounting principles generally accepted in the United States of America and the form and content requirements of OMB Circular A-136. These financial statements have been prepared from the books and records of the Fund. These financial statements are not intended to present, and do not present, the full cost of the Longshore and Harbor Workers' Compensation Act Program (Longshore Program). In addition to the Fund costs presented in these statements, the full cost of the Longshore Program would include certain direct costs of ESA in the form of salaries and expenses for administration of the Longshore Program and allocated costs of ESA and other DOL agencies incurred in support of the Longshore Program. The full cost of the Longshore Program is included in the Consolidated Financial Statements of the U.S. Department of Labor.

Accounting principles generally accepted in the United States of America encompass both accrual and budgetary transactions. Under accrual accounting, revenues are recognized when earned, and expenses are recognized when a liability is incurred. Budgetary accounting facilitates compliance with legal constraints on, and controls over, the use of federal funds. These financial statements are different from the financial reports, also prepared for the Fund pursuant to OMB directives, used to monitor the Fund's use of budgetary resources.

**LONGSHORE AND HARBOR WORKERS'
COMPENSATION ACT SPECIAL FUND**

**NOTES TO THE FINANCIAL STATEMENTS
For the Years Ended September 30, 2005 and 2004**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

C. Funds with U.S. Treasury

The Fund does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Treasury. The Funds with U.S. Treasury are trust funds that are available to pay current liabilities and finance authorized purchase commitments.

D. Investments

Investments in U.S. Government securities are reported at cost, net of unamortized premiums or discounts, which approximates market value. Premiums or discounts are amortized on a straight-line basis, which approximates the effective interest method. The Fund's intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain the operations of the Fund. No provision is made for unrealized gains or losses on these securities because, in the majority of cases, they are held to maturity.

E. Accounts Receivable, Net of Allowance

The amounts due as receivables are stated net of an allowance for uncollectible accounts. The allowance is estimated based on past experience in the collection of the receivables and an analysis of the outstanding balances. Also included as benefit overpayments receivable are Fund benefit overpayments made to individuals primarily from amended compensation orders and corrections of payment computations.

F. Accrued Benefits Payable

The Longshore and Harbor Workers' Compensation Special Fund provides compensation and medical benefits for work related injuries to workers in certain maritime employment. The Fund recognizes a liability for disability benefits payable to the extent of unpaid benefits applicable to the current period.

G. Deferred Revenue

Deferred revenues represent the unearned assessment revenues as of September 30, the Fund's accounting year end. The annual assessments cover a calendar year and, accordingly, the portion extending beyond September 30 has been deferred.

H. Financing Sources Other Than Exchange Revenue

Non-exchange revenues arise from the Federal government's power to demand payments from and receive donations from the public. Non-exchange revenues are recognized by the Fund for assessments levied against the public and interest income from investments.

The Fund's primary source of revenue is annual assessments levied on insurance carriers and self-insured employers. Assessments are recognized as non-exchange revenue when due. Included in revenues are recoveries of amounts

LONGSHORE AND HARBOR WORKERS' COMPENSATION ACT SPECIAL FUND

NOTES TO THE FINANCIAL STATEMENTS
For the Years Ended September 30, 2005 and 2004

H. Financing Sources Other Than Exchange Revenue - Continued

reassessed to carriers related to prior years. These reassessments primarily result from application of Agreed Upon Procedures (AUP) on reported carrier data. Recoveries amounted to $3,240,708 during fiscal year ended September 30, 2005 and $458,970 during fiscal year ended September 30, 2004.

The Fund also receives interest on Fund investments and on Federal funds in the possession of non-Federal entities.

NOTE 2 - FUNDS WITH U.S. TREASURY

Funds with the U.S. Treasury at September 30, 2005 and 2004 consisted of cash deposits of $13,309,829 and $465,067 respectively. These cash deposits at September 30, 2005 and 2004 included $143,307 and $14,464 respectively which are being held as security by authority of Section 32 of the Longshore and Harbor Workers' Compensation Act. These funds relate to the default of self-insured employers, are available for payment of compensation and medical benefits to covered employees of the defaulted companies.

Funds with U.S. Treasury at September 30, 2005 consisted of the following:

	Entity Assets					
	Unobligated Balance Available	Unobligated Balance Unavailable	Obligated Balance Not Yet Disbursed	Total Entity Assets	Non-entity Assets	Total
Special Fund	$ 0	$ 0	$ 13,309,829	$13,309,829	$ 0	$13,309,829

Funds with U.S. Treasury at September 30, 2004 consisted of the following:

	Entity Assets					
	Unobligated Balance Available	Unobligated Balance Unavailable	Obligated Balance Not Yet Disbursed	Total Entity Assets	Non-entity Assets	Total
Special Fund	$ 0	$ 0	$ 465,067	$ 465,067	$ 0	$ 465,067

LONGSHORE AND HARBOR WORKERS' COMPENSATION ACT SPECIAL FUND

NOTES TO THE FINANCIAL STATEMENTS
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NOTE 3 - INVESTMENTS

Investments at September 30, 2005 and 2004 consisted of the following:

	September 30, 2005			
	Face Value	Discount	Net Value	Market Value
Intragovernmental securities				
Marketable	$ 60,000,000	$ 0	$ 60,000,000	$ 60,000,000

	September 30, 2004			
	Face Value	Discount	Net Value	Market Value
Intragovernmental securities				
Marketable	$ 69,863,000	$ (209,679)	$ 69,653,321	$ 69,653,321

Investments of $8,252,000 and $9,586,548 at September 30, 2005 and 2004, respectively are being held as security by authority of Section 32 of the Longshore and Harbor Workers' Compensation Act. These investments are available for payment of compensation and medical benefits to covered employees of the defaulted companies. Investments at September 30, 2005 and 2004 consist of overnight securities and short-term U.S. Treasury Bills that are stated at amortized cost which approximates market respectively. Investments at September 30, 2005 bear an interest rate of 3.46% compared to rates varying from 1.34% to 1.89% for 2004. Interest rates on securities bought and sold during fiscal year 2005 ranged from 1.34% to 3.67% compared to 0.89% to 1.89% for fiscal year 2004.

NOTE 4 - ACCOUNTS RECEIVABLE, NET

Accounts receivable at September 30, 2005 and 2004 consisted of the following:

	2005	2004
Entity assets		
Benefit overpayments	$1,466,511	$ 1,466,511
Assessments receivable	193,903	289,053
Less: allowance for doubtful accounts	(438,891)	(438,891)
Total accounts receivable, net	$1,221,523	$ 1,316,673

Assessments receivable represent the unpaid annual assessments from the current and prior years. Accounts receivable from overpayments to claimants arise primarily from amended compensation orders and corrections of payment computations. These receivables are being primarily recovered by partial and total withholding of benefit payments.

LONGSHORE AND HARBOR WORKERS' COMPENSATION ACT SPECIAL FUND

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NOTE 4 - ACCOUNTS RECEIVABLE, NET - Continued

Changes in the allowance for doubtful accounts during FY 2005 and FY 2004 consisted of the following:

	2005				
	Allowance 9-30-04	Write Offs	Revenue Adjustment	Bad Debt	Allowance 9-30-05
Entity assets					
Benefit overpayments	$ (366,628)	$ 0	$ 0	$ 0	$ (366,628)
Assessment receivable	(72,263)	0	0	0	(72,263)
	$(438,891)	$ 0	$ 0	$ 0	$ (438,891)

	2004				
	Allowance 9-30-03	Write Offs	Revenue Adjustment	Bad Debt	Allowance 9-30-04
Entity assets					
Benefit overpayments	$ (381,135)	$ 381,135	$ -	$ (366,628)	$ (366,628)
Assessment receivable	(123,428)	(19,954)	71,119	0	(72,263)
	$(504,563)	$ 361,181	$ 71,119	$(366,628)	$ (438,891)

NOTE 5 - OTHER LIABILITIES

Other liabilities at September 30, 2005 and 2004 consisted of the following current liabilities:

	2005	2004
Other liabilities		
Assessment overpayments by carriers	$ 33,722	$ 372,776
Defaulted employer liability		
Held in investments	8,252,000	9,586,548
Held in cash	143,307	14,464
	8,395,307	9,601,012
Total other liabilities	$ 8,429,029	$ 9,973,788

Assessment overpayments are to be refunded upon request or applied to reduce future assessments.

Defaulted employer liability relates to funds and investments held by the Longshore Special Fund which are being held as security by authority of Section 32 of the Act. These funds and investments are available for compensation and medical benefits to covered employees of the defaulted companies. Management estimates that these funds and investments held will not be sufficient to cover the future benefits associated with the covered employees.

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NOTE 6 - RELATED PARTY TRANSACTIONS

The Fund reimburses the Office of Workers' Compensation Programs (OWCP) (a related entity within the Employment Standards Administration) for rehabilitation services provided to eligible claimants and certain direct expenses associated with administrative support of the Fund. Amounts paid to the OWCP were $2,022,567 in 2005 and $2,021,000 in 2004.

NOTE 7 – STATEMENT OF BUDGETARY RESOURCES

A. Apportionment Categories of Obligations Incurred

	2005	2004
Direct Obligations		
Exempt from apportionment	$ 132,905,496	$ 136,343,705

B Explanation of Differences Between the Statement of Budgetary Resources and the Budget of the United States Government

The Budget of the United States Government with actual amounts for the year ended September 30, 2005, has not been published as of the issue date of these financial statements. This document will be available in February 2006. In, addition, the reconciliation of the Report of Budget Execution (SF133) and the Statement of Budgetary Resources will be performed in FY 2006 after the Department receives the final SF133 reports from Trust Fund and allocated accounts.

A reconciliation of budgetary resources, obligations incurred and outlays, as presented in the Statement of Budgetary Resources to amounts included in the Budget of the United States Government for the year ended September 30, 2004 is shown below:

	2004		
(Dollars in Millions)	Budgetary Resources	Obligations Incurred	Outlays
Statement of Budgetary Resources	$ 203	$ 136	$ 135
District of Columbia Workers' Compensation	$ 16	$ 11	$ 11
Budget of the United States Government	$ 219	$ 147	$ 146

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NOTE 8 - CONTINGENCIES AND COMMITMENTS

The Division of Longshore and Harbor Workers' Compensation within ESA may be an interested party in various lawsuits related to benefits paid or payable. Per Statement of Federal Financial Accounting Standards (SFFAS) No. 5, as amended by SFFAS No. 12, a contingent liability should be disclosed if any of the three conditions for liability recognition are not met and there is at least a reasonable possibility that a loss or an additional loss my have been incurred.

A Longshore Harbor Workers' Compensation Act benefits claim has been filed against a company and its insurer for injuries a claimant sustained in the course of employment. A related civil case has been filed by the insurer seeking a judgment declaring the Longshore insurance policy void and excusing the insurer from any liability to the company or the claimant for the injuries sustained. The Government's response in all forums is to obtain determinations that the insurer is liable to pay the claimant's compensation and eliminate the possibility that the company will be deemed the only liable payer. This should protect the Fund from incurring a liability to pay the claimant's compensation pursuant to section 18(b). The chance of an unfavorable outcome is less than probable but more than remote. The immediate loss would be approximately $1 million in already accrued compensation benefits and medical expenses. Future expenses are expected to be higher.

Section 39(c)(2) of the Longshore and Harbor Workers' Compensation Act authorizes vocational rehabilitation of disabled employees and Section 8(g) provides additional compensation to disabled employees while undergoing rehabilitation training. Rehabilitation services paid from the Fund are mainly provided by private counselors and private training facilities. The rehabilitation agreements are funded by future assessments from the insurance carriers and self-insured employers. The amount of the outstanding rehabilitation agreements at September 30, 2005 is $4,925,955 compared to $4,507,966 for September 30, 2004.