U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210

NOV 15 2010

MEMORANDUM FOR: JAMES L. TAYLOR
Chief Financial Officer

FROM: ELLIOT P. LEWIS
Assistant Inspector General
for Audit

SUBJECT: FY 2010 Independent Auditors' Report
Report Number: 22-11-002-13-001

Attached is the Independent Auditors' Report on the U.S. Department of Labor's (DOL) FY 2010 financial statements. We contracted with the independent certified public accounting firm of KPMG LLP (KPMG) to audit the financial statements of the DOL as of and for the years ended September 30, 2010 and 2009. The contract required that the audit be conducted in accordance with generally accepted government auditing standards (GAGAS) and Office of Management and Budget (OMB) audit requirements. KPMG's opinion on the FY 2009 DOL financial statements is unqualified. As stated in the report, the scope of KPMG's work was not sufficient to enable them to express an opinion on the FY 2010 DOL financial statements. KPMG's report on internal control over financial reporting identified certain deficiencies that are considered to be material weaknesses and other deficiencies that are considered to be significant deficiencies, as follows:

Material Weaknesses

1. Lack of Sufficient Controls over Financial Reporting
2. Lack of Sufficient Controls over Budgetary Accounting
3. Improvements Needed in the Preparation and Review of Journal Entries
4. Lack of Adequate Controls over Access to Key Financial and Support Systems

Significant Deficiencies

5. Weakness Noted over Payroll Accounting
6. Untimely and Inaccurate Processing of Property, Plant, and Equipment Transactions

KPMG concluded DOL did not substantially comply with the requirements of the *Federal Financial Management Improvement Act (FFMIA) of 1996* as of September 30, 2010. Furthermore, KPMG concluded DOL's FY 2010 assessment process was not in full compliance with the *Federal Managers' Financial Integrity Act of 1982*.

KPMG is responsible for the attached auditors' report and the conclusions expressed in the report. However, in connection with the contract, we reviewed KPMG's report and related documentation and inquired of its representatives. Our review, as differentiated from an audit in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on DOL's financial statements; or conclusions about the effectiveness of internal control; or on whether DOL's financial management systems substantially complied with FFMIA; or conclusions on DOL's compliance with laws and regulations. Our review disclosed no instances where KPMG did not comply, in all material respects, with GAGAS and OMB audit requirements.

This report is for inclusion in the DOL's Agency Financial Report. We noted certain additional matters that did not rise to the level of a material weakness or significant deficiency that we will report to management separately.

If you have any questions, please contact Joseph Donovan, Jr. at (202) 693-5248.

We appreciate the cooperation of all DOL staff involved in this year's audit.

Attachment

cc: Karen Tekleberhan, Deputy Chief Financial Officer

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

Secretary and Inspector General
U.S. Department of Labor:

We have audited the accompanying consolidated balance sheet of the U.S. Department of Labor (DOL) as of September 30, 2009; the related consolidated statements of net cost and changes in net position, and combined statement of budgetary resources for the year then ended; and the statements of social insurance as of September 30, 2009, 2008, 2007, and 2006 (hereinafter referred to as "fiscal year [FY] 2009 consolidated financial statements"). Further, we were engaged to audit the accompanying consolidated balance sheet of DOL as of September 30, 2010; the related consolidated statements of net cost and changes in net position, and combined statement of budgetary resources for the year then ended; and the statement of social insurance as of September 30, 2010 (hereinafter referred to as "FY 2010 consolidated financial statements"). In connection with our FY 2010 engagement, we also considered DOL's internal control over financial reporting and DOL's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on the FY 2010 consolidated financial statements.

We have also examined DOL's compliance with section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA) as of September 30, 2010.

SUMMARY

As stated in our report on the financial statements, we concluded that DOL's consolidated financial statements present fairly, in all material respects, the financial position of DOL as of September 30, 2009; its net costs, changes in net position, and budgetary resources for the year then ended; and the financial condition of its social insurance program as of September 30, 2009, 2008, 2007, and 2006, in conformity with U.S. generally accepted accounting principles.

Also as stated in our report on the financial statements, the scope of our work was not sufficient to enable us to express an opinion on DOL's consolidated financial statements as of and for the year September 30, 2010.

As discussed in our report on the financial statements, the statements of social insurance present the actuarial present value of DOL's future expenditures to be paid to or on behalf of participants, estimated future income to be received from excise taxes, and estimated expenditures for administrative costs during a projection period ending in 2040.

Our consideration of internal control over financial reporting resulted in identifying certain deficiencies that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies, as defined in the Internal Control over Financial Reporting section of this report, as follows:

Material Weaknesses

1. Lack of Sufficient Controls over Financial Reporting

2. Lack of Sufficient Controls over Budgetary Accounting

3. Improvements Needed in the Preparation and Review of Journal Entries

4. Lack of Adequate Controls over Access to Key Financial and Support Systems

Significant Deficiencies

5. Weakness Noted over Payroll Accounting

6. Untimely and Inaccurate Processing of Property, Plant, and Equipment (PP&E) Transactions

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed the following instance of noncompliance and two other matters that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

1. *Federal Managers' Financial Integrity Act of 1982* (FMFIA)

As stated in our opinion on DOL's compliance with section 803(a) of FFMIA, we concluded that DOL did not comply, in all material respects, with the requirements of section 803(a) of FFMIA as of September 30, 2010.

Other deficiencies in internal control over financial reporting, potentially including additional material weaknesses and significant deficiencies, and other instances of noncompliance may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DOL's FY 2010 consolidated financial statements.

The following sections discuss our opinion on DOL's FY 2009 consolidated financial statements; the reasons why we are unable to express an opinion on DOL's FY 2010 consolidated financial statements; our consideration of DOL's internal control over financial reporting; our tests of DOL's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements; our opinion on compliance with FFMIA; and management's and our responsibilities.

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying consolidated balance sheet of the U.S. Department of Labor as of September 30, 2009; the related consolidated statements of net cost and changes in net position, and the combined statement of budgetary resources for the year then ended; and the statements of social insurance as of September 30, 2009, 2008, 2007, and 2006.

In our opinion, the FY 2009 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of Labor as of September 30, 2009; its net costs, changes in net position, and budgetary resources for the year then ended; and the financial condition of its social insurance program as of September 30, 2009, 2008, 2007, and 2006, in conformity with U.S. generally accepted accounting principles.

We were engaged to audit the accompanying consolidated balance sheet of the U.S. Department of Labor as of September 30, 2010; the related consolidated statements of net cost and changes in net position, and the combined statement of budgetary resources for the year then ended; and the statement of social insurance as of September 30, 2010.

In January 2010, DOL implemented a new financial accounting and reporting system. As a result of the implementation, DOL encountered a significant number of data migration, posting, reconciliation, and reporting issues that hindered its ability to assure the accuracy and completeness of consolidated financial statement balances and to provide data necessary for audit testing.

Specifically, DOL was unable to provide sufficient evidential matter that supports certain balance sheet accounts including fund balance with Treasury, intra-governmental accounts receivable, accounts receivable, other-advances, intra-governmental accounts payable, accounts payable, accrued benefits, and the components of net position, as reported in the accompanying DOL consolidated balance sheet as of September 30, 2010. Certain of these issues also impact the statement of social insurance as of September 30, 2010.

DOL was also unable to provide sufficient evidential matter that supports gross cost and earned revenue reported in the consolidated statement of net cost for the year ended September 30, 2010; budgetary financing sources and other financing sources reported in the consolidated statement of changes in net position for the year ended September 30, 2010; and budgetary resources, status of budgetary resources, change in obligated balance, and net outlays reported in the combined statement of budgetary resources for the year ended September 30, 2010.

We were unable to obtain certain representations from DOL management regarding consistency with U.S. generally accepted accounting principles with respect to the presentation of the accompanying FY 2010 consolidated financial statements.

It was impracticable to extend our procedures sufficiently to determine the extent, if any, to which DOL's FY 2010 consolidated financial statements may have been affected by the conditions discussed in the four preceding paragraphs. Accordingly, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying consolidated financial statements of the U.S. Department of Labor as of and for the year ended September 30, 2010.

As discussed in Note 1-W to the consolidated financial statements, the statements of social insurance present the actuarial present value of DOL's future expenditures to be paid to or on behalf of participants, estimated future income to be received from excise taxes, and estimated expenditures for administrative costs during a projection period ending in 2040. In preparing the statements of social insurance, management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statements. However, because of the large number of factors that affect the statement of social insurance and the fact that future events and circumstances cannot be known with certainty, there will be differences between the estimates in the statement of social insurance and the actual results, and those differences may be material.

The information in the Management's Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information sections is not a required part of the consolidated financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We were unable to complete certain limited procedures over this information as prescribed by professional standards because of the limitations on the scope of our engagement described in the previous paragraphs of this section of our report. We did not audit this information and, accordingly, we express no opinion on it.

The information in the Secretary's Message and Other Accompanying Information section are presented for purposes of additional analysis and are not required as part of the consolidated financial statements. This information has not been subjected to auditing procedures and, accordingly, we express no opinion on it.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Our consideration of the internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, in our FY 2010 engagement, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in Exhibit I to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in Exhibit II to be significant deficiencies.

As discussed in our report on the financial statements, the scope of our work was not sufficient to enable us to express an opinion on DOL's consolidated financial statements as of and for the year ended September 30, 2010. Had we been able to perform all of the procedures necessary to express an opinion, other matters involving internal control over financial reporting may have been identified and reported.

We noted certain additional matters that we will report to management of DOL in a separate letter.

COMPLIANCE AND OTHER MATTERS

The results of certain of our tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in the FFMIA, disclosed one instance of noncompliance that is required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04, as amended, and is described in Exhibit III.

Other Matters. DOL is currently reviewing two incidents regarding potential violations of the *Anti-deficiency Act.* As of the date of this report, no final noncompliance determination has been made for either of the two incidents.

We noted certain additional matters that we will report to management of DOL in a separate letter.

As discussed in our report on the financial statements, the scope of our work was not sufficient to enable us to express an opinion on DOL's consolidated financial statements as of and for the year ended September 30, 2010. Had we been able to perform all of the procedures necessary to express an opinion, other matters involving compliance with laws, regulations, contracts, and grant agreements may have been identified and reported.

OPINION ON COMPLIANCE WITH FFMIA

DOL represented that, in accordance with the provisions and requirements of FFMIA, the Secretary of Labor determined that DOL's financial management systems are not in substantial compliance with FFMIA.

We have examined the U.S. Department of Labor's compliance with section 803(a) of the *Federal Financial Management Improvement Act of 1996* as of September 30, 2010. Under section 803(a) of FFMIA, the U.S. Department of Labor's financial management systems are required to substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. We used OMB's *Implementation Guidance for the Federal Financial Management Improvement Act*, dated January 9, 2009, to determine compliance.

Our examination disclosed certain weaknesses in DOL's financial management systems' access controls and related manual controls. DOL was also unable to produce timely and reliable financial reports, including auditable FY 2010 consolidated financial statements. These matters are further described in Exhibit III.

In our opinion, because of the effects of the matters discussed in the preceding paragraph, the U.S. Department of Labor did not substantially comply with FFMIA section 803(a) as of September 30, 2010.

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RESPONSIBILITIES

Management's Responsibilities. Management is responsible for the consolidated financial statements; establishing and maintaining effective internal control; and complying with laws, regulations, contracts, and grant agreements applicable to DOL.

Auditors' Responsibilities. As discussed in our report on the financial statements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying consolidated financial statements of DOL as of and for the year ended September 30, 2010.

Regarding the FY 2009 consolidated financial statements presented herein, our responsibility is to express an opinion on the FY 2009 consolidated financial statements of DOL based on our audit. We conducted our FY 2009 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 OMB Bulletin No. 07-04, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of DOL's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall consolidated financial statement presentation.

We believe that our audit provides a reasonable basis for our opinion on the FY 2009 consolidated financial statements.

In connection with our FY 2010 engagement, we considered DOL's internal control over financial reporting by obtaining an understanding of DOL's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures. We did not test all controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our engagement was not to express an opinion on the effectiveness of DOL's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of DOL's internal control over financial reporting. Further, other matters involving internal control over financial reporting may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DOL's consolidated financial statements as of and for the year ended September 30, 2010.

In connection with our FY 2010 engagement, we performed tests of DOL's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, as amended. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to DOL. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our engagement and, accordingly, we do not express such an opinion. In addition, other matters involving compliance with laws, regulations, contracts, and grant agreements may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DOL's consolidated financial statements as of and for the year ended September 30, 2010.

Our responsibility also included expressing an opinion on DOL's compliance with FFMIA section 803(a) requirements as of September 30, 2010, based on our examination. Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and accordingly, included examining, on a test basis, evidence about DOL's compliance with the requirements of FFMIA section 803(a) 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.

KPMG

DOL's response to the findings identified in our engagement is presented in Exhibits I, II, and III. We did not audit DOL's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of DOL's management, DOL's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 15, 2010

1. Lack of Sufficient Controls over Financial Reporting

In fiscal year (FY) 2009, we reported a significant deficiency relating to the lack of sufficient internal controls over financial statement preparation. We recommended that the Chief Financial Officer (a) ensure that Office of Chief Financial Officer (OCFO) personnel perform a more detailed review of all financial information in the *Performance and Accountability Report* (PAR) including financial statements, notes, supplementary information, and supplementary stewardship information; and (b) update the *U.S. Department of Labor Manual Series* (DLMS) to include guidance for U.S. Department of Labor (DOL) supervisors to follow during their financial statement reviews, including procedures for comparing financial data reported on the different statements and notes to ensure accuracy and consistency.

In January 2010, DOL implemented the New Core Financial Management System (NCFMS) to replace its legacy accounting and reporting system, the Department of Labor Accounting and Related Systems (DOLAR$). In late 2009, we conducted a pre-implementation performance audit of NCFMS, which identified a number of implementation risks related to user acceptance, interface, integration, and mock data conversion testing. These risks were not addressed prior to implementation, which contributed to DOL subsequently facing many significant challenges related to its financial reporting process.

DOL encountered implementation issues related to migrating data from DOLAR$ to NCFMS, completing the interfaces between the legacy subsystems and NCFMS, developing new accounting processes to effectively use NCFMS, and identifying all the necessary reporting requirements. In addition, reports needed for management, control, and audit purposes were not readily available or had not been created upon activation of NCFMS.

As a result, the ability of management officials to monitor their budgets was significantly impacted and operational control procedures were not performed routinely throughout FY 2010. DOL also experienced delays in meeting certain Office of Management and Budget (OMB) reporting deadlines and in preparing audit deliverables.

Despite substantial effort by the OCFO, DOL has been unable to fully address many of these implementation problems. Specifically, we noted the following issues:

Reconciliation of Data: Data errors related to coding, configuration, and migration and subsequent operational problems created significant differences between the payroll, trust fund, and property modules and the NCFMS general ledger. DOL also identified a number of reconciling differences and adjustments related to beginning balances migrated from DOLAR$ to NCFMS that were not resolved until the third quarter of FY 2010. In addition, the system was not able to produce all required reports necessary to perform manual reconciliations between the subsystems, general ledger, and third party service providers. Although much progress had been made, DOL had not completed all necessary reconciliations as of September 30, 2010.

Also, DOL had significant difficulty reconciling its disbursement and collection activity with the U.S. Department of the Treasury's (Treasury) records subsequent to the implementation of NCFMS. The various differences and errors resulting from data migration and subsequent corrections significantly complicated and delayed efforts to verify the accuracy of the fund balance with Treasury account. In addition, the monthly submissions of the *Statement of Transactions* (SF-224) for the second quarter were delayed, and the collection and disbursement information for the SF-224s that were finally submitted to Treasury were based on estimated data because of the aforementioned difficulties. Further, we were informed that monthly fund balance with Treasury reconciliations were not performed for the eight month period ended August 31, 2010 prior to fiscal year end and a net un-reconciled difference of $1.7 billion was identified by DOL in its fund balance with Treasury account at that time. DOL was unable to materially reconcile the net differences that were identified in its fund balance with Treasury account as of September 30, 2010.

In addition, we identified an overstatement of debt related to repayable advances of $11 billion because DOL did not properly reconcile the balance to Treasury's records as of June 30, 2010. This error was corrected by DOL as of September 30, 2010.

The inability of DOL to complete reconciliations and resolve reconciling differences is primarily due to NCFMS implementation errors that prevented users from retrieving complete and accurate information from NCFMS and from producing reports needed for reconciliation purposes. In addition, resource constraints and competing priorities related to the correction of implementation errors reduced time available for staff to perform reconciliations and maintain effective internal control. Prompt resolution of differences and errors is an essential component of financial data integrity, and its absence compromises the integrity of the financial statements.

Interfaces between the General Ledger and Subsystems: Certain interfaces between the subsystems and NCFMS were not working properly subsequent to the system conversion. For instance, grant expense information in E-grants was not being transferred to NCFMS in a complete manner. In addition, certain grant obligations were not transmitted properly from NCFMS to the U.S. Department of Health and Human Services/Payment Management System in order for grantees to drawdown funds. In February 2010, certain "work-arounds" were developed and implemented to address these and other interface problems, and the majority of the underlying issues were corrected as of June 2010. We also noted that DOL experienced significant difficulties uploading data files from Treasury's Bureau of Public Debt and the Integrated Federal Employees Compensation System into NCFMS. As a result, DOL was unable to record the majority of the second quarter data related to the Unemployment Trust Fund (UTF) and Federal Employees' Compensation Act (FECA) activities in the general ledger until June 2010. Furthermore, significant differences existed between the data ultimately uploaded into NCFMS and these two subsystems.

Financial Processes: NCFMS-specific accounting processes were not fully developed upon implementation of the system. For example, processes needed to record current year apportionments, evaluate the accuracy of the grant accrual, and record property, plant, and equipment additions and deletions were not fully implemented and documented for a significant part of the year. In addition, DOL had not fully implemented and documented the process to compile the quarterly financial statements, including development of procedures related to eliminations and allocations. As a result, DOL was unable to submit second quarter financial statements to OMB.

DOL was eventually able to provide the second quarter financial statements for audit purposes on July 2, 2010. During our review of these financial statements, we noted numerous errors that were not identified in the OCFO review nor communicated to us prior to delivery of the financial statements. In addition, management's responses to our findings on the second quarter financial statements were not completely provided until three weeks after the due date. For example, we identified the following issues:

- Certain beginning balances in the financial statements did not agree with the ending balances reported in the FY 2009 audited consolidated financial statements.
- Certain balances that were reported in multiple places in the statements did not agree.
- The allocation for the working capital fund for the second quarter was not recorded in the general ledger and therefore was not included in the financial statements.
- The financial statements presented several abnormal balances, such as Unexpended Appropriations – Earmarked Funds.

Furthermore, the OCFO did not perform an initial overall analytical review to compare the current period financial statements to the prior period financial statements to determine the reasonableness of large or unusual fluctuations or identify additional errors.

The OCFO was able to submit the third quarter financial statements on July 22, 2010. However, upon delivery, the OCFO identified numerous errors in these financial statements that required significant adjustments, including errors identified in the second quarter financial statements that remained unresolved.

The delays in compiling the second quarter financial statements resulted from the initial data migration, system configuration, and coding errors, and an inability to produce reports from the system for external reporting purposes. The financial statement errors occurred because it was necessary for DOL to defer performance of a sufficiently detailed review and other financial analyses of the consolidated financial statements and trial balance to devote more resources to its corrective action plan related to NCFMS, which was not completed in time for submission of the third quarter financial statements. The lack of sufficient review of the DOL consolidated financial statements increases the risk that material errors or fraud would not be detected and corrected timely.

The OCFO also encountered significant difficulties in preparing the financial statements at year-end. The draft financial statements were initially due on October 22, 2010; however, the OCFO was unable to complete the initial draft financial statements until November 6, 2010. Further, several notes to the draft financial statements had not been completed at that time. In addition, the OCFO was not able to provide sufficient supporting documentation for all notes to the financial statements until November 11, 2010. Because the OCFO was unable to perform a sufficient review of the draft financial statements prior to submission to us, we identified numerous errors in the initial draft financial statements provided that were not identified in the OCFO review nor communicated to us prior to delivery of the draft financial statements. For example, we identified the following issues:

- Unexpended Appropriations - Other Funds in the amount of $10.8 billion was incorrectly presented as Unexpended Appropriations - Earmarked Funds in FY 2009 column on the balance sheet.

- Numerous balances in the notes to the financial statements did not agree to the financial statements or other notes. For example, the Energy Employees Occupational Illness Compensation Benefits Liability of $12.1 billion reported on the balance sheet as of September 30, 2010, was incorrectly reported as $7.966 billion in the notes to the financial statements. In addition, the undiscounted liability of $19.805 billion as of September 30, 2010, was incorrectly reported as $12.989 billion.

- Distributed offsetting receipts of $76 billion were incorrectly reported on the Reconciliation of Budgetary Resources Obligated to Net Cost of operations presented in the notes to the financial statements.

- Note 2, Funds with U.S. Treasury, included misclassifications totaling $2.1 billion.

We noted that the final FY 2010 consolidated financial statements were revised to correct these errors.

The OCFO informed us that the delay in submission of its draft financial statements was caused by difficulties encountered in completing the year-end Federal Agencies Centralized Trial Balance System II (FACTS II) accounting data submission. These difficulties prevented the OCFO from finalizing and recording the adjusting entries needed to begin preparation of the financial statements.

Identifying and Reporting Intragovernmental Transactions: Within NCFMS, various issues related to the identification and coding of intragovernmental transactions by trading partner, including incomplete vendor information, were encountered as a result of data migration errors. These errors prevented DOL from preparing and submitting the required intragovernmental information to Treasury for the second quarter of FY 2010. Although DOL was able to prepare and submit the required intragovernmental information to Treasury for the third and fourth quarters, we were informed that certain reconciliation procedures had not been completed for all trading partners. In addition, significant, unexplained reconciling differences were reported in Treasury's Intragovernmental Fiduciary Confirmation System (IFCS) as of June 30, 2010. For instance, interest receivable, investments, and interest revenue related to UTF had unexplained differences of $158 million, $7.2 billion, and $345 million, respectively. As of September 30, 2010, DOL had not resolved all errors related to intragovermental transactions because of competing priorities related to other implementation issues. As a result, DOL was unable to accurately classify and report its intragovernmental transactions and balances.

Accounting Resources: During our FY 2010 engagement, we observed that the OCFO did not have a sufficient depth of accounting personnel with the accounting expertise to perform all necessary functions and provide all prepared by client (PBC) items in support of the audit in a timely and accurate manner. As a result, the OCFO relied heavily on a few key employees and contractors to perform certain accounting functions because of their historical knowledge of certain processes, including UTF. In the absence of these key employees and contractors, the OCFO lacked additional resources who could respond to questions we raised in relation to these processes during the course of the engagement. In addition, the OCFO did not have a contingency plan in place to adequately and timely perform all accounting functions and internal control procedures related to these processes, without the assistance of these key individuals. For example, we noted that DOL did not record interest payable and interest expense related to the UTF repayable advances in the general ledger as of June 30, 2010 when one of its contractors was on extended leave. In addition, reconciliations and results of procedures performed by OCFO contractors related to the data migrated from DOLAR$ to NCFMS could not be provided in their absence, which significantly delayed our audit procedures.

Although OCFO management supplemented their staff with outside resources, the OCFO did not have sufficiently skilled and knowledgeable employees assigned to monitor its contractors. We noted weaknesses in supervision, communication, and coordination between the OCFO and its contractors. Further, certain PBC items, such as data extracts related to the general ledger transactions, undelivered orders, expenses, receivables, and UTF transfers were initially incomplete and/or incorrect. These issues were the result of poor communication with contractors and inadequate review of their work by OCFO employees. As a result, we encountered significant delays to the engagement, and the OCFO and its contractors were required to incur substantial effort to correct the issues.

Other Financial Reporting Controls: The grant accrual calculation was not reviewed by someone other than the preparer before it was recorded in the general ledger for the periods ended June 30 and September 30, 2010. Certain key elements of grant data changed with the implementation of NCFMS, requiring that the grant accrual database be modified. Because DOL encountered significant difficulties in modifying the grant accrual database, the person normally responsible for reviewing the grant accrual had to perform the calculation for the periods noted above. As a result, no one with sufficient expertise was available to perform the review of the grant accrual. Without proper review, the grant accrual could be misstated.

We also noted the OCFO incorrectly recorded UTF Accounts Receivable in the general ledger using the balance of $1.04 billion instead of the activity, which was $40.2 million as of June 30, 2010. This error was caused by a new contractor recording the UTF-related entries and resulted in an error of $1.0 billion that was subsequently corrected prior to year-end.

U.S. Standard General Ledger (USSGL) Compliance: In addition to the intragovernmental transactions identified above, we identified various other transactions that were not compliant with the USSGL. For example, we identified the following:

- Transfers totaling $3.7 billion were not properly recorded by the receiving agencies in the appropriation trust fund expenditure transfers collected account because NCFMS was not configured properly. This error was manually corrected as of September 30, 2010.

- The $4.05 billion change in the liability for estimated future benefits related to the Energy Employees Occupational Illness Compensation Program was incorrectly recorded as a contingent liability and a future funded expense in the general ledger. This issue was caused by DOL using the incorrect general ledger accounts to record this entry. The change in the liability was presented correctly in the financial statements as of September 30, 2010.

- Expended Appropriations and Appropriations Used were improperly recognized in the general ledger for Federal Employees' Compensation Act benefit payments that were not funded by appropriations because of the posting logic used in NCFMS. This situation resulted in abnormal balances of $3.8 billion for Expended Appropriations and Unexpended Appropriations Used in the general ledger as of September 30, 2010. The OCFO recorded an on-top adjustment prior to submission of the draft financial statements to correct this error.

- Expended Appropriations and Appropriations Used were improperly recognized in the general ledger for State Unemployment Insurance and Employment Service Operations expenditure transfers because of the posting logic used in NCFMS. This situation resulted in abnormal balances of $3.2 billion for Expended Appropriations and Unexpended Appropriations Used in the general ledger as of June 30, 2010. Although DOL implemented a manual process to substantially correct this error for financial reporting purposes, as of September 30, 2010, the configuration problem had not been resolved.

- Appropriations Used totaling $202 million were improperly recorded in certain earmarked funds because NCFMS was configured incorrectly. Although DOL implemented a manual process to correct this error for financial reporting purposes, as of September 30, 2010, the configuration problem had not been resolved.

- Expenditure Transfers were improperly recorded to expense because NCFMS was configured incorrectly. Although DOL did implement a manual process to correct the transfers and record them in the proper account, as of September 30, 2010, the configuration problem had not been corrected.

- Intragovernmental employee benefit program expenses in the amount of $187 million were misclassified as of September 30, 2010. This issue was caused by DOL incorrectly configuring its object class codes related to employee benefit programs in the general ledger.

Federal Managers' Financial Integrity Act of 1982 (FMFIA) Assessment Process: DOL was unable to complete and submit the results of its FMFIA assessment prior to its receipt of the draft FY 2010 internal control report, which cited four material weaknesses. The OCFO did verbally inform us initially that one material weakness had been identified related to financial reporting, which included deficiencies over journal entries. When we received the draft Management Assurances on November 6, 2010, we noted that management did not identify one material weakness that we identified during the FY 2010 audit engagement – Lack of Adequate Controls over Access to Key Financial and Support Systems – and did not identify all elements included in the Lack of Sufficient Controls over Budgetary Accounting material weakness we reported. Because management did not concur with our reported material weakness related to controls over access to key financial and support systems it was not reported in the Management Assurances.

DOL's FMFIA assessment process, including activities specifically related to Appendix A of OMB Circular No. A-123, *Management's Responsibility for Internal Control*, was not appropriately designed to identify material weaknesses in internal control and timely prepare and provide the draft assurance statement. In addition, the OCFO did not receive the financial management quarterly certifications from the DOL agencies, likely as a result of the issues encountered with the implementation of NCFMS.

The Government Accountability Office (GAO) *Standards for Internal Control in the Federal Government* (the Standards) states, "Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."

OMB Circular No. A-123 states, "The agency head must establish controls that reasonably ensure that obligations and costs are in compliance with applicable laws; funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports...."

OMB Circular No. A-136, *Financial Reporting Requirements* (September 2010), section V states,"…Agencies are required to reconcile intragovernmental balances and transactions at least quarterly. While much of this reconciliation will occur after the fact, there are tools available that enable agencies to reconcile certain transaction types prior to final report submission. These transaction types include investments or borrowings with the Department of the Treasury, benefit-related transactions with the Department of Labor and the Office of Personnel Management, and transfers of budget authority."

The USSGL contains the chart of accounts that provides the basic accounting structure for Federal agencies' general ledger systems. It incorporates both proprietary and budgetary accounts. It also provides the accounting transactions for events occurring throughout the Federal Government. These transactions illustrate the proper proprietary and budgetary entries for each accounting event.

FMFIA paragraph 3 states, "...The head of each executive agency shall, on the basis of an evaluation conducted in accordance with guidelines prescribed under paragraph (2) of this subsection, prepare a statement – that the agency's systems of internal accounting and administrative control fully comply with the requirements of paragraph (1)…." In addition, per OMB Circular No. A-123, Section IV.A, "The agency head's assessment of internal control can be performed using a variety of information sources. Management has primary responsibility for assessing and monitoring controls, and should use other sources as a supplement to -- not a replacement for -- its own judgment."

Because of the issues noted above, we consider the recommendations we made in FY 2009 **unresolved**. To close these recommendations and address the new control weaknesses identified during FY 2010, the Chief Financial Officer should (a) complete all necessary initial reconciliations of module and subsystem data to the NCFMS general ledger; (b) ensure that routine reconciliation controls are implemented and performed; (c) ensure that all necessary financial reports are developed and available to the agencies; (d) ensure that any remaining interface errors are promptly resolved; (e) fully document and implement all business processes and controls required for the accurate and timely operation of NCFMS; (f) promptly resolve the classification issues related to intragovernmental balances; (g) develop and implement policies and procedures to monitor the work of OCFO contractors, including the designation of appropriately skilled and knowledgeable individuals from the OCFO to monitor each accounting process that is primarily performed by a OCFO contractor, to ensure the work is being properly performed; (h) ensure that someone other than the preparer is properly reviewing the grant accrual calculation and the UTF accounts receivable journal entry prior to recording them in the general ledger; (i) review significant transactions for USSGL compliance and make any necessary corrections; (j) review its FMFIA assessment process and implement enhancements to better identify material weaknesses in internal control and more timely complete its draft FMFIA assurance statement; and (k) ensure that the draft DLMS policies and procedures requiring detailed review of all financial information in the draft financial statements are comprehensive and finalized and that OCFO personnel adhere to these policies. Financial statement review should include procedures for comparing financial data reported on the different statements to ensure accuracy and consistency; agreeing the financial data to the general ledger to ensure existence, completeness, and accuracy of financial data reported; and analyzing significant variances between current period and prior period financial information.

Management's Response: As indicated by the auditors, DOL encountered a number of challenges during FY 2010 with the implementation of the new financial management system, NCFMS. These challenges hampered our ability to perform certain quality assurance procedures relative to financial reporting and system operations, while simultaneously maintaining routine, day-to-day control activities and procedures. The OCFO chose to focus its attention and limited resources on identifying and implementing permanent system corrections to the many unforeseen system control and mapping issues. Workgroups were organized for both financial reporting and operational issues, and the OCFO aggressively managed the workgroups to ensure that issues identified with NCFMS were documented, tracked and corrected in a systematic manner.

While we generally concur with the auditor's recommendations, we note that many of the recommendations correspond with actions planned or already taken by the OCFO in its efforts to produce accurate and complete year-end financial statements. Several quality assurance steps were performed for year-end financial reporting, and we believe that many of the issues identified by the auditors will be fully resolved. For the recommendations not yet resolved, beginning in the first quarter of FY 2011 OCFO resources will be prioritized to focus on updating existing quality assurance documentation and to formally document NCFMS financial reporting processes. We anticipate these efforts will be completed by September 30, 2011.

With respect to our available resources and the use of contractor staff, we do not agree with the auditor's conclusions. As noted above, the NCFMS implementation created many challenges for DOL and stretched staffing resources in our attempts to address system-related implementation issues. As such, OCFO management secured additional contractor resources during FY 2010 to support NCFMS operational issues and quarterly financial reporting requirements. The use of contractor support for financial management is well established in the federal government. We will continue to use contractors as we deem necessary, and believe that the practice is a prudent use of available resources and one that produces effective results. We will continue to ensure that work performed by contractors is well documented, supervised, and readily available to the auditors.

In addition, DOL did complete its internal controls assessment process on a timely basis although we agree that a draft of the assurance statement was not provided to the auditors by the requested date. The discussion noted by the auditors was preliminary as the Department was considering how to present the material weaknesses, such as one overall material weakness in financial reporting with various subparts, (e.g., financial statements preparation process, account and reports reconciliations, journal voucher preparation and approval process, and data validation) or as separate weaknesses. We also informed the auditors that our assessment did not determine that there was a material weakness in controls over access to financial systems and management has responded to the auditors that it does not agree with their assessment.

Auditor's Response: We consider these recommendations **resolved and open**. FY 2011 audit procedures will determine whether these recommendations have been adequately addressed and can be considered closed.

2. Lack of Sufficient Controls over Budgetary Accounting

As part of the FY 2009 significant deficiency we reported relating to the lack of sufficient internal controls over financial statement preparation, we recommended that the Chief Financial Officer (a) implement procedures to require that OCFO staff reconcile the amount of distributed offsetting receipts reported on DOL's quarterly Statement of Budgetary Resources (SBR) to distributed offsetting receipts reported on Treasury's *Quarterly Distributed Offsetting Receipts by Department* Report, and (b) complete the quarterly reconciliations of the SBR to the *Report on Budget Execution and Budgetary Resources* (SF-133), including the completion of documented supervisory reviews over these reconciliations, by a certain date that facilitates timely identification and correction of potential SBR misstatements.

During FY 2010, DOL encountered numerous issues related to its budgetary accounting. Specifically, we noted the following issues:

Budgetary Resources: We tested the reconciliation of the *Apportionment and Reapportionment Schedules* (SF-132) to the SF-133 for the first quarter. We noted that the reconciliation identified a material difference between the SF-132 and SF-133, which lacked supporting documentation to substantiate that it was adequately researched and resolved. Upon further investigation, we noted that this difference was the result of appropriations received in the amount of $12.5 billion that were recorded twice in the general ledger, resulting in appropriations received being overstated. During the first quarter, DOL appropriately recorded the initial entry in an annual fund for approved funding related to the continuing resolution. However, the appropriation law that was subsequently passed changed it from an annual fund to a multi-year fund. DOL subsequently submitted an updated SF-132 for the multi-year fund, and upon OMB approval during the second quarter, recorded the $12.5 billion a second time without reversing the initial entry. The misstatement was corrected as of September 30, 2010. This error was not detected because the OCFO staff had limited time available to sufficiently and timely perform control activities due to competing priorities related to efforts resolving NCFMS implementation issues.

During our second quarter testing, we noted that DOL recorded an adjustment in the general ledger to decrease Appropriations Received in order to correct data migration errors stemming from the implementation of NCFMS. However, this entry was not properly reversed in the subsequent period, and as a result, Appropriations Received was understated by $224 million. The misstatement was corrected as of September 30, 2010.

DOL properly recognized a proprietary accounts receivable for amounts due to the FECA Special Benefit Fund and UTF from other Federal agencies for unreimbursed benefit payments. However, it did not record a corresponding budgetary accounts receivable for the earned portion of its FECA and UTF reimbursements that was payable with current budget authority of other Federal agencies. As a result, uncollected customer payments from Federal sources reported on the SBR were understated by approximately $1.5 billion as of September 30, 2010.

Lack of Budgetary Reconciliations: The following budgetary reconciliations were not prepared by management for the second and third quarters: (1) SF-132 to the SF-133; (2) SF-133 to the SBR; (3) budgetary to proprietary account relationship analysis; (4) net outlays per the Government-wide Accounting (GWA) Account Statement Expenditure Activity Report to the SBR; and (5) distributed offsetting receipts per the SBR and general ledger to distributed offsetting receipts per Treasury's *Quarterly Distributed Offsetting Receipts by Department Report* (Department Report). While these reconciliations were performed in prior years, the OCFO informed us that the reconciliations would not be provided for the second and third quarters of FY 2010 because the OCFO staff needed to focus its efforts on resolving issues related to the implementation of NCFMS. Because the OCFO did not perform these reconciliations, we identified the following differences as of June 30, 2010:

<u>SF-132 to the SF-133</u>

- Spending Authority from Offsetting Collections: Expenditure Transfers from Trust Funds Collected, Anticipated reported on the SF-133 and in the general ledger was overstated by $563 million.
- Temporarily not Available Pursuant to Public Law was overstated and total budgetary resources reported on the SF-133 and in the general ledger were understated by $485.3 million.
- Appropriation Actual reported on the SF-133 and in the general ledger was overstated by $11.95 billion while Appropriation Anticipated was understated by $22.45 billion.

These misstatements were correct in the general ledger as of September 30, 2010.

<u>SF-133 to the SBR</u>

- Unobligated Balance Brought Forward, October 1, reported on the SBR exceeded the amounts reported on both the SF-133 and the general ledger by $14.3 billion.
- Appropriation: Borrowing Authority reported on the SBR and in the general ledger exceeded the amounts reported on the SF-133 by $11 billion.
- Nonexpenditure Transfers, Net reported on the SBR was less than the amount report on the SF-133 by $28.8 billion.
- Total Budgetary Resources reported on the SBR exceeded the amount reported on the SF-133 by $6 billion.
- Obligations Incurred reported on the SBR exceeded the amount reported on the SF-133 by $18.8 billion.
- Net Outlays reported on the SBR exceeded the amount reported on the SF-133 by $3 billion.

The first three items noted above were corrected as of September 30, 2010. We were unable to determine the status of the remaining items because the final FY 2010 SF-133s were not submitted as of our report date.

Budgetary to Proprietary Account Relationship Analysis

We identified numerous differences between budgetary and proprietary accounts during our account relationship analysis as of June 30, 2010. Specifically, we identified material differences between budgetary and proprietary accounts related to fund balance with Treasury, accounts receivable, accounts payable, expenses, expended appropriations, unexpended appropriations, and revenue. These differences ranged from $1.6 billion to $14.8 billion. We also performed the account relationship analysis as of September 30, 2010. While we identified fewer differences at year end, we did note several differences related to expended appropriations, unexpended appropriations, accounts payable, expenses, and revenue. These differences ranged from $482 million to $3.2 billion. These differences were resolved in the final FY 2010 financial statements.

Distributed Offsetting Receipts

During our March 31, 2010 testing, we noted that distributed offsetting receipts reported on the SBR did not agree to Treasury's Department Report. The amount reported on the SBR was understated by approximately $43.8 billion. DOL subsequently corrected the discrepancy in its June 30, 2010 SBR. However, we identified that the distributed offsetting receipts reported on the SBR as of June 30, 2010 did not agree to the general ledger. When we compared the distributed offsetting receipts recorded in the general ledger to Treasury's Department Report as of June 30, 2010, we noted that the general ledger was understated by $11.4 billion. This misstatement was corrected as of September 30, 2010.

Nonexpenditure Transfers: During our testing, we identified that nonexpenditure transfers in the amount of $12.5 billion were recorded twice in the general ledger related to the Appropriations Received issue discussed in the Budgetary Resources section above. Furthermore, because the transfer was from a general fund to UTF, it was not compliant with OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*, or the USSGL. This misstatement was corrected as of September 30, 2010.

In addition, we identified a nonexpenditure transfer in the amount of $16.6 billion that was incorrectly recorded in the general ledger as Transfers – Current-Year Authority instead of Amounts Appropriated from Specific Invested TAFS – Transfer-Out. As a result, Nonexpenditure Transfers, Net was understated and Actual Appropriation was overstated by $16.6 billion as of June 30, 2010. The error also resulted in noncompliance with the USSGL at the transactional level. This error occurred because the OCFO did not have policies and procedures in place regarding how to properly record UTF repayable advances. An on-top adjustment was recorded to the year-end financial statements to correct this issue.

We also identified 17 nonexpenditure transfers that were recorded in the general ledger but were not supported by a *Non Expenditure Transfer Authorization* (FMS 1151). This resulted in Nonexpenditure Transfers, Net being overstated by $337 million as of June 30, 2010. We submitted follow-up questions to DOL to determine the cause of these discrepancies but did not receive a response to our inquiry. A $40 million adjustment was subsequently recorded in the general ledger to partially correct this error as of September 30, 2010.

Budgetary Entries for Multi-year and No-Year Funds: DOL did not record certain apportionments approved by OMB for multi-year and no-year funds. Our procedures disclosed eight instances where an apportionment approved by OMB was not recorded in the general ledger during the first quarter of FY 2010 because DOL had not developed policies and procedures for this activity. This resulted in Unobligated Balances Available being understated by approximately $1.5 billion as of December 31, 2009. This misstatement was corrected as of September 30, 2010.

Obligations and Fund Control: Certain contracts and obligations were not migrated from DOLAR$ or were migrated with incorrect identifying information. As a result, several agencies reported concerns regarding the accuracy of the balances associated with their unliquidated and unpaid obligations, which adversely affected their ability to monitor and control their budgets. In addition, the posting logic contained within NCFMS prevented the reconciliation of paid and unpaid obligations from the purchasing and payables modules.

Furthermore, quarterly reviews of UDOs to determine whether any UDO balances required deobligation were not performed during the fiscal year. Because of resource constraints and competing priorities related to NCFMS implementation issues, the OCFO did not have sufficient resources to implement formal processes for the quarterly reviews. Without effective controls to monitor the status of UDOs and deobligate remaining funds timely, UDOs may be overstated.

In addition, we performed an analysis over DOL's obligations as of June 30, 2010. Specifically, we compared the amount of obligations incurred reported on the SF-133s to the total amount available to obligate on the SF-132s. Based on our review, we determined that the amount of obligations incurred exceeded total funds available by $9.7 billion, raising a question about compliance with the *Anti-deficiency Act*. We submitted the results of our analysis to OCFO personnel and asked them to investigate and identify the causes of these discrepancies. As of the date of this report, the OCFO had not yet provided us a response. Additionally, we could not perform the same comparison as of September 30, 2010 because DOL did not submit the final FY 2010 SF-133s as of our report date.

Reconciliation of the SBR and the Budget of the United States Government: The balances reported in the initial reconciliation to the Budget of the United States Government related to Budgetary Resources, Obligations Incurred, and Net Outlays as of September 30, 2009, did not agree to the underlying supporting documentation. The differences were caused by the improper exclusion of amounts related to the Black Lung Disability Trust Fund refinancing from the Budget of the United States Government line item. As a result, DOL improperly presented a reconciling difference between the SBR and the Budget of the United States Government of $6.5 billion for each of the three aforementioned categories. We communicated the error to DOL, and it was subsequently resolved in the revised reconciliation. The error occurred because DOL did not perform an adequate review of the reconciliation prior to submitting it to us.

USSGL Compliance: In addition to certain issues noted above, we identified the following budgetary transactions that were not recorded in compliance with the USSGL.

- DOL did not properly record the post-closing budgetary entries for unobligated balances related to unexpired multi-year funds at the end of FY 2009. While this error had no financial statement impact as both of the accounts affected were properly reported as Unobligated Balance Not Available in the FY 2009 consolidated financial statements, it did result in noncompliance with the USSGL at the transactional level that continued in FY 2010. This misstatement, which was subsequently corrected as of June 30, 2010, occurred because DOL did not develop policies and procedures for recording such entries. Additionally, the preparer of the entries did not have the technical accounting proficiency needed to properly record the entries, and the entries were not properly reviewed by someone other than the preparer prior to recording them in the general ledger.

- Budgetary and proprietary entries were not recorded simultaneously for economic events related to the enactment of an appropriation or budget authority. On average, the entries we identified were recorded 10 days apart, but we identified several transactions that were recorded 60 days or more apart. The budget and proprietary entries were not recorded simultaneously because they were recorded by two separate agencies that did not coordinate accordingly.
- Appropriated receipts from trust funds in the amount of $599 million were improperly recorded in the general ledger as Other Appropriations Realized instead of Appropriated Trust or Special Fund Receipts as of September 30, 2010. The entries to record the appropriated receipts were not properly reviewed by someone other than the preparer prior to recording them in the general ledger. This misstatement was subsequently corrected through a post-closing journal entry.

The Standards state:

- "Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available."
- "Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."
- "Transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in summary records. In addition, control activities help to ensure that all transactions are completely and accurately recorded."
- "Control activities occur at all levels and functions of the entity. They include a wide range of diverse activities such as approvals, authorizations, verifications, reconciliations, performance reviews, maintenance of security, and the creation and maintenance of related records which provide evidence of execution of these activities as well as appropriate documentation."
- "The documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. All documentation and records should be properly managed and maintained."

According to OMB Circular No. A-136, section II.4.6.1, "... Information on the SBR should be reconcilable to the budget execution information reported on the SF 133 *Report on Budget Execution and Budgetary Resources* and with information reported in the Budget of the United States Government to ensure the integrity of the numbers presented. The SBR is an agency-wide report, which aggregates account-level information reported in the SF 133 ..."

OMB Circular No. A-136, section II.4.9.35 states, "Identify and explain material differences between amounts reported in the SBR and the actual amounts reported in the Budget of the United States Government as required by SFFAS No. 7. Since the financial statements are now published before the Budget, this reconciliation will be based on the prior year's SBR and actual amounts for that year in the most recently published Budget."

OMB Circular No. A-11 states, "… Nonexpenditure transfers are limited to transactions in which both accounts are within the same fund group (i.e., trust-to-trust or Federal-to-Federal)."

OMB Circular No. A-11 also states, "The Antideficiency Act 665(a), No officer or employee or the United States shall make or authorize any expenditure from or create or authorize an obligation under any appropriations or fund in excess of the amount available therein:.."

OMB Circular No. A-11 states, "You need to adjust the spending authority from cash collections if the account is authorized to perform reimbursable work for another Federal account and you incur obligations against receivables from Federal sources and unfilled customer orders from Federal sources without an advance—that is, before receiving the cash. The law allows you to incur such obligations as long as the paying account is a Federal account and an obligation is recorded against resources available to the paying account. For example, a financing account can obligate against a subsidy accounts receivable from the program account before the cash is received from the program account if the program account has recorded an obligation in the form of a subsidy accounts payable to the financing account. (You cannot incur obligations against customer orders received from non-Federal sources without an advance, unless a law specifically allows it.)"

The USSGL contains the chart of accounts that provides the basic accounting structure for Federal agencies' general ledger systems. It incorporates both proprietary and budgetary accounts. It also provides the accounting transactions for events occurring throughout the Federal Government. These transactions illustrate the proper proprietary and budgetary entries for each accounting event.

Because of the issues noted above, we consider the recommendations we made in FY 2009 **unresolved**. To close these recommendations and address the new control weaknesses identified during FY 2010, the Chief Financial Officer should ensure that (a) unresolved errors identified above are properly researched and resolved; (b) policies and procedures over the SF-132 and SF-133 reconciliations are enhanced to address the minimum documentation requirements needed to substantiate that identified differences were properly researched and resolved; (c) an evaluation is performed over FECA and UTF Federal receivables to determine the proper recording of the corresponding budgetary receivable in the general ledger; (d) individuals performing supervisory reviews are required to check the reconciliations for appropriate supporting documentation; (e) adequate resources are in place to complete all necessary reconciliations timely and to maintain adequate internal controls over financial reporting, both while NCFMS implementation issues are being resolved and for all periods thereafter; (f) procedures are implemented to periodically obtain and review the results of the agencies' review of their unliquidated obligations and ensure expired and invalid UDOs are deobligated timely in the general ledger either by the agency or OCFO; (g) appropriate corrective actions are performed to ensure that the identifying information and balances for obligations are correct, and that the posting logic in NCFMS is properly configured; (h) preparers of budgetary entries are properly trained and possess the technical accounting proficiencies needed to properly record the entries; (i) one agency is responsible for recording both the budgetary and proprietary journal entries for economic events, or if separate agencies continue to record the entries, that those agencies are appropriately coordinating; and (j) procedures are developed and implemented for multi-year and no-year funds to ensure that post-closing entries for unobligated balances are properly recorded at year end, and reapportionments are promptly recorded to the general ledger in the subsequent year.

Management's Response: Management concurs with these recommendations and has initiated appropriate corrective action plans. We recently completed a comprehensive review of all budgetary accounts in preparation and support of the year-end FACTS II reporting process. Budgetary accounts were analyzed and adjusted as necessary to ensure accurate budgetary reporting. The year-end Statement of Budgetary Resources was extensively reviewed and subjected to various analytical procedures, and our agencies are currently reviewing their respective SF-133 reports for accuracy and completeness.

Management is also reviewing existing policies and procedures to identify areas that could be strengthened within our budgetary accounts reconciliation processes, particularly the SF-132 to SF-133 reconciliation. As part of our FY 2011 operating plan, the OCFO will implement changes to ensure that quarterly reconciliations are carefully reviewed and approved, and that reviews include specific steps to confirm that adequate supporting documentation has been provided for all reconciliations performed.

In addition, a corrective action plan has been developed and implemented to address auditor findings regarding obligation validations and postings to NCFMS. The OCFO fiscal year-end closing checklist includes tasks for unexpired multi-year and no-year funds to ensure that post-closing entries for unobligated balances are properly recorded at year end, and that reapportionments are promptly recorded to the budgetary subsystem and general ledger. The closing for FY 2010 was managed using a consolidated checklist based upon auditor recommendations.

Again, we acknowledge that implementation of a new accounting system has required substantial additional resources, and has in some instances changed the skill levels necessary to perform routine operational activities. The OCFO is committed to providing additional training and support as needed to ensure that budgetary accounts are recorded accurately, completely and timely by OCFO and agency staff.

Auditor's Response: We consider these recommendations **resolved and open**. FY 2011 audit procedures will determine whether these recommendations have been adequately addressed and can be considered closed.

3. Improvements Needed in the Preparation and Review of Journal Entries

During the FY 2006 audit, we noted that accounting staff from all DOL agencies were able to prepare and enter journal entries into DOLAR$ without approval. Although the OCFO developed Department-wide manual policies and procedures designed to ensure the segregation of journal entry preparation and approval authority in the second quarter of FY 2007, which was revised and reissued in the second quarter of FY 2008, the same lack of supporting documentation evidencing management review and approval was noted during the FYs 2007, 2008, and 2009 audits.

During the course of the FYs 2006, 2007, 2008, and 2009 audits, we issued several recommendations to the OCFO, including the FY 2007 recommendation that management reconfigure DOLAR$ (and its successor system) so that journal entries entered into the DOLAR$ general ledger system (and its successor system) are required to be approved electronically by an individual other than the preparer before posting. We also recommended that:

- Agencies implement manual compensating review controls until system controls have been implemented.
- OCFO management monitor DOL employees' and agencies' compliance with DOL-wide policies and procedures in place for documenting the review of all journal entries.
- OCFO management design and implement detective controls that require supervisors to periodically generate and review activity reports that list all journal entries posted to DOLAR$.
- OCFO management revise DOL-wide policies and procedures to require that all manual entries, including top-side adjustment entries, be documented and reviewed and approved by a supervisor or someone other than the preparer before the financial statements are adjusted.

During our FY 2010 engagement, we tested a sample of 151 journal entries recorded in DOLAR$ from October 1, 2009, through December 31, 2009. For 10 of these journal entries, the OCFO did not provide support evidencing that they had been properly reviewed by a supervisor or someone other than the preparer before they were posted to DOLAR$. Additionally, 20 of these journal entries were not supported by adequate supporting documentation (e.g., DL-1280, Miscellaneous Obligations Record, Invoice, or equivalent), which reflected the underlying economic transactions. Furthermore, seven of these journal entries were not in accordance with the USSGL.

In addition, we selected a sample of 242 journal entries recorded in NCFMS from January 1, 2010, through June 30, 2010. The OCFO was unable to provide any supporting documentation for 181 of the journal entries selected. None of the 61 journal entries tested had sufficient documentation to evidence that the entry was properly reviewed by a supervisor or someone other than the preparer prior to being posted. Additionally, 48 of these journal entries were not supported by adequate documentation, which prevented us from determining whether these journal entries were recorded in the proper period and in accordance with the USSGL.

In addition, we identified that 110 of the 242 journal entries were not prepared and approved by DOL personnel within NCFMS, because these entries were directly uploaded into the general ledger by the OCFO's shared service provider (SSP). Of these 110 journal entries, 104 (including 32 of the 61 exceptions noted above) did not have documentation to support that they were properly reviewed and approved by a DOL supervisor prior to posting.

By posting transactions to the general ledger without proper review and approval and allowing individuals the authority to prepare and approve their own transactions, there is an increased risk that a material error would not be prevented or detected and corrected in a timely manner. In addition, without adequate supporting documentation, management is unable to determine the appropriateness of transactions posted to the general ledger.

DOL supervisors did not sufficiently review journal entries to ensure they were properly prepared and supported before posting to the general ledger. In addition, certain individuals did not follow, or document that they followed, DOL policies for the proper segregation of duties related to the preparation and posting of journal entries.

In the case of the journal entries posted by the SSP in Q2 and Q3, the journal entries were not automatically routed to the appropriate authorized approver in NCFMS because of system errors, necessitating the posting by the SSP. Given time constraints, proper DOL approval of some of these entries was not completed and documented.

In addition, DOL did not reconfigure DOLAR$ to provide for electronic approval by an individual other than the preparer before posting because of the implementation of NCFMS in January 2010.

The Standards state, "Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. The documentation should appear in management directives, administrative policies, or operating manuals and may be in paper or electronic form. All documentation and records should be properly managed and maintained."

The Standards also state that, "Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event."

Furthermore, the Standards state that, "Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."

Because management has implemented the new general ledger system that requires electronic approval by someone other than the preparer before journal entries are posted, we consider the recommendation we made in FY 2007 **resolved and closed**. In addition, the recommendations we made in FY 2006 through FY 2009 related to manual controls were **withdrawn and closed** because of the change in the control environment resulting from the new general ledger system implementation.

To address the issues identified during FY 2010, we recommend that the Chief Financial Officer (a) evaluate the system errors that are preventing certain journal entries from being routed to the approver, and develop and implement appropriate corrective action; (b) enhance policies and procedures and provide related training to address the minimum documentation requirements needed to sufficiently support journal entries; and (c) develop monitoring controls to ensure that supervisors or individuals other than the preparer are performing adequate reviews of journal entries and related documentation before the entries are posted to ensure they are properly supported.

Management's Response: Management concurs with the findings and recommendations noted above. To remediate current year findings pertaining to sufficient journal voucher supporting documentation and secondary monitoring procedures, management has developed a preliminary corrective action plan, to include milestone dates, which will be finalized by management in the first quarter of FY 2011. Management anticipates staff will begin executing this corrective action plan beginning in March, 2011.

Our corrective action plan includes performing a gap analysis to assess the adequacy of existing policies regarding journal voucher creation, approval, and supporting documentation requirements. We will then draft updates to existing policy to reflect changes due to implementation of NCFMS, such as developing posting logic for standard journal voucher templates and developing requirements to attach electronic supporting documentation for each journal voucher. Further, we will develop a mandatory training program for key stakeholders responsible for journal voucher creation and approval, and evaluate the current staff against required skill sets and competencies to ensure they can accomplish and sustain the new control activity.

However, management does not agree that journal entries directly uploaded by the OCFO SSP were not prepared, properly reviewed, and approved by authorized personnel and/or DOL supervisors prior to posting in NCFMS. Management considers vendor responsibilities with regard to manual JVs to include the upload and transfer of JVs to the general ledger as part of the SSP services provided. Systematic controls inherent to the NCFMS system are designed to ensure management review and approval of all data changes to journal vouchers prior to posting.

Auditor Response: We consider these recommendations **resolved and open**. FY 2011 audit procedures will determine whether these recommendations have been adequately addressed and can be considered closed.

4. Lack of Adequate Controls over Access to Key Financial and Support Systems

In FY 2006 through FY 2009, we reported a significant deficiency relating to the lack of adequate controls over access to key financial and support systems.

We recommended that the Chief Information Officer (a) coordinate efforts among the DOL agencies to develop and/or enforce procedures and controls to address access control weaknesses in current financial management systems; (b) monitor the agencies' progress to ensure that procedures and controls are appropriately implemented and maintained; and (c) ensure that sufficient resources are available to develop, implement, and monitor the procedures and controls that address control weaknesses.

In FY 2010, DOL agencies were able to complete corrective action to address certain previously-identified control weaknesses. However, the results of our FY 2010 testing of DOL's information technology (IT) systems indicated that access control weaknesses continued to be systemic across various DOL agencies. In our testing, we identified new access control weaknesses in addition to access control weaknesses that were reported in prior years.

We have classified the weaknesses identified into the following three categories: account management, system access settings, and system audit log reviews. The first two categories summarize those weaknesses identified related to controls that are designed to help prevent unauthorized access to IT systems. The specific weaknesses identified in these two categories were as follows:

Account Management

- Account management controls were not performed, evidenced by incomplete or missing access requests, non-disclosure agreements, modification forms, and termination forms;
- Certain user accounts were granted more privileges than what was requested on their access request forms;
- User accounts were not timely removed for separated users. Certain separated users had active system accounts, and in some cases, separated users accessed systems after their separation dates;
- Certain system account access was not properly restricted to those with a need-to-know;
- Periodic user account reviews or re-certifications were not appropriately performed;
- Procedures requiring periodic review of data center access were not updated;
- Generic accounts existed on a system without a proper business justification for approximately half of the fiscal year;
- Multiple user accounts existed for the same user; and
- Incidents were not timely reported.

System Access Settings

- Unnecessary services were not disabled;
- Servers were not configured to the most appropriate settings;
- Inactive accounts were not disabled in a timely manner; and
- Password settings and remote session timeouts did not comply with the Office of the Chief Information Officer Computer Security Handbook.

The account management access control weaknesses increase the risk that current employees, separated employees, and/or contractors may obtain unauthorized or inappropriate access to financial systems and/or data. Such access could lead to unauthorized activities and/or inappropriate disclosures of sensitive data. Additionally, system access setting weaknesses may be exploited, in either a singular fashion or in combination, by a malicious user, which may affect the confidentiality, integrity, and/or availability of DOL systems and data.

The system audit logs review category represents controls designed to detect unauthorized access to IT systems. Although DOL has certain detective controls in place to mitigate the aforementioned risks, we also identified certain weaknesses in those controls, as follows:

System Audit Logs Review

- Certain system administrator activities were not properly logged;
- Audit logs monitoring user and administrator activity, changes to security profiles, remote access logs, access to sensitive directories, and failed login attempts were not reviewed, or documentation of audit log reviews was not maintained;
- Audit logs monitoring firewall and Intrusion Detection System activity were not reviewed; and
- Application-level audit logs (e.g., high risk transactions) were not proactively reviewed.

The lack of system audit log reviews may allow for unauthorized or inappropriate activities to go undetected by management. Collectively, the aforementioned weaknesses pose a significant risk to the integrity of DOL's data, which could ultimately impact its ability to accurately and timely perform its financial reporting duties. The specific nature of these weaknesses, their causes, and the systems impacted by them has been communicated separately to management.

Additionally, during the second quarter of FY 2010, DOL implemented a new general ledger system, which significantly changed its control environment and led to a deterioration of manual compensating controls that had historically mitigated certain access control weaknesses. As a result, we consider the recurring prior year access control weaknesses coupled with new access control weaknesses identified in our FY 2010 testing of DOL's IT systems a material weakness in the aggregate.

The identified IT control weaknesses were a result of systemic issues in the implementation and monitoring of Departmental procedures and controls. DOL agencies have not invested the necessary level of effort and resources to ensure that IT policies and procedures are operating effectively.

Based on these facts noted as part of our FY 2010 engagement, we consider the recommendations we made in FY 2009 **unresolved**. To close these recommendations, the Chief Information Officer should (a) coordinate efforts among the DOL agencies to develop procedures and controls to address access control weaknesses in current financial management systems; (b) monitor the agencies' progress to ensure that procedures and controls are appropriately implemented and maintained; and (c) ensure that sufficient resources are available to develop, implement, and monitor the procedures and controls that address access control weaknesses.

Management's Response: The Office of the Assistant Secretary for Administration and Management (OASAM) does not concur with the aggregated material weakness regarding lack of adequate controls over access to key financial and support systems. DOL management asserts DOL policies, procedures, and standards collectively provide compound safeguards and redundant security measures to ensure the integrity of DOL financial systems.

The findings, as presented, do not adequately represent the operating environments of the systems audited in a holistic manner. The financial systems are physically and logically separated with appropriate supporting boundary controls. The segregated environments that host DOL financial applications provide supplemental controls aligned to the security best practice concept of *defense in depth*. The layers of security safeguards required to be overcome to successfully exploit access control weaknesses identified in the report suggests that the report does not accurately reflect the risk associated with the identified vulnerabilities.

The diversity and inconsistent distribution of the findings across systems and fiscal years does not support a Department-wide systemic access control deficiency, but rather system and agency specific access control weaknesses. In FY 2010 64% of the financial system audit findings related to only two agencies and 33% of the total were attributed to two individual systems in separate agencies. This distribution of control weakness finding supports the need for a focused effort within the offending agencies and systems; however, this does not substantiate a Department-wide material weakness.

A Department-wide comprehensive risk strategy was established to address identified conditions associated with the FY 2009 audit findings, and the following milestones were achieved in FY 2010:

- Developed FY 2010 Agency Core Profiles to establish a baseline for overall compliance, including access control and configuration management elements;
- Implemented an Enterprise Risk Management Compliance Program (RMCP) to measure agency compliance with security control requirements and Plan of Action and Milestone (POAM) resolution with the issuance of Agency Dashboards planned for FY 2011 Q2; and

- Successful resolution of the highest priority FY 2009 configuration management findings for the timely application of patches and access restrictions to sensitive files, directories and software.

Management remains committed to safeguarding DOL financial systems. In FY 2011, Management will continue to deploy policies, procedures, and automated tools aimed at strengthening providing continuous monitoring of the overall security posture of DOL's computer security program.

Auditor Response: The details of our FY 2010 IT findings and recommendations were provided to DOL management through the established Notification of Findings and Recommendations process. Although we did not identify any individual finding as a material weakness, we evaluated the combination of certain findings, in accordance with auditing standards generally accepted in the United States of America, to conclude that a material weakness does exist, taking into consideration that certain findings, when assessed in aggregate, identified deficiencies in both detective and preventive access controls related to one or more financial systems. Although management stated that they do not concur with our recommendations, they plan on taking steps to address them. Therefore, these recommendations are considered **resolved and open**. FY 2011 audit procedures will determine whether these recommendations have been adequately addressed and can be considered closed.

5. Weakness Noted over Payroll Accounting

During fiscal years (FY) 2006 through 2010, the U.S. Department of Labor (DOL) used the U.S. Department of Agriculture's (USDA) Office of Chief Financial Officer (OCFO)/National Finance Center (NFC) to process its payroll. For each pay period, DOL submitted to the NFC payroll information that included all DOL employees for the period, along with their hours worked, leave used, and other payroll-related information for the period. The NFC processed the payroll for DOL each period and made available for download a Detail Pay and Deduct Register report for each DOL Human Resources office.

In FY 2006, we noted that DOL did not utilize the Detail Pay and Deduct Register reports to perform reviews or reconciliations of data processed by the NFC, and no other controls were in place during the year to ensure that the information that was submitted to NFC via Time and Attendance records was reconciled to what was shown as paid in the Detail Pay and Deduct Register.

We recommended that management develop and implement policies and procedures to reconcile payroll information provided to the NFC to the payroll information processed by the NFC each pay period. These reconciliations should be documented, reviewed, approved by an appropriate supervisor, and maintained.

As part of DOL's corrective action plan for FY 2007, the OCFO's PeoplePower Task Force created a Time and Attendance Reconciliation Report, and the DOL OCFO issued policies and procedures that stated that each DOL Human Resources office should review the Time and Attendance Reconciliation Reports each pay period and research and resolve differences identified. No offices that we tested in FY 2007 complied with the new OCFO procedures, but two offices that we tested performed their own reconciliation procedures.

During FY 2008, the OCFO issued revised policies and procedures dated October 23, 2007, requiring a review of the Time and Attendance Reconciliation Reports, and implemented these policies and procedures. The OCFO also performed monitoring department-wide to ensure that the reviews were completed, documented, and approved by an appropriate supervisor, and maintained. However, we noted that the reconciliation tested from the Atlanta processing center did not contain a signature to validate the review. In addition, the Time and Attendance Reconciliation Reports do not contain a space for the date of the review; therefore, the timeliness of the reconciliations and certifications was not verifiable. Furthermore, the policies and procedures issued and the related reviews and audits reconciled and certified time and attendance records only.

In FY 2009, DOL issued revised policies and procedures with an effective date of July 24, 2009, to provide guidance on the need for agencies to review payroll-related items other than time and attendance records. In addition to the revised policies issued, OCFO management represented that they also implemented a procedure to monitor the completion of the reviews of payroll-related items other than time and attendance. Since the revised policies and procedures were not effective until the last quarter of FY 2009, our testwork focused on the time and attendance reconciliation policies that were effective for the first three quarters (i.e., the majority) of FY 2009, and we did not test the revised procedures implemented in July 2009. Our test results for the first three quarters indicated that insufficient evidence existed to determine that the preparation and review of payroll-related items, including time and attendance, were completed.

In FY 2010, we tested the revised policies and procedures issued by DOL in July 2009. We selected a sample of 25 reviews of payroll-related items from various agencies for the period of October 1, 2009, to June 30, 2010. Although we eventually received all 25 agency reviews selected, they were not provided timely, and DOL did not respond to our follow-up questions regarding the information submitted to us. For the 25 Payroll/Time and Attendance Reconciliation Reports tested, we identified the following exceptions:

- 11 instances where HR offices failed to provide sufficient documentation to support that errors were adequately researched and corrective actions were initiated;
- 14 instances where HR officials did not review the Payroll/Time and Attendance Reconciliation Reports and investigate issues timely; and
- 9 instances where supervisor and HR certifier review and approval of the Payroll/Time & Attendance Reconciliation Certification & Review form were not documented.

As a result, we noted insufficient evidence existed to determine that the preparation and review of payroll-related items, including time and attendance and gross pay, were completed properly and timely and identified issues were resolved. The OCFO policy and procedures issued in July 2009, requiring the responsible HR official to review the Payroll/Time and Attendance Reconciliation Reports and investigate issues identified, were not adequately enforced by the HR officials' supervisors.

We also noted that the OCFO monitoring control for the Payroll/Time and Attendance Reconciliation Reports was not routinely performed and was not operating effectively. The OCFO's failure to adequately monitor compliance with the July 2009 policy and procedures was partially attributed to the decentralized HR organization within DOL. As a result of the organizational structure, the OCFO had difficulty obtaining the needed documentation to monitor that the Payroll/Time and Attendance Reconciliation Reports were being properly completed, in a timely fashion, and adequately reviewed.

Although the Payroll/Time and Attendance Reconciliation Reports had been updated to include hourly pay and total earnings, the reports continued to lack sufficient details, such as employee and employer withholdings, to arrive at an employee's net pay and total benefits expense. These reports were not properly designed to contain the information needed to ensure that errors in all relevant payroll-related items were identified and resolved timely as the OCFO did not sufficiently consider all items that should have been addressed in the reconciliation.

In addition, the last reconciliation of the payroll register provided by the NFC to the general ledger was completed as of December 31, 2009. OCFO management represented that they did not have adequate resources to resolve New Core Financial Management System (NCFMS) implementation issues and perform payroll reconciliations simultaneously. As a result, management has not reconciled the payroll register to the general ledger for the majority of FY 2010.

The lack of compensating reconciliation controls around the NFC compensation outputs increases the risk that payroll-related line items may be misstated due to errors in payroll processing by the NFC. In addition, DOL's failure to reconcile the NFC payroll registers to the general ledger since the implementation of NCFMS further increases the risk that a payroll-related misstatement would not be detected by management.

Federal agencies that use external service providers, such as the NFC, should have controls in place to ensure the accuracy of processing outputs. As stated by the USDA Office of Inspector General (OIG) in its FY 2010 Report No. 11401-33-FM, "The relative effectiveness and significance of specific controls at NFC and their effect on the assessments of control risk at customer agencies are dependent on their interaction with the controls and other factors present at individual customer agencies."

Office of Management and Budget (OMB) Circular No. 123, *Management's Responsibility for Internal Control*, states, "Application control should be designed to ensure that transactions are properly authorized and processed accurately and that the data is valid and complete. Controls should be established at an application's interfaces to verify inputs and outputs, such as edit checks."

Additionally, per the Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* (the Standards), "Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."

Based on our FY 2010 audit results, we consider the recommendation we made in FY 2006 as **resolved and open.** To close this recommendation and address the new control weakness identified during FY 2010, the Chief Financial Officer should ensure that (a) the Payroll/Time and Attendance Reconciliation Reports are properly designed to reflect the necessary payroll-related information to conduct an adequate reconciliation; and (b) proper monitoring is routinely completed by the OCFO to ensure that the July 2009 policy and procedures are implemented and complied with throughout DOL.

We recommend that the Director of the Human Resource Center ensure that the OCFO July 2009 policy and procedures are properly and consistently implemented, by enforcing the requirements that all payroll-related reconciliations are documented, reviewed, and approved by an appropriate supervisor, and maintained.

Management's Response: Management concurs with the recommendations noted above. We prepared a draft corrective action plan, which will enhance the reconciliation process through documentation, communication and monitoring of the procedure, the assigned staff and the controls.

To remediate current-year findings, management has designed and will implement a corrective action plan in order to perform all necessary payroll reconciliations, to include SF-224, Statement of Transactions, payroll reconciliation and the reconciliation of payroll expenses from NFC to information recorded in NCFMS. We anticipate staff will be available to execute on these corrective action plans beginning in January 2011.

Management understands that effective reconciliation controls, including timely preparation of proper reconciliations and resolution of differences, will enhance quarterly consolidated financial statements and minimize differences between DOL's general ledger and the NFC-processed payroll data. Likewise, management recognizes the importance of accurate information when performing effective reviews of financial statements. As a result, OCFO management will initiate actions to revise the Payroll/Time and Attendance Reconciliation reports to reflect the necessary payroll-related information to conduct adequate reconciliations.

OCFO management will work with the Director, Human Resource Center and the Office of Inspector General to design and implement internal audit procedures to ensure that revised payroll monitoring procedures are implemented and consistently applied agency-wide.

Auditor Response: We consider these recommendations **resolved and open**. FY 2011 audit procedures will determine whether these recommendations have been adequately addressed and can be considered closed.

6. Untimely and Inaccurate Processing of Property, Plant, and Equipment (PP&E) Transactions

Because of the implementation of NCFMS, DOL had to revise its process for recording PP&E transactions in the general ledger. As of June 30, 2010, we noted that DOL's revised process had not been implemented, which resulted in the untimely processing of certain PP&E transactions. Specifically, during our testwork over DOL's PP&E balances as of June 30, 2010, we noted the following errors in both the general ledger and the related PP&E module:

- Untimely recording of construction-in-progress additions in the amount of $46.8 million;
- Untimely recording of building deletions in the amount of $9.2 million; and
- Untimely recording of transfers to the building account in the amount of $47.1 million.

During July 2010, the OCFO performed an analysis of current year additions and deletions related to the construction-in-progress and buildings asset categories, resulting in correcting adjustments being recorded in the general ledger via journal entry. However, as of August 31, 2010, an analysis of current year additions and deletions to the remaining PP&E asset categories (i.e., other structures and facilities, land, leasehold improvements, internal use software, software in development, and equipment) had yet to be performed. As a result, certain other additions and deletions may have been omitted from the PP&E module and the related general ledger accounts.

In addition to the issues noted above, we also noted inaccuracies in the calculation of accumulated depreciation within the PP&E module. Subsequent to the implementation of NCFMS, the OCFO performed an analysis of the accumulated depreciation balances calculated by the newly implemented PP&E module. As a result of this analysis, the OCFO determined that the system-calculated balances were overstated by $228.6 million. The OCFO elected not to record these balances in the general ledger, but instead utilized the December 31, 2009, accumulated depreciation balances, which were converted from the prior general ledger for interim financial reporting purposes. At year-end, DOL posted a manual adjustment to both the accumulated depreciation and current year depreciation expense accounts to record current year activity.

The above misstatements resulted in the net book value of PP&E recorded in the NCFMS general ledger and related PP&E module initially being understated by $37.7 million and $266.3 million, respectively. Furthermore, the continued inability of DOL to timely and accurately record PP&E additions and deletions, and also to timely and accurately calculate accumulated depreciation and depreciation expense, increases the likelihood that PP&E will continue to be misstated going forward.

As stated above, DOL implemented a new general ledger system in January 2010. The above issues occurred as a result of DOL's failure to dedicate the resources necessary to implement a formalized process for identifying and recording PP&E additions and deletions in NCFMS. Additionally, as of June 30, 2010, the PP&E module within NCFMS was not configured to accurately calculate either accumulated depreciation balances or current year depreciation expense amounts.

Statement of Federal Financial Accounting Standards (SFFAS) No. 6, *Accounting for Property, Plant, and Equipment*, paragraph 34 states that, "PP&E shall be recognized when title passes to the acquiring entity or when the PP&E is delivered to the entity or to an agent of the entity. In the case of constructed PP&E, the PP&E shall be recorded as construction work in process until it is placed in service, at which time the balance shall be transferred to general PP&E." In addition, paragraph 36 states, "Depreciation expense shall be accumulated in a contra asset account—accumulated depreciation."

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

OMB Circular No. A-123 states, "Transactions should be promptly recorded, properly classified, and accounted for in order to prepare timely accounts and reliable financial and other reports."

We recommend that the Chief Financial Officer (a) dedicate the appropriate resources to implement the documented process for identifying and recording PP&E additions and deletions in NCFMS to ensure that these transactions are accurately and timely recorded; and (b) configure NCFMS to accurately calculate both accumulated depreciation balances and current year depreciation expense amounts.

Management's Response: Management agrees with the recommendation that the NCFMS needs to be configured to record PP&E additions, deletions and depreciation in a timely manner. However, the conditions noted above were not caused because the OCFO did not dedicate resources necessary to implement formalized processes. Formalized processes for identifying and recording PP&E additions and deletions, and calculating depreciation expense, were developed and documented in the NCFMS *Acquire to Dispose* and *Build to Cost* user manuals. The conditions noted occurred because the NCFMS PP&E subledgers were not properly configured or working as intended.

As such the NCFMS subledgers and the related amounts noted by the auditor were not used for reporting purposes and transactions were recorded directly in the general ledger. OCFO implemented alternative procedures to ensure that PP&E transactions and depreciation expense from migration, on January 1. 2010, through September 30, 2010 were properly recorded in the general ledger. The alternative procedures applied included:

<u>Construction in Progress</u>:

- Determined the status of each construction in progress (CIP) project;
- Analyzed the recorded expenses according to project status and compiled the costs that needed to be transferred to either CIP or PP&E in use;
- Analyzed the costs previously recorded as CIP and determined those costs that needed to be transferred to either PP&E in use or written-off;
- Created subsidiary ledgers to provide an audit trail of balances and transactions; and
- Recorded applicable costs in CIP and transferred the accumulated costs of completed projects to PP&E.

<u>PP&E:</u>

- Obtained the list of disposals of land and buildings and compiled the costs of the retired assets by inventory number;
- Obtained the data files of DOL property under IOUE custody, compiled the costs of additions and dispositions of such property and calculated depreciation expense;
- Analyzed the recorded balance of equipment, compiled the costs of additions and dispositions of equipment and calculated depreciation expense for equipment;
- Calculated depreciation expense for all other PP&E;
- Prepared supporting work papers to provide an audit trail of balances and transactions; and
- Record additions, deletions and depreciation expense.

<u>Software</u>

- Analyzed the status of software projects in development for EBSA, ETA and MSHA (other agencies do not have major software projects);
- Analyzed the recorded expenses according to the completion status of the projects and compiled the costs that needed to be transferred to either software in development or software in use;
- Calculated the DOL labor and overhead costs associated with the software projects in development;
- Calculated depreciation expense for software in use including for those projects that became operational;
- Prepared supporting work papers to provide an audit trail of balances and transactions; and
- Recorded additions, deletions and depreciation expense.

Based on the above procedures, we believe that PP&E balances and depreciation expense are properly stated as of September 30, 2010, and for the year then ended.

As noted above, the OCFO agrees with the audit recommendation and will work to ensure that the NCFMS PP&E subledgers are properly configured so that PP&E transactions (additions, deletions and depreciation expense) are properly and timely recorded in the general ledger in FY 2011.

Auditor Response: We consider these recommendations **resolved and open**. FY 2011 audit procedures will determine whether these recommendations have been adequately addressed and can be considered closed.

1. Federal Managers' Financial Integrity Act (FMFIA) of 1982

FMFIA requires that agencies establish internal controls and financial systems that provide reasonable assurance that the integrity of Federal programs and operations is protected. It requires that the head of the agency provide an annual assurance statement about whether the agency has met this requirement.

The U.S. Department of Labor's (DOL) FY 2010 FMFIA assessment process was not in full compliance with FMFIA. Specifically, we noted that DOL was unable to prepare and provide a complete draft of the fiscal year (FY) 2010 FMFIA assurance statement in a timely manner. Further, DOL did not complete and submit the results of its FMFIA assessment prior to its receipt of the draft FY 2010 internal control report. See Material Weakness No. 1 in Exhibit I for further information.

FMFIA paragraph 3 states, "...The head of each executive agency shall, on the basis of an evaluation conducted in accordance with guidelines prescribed under paragraph (2) of this subsection, prepare a statement – that the agency's systems of internal accounting and administrative control fully comply with the requirements of paragraph (1)…" In addition, per Office of Management and Budget Circular No. A-123, Section IV.A, "The agency head's assessment of internal control can be performed using a variety of information sources. Management has primary responsibility for assessing and monitoring controls, and should use other sources as a supplement to -- not a replacement for -- its own judgment."

We recommend that DOL follow the recommendation provided in Material Weakness No. 1, in Exhibit I, and improve its process to ensure compliance with the requirements of FMFIA in FY 2011.

2. Federal Financial Management Improvement Act (FFMIA) of 1996

Under section 803(a) of FFMIA, DOL's financial management systems are required to substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger (USSGL) at the transaction level. DOL represented that in accordance with the provisions and requirements of FFMIA, the Secretary of Labor determined that DOL's financial management systems are not in substantial compliance with FFMIA.

As a result of FY 2010 testing, we concluded that DOL did not substantially comply with the requirements of section 803(a) of FFMIA. Specifically, we noted the following:

- DOL was unable to produce auditable financial statement based on data from its financial accounting and reporting system, and numerous financial reports were not available to perform analyses or complete decision making. See Material Weakness No. 1 in Exhibit I for further information.

- Numerous information technology (IT) general and application control weaknesses related to computer security were identified as part of the IT testing in FY 2010. These weaknesses impact the IT environments and systems in several large DOL agencies. See Material Weakness No. 4 in Exhibit I for further information.

- Several material transactions, such as nonexpenditure transfers, appropriations used, appropriated receipts, unexpended appropriations, and the change in actuarial liability, were not recorded in accordance with the USSGL. See Material Weakness Nos. 1, 2 and 3 in Exhibit 1.

- Certain budgetary and proprietary accounts were not in balance as of September 30, 2010. See Material Weakness No. 2 in Exhibit 1.

We recommend that DOL follow the recommendations provided in Material Weakness Nos. 1, 2, 3 and 4 in Exhibit I, and improve its processes to ensure compliance with FFMIA section 803(a) requirements in FY 2011.