TESTIMONY
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COMMITTEE ON EDUCATION AND THE WORKFORCE

The American Worker at a Crossroads Project

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I am pleased to appear before you to discuss financial management and accounting at the Department of Labor (DOL). I am here in my capacity as Deputy Inspector General. From the outset I would like to emphasize that views expressed today are those of the Office of Inspector General (OIG), consistent with its independent role to provide oversight of the Department. As requested by the Subcommittee, I will focus my testimony on:

- explaining our role in this area,
- providing a historical perspective on auditing the DOL''s financial statements,
- discussing audit procedures and major findings of the Consolidated Financial Statement Audit for Fiscal Year (FY) 1997,
- explaining the nature of DOL bad debt expenses, and
- discussing the future of financial management.

The Role of the Office of Inspector General

The Office of Inspector General has various statutory mandates in this area. Under the Inspector General Act of 1978, as amended, the OIG is responsible for conducting audits to identify deficiencies in DOL programs and operations and recommending corrective action. However, with regard to financial management and accounting of DOL resources, the OIG is also specifically mandated under the Chief Financial Officers'' Act (CFO) of 1990 and the Government Management Reform Act (GMRA) of 1994, to annually audit the Department''s financial statements and provide an opinion as to whether they are fairly presented. Moreover, under the Federal Financial Management Improvement Act (FFMIA) of 1996, the OIG is required to report whether financial management systems are in substantial compliance with Federal requirements and standards. Through our audits of DOL''s financial statements and extensive technical assistance provided to the Department, we have demonstrated our long-term commitment to improving financial management in DOL.

Historical Overview of DOL Financial Management

Ensuring adequate financial management by Federal agencies has been a long-standing concern to Congress and the Executive Branch, as evident from a number of laws that have been enacted. Some of the major laws that currently drive the process are briefly explained in Attachment 1 of this statement.

Early OIG Financial Statement Audits

In the mid-1980s, the OIG saw a need for the Department to implement financial management discipline in its operations. To this end, we began preparing and auditing the Department''s annual financial statements in 1986. Our strategy was to provide the leadership and expert assistance needed to effect long-term changes in the way the Department accounted for its resources. After the OIG provided significant technical assistance, the Department was able to begin preparing its own financial statements for FY 1991, with the OIG continuing to provide audit oversight.

Our first audit of the Department's financial statements disclosed that financial operations were not integrated and controls over financial reporting were very weak. Moreover, the audit found that the accounting system, which was more than 15 years old, was barely functioning and was not meeting the needs of the Department. The audit also found that the Department did not have sufficient staff capable of preparing financial reports.

Improvements Achieved by the Department

Since 1987, DOL has made significant progress toward improving its financial operations and reporting. Some of the Department's major overall financial management accomplishments include:

- Being the first cabinet-level agency to prepare and have audited financial statements, and doing so four years before it was statutorily required;
- Installing a central accounting system;
- Establishing accounting practices that conform to the Standard General Ledger; and
- Integrating previously separate accounting operations of the program agencies into the Department's general ledger, which helps ensure adequate, centralized management over DOL finances.

Another major overall improvement -- full implementation of the CFO Act -- was achieved after several years of disagreement between the Department and the OIG. Prior to 1997, the OIG repeatedly raised concerns with various Departmental proposals as to how the CFO would function within DOL. We were concerned that the proposed structures for that office were inconsistent with the statutory responsibilities of the CFO. Our position was that the CFO needed to have the appropriate responsibility and authority to provide adequate stewardship over DOL's finances. We cautioned that many of the long-term problems experienced by DOL were due to the lack of centralized authority and varying degrees of agency autonomy, which resulted in inconsistent accounting throughout the Department. In response to the concerns we raised, the Department worked with us and OMB to develop an organizational structure and related departmental policies that provided the CFO with the appropriate authority to carry out the duties embodied in the CFO Act.

In addition to overall financial management improvements, the Department corrected a number of significant, program-specific deficiencies. Some of the most significant improvements include:

- establishing a system to account for the hundreds of millions of dollars in advances to Employment and Training Administration (ETA) grantees,
- improving timeliness and accuracy in recording million of dollars worth of ETA grant transactions,
- accounting for ETA property and equipment, particularly the hundreds of millions of dollars invested in Job Corps Centers,
- providing for a full accounting of the $30 billion Unemployment Insurance Program(UI), including establishing systems to provide information on the billions of dollars owed in UI overpayments and delinquent taxes, amounts deemed uncollectible, as well as reconciliation of these amounts with State records,
- accounting for amounts to be charged back to Federal Agencies for benefit payments to Federal employees and amounts collected and not collected from Federal Agencies, as well as reconciliation of these amounts with State records,
- calculating the significant future liability related to Federal employees' worker compensation (currently totals approximately $18 billion), and
- reconciling a $100 million variance relating to total DOL funds between DOL and Treasury records.

FY 1997 Consolidated Financial Statement Audit

Audit Procedures

The OIG audited the Department''s financial statements for FY 1997. The procedures used to carry out such a comprehensive audit include testing the financial transactions and reporting on the results of our audit. The testing phase of our audit includes obtaining from the CFO the actual financial statements and the general ledger used to compile the financial statements. In this phase, we also assess and test the effectiveness of financial management controls. The OIG then tests representative samples of each fund, account, or function to determine if the funds were spent in accordance with the applicable laws and regulations, and accounted for in conformance with accounting principles and standards. Subsequently, we analyze our findings and determine whether there are any material weaknesses or reportable conditions.

A material weakness is a serious internal control weakness or procedural weakness identified during the audit that may affect how reliable the financial statements are to the reader or decision maker who uses the statements or report.

A reportable condition is a problem that is not as serious as a material weakness, but it is something of which the reader should be aware because it usually indicates a significant deficiency in how the agency operates. A reportable condition usually indicates a problem that could adversely affect the agency''s ability to record, process, summarize, and report financial or performance data in accordance with established legislation, regulations, principles or standards.

The auditing profession has no set rules or levels to determine materiality. Therefore, it is up to the auditor to determine materiality based on many considerations. Total dollars audited is only one consideration. For example, this OIG generally uses one percent of the dollars audited in each project as the materiality level for that project. Thus, if we are auditing a $2 billion dollar program, our overall materiality level would be

$20 million. This means that if the total errors found as a result of our testing exceeds the $20 million then the statements may not be fairly presented. However, to determine materiality, we also take into account qualitative considerations such as the potential fraud and significant non-compliance with laws and individually significant line items, or components of the financial statements.

Once we determine whether the statements are fairly presented and whether there are any reportable conditions or material weakness, the results of our work are reported to DOL and an audit report is issued.

Audit Opinion

For FY 1997, the OIG was able to provide DOL for the first time with an unqualified opinion on its consolidated financial statements and the financial statements of the Unemployment Insurance, Black Lung, and Longshore Trust Funds, as well as the Federal Employees'' Compensation Act (FECA) Special Fund. An unqualified or "clean" opinion means the auditors were able to obtain sufficient, competent evidence relating to the amounts and disclosures in the financial statements and that the statements were consistent with Federal accounting standards.

As I previously stated, since the inception of the annual consolidated financial statement audit for the Department, the OIG has identified weaknesses and has worked with management to resolve many of the issues identified in audits. Our audit disclosed that, during 1997, DOL achieved a number of improvements and made substantial progress in closing six long standing material weaknesses and system weaknesses reported in prior years. In total, 28 prior-year recommendations were closed.

However, the most significant issue addressed in 1997 was the removal of the limitation on the scope of our audit. This limitation resulted from our lack of jurisdiction to audit revenues of the Unemployment Trust Fund and the Black Lung Disability Trust Fund that are collected and administered by Treasury. Despite financial management weaknesses identified by the OIG, it was this audit scope limitation that had prevented DOL from receiving a clean audit opinion for the last 5 years. This limitation was resolved when the General Accounting Office was able to conduct the necessary audit work to determine that the revenues are presented fairly in the financial statements.

Bad Debt Expense

As requested in your letter of invitation, I will now explain what constitutes the Department's $655 million in bad debt expense that was reported in the 1997 financial statements. Let me begin by saying that this, of course, is a significant figure. However, it is important to keep in mind that although a Federal agency may be owed money, these sums are often not collected 100 percent. A certain percentage of receivables will eventually prove to be uncollectible.

When the Department establishes a receivable, it does not know at that point that a particular receivable will not be collected in the future, but it does know that of all of its receivables, a certain percentage will eventually prove to be uncollectible. In order to not overstate the value to DOL of all its receivables, Federal accounting standards require that a loss on receivables be recognized when it is more likely than not that the receivables will not be totally collected. Accordingly, an allowance is established to reduce total receivables down to the amount which is believed to be collectible. The allowance should be estimated on each annual financial reporting date and when information indicates that the latest estimate is no longer correct.

Estimates of losses resulting from the inability to collect the funds may be based on an analysis of individual, significant accounts and groups of accounts that have similar characteristics that tell something about the risk that they will not be collected 100 percent. This could include the age of the receivable (the longer the receivable has been outstanding the less likely it will be collected), the type of debtor (e.g. a local government, a business, an individual), a payment record, or geographic regions, etc.

Although the Department knows it will not collect a certain percentage of accounts receivable, the receivables remain on the books nonetheless, and attempts should be made to collect all of them. Accounts receivable are not completely removed from the books until they are written off. When an account receivable is actually written off, the gross receivables are reduced and the allowance for uncollectible accounts is also reduced by the same amount. There is no effect on bad debt expense at this time because bad debt expense was recognized when the allowance for uncollectible accounts was established or adjusted.

Attachment 2 of this statement is a chart that details the bad debt expense reported by the DOL for FY 1997. As indicated by the chart, 97 percent of DOL's bad debt expense is in the Unemployment Trust Fund. The Unemployment Trust Fund is used to account for Federal and State funds used to finance the unemployment insurance system in each State. The bad debt expense pertains to benefit overpayments and delinquent State unemployment taxes. By their very nature, these amounts have a very high risk of not being collectible. Benefit overpayments are due from individuals who received payments through false claims or UI administrative error. State unemployment tax receivables represent those amounts that are delinquent. Additionally, these receivables may be many years old, since individual State laws govern write-offs and many State laws limit them.

Mr. Chairman, the other significant sources of bad debt expense for FY 1997 were the Black Lung Disability Trust Fund and Wage and Hour''s Back Wage Program. The bad debt in the Black Lung Disability Trust fund pertains to benefit overpayments to disabled miners and allowable benefits paid to disabled miners which are the legal responsibility of a mine operator. In many cases, these mine operators are out of business and bankrupt. Bad debt expense for the Back Wage Program stems from uncollected penalties assessed against employers and uncollected back wages employers had agreed to pay to DOL for remittance to affected employees.

Improvements Still Needed

As I indicated, there has been significant progress related to financial management of the Department in past years. Consistent with the findings of our most recent financial statement audit, much of what remains to be done involves improvements to individual agency subsidiary systems that we identified in our audit as reportable conditions. Areas needing attention include: complying with FFMIA requirements, addressing remaining issues related to ETA grant accounting, and accounting for back wages and civil monetary penalties.

Compliance with FFMIA Requirements

Mr. Chairman, our review of DOL's compliance with laws and regulations, conducted as part of the FY 1997 financial statement audit, disclosed that DOL was not fully compliant with FFMIA. This statute requires Federal agencies to be in substantial compliance with Federal financial system requirements, Federal accounting standards, and the U.S. Standard General Ledger. FFMIA intends to provide taxpayers with assurances as to the expenditure of their tax dollars and to ensure the availability of credible, timely, and consistent information regarding Federal programs and operations by which to make decisions.

However, our audit disclosed that seven DOL subsidiary systems do not meet one or more of the criteria for Federal accounting systems referenced in the FFMIA. Therefore, DOL will need to change the design and function of the systems, as well as the discipline in maintaining the system, to bring them up to compliance.

Remaining ETA Grant Accounting Issues

Mr. Chairman, the second area of concern relates to ETA grant accounting. As you are aware Mr. Chairman, ETA is DOL''s largest grant awarding agency. In FY 1997, ETA incurred $7.8 billion in grant expenses out of a total of $8.2 billion in grants awarded by the Department. These grants fund employment and training programs and pay for the administration of unemployment insurance programs run by the States. Needless to say Mr. Chairman, this is an area to which we have given a great deal of audit attention and worked with DOL to effect positive changes.

Despite many improvements in this area in the past few years, our audit revealed that DOL needs to address issues related to cost reporting, grant close-outs, and accounting for debt activity. We found that more attention is needed by management to ensure that ETA cost data is recorded promptly. While adequate systems are in place to facilitate this, there are still pockets of ineffectiveness within DOL with respect to complying with such requirements. For example, in our audit we found that an ETA regional office failed to record grant cost data for the Job Corps program in FY 1997. This caused a $69 million understatement of costs.

We also found that grantee cost reports were not being recorded promptly. This is the result of delays by grantees in providing reports to ETA and delays by ETA in recording the information. Because grants represent billions of taxpayer dollars, we have recommended that management provide increased guidance and communication as to what is required, to ensure that systems established to improve grant accounting are effective in doing so.

Another deficiency identified, and in which the Subcommittee has expressed interest, is that of grant close-outs. Grant close-outs are conducted to complete a full accounting for the substantial dollars in each of the thousands of grants awarded by the Department. As of the date of our audit, there was a backlog of some 300 grants that needed to be closed out. The backlog stems from a re-organization within ETA in 1995 that resulted in confusion as to which components were responsible for this function. ETA has demonstrated much progress in this area. However, in order for ETA to be in compliance with Federal regulations, it must eliminate the backlog. ETA also needs to continue to improve its closeout tracking system; formally document descriptions of component responsibilities; and enforce its own internal policies for the closeout process.

With respect to accounting for debt activity, Mr. Chairman, our audit found that weaknesses identified in prior years continued. Our major concerns are that the accounting system for ETA debts was not maintained current and that it does not allow for tracing transactions to source documents. We also found that ETA does not charge administrative costs or penalties to its debtors, as provided in the Debt Collection Act of 1982. These weaknesses diminish the Department's ability to collect debts or to do so in a timely manner.

Accounting for Back Wages and Civil Monetary Penalties

The third major area needing improvement is the accounting for back wages and civil monetary penalties related to wage hour violations. As you are aware, Mr. Chairman, the Employment Standards Administration (ESA) was created to enforce a variety of statutes that prescribe standards and conditions of employment. These include minimum wage, child labor restrictions, overtime pay, migrant and agriculture worker protection, as well as other employment standards laws.

Under the provisions of various labor standards laws, back wages are determined and collected by ESA for remittance to the affected employees or, if the employees cannot be located, to the U.S. Treasury. In addition, ESA has the authority to assess civil monetary penalties for wage and hour violations

Our audit found that long-term accounting weaknesses in this area continue. Our audit found that systems to account for back wages owed, collected, and/or remitted -- as well as those to account for penalties assessed -- do not process financial information effectively, accurately, or timely.

Without accurate and timely information as to what is owed by an employer and to whom -- whether it is back wages or penalties -- the Department's ability to carry out its mission of protecting employee rights in this area is hampered. Such weaknesses result in wages either being not collected or collected many years later, when the employee may not be reachable. Also problematic is our finding that when wages are collected and the employee is not found, the amounts are still not consistently remitted back to the Treasury. Our audit for FY 1997 found that only half of $8.5 million in wages previously identified as needing to be reverted to the Treasury were actually sent to Treasury.

The Future of Financial Management: Linking Cost Accounting to Results

Mr. Chairman, with passage of the Government Performance and Results Act (GPRA), Congress intended to improve management and accountability in Federal agencies. The intent of GPRA is to create a management process where federal agencies develop strategic plans, articulate program goals, allocate federal resources to meet desired performance levels, and measure and report program results.

Audited financial statements are a vital component of ensuring accountability over Federal funds. However, in order to achieve full accountability, the Department needs to create a fully integrated strategic management process in which program objectives in strategic plans, the resources appropriated for carrying out the programs, the costs of activities, and the performance results achieved are closely linked. To this end, the Department needs to ensure the successful expansion of financial accounting to include cost accounting. Cost accounting is the discipline of identifying the full cost of specific programs and activities.

Unlike the private sector where success is largely measured in terms of a bottom line, the success of Government needs to be determined through both financial and performance information. By linking this type of information, the Department and Congress can determine the value and future direction of Federal programs and achieve the accountability demanded by the public. However, most Federal agencies have not yet achieved this linkage.

At this point, the OIG is satisfied with the Department's latest efforts in this area. Initially cost accounting will be performed at the DOL goal level. Eventually cost information will be accumulated for specific activities and performance results. It is vitally important for DOL to ensure that the performance and cost information generated be accurate and auditable in order for DOL's reporting to be credible.

Mr. Chairman, this concludes my prepared statement. I will be pleased to answer any questions that you or the other Members of the Subcommittee may have.

Attachment 1

MAJOR FINANCIAL MANAGEMENT LAWS

<u>The Federal Manager''s Financial Integrity Act (FMFIA) of 1982</u>: Requires that each Federal agency regularly evaluate the effectiveness of management control in its programs annually provide written assurance to the President that Agency management controls and financial management systems provide reasonable assurance that the objectives of the Federal Managers Financial Integrity Act (FMFIA) were achieved.

<u>The Chief Financial Officers Act (CFO Act) of 1990</u>: Intends to improve accounting, financial management, and internal controls systems in each Federal Agency and deter fraud, waste, and abuse of Government resources. Requires the designation of the Chief Financial Officer for each Federal Agency to oversee all financial management activities and that agency financial statements be audited annually by Agency OIGs.

<u>The Government Performance and Results Act (GPRA) of 1993</u>. Requires all Federal Agencies to develop long-term strategic plans with measurable goals and objectives and annual performance plans with targeted levels of performance that are linked to Agency budgets.

<u>The Government Management Reform Act (GMRA) of 1994</u>. Requires agencies to prepare Accountability Reports. Accountability Reports are intended to streamline reporting by providing critical financial and program performance information into a single report. The annual financial statements and the related auditor''s report are major component of these Accountability Reports.

<u>The Federal Financial Management Improvement Act (FFMIA) of 1996</u>. Requires Federal agencies to be in compliance with Federal financial system requirements, Federal accounting standards, and the U.S. Standard General Ledger. It also requires the OIG to report whether financial management systems substantially comply with Federal financial management systems requirements, applicable accounting standards, and the United States Standard General Ledger at the transaction level. FFMIA intends to provide taxpayers with assurances as to the expenditure of their tax dollars and to ensure the availability of credible timely, and consistent information regarding Federal programs and operations by which to make decisions.

Attachment 2

FY 1997 DOL BAD DEBT EXPENSE

Unemployment Trust Fund	$ 635,554,000
Black Lung Disability Trust Fund	10,544,000
District of Columbia Trust Fund	585,000
Longshore and Harbor Workers'' Trust Fund	358,000
Back Wage	4,209,000
Training and Employment Services - Grants	1,792,000
FECA	1,580,000
Other	1,222,000
TOTAL	**$ 655,844,000**