U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210

INFORMATION

DEC 29 2003

MEMORANDUM FOR THE SECRETARY

Gordon S. Heddell

FROM: GORDON S. HEDDELL
Inspector General

SUBJECT: FY 2003 Auditor's Report
Report No. 22-04-003-13-001

Attached is the FY 2003 Auditor's Report on the Department's FY 2003 financial statements. We contracted with the independent certified public accounting firm of R. Navarro & Associates, Inc., CPAs (RNA) to audit these statements. RNA's opinion on the Department's consolidated financial statements is unqualified, and RNA's report on internal control notes no material weaknesses. I commend the Department for continuing to maintain this significant accomplishment.

RNA's report on internal control notes reportable conditions in the following areas: Job Corps real property; Federal Employees' Compensation Act (FECA) benefit payments; information technology general controls and security; accounting for grants; accountable property; Unemployment Insurance benefit overpayments; and capitalized assets.

RNA's report on compliance with laws and regulations noted that the Department's managerial cost accounting system did not substantially comply with the requirements of the *Federal Financial Management Improvement Act of 1996* (FFMIA). RNA noted no other instances of noncompliance with laws and regulations.

Attachment

cc: Samuel T. Mok
Patrick Pizzella

R. NAVARRO
& ASSOCIATES, INC.
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

TO THE HONORABLE
ELAINE L. CHAO
SECRETARY OF LABOR

The *Chief Financial Officers Act of 1990* (CFO Act) requires agencies to report annually to Congress on their financial status and any other information needed to fairly present the agencies' financial position and results of operations. To meet the CFO Act reporting requirements, the United States Department of Labor (DOL), a Department of the United States Government, prepares annual financial statements, which are subjected to audit.

The objectives of the audit are to express an opinion on the fair presentation of DOL's principal financial statements, obtain an understanding of the Department's internal control, and test compliance with laws and regulations that could have a direct and material effect on the financial statements.

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

We have audited the consolidated balance sheet of DOL as of September 30, 2003 and the related consolidated statements of net cost, changes in net position, financing, and custodial activity and the combined statement of budgetary resources for the year then ended. These financial statements are the responsibility of DOL's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of DOL as of September 30, 2002, were audited by the U.S. Department of Labor, Office of Inspector General, whose report dated January 6, 2003, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

RELATIONSHIP TO THE SINGLE AUDIT ACT

The financial statements for the year ended September 30, 2003, include:

- costs for grants, subsidies, and contributions primarily with various state and local governments and nonprofit organizations in the amount of $10.5 billion;
- costs for unemployment benefits incurred by state employment security agencies in the amount of $53.4 billion;
- state employer tax revenue of $24.8 billion;
- net receivables for state unemployment taxes, reimbursable employers, and benefit overpayments of $.8 billion; and
- reimbursements from state, local, and nonprofit reimbursable employers for unemployment benefits paid on their behalf, in the amount of $2.1 billion.

Our audit included testing these costs, financing sources, and balances at the Federal level only. Pursuant to a mandate by Congress, the examination of these transactions below the Federal level is primarily performed by various auditors in accordance with the Single Audit Act of 1984, as amended, and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. The results of those audits are reported to Federal agencies that provide direct grants, and each Federal agency is responsible for resolving findings for its awards.

OPINION ON FINANCIAL STATEMENTS

In our opinion the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and net position of the Department of Labor as of September 30, 2003; and the net cost, changes in net position, budgetary resources, reconciliation of net cost to budgetary resources, and custodial activity for the year then ended in conformity with accounting principles generally accepted in the United States of America:

OTHER ACCOMPANYING INFORMATION

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

The supplementary information included in the Management Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information sections of the Performance and Accountability Report are required by the Federal Accounting Standards Advisory Board and OMB Bulletin No. 01-09. We have applied limited procedures, performed at the Federal level only, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the information. However, we did not audit the information and express no opinion on it.

The information included in the Annual Performance Report, Financial Performance Report, Management and Performance Challenges and the report appendices are presented for purposes of additional analysis. Such information has not been subjected to the auditing procedures applied in the audit of the consolidated and combined financial statements and, accordingly, we express no opinion on it.

REPORT ON INTERNAL CONTROL

In planning and performing our audit, we considered DOL's internal control over financial reporting by obtaining an understanding of the Department's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control. Consequently, we do not provide an opinion on internal control.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the agency's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may nevertheless occur and not be detected. We noted certain matters, discussed in the following paragraphs, involving the internal control and its operations that we consider to be reportable conditions. However, none of the reportable conditions is believed to be a material weakness.

In addition, we considered DOL's internal control over Required Supplementary Stewardship Information by obtaining an understanding of the agency's internal controls, determining whether they had been placed in operation, assessing control risk, and performing tests of controls as required by OMB Bulletin No. 01-02. The objective of our audit was not to provide assurance on these internal controls. Accordingly, we do not provide an opinion on such controls.

Finally, with respect to internal control relating to performance measures included in the Performance Report, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

REPORTABLE CONDITIONS

Current Year Reportable Conditions

Job Corps Real Property

DOL owns a significant amount of real property, which is capitalized and depreciated in the Department's accounting records, and is reported in the Department's financial statements.

Our audit found that ETA did not sufficiently utilize the property subsidiary system, the Capitalized Assets Tracking and Reporting System (CATARS) as a complete property management system in accordance with the CATARS user guide, and did not establish sufficient controls to ensure that Job Corps capitalized real property was safeguarded and accurately reported in CATARS and the Department of Labor Accounting and Related Systems (DOLAR$) general ledger. Specifically, we found the following:

- Annual physical inventories were not conducted each fiscal year in order to verify that the capitalized assets recorded in CATARS were actually on-site and in usable condition. As a result, Job Corps real property was not sufficiently safeguarded against waste, loss, unauthorized use, or misappropriation and was not accurately recorded in the Department's financial statements.

- Certain capitalized additions and dispositions were not recorded in CATARS or the general ledger (DOLAR$), resulting in a $24 million understatement of property.

- Asset descriptions included in CATARS were not sufficient to verify existence and condition of the corresponding asset. This situation increases the risk that Job Corps property may be subject to loss or misuse, and that property may be inappropriately valued or classified in the Department's general ledger and financial statements.

- Land reported in the general ledger did not agree with what was recorded in CATARS, and the two records were not reconciled. As a result, CATARS was understated by approximately $70 million, and the financial statements were misstated by $13 million.

We recommend the Chief Financial Officer and the Assistant Secretary for Employment and Training ensure that: an annual physical inventory of all Job Corps real property is performed and the results reconciled to CATARS and DOLAR$; additions and dispositions are recorded timely in CATARS by developing and implementing appropriate quarterly procedures; sufficient descriptive details of all capitalized property items are obtained

and corrected in CATARS; total land costs are recorded in CATARS and allocated to the specific Job Corps center; and property recorded in CATARS is reconciled monthly to property recorded in DOLAR$ and all necessary adjustments are recorded on a timely basis.

Management has stated that they agree with the need to improve controls over Job Corps real property and are implementing various corrective actions to ensure that both CATARS and DOLAR$ reflect accurate and complete property balances, and that assets are sufficiently safeguarded.

Federal Employees' Compensation Act (FECA) Compensation Payments

In order to determine continuing eligibility for FECA compensation payments, ESA's Office of Workers' Compensation Programs (OWCP) Claims Examiners (CEs) are required to obtain and review medical evidence on a periodic basis, depending on the status of the claimant. Where injury-related disability has ceased, the CE is to notify the claimant of the proposed termination of benefits. OWCP has the burden of proof to justify the termination of benefits by positive and specific evidence that injury-related disability has ceased.

Our audit included tests of 146 FECA case files, at 5 of 12 District offices, where medical evidence was required to be obtained in the current year. Of these 146 cases, 27 cases (18 percent) did not have current medical evidence in the case file.

The lack of current medical evidence in the case files occurred because OWCP does not have effective controls to ensure CEs request and receive current medical evidence timely. Because OWCP did not follow its procedures, it could not take steps to suspend or terminate benefits if the medical evidence did not support continuing eligibility. Without adequate procedures for obtaining and reviewing current medical evidence, the risk of improper payments increases.

We recommend that the Chief Financial Officer ensure that the Assistant Secretary for the Employment Standards Administration develops and implements effective controls (e.g., automated procedures) that will ensure Claims Examiners obtain and review current medical evidence as required by FECA program policy. Management indicated a new automated tracking system will be implemented in January 2004, which, combined with additional training, will correct these deficiencies.

Prior Year Reportable Conditions

Information Technology (IT) Controls

While the Department has made progress in strengthening its IT environment in the last 5 years, there are certain areas where the Department can continue to make improvements:

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

The Department still lacks strong logical security controls to secure the Department's data and information. Continuing weaknesses were identified with the Department's technical security standards and policies; logging, monitoring and response controls; system

administration procedures; and the overall security framework.

Management concurs with the need to improve security controls and has outlined a plan for corrective action with targeted implementation dates by the end of FY 2004.

The Department has not developed and performed comprehensive tests of all continuity of operations/disaster recovery plans for critical systems and processes.

Prior to FY 2002, the Department had a reportable condition related to the need for greater disaster recovery/business continuity controls. In FY 2002, the reportable condition was removed based on increased Department efforts in this area. Testing conducted in the current year, however, showed that the Department's agencies are in varying stages of disaster recovery plan development and testing, and the Department has not coordinated disaster recovery efforts across all agencies or conducted a Department-wide test of disaster recovery plans. Given these conditions, there is a high likelihood that the Department could not recover its key operations in a timely manner in the event of a major disaster.

Management concurs that existing disaster recovery plans need to be improved, and stated that the Department will further coordinate agency efforts to update the current Continuity of Operations Plan to accurately reflect DOL-wide processing priorities and include disaster recovery test procedures, and to develop and implement a comprehensive test.

The Department has not corrected known vulnerabilities associated with its IT systems.

The FY 2003 audit included an analysis of the percentage of prior year findings and recommendations closed by the Department and each agency during FY 2003. While some agencies have been effective in correcting known vulnerabilities, overall the Department-wide closure rate of prior IT findings was approximately 47 percent. Additionally, almost 60 percent of the prior year findings and recommendations remaining at September 30, 2003, are over 2 years old, and some go back as far as 1997.

Management concurs that additional efforts are necessary to resolve known vulnerabilities. Management indicated that the Department will instruct agencies to apply a more rigorous verification and validation of agency Plans of Actions and Milestones to ensure that agencies have applied adequate funding and resources towards appropriate corrective actions and that appropriate mitigation activities are completed.

Accounting for Grants

The OIG previously reported the following deficiencies with regards to ETA's grant accounting:

- Various accounting errors were noted in amounts recorded for ETA's grants and contracts. In FY 2003, we continued to note errors at both the national and regional offices. For example, at the national level we identified that costs reported by grantees in the Electronic Information Management System (EIMS) grant

cost module did not agree to corresponding amounts recorded in DOLAR$, and that ETA was not reconciling the cost information. At the regional offices, we noted errors in various Job Corps contracts selected for testing.

- Transfers of WIA funds between programs are not accounted for in ETA's accounting records.

- ETA's grantees and contractors are often delinquent in submitting required cost reports. While efforts have been made to address this finding, our FY 2003 audit continued to note delinquent reporting.

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

Accountable Property

The OIG previously reported that several agencies did not have adequate procedures and systems to track accountable property (general property, plant, and equipment that does not meet the Department's capitalization threshold). As of FY 2003, two agencies had not fully implemented accountable property inventory systems.

Management concurs with the need to improve controls over accountable property and is currently working to develop a Department-wide property system. A property management software package was purchased and is scheduled for implementation in FY 2004.

Capitalized Assets

The OIG previously reported that management's capitalized asset tracking and reporting procedures do not ensure that disposals of capitalized assets are identified and reported in a timely and accurate manner, and that assets are adequately safeguarded against loss or theft. To adequately safeguard assets, a physical inventory should be taken on an annual basis to determine that all of the items in CATARS exist and are in use. A reconciliation should be performed to identify differences between the physical inventory and CATARS and to determine the circumstances as to why property items were not located.

While physical inventories were conducted during the fiscal year, we continued to note that certain agencies within the Department were merely removing items from CATARS that could not be found, rather than researching to find out the actual disposition of the missing assets. In addition, dispositions were not recorded timely but were recorded only after items were identified as missing in the physical inventory process.

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

Unemployment Insurance Benefit Overpayments

The OIG previously reported certain deficiencies in the internal controls over Unemployment Insurance (UI) benefit payments. Specifically, the OIG identified that UI overpayment data collected by the

Benefit Accuracy Measurement (BAM) unit reflect significantly higher overpayments than those established as accounts receivable by the states' Benefit Payment Control (BPC) system. We also found that there has been little change in the rate of overpayments (about 8.5 percent) since 1989.

Management contends that the actions outlined in its corrective action plan developed in response to this finding in prior years will eventually result in a significant reduction in the detectable, recoverable overpayment rate.

While we recognize that management has taken certain corrective actions, we noted that the actual UI benefit overpayment rate for 2002 did not reflect improvement. The UI benefit overpayment rates for 2002 and 2001 were 9.1 percent and 8.2 percent, respectively. We conclude that additional evaluation of UI overpayments is necessary.

We noted other matters involving the internal control and its operations that will be reported to the management of DOL in a separate letter.

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

The management of the DOL is responsible for complying with laws and regulations applicable to the Department. As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain laws and regulations specified in OMB Bulletin No. 01-02, including the requirements referred to in the FFMIA. We limited our tests of compliance to these provisions and we did not test compliance with all laws and regulations applicable to the DOL.

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

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

REPORT ON COMPLIANCE WITH FFMIA

We have examined DOL's compliance with the requirements of FFMIA as of September 30, 2003. These include implementing and maintaining financial management systems that substantially comply with: (1) financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger (SGL) at the transaction level. Management is responsible for DOL's compliance with these requirements.

Our responsibility is to express an opinion on DOL's compliance based on our examination.

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

In our opinion, as of September 30, 2003, DOL substantially complied with the requirements of FFMIA, except for applicable Federal accounting standards as described below:

Prior Year Compliance Finding

Implementation of Managerial Cost Accounting (MCA)

The OIG previously reported that the Department of Labor was not in compliance with the requirements for managerial cost accounting contained in Statement of Federal Financial Accounting Standards Number 4 (SFFAS No. 4), *The Managerial Cost Accounting Concepts and Standards for the Federal Government.* Specifically, DOL had not defined outputs for its operating programs nor developed the capability to routinely report the cost of outputs at the operating program and activity levels for use in managing program operations. Additionally, DOL did not use managerial cost information for purposes of performance measurement, planning, budgeting or forecasting. These findings led the OIG to conclude that DOL did not substantially comply with FFMIA requirements.

In FY 2003, management developed a comprehensive plan to implement managerial cost accounting within the Department, which provides an overall strategy for MCA implementation and high-level plans for individual agencies to initiate and execute. We concluded that this plan satisfactorily addressed the concerns raised in the original OIG finding.

However, the conclusion that the Department is not in compliance with SFFAS No. 4, and consequently not in substantial compliance with FFMIA, will remain until the managerial cost accounting systems are fully implemented.

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

This report is intended solely for the information and use of the management of the U.S. Department of Labor, the Office of Management and Budget, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

R. Navarro & Associates, Inc.

December 18, 2003