



NOV 14 2005

INFORMATION

MEMORANDUM FOR THE SECRETARY

Gordon S. Heddell

FROM:

GORDON S. HEDDELL
Inspector General

SUBJECT:

FY 2005 Independent Auditor's Report
Report No. 22-06-003-13-001

Attached is the Independent Auditor's Report on the Department's FY 2005 financial statements. We contracted with the independent certified public accounting firm of R. Navarro & Associates, Inc., CPAs (RNA) to audit these statements as of September 30, 2005, and 2004, and for the years then ended. RNA's opinion on the Department's consolidated financial statements is unqualified, and RNA's report on internal control notes no material weaknesses. RNA's report on compliance with laws and regulations noted that the Department substantially complied with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA). RNA noted no instances of noncompliance with other laws and regulations. I commend the Department for continuing to maintain these significant accomplishments.

RNA's report on internal control notes reportable conditions in the following areas: Incomplete and Inappropriate Capitalization of Internal Use Software and Software License Fees, Job Corps Property, Employment Standards Administration Benefit Program Accounting, Federal Employees Compensation Act Medical Benefit Payments and Receivables and Continuing Eligibility for Compensation Payments, Information Technology Application and Security Controls, Errors in State Unemployment Insurance (UI) Reporting, Procurement, Grant Accounting, UI Benefit Overpayments, and Implementation of Managerial Cost Accounting. However, none of the reportable conditions noted are considered material weaknesses.



Independent Auditor's Report

To the Honorable Elaine L. Chao Secretary of Labor

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

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

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

Relationship to the Single Audit Act

The financial statements for the years ended September 30, 2005 and 2004, include:

- costs for grants, subsidies, and contributions primarily with various state and local governments and nonprofit organizations in the amounts of \$9.4 billion and \$10.1 billion, respectively;
- costs for unemployment benefits incurred by state employment security agencies in the amounts of \$32.3 billion and \$41.7 billion, respectively;
- state employer tax revenue of \$33.1 billion and \$30.1 billion, respectively;
- net receivables for state unemployment taxes, reimbursable benefits, and benefit overpayments of \$.9 billion and \$1.0 billion, respectively; and
- reimbursements from state, local, and nonprofit reimbursable employers for unemployment benefits paid on their behalf, in the amounts of \$1.9 billion and \$2.4 billion, respectively.

Our audits 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 aforementioned financial statements present fairly, in all material respects, the assets, liabilities, and net position of the DOL as of September 30, 2005 and 2004; and the net cost, changes in net position, budgetary resources, reconciliation of net cost to budgetary resources, and custodial activity for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Other Accompanying Information

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

The supplementary information included in the Management's 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 Circular A-136, *Financial Reporting Requirements*. 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 Secretary's Message, Performance Section, Chief Financial Officer's Letter, 2005 Top Management Challenges Facing the Department of Labor Identified by the Office of Inspector General 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 caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of inherent limitations in internal controls, misstatements, losses, or noncompliance may, nevertheless, occur and not be

detected. We noted 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 are 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 Section, 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

Incomplete Capitalization of Internal Use Software Costs

Statement of Federal Financial Accounting Standard (SFFAS) No. 10 requires agencies to capitalize costs related to the development of internal use software, such as direct salary and fringe benefits of federal employees involved and related indirect costs such as overhead, rent, and travel. Our FY 2005 audit identified more than \$53 million of internally-developed software costs that were not appropriately capitalized in accordance with generally accepted accounting principles (GAAP) and DOL policy. Specifically, DOL agencies did not capitalize software development costs, such as the direct salary and fringe benefit costs associated with Federal employees involved with software development, and the related indirect costs such as overhead, rent, and travel. Three of the agencies involved were unaware of the capitalization requirements, and we concluded that the OCFO was not sufficiently monitoring agencies in this regard. Accordingly, we recommended that the Chief Financial Officer (CFO) monitor agency compliance with Federal and departmental accounting requirements for internal use software. Management recorded appropriate adjustments to the year-end financial statements, and agreed to monitor agency compliance and reissue the guidance for capitalizing costs of internally-developed software.

Software License Fees Inappropriately Capitalized

Our FY 2005 audit disclosed that DOL agencies inappropriately capitalized \$6.7 million of software licenses acquired in FY 2005, and \$2.4 million acquired in prior years. The costs of these licenses did not meet the criteria for capitalization established in GAAP, and, accordingly, the costs should have been expensed in the year acquired. We found that DOL's policy manual, the Department of Labor Manual Series (DLMS), did not provide guidance or requirements as to how DOL agencies should account for software license fees, and that the OCFO was not monitoring agencies in this regard. We recommended that the CFO issue relevant written guidance, monitor agency compliance over accounting for software licenses, and record appropriate adjustments in the general ledger. Management agreed with the recommendations and expensed approximately \$4.9 million of license fees in FY 2005 and will research the remaining amounts and make the appropriate adjustments in FY 2006. Management also agreed to issue relevant guidance and monitor agency compliance over accounting for software license costs.

Internal Control Weaknesses Noted for 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. In the FY 2003 audit, we reported errors in amounts reported for Job Corps real property, and concluded that ETA did not establish sufficient controls to ensure that capitalized real property was safeguarded and accurately reported in the Capitalized Assets Tracking and Reporting System (CATARS) and the Department of Labor Accounting and Related Systems (DOLARS) general ledger. We recommended that management record property transactions timely and make other improvements over accounting for real property. During the FY 2005

audit, our review of the construction in progress (CIP) account disclosed that the account inappropriately contains completed construction projects. We identified 18 CIP contracts that were completed and should have been transferred from CIP to the buildings or leasehold improvements accounts. The value of these completed projects was \$55.5 million. We identified three additional contracts, valued at \$2.8 million, that were inappropriately recorded in the CIP account (these items were not for construction projects), and six items recorded in the property accounts that had been disposed and should have been written off. The net book value of the disposed items was \$.4 million.

Management responded that they performed a complete review of items in CIP, and moved over 100 old items out of CIP during the year. Additionally, they made changes to their procedures to ensure that newly finished structures entered into CATARS were in accordance with the newly reorganized asset designation and identification system. The documentation of the remaining completed projects was not available until near year-end, and could not be properly entered into CATARS. Management made an adjustment for the value of the completed projects so as to properly present the effect of completing these construction projects. Work for all the remaining projects will be completed by December 31, 2005.

Weaknesses Noted Over ESA Benefit Program Accounting

The Employment Standards Administration's (ESA) Office of Management, Administration, and Planning (OMAP) performs the accounting for ESA's benefit programs, including Federal Employees' Compensation Act (FECA), Energy Employees Occupational Illness Compensation Program Act (EEOICPA), Longshore and Harbor Workers' Compensation Act (LHWCA), and District of Columbia Compensation Act (DCCA). These accounting procedures include entering transactions in the DOLAR\$ general ledger, reconciling accounts, and working with employing agencies to ensure receivables are paid. Many of these transactions are entered in DOLAR\$ as monthly summary journal entries from various subsidiary records. In FY 2005, we noted several instances when the accounting for these activities was not performed timely, completely, or accurately. OMB Circular A-127 requires agency financial systems to provide reliable and timely information.

In addition, we found that ESA did not maintain its subsidiary system for tracking the balance of Intra-governmental Accounts Receivable for the FECA program. Although the OCFO has maintained other receivable records, ESA was not following up with employing agencies or managing the receivable balances. Without an adequate subsidiary system, ESA cannot properly manage its receivables or accurately report the employing agency balances.

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

These accounting and reconciliation problems arose because there was a significant employee turnover in OMAP, and ESA did not have sufficiently detailed or comprehensive written procedures to enable new staff to perform the required activities in an accurate and timely manner. In FY 2005, these weaknesses jeopardized the timely and accurate issuance of the accountability report.

We recommend that the Chief Financial Officer and the Assistant Secretary for Employment Standards: ensure that OMAP develops adequate detailed written procedures that address all significant aspects of its accounting and financial management; ensure that OMAP implements a human resource transition/succession plan which includes a description of key positions and detailed written procedures for the duties assigned to the position; ensure that OMAP and OWCP develops and implements reconciliation procedures for the benefit payment histories and the SF-224, FMS 6653 and the DOLAR\$ general ledger; and ensure that OMAP maintains a current Intragovernmental Receivable subsidiary ledger and establishes

written procedures for collecting the receivables. Management generally concurs and has begun taking steps to address these recommendations.

Errors in FECA Medical Bill Processing

Our FY 2004 audit disclosed errors in the processing of FECA medical bills, which were attributed to the fact that management did not have a quality assurance and internal audit plan in place prior to implementation of a new medical bill payment system. Both prior to and in response to this finding, management took steps to correct some of the weaknesses identified in the audit. We recommended that management move forward with full implementation of the proposed corrective actions, and adjust the accounting records accordingly. In response, management implemented certain corrective actions to improve processing of medical bills. However, our FY 2005 audit identified that medical bills paid during the year were not consistently priced in accordance with the appropriate fee schedules. We identified that management needs to take additional actions to reduce these errors, including: modify the duplicate pay edit; ensure that version changes to Grouper/Pricer are controlled and documented; improve controls over the fee schedule changes, so that the effective date is not before the implementation date; and strengthen the controls over the manual override function. Management partially concurred with our recommendations, and indicated that corrective actions had already been implemented to resolve these audit findings.

Lack of System to Track FECA Medical Bill Receivables

Our FY 2004 audit disclosed that ESA did not have a system to track and record medical bill overpayments (receivables), and, accordingly, these receivables were not recorded in the general ledger. Without an effective system, receivables cannot be adequately monitored and managed, and we estimate that the Department's accounts receivable are understated by approximately \$2 million to \$4 million, annually.

In the FY 2004 report, we recommended that ESA develop and implement a system to identify and record receivables resulting from overpayment of medical bills. In response, management indicated that the case management system, inclusive of the receivable system, would be deployed in FY 2005. However, our FY 2005 audit found that the system implementation was postponed to March, 2006.

Lack of Current Medical Evidence to Support FECA Compensation Payments

We previously reported that ESA's Office of Workers' Compensation Programs (OWCP) did not have adequate controls to ensure that current medical evidence is maintained in the case files to support the continuing eligibility of claimants, which increases the risk of improper payments. This was a result of OWCP not properly following its procedures. We recommended that management implement automated procedures to ensure medical evidence is obtained and reviewed. In our FY 2005 audit, we continued to note a high error rate where case files did not contain current medical evidence. Management developed a corrective action plan that calls for the completion in March 2006 of an automated system to track the status of medical evidence in the case files.

Lack of Strong Application Controls Over Financial Information

In the FY 2004 audit, we reported that DOL lacked strong application controls over the access to and protection of financial information. Our FY 2005 application controls testing noted the continued presence of numerous weaknesses in the information protection controls over applications. Specifically, we noted consistent weaknesses across the applications tested in the following application control areas:

- Identification and documentation of supporting environments, such as process flow documentation and mapping;
- Application password settings, such as passwords that do not adhere to complexity requirements;
- User access, such as incomplete access request and termination forms;
- Lack of application segregation of duties policies or enforcement of segregation of duties policies;
- User recertification, including lack of user recertification, or incomplete recertification documentation;
- Audit trails, such as lack of monitoring of sensitive application functions and incomplete audit logs; and

- Controls over output to other applications, including reconciliation of control totals and record counts.

These findings are a result of a breakdown in the implementation and monitoring of Departmental processes and procedures for application controls. These application control weaknesses could lead to users with inappropriate access to financial systems, inefficient processes, lack of completeness, accuracy, or integrity of financial data, or the lack of detection of unusual activity within financial systems.

In FY 2004, we recommended that the CIO ensure that the individual agencies correct the specific application control weaknesses identified during the audits, and coordinate efforts with the OCFO to develop and/or enforce procedures and controls to address consistent or systemic application control weaknesses on current and future financial management systems.

The OCIO generally concurred with the recommendations, and devised detailed plans to addresses the vulnerabilities associated with application and logical security control weaknesses systematically and consistently. In addition, the OCIO indicated that monthly meetings will be held with the effected agencies to ensure that security weaknesses identified in the audit are corrected in accordance with the agencies' respective plans of action and milestones.

Lack of Strong Logical Security Controls

In prior years, the OIG reported that DOL lacked strong logical security controls to secure the Department's networks and information. The FY 2005 audit identified continuing weaknesses, as follows:

- Technical security standards and policies need to be updated and implemented to include stronger logical security controls. Specifically, patches need to be applied to systems in a timely manner; unnecessary services need to be disabled; and access to sensitive files and directories needs to be restricted.
- Background check policies and procedures need to be created for contract staff and need to be enforced for federal staff to ensure that adequate levels of clearance are maintained for applicable staff.
- Segregation of duties policies need to be created and enforced for general support systems of financial applications.

These findings are a result of a breakdown in the implementation and monitoring of Departmental processes and procedures for logical security controls. These logical security control weaknesses could lead users to gain unauthorized access to the agency applications and data, or potential modification or disclosure of agency data.

In prior years, the OIG recommended that the CIO ensure the specific security weaknesses identified during the audits and reported in various agency reports are addressed by the individual agencies, and enhance the Department's security program to include testing of the noted weaknesses as part of the CIO's new testing process.

The OCIO generally concurred with the recommendations, and devised detailed plans to addresses the vulnerabilities associated with application and logical security control weaknesses systematically and consistently. In addition, the OCIO indicated that monthly meetings will be held with the effected agencies to ensure that security weaknesses identified in the audit are corrected in accordance with the agencies' respective plans of action and milestones.

Errors Reported by States on ETA 2112 Not Corrected by ETA

On a monthly basis, states are required to submit form ETA 2112, UI Financial Transaction Summary Unemployment Fund, which provides a summary of transactions for the state unemployment fund. Our audit of UI activity recorded in FY 2005 identified that the state reporting entities did not consistently report certain UI transactions, and that ETA did not effectively review the monthly reports in order to detect and

correct these errors on a timely basis. As a result, the financial statements of the Department were misstated. Specifically, we noted the following:

- One state reported a \$149 million withdrawal from their unemployment fund as a negative deposit, which effectively overstated the amount recorded in DOLAR\$ as UI benefit payment expense.
- One state inappropriately reported private loan proceeds as employer tax revenue, overstating the revenue by \$230 million.
- Other states incorrectly reported Trade Readjustment Assistance, NAFTA and/or TRA funds as UI deposits.

We also noted that the aggregate ending cash balance in the states' benefit payment accounts as reported on the ETA 2112 did not agree to the corresponding advance or accounts payable balances recorded in DOLAR\$. Research into these differences disclosed an estimated \$222 million understatement of benefit payment expense.

We concluded that ETA was not sufficiently monitoring information reported by States on the ETA 2112 reports, and had not provided adequate instructions or training on reporting UI Trust Fund activity. Accordingly, we recommend that additional instructions be provided to the UI reporting entities, procedures be implemented to review data reported on the ETA 2112, and that differences in ending cash balances be reconciled and adjusted as necessary. Management concurred with these findings, and has indicated that various edit checks and reconciliation procedures will be implemented in FY 2006.

OASAM's Procurement Files Lack Sufficient Documentation

In the FY 2004 audit, we reported that OASAM's procurement files lacked sufficient documentation and were poorly organized. Based on the condition of the files and the lack of critical procurement documentation, it was clear that files were not being maintained in accordance with existing procurement policies and procedures. As a result, management was not able to demonstrate compliance with the sections of the FAR pertaining to contract competition for three contracts. We recommended that management improve record maintenance, establish consistent practices, and develop a monitoring process to ensure compliance with applicable procurement requirements.

In response, OASAM implemented a series of policy and procedural changes designed to improve record maintenance, ensure consistent and compliant procurement practices, and raise awareness and proficiency in the procurement award process. Files were reorganized, and our review of a sample of 10 FY 2005 procurement actions identified a significant improvement in that regard. However, the Office of Procurement Services' (OPS) assessment of FY 2005 procurement activities identified that contract renewal actions were not processed by October 1, 2004 in full compliance with the FAR. For this reason, OPS requested a class sole source and ratification authority for FY 2005 continuing service procurement actions. The request was approved and a Justification for Other Than Full and Open Competition (JOTFOC) was executed retroactive to October 1, 2004.

Because the majority of procurement actions made by OPS in FY 2005 were for continuing services subject to the JOTFOC and/or ratification, we were unable to conclude as to whether or not OPS would be able to produce fully documented and compliant contract awards under routine operating procedures, pursuant to applicable procurement laws and regulations. In addition, the authorizing ratification document indicated that approval was contingent on the receipt of the monthly reports detailing individual contract actions awarded under the authority, along with the planned or actual procurement strategies to assure full FAR compliance next year. We found that OPS did not comply with this provision.

Management believes that the procedural changes made in FY 2005 have resolved the original audit findings, and has stated that the report required by the JOTFOC will be completed by the end of the first quarter of FY 2006. However, we remain unable to conclude whether or not OPS' revised operating procedures would

produce fully documented compliance with applicable procurement requirements since the majority of procurement actions made in FY 2005 were subject to a one-time sole source process.

Inaccurate Grant Accounting

The OIG previously reported that significant errors were made in amounts recorded for ETA's grants and contracts. These errors were attributed to a lack of sufficient internal control procedures to identify and correct errors on a timely basis. The OIG recommended that management establish procedures to identify and correct accounting errors on a timely basis, including implementation of review procedures and exception reports. ETA management concurred, and implemented various improvements designed to detect potential accounting errors. However, our FY 2005 audit continued to note accounting errors in grants selected for testing, and identified differences in the total costs reported by grantees in ETA's grant cost subsidiary and the corresponding amounts recorded in the general ledger. ETA management concurs with our conclusions, and plans to implement additional procedures to address these audit findings.

Deficiencies in Controls Over Unemployment Insurance (UI) Benefit Overpayments

The OIG's FY 2001 audit disclosed 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. The OIG also found that there had been little change in the rate of overpayments (about 8.5 percent) since 1989. The OIG recommended that management develop a plan to use the BAM data as the impetus for improving internal controls over the benefit payment process, and include procedures to identify statistically valid improvements, or lack thereof, in overpayment rates. In response, management implemented corrective actions, including a Government Performance and Results Act (GPRA) goal, which they believed would result in a significant reduction in the detectable, recoverable overpayment rate. However, we found that recent UI data does not reflect improvements in the rate of overpayments or in the rate measured with the GPRA goal. The published UI-benefit overpayment rates for calendar years (CY) 2004, 2003 and 2002 were 9.9 percent, 9.3 percent, and 9.1 percent, respectively, each year reflecting an increase rather than a decrease in the rate of overpayments.

Management believes that the corrective actions taken in response to this finding have resulted in a significant reduction in the detectable, recoverable overpayment rate, and that the fiscal year data presented in this Performance and Accountability Report (PAR) reflects a decline in the overpayment rate from 9.7 percent in FY 2004 to 9.46 percent for FY 2005. These rates are based on data obtained through June 30, 2005, whereas the data obtained for our audit evaluation was based on annual published data for the years ended December 31, 2004, 2003 and 2002. We conclude that six additional months of data is not sufficient evidence to substantiate a permanent downward trend in the UI overpayment rate, and that the overpayment rate reported by management for FY 2005 (9.46 percent) reflects an increase from the rate reported in 2001 with the original audit finding (8.2 percent).

Implementation of Managerial Cost Accounting

In the FY 2002 audit, the OIG reported that DOL was not in compliance with the requirements for managerial cost accounting (MCA) contained in Statement of Federal Financial Accounting Standards (SFFAS) No. 4. 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. Further, DOL did not adequately link cost information to performance measures at the operating program level for use in managing program operations on a routine basis or use managerial cost information for purposes of performance measurement, planning, budgeting or forecasting.

Management concurred with this finding, and developed a comprehensive plan to implement a Department-wide MCA system that complies with the requirements of SFFAS No. 4. Cost models were developed for substantially all of DOL's agencies and their major programs, the MCA system was certified for processing, and the cost accounting software was installed throughout each of the program agencies.

However, while the department has made significant progress in implementing managerial cost-accounting capabilities, current cost information is not yet being widely used for decision making on a day-to-day basis. Management concurs, and has indicated that the Department's focus during FY 2006 will shift to expanding the use of cost information by managers at all levels for decision making on a day-to-day basis.

Other Matters

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 those provisions and we did not test compliance with all laws and regulations applicable to the DOL. Providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

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

Report on Compliance With FFMIA

We have examined DOL's compliance with the requirements of FFMIA as of September 30, 2005. 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 of DOL's compliance with specified requirements.

In our opinion, as of September 30, 2005, DOL substantially complied with the requirements of FFMIA.

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.

November 10, 2005