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OFFICE OF LABOR-
MANAGEMENT STANDARDS



OLMS COULD DO MORE TO IMPROVE THE EFFECTIVENESS OF THE COMPLIANCE AUDIT PROGRAM

Date Issued: September 13, 2012
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BRIEFLY...

Highlights of Report Number **09-12-001-04-421**, issued to the Director, Office of Labor-Management Standards.

WHY READ THE REPORT

The Office of Labor-Management Standards' (OLMS) mission is to administer provisions of the Labor-Management Reporting and Disclosure Act of 1959, as amended (LMRDA), which primarily establishes standards for labor union democracy and financial integrity and requires reporting and public disclosure of union reports. OLMS helps American workers by providing union oversight to:

- help eliminate or prevent improper or corrupt practices by labor unions and their officers and representatives.
- identify serious violations of the LMRDA and related acts covering Federal employee unions which interfere with democratic procedures within labor organizations.
- help unions improve their organizational and administrative effectiveness.

As part of the effort to help ensure union financial integrity, OLMS conducts a compliance audit program (CAP). OLMS designed compliance audits to verify LMRDA or CSRA compliance, investigate potential violations of the law, and provide compliance assistance to help unions meet statutory requirements.

WHY OIG CONDUCTED THE AUDIT

We conducted this audit to determine if OLMS had: (1) evaluated the effectiveness of its CAP and its impact on safeguarding union assets, (2) selected unions for audit using the most effective strategies, and (3) ensured unions corrected violations of LMRDA.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full agency response, go to:

<http://www.oig.dol.gov/public/reports/oa/2012/09-12-001-04-421.pdf>

September 2012

OLMS COULD DO MORE TO IMPROVE THE EFFECTIVENESS OF THE COMPLIANCE AUDIT PROGRAM

WHAT OIG FOUND

OLMS could do more to improve the CAP effectiveness in verifying LMRDA compliance. Specifically, OLMS has not: (1) fully evaluated the effectiveness of the CAP and its impact on safeguarding union fund assets, (2) demonstrated it was using the most effective strategies for selecting unions for audit, and (3) ensured that unions corrected financial control weaknesses that allowed recordkeeping violations.

The OLMS performance measurement process did not evaluate the effectiveness of the CAP. The CAP objective is to verify LMRDA compliance, and provide compliance assistance to help unions meet statutory requirements. However, OLMS' performance measure for the CAP measured the percentage of CAP audits that identified a potential criminal violation. This did not measure CAP outcomes.

In addition, OLMS could not demonstrate it used the most effective strategies to identify unions with the most significant LMRDA violations. OLMS did not have a risk-based mechanism to correlate CAP strategies for selecting unions for audit with CAP outcomes to determine which strategies disclosed the most significant LMRDA violations or were most effective in improving the safeguarding of union assets.

Finally, OLMS did not always ensure correction of financial control weaknesses that allowed union recordkeeping violations. While OLMS required corrective action for violations in other areas, they did not follow up with unions to ensure they corrected control weaknesses related to recordkeeping.

WHAT OIG RECOMMENDED

The OIG recommended: OLMS develop performance measures that evaluate the effectiveness of the CAP in safeguarding union assets by verifying LMRDA compliance; implement a risk-based process that will define the most significant LMRDA violations and use strategies to direct OLMS CAP resources to unions with the most significant LMRDA violations; and develop a process that documents unions correct financial controls over recordkeeping.

OLMS did not agree that it should develop better performance measures. OLMS also stated that it had developed risk-based processes and were testing them. Finally, OLMS did not believe it would be cost effective to develop a process to document unions correct financial controls over recordkeeping.

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U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210



September 13, 2012

Assistant Inspector General's Report

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The Office of Inspector General (OIG) conducted a performance audit of the Department of Labor's (DOL) Office of Labor Management Standards (OLMS) Compliance Audit Program (CAP). OLMS administers and enforces provisions of the Labor-Management Reporting and Disclosure Act of 1959 (LMRDA). OLMS also administers provisions of the Civil Service Reform Act of 1978 (CSRA)¹ relating to standards of conduct for Federal employee organizations, which are comparable to LMRDA requirements. These laws promote union democracy and financial responsibility in private and public sector labor unions. In Fiscal Year (FY) 2011, OLMS received \$41.3 million to oversee about 25,000 national and local unions reporting receipts of approximately \$19 billion.

The CAP is part of OLMS' oversight of union financial responsibility. Through the CAP, OLMS conducts audits of unions covered by the LMRDA. OLMS designed the CAP to detect embezzlements and other criminal and civil violations of the LMRDA. OLMS also uses the CAP to provide compliance assistance to help unions meet statutory requirements.

To determine if the CAP was effective in detecting embezzlements and other criminal and civil violations of the LMRDA, OIG's audit objectives were to answer the following questions:

Has OLMS:

1. Evaluated the effectiveness of its CAP and its impact on safeguarding union assets?
2. Selected unions for audit using the most effective strategies?

¹ CSRA made most of LMRDA provisions applicable to Federal unions. Therefore, we will only refer to LMRDA in the report.

3. Ensured unions corrected violations of LMRDA?

Our audit covered compliance audits that OLMS closed from April 1, 2010, through March 31, 2011. We reviewed and analyzed the LMRDA, CSRA, and applicable OLMS regulations, policies, and procedures. In addition, we performed detailed testing on a sample of 99 CAP audits out of a universe of 428. The 428 audits represented \$263,189,088 of union receipts. Each of these audits covered a separate local or national union.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

RESULTS IN BRIEF

OLMS could do more to improve the CAP effectiveness in verifying LMRDA compliance. Specifically, OLMS has not (1) fully evaluated the effectiveness of the CAP and its impact on safeguarding union fund assets, (2) demonstrated it was using the most effective strategies for selecting unions for audit, and (3) ensured that unions corrected financial control weaknesses that allowed recordkeeping violations.

The OLMS performance measurement process did not evaluate the effectiveness of the CAP. The CAP objective is to verify LMRDA compliance, and provide compliance assistance to help unions meet statutory requirements as a means of safeguarding union assets. OLMS' performance measure for the CAP measured the percentage of CAP audits that identified a potential criminal violation. This is not a measure of CAP effectiveness because (1) it measures OLMS activity not program outcomes, and (2) does not reflect any non-criminal activity of the CAP. Overall, it does not measure the effectiveness of the CAP program in safeguarding union assets.

In addition, OLMS could not demonstrate it used the most effective strategies to identify unions with the most significant LMRDA violations. OLMS did not have a risk-based mechanism to correlate CAP strategies for selecting unions for audit with CAP outcomes to determine which strategies disclosed the most significant LMRDA violations or were most effective in improving the safeguarding of union assets. OLMS has started to develop a mechanism that, according to OLMS, will enhance CAP targeting to better select unions with the greatest likelihood of criminal violations. However, OLMS has not yet determined how to use risk-based analysis to identify which are the most significant violations and correlate strategies to these outcomes. Without this mechanism in place, OLMS could not demonstrate it was using the most effective risk-based strategies to identify unions with the most significant LMRDA violations.

Finally, OLMS did not always ensure correction of financial control weaknesses that allowed union recordkeeping violations. While OLMS required corrective action for violations in other areas, such as bonding and financial reporting, they did not follow up with unions to ensure they corrected control weaknesses related to recordkeeping to prevent violations from reoccurring. Recordkeeping violations represent control weaknesses that, left uncorrected, could put union funds at risk.

We recommended OLMS develop performance measures that evaluate the effectiveness of the CAP in safeguarding union assets by verifying LMRDA compliance; implement a risk-based process that will define the most significant LMRDA violations and use strategies to direct OLMS CAP resources to unions with the most significant LMRDA violations; and develop a process that documents unions correct financial controls over recordkeeping.

OLMS RESPONSE

In response to the draft report, OLMS stated that it recognized that the measure being used did not tell OLMS whether the CAP is changing behavior or increasing compliance. However, OLMS disagreed with the recommendation to develop better performance measures to evaluate the effectiveness of the CAP. OLMS stated it had pursued creating an outcome measure to better measure CAP results but did not have the resources to implement. Further, OLMS did not agree that its performance measure should include non-criminal [civil] outcomes. OLMS said it recognizes its performance measure did not measure civil violations of the LMRDA; however, OLMS stated this was purposeful and that the measure shows the success of the CAP in its primary objective of detecting embezzlement.

OLMS agreed, in part, with the recommendation to implement a risk-based process that will define the most significant LMRDA violations and use strategies to direct OLMS CAP resources to unions with the most significant LMRDA violations. OLMS agreed that, at the time of the audit, it could not demonstrate it was using the most effective risk-based strategies to identify unions with the most significant LMRDA violations. However, OLMS disagreed that it failed to identify which LMRDA violations were the most significant in terms of protecting union financial integrity. Finally, OLMS did not dispute the finding that, at the time of the audit, OLMS did not have a process to correlate CAP strategies for selecting unions for audit with CAP outcomes. However, OLMS stated it has developed and is currently testing two such models.

Finally, OLMS disagreed with the finding to develop a process that verifies unions correct financial controls over recordkeeping. OLMS said that, to be meaningful, such a process requires OLMS to subsequently conduct on onsite review to physically verify controls were in place and deficiencies remedied. OLMS concluded this would be an imprudent use of its resources.

OLMS' response is included in its entirety at Appendix D.

OIG CONCLUSION

We continue to believe OLMS should develop better performance measures for the CAP program. While OLMS places heavy reliance on the fact that their percentage of CAP cases that detect possible criminal violations has risen over the last several years as an indication of success. However, it may well indicate that criminal activity is becoming more widespread. This ambiguity contributes to it being a poor outcome measure overall.

Further, the OLMS Handbook states that OLMS designed CAP to verify LMRDA compliance, and provide compliance assistance to help unions meet statutory requirements. OLMS confirmed this in its response to our draft report. Given these CAP program objectives, we believe the current performance measure is incomplete. We agree that detecting embezzlement is important; however, we disagree that OLMS' current measure shows the success of its CAP. It only measures the percentage of compliance audits that results in a criminal case being opened while ignoring any other benefits of the CAP.

For recommendation 2, we acknowledge that during our review period, OLMS was developing and currently testing, two risk-based strategies to identify unions with the most significant LMRDA violations. Once the strategies are completely tested and OLMS implements at least one, we believe our recommendation may be satisfied.

We revised recommendation 3 to clarify that we were not recommending OLMS revisit all unions with recording keeping violations. Rather, we believe OLMS should put a process in place that will provide OLMS more assurances that unions took actions to address the problems. This could include requiring unions to provide documentation for how they corrected identified weaknesses, sending in copies of certain records over a period of time, or providing some other method of documented assurances to OLMS that changes were made. The current lack of follow-up does not provide any assurances of corrections.

RESULTS AND FINDINGS

Objective 1 — Has OLMS evaluated the effectiveness of its CAP and its impact on safeguarding union assets?

Developing a measure that incorporates all outcomes will result in OLMS better evaluating CAP effectiveness

Finding 1 — OLMS Performance Measurement Process Did Not Evaluate Overall CAP Effectiveness

The OLMS performance measurement process did not evaluate the effectiveness of the CAP. OLMS used an output measure that only measured the percentage of CAP audits

that identified a potential criminal violation. This did not measure the CAP program’s effectiveness in safeguarding union assets. Specifically, it reports internal activity managed by OLMS but does not measure program outcomes against achieving the intended result of the CAP program. The measure does not measure changes in program conditions that OLMS is trying to influence. Further, this measure did not recognize non-criminal outcomes, such as insufficient bonding of union assets, deficient filing, failure to file, or failure to maintain records. As a result, OLMS did not determine overall if its CAP was effective in detecting criminal and civil violations of the LMRDA to improve safeguards of union assets.

The Government Performance and Results Act (GPRA) of 1993 guides Federal performance measurement by systematically holding Federal agencies accountable for achieving program results. GPRA stresses the establishment of goals and the measurement of program outcomes as a means of effective program management. OMB Circular A-11, which implements GPRA, defines outcomes as “The desired results of a program.” To measure program outcomes, OMB Circular A-11 defines an outcome measure as:

A type of measure that indicates progress against achieving the intended result of a program and indicates changes in conditions that the government is trying to influence.

OMB Circular A-11 stresses the importance and benefits of measuring program outcomes versus program outputs, which are the products of a program or the internal activity of an agency.

As required by GPRA, OLMS established performance goals and measures for its programs. OLMS established one program measurement for the CAP. The CAP performance measure was the percent of CAP audits that identified a potential criminal violation. Each year OLMS established a goal in terms of the percentage of CAP audits that would identify a potential criminal violation. OLMS then monitored the CAP in terms of this percentage and reported the results as part of its GPRA reporting.

For example, in FY 2008, OLMS established a baseline and targets of the percentage of CAP audits that identified a potential criminal violation. The table below shows the baseline, fiscal year targets, and percentage of audits that identified a potential criminal violation for FY 2008 through 2011.

OLMS CAP GPRA Goals and Results				
	FY 2008	FY 2009	FY 2010	FY 2011
Target	Base	12.0%	12.5%	13.0%
Result	11.5%	12.1%	14.6%	14.9%

According to OLMS officials, they established this measure and the annual goals to increase union financial integrity, democracy, and labor-management transparency.

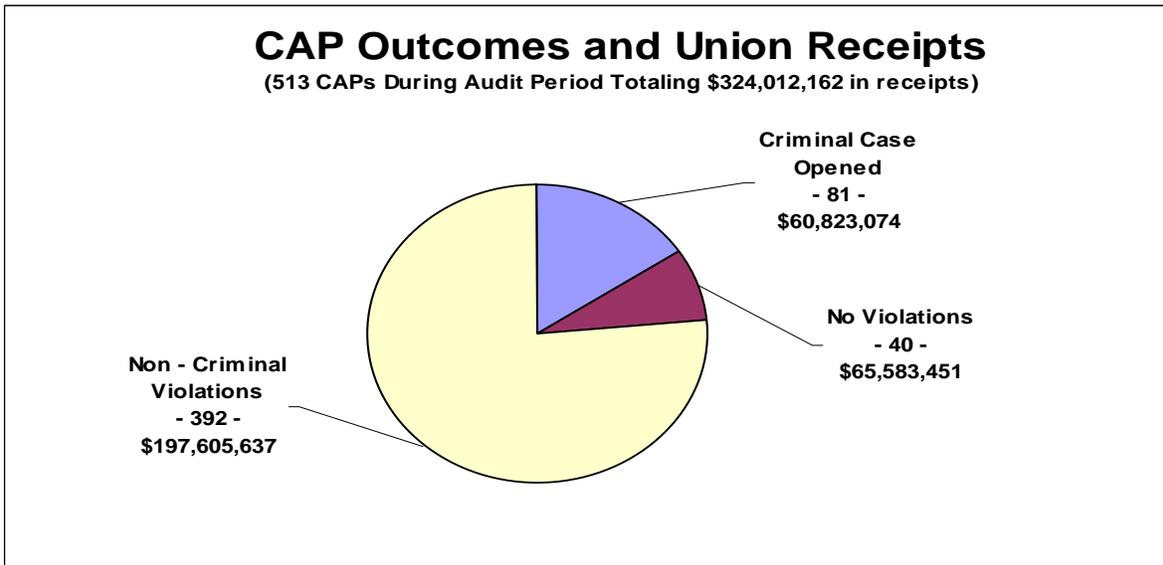
However, this measure does not assess whether union financial integrity, democracy or transparency have actually increased. It measures OLMS activity rather than its success in safeguarding union assets through criminal indictments and convictions.

In addition, according to OLMS, the CAP objective is to uncover both criminal and non-criminal violations of the LMRDA. Specifically, according to the OLMS Handbook, OLMS designed CAP to verify LMRDA compliance and provide compliance assistance to help unions meet statutory requirements. The current performance measure, however, only relates to potential criminal LMRDA violations. It does not measure any impact of OLMS' non-criminal activities in CAP.

As a result, most CAP efforts are not included in GPRM measurement. The large majority of CAP audits and related resources identify non-criminal LMRDA violations. For example, during our audit period, OLMS closed 513² CAP audits covering 513 unions and over \$324 million in receipts. Of these:

- 392, or 76 percent, found a variety of non-criminal violations, such as insufficient bonding of union assets, deficient filing, failure to file, and failure to maintain records.
- 81, or 16 percent, found violations that resulted in a criminal case.
- 40, or 8 percent, found no violations.

The following chart shows the distribution of CAP audit outcomes:



² 513 represents the total number of audits closed during our audit period. This includes the 428 audits in our sample universe plus 81 audits that resulted in a criminal case and 4 audits we eliminated because they did not file a financial report and had zero dollars in receipts.

As this chart shows, the majority of CAP results are non-criminal, but OLMS does not measure any non-criminal results from the CAP.

Overall, OLMS did not determine if its CAP was effective in improving safeguarding of union assets. The current measure only identifies whether the CAP is increasing or decreasing referrals for criminal cases, not whether the CAP is actually affecting financial integrity in unions. Further, the current measure only reflects referrals for criminal investigation while the majority of CAP resources identify non-criminal results. OLMS needs to create a performance measure that measures actual CAP outcomes and incorporates both criminal and non-criminal outcomes.

Objective 2 — Has OLMS selected unions for audit using the most effective strategies?

Implementing a risk based process to identify effective strategies will result in better selection of those unions with the most significant LMRDA violations

Finding 2 — OLMS Does Not Have A Process to Identify Effective Strategies For Selecting Those Unions With The Most Significant LMRDA Violations

OLMS could not demonstrate it was using the most effective risk-based strategies to identify unions with the most significant LMRDA violations. OLMS did not have a process to correlate CAP strategies for selecting unions for audit with CAP outcomes. In addition, OLMS had not determined which LMRDA violations were the most significant in terms of protecting union financial integrity. As a result, OLMS could not demonstrate it was selecting unions for audit that had the greatest risk for LMRDA violations that affected the safeguarding of union assets.

OLMS has a large universe of unions to oversee. In FY 2011, there were about 25,000 unions submitting annual reports to OLMS. These 25,000 unions consisted of about 5,300 large unions (21 percent) with assets over \$250,000, 12,100 medium-sized unions (48 percent) with assets between \$10,000 and \$250,000, and 7,700 small unions (31 percent) with assets less than \$10,000. In our audit period, OLMS closed CAP audits on 124 large unions (29 percent), 272 medium-sized unions (64 percent), and 32 small unions (7 percent). While OLMS used many strategies, including size of the union, to target unions for CAP audits, it could not demonstrate that it was using the most effective strategies to identify the most significant violations.

In the FY 2011 to 2016 strategic plan, OLMS stated its goal was to use its resources more efficiently to deter and detect wrongdoing by becoming more effective at selecting unions for audit. To do this, OLMS delegated the responsibility for selecting unions for audit to the District Office level. The OLMS National Office's role in selecting unions for audit was to provide general guidance on how the District Offices were to select unions for CAP audits. They did this through the CAP Handbook, annual Program Operations Plan guidance, and ongoing guidance to the District Offices. Additionally, they facilitated the sharing of union selection ideas across the organization.

While the OLMS National Office provided guidance and facilitated idea sharing, they did not have a mechanism to analyze CAP results based on risk and determine the best union selection strategies that produced the most significant results. Prior to June 2011, OLMS recorded the union selection reasons in a case data system that did not capture the information in a useable format. For each CAP case, District Offices entered the union selection strategy in a narrative, non-standard format. This format made any analysis to identify the most effective union selection strategies difficult. For example, one case in our sample had the following narrative for case selection:

Treasurer ... claims to have mailed (via the US Postal Service) the LM-3³ for FYE 06/30/2009 to OLMS on no less than four occasions since December 11, 2009 and to have faxed it once. Despite ... claims, OLMS has not received the required delinquent report. Due to an expressed concern from ... current President regarding current recordkeeping and filing issues, a CAP is being opened with the cooperation of the current officers. There is no known embezzlement of funds at this time.

This narrative format did not allow OLMS National Office or its District Offices to easily extract CAP case selection strategies and correlate CAP case results. Further, the District Offices did not have guidance to determine which LMRDA violations were significant in relation to safeguarding union assets. For example, there was no guidance as to whether a reporting violation was as significant as a bonding violation. Overall, there was no means to correlate strategy used to the significance of the results.

In 2009, OLMS engaged a consultant to measure CAP predications against one outcome – fraud. The consultant performed extensive analysis and correlated CAP selection strategies with fraud occurrences. However, there were no indications that OLMS used the results of this analysis in its strategies or in selecting unions for audit.

In our reviews of District Offices, we found that each District had developed its own strategies for selecting cases. District Offices used a variety of strategies to select unions for audit: union member complaints, delinquent and deficient reports, selected industries, etc. For example, one district office used lack of prior audit coverage as a targeting strategy and based over 50 percent of its CAP caseload on this strategy. In comparison, another District did not use this strategy at all. There was no empirical data to support either approach or to evaluate the significance of the outcomes. While these differing approaches may have been appropriate, OLMS did not have any empirical data to determine whether they were effective identifying unions with high risk for the most significant LMRDA violations.

³ The LM reports are reports that unions file annually with OLMS, which shows their financial status. The type of LM report filed depends upon the size of the union. LM-2 filers have annual receipts of \$250,000 or more, LM-3 filers have annual receipts of \$10,000 or more but less than \$250,000, and LM-4 filers have annual receipts under \$10,000.

In a 2010 proposal recognizing this problem, OLMS stated:

For CAP cases, there is a wide variance in the level of detail entered in the predication⁴ field, ranging from long, detailed narratives to "district director discretion." This non-uniformity makes it impossible to correlate CAP predications to fallout rates.

In response to the need for better data related to predications and results, OLMS has started to develop a mechanism that it believes will identify which union selection strategies result in the best performance outcomes. In June 2011, OLMS changed their case data system to require District Offices to select one of 18 specific codes to identify the reason(s) used to open a CAP audit. OLMS also instructed District Offices to code retroactively all CAP audits opened since October 1, 2010, with one of the 18 codes for selecting a union for audit. According to OLMS officials, these codes will enable them to identify those union selection strategies that produce the greatest number of potential criminal violations.

However, OLMS officials stated that they had not yet performed analysis on the new system to determine which union selection strategies are most effective. Further, the proposal does not include a process for OLMS to evaluate the CAP results in terms of the significance of the results and correlation to the 18 codes. In addition, the proposal indicates that OLMS may only evaluate CAP results in terms of potential criminal activity.

We believe OLMS needs to include non-criminal violations in its risk analysis and determine which violations are the most significant in terms of safeguarding union assets. OLMS could then correlate CAP predications to all violations based on risk and impact. Without this additional analysis and determination, OLMS has not been able to determine which strategies are most effective in identifying high-risk unions with the most significant violations of LMRDA.

With budget and resource constraints in recent years, this may become a critical issue. For FY 2011, OLMS reported that it conducted 461 CAP audits, a reduction from the average of 719 in the previous 4 years. If OLMS continues to conduct fewer CAP audits, it is imperative that they select unions for audit with the most significant violations of LMRDA. This is increasingly important when considering that OLMS oversees roughly 25,000 unions. Each CAP audit is of critical importance in providing safeguards over the roughly \$19 billion in union funds. OLMS should ensure that its new process is risk-based and should complete and utilize it to evaluate and identify which union selection strategies result in the best performance outcomes.

Objective 3 — Has OLMS ensured unions corrected violations of LMRDA?

Developing a process to verify unions correct financial controls over recordkeeping will result in improving the safeguarding of union assets

⁴ Predication is a term for the reason to select a union for audit.

Finding 3 — OLMS Does Not Have A Process That Verifies Unions Correct Financial Controls Over Recordkeeping

OLMS did not always ensure correction of financial control weaknesses that allowed union recordkeeping violations. While OLMS required corrective action for violations in other areas, such as bonding and financial reporting, they did not follow up with unions to ensure they corrected control weaknesses related to recordkeeping to prevent violations from reoccurring. OLMS officials stated that they did not have enough resources to follow up with unions on recordkeeping violations. However, recordkeeping violations represented financial control weaknesses that, left uncorrected, could put union funds at risk.

OLMS regulations require unions to provide internal controls over union funds. Specifically, 29 Code of Federal Regulations (CFR) Title IV, Section 458.32, states:

Every labor organization shall provide accounting and financial controls necessary to assure the maintenance of fiscal integrity.

For many violations that OLMS uncovered in CAP audits, such as inadequate bonding, and delinquent and deficient filing, OLMS required the unions to provide documentation that verified that the union corrected the violations. However, for recordkeeping violations, OLMS accepted union assurances that the union would correct them in the future. This action did not provide reasonable assurance that unions implemented controls that improved recordkeeping.

Recordkeeping violations were the most common type of violation identified by CAP audits. Examples included:

- A union did not retain sufficient documentation or descriptive information for \$13,426 in reimbursed expenses and \$40,797 in debit card transactions incurred by former secretary-treasurer.
- A union did not record in its receipts records the source or purpose of at least \$8,882 in income received.
- A union did not retain sufficient documentation for approximately \$6,252 in debit card transactions and expenses and did not require officers and employees to submit itemized receipts for meal expenses totaling at least \$3,927.
- A union did not retain bank statements for the period April 1, 2007, to March 31, 2009.

We found that 55 of the 99 CAP audits in our sample identified 140 recordkeeping violations. In all 55 audits, OLMS accepted union assurances recordkeeping violations would not reoccur but did not follow up to ensure the unions improved their financial

controls to prevent the identified recordkeeping violations. These 55 unions had receipts of approximately \$24.5 million, or 37 percent of the \$66.4 million in our sample.

Only by follow-up action, will OLMS know if unions implement proper financial controls to correct and prevent recordkeeping violations. Without such actions, those unions' funds are potentially at risk.

RECOMMENDATIONS

We recommend that the OLMS Director:

1. Develop performance measures that evaluate the effectiveness of the CAP in safeguarding union assets by verifying LMRDA compliance.
2. Implement a risk-based process that will define the most significant LMRDA violations and use strategies to direct OLMS CAP resources to unions with the most significant LMRDA violations.
3. Develop a process that documents unions correct financial controls over recordkeeping.

We appreciate the cooperation and courtesies that OLMS personnel extended to the Office of Inspector General during this audit. OIG personnel who made major contributions to this report are listed in Appendix E.



Elliot P. Lewis
Assistant Inspector General
for Audit

Appendices

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Appendix A**Background**

OLMS administers and enforces provisions of LMRDA. OLMS also administers provisions of the CSRA relating to conduct of Federal employee organizations, which are comparable to LMRDA requirements. These laws promote democracy and financial responsibility in private and public sector labor unions. In FY 2011, OLMS received \$41.3 million to oversee about 25,000 national and local unions reporting receipts of approximately \$19 billion.

OLMS ensures compliance with the provisions of the LMRDA and CSRA in four ways:

- Public Disclosure of Reports
- Compliance Audits
- Investigations
- Education and Compliance Assistance

As part of its oversight of union financial responsibility, OLMS conducts audits of unions covered by the LMRDA through its CAP. OLMS designed its compliance audits to verify LMRDA compliance, investigate potential violations of the law, and provide compliance assistance to help unions meet statutory requirements. For each CAP audit, OLMS sends a closing letter to the union describing the reporting, recordkeeping, and internal control problems identified during the audit. The closing letters do not purport to be an exhaustive list of all possible problem areas since the audits are limited in scope.

OLMS conducts audits of local unions and intermediate bodies under the CAP using investigators in 20 OLMS District Offices throughout the country.

OLMS total budget authority for FY 2009 through FY 2011 was as follows:

FY 2009 – \$45,726,000
 FY 2010 – \$41,367,000
 FY 2011 – \$41,367,000

For the same period, OLMS conducted the following number of CAP audits:

FY 2009 – 746 cases
 FY 2010 – 541 cases
 FY 2011 – 461 cases

For the period of April 1, 2010, through March 31, 2011, OLMS reported 432⁵ non-embezzlement audits under CAP, covering unions with approximately \$263 million in receipts.

⁵ This includes the 428 audits in our sample universe and 4 audits that did not file a financial report and had zero dollars in receipts.

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Appendix B

Objectives, Scope, Methodology, and Criteria

Objectives

To determine if the CAP was effective in verifying LMRDA compliance, OIG's audit objectives were to answer the following questions:

Has OLMS:

1. Evaluated the effectiveness of its CAP and its impact on safeguarding union assets?
2. Selected unions for audit using the most effective strategies?
3. Ensured unions corrected violations of LMRDA?

Scope

Our audit work covered compliance audits that OLMS closed from April 1, 2010, through March 31, 2011. We reviewed and analyzed the LMRDA, CSRA, and applicable OLMS regulations, policies, and procedures.

There were 513 CAP audits closed during the audit period. The 513 audits covered \$324,012,162 of union receipts. To develop our audit sample, we removed all audits that resulted in a criminal case and eliminated four audits because the unions involved had not filed a financial report and had zero dollars in receipts. The remaining 428 audits represented \$263,189,088 of union receipts.

We reviewed and analyzed a statistical sample of 99 of the 428 CAP audits. These 99 audits represented \$66,418,875 of union receipts.

We conducted fieldwork at the OLMS National Office in Washington, DC and eight District Offices: Boston, Pittsburgh, Chicago, Cincinnati, Atlanta, Washington, DC, Los Angeles, and Seattle.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Methodology

In planning and performing our audit, we considered OLMS' internal controls that were relevant to our audit objectives. We confirmed our understanding of these controls

through interviews and reviewing policies and procedures. Our consideration of internal controls relevant to our audit objective would not necessarily disclose all matters that might be significant deficiencies. Because of inherent limitations in internal controls, misstatements or noncompliance may nevertheless occur and not be detected.

We reviewed and analyzed the LMRDA, CSRA, federal regulations and other criteria related to our audit objectives.

Objective 1 - Has OLMS evaluated the effectiveness of its CAP and its impact on safeguarding union fund assets?

For this objective, we interviewed OLMS National Office staff to determine if they evaluated the effectiveness of the CAP program. We reviewed the OLMS GPRA performance measure process and determined how OLMS calculated the percentage of criminal cases that resulted from CAP audits. We also reviewed the outcomes of all 513 CAP audits initiated during the audit period to determine the outcomes for performance measurement.

Objective 2 – Has OLMS selected unions for audit using the most effective strategies?

For this objective, we interviewed staff at the National Office about the strategies used to select unions for compliance audits and how they identified the most effective strategies. We also interviewed the District Directors at each of the eight sites we visited about the strategies they use to select unions for audits. We also reviewed OLMS policies and procedures related to union selection strategies and reviewed OLMS' proposal to develop a new process to track the effectiveness of their union selection strategies.

Objective 3 – Has OLMS ensured that unions corrected LMRDA recordkeeping violations?

For this objective, we interviewed OLMS staff at the National Office and eight District Offices about the process for correcting violations. We reviewed policies and procedures that cover violation resolution. We analyzed a sample of 99 audits from across the 8 District Offices to identify the different types of violations (reporting, recordkeeping, and other) and what actions OLMS took to resolve them.

Data Reliability

In planning and performing the audit, we relied on computer-generated data obtained from OLMS. OLMS provided us with a data file of audits that OLMS closed from April 1, 2010, through March 31, 2011. This data file, which OLMS generated from its Case Data System (CDS), contained 513 records of audits that OLMS closed during our audit period.

For data completeness, we compared the number of CAP audits closed in the FY 2010 OLMS Annual Report to the number of CAP audits closed in the data file. For FY 2011, we compared OLMS' Performance Review & Analysis case inventory for the first two quarters of FY 2011 to the data file received for all audits closed for the same period.

Additionally, we compared the information OLMS provided us from the CDS with the information in the CAP case files to assess the data's authenticity and we tested for data accuracy by checking the CDS data for missing data, inconsistent data and for dates outside of our audit period. We determined the data to be sufficient and appropriate for the purpose of our audit.

Sampling

To determine CAP audits closed, we obtained a data file, reviewed OLMS' CDS system database and determined that 513 of the audits were within our audit period of April 1, 2010, through March 31, 2011. We then eliminated 81 CAP audits that resulted in criminal cases and 4 audits that the database listed as not having filed an annual report and having zero dollars in receipts. This resulted in a universe of 428 CAP audits assigned to 20 District Offices in 4 regions.

We designed a 2-stage stratified cluster random sampling plan. In the first stage, we stratified the District Offices into four different strata and we randomly sampled 8 out of 20 District Offices. In the second stage, we randomly sampled 99 CAP audits from the 8 District Offices

Criteria

- Labor-Management Reporting and Disclosure Act of 1959
- Civil Service Reform Act of 1978
- 29 CFR Title IV
- Government Performance Results Act of 1993
- U. S. Department of Labor Strategic Plan Fiscal Years 2011 to FY 2016
- OMB Circular A-11

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Appendix C

Acronyms and Abbreviations

CAP	Compliance Audit Program
CDS	Case Data System
CFR	Code of Federal Regulations
CSRA	Civil Service Reform Act of 1978
DOL	Department of Labor
FY	Fiscal Year
GPRA	Government Performance and Results Act of 1993
LMRDA	Labor-Management Reporting and Disclosure Act of 1959
OIG	Office of Inspector General
OLMS	Office of Labor Management Standards
OMB	Office of Management and Budget
POP	Program Operations Plan

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OLMS Response to Draft Report

U.S. Department of Labor

Office of Labor-Management Standards
Washington, DC 20210
(202) 693-0202



July 27, 2012

MEMORANDUM TO: ELLIOT P. LEWIS
Assistant Inspector General for Audit

FROM: JOHN LUND, PhD 
Director, Office of Labor-Management Standards

SUBJECT: OIG Audit of OLMS Compliance Audit Program

This memorandum responds to your June 27, 2012, transmittal of the Office of Inspector General Draft Audit Report Number 09-12-001-04-421, "OLMS Could Do More to Improve the Effectiveness of the Compliance Audit Program." We appreciate this opportunity to respond to the findings and recommendations of the OIG and to reiterate our demonstrated commitment to continuously improve the Compliance Audit Program (CAP). While OLMS agrees with many of the findings and recommendations, we will take this opportunity to provide comment and, in certain areas, our disagreement.

Recommendation 1: Develop performance measures that evaluate the effectiveness of the CAP in safeguarding union assets by verifying LMRDA compliance.

The draft report provides:

Overall, OLMS did not determine if its CAP was effective in improving safeguarding of union assets. The current measure only identifies whether the CAP is increasing or decreasing referrals for criminal cases, not whether the CAP is actually affecting financial integrity in unions. Further, the current measure only reflects referrals for criminal investigation while the majority of CAP resources identify non-criminal results. OLMS needs to create a performance measure that measures actual CAP outcomes and incorporates both criminal and non-criminal outcomes.

OLMS agrees with the importance of CAP in safeguarding union assets but does not concur with this specific recommendation. As explained below, CAP is an important tool that OLMS uses to detect criminal violations of the LMRDA. The CAP performance measure was not intended to serve as a broad compliance outcome measure. OLMS, in coordination with the Department of Labor, has pursued the creation of a compliance outcome measure using the audit program, but OLMS simply does not have the appropriated resources to implement it.

In support of its recommendation, OIG concludes that the key financial integrity measure used by OLMS with respect to CAP audits, the percentage of audits that “fall-out” into a criminal investigation, measured “outputs,” not program “outcomes.” OLMS recognizes that the fallout rate, for example, does not tell us whether OLMS in general or CAP specifically is changing behavior and increasing compliance in this area. This is not an oversight, however. Previous attempts to formulate such a compliance measure indicated that the sample size of random audits required to draw valid statistical inferences well exceeded the number of audits OLMS currently conducts with its available resources. Therefore, because OLMS is unable to conduct the required number of random audits necessary to produce a compliance outcome measure, OLMS has chosen to influence behavior by increasing its effectiveness in detecting and prosecuting criminal violators.

Even if OLMS were able to conduct the number of random audits necessary to produce a statistically valid compliance outcome measure, this initiative would by necessity reduce the number of targeted audits, i.e., audits selected due to the presence of predicates and indicators correlating with criminal activity. The result would therefore represent a tradeoff: random audits could not be increased unless these targeted audits were decreased. Forgoing targeted audits that are now successful at an approximate 15% rate (in terms of resulting in a criminal case) for the sole purpose of generating a measure constitutes a poor use of resources.

The draft report also observes (correctly) that the fallout rate measure fails to recognize “non-criminal” outcomes, such as “insufficient bonding of union assets, deficient filing, failure to file, or failure to maintain records.” OLMS does not agree that its performance measure should include these “non-criminal” outcomes.

The primary objective of CAP is to uncover embezzlement and other criminal and civil violations of the LMRDA.¹ When a CAP audit reveals embezzlement or fraud, a criminal investigation (i.e., “fallout”) is opened and pursued. The OLMS performance goal to increase the CAP-to-criminal case fallout rate reflects CAP’s primary function as a criminal discovery tool. Its purpose in detecting civil violations is important, but secondary.² Criminal violations are more serious, carry more severe penalties, receive higher Department of Justice priority, command greater public attention and generate a greater deterrent value than civil violations. In addition to a criminal conviction, other remedies attaching to criminal cases include restitution and debarment from serving in any union capacity for up to 13 years. The LMRDA, on the other hand, does not provide for any civil penalties. In our judgment it is, for example, more important to discover that a union officer is misappropriating union funds than it is to ensure that a union has corrected internal financial controls. This OLMS policy is consistent with a critical assessment OLMS’ predecessor agency, Labor-Management Standards Enforcement (LMSE), received in 1984 from the OIG. “CAP has uncovered few criminal violations... Although 2701 CAP audits were completed through FY 1983, data developed by LMSE... indicate that only 25

¹ It is a Federal crime for a labor union officer or employee to embezzle from or defraud the union. To protect unions and their members, OLMS conducts criminal investigations and refers cases to U.S. Attorney’s Offices so that violators are criminally prosecuted and barred from serving in any union capacity for 13 years.

² The question of whether OLMS is accurately measuring CAP’s effectiveness depends in large part on a shared understanding of the purpose of CAP. Its primary purpose is to identify fraud and embezzlement. Detecting civil violations is a primary purpose of other OLMS programs.

convictions have resulted; a success rate of less than one percent.”³ OLMS’ policy to use CAP for criminal discovery is also consistent with guidance OLMS received in 1987 from the OIG. The 1987 OIG report provided, “The CAP handbook is a good functional tool which could be used selectively to screen embezzlement allegations, but should not be applied as a blanket enforcement program.”⁴ For these reasons and others, we believe it is evident that a proportional increase in the CAP- to-criminal case rate is weighty evidence that OLMS is indeed meeting its statutory mandate to protect union member assets.

OLMS can demonstrate CAP effectiveness in its intended objectives, both in detecting criminal violations (through higher fallout rates) and in preserving and protecting union assets (through criminal indictments and convictions). Since implementing this performance measure in FY 2009, OLMS has accomplished the following results:

- (1) In FY 2009, OLMS exceeded its performance goal (12.0%) by increasing its CAP-to-criminal case fallout rate to 12.1 percent. OLMS field offices completed 746 CAP audits in the year, 91 of which resulted in 99 criminal fallout investigations (some yielded more than one). All 99 of these criminal investigations have been completed. Of these cases, 46 were referred with a recommendation for prosecution. Those 46 referred cases have thus far yielded 40 indictments and 31 convictions. The 31 convictions yielded to date from criminal case fallouts arising from these 746 audits represent a CAP-to-fallout-to-conviction rate of 4.2% - far exceeding the less-than-1% rate the OIG noted in 1984. This rate will continue to increase as additional convictions are obtained from 10 cases that have been referred but are still pending.
- (2) In FY 2010, OLMS exceeded its goal (12.5%) by increasing its CAP-to-criminal case fallout rate to 14.6 percent. OLMS completed 541 CAP audits, 79 of which fell out, resulting in 88 criminal investigations. Of these 88 criminal investigations, 77 have been completed. Of the 77 cases, 29 were referred with a recommendation for prosecution. The 29 referred cases have thus far yielded 21 indictments and 11 convictions. This represents a CAP-to-fallout-to-conviction rate of 2.0%. This rate will continue to increase as additional convictions are obtained from the 11 active and 13 pending cases.
- (3) In FY 2011, OLMS exceeded its goal (13.0%) by increasing its CAP-to-criminal case fallout rate to 15.2 percent. OLMS completed 461 CAP audits, 70 of which fell out, resulting in 77 criminal investigations. With 32 active investigations and 14 cases pending adjudication, it is too early to report or evaluate the CAP-to-fallout-to-conviction rate for FY 2011 fallouts.

While OLMS does not dispute the OIG’s conclusion that this performance measure may not measure civil violations of the LMRDA, the measure shows the success of CAP in its primary objective: detecting embezzlement.

³ See Recommendations for LMSA Reorganization, Office of Inspector General (1984).

⁴ See Survey of the Compliance Audit Program Administered by the Office of Labor-Management Standards, Office Audit, Office of the Inspector General (Draft) (1987). OLMS records do not contain a version of this survey designated as a “final” report.

Recommendation 2: Implement a risk-based process that will define the most significant LMRDA violations and use strategies to direct OLMS CAP resources to unions with the most significant LMRDA violations.

In support of this recommendation, OIG concluded:

OLMS could not demonstrate it was using the most effective risk-based strategies to identify unions with the most significant LMRDA violations. OLMS did not have a process to correlate CAP strategies for selecting unions for audit with CAP outcomes. In addition, OLMS had not determined which LMRDA violations were the most significant in terms of protecting union financial integrity. As a result, OLMS could not demonstrate it was selecting unions for audit that had the greatest risk for LMRDA violations that affected the safeguarding of union assets.

OLMS concurs, but only in part, with this statement.⁵ OLMS does not dispute the OIG's conclusion that OLMS could not demonstrate, at the time of the audit, it was using the *most effective* risk-based strategies to identify unions with the most significant LMRDA violations. However, OLMS has developed and is currently evaluating two risk-based strategies in addition to those used over the review period. Moreover, those risk-based strategies used by OLMS during the period of review to target CAP audits were still quite effective in identifying unions with the most significant LMRDA violations (i.e., criminal violations); from FY 2009 to FY 2011, the CAP-to-criminal case fallout rates rose from 12.1% in FY 2009 to 14.6% in FY 2010, and up to 15.2% in FY 2011.

OLMS disagrees that it failed to identify which LMRDA violations were the most significant in terms of protecting union financial integrity. LMRDA criminal violations are the most significant in protecting union financial integrity, and OLMS has thus implemented its union financial integrity goal to increase CAP's detection of criminal violations. OLMS further disagrees with the finding that it was unable to demonstrate it was selecting unions for audit that had the greatest risk for LMRDA violations. OLMS has been highly successful in selecting unions for audit that had a high risk for LMRDA violations, as demonstrated by the increased CAP-to-criminal case fallout rates, discussed above.

Finally, OLMS does not dispute the finding that *at the time of the audit*, OLMS did not have a process to correlate CAP strategies for selecting unions for audit with CAP outcomes. However, as the OIG acknowledges, OLMS has such a process now. OLMS has developed and is currently testing *two* such models, one based on CAP predicates and the second based upon financial and other data gleaned from the Form LM-2, Form LM-3 and Form LM-4 reports filed each year by covered unions:

CAP predicate risk-based model: In October 2010, OLMS revised its Case Data System (CDS) to better track the predications for opening CAP cases and allow OLMS to correlate CAP predications to fallout rates. If particular CAP predications or combinations of predications correlate to higher fallout rates, then OLMS can emphasize those targeting methods in the future. As of June 30, 2012, OLMS had 18 months of data and correlated CAP predicates with fall-out

⁵ For the reasons discussed above, OLMS does not concur with the recommendation that it should develop audit targeting criteria that would select for unions with civil violations.

rates. In one analysis, two key sets of facts regarding each of the 18 predicates are captured. The first concerns each single predicate, standing alone. In this case, the number of audits and fall-outs associated with each standalone predicate is listed, enabling us to calculate a fallout rate. These include such predicates as complaints from union officials or members, single year delinquent reports or an open delinquency case, or a cash reconciliation imbalance in one year's report. In a separate analysis, each predicate is analyzed in conjunction with one or two other predicates, to determine whether predicates in combination better correlate with fraud than each does separately. For example, union affiliation standing alone generated no fallouts, but matched together with other predicates, was associated with a 27.3% fallout rate.

OLMS will refresh these analyses in the same format and distribute them to all field offices on a quarterly basis, emphasizing the best targeting practices and direct field offices to refine or change their office strategies as appropriate.

LM report data risk-based model: In 2011, OLMS developed its own risk-based model based on labor organization report filing data. The database analyzes annual financial report data for the prior four-year period to identify certain "red flag" conditions for CAP targeting purposes that enable a "risk scoring" of each filer. To date, 29 CAP audits opened using this risk-based model have been completed and yielded 6 fallout criminal cases (20.7 % fallout).

OLMS is confident that it has indeed implemented a risk-based process to identify and utilize strategies to direct OLMS CAP resources to unions with the most significant LMRDA violations (i.e., criminal violations).

Recommendation 3: Develop a process that verifies unions correct financial controls over recordkeeping.

The OIG report provides:

OLMS did not always ensure correction of financial control weaknesses that allowed union recordkeeping violations. While OLMS required corrective action for violations in other areas, such as bonding and financial reporting, they did not follow up with unions to ensure they corrected control weaknesses related to recordkeeping to prevent violations from reoccurring. OLMS officials stated that they did not have enough resources to follow up with unions on recordkeeping violations. However, recordkeeping violations represented financial control weaknesses that, left uncorrected, could put union funds at risk.

OLMS does not concur with this finding and recommendation. Although OLMS recognizes the importance of unions correcting recordkeeping deficiencies, agency resources prevent OLMS from taking the additional steps implicitly recommended by the report. While OLMS acknowledges that it does not have a formal process to ensure correction of financial control weaknesses, such a process would be an imprudent use of OLMS staff resources. Each CAP audit consumes about 10 staff days. To be meaningful, a program designed to effectively "follow-up with unions on recordkeeping violations" would require OLMS to subsequently conduct an onsite review of the union records to physically verify that proper internal controls are actually in place and to verify that the recordkeeping deficiencies had been remedied. Assuming that this abbreviated financial inquiry could be done in two staff days (which is a

conservative estimate, in that it does not include travel time), following up on 461 audits would require 922 staff days. Absent new resources, this increased workload would result in 92 fewer CAP audits being conducted on an annual basis. Assuming a 13% fallout rate, this would equate to approximately 12 fewer embezzlement cases uncovered. In OLMS' judgment, union financial integrity is better secured by conducting an additional 12 criminal investigations, rather than a return visit to 922 unions whose recent audit history proved them to be free of criminal wrongdoing.

It is worth noting that a prior OIG audit report (1987) faulted the CAP program for focusing on "non-significant" violations that had "no material effect" on the union's financial position:

Most violations occurring at local unions (170 of 212, or 80 percent) appeared to have no material effect on the reported labor organization financial position, or represented no serious potential for loss to the membership. For example, 145 of the 170 violations we classified as non-significant fell into three violation categories – failure to maintain adequate records, filing deficient annual reports, and failure to file updated constitution/bylaws with OLMS... The majority of reported violations reflected technical, clerical, or administrative error or oversight on the part of labor organization administrative staff or officials.

While OLMS does not agree with the OIG's 1987 description of recordkeeping violations as "non-significant," OLMS does agree that recordkeeping violations are less significant than criminal violations. Developing and implementing a program to follow-up with unions on recordkeeping violations would not be a prudent use of agency resources.

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Appendix E

Acknowledgements

Key contributors to this report were Ralph McClane, Audit Director, Mary Stepney, Audit Manager, Marsha Secuskie, Samantha Cash, Aaron Talbert, Enrique Lozano, and Mary Lou Casazza.

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