INVESTIGATING FINANCIAL MISMANAGEMENT AT THE U.S. DEPARTMENT OF LABOR

HEARING

BEFORE THE

SUBCOMMITTEE ON HEALTH, EMPLOYMENT, LABOR AND PENSIONS

COMMITTEE ON EDUCATION AND THE WORKFORCE

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C O N T E N T S

INVESTIGATING FINANCIAL MISMANAGEMENT AT THE U.S. DEPARTMENT OF LABOR

Thursday, June 2, 2011
U.S. House of Representatives
Subcommittee on Health, Employment, Labor and Pensions
Committee on Education and the Workforce
Washington, DC

The subcommittee met, pursuant to call, at 10:01 a.m., in room 2175, Rayburn House Office Building, Hon. Phil Roe [chairman of the subcommittee] presiding.

Present: Representatives Roe, DesJarlais, Noem, Roby, Heck, Ross, Andrews, Kildee, Hinojosa, and Wu.

Also present: Representative Kline.

Staff present: Andrew Banducci, Professional Staff Member; Katherine Bathgate, Press Assistant/New Media Cordinator; Casey Buboltz, Coalitions and Member Services Coordinator; Ed Gilroy, Director of Workforce Policy; Benjamin Hoog, Legislative Assistant; Marvin Kaplan, Professional Staff Member; Barrett Karr, Staff Director; Ryan Kearney, Legislative Assistant; Krisann Pearce, General Counsel; Molly McLaughlin Salmi, Deputy Director of Workforce Policy; Linda Stevens, Chief Clerk/Assistant to the General Counsel; Alissa Strawcutter, Deputy Clerk; Joseph Wheeler, Professional Staff Member; Kate Ahlgren, Minority Investigative Counsel; Aaron Albright, Minority Communications Director for Labor; Tylease Alli, Minority Clerk; Daniel Brown, Minority Junior Legislative Assistant; Jody Calemine, Minority Staff Director; Brian Levin, Minority New Media Press Assistant; Megan O'Reilly, Minority General Counsel; Julie Peller, Minority Deputy Staff Director; Meredith Regine, Minority Policy Associate, Labor; and Michele Varnhagen, Minority Chief Policy Advisor and Labor Policy Director.

Chairman ROE. I would like to call the meeting to order. A quorum being present, Subcommittee on Health, Employment, Labor and Pensions will come to order.

Good morning, everyone.

And welcome to our witnesses. Thank you for taking time out of your schedule to be here today.

Six months ago, under the leadership of Mr. Andrews, this subcommittee held an independent audit of the Department—examined an independent audit of the Department of Labor's financial records. It was our first look at the department's new financial management system implemented at great cost to the taxpayers for the understanding that it would improve the department's ability to track the money it spends.

At the time a number of challenges surrounding implementation of the new system meant Congress and taxpayers were unable to receive a full evaluation of the department's financial management. For the first time in more than a dozen years the department cannot issue an unqualified report. In other words, the department failed to produce enough information for independent auditors to make an informed judgment on the department's finances.

As I noted in December, any time an organization places a record system responsible for tracking billions of dollars, errors, unfortunately, are not uncommon. However, it is up to the organization's executive management to take responsibility for the mistakes and work to prevent them in the future.

It appears this was the course the Department of Labor planned to take last winter. James Taylor, Mr. Taylor is here, the department's chief financial officer, was with us in December, and is here again today. He stated the department was undertaking many steps to overcome the problems that caused last year's incomplete report.

Mr. Taylor testified, "We are confident these actions will prove the 2010 disclaimer a temporary hiccup in what has been and what will be again a long record of unqualified opinions and sound financial management at the department."

We are here today to examine whether the department has lived up to this promise. Regrettably the answer is no. The challenges plaguing the Department of Labor's financial management still persist. The most recent audit found the same material weaknesses and significant deficiencies identified in last year's report.

The Department of Labor is the only executive agency to have multiple new material weaknesses in its financial management system. According to the independent audit of KPMG, certified by the department's Office of Inspector General, the department does not have sufficient controls over financial reporting and budgetary accounting. It lacks adequate controls over access to key financial systems, and improvements are required in how the department prepares and reviews journal entries.

The problems I have just described only relate to the four material weaknesses identified in the report. The department also has significant deficiencies over its payroll, and does not prevent untimely and inaccurate processing of certain transactions.

Last, but certainly not least, the department is in violation of two federal laws intended to promote the integrity of financial management in the federal government. Despite having roughly 6 additional months to improve its record, department's finances have failed to receive a clean bill of health, the first time since fiscal year 1997.

Some may argue the report we are discussing today signifies a clean audit. According to this logic, simply completing the report, albeit 6 months behind schedule, results in a passing grade. However, the numerous instances of financial—however, numerous instances of financial mismanagement.

However, such logic is neither supported by standard accounting practices or a common sense. We should deal with the facts as presented by the professionals at KPMG, and avoid underestimating the seriousness of this report.

The department oversees a number of federal efforts aimed at assisting the nation's workforce, including unemployment insurance, worker's compensation and various job training programs. At a time when the national debt exceeds $14 trillion and more than 13 million individuals are seeking work, every dollar counts. Any misallocation of scarce resources is a disservice to taxpayers and workers.

The department's financial mismanagement is evidenced by the recent independent audit is unacceptable. I hope the administration can explain the disturbing facts of the recent audit, and provide a concrete plan to ensure this does not happen again.

And now we yield to Mr. Andrews, the senior Democratic member of the subcommittee, for his opening remarks.

[The statement of Mr. Roe follows:]

Prepared Statement of Hon. David P. Roe, Chairman, Subcommittee on Health, Employment, Labor, and Pensions

Good morning everyone. Welcome to our witnesses; thank you for taking time out of your busy schedules to be with us today.

Six months ago, under the leadership of Mr. Andrews, this subcommittee examined an independent audit of the Department of Labor's financial records. It was our first look at the department's new financial management system, a system implemented at great cost to taxpayers with the understanding it would improve the department's ability to track the money it spends.

At the time, a number of challenges surrounding implementation of the new system meant Congress and taxpayers were unable to receive a full evaluation of the department's financial management. For the first time in more than a dozen years, the department could not issue an "unqualified report." In other words, the department failed to produce enough information for independent auditors to make an informed judgment on the department's finances.

As I noted in December, anytime an organization replaces a records system responsible for tracking billions of dollars, errors are unfortunately not uncommon. However, it is up to an organization's executive management to take responsibility for the mistakes and work to prevent them in the future.

It appears this was the course the Department of Labor planned to take last winter. James Taylor, the department's chief financial officer who was with us in December and is with us again today, stated the department was undertaking "many steps to overcome the problems" that caused last year's incomplete report. Mr. Taylor testified, "We are confident these actions will prove the 2010 disclaimer a temporary hiccup in what has been, and will again be, a long record of unqualified opinions and sound financial management at the Department."

We are here today to examine whether the department has lived up to this promise. Regrettably, the answer is no. The challenges plaguing the Department of Labor's financial management still persist. The most recent audit found the same material weaknesses and significant deficiencies identified in last year's report. The Department of Labor is the only executive agency to have multiple new material weaknesses in its financial management system.

According to the independent audit by KPMG, certified by the department's Office of Inspector General, the department does not have sufficient controls over financial reporting and budgetary accounting, it lacks adequate controls over access to key financial systems, and improvements are required in how the department prepares and reviews journal entries.

The problems I have just described only relate to the four material weaknesses identified in the report. The department also has significant deficiencies over its payroll and does not prevent untimely and inaccurate processing of certain transactions. Last, but certainly not least, the department is in violation of two federal laws intended to promote the integrity of financial management in the federal government.

Despite having roughly six additional months to improve its record, the department's finances have failed to receive a clean bill of health for the first time since fiscal year 1997. Some may argue the report we are discussing today signifies a "clean" audit. According to this logic, simply completing the report—albeit six months behind schedule—results in a passing grade, despite the numerous instances of financial mismanagement. However, such logic is neither supported by standard accounting practices or commonsense. We should deal with the facts as presented by the professionals at KPMG, and avoid understating the seriousness of this report.

The department oversees a number of federal efforts aimed at assisting the nation's workforce, including unemployment insurance, workers' compensation, and various job training programs. At a time when the national debt exceeds $14 trillion and more than 13 million individuals are searching for work, every dollar counts. Any misallocation of scare resources is a disservice to taxpayers and workers. The department's financial mismanagement, as evidenced by the recent independent audit, is unacceptable. I hope the administration can explain the disturbing findings of the recent audit, and provide a concrete plan to ensure this doesn't happen again.

I will now yield to Mr. Andrews, the senior Democrat member of the subcommittee, for his opening remarks.

Mr. ANDREWS. Thank you. Good morning, Mr. Chairman. Thank you for your courtesies.

I would like to welcome the witnesses, and welcome back the witnesses I think in at least two of the cases, maybe three.

On May 23rd of 2011 the Department of Labor received an unqualified audit letter, which is a clean audit. How we got there was slower than it should have been.

I want to make two points this morning. The first is the reason for the delay in getting that clean audit letter. And the second is to respectfully challenge my friend's assertion that the existence of exceptions in the clean audit letter are somehow evidence of financial mismanagement. They most emphatically are not.

In 1989 the Department of Labor began using a software system to keep track of its books. And when 2002 rolled around they were still using that same software system. Now I think it would be true in most of corporate America or any government institution in America, if you are using in 2002 a piece of software generated in 1989, it probably did not work very well.

The Bush Labor Department reached that conclusion. It reached the conclusion they need to replace that software system. So in 2002 the prior administration began a process to replace that software system.

That process was an unmitigated disaster. The prior administration spent $35 million, and by 2007 they concluded that that system would never work, and they junked it.

So for the better part of 6 years and $35 million, the prior administration tried to implement a piece of bookkeeping software that would give the department and the tax payers better access to financial data. In 2007 the prior administration began to correct this remedy and come up with a third system.

By the time the new administration took office in January of 2009, that new system, which cost about $25 million, was partially implemented. It was partially implemented because the training that was needed to train the department employees on how to best use that system had not yet been fully done. So when the new administration took office, it was in the midst of helping to complete that implementation in that new system.

Mr. Taylor, with whom we are pleased to welcome back to the committee, I believe, took office in June of 2010 at the Department of Labor as the chief financial officer. And he walked into a bit of a difficult situation because that software system was not yet fully implemented. The employees were not yet fully trained.

By the time we reached the fall of 2010 it became obvious that KPMG was not going to be able to do due diligence on the financial audits because the correct documentation was not in place.

As was our responsibility under the rules of the Congress, on December 7th of last year, the subcommittee, which I was then privileged to chair, and Mr. Roe—Dr. Roe was the senior minority member at the time, discharged our duty and had a hearing, and effectively said, when are you going to fix this problem so we can have an audit? Mr. Taylor made a commitment to the committee and to the public that he would lead an effort to make sure that that audit was completed by the spring.

Mr. Taylor, you have honored that commitment. The audit documents were in place so the audit could be completed by the spring. And in fact on May 23rd of 2011, KPMG, through the IG's Office, issued a clean audit letter.

Now, my friend refers to the four exceptions in the clean audit letter as somehow evidence of financial mismanagement. Well, if that were the case, we had financial mismanagement in 2001, 2002, 2003, 2004, 2005, 2006, 2007 and 2008. Because in each of those 8 fiscal years there were significant exceptions made to the audit as well.

As a matter of fact, in those 8 fiscal years where the prior administration was running the department, there were 64 exceptions in total to the eight clean audit letters that were issued.

Now, I do think we should focus in these exceptions and fix them. I would love to see an audit issued, timely audit issued for the 2011 fiscal year that has no exceptions in it. And I think that should be our goal. But I do think we should—we should begin today with a reflection of a record that says that we are looking at a department that received a clean audit letter.

And I think we should thank you, Mr. Taylor, for honoring your commitment to the committee and putting us in position to produce that clean audit letter.

So at this I would thank the witnesses, and turn back to my friend, the chairman.

Chairman ROE. I thank the gentleman.

Pursuant to Rule 7(c), all members will be permitted to submit written statements to be included in the permanent hearing record. And without objection, the hearing record will remain open for 14 days to allow such statements and other extraneous material referenced during the hearing to be submitted for the official hearing record.

Now it is my pleasure to introduce our distinguished panel of witnesses.

Mr. Elliot P. Lewis is the assistant inspector general for audit to the Department of Labor.

Welcome back, Mr. Lewis.

Mr. Lewis has been with the Department of Labor since 1991 serving in a variety of positions within the Inspector General's Office of Financial Management Audits. Before joining the Federal Government, he was a partner at T.R. McConnell and Company, CPAs in Columbia, South Carolina from 1986 to 1991. And that is a—it was probably about as hot in Columbia, South Carolina as it was here yesterday.

Heather Flanagan is a partner for audit at KPMG, LLC.

KPMG is an audit, tax and advisory service provider that has served as independent auditor for DOL since fiscal year 2006. KPMG also prepared audits in fiscal year 2010 for the Departments of Commerce, Energy, Homeland Security, Interior, Justice, Treasury, and the DSA, the Office of Personnel Management and the Small Business Administration.

Mr. James L. Taylor is the chief financial officer of the Department of Labor. Prior to his work at DOL, Mr. Taylor was deputy federal inspector for the Department of Homeland Security where he assisted the Inspector General in managing over 600 audits, inspectors and investigators. Mr. Taylor has also served as deputy chief financial officer for the Department of Commerce and FEMA.

Before I recognize each of you today will be—provide your testimony let me briefly explain our lighting system. You each have 5 minutes to present your testimony. When you begin the light in front of you will turn green. With 1 minute left the light will turn yellow. And when your time is expired the light will turn red, at which point I will ask you that you wrap up your remarks as best as possible.

And after everyone has testified, members will each have 5 minutes to ask questions. And I will try to also adhere to the 5 minutes rule.

We will start now with Mr. Lewis.

STATEMENT OF ELLIOT P. LEWIS, ASSISTANT INSPECTOR GENERAL FOR AUDIT, U.S. DEPARTMENT OF LABOR

Mr. LEWIS. Mr. Chairman and members of the subcommittee, thank you for the opportunity to discuss the audit of the U.S. Department of Labor's revised fiscal year 2010 consolidated financial statements.

As I detailed in my December testimony, following the implementation of a new financial system known as New Core, which replaced a 20-year-old accounting system, the department encountered a significant number of problems and errors involving data migration, integration with other systems, reconciliations in system configuration. This resulted in the department's inability to provide timely and accurate financial data, and the auditors being unable to give an opinion on the financial statements.

Since November of last year the department was able to successfully mitigate the issues it experienced in 2010 to provide the necessary data for audit, and to revise and reissue the consolidated financial statements.

In March of 2011 the CFO resubmitted its financial report and KPMG was able to complete the audit procedures necessary to render an unqualified, or clean, opinion. It is important to note the DOL's received an unqualified opinion on its financial statements for 14 consecutive years.

However, while the opinion is unqualified for 2010, it is also important to emphasize that this does not guarantee an unqualified opinion for 2011. KPMG reported deficiencies in the department's internal controls and made numerous recommendations to address them. These issues need to be addressed to help ensure the department's ability to produce accurate financial statements in the future.

The auditors identified several material weaknesses, which posed the greatest risk that the department's financial statements could be incorrect. Specifically, they found that the department needs to implement and perform routine reconciliations. Moreover, they need to develop and document all business processes and controls required to accurately and timely record certain transactions.

Second, the department needs to ensure that financial obligations are correct and properly recorded. They also need to ensure staff are trained and possess the technical knowledge needed to properly record budgetary transactions.

Third, the department needs to enhance supervision of adjusting journal entries and improve related documentation.

Finally, the department needs to develop policies and controls to ensure appropriate access to financial management systems.

In addition to the material weaknesses, the auditors noted two significant deficiencies: the need to ensure payroll is properly processed, and the need to improve the timeliness and accuracy of the accounting for property plan and equipment. Our audit of the 2011 statements will be assessing the extent to which the department has corrected these control weaknesses.

Mr. Chairman, the department continues to make improvements to the new financial system, and to improve its financial management business processes. As this will obviously not be the last IT system the department replaces, it is equally important to look at this implementation for any lessons that can be gleaned from a broader project management standpoint.

For example, for future IT system development projects, the department needs to fully understand and develop system requirements before beginning the procurement process, ensure that interfaces with other key departmental systems are built and tested prior to implementation, identify the proper user base, ensure that users are properly trained, establish strict project management oversight responsibility, and establish a viable funding plan prior to starting the project.

By applying these lessons learned, the department will be better positioned to efficiently deliver future IT system development projects that are timely deployed and fully meet business needs.

Thank you, Mr. Chairman, for the opportunity to present the results of the audit. I would be pleased to answer any questions that you or other members of the subcommittee may have.

[The statement of Mr. Lewis follows:]

Prepared Statement of Elliot P. Lewis, Assistant Inspector General for Audit, Office of Inspector General, U.S. Department of Labor

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to discuss the audit of the U.S. Department of Labor's (DOL's) revised Fiscal Year (FY) 2010 Consolidated Financial Statements.

Background

The Chief Financial Officers Act of 1990, P.L. 101-576, requires Offices of Inspectors General (OIG) to audit and report on their agency's Consolidated Financial Statements in accordance with generally accepted auditing standards and OMB guidance. In order to fulfill this responsibility, the DOL OIG contracts with an independent public accounting firm, KPMG LLP, to conduct the audit. OMB requires that the audit be completed by November 15 of each year. For an agency as large as DOL, the complexity of this audit requires that, in order to meet this deadline and complete all steps necessary to render an opinion on the statements, the Department must provide significant financial information and supporting documentation throughout the fiscal year. Therefore, an inability on the part of the Department to produce the necessary information in a timely manner can affect the successful completion of the audit and may result in a less-than-favorable opinion for the Department or a Disclaimer of Opinion, which is the inability to render an opinion.

Specific reasons for the disclaimer of opinion

Mr. Chairman, as detailed in my previous testimony in December, it was the Department's inability to provide timely and accurate financial data that resulted in the Department receiving a Disclaimer of Opinion for FY 2010. Following the implementation of a new financial system known as the New Core Financial Management System (New Core), the Department encountered a significant number of problems and errors involving data migration, integration with other systems, reconciliation, and system configuration. Several examples of the problems they encountered were:

Data Migration

Internal agency codes and general ledger accounts that were incorrectly migrated to New Core.

Certain transaction identification and coding that were not properly captured in New Core when migrated.

Integration with Other Systems

Integration between New Core and other financial systems that were not properly working subsequent to the implementation. For example, the Department was unable to record in a timely manner the majority of transactions related to the Unemployment Trust Fund and the Federal Employees' Compensation Act.

Reconciliation

Incomplete account reconciliations as of September 30. For example, the Department could not reconcile its underlying supporting data for certain Unemployment Trust Fund balances to the general ledger in a timely manner.

System Configuration

Improper system configurations resulting in the inability to properly record certain transactions in accordance with the United States Standard General Ledger requirements. As a result, the Department had to implement manual processes to correct these errors.

Audit of the Department's revised FY 2010 consolidated financial statements

In my December testimony, I identified several actions which the Department needed to take in order to reissue its FY 2010 Consolidated Financial Statements. In the intervening months, Mr. Chairman, the Department was able to successfully mitigate the issues it experienced in FY 2010 to provide the necessary data for audit and to revise and reissue the Consolidated Financial Statements. Some of the major adjustments made by the Department since November 15 include:

Resolving integration errors between New Core and other financial systems by reconciling and investigating differences.

Reviewing all significant transactions to ensure they were in accordance with United States Standard General Ledger requirements.

Adjusting and providing sufficient documentation for the Consolidated Financial Statements balances, by correcting material errors not identified as of November 2010, which impacted fund balance with treasury and accounts payable.

In March 2011, the CFO submitted a draft of the Department's revised Consolidated Financial Statements for audit and KPMG was able to complete the audit procedures necessary to render an unqualified or "clean" opinion. The Department has now received an unqualified opinion on its financial statements for 14 consecutive fiscal years.

Material weaknesses and significant deficiencies

Even though the Department received an unqualified opinion, KPMG reported deficiencies in the Department's internal controls and made numerous recommendations to address them. A deficiency in internal control exists when the design or operation of a control does not allow management or its employees, in the normal course of performing their assigned functions to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the agency's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

In terms of material weaknesses, the auditors found that the Department needs to implement and perform routine reconciliations, as well as develop and document all business processes and controls required to accurately and timely record transactions, including those from DOL subsystems and other Federal agencies.

Second, the Department needs to ensure that financial obligations are correct and properly recorded, as well as ensuring users are trained and possess the technical knowledge needed to properly record budgetary transactions.

Third, the Department needs to enhance supervisory monitoring reviews of adjusting journal entries and related documentation.

Finally, the Department needs to coordinate efforts with individual DOL agencies to develop policies and controls to address, as well as monitor, access to financial management systems.

In addition to the material weaknesses, the auditors noted the following significant deficiencies. The auditors found that the Department needs to design time and attendance reports that reflect the necessary information for it to ensure that payroll is properly processed. Lastly, the Department needs to improve the timeliness and accuracy of its accounting for property, plant, and equipment.

Lessons learned

Mr. Chairman, the Department continues to make improvements to the new financial system and to improve its financial management business processes. As this will obviously not be the last system that the Department replaces, it is equally important to look at this implementation for any broader lessons that can be gleaned from a project management standpoint. For example, in the future the Department needs to:

Fully understand and develop system requirements before beginning the procurement process;

Ensure that interfaces with other key Departmental systems are built and tested prior to implementation;

Identify the proper user base;

Ensure that users are properly trained;

Establish strict project management oversight responsibility;

Establish a viable funding plan prior to starting the project.

Conclusion

Mr. Chairman, the Department has taken sufficient and appropriate corrective actions to enable KPMG to issue an opinion on the revised statements. Although the opinion is unqualified, it is important to emphasize that this does not guarantee an unqualified opinion for the FY 2011 statements. Our audit of the FY 2011 statements will be assessing the extent to which the Department has corrected the control weaknesses recently identified in the 2010 audit.

Thank you, Mr. Chairman, for the opportunity to present the results of the audit. I would be pleased to answer any questions that you or other members of the Subcommittee may have.

Chairman ROE. Okay. Thank you, Mr. Lewis.

Ms. Flanagan?

STATEMENT OF HEATHER K. FLANAGAN, PARTNER, KPMG, LLC

Ms. FLANAGAN. Chairman Roe, Ranking Member Andrews, and members of the subcommittee, my name is Heather Flanagan, and

I am an audit partner with KPMG. Thank you for the invitation to come before you today to discuss the two audit engagements of the U.S. Department of Labor's fiscal year 2010 consolidated financial statements.

KPMG, under contract to the DOL Office of Inspector General, was engaged to audit DOL's fiscal year 2010 consolidated financial statements. During fiscal year 2010 DOL encountered significant functionality and operational issues related to its new financial accounting and reporting system, which was implemented in January 2010.

These issues hindered DOL's ability to ensure the accuracy and completeness of financial statement balances, and to generate the critical financial statement data necessary to complete our testing over the consolidated financial statements during our initial audit engagement. I will discuss the more significant areas that were impacted by these issues.

The first was the Unemployment Trust Fund. We were unable to complete testing over the fund's significant accounts because DOL was unable to provide to us in a timely fashion complete and accurate data that reflected the balances recorded in the general ledger.

The second significant area was gross cost. We were unable to complete testing over certain expenses because a complete and accurate population of these expenses that agreed to the balances in the general ledger could not be provided in a timely fashion.

The third important area was budget accounts. The final report on budget execution and budgetary resources, known as the FF-133, for the fourth quarter was not provided to us prior to the November 15th reporting deadline. Therefore we were unable to complete our testing of the statement of budgetary resources.

The fourth significant area was fund balance with Treasury. DOL was unable to reconcile the net differences that were identified between its fund balance with Treasury accounts as of September 30, 2010, and Treasury's records.

The fifth significant area was financial reporting. DOL management was unable to provide certain representations regarding consistency with U.S. Generally Accepted Accounting Principals with respect to the presentation of the fiscal year 2010 financial statements that it issued in November.

It was impractical to extend our procedures sufficiently to determine whether the financial statements may have been affected by these issues. As such, we issued a disclaimer of our opinion on the fiscal year 2010 consolidated financial statements issued by DOL on November 15th.

Under government auditing standards we are required to report material weaknesses and significant deficiencies identified during the engagement. During our initial fiscal year 2010 engagement we identified the following deficiencies in internal control over financial reporting that we considered to be material weaknesses or significant deficiencies:

The lack of sufficient controls over financial reporting, a lack of significant controls over budgetary accounting, improvements needed in the preparation and review of journal entries, lack of adequate controls over access to key financial and support systems, weakness noted over payroll accounting, and untimely and inaccurate processing of property, plant and equipment transactions.

DOL recognized the need for, at a minimum, an audited consolidated balance sheet as of September 30, 2010 in order to receive an opinion on all of its consolidated financial statements in fiscal year 2011. Therefore, DOL decided to revise and reissue its fiscal year 2010 consolidated financial statements where certain malaises were performed, errors were identified and adjusting journal entries were recorded to correct the previously reported amounts as necessary.

As a result, DOL requested that the OIG perform audit procedures necessary to report on its revised fiscal year 2010 consolidated financial statements in anticipation of receiving an updated audit report. In December 2010 the OIG engaged KPMG to audit these revised financial statements.

We have looked at their efforts on testing the details on each significant account during the second fiscal year 2010 engagement. As required by government auditing standards, we will determine during our fiscal year 2011 audit of DOL consolidated financial statements whether DOL management has taken appropriate corrective actions to address the findings and recommendations identified during our fiscal year 2010 audit engagements.

DOL was ultimately able to reconcile accounts and record necessary adjusting entries to corrective financial statement balances. In addition, DOL was able to provide the necessary data for testing and the relevant evidence to support the balances supported in the financial statement.

As a result, we were able to complete our audit procedures, and on May 20, 2011 we issued an updated audit report with an unqualified opinion on DOL's revised fiscal year 2010 consolidated financial statements.

Thank you for the opportunity to discuss the results of these two fiscal year audit engagements. And I would be happy to answer any questions you may have.

[The statement of Ms. Flanagan follows:]

Prepared Statement of Heather Koppe Flanagan, Partner, KPMG, LLP

Chairman Roe, Ranking Member Andrews, and Members of the Subcommittee; thank you for the invitation to come before you today to discuss the two audit engagements of the U.S. Department of Labor's (DOL) fiscal year (FY) 2010 consolidated financial statements.

KPMG LLP (KPMG), under contract to the DOL Office of Inspector General (OIG), was engaged to audit DOL's FY 2010 consolidated financial statements. During FY 2010, DOL encountered significant functionality and operational issues related to its new financial accounting and reporting system, the New Core Financial Management System (NCFMS), which was implemented in January 2010. These issues hindered DOL's ability to assure the accuracy and completeness of consolidated financial statement balances and to provide us the critical financial data necessary to complete our testing over DOL's FY 2010 consolidated financial statements during our initial audit engagement. The significant areas that were impacted by these issues are discussed in more detail below.

Unemployment Trust Fund (UTF)—We were unable to complete testing over the UTF significant accounts (i.e., unemployment benefit expenses, accrued benefits, revenue, accounts receivables, advances and transfers) because DOL was unable to timely provide us complete and accurate populations of the related data that reflected the balances recorded in the general ledger. This situation was caused by errors in recording UTF transactions and failure to perform certain reconciliations to the general ledger.

Gross Costs (Non-Payroll, Non-Benefits)—In addition to unemployment benefit expenses, we were unable to complete testing over certain other expenses because a complete and accurate population of these expenses that agreed to the related balances recorded in the general ledger could not be provided timely. In addition, because we could not test these expenses, our testing over the grant accrual could not be completed.

Budget Accounts—The final Report on Budget Execution and Budgetary Resources (SF-133) for the fourth quarter was not provided to us prior to the November 15, 2010 Office of Management and Budget (OMB) reporting deadline. Therefore, we were unable to complete our testing over the fourth quarter reconciliations of the Statement of Budgetary Resources (SBR) to the SF-133s and reconciliations of the SF-133s to the Apportionment and Reapportionment Schedule (SF-132s). As a result, we were unable to conclude on budgetary resources, the status of budgetary resources, the change in obligated balance, and net outlays reported in the SBR. Further, a complete and accurate population of undelivered orders recorded in the general ledger as of September 30, 2010 could not be provided for testing, and we were unable to complete the procedures necessary to conclude on borrowing authority related to repayable advances to the UTF.

Fund Balance with Treasury—DOL was unable to reconcile the net differences that were identified between its fund balance with Treasury account as of September 30, 2010 and the U.S. Department of the Treasury's records, which prevented us from completing our testing of this balance.

Financial Reporting—DOL management was unable to provide certain representations regarding consistency with U.S. generally accepted accounting principles with respect to the presentation of the FY 2010 consolidated financial statements that it issued on November 15, 2010.

It was impractical to extend our procedures sufficiently to determine the extent, if any, to which DOL's FY 2010 consolidated financial statements may have been affected by the aforementioned issues. As such, our initial audit engagement resulted in a disclaimer of an opinion on the FY 2010 consolidated financial statements issued by DOL on November 15, 2010. A disclaimer of opinion states that the auditors do not express an opinion on the financial statements as they were unable to form or have not formed an opinion as to the fairness of presentation of the financial statements in conformity with generally accepted accounting principles.

In planning and performing our initial FY 2010 audit engagement, we considered DOL's internal control over financial reporting by obtaining an understanding of DOL's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as required by auditing standards generally accepted in the United States and Government Auditing Standards. These procedures were designed to assist us in planning our auditing procedures and contribute to the evidence supporting the auditors' report on the financial statements. However, the objective of our engagement was not to express an opinion on the effectiveness of DOL's internal control over financial reporting and therefore our procedures were not designed to identify all deficiencies in internal control. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.

Under Government Auditing Standards, we are required to report material weaknesses and significant deficiencies identified during the audit engagement. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

During our initial FY 2010 audit engagement, we identified the following deficiencies in internal control over financial reporting that we considered to be material weaknesses or significant deficiencies.

Material Weaknesses

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

Significant Deficiencies

5. Weakness Noted over Payroll Accounting

6. Untimely and Inaccurate Processing of Property, Plant, and Equipment Transactions

DOL recognized the need for, at minimum, an audited consolidated balance sheet as of September 30, 2010, in order to receive an opinion on all its consolidated financial statements in FY 2011. Therefore, DOL decided to revise and reissue its FY 2010 consolidated financial statements once certain analyses were performed, errors were identified, and adjusting journal entries were recorded to correct the previously reported amounts, as necessary.

As a result, DOL requested that the OIG perform audit procedures necessary to report on its revised FY 2010 consolidated financial statements, in anticipation of receiving an updated audit report. In December 2010, the OIG engaged KPMG to audit these revised financial statements.

Because of the aforementioned control deficiencies, our planned audit approach for the second FY 2010 audit engagement did not include additional tests of controls, and we did not rely on internal controls in the areas requiring audit work. Therefore, we focused our efforts on testing the details of each significant account during the second FY 2010 audit engagement. As required by Government Auditing Standards for financial statement audits, we will determine during our FY 2011 audit of DOL's consolidated financial statements whether DOL management has taken appropriate corrective action to address the findings and recommendations identified during our FY 2010 audit engagement.

DOL was ultimately able reconcile accounts and record necessary adjusting entries to correct its consolidated financial statement balances. In addition, DOL was able to provide the necessary data for testing and the relevant evidence to support the balances reported in the consolidated financial statements. As a result, we were able to complete our audit procedures, and we issued an updated audit report with an unqualified opinion on DOL's FY 2010 consolidated financial statements on May 20, 2011.

Thank you for the opportunity to discuss the results of these two FY 2010 audit engagements. I would be happy to answer any questions the Subcommittee may have.

Chairman ROE. Thank you.

Mr. Taylor?

STATEMENT OF JAMES L. TAYLOR, CHIEF FINANCIAL OFFICER, U.S. DEPARTMENT OF LABOR

Mr. TAYLOR. Good morning, Mr. Chairman, and thank you. And Ranking Member Andrews and members of the subcommittee, I really do appreciate this opportunity to come before you today to provide an update on the financial management activities of the Department of Labor.

Specifically I will address the department's fiscal year 2010 financial statement audit, a topic about which I testified before this subcommittee last December. That hearing occurred because the department was able to achieve an unqualified opinion on 2010 financial statements.

During the hearing, I, as a deputy chief financial officer, committed to this subcommittee to recommitting our financial statements to the department's Office of Inspector General, an independent auditor in the hopes that the auditor would be able to issue a new opinion.

As you are aware, the department's independent auditor issued a disclaimer of opinion in November on the 2010 financial statements. The auditors did not have sufficient time to complete the audit activities in November, primarily due to the department's transition to a new financial management system and the implementation and data conversion issues that arose from that effort.

At that time our need to focus on supporting the department's mission and ensure funds were appropriately obligated at year-end did not allow us time to provide the auditors the data they required in a timely fashion.

Since then we have continued to work in improving our financial reporting with the goal of resubmitting our statements and opinion, a clean opinion. We identified outstanding issues with our financial data, and established and met all major milestones in the audit process.

As a result of that effort I am pleased to report that KPMG, as you just heard, did provide a clean or unqualified opinion on the department's fiscal year 2010 consolidated financial statements. An unqualified opinion is the most favorable of all financial audit outcomes, and means that the financial statements present fairly in all material aspects the financial position and operating results of the Department of Labor.

As a result of the revised opinion we obtained late last month, the department now has received an unqualified opinion on its financial statements for 14 consecutive fiscal years.

Both the original and revised 2010 audit reports note four material weaknesses that remain in need of the department's attention. Two points should be considered when reviewing these material weaknesses.

First, every single one of them has been reported previously. They were reported significant deficiencies, in some case for as many as 4 years.

In addition, as my colleagues note in their respective testimonies, these material weaknesses existed as of September 30, 2010. KPMG did not conduct any further review of the status of these weaknesses as part of the recent financial statement resubmission effort.

However, KPMG does not in its latest report for each of the financial management weaknesses, that we did in fact correct material areas identified, or provide evidence of the proper reconciliations previously missing.

Over the past 6 months we have continued to work to normalize the department's financial operations and resolve outstanding data integrity issues arising from the integration of a number of existing legacy systems into a modern financial management cloud environment. We are making operations more efficient and effective for users, and continuing user outreach and training efforts.

While there is still work to be done in all these areas, we are buoyed by the unqualified opinion we received, and we will build from this experience as we continue to strengthen the department's financial management environment. And based on the work already completed, I can not only assure the subcommittee that we have made substantial efforts in resolving the three material weaknesses specific to financial management, but I can also tell you unequivocally that the current financial system provides the department with unprecedented control over its financial activities.

In closing, Mr. Chairman, I am pleased that the department was able to secure an unqualified opinion on the department's 2010 financial statements, and the accompanying assurance the statements are presented fairly. Our stakeholders can have confidence in the data we have presented, and that the department has been financially transparent and accountable.

We have overcome last year's temporary setback. We recognize there are still improvements we need to make in our financial operations and our financial reporting. We are extremely proud and appreciative of the work of our staff, but also our colleagues in the Office of Inspector General and KPMG in completing this process. Their expertise has been invaluable in assessing and addressing the issues we have encountered.

Thank you for your time, sir. And I would be happy to answer any questions the subcommittee may have.

[The statement of Mr. Taylor follows:]

Testimony of

James L. Taylor

Chief Financial Officer

U.S. Department of Labor

Before The

Subcommittee on Health, Education, Labor, and Pensions

Committee on Education and the Workforce

U.S. House of Representatives

June 2, 2011

Thank you, Mr. Chairman, Ranking Member Andrews and Members of the Subcommittee. I appreciate the opportunity to come before you today to discuss financial management at the Department of Labor (DOL). Specifically, I understand this hearing is to provide an update on the Department's FY 2010 financial statement audit, a topic about which I testified before this Subcommittee on December 7, 2010.[1] This hearing took place because the Department was unable to achieve an unqualified opinion on its FY 2010 financial statements. During the hearing, I, as the Department's Chief Financial Officer, committed to the Subcommittee to resubmitting our financial statements to the Department's Office of Inspector General and independent auditor in the hopes that the auditor would issue a new – and critically an unqualified – opinion.

I am pleased to report that the Department's independent auditor, retained under contract by the Department's Inspector General, has in fact issued an unqualified, or "clean," opinion on the Department's FY 2010 consolidated financial statements. An unqualified opinion is the most

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[1] H.R. Subcomm. on Health, Employment, Labor and Pensions of the Comm. on Education and Labor. *Review of the Independent Audit of the Labor Department's Fiscal Year 2010 Consolidated Financial Statements*, 111th Cong. 21-22 (Dec. 7, 2010).

favorable of financial audit outcomes and means that the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of the audited entity in conformity with generally accepted accounting principles. Critically, this opinion must be issued by an independent, expert, third party who adheres to strict auditing and ethical standards.

As a result of the revised opinion we obtained late last month, the Department now has received an unqualified opinion on its financial statements for 14 consecutive fiscal years. The American people can continue to have confidence in the Department's financial operations and stewardship of the resources with which it has been entrusted. The Department's revised FY 2010 *Agency Financial Report* has been distributed to the Department's various Congressional oversight committees and posted to the Department's public website.

As you are aware, the Department's independent auditors issued a disclaimer of opinion in November 2010 on the FY 2010 financial statements. The auditors did not have sufficient time to complete audit activities in November, primarily due to the Department's transition to a new financial management system and the implementation and data conversion issues arising during that effort. At that time, our need to focus on supporting the department's mission and ensure funds were appropriately obligated at year-end did not allow us time to provide the auditors the data they required in a timely fashion. Since then, we have continued to work to improve our financial reporting, with the goal of resubmitting our FY 2010 financial statements and obtaining a clean opinion. We identified outstanding issues with our financial data, and established and met all major milestones in the audit process. We are extremely appreciative of the work of our colleagues in the Office of Inspector General and KPMG in completing this process. Their expertise has been invaluable in assessing and addressing the issues we have encountered.

While I am proud that we were able to achieve an unqualified opinion, I am also aware that there is significant work left to do. Both the original and revised FY 2010 audit reports note four areas that remain in need of the Department's attention. I can report today that we have made significant progress in resolving or mitigating many of the concerns leading to these findings.

Over the past six months we have continued to work to normalize the Department's financial operations and resolve outstanding data integrity issues arising from the integration of a number of existing legacy systems into a new, modern financial management environment. We are addressing system functionality, making operations more efficient and effective for users, and continuing user outreach and training efforts. While there is still work to do in all of these areas, we are buoyed by the unqualified, clean opinion we received from the independent auditor and we will build from this experience as we continue to strengthen the Department's financial management environment.

As I discussed in December, the initial disclaimer of opinion resulted from several key challenges: (1) user issues (e.g., an underestimated user base and a lack of understanding of substantial business process changes), (2) data quality issues, and (3) consistent project management and oversight. I would like to update the Subcommittee on our progress in each of these areas.

User Issues

In December, I noted that the Department significantly underestimated the system's user base during the planning process that started in 2008, resulting in a contract that did not anticipate sufficient training and system support. We have worked closely with our contractor technically and logistically to accommodate the increased and necessary numbers of users; and we continue to work with the Department's component agencies to ensure that the user community has been correctly identified and is supported. However, the Department's challenges in fully identifying the user base led to insufficient staff training initially, which in turn led to difficulty adapting to new business processes and practices in a new operating environment. With an additional six months of experience using the system, financial management personnel are more cognizant of how the system and its transparent internal controls work and thus we are seeing improvements in financial management outcomes. We continue to provide our users with training opportunities and hold weekly and biweekly outreach meetings with all subsets of our user community to ensure that problems are identified and resolved quickly. We have made tremendous progress in the last six months, and I believe that we are moving in the right direction.

Data Quality Issues

One of the key benefits of the effort to obtain an unqualified opinion on the FY 2010 financial statements was to fix the data quality issues that the auditor cited in the disclaimed opinion issued in November. As you are aware, we experienced a number of issues migrating old data from our legacy accounting system to the new system, and have had challenges transferring accurate data between the new financial management system and our legacy travel, procurement, grants, and human resources systems. The last six months have provided time to cleanse this data, synchronize our systems, and improve our interfaces, enabling us to provide more reliable and consistent data and reduce system errors that often delayed the ability of our financial management professionals to perform their work.

Oversight Issues

I identified a lack of consistent project management as a reason for system implementation and startup issues, noting that the career Deputy Chief Financial Officer and Associate Deputy Chief Financial Officer overseeing the system implementation both separated from the Department shortly after the system launched in January 2010. The Department has filled both of these positions in recent months, and we have direct and experienced day-to-day executive oversight over the system. Further, the Department's senior leadership has been routinely engaged in our efforts to obtain an FY 2010 audit opinion. These developments have greatly enhanced our ability to resolve outstanding issues and work with our colleagues throughout the Department to ensure that they are able to conduct the Department's financial business in an accurate and efficient manner.

Overall, we have worked closely with the Office of Management and Budget to discuss and assess our "lessons learned" during the system's implementation as part of its required Government-wide review of financial system modernization efforts. As I mentioned in December, the types of issues we experienced in producing auditable financial statements are relatively common for Federal agencies implementing a new system. I believe that adequately addressing the core areas I have highlighted will play a significant role in reducing the implementation issues that agencies tend to experience. This in turn should lead to more timely and accurate financial data preparation and submission.

In closing, Mr. Chairman, I am pleased that the Department was able to secure an unqualified opinion on the Department's FY 2010 financial statements and the accompanying assurance that the statements are presented fairly. Our stakeholders can have confidence in the data we have presented and that the Department has been financially transparent and accountable. We have overcome last year's temporary setback, but recognize that there are still improvements to make in our financial operations and reporting. FY 2011 is the first full fiscal year and audit cycle in which we are using only the new financial management system to record financial data and produce reports, and we are confident that we will be able to provide the auditors with a timely and auditable set of financial statements and accompanying data so that they may provide an opinion in November 2011.

Thank you for your time, and I would be happy to answer any questions you may have.

Chairman ROE. I thank the members. And I will start the questioning off today.

I was the mayor of Johnson City, Tennessee. And when I first went on the commission we had 53 audit findings. So I am very familiar with audit findings. And some were material.

And I appreciate the fact and the history that the ranking member gave us. But the problem with this is, and I am going to go through some definitions because I am not a CPA or an auditor, so that the average people can understand what we are talking about.

An unqualified audit simply means, as I understand it, that the auditor has all the information they need to provide an opinion. I think.

Is that correct? And I have stated that properly, Ms. Flanagan?

Ms. FLANAGAN. Yes, that is correct.

Chairman ROE. Okay. So—and clean would refer to me that there is absolutely nothing wrong. That would be how I would view it if I heard that. So this verbiage means that unqualified means that the people looking at it, in your case KPMG, has the information they need to be able to render an opinion. It does not mean that everything is okay with what is going on.

I sort of appreciate the position, Mr. Taylor, you were in. You came 18 months into this. You lost two of your senior people, and you had a brand new system. I get that.

And also, Mr. Lewis, you made some great points. I hope that is not lost on other people that are doing this the five or six points you brought out that this is how we want to move forward if you put in somewhere else. It made absolute sense that this—you could extrapolate this over any department that may be implementing a new system.

However, if I were in—and so a clean audit and an unqualified audit means that we have got all the information. It does not mean that there is not a problem there. And some of the problems that we looked at in these, especially some that I viewed in here where there was an ability not to know where Labor's money and Treasury and the fund balances.

The things that I read about in here about unexpected appropriations where $10 billion, which is $10,000 million, is incorrectly presented as something else as an unexpected appropriation, if this kind of audit were seen in a private, I were going out and buying a stock in a company and I saw this kind of audit, that company would be off the board, I think, because of the lack of confidence people would have. And that is what we are dealing with here, is the confidence of the American people. In my case the confidence of the citizens of Johnson City, Tennessee that we could actually look at this audit and know that their money was being spent and looked at just exactly like they would look at their own businesses.

And I think, Mr. Taylor, that is what you are trying to say today, is that you want to get to that point. But I think these material weaknesses are very significant. And the fact that they occurred before does not give me any warm and fuzzy feeling.

And then in the November 15th, I suppose, Ms. Flanagan, you will have a chance to look at, which is only 5 months, you will have a chance to look at this again. And at that point in time I assume that you will have all the information you need at that point to make a decision.

Am I right, Mr. Taylor, that you will have all of the data that she needs, or their company needs I should say——

Mr. TAYLOR. Yes, sir.

Chairman ROE. So it will not be a situation like we faced last year in December when Mr. Andrews held a committee hearing. Am I right on that?

Mr. TAYLOR. You are correct.

Chairman ROE. And can we expect in 5 months, now that you—a year is not long. You have been there a short time. But can we expect these material weaknesses to be rendered. I mean to be held harmless, to be taken care of?

Mr. TAYLOR. I am very comfortable that as we stand right now that at least two of the material weaknesses are resolved. And in fact we could not have been able to do the resubmission that we did to get the unqualified opinion if we had not resolved them.

Chairman ROE. Which are?

Mr. TAYLOR. One material—I am sorry?

Chairman ROE. Which ones are they?

Mr. TAYLOR. The one I know on the journal vouchers, the adjustments that were made, and on budgetary accounting.

On financial reporting I think we made significant progress. We have a lot of work to do, still have a lot of work to do there because of the integration issues. But I think we have made a lot of progress. That will obviously depend on the independence of the infinite review of the auditors.

The fourth material weakness is, I just want to point out, is for an overall access issue to systems throughout the department, not just the financial system. And it is one with which the department's Office of the CIO does not concur.

So three of those are really financial management. One is an overall systems access issue that the department has.

Chairman ROE. I guess a question I was confused with on reading all this information was how can a fund balance in the Department of Labor and Treasury be not reconciled when you are talking about billions of dollars?

Ms. Flanagan, I am going to ask you that question. You are the auditor.

Ms. FLANAGAN. It is not uncommon to have differences between an agency's fund balance of treasury accounts and Treasury. However, normally there is a reconciliation process that occurs monthly in order to identify and resolve those differences.

Chairman ROE. Okay. Well, I guess the reason, if I go to explain it to somebody at a local diner, how can I explain to them that there are billions of dollars that do not account from one account to the other? How do I do that?

Ms. FLANAGAN. That is more of an accounting question versus an auditing question. I mean the basic analogy is always a bank statement and does your checking account agree to your bank statement.

And in the case of the department last year, it did not, by millions of dollars during the year. And it was eventually reconciled.

Chairman ROE. Okay. I thank you.

Mr. Andrews?

Mr. ANDREWS. Thank you, Mr. Chairman.

I thank the witnesses for their testimonies.

I think there is a shared goal here that every dime the taxpayers send to the department is properly spent and properly accounted for, and there is no dispute about that.

Ms. Flanagan, what is an unqualified letter? What is the meaning of that? Explain that to a layperson.

Ms. FLANAGAN. An unqualified opinion relates solely to the financial statements themselves and the balances that are reported in them. An unqualified opinion says that those balances are materially correct, and that the——

Mr. ANDREWS. And material——

Ms. FLANAGAN [continuing]. Users of those statements can rely on them.

Mr. ANDREWS. Materially correct means that the representations on a document match the actual money that was received and spent. Is that basically right?

Ms. FLANAGAN. Yes.

Mr. ANDREWS. Okay.

Now let us, so the clean audit letter that was issued, in layperson's terms, mean that we have an accurate accounting of how much the department took in and how much money it spent?

Ms. FLANAGAN. Correct.

Mr. ANDREWS. Okay.

Now, Mr. Taylor, let us talk about the four exceptions. Because the chairman's right, our goal should be zero exceptions.

And the fact that these are exceptions that existed long before you got there and long before the administration got there and Secretary Solis got there, so what?

I mean we want them done. We want them done away with, and it is our common job to do something about that.

If you were explaining to one of the chairman is constituents in a diner, we have more diners in New Jersey than in Tennessee, so we will make it in New Jersey. What these two exceptions that you think are unresolved mean. What do they mean? What are we doing wrong that we need to fix?

Mr. TAYLOR. In the case of the financial reporting we have for the first time an integrated approach to all of our financial reporting, which never existed before. When you had to do an external report it was almost a data call. You almost had to go out and get data new every time. Now it all comes into one place.

We have to make sure that the data in all those systems is moving across the interfaces in an accurate and smooth way.

Mr. ANDREWS. Can you help me with interfaces?

Mr. TAYLOR. Sorry.

Mr. ANDREWS. We just lost the guy in the——

Mr. TAYLOR [continuing]. It is really about——

Mr. ANDREWS. Here is what he wants to know. If my tax money is being used for a job training program in Tennessee, how can I be sure that they got the amount of money they were supposed to and they spent the money on what they were supposed to by the time they were supposed to spend it on?

Do either of these weaknesses relate to that problem?

Mr. TAYLOR. They do not relate to control over financial management. They relate to reporting. And we have processes in place that will provide the reporting required to accurately manage the financial activities.

In fact, last year even though we could not provide the auditors with the information they needed to complete their work, we did not have, after reviewing this twice now, we did not have a single violation in the Efficiency Act, and we did not leave any more money unspent that we had in prior years. So we really focused on that management part.

Mr. ANDREWS. What is your plan to resolve these two remaining exceptions that you think are still lingering?

Mr. TAYLOR. Well, the one exception is the department-wide issue relating to access to financial systems. As I mentioned, the Chief Information Officer's Office does not concur with the finding. It has been there for a number of years.

We believe in the department that we have redundant controls to resolve it.

Mr. ANDREWS. Now, is the access problem that people who maybe should not have access do? Or people who need access do not? What is the nature of the problem?

Mr. TAYLOR. It is a security issue. People who do not——

Mr. ANDREWS. Want to be sure that only people that are properly secured and checked have access to financial systems.

Mr. TAYLOR. That is my understanding——

Mr. ANDREWS. And there is some disagreement over whether there is a problem there. But I think we all agree that we only want the people who are supposed to have access to have access.

Mr. TAYLOR. Absolutely.

Mr. ANDREWS. And what is the second problem that you are working on?

Mr. TAYLOR. And the second one is financial reporting. And that is the preparation, the accurate preparation of the timeliness of the financial reporting. And that is where we are still working.

Mr. ANDREWS. Is the problem more accuracy or timeliness?

Mr. TAYLOR. More timeliness, but some accuracy.

Mr. ANDREWS. Okay. So, and if I understand the timeliness problem is you got to perform two intermediate tasks at the final answer that you want?

Mr. TAYLOR. At the time, yes. That would be correct, yes——

Mr. ANDREWS. You want to try to get it sooner——

Mr. TAYLOR. More than we—definitely as of the end of 2010.

Mr. ANDREWS. Is there any disagreement over whether that problem exists?

Mr. TAYLOR. No.

Mr. ANDREWS. Do you concur with the finding of the exception?

Mr. TAYLOR. In fact as of 2010 we concur with all of them.

Mr. ANDREWS. I appreciate it.

I, again, I do want to commend you again that you came here 6months roughly after you started this job, walked into a real problem, promised the tax payers and the committee that there will be the documents to have an audit done by the spring. You delivered on that promise. And the audit came back with an unqualified opinion. We thank you for your professionalism and your efforts.

Mr. TAYLOR. Thank you.

Mr. ANDREWS. I yield back.

Chairman ROE. I will thank the gentleman for yielding.

Ms. Roby?

Ms. ROBY. Thank you, Mr. Chairman.

Thank you to each of our witnesses that are here today. We really appreciate you taking time to be here.

I have one very, very simple question for Mr. Lewis. And I would like for you to explain to us, the members of this committee, the difference between a material weakness and a significant deficiency. And I want you to tell us which is more serious.

Mr. LEWIS. Okay. Well, first off the material weakness is the more serious.

Both material weakness and significant deficiencies involve problems with the design or the operation of your accounting systems that not only feed the financial statements and produce the financial statements, but are supporting all of your other day-to-day operations of running the department and issuing grants, et cetera, so all the controls and aspects of running those systems.

If we detect weaknesses in those systems either in how they are designed, they were not designed properly, they do not have good controls; or they have good controls but they are not being utilized as they were meant to be utilized, then we make note of those exceptions.

The auditors will then evaluate how extensive they think that problem is, how much is at risk, say in a particular system, how much money does it process, you know, how much could go wrong if that control is not working or is not there. That is how they make their decision of whether it is a significant deficiency or it is a material weakness.

The material weaknesses are the ones that could most likely result in you having a significant error in the financial statements. And these are all being judged against the department's financial statements at that level.

Ms. ROBY. So here we have four material weaknesses. Can you site other instances where there were four material weaknesses? How many times were there other material weaknesses like this in the department over the past 10 years?

Mr. LEWIS. In the past 10 years we have not had any material weaknesses. I think, as someone stated earlier, these were issues that have been around to some degree, and in some nature year-after-year. But it was last year, with the, you know, combination of putting in a new system that triggered them to what was a significant deficiency from becoming, you know, to becoming a bigger problem——

Ms. ROBY. A larger problem.

Mr. LEWIS [continuing]. And becoming a material weakness.

Ms. ROBY. Thank you so much.

I yield back, Mr. Chairman.

Chairman ROE. Mr. Kildee?

Mr. KILDEE. Thank you, Mr. Chairman.

Mr. Lewis, are there findings in this audit report which are the same that we discussed in December? Are those findings uncommon among federal agencies?

Mr. LEWIS. I have not done my own comparison to all the other agencies, but I, you know in my experience in doing other audits and what I have seen of other agencies I do not suspect that what we have is highly unusual, what we have seen in other entities.

Mr. KILDEE. As we discussed last December, was there any indication whatsoever of waste, fraud or abuse or incompetence?

Mr. LEWIS. There was nothing that the auditors brought to our attention that they felt would fit that category.

Mr. KILDEE. None of those categories.

In the private sector, I am co-chair of the Automotive Caucus here in the Congress, and helped lead General Motors and Chrysler to their problems. How does the auditing within government, particularly this agency here, compare to the level of quality in the auditing in the private sector?

Mr. LEWIS. I think it is quite comparable. We are operating under not only the same standards that the commercial auditors would follow in a commercial entity, but additional standards that the GAO imposes when you are doing a government audit. So it is a high standard.

Mr. KILDEE. What can we do, and within our system, that you feel basically is comparable to—in the private sector and there is no indication of waste, fraud and abuse or competence? What can we do to get better, a higher level of audits?

Mr. LEWIS. Upon interpreting that correctly in terms of what can we do to better address the problems we are identifying in the audit? Is that it?

Mr. KILDEE. Yes.

Mr. LEWIS. Is that fair?

Mr. KILDEE. Yes.

Mr. LEWIS. I think it is really a matter of having the attention and the commitment at the highest level in an agency to address the problems that are identified in the audit, and to address them when they are hopefully smaller issues. You know when we bring them as significant deficiencies to really try to resolve them at that point before you get to a year when you compound it with other things, and what was a small problem has now become a larger problem.

Mr. KILDEE. So at least in their attitude toward working in an agency, having responsibility or leadership in the agency that they have at least mentally a high level of priority to make sure that it would be able to get an audit that would be helpful and correctly revealing of what the situation is.

Mr. LEWIS. I did not quite catch the question.

Mr. KILDEE. Well, there is attitude toward the fact that you are going to be audited, and that the audit is very, very important to us.

Mr. LEWIS. Yes.

Mr. KILDEE. And to the chief executive. That this auditing is very important is that our level of priority are sufficiently high that would help these audits reveal better than they are now.

Mr. LEWIS. Yes. I mean that is very important to the, not just the successful audit, but the successful financial management in the department and in any department that there be that commitment and attention to it from the top.

Mr. KILDEE. If you have got a regular pattern of problem auditing, might you trace that then to a lack of prioritizing within that agency?

Mr. LEWIS. You could certainly, I think, draw that conclusion that if you see things repetitively that it is could be a commitment to addressing those problems.

Mr. KILDEE. Thank you very much.

Chairman ROE. I thank the gentleman for yielding.

Ms. Noem?

Ms. NOEM. Yes. I would yield my time to the chairman.

Chairman ROE. Okay. Thank you for yielding.

Just a couple of questions, and I think Mr. Kildee hit on it, and all of us have here. I think that the reason that a financial audit is so critical for a couple reasons.

One, it protects the people, Mr. Taylor, in the organization when you take over that you are not doing anything wrong.

And secondly, we have a public trust. I know as mayor we had a public trust so that the people. I mean there is enough conspiracy out there that people, and we do a good enough job of wasting people's money anyway, that they do not want to think there is any fraudulent use of it.

And they see $700 toilets and all of that, and I understand their frustration when they see this go on in government. We expect it in the private sector. We expect it in the public sector. And the bar probably should be even higher in the public sector. So that is one of the reasons I think this is absolutely critical so people can trust us, can trust these departments that their money is being spent properly.

And I guess the question, one of the questions I wanted to get to, and either Ms. Flanagan or Mr. Lewis, just a question is that when the KPMG audited this as per request of the OIG, they found that the DOL failed to comply with two federal laws. The Federal Financial Management Improvement Act of 1996 and the Federal Manager's Financial Integrity Act of 1982 was deficient in its management of $173 billion budget. Could you all comment on that and what that was?

Ms. FLANAGAN. Related to the act of 1996, that act requires financial systems to comply with three requirements. One of those requirements relates just to financial systems. And an indicator that there is non-compliance is that the system cannot produce auditable financial statements in a timely manner, which was certainly the case in November of 2010.

Also those requirements relate to transactions recorded in accordance with the U.S. Standard General Ledger, which we cited non-compliance with in our report. And also accounting, just federal accounting standards, which in November the department was unable to represent that their statements were fairly presented in accordance with those accounting principles.

Those situations occurred as of September 30th, and we did not reassess them during our second audit engagement this year.

The other act related—the act of 1982, the deficiencies we found or non-compliance we found related to that act was the process that the department has to do its reporting under that act. And we felt that that reporting was done untimely and was reliant on obtaining a draft of our internal control report prior to them issuing their management refreshment statement.

Chairman ROE. Yes. I do not think this was intentional. I think, I mean I do not think anybody set out to intentionally do this. I think you discovered it.

And I guess, Mr. Lewis, and you may or may not know this, are there any penalties associated with it when you break these laws? I know it is obviously a civil law, but are there any penalties associated?

Mr. LEWIS. I do not know of any penalty associated with it other than you are in non-compliance. And I would, with the first one Ms. Flanagan was discussing, you could look at it that the things that are required in order to get a clean opinion on your audit are legal requirements in effect. And by not being able to get the clean opinion, you know, most entities should be automatically out of compliance with that act.

Chairman ROE. I think, again, back to my point, and I think all of us on this panel on both sides want us to have the public trust. And I think the public feels like if I have to obey the law then federal agencies should obey the law. And I think that is the reason that this is extremely important. Not only to protect the DOL, but to protect the public.

So at this point I will yield the balance of my time to Mr. Hinojosa.

Mr. HINOJOSA. Thank you, Mr. Chairman.

Chairman Kline and Ranking Member Miller, today's hearing must focus on the steps that the Department of Labor's taking to strengthen its financial management system. It is important to note that between the years 2003 and 2008 the Bush administration spent approximately $35 million on an effort to replace a 25-year-old financial system at the Department of Labor, a system which failed to comply with applicable statutory and regulatory requirements, and ultimately was abandoned.

In 2008 the Bush administration made another attempt to implement Department of Labor's financial management system, but I understand that there were complications once again.

As a member of this committee it is reassuring to know that under President Obama's leadership that Secretary Hilda Solis and her staff have been working diligently to resolve the issues in a timely manner.

My first question goes to James Taylor. And I apologize that I came in a bit late because I was at another meeting. So if this was discussed with somebody before me, I apologize for that. But I would like to know.

In your testimony, Mr. Taylor, you indicate that the department's independent auditor has issued a clean opinion on the department's 2010 consolidated financial statements. Can you share with us in this committee what some of those issues and concerns were when you joined DOL?

Mr. TAYLOR. Well, the implementation had been initiated. It was behind schedule. Essentially the financial statements had to be prepared for more than one system because the conversions in the new system occurred in January of 2010. So the fiscal year began in the first quarter actually was in the old system.

Media conversions are always a problem. Same thing happened at the Department of Energy in 2005, and they lost their clean opinion in GAAP material weakness. It took them 2 years to get their clean opinion back.

In our case when I came in at the end of January, it was clear that we could not perform our primary function, which is supporting the mission of the department and making sure that our funds were properly expended, in addition to providing the auditors information they need in a timely basis. And we were pretty much clear in saying that early on in that last quarter.

So we knew we were not going to get a clean opinion. We knew we were probably going to get unqualified for a couple months before it occurred. And so we focused first on the mission.

The interfaces with the legacy systems—the new financial system is a cloud environment, or a shared service environment. We do not have any infrastructure at all for the financial system within the department. It is the first department to do this. It is very complicated.

In addition, the existing entities in the department, the existing systems for procurement, for HR, for travel, all of those systems were purchased as standalone. It did not really interface with one another, or were not integrated. This process integrated all those activities.

On top of that you had a 20 plus year old financial database, and trying to convert that to the latest, more robust reporting system was very complicated. We ran into those kinds of issues during the year. And those were the challenges that we faced coming in.

Mr. HINOJOSA. I have an MBA and I run a business for 25 years, a large one. And I know how difficult it is to make those changes when the software systems do not interface, and that you have to run them parallel for a certain number of months, 3, sometimes 6.

Did you all do that? Were they run parallel so that you could see how the old system and the new one were going to interface?

Mr. TAYLOR. Yes, sir. What we did, it was not really intentional. The original plan was that the department was going to convert as of October 1st.

I have done this at the Department of Commerce and at FEMA previously. When you try to—and usually in IT development running parallel makes a lot of sense, particularly for processing systems. When you have a system of record like a financial system, it is extremely complicated to keep the two in balance when you are trying to run more than one simultaneously.

Mr. HINOJOSA. If you did that will the Department of Labor be in compliance with all the federal laws as of the end of this September 30, 2011?

Mr. TAYLOR. Well, now this will be the first year on the new system, totally on the new system. And we are very confident we will be in total compliance.

Mr. HINOJOSA. With that I yield back, Mr. Chairman.

Chairman ROE. Thank the gentleman for yielding.

Dr. DesJarlais?

Mr. DESJARLAIS. Good morning.

Mr. Taylor, in December you suggested DOL was focused on resubmitting the fiscal year 2010 statements to OIG for the audit and normalizing financial operations. How much did this review process cost?

Mr. TAYLOR. The review process itself, we did not spend money, any specific money for the resubmission effort. We have added about $7 million to the contract itself, and those required to help resolve issues and do the data conversion.

Mr. DESJARLAIS. Has that impacted the fiscal year 2011 audit?

Mr. TAYLOR. No, sir. In fact I think we had to do what we did. The resubmission was really a milestone, and it was a nice target to keep us focused. But everything that we did would have had to be done anyway in order for us to get a clean opinion in 2011.

Mr. DESJARLAIS. Okay. Thank you.

Mr. Lewis, beginning in 2006 the Office of the Deputy Secretary started holding regular quarterly meetings about operations at the OCFO. From what I understand OIG took part in these meetings along with the deputy secretary, the assistant secretary for administration management and the CFO.

Do these meetings continue to occur?

Mr. LEWIS. Yes.

Mr. DESJARLAIS. Okay. And did you find these meetings beneficial?

Mr. LEWIS. Yes. That is, I believe you are referring to the department's internal control board, and that continues and we participate in that. And I think that is beneficial and it is a requirement that they do that to do their own self-assessment of their operations.

Mr. DESJARLAIS. Okay.

In 2010 several warnings had been sent out. And I am interested in hearing about fiscal year 2011 audit, which is currently under way. Specifically I would like to know where we are in the process and whether or not your office has issued any alert memoranda thus far related to the 2011 audit.

Mr. LEWIS. We have not issued anything at this point related to the 2011 audit. It is at a very early stage because the auditors have been focused on the reissued statements in 2010 and ensuring that we had good beginning balances for 2011. So now that that has been settled, they are now starting to just really focus on the 2011 period.

Mr. DESJARLAIS. Okay. Thank you.

And Mr. Chairman, that is all I have. Would you like me to yield my time?

Okay. Thank you.

Chairman ROE. Dr. Heck?

Mr. HECK. I have no questions at this time, Mr. Chairman. Thank you.

Chairman ROE. Mr. Andrews?

Mr. ANDREWS. We have no further questions, Mr. Chairman. I would be happy to defer until Noem or whomever else's questions.

Well, in that case, I want to thank the chairman and my colleagues and the witnesses for doing boring, non-media centered, really necessary work. We live in an environment where the top news story in Capitol Hill seems to get more bizarre as the weeks go on. I will not comment on this week's story.

But our real work here is to be good stewards of the public trust and the taxpayer's money. And it is a very legitimate question when an audit is delayed as to whether we are, each of us is discharging that duty responsibly.

And I am encouraged by the news since the December hearing. And I thank, Mr. Taylor, you and your team who have made that possible.

And I thank Ms. Flanagan and Mr. Lewis for their continued vigilance to ensure that we get the right result.

I am hopeful that we will be able to have a totally boring and non-eventful fiscal year 2011, meaning that we have no delay in the audit being completed, and a clean letter being issued, and zero out those exceptions if we can.

But I think that the hard work of government is the boring work of government. So thank you for doing it in a way that is not flashy, but important.

And Mr. Chairman, I am glad we had a chance to share these titillating 56 minutes, but who is counting? I do appreciate the chance to be with you this morning. And yield back.

Chairman ROE. I thank the gentleman for yielding. And having spent 6 years in local government, you are right.

It does not make the headlines going from 53 audit findings to zero. But zero is where we ought to be. That is what we require in public companies. If public companies come out with sloppy audits, they go out of business and people lose jobs. And I think we have a fiduciary responsibility to gain the public trust.

There is a huge distrust of government now, both sides of the aisle. It is absolutely imperative that we have that. And you cannot have that when people pick up a newspaper in the local diner and say we do not know where billions of dollars went.

And it does not necessarily mean there has been anything done wrong with it, but we should be able to count that competent people can do that. And I think that there are three competent people sitting in front of us right now.

And I heard Mr. Taylor say that in November the 15th he expects two of these material findings to be resolved, and hopefully the other two will be. That is the goal is to have no findings whatsoever.

And I also appreciate each of you coming here and presenting this, as the ranking member said, maybe not the most exciting thing, but I think extremely important, I found in my previous life. So thank you for being here.

And with no further comments, the meeting is adjourned

[Additional submissions of Mr. Roe follow:]

U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210

MAY 23 2011

MEMORANDUM FOR: JAMES L. TAYLOR
Chief Financial Officer

FROM: Elliot P. Lewis
ELLIOT P. LEWIS
Assistant Inspector General
for Audit

SUBJECT: FY 2010 Independent Auditors' Report
Report Number: 22-11-015-13-001

Attached is the Independent Auditors' Report on the U.S. Department of Labor's (DOL) reissued FY 2010 financial statements. We contracted with the independent certified public accounting firm of KPMG LLP (KPMG) to complete the audit of DOL's financial statements as of, and for the years ended, September 30, 2010, and 2009. The contract required that the audit be conducted in accordance with generally accepted government auditing standards (GAGAS) and Office of Management and Budget (OMB) audit requirements.

As discussed in the opinion on the financial statements, in KPMG's report dated November 15, 2010, KPMG did not express an opinion on DOL's FY 2010 consolidated financial statements. This disclaimer of opinion resulted from DOL's implementation of a new financial accounting and reporting system which hindered its ability to assure the accuracy and completeness of consolidated financial statement balances and to provide data necessary for audit testing by the Office of Management and Budget (OMB) deadline for issuing the report. Since that date, DOL has adjusted certain consolidated financial statement balances and provided KPMG with sufficient support of the balances reported in the consolidated financial statements. Accordingly, KPMG's present opinion on the reissued DOL financial statements is unqualified.

KPMG's report on internal control over financial reporting identified certain deficiencies that are considered to be material weaknesses and other deficiencies that are considered to be significant deficiencies, as follows:

Material Weaknesses

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

<u>Significant Deficiencies</u>

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

KPMG concluded DOL did not substantially comply with the requirements of the *Federal Financial Management Improvement Act (FFMIA) of 1996* as of September 30, 2010. Furthermore, KPMG concluded DOL's FY 2010 assessment process was not in full compliance with the *Federal Managers' Financial Integrity Act of 1982*. KPMG is responsible for the attached auditors' report and the conclusions expressed in the report. However, in connection with the contract, we reviewed KPMG's report and related documentation and inquired of its representatives. Our review, as differentiated from an audit in accordance with GAGAS, was not intended to enable us to express, and we do not express, an opinion on DOL's financial statements; or conclusions about the effectiveness of internal control; or on whether DOL's financial management systems substantially complied with FFMIA; or conclusions on DOL's compliance with laws and regulations. Our review disclosed no instances where KPMG did not comply, in all material respects, with GAGAS and OMB audit requirements.

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

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

We appreciate the cooperation of all DOL staff involved in the audit.

Attachment

cc: Karen Tekleberhan, Deputy Chief Financial Officer
Stan Karczewski, Division Chief of Financial Reporting and Compliance

Management Assurances

Federal Managers' Financial Integrity Act of 1982 (FMFIA)

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

Appendix A of OMB Circular A-123 provides specific requirements for conducting management's assessment of internal control over financial reporting, and also requires the agency head to provide an assurance statement on the effectiveness of internal controls over financial reporting.

Federal Financial Management Improvement Act of 1996 (FFMIA)

FFMIA requires that agencies implement and maintain financial management systems that comply substantially with the Federal financial management system requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. The agency head is to make an annual determination whether the financial systems substantially comply with FFMIA.

Federal Managers' Financial Integrity Act

The Department of Labor's management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers' Financial Integrity Act (FMFIA). DOL is able to provide a qualified statement of assurance that the internal controls and financial management systems meet the objectives of FMFIA, with the exception of 3 material weaknesses over financial reporting. The weaknesses are summarized on the following page.

DOL conducted its assessment of the effectiveness of internal control over the efficiency and effectiveness of operations and compliance with applicable laws and regulations in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control*. Based on the results of this evaluation, DOL can provide reasonable assurance that its internal control over the effectiveness and efficiency of operations and compliance with applicable laws and regulations as of September 30, 2010, was operating effectively and no material weaknesses were found in the design or operation of the internal controls. Due to the material weaknesses noted in the financial reporting processes, DOL's financial management systems are not in substantial conformance with Section 4 of FMFIA.

In addition, DOL conducted its assessment of the effectiveness of internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular A-123. Based on the results of this evaluation, DOL identified 3 material weaknesses in its internal control over financial reporting as of June 30, 2010. Other than the exceptions noted on the following page, the internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal control over financial reporting.

Federal Financial Management Improvement Act of 1996

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires agencies to implement and maintain financial management systems that are substantially in compliance with Federal financial management systems requirements, Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. Due to the material weaknesses noted in the financial reporting processes, DOL's financial management systems do not substantially comply with FFMIA as of September 30, 2010.

Hilda L. Solis
Secretary of Labor

Seth D. Harris
Deputy Secretary of Labor

James L. Taylor
Chief Financial Officer

T. Michael Kerr
Assistant Secretary for Administration and Management/Chief Information Officer

November 14, 2010

Summary of Material Weaknesses

Weaknesses over Financial Reporting -- DOL implemented the New Core Financial Management System (NCFMS) in January 2010. The Department experienced significant transaction and reporting errors in its financial reporting processes resulting from the implementation. This was primarily due to data migration problems that required significant corrections during the remainder of the year; interfaces with subsystems initially not operating as intended; certain processes, such as for accounting for property, plant, and equipment, were not functioning properly within the new system and required workarounds; and lack of adequate policies and procedures to account for and reconcile data on a timely basis and the preparation and review of financial statements and reports. The Department was not able to prepare interim financial statements for the quarter ending March 31, 2010, for submission to OMB. Such financial statements were completed by early July but were not accurate. The Department is currently unable to produce auditable financial statements on a timely basis. Audit readiness and financial reporting have been delayed as a result of the need to resolve issues related to the migration, process workarounds, and legacy interfaces. Although significant progress has been made to correct the migrated data and resolve the issues with the interfaces such that day-to-day financial transaction processing is being performed on a timely basis, the Department must complete the correction of inaccurate data from the migration and implement formal policies and procedures for the preparation and review of interim and annual financial statements and reports. Management is in the process of implementing corrective action plans to address these deficiencies and expects to complete the corrective actions by the end of FY 2011.

Weakness over Preparation and Review of Journal Vouchers -- Journal vouchers, which are used to account for various significant activities, were not available when NCFMS was implemented in January 2010. Journal voucher templates, which are used to prepare the journal vouchers, were then created and training was provided to the users in late April 2010. An Accounting Handbook that explained how the journal vouchers are to be used was not prepared until July 2010. During the third and fourth quarter, additional journal voucher templates had to be prepared as it was determined that certain accounting transactions were not being properly recorded in the new system. A significant amount of journal vouchers were prepared and recorded in the new system prior to June 30, 2010, that subsequently needed to be corrected. In addition, a significant amount of the journal vouchers were not adequately supported or properly reviewed and approved by supervisory personnel. To remediate these deficiencies, management has developed a corrective action plan which includes assessing the adequacy of existing policies regarding journal voucher creation, approval, and supporting documentation requirements, drafting updates to existing policies to reflect needed changes and developing a mandatory training program for key stakeholders responsible for journal voucher creation and approval.

Weakness over Budgetary Accounts Reconciliations -- As of June 30, 2010, quarterly reconciliations between the *Apportionment and Reapportionment Schedules* (SF-132) and the *Report on Budget Execution and Budgetary Resources* (SF-133) were not performed, and the SF-133 was not reconciled to the *Statement of Budgetary Resources.* Formal policies and procedures were not in place for the reconciliations and the required documentation to support the handling of differences. The lack of these significant reconciliations places management at risk of preparing inaccurate financial reports and producing and relying on inaccurate status of funds data for operations, which could result in the inefficient and inappropriate use of appropriations, duplicate postings of multiyear funding, and possible Antideficiency Act violations. Management is currently reviewing existing policies and procedures to identify areas that can be strengthened with budgetary accounts reconciliation processes, particularly the SF-132 to SF-133 reconciliation, to ensure that all reconciliations are prepared, reviewed, and approved on a timely basis, properly documented, and differences resolved.

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

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

We have audited the accompanying consolidated balance sheets of the U.S. Department of Labor (DOL) as of September 30, 2010 and 2009; the related consolidated statements of net cost and changes in net position and combined statements of budgetary resources for the years then ended; and the statements of social insurance as of September 30, 2010, 2009, 2008, 2007, and 2006 (hereinafter referred to as "consolidated financial statements"). The objective of our audits was to express an opinion on the fair presentation of these consolidated financial statements. In connection with our fiscal year (FY) 2010 audit, we also considered DOL's internal control over financial reporting and tested DOL's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these consolidated financial statements.

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

SUMMARY

As discussed in our opinion on the financial statements, in our report dated November 15, 2010, we did not express an opinion on DOL's FY 2010 consolidated financial statements because DOL's implementation of a new financial accounting and reporting system hindered its ability to assure the accuracy and completeness of consolidated financial statement balances. Subsequently, management was able to prepare the consolidated financial statements, and we were able to obtain sufficient support of the balances reported in the consolidated financial statements. Accordingly, our present opinion on the FY 2010 consolidated financial statements, as presented herein, is different from that expressed in our previous report.

As stated in our opinion on the financial statements, we concluded that DOL's consolidated financial statements present fairly, in all material respects, the financial position of DOL as of September 30, 2010 and 2009; its net costs, changes in net position, and budgetary resources for the years then ended; and the financial condition of its social insurance program as of September 30, 2010, 2009, 2008, 2007, and 2006, in conformity with U.S. generally accepted accounting principles.

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

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

KPMG

Material Weaknesses

1. Lack of Sufficient Controls over Financial Reporting

2. Lack of Sufficient Controls over Budgetary Accounting

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

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

Significant Deficiencies

5. Weakness Noted over Payroll Accounting

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

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, exclusive of those referred to in the FFMIA, disclosed noncompliance with the *Federal Managers' Financial Integrity Act of 1982* (FMFIA) and one other matter that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

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

The following sections discuss our opinion on DOL's consolidated financial statements; our consideration of DOL's internal control over financial reporting; our tests of DOL's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements; our opinion on compliance with FFMIA; and management's and our responsibilities.

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying consolidated balance sheets of the U.S. Department of Labor as of September 30, 2010 and 2009; the related consolidated statements of net cost and changes in net position and the combined statement of budgetary resources for the years then ended; and the statements of social insurance as of September 30, 2010, 2009, 2008, 2007, and 2006.

In our report dated November 15, 2010, we did not express an opinion on DOL's FY 2010 consolidated financial statements because DOL's implementation of a new financial accounting and reporting system hindered its ability to assure the accuracy and completeness of consolidated financial statement balances. Subsequently, management was able to prepare the consolidated financial statements, and we were able to obtain sufficient support of the balances reported in the consolidated financial statements. Accordingly, our present opinion on the FY 2010 consolidated financial statements, as presented herein, is different from that expressed in our previous report.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of Labor as of September 30, 2010 and 2009; its net costs, changes in net position, and

KPMG

budgetary resources for the years then ended; and the financial condition of its social insurance program as of September 30, 2010, 2009, 2008, 2007, and 2006, in conformity with U.S. generally accepted accounting principles.

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

The information in the Management's Discussion and Analysis, Required Supplementary Stewardship Information, and Required Supplementary Information sections is not a required part of the consolidated financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

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

INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

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

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

KPMG

COMPLIANCE AND OTHER MATTERS

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

The results of our other tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

Other Matters. DOL is currently reviewing an incident regarding a potential violation of the *Anti-deficiency Act*. As of the date of this report, no final noncompliance determination has been made for this incident.

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

OPINION ON COMPLIANCE WITH FFMIA

DOL represented that, in accordance with the provisions and requirements of FFMIA, the Secretary of Labor determined that DOL's financial management systems were not in substantial compliance with FFMIA as of September 30, 2010.

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

Our examination disclosed certain weaknesses in DOL's financial management systems' access controls and related manual controls. DOL was also unable to produce timely and reliable financial reports, including auditable FY 2010 consolidated financial statements by the OMB reporting deadline of November 15, 2010. These matters are further described in Exhibit III.

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

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RESPONSIBILITIES

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

Auditors' Responsibilities. Our responsibility is to express an opinion on the FY 2010 and 2009 consolidated financial statements of DOL 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 OMB Bulletin No. 07-04, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of DOL's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

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

We believe that our audits provide a reasonable basis for our opinion.

In planning and performing our FY 2010 audit, we considered DOL's internal control over financial reporting by obtaining an understanding of DOL's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of DOL's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of DOL's internal control over financial reporting. We did not test all controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

As part of obtaining reasonable assurance about whether DOL's FY 2010 consolidated financial statements are free of material misstatement, we performed tests of DOL's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, as amended. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to DOL. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit and, accordingly, we do not express such an opinion.

Our responsibility also included expressing an opinion on DOL's compliance with FFMIA section 803(a) requirements as of September 30, 2010, based on our examination. Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and accordingly, included examining, on a test basis, evidence about DOL's compliance with the requirements of FFMIA section 803(a) and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on DOL's compliance with specified requirements.

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

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

KPMG LLP

May 20, 2011

1. Lack of Sufficient Controls over Financial Reporting

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

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

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

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

Despite substantial effort by the OCFO, DOL was unable to fully address many of these implementation problems during FY 2010. Specifically, we noted the following issues:

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

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

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

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

Interfaces between the General Ledger and Subsystems: Certain interfaces between the subsystems and NCFMS were not working properly subsequent to the system conversion. For instance, grant expense information in E-grants was not being transferred to NCFMS in a complete manner. In addition, certain grant obligations were not transmitted properly from NCFMS to the U.S. Department of Health and Human Services/Payment Management System in order for grantees to drawdown funds. In February 2010, certain "work-arounds" were developed and implemented to address these and other interface problems, and the majority of the underlying issues were corrected as of June 2010. We also noted that DOL experienced significant difficulties uploading data files from Treasury's Bureau of Public Debt and the Integrated Federal Employees Compensation System into NCFMS. As a result, DOL was unable to record the majority of the second quarter data related to the Unemployment Trust Fund (UTF) and Federal Employees' Compensation Act (FECA) activities in the general ledger until June 2010. Furthermore, significant differences existed between the data ultimately uploaded into NCFMS and these two subsystems. DOL was able to materially reconcile these differences for the year ended September 30, 2010.

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

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

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

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

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

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

The OCFO also encountered significant difficulties in preparing the financial statements at year-end for OMB's reporting deadline of November 15. The draft financial statements were initially due on October 22, 2010; however, the OCFO was unable to complete the initial draft financial statements until November 6, 2010. Furthermore, several notes to the draft financial statements had not been completed at that time. In addition, the OCFO was not able to provide sufficient supporting documentation for all notes to the financial statements until November 11, 2010. Because the OCFO was unable to perform a sufficient review of the draft financial statements prior to submission to us, we identified numerous errors in the initial draft financial statements provided that were not identified in the OCFO review nor communicated to us prior to delivery of the draft financial statements. For example, we identified the following issues:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

While we generally concur with the auditor's recommendations, we note that many of the recommendations correspond with actions planned or already taken by the OCFO in its efforts to produce accurate and complete year-end financial statements. Quality assurance steps were performed for year-end financial reporting, and as noted by the auditors many of the issues identified by the auditors were resolved prior to the issuance of the financial statements. For the recommendations not yet resolved, OCFO resources will be prioritized to address these recommendations.

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

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

Auditor's Response: Management has provided a corrective action plan to address our recommendations. FY 2011 audit procedures will determine whether these recommendations have been adequately addressed and can be considered closed.

2. Lack of Sufficient Controls over Budgetary Accounting

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

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

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

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

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

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

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

These misstatements were corrected in the general ledger for the year ended September 30, 2010.

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

- Unobligated Balance Brought Forward, October 1, reported on the SBR exceeded the amounts reported on both the SF-133 and the general ledger by $14.3 billion.
- Appropriation: Borrowing Authority reported on the SBR and in the general ledger exceeded the amounts reported on the SF-133 by $11 billion.

- Nonexpenditure Transfers, Net reported on the SBR was less than the amount report on the SF-133 by $28.8 billion.
- Total Budgetary Resources reported on the SBR exceeded the amount reported on the SF-133 by $6 billion.
- Obligations Incurred reported on the SBR exceeded the amount reported on the SF-133 by $18.8 billion.
- Net Outlays reported on the SBR exceeded the amount reported on the SF-133 by $3 billion.

These misstatements were corrected in the general ledger for the year ended September 30, 2010.

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

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

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

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

We also identified 17 nonexpenditure transfers that were recorded in the general ledger but were not supported by a *Non Expenditure Transfer Authorization* (FMS 1151). This resulted in Nonexpenditure Transfers, Net being overstated by $337 million as of June 30, 2010. We submitted follow-up questions to DOL to determine the cause of these discrepancies but did not receive a response to our inquiry. A $249 million adjustment was subsequently recorded in the general ledger to partially correct this error as of September 30, 2010.

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

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

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

In addition, we performed an analysis over DOL's obligations as of June 30, 2010. Specifically, we compared the amount of obligations incurred reported on the SF-133s to the total amount available to obligate on the SF-132s. Based on our review, we determined that the amount of obligations incurred exceeded total funds available by $9.7 billion, raising a question about compliance with the *Anti-deficiency Act*. We submitted the results of our analysis to OCFO personnel and asked them to investigate and identify the causes of these discrepancies. OCFO personnel provided sufficient evidence in March 2011 that these discrepancies were not instances of noncompliance with the *Anti-deficiency Act*.

Additionally, we initially could not perform the same comparison as of September 30, 2010 because DOL did not submit the final FY 2010 SF-133s to us as of November 15, 2010. Once DOL submitted the final FY 2010 SF-133s, we performed a similar analysis as of September 30, 2010 and determined that the amount of obligations incurred exceeded total funds available by $562,000. However, OCFO personnel provided evidence in April 2011 that this discrepancy was not an instance of noncompliance with the *Anti-deficiency Act*.

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

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

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

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

The Standards state:

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

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

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

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

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

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

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

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

Management's Response: Management concurs with these recommendations and has initiated appropriate corrective action plans. For FY 2010 year-end financial reporting we were able to address all significant issues and recorded adjustments as required. Budgetary accounts were analyzed and adjusted as necessary to ensure accurate budgetary reporting. The year-end Statement of Budgetary Resources was extensively reviewed and subjected to various analytical procedures.

Management is also reviewing existing policies and procedures to identify areas that could be strengthened within our budgetary accounts reconciliation processes, particularly the SF-132 to SF-133 reconciliation.

The OCFO fiscal year-end closing checklist includes tasks for unexpired multi-year and no-year funds to ensure that post-closing entries for unobligated balances are properly recorded at year end, and that reapportionments are promptly recorded to the budgetary subsystem and general ledger.

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

Auditor's Response: Management has provided a corrective action plan to address our recommendations. FY 2011 audit procedures will determine whether these recommendations have been adequately addressed and can be considered closed.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

***Management's Response*:** Management generally concurs with the findings and recommendations noted above and has initiated appropriate corrective actions to address these recommendations. We have revised our policies covering the preparation and approval of journal entries and the required supporting documentation. We have also provided training to staff preparing journal entries.

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

Auditor Response: Management has provided a corrective action plan to address our recommendations. FY 2011 audit procedures will determine whether these recommendations have been adequately addressed and can be considered closed.

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

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

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

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

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

Account Management

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

- Incidents were not timely reported.

System Access Settings

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

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

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

System Audit Logs Review

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

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

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

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

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

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

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

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

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

- Developed FY 2010 Agency Core Profiles to establish a baseline for overall compliance, including access control and configuration management elements;
- Implemented an Enterprise Risk Management Compliance Program (RMCP) to measure agency compliance with security control requirements and Plan of Action and Milestone (POAM) resolution and issued Agency Dashboards in March 2011; and
- Successfully resolved of the highest priority FY 2009 configuration management findings for the timely application of patches and access restrictions to sensitive files, directories and software.

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

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

5. Weakness Noted over Payroll Accounting

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

To close the prior year recommendation and address the new control weakness identified during FY 2010, the Chief Financial Officer should ensure that (a) the Payroll/Time and Attendance Reconciliation Reports are properly designed to reflect the necessary payroll-related information to conduct an adequate reconciliation; and (b) proper monitoring is routinely completed by the OCFO to ensure that the July 2009 policy and procedures are implemented and complied with throughout DOL.

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

***Management's Response*:** Management concurs with the recommendations noted above and has initiated appropriate corrective actions to address these recommendations.

Management understands that effective reconciliation controls, including timely preparation of proper reconciliations and resolution of differences, will enhance quarterly consolidated financial statements and minimize differences between DOL's general ledger and the NFC-processed payroll data. Likewise, management recognizes the importance of accurate information when performing effective reviews of financial statements. OCFO management will work with the Director, Human Resource Center and the Office of Inspector General to design and implement internal audit procedures to ensure that revised payroll monitoring procedures are implemented and consistently applied agency-wide.

Auditor Response: Management has provided a corrective action plan to address our recommendations. FY 2011 audit procedures will determine whether these recommendations have been adequately addressed and can be considered closed.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Auditor Response: Management has provided a corrective action plan to address our recommendations. FY 2011 audit procedures will determine whether these recommendations have been adequately addressed and can be considered closed.

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

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

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

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

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

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

Under section 803(a) of FFMIA, DOL's financial management systems are required to substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger (USSGL) at the transaction level. DOL represented that in accordance with the provisions and requirements of FFMIA, the Secretary of Labor determined that DOL's financial management systems were not in substantial compliance with FFMIA as of September 30, 2010.

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

- DOL was unable to produce auditable financial statements by the OMB reporting deadline of November 15, 2010 based on data from its financial accounting and reporting system, and numerous financial reports were not available to perform analyses or complete decision making. See Material Weakness No. 1 in Exhibit I for further information.

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

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

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

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

[Whereupon, at 10:57 a.m., the subcommittee was adjourned.]