REVIEW OF THE INDEPENDENT AUDIT OF THE LABOR DEPARTMENT'S FISCAL YEAR 2010 CONSOLIDATED FINANCIAL STATEMENTS

HEARING

BEFORE THE

SUBCOMMITTEE ON HEALTH, EMPLOYMENT, LABOR AND PENSIONS

COMMITTEE ON EDUCATION AND LABOR

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C O N T E N T S

REVIEW OF THE INDEPENDENT AUDIT OF THE LABOR DEPARTMENT'S FISCAL YEAR 2010 CONSOLIDATED FINANCIAL STATEMENTS

Tuesday, December 7, 2010
U.S. House of Representatives
Subcommittee on Health, Employment, Labor and Pensions
Committee on Education and Labor
Washington, DC

The subcommittee met, pursuant to call, at 2:00 p.m., in room 2175, Rayburn House Office Building, Hon. Robert Andrews [chairman of the subcommittee] presiding.

Present: Representatives Andrews, Tierney, Kucinich, Fudge, Kildee, and Roe.

Staff Present: Aaron Albright, Press Secretary; Ali Al Falahi, Staff Assistant, Tylease Alli, Hearing Clerk; Jose Garza, Deputy General Counsel; David Hartzler, Systems Administrator; Ryan Holden, Senior Investigator; Broderick Johnson, Staff Assistant; Sadie Marshall, Chief Clerk; Melissa Salmanowitz, Press Secretary; James Schroll, Junior Legislative Associate, Labor; Michele Varnhagen, Labor Policy Director; Matt Walker, Policy Advisor, Subcommittee on Health, Employment, Labor and Pensions; Michael Zola, Chief Investigative Counsel; Kirk Boyle, Minority General Counsel; Ed Gilroy, Minority Director of Workforce Policy; Ryan Kearney, Minority Legislative Assistant; Brian Newell, Minority Press Secretary; Molly McLaughlin Salmi, Minority Deputy Director of Workforce Policy; Ken Serafin, Minority Workforce Policy Counsel; and Linda Stevens, Minority Chief Clerk/Assistant to the General Counsel.

Chairman ANDREWS. Ladies and gentlemen, the subcommittee will come to order. Good afternoon. I would like to thank my colleagues for attending and our colleagues from the United States Department of Labor and the IG's Office for being with us. This hearing has a very narrow purpose, but it is one that is very important. Under House rule 11, clause 2, subclause O, when a department under our jurisdiction is unable to have its audit completed for a given fiscal year, the House rules require us to call a hearing to figure out exactly why that is.

And that is the purpose of today's hearing. I think it is an excellent example of transparency, and although it rarely happens, I am glad it is in our rules and I am very glad Mr. Lewis and Mr. Taylor are with us today.

A quorum being present, the hearing of the committee will come to order. I would note for the record that the chairman will yield time for the purpose of asking questions, unless the person asking for time makes a specific request otherwise.

Here is the history of our situation here. In 2008, the prior administration recognized that the financial accounting system of the Department of Labor was unduly cumbersome and needed to be modernized. And so a process began and a contract was awarded to modernize that system. It took a while to get things rolling. My understanding is the system went live in January of 2010. By the end of the 2010 fiscal year, which would have been September 30th of 2010, when it was time to audit the 2010 fiscal year for the Department, the documents and materials necessary for the IG's contractor to conduct that audit were not available, and that was because of implementation delays in the new financial accounting system.

So the question that is before the subcommittee today is, what was the cause of that delay, number one? And number two, are we in a position where that is to be fixed? It is my understanding in being briefed for the hearing that the answer to the second question is apparently yes; that when the 2011 fiscal year ends on September 30, 2011, that the Department's records will be fully auditable, we are assuming. But that would be, again, subject to this rule in the future if there are any further questions.

So again, the purpose of the hearing is to simply look at the question of why the materials necessary to complete the audit were not available to the inspector general's contractor for the 2010 fiscal year.

And at this time, I would like to yield to my friend, the gentleman from Tennessee, Dr. Roe, for any opening statement he would like to make.

Mr. ROE. Thank you, Mr. Chairman. Let me begin by thanking our distinguished panel for appearing today. As the notice announcing our hearing states, we will be reviewing an independent audit of the Labor Department's financial records. This is the Department with roughly a $16 billion budget, 30 agencies, and more than 17,000 employees. A great deal of time and resources were invested in this audit, and for good reason. Addressing the country's fiscal challenges will not be possible until every dollar spent by the Federal Government is accounted for.

Aside from our public responsibilities to be good stewards of our taxpayers' money, this year's audit is significant for several additional reasons. For starters, this will be the first time separate financial and performance audits are presented to Congress. I hope this will provide a more thorough examination of the Department of Labor's financial ledger, and we look forward to reviewing the performance audit early next year.

This is also our first look at the Department's new financial management system. This new system was implemented at the beginning of the year to better streamline and enhance the accountability of the Department's finances, as stated by the chairman.

We need to ask whether this has delivered the taxpayers the results that they deserve. The answer to our question may be connected to the final reason why this audit is so significant. For the first time in more than a dozen years, the Department failed to achieve a clean audit. KPMG, the independent firm tasked by the IG's Office with performing the audit, identified four material weaknesses in the Department's finances. Just one material weakness is significant to trigger a failing grade. Witnesses cite the audit included a lack of adequate controls over financial reporting and budgetary accounting, a failure to properly control access to financial and support systems, were these weaknesses a result of a failure of the new financial system or were they the result of a failure of the Department's leadership? Regardless of the cause, the result is still the same.

We do not know if the Department's financial records are accurate, and this is unacceptable. When an organization replaces a system responsible for tracking tens of billions of dollars, errors are not uncommon. However, it is the responsibility of that organization's leadership to anticipate potential problems and put in place a plan that preserves transparency and accountability through the transition process. That responsibility is all more critical when dealing with taxpayer dollars. We need to learn what actions the Labor Department's management team has undertaken to fix these weaknesses and what it plans to do in the future to ensure that this does not happen again.

These are important questions, and that is why I am disappointed an important voice in this discussion will not be heard today, the voice of KPMG. It is regrettable that members will be unable to hear from the technical experts who spent the past year looking over the books in the Department of Labor. Not only is this regrettable, it is a missed opportunity for the committee.

As we speak, the Federal Government is borrowing roughly 40 cents for every dollar it spends, and our national debt is quickly approaching $14 trillion. The American people have demanded we restore fiscal responsibility to the Federal Government. Each Federal agency must demonstrate sensible, efficient, and transparent management of the resources it has been entrusted with. That is the significance of our hearing today and the responsibility we must fulfill in the weeks and months ahead.

I am looking forward to hearing from our witnesses and exploring matters in the future. And I will say, Mr. Chairman, that this is my seventh audit that I have been involved in, six as a city commissioner and a city mayor, and I never one time attended an audit where the auditors weren't there to answer questions. So with that, I will yield back the balance of my time.

[The prepared statement of Mr. Roe follows:]

Prepared Statement of Hon. Phil Roe, Republican Member, Subcommittee on Health, Employment, Labor and Pensions

Thank you Mr. Chairman. Let me begin by thanking our distinguished panel for appearing today.

As the notice announcing our hearing states, we will be reviewing an independent audit of the Labor Department's financial records. This is a department with a roughly $16 billion budget, 30 agencies, and more than 17,000 employees. A great deal of time and resources were invested in this audit and for good reason: addressing the country's fiscal challenges will not be possible until every dollar spent by the federal government is accounted for.

Aside from our public responsibility to be good stewards of the taxpayers' money, this year's audit is significant for several additional reasons. For starters, this will be the first time separate financial and performance audits are presented to Congress. I hope this will provide a more thorough examination of the Labor Department's financial ledger, and we look forward to reviewing the performance audit early next year.

This is also our first look at the department's new financial management system. This new system was implemented at the beginning of the year to better streamline and enhance the accountability of the department's finances. We need to ask whether this has delivered the results taxpayers deserve.

The answer to our question may be connected to the final reason why this audit is so significant. For the first time in more than a dozen years the department failed to achieve a clean audit. KPMG, the independent firm tasked by the Inspector General's office with performing the audit, identified four material weaknesses in the department's finances. Just one material weakness is sufficient to trigger a failing grade.

Weaknesses cited in the audit include a lack of adequate controls over financial reporting and budgetary accounting, and a failure to properly control access to financial and support systems. Were these weaknesses the result of a failure in the new financial system? Or were they the result of a failure of the department's leadership? Regardless of the cause, the result is still the same: we do not know if the department's financial records are accurate. This is unacceptable.

When an organization replaces a system responsible for tracking tens of billions of dollars, errors are not uncommon. However, it is the responsibility of the organization's leadership to anticipate potential problems and to put in place a plan that preserves transparency and accountability through the transition process. That responsibility is all the more critical when dealing with taxpayer dollars. We need to learn what actions the Labor Department's management team has undertaken to fix these weaknesses and what it plans to do in the future to ensure this doesn't happen again.

These are important questions, and that is why I am disappointed an important voice in this discussion will not be heard today, the voice of KPMG. It is regrettable that members will be unable to hear from the technical experts who spent the past year looking over the books of the Department of Labor. Not only is it regrettable, it is a missed opportunity for the committee.

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I look forward to hearing from our witnesses and exploring these matters further. Thank you Mr. Chairman and I yield back.

Chairman ANDREWS. I thank the gentleman.

I would note for the record that under the rules of the committee, the minority was certainly free to invite anyone as its witness. And my understanding is there was not a formal invitation extended to the KPMG witnesses; is that correct?

Mr. ROE. I think there was, but I think they had a scheduling difficulty.

Chairman ANDREWS. Well, I want the record to reflect that the majority in no way discouraged or is opposed to that witness being present. The witness simply isn't present. Pursuant to committee rule 7(c), all members may submit an opening statement in writing which will be made a part of the permanent record.

At this time, I am going to begin by introducing the witnesses that we have with us today.

Mr. Elliot P. Lewis is the assistant inspector general for audit of the Office of the Inspector General at the United States Department of Labor, and he is responsible for all audits within the Department. Prior to his appointment as AIGA, he served as the deputy assistant inspector general for audit. Mr. Lewis is a CPA in the

State of South Carolina and received his B.S. from the University of South Carolina. Welcome, Mr. Lewis, to the committee.

Mr. James L. Taylor was confirmed by the United States Senate as the chief financial officer for the Department of Labor on June 22, 2010. Prior to this position he served as deputy inspector general for the Department of Homeland Security, where he assisted the inspector general in managing over 600 auditors, inspectors and investigators. He received his B.A. from Old Dominion University and an M.P.A. from the University of Delaware. Welcome, Mr. Taylor. We are happy to have you with us.

I think you are both veterans of Capitol Hill hearings and know that our practice is that your written statements, without objection, will be accepted as part of the written record. We would ask you to offer us a 5-minute summary of your written testimony, beginning with Mr. Lewis. At the conclusion of those summaries, we will go to questions from the members of the subcommittee.

I am sure you know the light system; that green means go, yellow means speed up, unlike when you are driving a car, and red means come to a screeching halt. I know we certainly would want you to finish your comments.

Mr. Lewis, we begin with you. Welcome to the subcommittee.

STATEMENT OF ELLIOTT P. LEWIS, ASSISTANT INSPECTOR GENERAL FOR THE OFFICE OF AUDIT, OFFICE OF INSPECTOR GENERAL, U.S. DEPARTMENT OF LABOR

Mr. LEWIS. Thank you, Mr. Chairman. Mr. Chairman and members of the subcommittee, thank you for the opportunity to discuss the audit of the U.S. Department of Labor's Fiscal Year 2010 Consolidated Financial Statements. The independent public accounting firm, KPMG, conducted the audit under a contract with the Office of the Inspector General.

My name is Elliot Lewis, and I am the assistant inspector general for audit at the Department of Labor. As you know, the OIG is an independent agency within the Department, and the views expressed in my testimony are based on the independent findings and recommendations of the audit work and are not intended to reflect the Department's position.

The CFO Act requires the OIG to audit and report on the Department's consolidated financial statements. OMB requires the audit be completed by November 15th each year. To enable the auditors to meet this deadline, the Department must provide significant financial information and supporting documentation throughout the year. Therefore, an inability on the part of the Department to produce the necessary information in a timely manner affects the successful completion of the audit and results in a less than favorable opinion for the Department.

As I will detail in my testimony, Mr. Chairman, for the most part it was the Department's inability to provide timely and accurate financial data that resulted in the Department receiving a disclaimer of opinion on its 2010 consolidated financial statements. The Department was unable to provide this data due to a host of system migration, integration and configuration problems that occurred when it implemented a new financial system. It is important to note that prior to this, the Department had received an unqualified opinion on its annual financial statements since 1997.

In the mid-2000s the Department decided that its financial system, DOLAR$, was outdated and no longer able to efficiently and effectively meet the Department's financial management requirements. In July 2008, the Department contracted to obtain a new system, which it named the New Core Financial System, or New Core. The Department planned a 15-month implementation period that would conclude at the end of fiscal year 2009. Upon implementation in January 2010, the Department encountered many unforeseen complications that in some cases it is still working to address today.

It is important to highlight the Department experienced much turnover in key leadership positions in the Office of the Chief Financial Officer during the time it was planning, developing, and implementing New Core. This included the retirement of its two top senior executives shortly after New Core was implemented.

The OIG contracted with KPMG to create a pre-implementation audit of New Core prior to its original scheduled deployment in October 2009. During this audit we issued two alert memoranda to inform the Department of issues requiring immediate attention: training of staff prior to implementation of the new system and timely completion of transaction workbooks to be used to record financial activity occurring after DOLAR$ was shut down before New Core became available.

The audit identified 11 implementation risks to future integrity and availability of the Department's financial data and recommended the Department take these risks into consideration when making its decision to implement New Core. The Department disagreed with many of our reported results and went forward with the implementation.

Following implementation, our attention turned to preparing for the consolidated financial statement audit. We issued several more alert memoranda regarding our concerns that problems resulting from the transition to New Core were preventing the Department from providing KPMG with the necessary information to complete the audit. While the Department worked to meet its goal of producing auditable financial statements, it continued to experience difficulties and ultimately was unable to do so, resulting in the disclaimer of opinion.

As stated in the audit report, the Department's ability to assure the accuracy and completeness of its financial statement balances and provide data necessary for audit testing was hindered by data migration, integration, reconciliation, and configuration issues. The audit report contained 24 specific recommendations related to findings that contributed to the disclaimer of opinion. The Department generally concurred with the recommendations and noted that many of them corresponded with corrective actions planned or already taken.

Going forward, the most important financial management issue facing the Department is the need to correct the New Core implementation issues in order to either reissue corrected financial statements or provide accurate and complete information for the auditors to audit the opening balances for 2011. The Department indicated that it plans to reissue its 2010 consolidated financial statements in early 2011. The OIG will continue to monitor the Department's actions.

There is much to be done, but the challenges are not insurmountable if appropriate resources are timely dedicated to the necessary corrective actions.

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 ANDREWS. Mr. Lewis, thank you for your service and for your testimony.

[The prepared 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 Fiscal Year (FY) 2010 Consolidated Financial Statements. The independent public accounting firm KPMG LLP conducted the audit under a contract with the Office of Inspector General (OIG). My name is Elliot Lewis and I am the Assistant Inspector General for Audit for the Department of Labor. As you know, the OIG is an independent agency within the Department of Labor, and the views expressed in my testimony are based on the independent findings and recommendations of the audit work and are not intended to reflect the Department's position.

Background

The Chief Financial Officers Act of 1990, P.L. 101-576, requires the OIG to audit and report on the Department's consolidated financial statements in accordance with generally accepted auditing standards, Government Auditing Standards, and OMB guidance. OMB requires that the audit be completed by November 15 of each year. This audit is of such complexity that, in order to meet this deadline and complete all steps necessary to render an opinion on the Consolidated Financial Statements, the Department must provide significant financial information and supporting documentation throughout the year. Therefore, an inability on the part of the Department to produce the necessary information in a timely manner affects the successful completion of the audit and results in a less than favorable opinion for the Department.

As I will detail in my testimony, Mr. Chairman, for the most part, it was the Department's inability to provide timely and accurate financial data that resulted in the Department receiving a Disclaimer of Opinion on its FY 2010 Consolidated Financial Statements. This was the result of a host of system migration, integration, and configuration problems that occurred when the Department implemented a new financial management system. It is important to note that prior to this, the Department had received an unqualified opinion on its annual consolidated financial statements since 1997.

By way of background, Mr. Chairman, audits of the Department's financial statements are important as they provide an independent assessment of whether the Department's financial position and condition are fairly stated, so that policy makers can rely upon them to make informed decisions. The financial statement audit also includes reports on internal controls over financial reporting and compliance with certain laws, regulations, contracts, and grant agreements.

The audit report includes a formal opinion on the financial position of the entity in conformance with generally accepted accounting principles (GAAP). An auditor may express four types of opinions in their report: unqualified, qualified, adverse, or disclaimer.

Unqualified opinion: issued when the financial statements presented are free from material misstatements and are presented fairly in accordance with GAAP.

Qualified opinion: issued when the financial statements, except for specific matters which do not comply with GAAP, are presented fairly.

Adverse opinion: issued when the auditor determines that the financial statements presented are materially misstated and when considered as a whole, do not conform with GAAP.

Disclaimer of opinion: issued when the auditor could not complete all of the necessary work to render an opinion because of a scope limitation(s). A disclaimer of opinion does not indicate the financial statements were materially misstated or did not conform with GAAP. However, since under those circumstances the auditors are not able to complete all of the necessary audit work, it also means that additional problems that have not yet been identified and reported to the Department may exist.

System migration history

The Department of Labor comprises 30 agencies and more than 17,000 employees throughout the United States. Prior to January 2010, the Department's financial management functions, processes, and activities related to its core mission responsibilities were centered on the Department of Labor Accounting and Related Systems (DOLAR$) mainframe accounting system. DOLAR$ had been in service since 1989.

In the mid-2000's, the Department decided that DOLAR$ was outdated and no longer able to efficiently and effectively meet the Department's financial management requirements. As a result, the Department began planning to migrate from DOLAR$ to a new financial management system. Through the implementation of this new system, the Department planned to automate previously manual processes and establish more effective internal controls.

After several failed attempts to procure a new system, in July 2008, the Department contracted with an external third-party shared service provider. The shared service provider offered the Department a pre-configured environment, with customized modules and sub-modules to meet the requirements of the Department's business processes. The Department named this new system the New Core Financial Management System (NCFMS).

The Department planned a 15-month implementation period that would conclude at the end of FY 2009. The Department planned to shut down DOLAR$ and start up NCFMS in October 2009.

Originally, NCFMS was scheduled to be fully operational by October 14, 2009. However, the Department postponed the deployment of the new system until January 14, 2010. Upon implementation, the Department encountered many unforeseen complications in the implementation of the new system that, in some cases, they are still working to address today.

It is important to highlight that the Department experienced much turnover in key leadership positions in the Office of the Chief Financial Officer during the time it was planning, developing, and implementing NCFMS. This included the retirement of its top two senior executives shortly after NCFMS was implemented.

System pre-implementation audit

The OIG contracted with KPMG to conduct a pre-implementation audit of NCFMS prior to its original scheduled deployment in October 2009. During the audit, we issued an Alert Memorandum to the then-Acting Chief Financial Officer (CFO) in August 2009, expressing concerns that staff be adequately trained prior to implementation of the new system. In particular, we noted that the conversion to NCFMS would have the greatest impact on 400 users of DOLAR$. Ensuring that these users received appropriate training before conversion would be critical to the success of the conversion. At that time, 93 of the 400 DOLAR$ users had not completed required training in any of the available training modules. In addition, none of the 5,125 secondary users—primarily those individuals involved with sub-systems such as Procurement, Grants, and Purchase Cards—had completed the required training.

The then-Acting CFO concurred with our assessment of the importance of training users in the new system and the importance of this training to the success of the implementation. She indicated that her office was starting an intensive hands-on training phase that would run through the planned October 2009 "Go Live" date, and beyond. Despite the Department's efforts, lack of sufficient user training resulted in many data entry errors in the new system.

In September 2009, we issued another Alert Memorandum raising concerns about the timely completion of the NCFMS Transactions Workbook. These workbooks were electronic spreadsheets to be used to record financial transactions during the period of time when DOLAR$ was expected to be unavailable and when NCFMS would become available—referred to as the Cut-Over period. The then-Acting CFO responded that the Department had delayed implementation of NCFMS until January 2010, and the Cut-Over plan would be reevaluated. As the auditors were unable to test much transactional data from NCFMS, we could not determine the extent to which cut-over issues caused problems.

The NCFMS pre-implementation audit report was issued in final on January 13, 2010, but we had provided the Department a draft containing our audit results on December 18, 2009. The report identified 11 implementation risks related to the design and execution of user acceptance testing, batch interface testing, real-time integration testing, and mock data conversion. The report concluded that these issues presented risks to the future integrity and availability of the Department's financial data.

We recommended that the Department take into consideration the risks we had identified when making its decision to implement NCFMS. The then-Acting CFO disagreed with many of our reported results, and the Department went forward with implementing NCFMS on January 14, 2010.

Audit of Consolidated Financial Statements

Following implementation, our attention turned to preparing for the Consolidated Financial Statements audit. In March 2010, we issued an Alert Memorandum expressing our concern that the Department would be unable to issue financial statements in sufficient time to allow KPMG to complete its audit by November 15, 2010, as required by OMB. Specifically, we raised concerns that the Department had not adequately verified that all data had migrated correctly, and that it had not developed procedures for certain key financial reporting processes.

We followed up in April highlighting certain key dates that the Department needed to meet in order to allow KPMG sufficient time to complete the necessary audit procedures. We noted that failure to meet these dates with complete and accurate information would critically impact KPMG's ability to complete its audit procedures and issue an opinion.

In July, the newly confirmed CFO indicated that the Department had encountered NCFMS implementation problems with accounting codes, configuration and migration of transaction level data, and ensuring transactions and general ledger account balances properly mapped to and supported the Department's various internal and external reports. The CFO stated that the complexity and volume of these transactions and mapping efforts had been underestimated, that much progress had been made, and that they were making up time after the initial delays. The CFO indicated that the initial conversion level errors and delays, once corrected and validated, would not result in continued delays in generating required reports.

Despite the Department's efforts, it was unable to meet KPMG's deadline for submitting second quarter financial data for audit testing. In June, we informed the Department that KPMG may not be able to complete a full scope audit by the OMB reporting deadline, which could result in the issuance of a disclaimer of an opinion.

In response, the CFO reported that his office was working diligently to resolve the NCFMS implementation issues. He indicated that additional staff had been assigned to this high priority effort, with a primary focus on the production of timely, accurate, and complete annual financial statements for FY 2010 in time to allow the completion of the audit work.

While the Department worked to meet its goal of producing auditable financial statements, it continued to experience difficulties and ultimately was unable to do so. On August 18, we informed the Department that, although audit work would continue until November 15, it was probable that the audit would result in the issuance of a disclaimer of an opinion, which in fact occurred.

Specific reasons for disclaimer of opinion

The audit report contained 24 specific recommendations related to findings that contributed to the disclaimer of opinion. The Department generally concurred with the recommendations and noted that many of the recommendations corresponded with corrective actions planned or already taken. The Department's ability to assure the accuracy and completeness of its financial statement balances and to provide data necessary for audit testing was hindered by data migration, integration with other systems, reconciliation, and system configuration issues as follows:

Data Migration:

The Department experienced numerous issues with the migration of data to the new system. For example:

Certain internal agency codes and general ledger accounts in DOLAR$ were incorrectly cross-walked to NCFMS during migration, causing data errors at the fund and general ledger account level.

Certain transaction identifiers were not properly captured in NCFMS when migrated from DOLAR$. For example, certain obligations were not properly classified between direct and reimbursable. In addition, various issues related to the identification and coding of intra-governmental transactions by trading partner, including incomplete vendor information, were encountered as a result of data migration errors. Because of these issues, the Department was not able to provide representations as to whether the intra-governmental balances presented in the financial statements were materially correct.

Integration with Other Systems

Interfaces between the NCFMS and subsystems were not properly working subsequent to the implementation. For example, grant expense information from the grant sub-system was not transferred to NCFMS in a complete manner. In addition, certain grant obligations were not transmitted properly from NCFMS to a third-party service provider in order for grantees to drawdown funds. The Department subsequently developed and implemented certain "work-arounds" to address these issues.

Data from Treasury and the Department's own Integrated Federal Employees' Compensation System could not be uploaded into NCFMS. As a result, the Department was unable to record the majority of transactions related to the Unemployment Trust Fund and the Federal Employees' Compensation Act timely. Additionally, once recorded, significant differences existed between the data uploaded into NCFMS and these subsystems.

Reconciliation

The Department was unable to complete in a timely manner certain account reconciliations as of September 30. For example, the Department was unable to reconcile its disbursement and collection activity with the U.S. Department of the Treasury's accounts. The Department was also unable to reconcile its underlying supporting data for certain Unemployment Trust Fund balances to the general ledger in a timely manner. Additionally, significant differences between the NCFMS property module and the general ledger existed.

System Configuration

NCFMS was not configured properly to record certain transactions in compliance with the United States Standard General Ledger (USSGL). As a result, the Department implemented manual processes, such as adjustments directly to the financial statement, to correct these errors. As of September 30, 2010, NCFMS was still not properly configured to record such transactions in accordance with the U.S. Standard General Ledger.

Going forward—what remains to be done

The most important issue facing the Department is the need to correct NCFMS implementation issues and related control deficiencies in order to either reissue corrected financial statements or provide accurate and complete information for the auditors to audit opening FY 2011 balances.

The Department has indicated that it plans to reissue its FY 2010 Consolidated Financial Statements in early 2011. Among the actions the Department still needs to take in order to produce the financial statements are:

promptly resolving the classification issues related to intra-governmental balances,

ensuring that any remaining interface errors are promptly resolved and that all necessary financial reports are developed and available to the program agencies in the Department,

completing all necessary initial reconciliations of module and subsystem data to the NCFMS general ledger and ensuring that routine reconciliation controls are implemented and performed, and

reviewing significant transactions for USSGL compliance and make any necessary corrections.

The OIG will continue to monitor the Department's actions to correct the problems that resulted in the disclaimer of opinion. There is much to be done, but the challenges are not insurmountable if appropriate resources are timely dedicated to all the necessary corrective actions.

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 ANDREWS. Mr. Taylor, welcome to the committee.

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

Mr. TAYLOR. Thank you, Mr. Chairman and members of the subcommittee. I appreciate the opportunity to come before you to discuss the financial management at the Department of Labor. And specifically, I do understand that the purpose of this hearing is to understand why the financial statement audit opinion for the Department of Labor fell from an unqualified opinion, or clean opinion, to a disclaimer. And a qualified opinion means that the independent auditors have determined that the financial statements fairly represent the position and activities of the Department. The disclaimer of opinion the Department of Labor received for 2010 means simply that the independent auditors could not complete the detailed effort required to opine on these statements. It does not necessarily mean that they found any statements materially in error.

In the case of the Department of Labor, this inability to complete the audit resulted from our transition to the New Core Financial Management System and the issues which arose. Irrespective of the cause, the Department's leadership is disappointed in this result. The fact that other agencies have experienced similar problems when replacing systems and also lost a clean audit opinion does not make this experience less disappointing. We have already taken steps to overcome these problems and we are working every day to bring the Department's financial systems into compliance with the highest financial standards.

It is because of this progress that I do intend to resubmit our financial statements to the Office of Inspector General within the next few months and request they fully audit our 2010 financial activities and possibly reissue their opinion.

To better put the financial system's effort in context, the Department spent $35 million between 2003 and 2008 in an effort to replace an old legacy system which had been in use for over two decades. When this previous effort failed, the Department awarded a contract for the development and implementation of the New Core Financial Management System in July of 2008. The Department was able to eliminate much of its risk by contracting for a product that was already in use within the Federal Government. And since the Department decided to use a shared service provider, we do not own any hardware or software associated with the implementation or the product. This eliminates the need for costly infrastructure maintenance and in-house technical resources. It also integrates a number of internal feeder systems, including procurement, travel, grants management and—procurement, travel, grants management and payroll, which produce realtime cross-platform financial data and reduces the transaction processing errors that result when those systems reconcile manually to the former system.

New Core took 18 months to implement at an initial cost of less than $15 million and an annual operational cost of approximately $20 million in program use 2010, and $11 million in 2011. The initial "go live" date was October 1st, but as has been mentioned, the launch was delayed until January 14, 2010 to provide additional time to train users and continue data migration activities.

The Department had failures during the New Core implementation. First, New Core user requirements were significantly underestimated during the contract development. The initial contract envisioned less than a quarter of the users who are now actually interfacing with the system. Having significantly underestimated the user base, the original contract did not account for the additional need for user training, system support from the contractor, and general system loading resulting from the more than double the number of day-to-day users.

Second, the new system also brought substantial business process changes that were not fully anticipated when the contractor was selected. We had dramatically changed how we process things like invoicing and travel payments and it is a more automated process. But that really impacted a cultural change in how the Department does business. And that was a lot for the Department, which has been doing the same way of business for 20 years, to swallow.

Third, we have a significant challenge with data migration from the old system to the new. This involved the transfer of detailed data, some of it decades old, from legacy financial computer systems to New Core. For instance, the financial data in the Department's legacy financial system was never reconciled with the financial data of the procurement system. Before being migrated to New Core, this was a task that had to be accomplished so that both systems could use the same financial information. These migration issues also impacted our ability to provide timely and accurate financial reporting.

Finally, the Department experienced significant turnover amongst the senior financial managers, as my colleague has already mentioned. The Department lacked a Senate-confirmed chief financial officer from January 2009 until I was confirmed in late June of this year. The Department career deputy CFO and the associate deputy CFO overseeing the implementation both retired shortly after the system launched in January 2010, leaving the Department without any permanent financial management leadership.

In spite of all these issues I have discussed, it is important to note that none of these problems impacted the mission of the Department. During 2010 we made a conscious decision that the first priority would be in supporting the activities of the Department's agencies. We succeeded in that objective. The necessary financial activities to provide unemployment benefits, job training grants, and support costs for workplace and mine safety inspections continued without interruption.

In closing, Mr. Chairman, the challenges which have occurred with implementation of the Department's new system are unfortunate, and I take responsibility for making sure they are overcome in a timely manner. While I was confirmed by the Senate in late June, I was detailed for my position as deputy IG in the Department of Homeland Security to serve as an advisor to the Deputy Secretary of Labor from late October 2009 to February 2010. And this was in order to assist the Department in identifying issues and trying to mitigate the problems prior to going live. So, I am very familiar with the issues the Department faces.

In addition to auditing DHS's financial activities immediately prior to coming to this position, I was previously charged with implementing financial systems as deputy CFO at FEMA and the Department of Commerce. While the process at DOL has certainly not been a seamless one, I have seen difficult implementations at other agencies, and I have no doubt that the challenges we have encountered at DOL can and will be overcome. Thank you, Mr. Chairman.

[The prepared statement of Mr. Taylor follows:]

Prepared Statement of James L. Taylor, Chief Financial Officer, U.S. Department of Labor

Thank you, Mr. Chairman, Ranking Member Price 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 in response to the Department's financial statement audit opinion dropping from an unqualified, or clean, opinion to a disclaimer.

An unqualified opinion 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, while a disclaimer states that the auditor does not express an opinion on the financial statements. As the auditors noted, the primary reason for the disclaimer was the transition to a new financial management system, and the implementation issues which arose during that effort. The Department shares the Committee's disappointment in this outcome, and we are committed to working with the Office of Inspector General (OIG) to identify and resolve the financial audit findings. We have already taken many steps to overcome the problems which disrupted our initial transition and we continue to work every day to bring the Department's financial systems into compliance with the highest accounting standards.

We are currently focused on normalizing financial operations, and plan to resubmit our FY 2010 statements within the next few months for review by the OIG. 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.

When I was confirmed by the Senate to the position of Chief Financial Officer in late June, I knew that my first year on the job would be dominated by the challenges of completing the modernization of the Department's financial management systems—a process that began and was substantially defined by the previous Administration.

I have worked in the federal financial management community for a number of different agencies. I have either implemented or audited the implementation of several financial management modernization projects. I have found that the complexity of implementing these initiatives almost always makes it difficult initially to obtain clean opinions from auditors. While the process at DOL has certainly not been a seamless one, I have seen difficult implementation problems at other agencies and I have no doubt that the challenges we have encountered at DOL can and will be overcome.

Introduction

The Department spent $35 million between 2003 and 2008 in an effort to replace an old financial system which failed to comply with applicable statutory and regulatory requirements. When this previous effort failed, the Department awarded a contract for the development and implementation of the Department's New Core Financial Management System (New Core or NCFMS) in July 2008, with a goal of replacing the legacy system which had been in use for over two decades. New Core is based upon a pre-configured software suite that is commercially available. The system generally met agency requirements and was preconfigured and pre-integrated to comply with all major Federal business processes. The Department was able to eliminate much of its risk by contracting for a product that was already in use within the Federal government, while also reducing development costs and accelerating the timeline for implementation. The Department does not own any hardware or software associated with New Core, eliminating the need for costly infrastructure, maintenance, and in-house technical resources dedicated to system maintenance.

This system will provide users with a modern set of software tools and resources to automate manual processes and produce operational efficiencies, and establish, monitor, and enforce more effective internal controls to ensure resources were being safeguarded and used appropriately. The new system will also allow the Department to more readily adapt to new Office of Management and Budget (OMB), Treasury, and Congressional requirements, and improve the accuracy and timeliness of financial reports. It will also integrate a number of internal, independently developed feeder systems, including procurement, travel, and grants management systems, producing real-time cross-platform financial data and reducing transaction processing errors that resulted when those systems were reconciled in the former core accounting system.

New Core took 18 months to implement at an initial cost of less than $15 million, and an annual operational cost of approximately $20 million in program year 2010 and $11 million in program year 2011, and would have been in alignment with the recent OMB directive on systems modernization. The initial "go live" date was October 1, 2009; however, the launch was delayed until January 14, 2010, to provide additional time to train users and continue data migration activities. While this delay was necessary from an operational perspective, it added to the growing pains during the transition that led to problems for the FY 2010 audit cycle.

In summary, Labor had failures on a number of fronts including: an underestimated user base; a lack of understanding of the substantial changes to business processes; and data quality problems. I will go into detail on each of these issues that are unfortunately common within the Federal space when implementing a financial system. The system was not the failure; the identification of system requirements and project planning were lacking. But we will overcome the transition and be back on track within a year through aggressive corrective actions that I have put into place with the support of the Department's leadership.

Underestimated User Base

New Core user requirements were significantly underestimated during contract development. The initial contract envisioned only 300 transactional users, or those with access to the day-to-day accounting system. As of September 2010, we have over 625 users requiring this level of access. Further, the Department estimated only 200 users who could query the system for reports. As of September 2010, we have over 1,400 users requiring this level of access. Having significantly underestimated the user base, the original contract did not account for the additional need for user training, system support from the contractor, and general system load resulting from more than double the number of day-to-day users contemplated, and seven times the number of users requiring financial reports to ensure they are within their spending limits in order to run their programs effectively.

Lack of Understanding of Substantial Business Process Changes

The new system also brought substantial business process changes that were not fully anticipated when the contractor was selected. With real-time feedback on errors, automated invoice processing, and other enhancements, users were required to learn an entirely new way of performing the Department's financial management functions. Career staff, who had been performing functions a certain way for decades, were required to relearn basic processes and perform their functions in an entirely new environment. This change in business practice impacted every financial activity performed in the department, from processing grants and procurement actions to travel and personnel actions. While training in the National Office and regional sites was increased and an onsite training room with live system access and onsite support to aid individual users was created to address this shortcoming, the Department nevertheless had to play catch-up for months following the launch of the system as users became accustomed to a new way of tracking financial transactions.

We have also faced challenges adjusting to the more transparent internal controls environment that New Core provides. Numerous controls are embedded in the new system to prevent improper payments, Anti-Deficiency Act violations, fraud, and abuse. In the previous environment, these controls were largely performed manually by the CFO's office out of the general user's view. Now, real-time funds checks performed by New Core create error messages that the user sees and transactions will not be processed if the error messages are not resolved. These messages are interpreted by the user as system errors rather than spending controls because they were never visible to the user before. It has taken time for our travel, grants, and procurement user communities to become acclimated to seeing and resolving error messages related to transaction validation rules. As users realize that these are not system errors, we can focus more attention on resolving real data migration and system integration issues affecting our system and its users.

Data Quality Challenges

While working through the issues caused by an expanded user base, we have also faced significant challenges with data migration from the old system to the new one. This involved the transfer of significant amounts of granular data, some of it decades old, from legacy financial and feeder systems to a modern system. For instance, the financial data in the Department's legacy financial system was never reconciled with the financial data in the procurement system. Before being migrated to New Core, the contract data had to be reconciled so that both systems would use the same financial data. This synchronization required enormous manual effort for NCFMS program staff and Department contracting staff, and was significantly more time consuming than anticipated. This situation was exacerbated with the migration of old vendor data, some of which was outdated and included erroneous banking data. This had a negative impact on the Department's ability to make timely vendor payments. We had to dedicate significant staff resources to this effort, as data transfer issues between systems have affected day-to-day financial information and hampered operations. These migration issues also affected our ability to provide timely and accurate financial reporting, both to DOL managers and externally to OMB, Treasury, and the audit team. This, in turn, significantly contributed to the disclaimed opinion.

The decision to delay the launch of New Core from October 2009 to January 2010 also meant that we operated two accounting systems during one fiscal year. Migrating previous fiscal years' data was challenging but the numbers were largely static. Migrating "live" financial data between systems for the same fiscal year was extremely difficult due to the inherent fluctuations in the numbers. Transactions initially processed in one system had to be reconciled with the new system while new transactions were posted for the current period, essentially doubling the workload for our staff and creating a significant resource burden.

Consistent Project Management

The Department experienced significant turnover amongst its senior financial managers during most of the system's implementation and post-launch phases. The Department lacked a Senate-confirmed Chief Financial Officer from January 2009 until my confirmation in June 2010. The Department's career Deputy Chief Financial Officer and the Associate Deputy Chief Financial Officer overseeing the implementation both retired shortly after the system launched in January 2010, leaving the Department without any permanent financial management leadership. Coming at a critical period in the implementation, this gap in leadership led to delays in identifying and resolving some of the problems encountered during the startup of the new financial system and the business process re-engineering required to adapt DOL's existing procedures to the new system.

In spite of all the issues I have discussed here, it is important to note that the implementation issues I have been outlining did not impact the mission of the Department. During 2010, we made the conscious decision to focus on ensuring the mission was accomplished. We succeeded in that objective. The activities necessary to provide unemployment benefits, job training grants, support costs for workplace and mine safety inspections continued to function. In addition, we have made significant progress in addressing all of the challenges outlined earlier; and I am pleased to report that in 2011 we will be able to provide more accurate financial reporting and support for the Department's programs. The Department has nearly reached pre-implementation late payment rates and expects to improve operational efficiencies in 2011 beyond the benchmarks of the previous system. Additional data migration activities have substantially improved throughput despite the implementation of system-enforced internal controls and segregation of duties. Our issuance of grants, travel payments and procurements is consistently performed accurately and timely by New Core, nearly eliminating the need for manual workarounds previously necessary to release funds due to system integration and data migration issues. We continue to work closely with OMB, our Inspector General, and our component agencies to resolve remaining financial reporting issues and do not expect these issues to have a material impact on the FY 2011 financial audit process. In fact, since we have made so much progress in resolving the implementation and financial reporting issues, it is my intention to resubmit our financial statements to the Office of Inspector General within the next few months to provide it the opportunity to fully audit our 2010 financial activities and potentially issue a revised opinion. As examples of our progress, New Core is now properly recording all grant obligations, costs, and payments. We also had difficulty preparing and reconciling the monthly submissions of the Statement of Transactions (SF-224) for several months following implementation of NCFMS, an issue which has also been resolved as the SF-224 reports are now being reconciled on a monthly basis and submitted timely.

In closing, Mr. Chairman, I have been involved in federal financial management for 30 years, both in the CFO and Inspector General communities. I've also directed the implementation of new financial systems on several occasions. The challenges which have occurred with the implementation of the Department's new system are unfortunate and I take responsibility for making sure they are overcome in a timely manner. The fact that other agencies have experienced similar problems when replacing older systems, and also lost their clean audit opinions, does not make this experience any less disappointing. However, we are confident that this situation is temporary and we remain on the right track to regain our clean audit opinion.

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

Chairman ANDREWS. Thank you, gentlemen, both very much. I appreciate it. We will begin with questions. Mr. Taylor, I think I heard you say that some time in the next few months the Department should be ready to present to the auditing firm consolidated financial statements that are auditable; is that correct?

Mr. TAYLOR. Yes, sir, it is.

Chairman ANDREWS. Do we know about when that will be?

Mr. TAYLOR. Our goal is to have it by the end of July—end of January, I'm sorry.

Chairman ANDREWS. January of 2011?

Mr. TAYLOR. Yes, sir.

Chairman ANDREWS. And although I know you can't assure the future, is it your opinion that when fiscal year 2011 closes on September 30, 2011, that the statements, the consolidated financial statements, will be auditable at that point for 2011?

Mr. TAYLOR. I am very comfortable that they will be.

Chairman ANDREWS. And Mr. Lewis, I assume it is then your agency's decision as to whether to issue a supplemental report or not, based upon those new consolidated financial statements?

Mr. LEWIS. That is correct. But we have been working very closely with the CFO's Office with the Department on that note, and that is exactly what we plan to do. If the Department wants to reissue and get a new opinion, we will certainly do that.

Chairman ANDREWS. Speaking only for myself, not for the other members of the committee, I think it will be a very desirable result so that we have your imprimatur on that.

Let me ask—well, let me ask one other question, Mr. Lewis. And I know that because you are dealing with unaudited—with really unauditable statements at this point, you really can't give a definitive answer. But in the review of the unauditable statements that your contractor looked at for fiscal 2010, was there any evidence whatsoever of fraud or theft?

Mr. LEWIS. No.

Chairman ANDREWS. Was there any evidence of any nefarious misconduct that you saw?

Mr. LEWIS. No.

Chairman ANDREWS. So am I correct in characterizing this as an absence of sufficient information to make a qualified audited judgment?

Mr. LEWIS. Correct.

Chairman ANDREWS. Mr. Taylor, let me ask you a question which is a bit broader, which I think concerns a lot of members of the committee. And I do understand that you did not get confirmed until June 22nd of 2010, which is nearly 6 months after, I guess more than 6 months after the system went live, around 6 months, so I am not in any way accusing you when I ask these questions. But a taxpayer would certainly wonder the following. In July of 2008, long before Secretary Solis took office, by the way, in July of 2008 the Department makes a decision to implement a new financial management accounting system. That system is not yet in a position to produce auditable financial statements by November 15th of 2010. Why? What happened?

Mr. TAYLOR. That is a very legitimate question. The actual implementation took 18 months. And 18 months in the Federal sphere is actually a very short period of time. And OMB is pushing other departments to——

Chairman ANDREWS. We may want that sphere to change.

Mr. TAYLOR. I totally agree. And other systems I have been involved in took years to accomplish the same end. The planning for the implementation and the actual cut-over of 18 months is actually a very reasonable time frame in my history of doing this.

Chairman ANDREWS. I will confess to you that my governmental experience is at much smaller levels of government, county government, and my private sector experience is really limited to being an observer, obviously. But I don't know many publicly traded companies who can get away with that explanation to the shareholders that it will take 18 months to implement. As a matter of fact, I think the Securities and Exchange Commission would never accept that explanation.

Again, I am not in targeting these questions at you, holding you accountable, because you didn't arrive until June of 2010. But what do you think we could do to implement a system the next time we do such a thing more expeditiously? I mean, why does it take 18 months at a minimum? And my understanding is there is no allegation of any software malfunction; is that right?

Mr. TAYLOR. That is correct.

Chairman ANDREWS. It is more a matter of training people how to use it and how to do the data entry and what practices they should follow; is that right?

Mr. TAYLOR. A lot of the time is used up in making sure that you undergo the proper training and that the interfaces are set up appropriately.

Chairman ANDREWS. Are all of the users of the system employees or contractors of the Department of Labor, or do nonemployees and contractors also use it?

Mr. TAYLOR. Employees of the Department of Labor.

Chairman ANDREWS. So really everybody who uses this is being compensated somehow by the Department?

Mr. TAYLOR. Correct.

Chairman ANDREWS. And again, I understand this goes back to prior to Secretary Solis, and I am not asking this question in any kind of partisan method at all, but I must say that taxpayers would wonder why it takes so long to implement such a thing, and I think it is a lesson we could all learn to avoid such a thing. When this amount of money is being handled, you know, the possibility that we don't know where it is and what it is being spent for, because the system is not auditable, is not a very good result.

Now, on the other side of the coin, it looks to me like you have made a lot of progress since June. And I am encouraged to hear Mr. Lewis says he will be receiving these reports. And I hope that the sequel to this riveting hearing is that a letter has been issued by the auditor, which gives a clean audit to the Department. We certainly hope that will be the case.

I thank you, and I would ask Mr. Roe for his questions.

Mr. ROE. Thank you, Mr. Chairman. And just briefly, a couple of questions. The way I understand this is that the IG is an independent agency within the Department of Labor, correct?

Mr. LEWIS. Correct.

Mr. ROE. And also in reading your testimony was that you didn't feel like you needed—and I agree with you—the resources to carry on this audit. And that is why the outside firm was—which I think also was a good idea—they had the resources. That is why I think it would be very important for them to be here.

Because you just made a statement a minute ago that I have to disagree with a little bit, which is you stated that—and you may be absolutely right in doing this, but I would be reluctant I think to say it—that you didn't see any fraud, abuse or anything. If you don't have all the information available to you it would be hard, I think, to make that statement when the material weaknesses, and that is whatever a serious problem is, and I guess that is are you a little bit overweight, I am not sure what a serious problem is, a definition of that. But a material weakness would be a lack of sufficient controls over financial reporting. So you really couldn't make that statement if you didn't have those controls, could you?

Mr. LEWIS. Well, let me make that more distinctive. In what we could look at—because you are right, we were limited; we didn't see, which that is different to me than saying there is not any there. If I was asked, is there any fraud or malfeasance there, I couldn't answer that question. Probably even if we had completed the entire audit, I wouldn't be able to answer that. To the extent of what we were able to look at, we didn't see that in what we were able to look at. But you are correct, there was a lot that we could not look at.

Mr. ROE. Well, it appears to me that we went from an older system, the so-called legacy system that you had, and we had 12—I mean, since 1997 all the audits were fine, and then we switched to this new system and all of a sudden there were all kinds of findings that didn't allow you to have a clean audit. So, I agree that something happened. And I think we need to know what that something is, whether, as the chairman said, whether it is personnel that are there and so on to clean this up. Because I don't—I am not implying there is any intent, I am just saying there is no way that you could say there is not, that something didn't happen when you don't have information there.

And Mr. Taylor, I appreciate you haven't been on board very long, so just a few months. How much did the DOL spend initially on the 2010 audit and how much will be spent cleaning up this; do you know?

Mr. LEWIS. The normal cost for a year is around $4 million. We have spent maybe $400,000 over that at this point because of the additional work that had to be done as a result of this. We are right now, as we sit here, negotiating with the firm in terms of what would be the additional cost to finish and what would be the additional cost if we actually reissued the statements and reissued the opinion in the middle of the year, which we wouldn't have to do.

Mr. ROE. And those costs were about the same for either system, the new automated system or the legacy system you were using?

Mr. LEWIS. Yes.

Mr. ROE. So the cost for auditing were about the same?

Mr. LEWIS. Yeah. The audit cost was comparable this year to previous years, had we not run into the problems we did.

Mr. ROE. And Mr. Taylor, when do you see this being—I know the chairman asked these questions—when do you see this being brought to fruition when we no longer will have this problem?

Mr. TAYLOR. Well, in terms of the problem themselves, many of them have already been resolved. The auditors simply have not had a chance to come in and reaudit the activity. So we are convinced that the operational issues that were identified in the audit report, they have been resolved. Day-to-day activities in the Department have better internal controls and are processing very smoothly.

In terms of getting the auditors to come in and read and look at our work and be able to look at the financial reports that we didn't give them the opportunity to do before, by the end of January.

Mr. ROE. The other question is, it is over now, but I would have thought when you switched to a new system you might want to parallel it the first year to make sure that they balanced up. I would have thought when you switched to an entirely new system you would have run your old along there at the same time. Have you thought of doing that?

Mr. TAYLOR. That comes up a lot. And in some IT systems that makes sense. But I have done this about 3 or 4 times now and never been involved in an activity where we ran parallel financial systems, because the financial systems are the systems of record. And in order to keep two systems operating at the same time for an extended period of time and keep them in sync is a very resource-intensive effort and it is really difficult to do successfully. In fact, part of the problems we have this year was the fact that because we delayed doing the implementation until January, that meant the first quarter was all on the old system. We did run parallel for the first quarter in trying to complete better training and do some other things to mitigate the problems going forward. And that posed a lot of problems for us that resulted in what you saw here with the disclaimer.

Mr. ROE. Thank you, Mr. Chairman. I yield back.

Chairman ANDREWS. I thank the gentleman from Tennessee. The chair recognizes the gentleman from Michigan, Mr. Kildee, for his questions for 5 minutes.

Mr. KILDEE. Thank you, Mr. Chairman. Mr. Lewis, why was a decision made to replace the old accounting system in the year in question? Was this an appropriate time to undertake such a complex task? And, maybe, also why has that not been replaced earlier?

Mr. LEWIS. Well, there had been other efforts to replace the system earlier that did not succeed for various reasons, lack of funding. But I think it was replaced because it was a very old system. Although it was functioning, I think it took more work to meet the demands of what is expected from an agency or entity, any entity today, in terms of having realtime financial information that the old system wasn't capable of providing. Although it could eventually comply with what needed to be done, it didn't really have the realtime capability to provide information. So I think that was an appropriate reason for replacing a system that had been around since the mid-1980s.

Mr. KILDEE. Mr. Taylor, you had been auditing in various agencies. Are there similar problems that you worry about in maybe some other agencies of government similar to the problems that we found here in the Department of Labor?

Mr. TAYLOR. Well, without having direct knowledge of other departments, I can tell you that what I have seen in my career is that whenever you try to replace a legacy system you run into similar problems. I have seen them before, experienced them before.

And in my prior job as deputy IG we were working with the Department of Homeland Security so that they could actually produce an integrated system. They are working on that at the same time on a much grander scale than the Department of Labor, but they have the same issues.

Mr. KILDEE. Thank you very much. Thank you, Mr. Chairman.

Chairman ANDREWS. I thank the gentleman. The chair is happy to recognize the gentlelady from Ohio, Ms. Fudge, for her questions for 5 minutes.

Ms. FUDGE. Thank you very much, Mr. Chairman. And thank you both. I certainly do thank both the chair and the ranking member for asking questions that everyday citizens would ask. I think it is very important. I happen to have served actually in every level of government from local, county, State, and now Federal. And with the exception of the Federal, I have dealt with these kinds of issues on a number of occasions. And I would say that 18 months really is very good, quite frankly, especially when you are dealing with an agency as large as the Department of Labor. And people who have been used to a system for very long, all of us know that most of us are resistant to change, and it is a very difficult process. Clearly, I would hope that as you look at the findings, that we would in fact have a clean or unqualified audit in the near future.

And I too am concerned about the fact that our auditor, KPMG, as large a company as it is, could not find one person to be here today. Certainly timing with us is an issue. It is an issue for us sitting here. But to have a company that size that has received these kinds of resources from the government, I would have to believe that some one person could have shown up today. Just in terms of a time frame—and the ranking member mentioned this to you as well—do you believe that you are 80 percent there, 60 percent there? If you could please, Mr. Taylor, or Mr. Lewis?

Mr. TAYLOR. Well, in terms of performing financial reporting on a day-to-day basis, we are there. We can do the financial reporting right now with the current—with the new system. In terms of providing the extracts, data extracts and the information that the auditors need to complete their work and the samples, I think we are just about there as well. And I think that by the end of January we will definitely be there.

Ms. FUDGE. So then you no longer have the problem of trying to transfer data from one system to another. You have complete information. All that you need to have right now to get this thing 100 percent operational and to be put in a position to either file a new report and/or get a clean audit, you are saying are there?

Mr. TAYLOR. If I could make a clear distinction. In terms of being operational, we are 100 percent operational. We are supporting the day-to-day activities of the Department as we speak. There is no grant, no contract, no personnel action that cannot be accomplished in the current system. In terms of providing all the information to the auditors that they require, I think we are pretty much there now, but I think that by the January time frame I think that we will have it all.

And there will always be issues that arise in any operation. But the idea when you are on the audit side, you look at materiality. And the question is, materially do you have any issues? And right now, materially, I don't think I do have any issues.

Ms. FUDGE. And my last question is, so you are the person that would be held responsible if in fact by the end of January this thing doesn't come out the way it should?

Mr. TAYLOR. If I cannot provide the information to the auditors by the end of January, yes, I am the one who is accountable for that.

Ms. FUDGE. Thank you so much, Mr. Chairman. I yield back.

Chairman ANDREWS. I thank the gentlelady. I would ask the ranking member if he has any concluding comments.

Mr. ROE. Just very briefly, again, I agree with Congresswoman Fudge that it would have been a lot better, I think, had the auditors been here. But you all have been very forthright and forthcoming. I think we will know by the end of January.

When will we be able to—in this subcommittee—be able to have that information when the auditors have looked, because I would like to know that this has been cleared up, that there are no findings. When can we expect to find that?

Mr. LEWIS. Well, of course, that will be dependent on exactly what the Department provides us and when they provide it. But probably within a couple of months after they have given us the final clean information and that there are no problems with it, that is probably the earliest we would see something.

Mr. TAYLOR. April time frame, assuming that we meet our schedule.

Mr. ROE. The subcommittee should be able to have findings of a clean audit when the auditors have looked at all the data that is there, issue a report on whether it is clear or not?

Mr. LEWIS. Correct.

Mr. ROE. Well, I appreciate you being here, and I thank you for your testimony.

Chairman ANDREWS. I thank my friend, I thank my colleagues, and especially thank the witnesses.

It occurs to me the committee then has three agenda items going forth from today.

Number one is we would encourage, Mr. Taylor, you and the Department to, as you are, expeditiously meet the deadline of providing the consolidated statements to the IG.

Number two, when the IG and its contractor have completed their thorough review of those statements, we would be eager to receive your conclusions in April or whenever that is.

And then number three, I think all members of the committee are interested in the more generic problem of how we can avoid this kind of delay in the future so that we never again have a situation, if we can avoid it, where the Labor Department or any other department is in a position where there is an inability to provide auditable and complete data by the deadline.

And we appreciate, Mr. Taylor, your efforts in solving this problem. Mr. Lewis, we appreciate you and your organization being very vigilant for the taxpayers and for those who depend upon the Department.

And, without objection, members will have 14 days to submit additional materials or questions of the hearing record.

[An additional submission of Mr. Andrews follows:]

U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210

NOV 15 2010

MEMORANDUM FOR: JAMES L. TAYLOR
Chief Financial Officer

Elliot P. Lewis

FROM: ELLIOT P. LEWIS
Assistant Inspector General
for Audit

SUBJECT: FY 2010 Independent Auditors' Report
Report Number: 22-11-002-13-001

Attached is the Independent Auditors' Report on the U.S. Department of Labor's (DOL) FY 2010 financial statements. We contracted with the independent certified public accounting firm of KPMG LLP (KPMG) to audit the financial statements of the DOL 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. KPMG's opinion on the FY 2009 DOL financial statements is unqualified. As stated in the report, the scope of KPMG's work was not sufficient to enable them to express an opinion on the FY 2010 DOL financial statements. 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

Significant Deficiencies

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*.

Working for America's Workforce

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 will report 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 this year's audit.

Attachment

cc: Karen Tekleberhan, Deputy Chief Financial Officer

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 sheet of the U.S. Department of Labor (DOL) as of September 30, 2009; the related consolidated statements of net cost and changes in net position, and combined statement of budgetary resources for the year then ended; and the statements of social insurance as of September 30, 2009, 2008, 2007, and 2006 (hereinafter referred to as "fiscal year [FY] 2009 consolidated financial statements"). Further, we were engaged to audit the accompanying consolidated balance sheet of DOL as of September 30, 2010; the related consolidated statements of net cost and changes in net position, and combined statement of budgetary resources for the year then ended; and the statement of social insurance as of September 30, 2010 (hereinafter referred to as "FY 2010 consolidated financial statements"). In connection with our FY 2010 engagement, we also considered DOL's internal control over financial reporting and DOL's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on the FY 2010 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 stated in our report 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, 2009; its net costs, changes in net position, and budgetary resources for the year then ended; and the financial condition of its social insurance program as of September 30, 2009, 2008, 2007, and 2006, in conformity with U.S. generally accepted accounting principles.

Also as stated in our report on the financial statements, the scope of our work was not sufficient to enable us to express an opinion on DOL's consolidated financial statements as of and for the year September 30, 2010.

As discussed in our report 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.

KPMG

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:

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 disclosed the following instance of noncompliance and two other matters that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

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

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.

Other deficiencies in internal control over financial reporting, potentially including additional material weaknesses and significant deficiencies, and other instances of noncompliance may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DOL's FY 2010 consolidated financial statements.

The following sections discuss our opinion on DOL's FY 2009 consolidated financial statements; the reasons why we are unable to express an opinion on DOL's FY 2010 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.

REPORT ON THE FINANCIAL STATEMENTS

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

KPMG

In our opinion, the FY 2009 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, 2009; its net costs, changes in net position, and budgetary resources for the year then ended; and the financial condition of its social insurance program as of September 30, 2009, 2008, 2007, and 2006, in conformity with U.S. generally accepted accounting principles.

We were engaged to audit the accompanying consolidated balance sheet of the U.S. Department of Labor as of September 30, 2010; the related consolidated statements of net cost and changes in net position, and the combined statement of budgetary resources for the year then ended; and the statement of social insurance as of September 30, 2010.

In January 2010, DOL implemented a new financial accounting and reporting system. As a result of the implementation, DOL encountered a significant number of data migration, posting, reconciliation, and reporting issues that hindered its ability to assure the accuracy and completeness of consolidated financial statement balances and to provide data necessary for audit testing.

Specifically, DOL was unable to provide sufficient evidential matter that supports certain balance sheet accounts including fund balance with Treasury, intra-governmental accounts receivable, accounts receivable, other-advances, intra-governmental accounts payable, accounts payable, accrued benefits, and the components of net position, as reported in the accompanying DOL consolidated balance sheet as of September 30, 2010. Certain of these issues also impact the statement of social insurance as of September 30, 2010.

DOL was also unable to provide sufficient evidential matter that supports gross cost and earned revenue reported in the consolidated statement of net cost for the year ended September 30, 2010; budgetary financing sources and other financing sources reported in the consolidated statement of changes in net position for the year ended September 30, 2010; and budgetary resources, status of budgetary resources, change in obligated balance, and net outlays reported in the combined statement of budgetary resources for the year ended September 30, 2010.

We were unable to obtain certain representations from DOL management regarding consistency with U.S. generally accepted accounting principles with respect to the presentation of the accompanying FY 2010 consolidated financial statements.

It was impracticable 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 conditions discussed in the four preceding paragraphs. Accordingly, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying consolidated financial statements of the U.S. Department of Labor as of and for the year ended September 30, 2010.

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 were unable to complete certain limited procedures over this information as prescribed by professional standards because of the limitations on the scope of our engagement described in the previous paragraphs of this section of our report. We did not audit this information and, accordingly, we express no opinion on it.

The information in the Secretary's Message 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 engagement, 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.

As discussed in our report on the financial statements, the scope of our work was not sufficient to enable us to express an opinion on DOL's consolidated financial statements as of and for the year ended September 30, 2010. Had we been able to perform all of the procedures necessary to express an opinion, other matters involving internal control over financial reporting may have been identified and reported.

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

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.

Other Matters. DOL is currently reviewing two incidents regarding potential violations of the *Anti-deficiency Act*. As of the date of this report, no final noncompliance determination has been made for either of the two incidents.

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

As discussed in our report on the financial statements, the scope of our work was not sufficient to enable us to express an opinion on DOL's consolidated financial statements as of and for the year ended September 30, 2010. Had we been able to perform all of the procedures necessary to express an opinion, other matters involving compliance with laws, regulations, contracts, and grant agreements may have been identified and reported.

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 are not in substantial compliance with FFMIA.

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. 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.

* * * * * * *

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. As discussed in our report on the financial statements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying consolidated financial statements of DOL as of and for the year ended September 30, 2010.

Regarding the FY 2009 consolidated financial statements presented herein, our responsibility is to express an opinion on the FY 2009 consolidated financial statements of DOL based on our audit. We conducted our FY 2009 audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 07-04, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit 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.

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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 audit provides a reasonable basis for our opinion on the FY 2009 consolidated financial statements.

In connection with our FY 2010 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 a basis for designing our auditing procedures. We did not test all controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our engagement was not to express 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. Further, other matters involving internal control over financial reporting may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DOL's consolidated financial statements as of and for the year ended September 30, 2010.

In connection with our FY 2010 engagement, 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 engagement and, accordingly, we do not express such an opinion. In addition, other matters involving compliance with laws, regulations, contracts, and grant agreements may have been identified and reported had we been able to perform all procedures necessary to express an opinion on DOL's consolidated financial statements as of and for the year ended September 30, 2010.

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 engagement is presented in Exhibits I, II, and III. 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

November 15, 2010

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 has been unable to fully address many of these implementation problems. 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. Although much progress had been made, DOL had not completed all necessary reconciliations as of 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. Further, 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 unable to materially reconcile the net differences that were identified in its fund balance with Treasury account as of 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 as of September 30, 2010.

The inability of DOL to complete reconciliations and resolve reconciling differences is 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.

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. 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. Further, 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. As of September 30, 2010, DOL had not resolved all errors related to intragovermental transactions because of competing priorities related to other implementation issues. As a result, DOL was unable to accurately classify and report its intragovernmental transactions and balances.

Accounting Resources: During our FY 2010 engagement, 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 engagement. 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. Further, 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 engagement, 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, 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 engagement – 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."

Because of the issues noted above, we consider the recommendations we made in FY 2009 **unresolved**. To close these recommendations and address the new control weaknesses identified during FY 2010, the Chief Financial Officer should (a) complete all necessary initial reconciliations of module and subsystem data to the NCFMS general ledger; (b) ensure that routine reconciliation controls are implemented and performed; (c) ensure that all necessary financial reports are developed and available to the agencies; (d) ensure that any remaining interface errors are promptly resolved; (e) fully document and implement all business processes and controls required for the accurate and timely operation of NCFMS; (f) promptly resolve the classification issues related to intragovernmental balances; (g) 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 a OCFO contractor, to ensure the work is being properly performed; (h) 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; (i) review significant transactions for USSGL compliance and make any necessary corrections; (j) 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 (k) 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. Several quality assurance steps were performed for year-end financial reporting, and we believe that many of the issues identified by the auditors will be fully resolved. For the recommendations not yet resolved, beginning in the first quarter of FY 2011 OCFO resources will be prioritized to focus on updating existing quality assurance documentation and to formally document NCFMS financial reporting processes. We anticipate these efforts will be completed by September 30, 2011.

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: We consider these recommendations **resolved and open**. 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.

DOL properly recognized a proprietary accounts receivable for amounts due to the FECA Special Benefit Fund and UTF from other Federal agencies for unreimbursed benefit payments. However, it did not record a corresponding budgetary accounts receivable for the earned portion of its FECA and UTF reimbursements that was payable with current budget authority of other Federal agencies. As a result, uncollected customer payments from Federal sources reported on the SBR were understated by approximately $1.5 billion 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 correct in the general ledger as of 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.

The first three items noted above were corrected as of September 30, 2010. We were unable to determine the status of the remaining items because the final FY 2010 SF-133s were not submitted as of our report date.

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 $40 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. As of the date of this report, the OCFO had not yet provided us a response. Additionally, we could not perform the same comparison as of September 30, 2010 because DOL did not submit the final FY 2010 SF-133s as of our report date.

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.

Because of the issues noted above, we consider the recommendations we made in FY 2009 **unresolved**. To close these recommendations and address the new control weaknesses identified during FY 2010, the Chief Financial Officer should ensure that (a) unresolved errors identified above are properly researched and resolved; (b) 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; (c) an evaluation is performed over FECA and UTF Federal receivables to determine the proper recording of the corresponding budgetary receivable in the general ledger; (d) individuals performing supervisory reviews are required to check the reconciliations for appropriate supporting documentation; (e) 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; (f) 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; (g) 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; (h) preparers of budgetary entries are properly trained and possess the technical accounting proficiencies needed to properly record the entries; (i) 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 (j) 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. We recently completed a comprehensive review of all budgetary accounts in preparation and support of the year-end FACTS II reporting process. 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, and our agencies are currently reviewing their respective SF-133 reports for accuracy and completeness.

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. As part of our FY 2011 operating plan, the OCFO will implement changes to ensure that quarterly reconciliations are carefully reviewed and approved, and that reviews include specific steps to confirm that adequate supporting documentation has been provided for all reconciliations performed.

In addition, a corrective action plan has been developed and implemented to address auditor findings regarding obligation validations and postings to NCFMS. 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 closing for FY 2010 was managed using a consolidated checklist based upon auditor recommendations.

Again, we acknowledge that 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 by OCFO and agency staff.

Auditor's Response: We consider these recommendations **resolved and open**. 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 engagement, 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 the new general ledger system that requires electronic approval by someone other than the preparer before journal entries are posted, we consider the recommendation we made in FY 2007 **resolved and closed**. In addition, the recommendations we made in FY 2006 through FY 2009 related to manual controls were **withdrawn and 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 concurs with the findings and recommendations noted above. To remediate current year findings pertaining to sufficient journal voucher supporting documentation and secondary monitoring procedures, management has developed a preliminary corrective action plan, to include milestone dates, which will be finalized by management in the first quarter of FY 2011. Management anticipates staff will begin executing this corrective action plan beginning in March, 2011.

Our corrective action plan includes performing a gap analysis to assess the adequacy of existing policies regarding journal voucher creation, approval, and supporting documentation requirements. We will then draft updates to existing policy to reflect changes due to implementation of NCFMS, such as developing posting logic for standard journal voucher templates and developing requirements to attach electronic supporting documentation for each journal voucher. Further, we will develop a mandatory training program for key stakeholders responsible for journal voucher creation and approval, and evaluate the current staff against required skill sets and competencies to ensure they can accomplish and sustain the new control activity.

However, 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: We consider these recommendations **resolved and open**. 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.

Based on these facts noted as part of our FY 2010 engagement, we consider the recommendations we made in FY 2009 **unresolved**. To close these recommendations, 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 with the issuance of Agency Dashboards planned for FY 2011 Q2; and

- Successful resolution 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. Therefore, these recommendations are considered **resolved and open**. 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."

Based on our FY 2010 audit results, we consider the recommendation we made in FY 2006 as **resolved and open.** To close this 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. We prepared a draft corrective action plan, which will enhance the reconciliation process through documentation, communication and monitoring of the procedure, the assigned staff and the controls.

To remediate current-year findings, management has designed and will implement a corrective action plan in order to perform all necessary payroll reconciliations, to include SF-224, Statement of Transactions, payroll reconciliation and the reconciliation of payroll expenses from NFC to information recorded in NCFMS. We anticipate staff will be available to execute on these corrective action plans beginning in January 2011.

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. As a result, OCFO management will initiate actions to revise the Payroll/Time and Attendance Reconciliation reports to reflect the necessary payroll-related information to conduct adequate reconciliations.

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: We consider these recommendations **resolved and open**. 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: We consider these recommendations **resolved and open**. FY 2011 audit procedures will determine whether these recommendations have been adequately addressed and can be considered closed.

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

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. Further, DOL did not complete and submit the results of its FMFIA assessment prior to its receipt of the draft FY 2010 internal control report. 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 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 (FFMIA) of 1996

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 are not in substantial compliance with FFMIA.

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 statement 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 1.

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.

Chairman ANDREWS. And, without objection, the hearing is adjourned.

[Whereupon, at 2:41 p.m., the subcommittee was adjourned.]

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