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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretary Of Labor

**First-Year Implementation ~~Of The~~
Federal Managers' Financial
Integrity Act ~~In The~~
Department ~~Of~~ Labor**

GAO conducted a review of 22 federal agencies' efforts to implement the Federal Managers' Financial Integrity Act of 1982. The act was intended to help reduce fraud, waste, and abuse across the spectrum of federal government operations through agencies' annual self-assessments of their internal controls and accounting systems.

This report highlights the progress made and problems encountered by Labor in its first year of experience with this new act. The report focuses on the evaluation of internal controls, reviews of accounting systems, and the actions being taken by Labor as a result of specific GAO proposals to improve the internal control process.



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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

HUMAN RESOURCES
DIVISION

B-202205

The Honorable Raymond J. Donovan
The Secretary of Labor

Dear Secretary Donovan:

This report presents the results of our review of the Department of Labor's efforts to implement and comply with the Federal Managers' Financial Integrity Act of 1982. Our review was part of a GAO assessment of 22 federal agencies' efforts to implement the act during the first year.

The act establishes a framework for improving the effectiveness of financial management in federal agencies. As you know, the act requires you to report annually to the President and the Congress on Labor's compliance with internal control standards prescribed by the Comptroller General. Compliance evaluations are to be performed in accordance with internal control guidelines issued by the Office of Management and Budget (OMB). The act also requires you to report on whether Labor's accounting systems conform to the principles and standards prescribed by the Comptroller General. OMB is currently developing government-wide guidelines for performing assessments of agency accounting systems.

The OMB guidelines provide a basic approach to evaluating, improving, and reporting on internal controls. OMB recommends the following process as an efficient, effective way to perform the required evaluations: (1) organizing the internal control evaluation process; (2) segmenting into units each agency's programs and administrative functions for evaluation (called "assessable units"); (3) conducting vulnerability assessments of each assessable unit to determine the risk of waste, loss, unauthorized use, or misappropriation; (4) reviewing internal controls; (5) taking corrective actions; and (6) reporting on the adequacy of internal controls and plans for corrective action.

Labor has made progress in complying with the requirements of the act. On December 19, 1983, you reported to the President and the Congress, fully describing the first year's implementation of the internal control process and adequately discussing the Department's material weaknesses and accounting system variances.

Further, your order of May 18, 1982, establishes a basis for evaluating and reporting on the status of internal controls. The order requires that an Internal Control Policy Board (the Board), comprised of top level management, be established and chaired by the Assistant Secretary for Administration and Management or his designee. The Board is responsible for providing policy direction and oversight for the internal control process. Your order also assigns responsibility for ensuring effective internal controls to each of the Department's organizational unit heads and requires them to report to you on their activities' and programs' compliance with internal control standards prescribed by the Comptroller General and the guidelines for evaluation of internal controls issued by OMB. Moreover, Labor's managers are being held accountable for ensuring effective internal controls through their annual performance plans which include responsibilities relating to internal controls.

However, some aspects of Labor's internal control and accounting systems evaluation process could be improved to provide for better and more comprehensive evaluations. We found that Labor's process for developing a department-wide inventory of assessable units did not ensure coverage of all activities in the vulnerability assessment process because explicit guidelines were not provided on how to develop such an inventory. The Board had no mechanism for ensuring that all assessable units were covered. In addition, the Board did not provide sufficient guidance for consistently applying assessment factors in determining the vulnerability of the various functions and did not adequately monitor the organizational units' compliance with their approved plans for conducting assessments. We also found that organizational units were not required to follow the department-wide guidelines which were similar to OMB's in performing internal control reviews. While the organizational units we reviewed developed guidelines for performing and documenting internal control reviews, the results showed that OMB's guidelines were not completely followed.

In addition, Labor's approach did not result in a comprehensive, structured evaluation of accounting systems compliance which includes assuring a complete inventory of accounting

systems and testing systems to provide reasonable assurance that all accounting system weaknesses were identified. However, your year-end letter reported that the Department's accounting systems, taken as a whole, generally comply with the principles, standards, and related requirements of the Comptroller General, with some variations. We believe this openness in discussing the systems' variations, along with plans to ultimately modernize its accounting systems, indicates Labor's intentions to fully implement the intent of this section of the act.

Accordingly, in a draft of this report we made the following specific proposals:

- Require development of more descriptive inventories of assessable units to better ensure complete department-wide coverage.
- Establish sufficient guidance for applying assessment factors during the vulnerability assessment process.
- Require the organizational units to follow guidelines which would meet OMB's objectives for conducting internal control reviews.
- Ensure adequate Internal Control Policy Board monitoring of organizational units' compliance with department-wide guidance and with their approved plans for conducting assessments.
- Establish a comprehensive approach and related policy and guidance for conducting full accounting systems compliance evaluations, including provisions for testing manual and automated procedures, processes, and controls and periodically validating the accounting systems inventory.

As Labor makes further progress in implementing the internal control and accounting systems evaluations to meet the act's objectives and in correcting known weaknesses, and as it implements our proposals, Labor should have a more meaningful basis for concluding whether its internal control and accounting systems meet the objectives of the act.

In commenting (April 4, 1984) on a draft of this report, Labor generally agreed with our findings, conclusions, and proposed corrective actions and indicated that it is taking

actions to address our concerns. Specifically, Labor acknowledged the need to develop a more refined inventory of assessable units and issued instructions to all units to prepare an internal control plan defining the assessable units and the methodology to be used in conducting vulnerability assessments. Also, in order to apply assessment factors on a more consistent basis, the Board decided to develop a standard assessment instrument for each function in the Department. In addition, the Department believes that current revisions in the assessment process and monitoring will provide better assurance that the assessment process is properly implemented and carried out in the units. Labor also agreed that the units should follow guidelines which meet OMB's objectives for conducting internal control reviews. Finally, Labor agreed that a comprehensive approach for conducting full accounting systems compliance evaluations was needed. Details on our findings and specific proposals and Labor's comments are contained in appendixes I and III, respectively.

Because of Labor's responsiveness to our specific proposals, we have not included any recommendations in this report, but we plan to monitor Labor's progress in these areas as part of our continuing reviews of federal agencies' implementation of the Financial Integrity Act. We are pleased with the assistance your officials provided and hope that this cooperative spirit can continue during future implementation of this important legislation.

Copies of this report are being sent to the Director of OMB, the Senate Committee on Governmental Affairs, the House Committee on Government Operations, selected congressional committees and subcommittees, and other interested parties.

Sincerely yours,



Richard L. Fogel
Director

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ABBREVIATIONS

ADP	automated data processing
GAO	General Accounting Office
OASAM	Office of the Assistant Secretary for Administration and Management
OIG	Office of the Inspector General
OMB	Office of Management and Budget

FIRST-YEAR IMPLEMENTATION OF THE FEDERAL MANAGERS'
FINANCIAL INTEGRITY ACT IN THE DEPARTMENT OF LABOR

INTRODUCTION

Responding to continuing disclosures of fraud, waste, and abuse across a wide spectrum of government operations, which were largely attributable to serious weaknesses in agencies' internal controls, the Congress in August 1982 enacted the Federal Managers' Financial Integrity Act, 31 U.S.C. 3512(b) and (c). The act was enacted for the purpose of strengthening the existing requirement of the Accounting and Auditing Act of 1950 that executive agencies establish and maintain systems of accounting and internal control in order to provide effective control over, and accountability for, all funds, property, and other assets for which the agency is responsible (31 U.S.C. 3512(a)(3)).

We believe that full implementation of the act will enable the heads of federal departments and agencies to identify their major internal control and accounting problems and improve controls essential to the development of an effective management control system and a sound financial management structure for their agencies. To achieve these ends, the act requires:

- Each agency to establish and maintain its internal accounting and administrative controls in accordance with the standards prescribed by the Comptroller General, so as to reasonably assure that: (1) obligations and costs comply with applicable law; (2) all funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures applicable to agency operations are recorded and properly accounted for.
- Each agency to evaluate and report annually on internal control systems. The report is to state whether agency systems of internal control comply with the objectives of internal controls set forth in the act and with the standards prescribed by the Comptroller General. The act also provides for agency reports to identify the material weaknesses involved and describe the plans for corrective action.
- Each agency to prepare a separate report on whether the agency's accounting systems conform to principles, standards, and related requirements prescribed by the Comptroller General.

- The Office of Management and Budget (OMB) to issue guidelines for federal departments and agencies to use in evaluating their internal accounting and administrative control systems. These guidelines were issued in December 1982.
- The Comptroller General to prescribe standards for federal agencies' internal accounting and administrative control systems. The Comptroller General issued these standards in June 1983.

This report on the Department of Labor is 1 of 22 reports on federal agencies' efforts to implement the act during the first year.

Labor's purpose is to foster, promote, and develop the welfare of U.S. wage earners, to improve their working conditions, and to advance their opportunities for profitable employment. To accomplish its objectives during fiscal year 1983, the Department employed about 19,000 people and had a budget authority totaling about \$36 billion.

OVERVIEW OF LABOR'S FIRST-YEAR EFFORT TO IMPLEMENT THE ACT

Labor has taken steps to implement its internal control evaluation program and is making progress in identifying weaknesses in and improving internal controls. Labor began its internal control improvement in response to OMB Circular A-123, which was issued in October 1981. Many of the Department's policies and procedures for its internal control programs were based on draft OMB guidelines which were revised before being formally issued in December 1982. Although there are minor differences between Labor's policies and procedures and OMB's guidelines, the phases of the Department's internal control evaluation process generally parallel those set forth in OMB's guidelines.

The OMB guidelines provide a basic approach to evaluating, improving, and reporting on internal controls. OMB recommends the following process as an efficient, effective way to perform the required evaluations: (1) organizing the internal control evaluation process; (2) segmenting into units each agency's programs and administrative functions for evaluation (called "assessable units"); (3) conducting vulnerability assessments to determine the risk of waste, loss, unauthorized use or misappropriation of funds, property, or other assets; (4) reviewing internal controls; (5) taking corrective actions; and

(6) reporting on the adequacy of internal controls and plans for corrective action.

Labor generally employed a decentralized approach to implementing the act. The Department was segmented into organizational units whose heads were assigned responsibilities for evaluating, improving, and reporting on the status of internal controls. The following describes Labor's approach to accomplishing the internal control process suggested in OMB's guidelines.

Organizing the process

On May 18, 1982, the Secretary of Labor issued an order to ensure that internal controls are incorporated in administering all departmental programs and administrative activities. It also outlined Labor's approach to addressing OMB Circular A-123. The Assistant Secretary for Administration and Management was assigned responsibility for executing provisions of the order, and heads of the organizational units were assigned responsibility for planning and implementing the internal control effort. The Department is requiring that individual managers' fiscal year 1984 performance plans include responsibilities relating to internal controls.

The Secretary's order also requires that an Internal Control Policy Board (the Board), comprised of top level management, be established and chaired by the Assistant Secretary for Administration and Management or his designee. The Board is responsible for providing policy direction and oversight for the internal control process. The Board is also responsible for providing for guidance, technical assistance, and training to the organizational units. The Office of Financial Policy and Systems within the Office of the Assistant Secretary for Administration and Management (OASAM) provides part-time staff for the Board. Labor has not designated a full-time department-wide internal control officer.

The Office of Inspector General (OIG) issued a statement in September 1983 formalizing its role in the internal control process and recognizing management's primary responsibility in that process. It sets forth the following objectives for the OIG: (1) to serve as a partner with management (training and technical assistance) and (2) to provide an independent quality assurance function.

Segmenting the department

Labor segmented into 13 organizational units. These units were the Department's component agencies (such as the Employment and Training Administration), major offices (such as the Office of the Solicitor), and one unit called departmental management. This last unit was comprised of smaller components, such as the Office of the Secretary.

The units developed their own approaches to conducting the internal control evaluation process under broad guidance from the Board. Labor had no standard definition of assessable unit, so each unit developed its own definition and inventory of units. The Department did not develop an overall inventory of assessable units.

Vulnerability assessments

The Board organized the Department's functions subject to vulnerability assessment into two groups--administrative functions common to all organizational units (payroll, time and attendance, etc.) and programmatic functions specific to the various Labor units. The seven common administrative functions were assessed department-wide using standardized assessment instruments. These completed instruments represent nearly all the documentation of the results of these assessments.

The Board did not issue standard assessment instruments for the 13 organizational units to follow in conducting vulnerability assessments of program-specific functions. Rather, it issued a policy statement which required each unit to submit an assessment plan for approval and specified the evaluation factors which had to be included to meet the Board's minimum requirements. The Board also required that the units consider 10 standard program functions in identifying operations which would be subject to assessment. Some degree of quality assurance was provided by a preapproval review of the plans by the Board staff.

Labor provided some formal training related to performing vulnerability assessments in the organizational units we reviewed. The training consisted of a discussion of the vulnerability assessment plan and how it related to the assessor's area of responsibility. The Department provided more complete training, covering the entire internal control process, to the officials appointed by the heads of the organizational units to manage the internal control process (internal control officers).

According to Labor officials, persons involved in managing the functions being assessed performed the vulnerability assessments. These managers were generally division or branch chiefs with considerable knowledge of the program or administrative function being assessed. In other cases, assessments were conducted by personnel familiar with the program or function being assessed. Some of these managers indicated a knowledge of internal controls and internal control techniques stemming from their management experience. The OIG, Office of the Comptroller, and other financial management personnel did not perform vulnerability assessments of programs and functions other than those for which they were directly responsible.

The results of the vulnerability assessments were compiled and forwarded to the Board staff for review.

Internal control reviews

Labor contracted with a certified public accounting firm to develop an internal control review guide and to conduct training sessions on performing reviews. However, the Department did not require use of this guide or any guidelines for conducting internal control reviews.

The Board outlined the basic requirements for planning and scheduling internal control reviews, but delegated much of the responsibility for designing and implementing the reviews to the units. In May 1983, the Department Comptroller requested Labor's internal control officers to review their vulnerability assessments and determine which functions required comprehensive reviews and which had internal control weaknesses that could be corrected without further review. The internal control officers were also required to submit action plans to the Board indicating timetables and the names of the officials responsible for each review and corrective action. Eleven of the 13 units submitted plans by July 1983.

Although all the unit plans were reviewed and approved by the Board staff, the units took different approaches toward identifying and implementing reviews. Not all internal control reviews were undertaken solely on the basis of vulnerability assessment results. Some units considered OIG reports, hotline complaints, and general knowledge of the function or program in their decision to conduct a review. Twenty-three internal control reviews were completed as of September 30, 1983.

The internal control reviewers in the organizational units we reviewed were either senior program managers or members of

the units' internal control groups. The results of their reviews were addressed to the managers responsible for implementing corrective actions.

Follow-up systems

Labor is still developing a formal tracking and follow-up system which will have the capability of effectively and systematically monitoring the internal control process. The Department's OIG and its Office of the Comptroller currently have systems which track problems identified in OIG reports, GAO reports, and management analyses staff reports. The OIG is currently updating its tracking system to make it compatible with its new automated follow-up system. The OIG is planning to include problems identified in the internal control process in the new follow-up system. Until the new follow-up system is implemented, problems identified in the internal control process will be tracked by the organizational units, mostly by manual means.

Year-end report

Labor's December 19, 1983, report to the President and the Congress fully described the implementation of the internal control process during the first year and adequately discussed areas of departmental concern. Some examples of material weaknesses cited in the report include (see app. II for all material weaknesses and accounting system variances):

- the Department's automated data processing (ADP) management is deficient in several areas,
- the monitoring of cash advances to grantees and third-party deliverers was inadequate to assure that balances in their possession were not excessive, and
- the Department has no quality control system for annually assessing a state agency's performance in managing its unemployment insurance program.

The OIG reviewed and concurred with the Secretary's year-end report as a means of indicating agreement with the report's accuracy and completeness.

Each organizational unit was required to provide a letter to the Secretary summarizing the first-year internal control evaluation process and its results. These unit letters were consolidated by Board staff into the comprehensive year-end

report. The report provided a foundation for improving internal controls in that it described actions Labor plans to take to correct the material weaknesses identified.

Accounting systems compliance

The Secretary's year-end letter of December 19, 1983, reported that the Department's accounting systems, taken as a whole, generally comply with the principles, standards, and related requirements of the Comptroller General, with some variations. These variations, plans for addressing them, and plans for eventual modernization of the Department's accounting systems are covered in general terms in an attachment to the letter. The system modernization or revision projects are being monitored in detail through existing mechanisms, such as the OASAM management-by-objective program.

The Department's conclusion regarding system compliance was based on information contained in the year-end assurance letters from the head of each organizational unit to the Secretary. The bases for the units' letters varied since Labor did not require that a particular approach or methodology be followed to support conclusions on system conformance. OASAM reported on the department-wide Integrated Accounting System, and the other units reported on their program accounting systems, if any.

Although Labor, as of February 1984, had not developed a formal comprehensive approach which would provide reasonable assurance that all deviations from accounting principles and standards are identified, it was open in disclosing the variations which were reported by the units. We believe this openness, along with plans to ultimately modernize its accounting systems, indicates Labor's intentions to fully implement the intent of this section of the act.

Efforts to consider ADP

The Board required that certain aspects of ADP be considered from a programmatic perspective in unit vulnerability assessment plans. The organizational units we reviewed chose varying approaches to ADP assessment. One unit provided questions for assessors to use in reviewing selected ADP general controls relating to matters such as security, privacy, and cost effectiveness, but these questions did not cover all of the aspects required to be considered. For example, these questions did not address documentation and maintenance of systems or software control. Another unit's reviewers provided

comments explaining the basis for the two ADP assessments of general controls that were undertaken. The two other units we reviewed simply included "ADP" or "automated" in their standard vulnerability assessment form. Neither of these units' assessments included any written comment or explanation of their numerical rating.¹

For a department-wide assessment, Labor decided to use a 1983 OIG report on its ADP management. As stated in its year-end report, the Department recognizes deficiencies in the following four ADP areas: (1) policies, procedures, and standards; (2) the structure for oversight, direction, and planning; (3) inventories; and (4) security. A follow-up OIG review will be used for department-wide internal control review purposes in an attempt to begin correcting ADP internal control problems.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our review was to evaluate Labor's progress in implementing the Financial Integrity Act and reporting on the status of the Department's internal control and accounting systems. Because our first-year review was limited to an evaluation of the implementation process, we did not independently determine the status of Labor's internal control systems or the extent to which Labor's accounting systems comply with the Comptroller General's principles and standards.

Our audit work was conducted from July through December 1983. Work was performed at Labor headquarters and its Philadelphia and Atlanta regional offices. We also visited three mine safety field locations and one field location which administers federal employee compensation programs. In addition, we met with OMB officials to discuss their monitoring of Labor's implementation of the act and to review related documentation.

We focused our efforts primarily on the following units:

1. Employment Standards Administration,
2. Employment and Training Administration,
3. Mine Safety and Health Administration, and

¹The reviews by the four units did not assess ADP application controls, and ADP general controls were only partially assessed.

4. Office of the Assistant Secretary for Administration and Management.

These units were selected because collectively they (1) represented about 99 percent of the estimated budget authority for fiscal year 1983, (2) performed about 88 percent of the vulnerability assessments, and (3) accounted for over half of the internal control reviews scheduled. The Philadelphia and Atlanta regional offices were selected because Labor officials told us that these offices carried out most of the programs for which the headquarters units we reviewed were responsible. Emphasis was placed on OASAM activities also because the Secretary of Labor designated this office as the focal point for accumulating and preparing the information needed to meet the act's reporting requirements.

We initially met with Labor officials assigned responsibility for ensuring overall Department accomplishment of reporting under the act. At this level we determined the rationale for, and obtained documentation related to, Labor's approach to organizing and segmenting the agency for the purposes of conducting vulnerability assessments and internal control reviews. We also analyzed documents prepared by each organizational unit in support of its methodology for conducting vulnerability assessments and internal control reviews, with particular attention to determining whether all departmental functions were considered in the assessment process.

Our audit work at each of the four units selected for detailed review included:

- interviewing the highest level official assigned responsibility for managing and ensuring completion of internal control activities;
- obtaining and analyzing documentation related to the processes (particularly vulnerability assessments and internal control reviews);
- interviewing officials who performed vulnerability assessments and internal control reviews;
- interviewing officials assigned responsibilities for assessing ADP functions both department-wide and within each unit, and accounting systems for purposes of meeting the act's accounting systems reporting requirements; and

--assessing information, statistics, and content of the input to the Secretary of Labor's year-end report relative to fulfilling the act.

We interviewed 19 officials who conducted vulnerability assessments. Labor records did not indicate how many officials were involved with conducting its vulnerability assessments. We reviewed 12 of the 23 internal control reviews which were completed by September 30, 1983, and interviewed nine officials who conducted or directed those reviews. We selected all seven of the reviews completed by September 30, 1983, in three of the four units and judgmentally selected five out of eight reviews in the fourth unit.

We performed our work in accordance with generally accepted government auditing standards.

ENHANCEMENTS NEEDED IN SUBSEQUENT YEARS'
EFFORTS TO EVALUATE AND IMPROVE
INTERNAL CONTROLS

Labor has made progress in making the required evaluation of its system of internal accounting and administrative control. The Department has taken corrective actions and plans to apply many of the lessons learned during the first year to future internal control efforts. However, some improvements are needed which, if undertaken, would make the results more meaningful. The following sections include our findings and proposed corrective actions.

Refining the segmentation process
could enhance results

The OMB guidelines require segmenting and identification of assessable units. The basic goal of dividing the agency into components, programs, and administrative functions is to develop a department-wide inventory of assessable units covering all the Department's activities and functions, each of which can be the subject of a vulnerability assessment. Labor did not develop a process which would ensure a complete inventory of assessable units.

The Board delegated most internal control process responsibilities to the organizational units and did not provide them with explicit guidelines on how to develop an inventory of assessable units. Instead, the units were given very broad guidance from the Board. While devising its plan, each unit developed its definition of an assessable unit.

In developing the inventory of what was to be assessed, each unit considered some or all of the following four factors: organizational subdivisions, functions, programs, and geographic locations. Varying coverage of these factors in the assessment process made it difficult to determine whether all functions within the organizational units were adequately covered.

The Board required the organizational units to identify and report to it such functions as cash or debt collection which were to be assessed, but it did not require an explanation of how these functions would be covered in each of the organization's assessable units. For example, one unit considered and reported each subunit's functions as separate assessments, while other units combined several completed assessments relative to the same function into one assessment. In this latter case it would be difficult to determine whether all activities were included in the assessment. In any case the Board did not determine whether all functions and activities were covered. Consequently, the Board had little assurance that all areas of potentially high vulnerability were identified.

In a draft of this report we proposed that the Secretary require each organizational unit to submit to the Board an inventory of assessable units that includes a description of how each organizational subdivision, program, function, and geographic location is covered and that the Board review these inventories to ensure that the segmenting methods used have resulted in complete coverage of the Department.

In its comments dated April 4, 1984 (see app. III), Labor concurred with our proposal. The Department agreed that it needs to develop a more refined inventory of assessable units and is taking action to ensure such an inventory. In fact, the Board recently issued instructions to all units to prepare an internal control plan defining the assessable units and the methodology to be used by the unit in conducting its vulnerability assessments. However, Labor does not believe that it overlooked a significant function during the previous round of assessments.

Improvements in the vulnerability assessment process could produce more consistent and usable department-wide results

The OMB guidelines issued in December 1982 state that the vulnerability assessment process consists of analyses of (1) general control environment, (2) risk inherent in the activity, and (3) existing safeguards against loss. Labor attempted to follow this guidance, which was in draft form at the time the Department conducted its assessments, using the decentralized approach previously discussed.

Labor segmented into 13 organizational units, each of which was required to submit a vulnerability assessment plan. The Board mandated that all plans address the three OMB-required analyses. While the Board distributed some guidance in the form of a sample vulnerability assessment plan and another agency's contractor-developed assessment process guide, our work showed several shortcomings in department-wide guidance.

No standard requirements for applying the assessment factors were established. The instructions supplied with the assessment instruments were not specific enough to preclude varying interpretations. For example, in determining the degree of vulnerability for a function's "audit situation," a factor in the inherent risk analysis, an assessor must consider whether (1) it had been audited recently, (2) it had not been audited recently, or (3) audits are outside the manager's control and therefore always an area of vulnerability. We found that one organizational unit rated its functions highly vulnerable because of reason 3, whereas if reasons 1 or 2 applied, the function could have been rated low or moderately vulnerable. Another unit rated its functions highly vulnerable because of reason 2, whereas if reasons 1 or 3 applied, the function could have been rated low or moderately vulnerable. We believe there needs to be a consistent basis for applying these factors to ensure that results are comparable department-wide.

Another problem is staff support to the Board. No full-time staff were assigned to the Board for monitoring organizational units' compliance with approved plans. The Board used temporary staff on detail from other Labor offices to complete major projects and, for the most part, only one individual spent part of his time supporting the Board's efforts at monitoring the implementation of the act and OMB guidelines. We found that one of the four organizational units we reviewed did

not follow its approved vulnerability assessment plan. This unit, which accounted for over 50 percent of the assessments reported to the Board, did not report its assessment results in the form approved by the Board. We believe that with better monitoring this problem could have been detected and resolved.

In a draft of this report, we proposed that the Secretary of Labor clarify guidance for applying assessment factors so they are applied consistently throughout the Department. In addition, we proposed that the Secretary of Labor improve Board monitoring of the assessment process.

In its comments, the Department concurred with our proposal that assessment factors should be applied on a more consistent basis. In fact, the Board recently decided to develop standard assessment instruments for each function in the Department. The Department also believes that current revisions in the assessment process and monitoring will provide better assurance to the Board that the assessment process is properly implemented and carried out in the units.

Internal control reviews could provide more information for evaluating overall status of Labor's internal control systems

OMB guidelines suggested the following six-phase approach for conducting internal control reviews.

- Identifying the event cycles.
- Analyzing the general control environment.
- Documenting the event cycle.
- Evaluating the internal controls within the event cycle.
- Testing the internal controls.
- Reporting the results.

The Secretary's May 18, 1982, order directed the Board to prescribe standards for the reviews which Labor's organizational units would be conducting. However, as previously mentioned on page 5, Labor developed guidelines which generally followed OMB's but did not require organizational units to follow them in identifying, performing, and reporting on

internal control reviews. Instead, the Board permitted each organizational unit to develop its approach to conducting internal control reviews.

To provide for more meaningful assurance on the status of internal controls, the units should consistently follow guidelines which include a phased approach similar to the one recommended by OMB. We examined 12 of the 23 internal control reviews completed as of September 30, 1983, and the chart below indicates the number that followed the six OMB-suggested review phases.

<u>Internal control review phase</u>	<u>Essentially followed</u>	<u>Not followed</u>
Identify event cycles	5	7
Analyze general control environment	0	12
Document event cycles	4	8
Evaluate internal controls	11	1
Test internal controls	7	5
Report results	11	1

Of the four units we reviewed, two allowed their analysts to perform their reviews without having unit-wide guidelines. The third unit performed two kinds of reviews--preliminary reviews which followed unit-wide guidelines, and one review that generally followed OMB guidelines. The fourth unit had not completed any reviews by September 30, 1983.

In a draft of this report, we proposed that the Secretary of Labor require the organizational units to follow guidelines which would meet OMB's objectives for conducting internal control reviews.

The Department concurred with our proposal and stated that it is departmental policy that full-scale internal control reviews be conducted in a manner which would meet the OMB objectives. However, the Department did not indicate how it would ensure compliance with this policy. We suggest, therefore, that Labor include monitoring of the units' internal control reviews as part of the Board's responsibility.

IMPROVEMENTS NEEDED IN EFFORTS TO
ASSESS COMPLIANCE WITH ACCOUNTING
PRINCIPLES AND STANDARDS

The section of the act which deals with accounting system compliance requires the head of each executive agency to report annually to the President and the Congress on whether the agency's accounting system conforms to the principles, standards, and related requirements prescribed by the Comptroller General.

We believe that these reports should be based on formal, comprehensive, structured evaluations of the compliance of accounting systems. Since the reports address operational accounting systems, it is critical that all operating systems be included in the inventory of systems to be reviewed and that systems be tested to determine if manual and automated procedures, processes, and controls are operating as intended. We believe a structured approach, which includes inventorying and testing systems, is essential to providing reasonable assurance that all system variances are identified.

During the first year, this section of the act received less of Labor's attention than the act's other requirements, in terms of developing a formalized comprehensive approach to provide a basis for the Secretary's year-end report. Labor's emphasis on the act's other internal control aspects was understandable because work was already underway to address OMB Circular A-123 requirements which closely parallel those of the act. In addition, OMB issued guidelines for agencies to follow in evaluating, improving, and reporting on internal controls as required by the act. Labor, therefore, did not develop a comprehensive approach to determine if its accounting systems operate in compliance with the Comptroller General's principles and standards. Rather, units' letters, which provided the basis for the Secretary's report, were developed from information that was readily available, such as staff knowledge of system operations or information previously developed during other studies.

Although certain initial steps have been taken toward implementation of the act's accounting system requirements, we believe that Labor needs to consider additional steps in preparing for future years. The following discusses some suggestions for improving future efforts.

At a September 1983 OMB meeting of agency representatives on implementation of the accounting system compliance section

of the act, the Comptroller General cited the need for developing an inventory of accounting systems as a building block toward full implementation of this section of the act. Labor has had an inventory of its accounting systems for several years. Labor's systems were approved by GAO in the early 1970s. According to Labor officials, the designs have not materially changed. However, systems are dynamic and inventories should periodically be examined for completeness. Thus, we believe Labor should validate its longstanding inventory of accounting systems to ensure that it reflects all of the Department's operations, procedures, and processes. In this regard, the Comptroller General's April 18, 1983, memorandum to heads of departments and agencies includes the definition of an accounting system. A validation effort would better ensure that everything which should be considered when reporting under the act has been identified.

Two organizational units reported on accounting systems in their assurance letters to the Secretary but did not have systems included on the Department's inventory. While this could reflect differing interpretations of what is considered to be part of Labor's Integrated Accounting System, it could also reflect new systems or systems which were omitted from the inventory. We believe the validation effort should be done by one organizational unit to ensure consistent application of the Comptroller General's accounting system definition throughout the Department, as well as consistent application of what is included in the Integrated Accounting System. Such an effort would identify for the organizational units what they are expected to report on in their year-end assurance letters. It would also provide reviewers of the units' letters a list of what should have been evaluated and reported upon and thus a means to measure comprehensiveness of coverage.

According to an attachment to the Secretary's year-end report, a thorough analysis of all accounting systems is planned in fiscal year 1984. Inventory validation could be incorporated into this analysis.

The Department requires that organizational units' year-end assurance letters include a statement on accounting system compliance, or a negative report when units have no system to report upon. In addition, although not required under the act, the letters were to describe exceptions to the Comptroller General's principles and standards, their significance, and plans for corrective action. We support these Labor requirements, particularly the latter as it allows for a central compilation of known variations. We suggest that the letters also identify

the individual systems covered by the report and include information on the scope and methodology of units' efforts to evaluate system compliance. Further, we suggest that a policy be developed and guidance provided on what constitutes adequate documentation of compliance evaluations.

Some of the policies and mechanisms which Labor has developed to comply with the internal control requirements of the act appear to be appropriate for addressing the act's accounting system requirements. While some of these have been informally adopted, we believe they should be promulgated department-wide and suggest that adoption of others be considered. For example, the accounting system compliance portion of the Secretary's report was handled by the Board even though the authority and responsibility for this was not formally delegated to the Board. We believe, therefore, that the Secretary's order establishing the Board should be amended accordingly. We also believe that the units should be required to submit plans for conducting accounting system evaluations for the Board's review and approval similar to the plans required for vulnerability assessments and internal control reviews.

The preceding suggestions point to the need for a comprehensive, structured approach to evaluating compliance of accounting systems with the Comptroller General's principles and standards. We believe that such an approach, including tests and validations of the inventory of accounting systems, is essential to providing the Department with reasonable assurance that all accounting system variances and weaknesses are identified.

In our draft report, we proposed that the Secretary of Labor require the development of a comprehensive approach and related policy and guidance for conducting full accounting system compliance evaluations, including provision for testing manual and automated procedures, processes, and controls and periodically validating the accounting systems inventory.

The Department concurred with our proposal. However, it pointed out that the absence of GAO or OMB guidance on complying with the accounting system compliance section of the act (section 4) contributed greatly to the Department's proceeding in reviewing its accounting systems without a formalized structure. Labor believes that, even without the formalized structure, all significant variances from the Comptroller General's principles and standards were contained in the Secretary's year-end report. The Department agreed that a more

formalized structure is necessary; however, until specific guidance is received, it believes establishment of a formalized structure would be premature. It is in the process of developing a more formalized interim process for evaluating accounting systems pending issuance of final guidance.

Under section 4 of the act, there is no requirement for either GAO or OMB to issue guidance on how to evaluate agency accounting systems to determine whether they comply with the Comptroller General's principles and standards. OMB has, however, assumed the responsibility to issue such guidelines and has consulted with us on their development. Issuance of the final guidelines, according to OMB, will be in the near future.

DEPARTMENT-WIDE MATERIAL WEAKNESSES AND ACCOUNTING
SYSTEM VARIANCES REQUIRING FURTHER CORRECTIVE
ACTIONS AS SHOWN IN LABOR'S DECEMBER 19, 1983,
REPORT TO THE PRESIDENT AND THE CONGRESS¹

ADMINISTRATIVE CONTROL WEAKNESSES

1. The Department's ADP management is deficient in the following four areas: ADP policies, procedures, and standards; the structure for ADP oversight, direction, and planning; ADP inventories; and ADP security. Additionally, some computer programs lack sufficient "key controls" to maintain their integrity.
2. Rules and regulations necessary for full implementation of the Debt Collection Act of 1982 have not been promulgated by the Department.
3. The procurement environment in which the Department operates has become increasingly complex. This has required greater management attention to fundamental policy and planning issues. The Department's concentration of effort in establishing a more effective management framework for carrying out new procurement policies may have resulted in deviations from these new policies. Potential problems include: less than optimal levels of competition, lack of assurance that all goods and services are fully received, insufficient contracting officer training, and lack of effective procurement planning. Additionally, some aspects of the recordkeeping and reports, e.g., Federal Procurement Data System, may not be fully accurate.
4. Documentation of the Department's system of internal control does not meet GAO's Standards for Internal Control in the Federal Government issued June 1, 1983. These standards require that documentation identify all control objectives and the specific techniques to achieve these objectives. The Department's documentation does not reach this level of specificity for all of its controls.

¹In an attachment to the report, Labor cited its plans and schedules for correcting these material weaknesses and accounting system variances.

5. There is no quality control system on which to assess on an annual basis a state agency's performance in managing its Unemployment Insurance Program. A quality control system would measure error rates and identify causes of error and corrective actions needed to improve management.
6. Controls in the Black Lung Program and in the administration of the Federal Employees Compensation Act must be modified to reasonably assure that payments to medical providers are accurate and timely; that medical providers engaging in illegal activities are debarred; that information on recipients' medical status and earnings is current; and that charges by providers for medical services rendered are reasonable.
7. Procedures for accounting for government property in the possession of grantees are inadequate to maintain an accurate inventory.

ACCOUNTING SYSTEM VARIANCES
FROM GAO PRINCIPLES, STANDARDS,
AND RELATED REQUIREMENTS

1. The department-wide Integrated Accounting System is 14 years old. The system's documentation has not been kept fully current and needs to be comprehensively updated. The Integrated Accounting System ADP software does not operate efficiently and requires modernization. User documentation is out of date and does not always reflect the current operating systems and their uses.
2. While management reporting from the Integrated Accounting System is reasonably adequate and timely, a revised Management Information System using the latest ADP technology and applications would greatly improve the system's capability to serve today's management needs and provide flexibility to meet new and changing requirements.
3. The accounts receivable capabilities in the Integrated Accounting System are inadequate to manage the new responsibilities of the Department to administer the provisions of the Debt Collection Act of 1982.
4. The Working Capital Fund was designed to operate on a cost basis, as outlined in the GAO-approved system, but is not being managed on that basis. Provisions in the system for depreciation of equipment and replacement reserves are generally not used.

5. The Department's property management system needs improvements in the following areas: standardizing capitalization and reporting criteria, standardizing and modernizing of automated systems, providing more timely management reports, more effective controlling and inventorying of excess property, improving controls on newly acquired property and leased equipment, and improving financial reconciliation with the accounting system.

U.S. Department of Labor

Office of the Assistant Secretary
for Administration and Management
Washington, D.C. 20210



APR 4 1984

Mr. Richard L. Fogel
Director
Human Resources Division
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. Fogel:

In reply to your letter to the Secretary of Labor requesting comments on the draft GAO report entitled "First Year Implementation of the Federal Managers' Financial Integrity Act in the Department of Labor," the Department's response is enclosed.

The Department appreciates the opportunity to comment on this report.

Sincerely,

A handwritten signature in black ink that reads "Thomas C. Komarek".

THOMAS C. KOMAREK
Assistant Secretary for
Administration and Management

Enclosure

U. S. Department of Labor's Response To
The Draft General Accounting Office Report
Entitled --

"First Year Implementation Of The Federal
Managers' Financial Integrity Act In The
Department of Labor."

Recommendation: The Secretary of Labor require each organizational unit to submit to the Internal Control Policy Board an inventory of assessable units that includes a description of how each organizational subdivision, program, function, and geographical location is covered, and that the Board review these inventories to ensure that the segmenting methods used has resulted in complete coverage of the Department.

Response: The Department concurs.

Comments: The Department agrees that there is a need to develop a more refined inventory of assessable units. In fact, on February 21, 1984, the Board issued instructions to all agencies to prepare an internal control plan defining the assessable units, and the methodology to be used by the agency in conducting its vulnerability assessments, including how all functions and locations in the agencies will be covered. This memorandum was discussed in detail with the agencies' internal control officers on February 28, 1984. Finally, while all concur that there is a need to develop a more refined inventory of assessments, we do not believe that there was a significant function overlooked during the previous round of assessments.

Recommendation: The Secretary of Labor clarify guidance for applying assessment factors so they are applied consistently throughout the Department. In addition, the Secretary of Labor should improve Board monitoring of the assessment process.

Response: The Department concurs.

Comments: The Department agrees that assessment factors should be applied on a more consistent basis. This was recognized by the agency internal control officers at their February 28, 1984, meeting. This was one of the concerns which led to the Board's recent decision to develop standard assessment instruments for each function in the Department. With respect to the Board's improving its monitoring of the assessment process, current revisions in our process and monitoring will provide better assurance to the Board that the assessment process is properly

implemented and carried out in the agencies. These revisions include the implementation in each agency of a quality assurance process for vulnerability assessments, the implementation of our automated tracking system, quarterly status reports to the Board, and the Office of Inspector General's reviews and audits.

Recommendation: The Secretary of Labor require the organizational units to follow guidelines which would meet OMB's objectives for conducting internal control reviews.

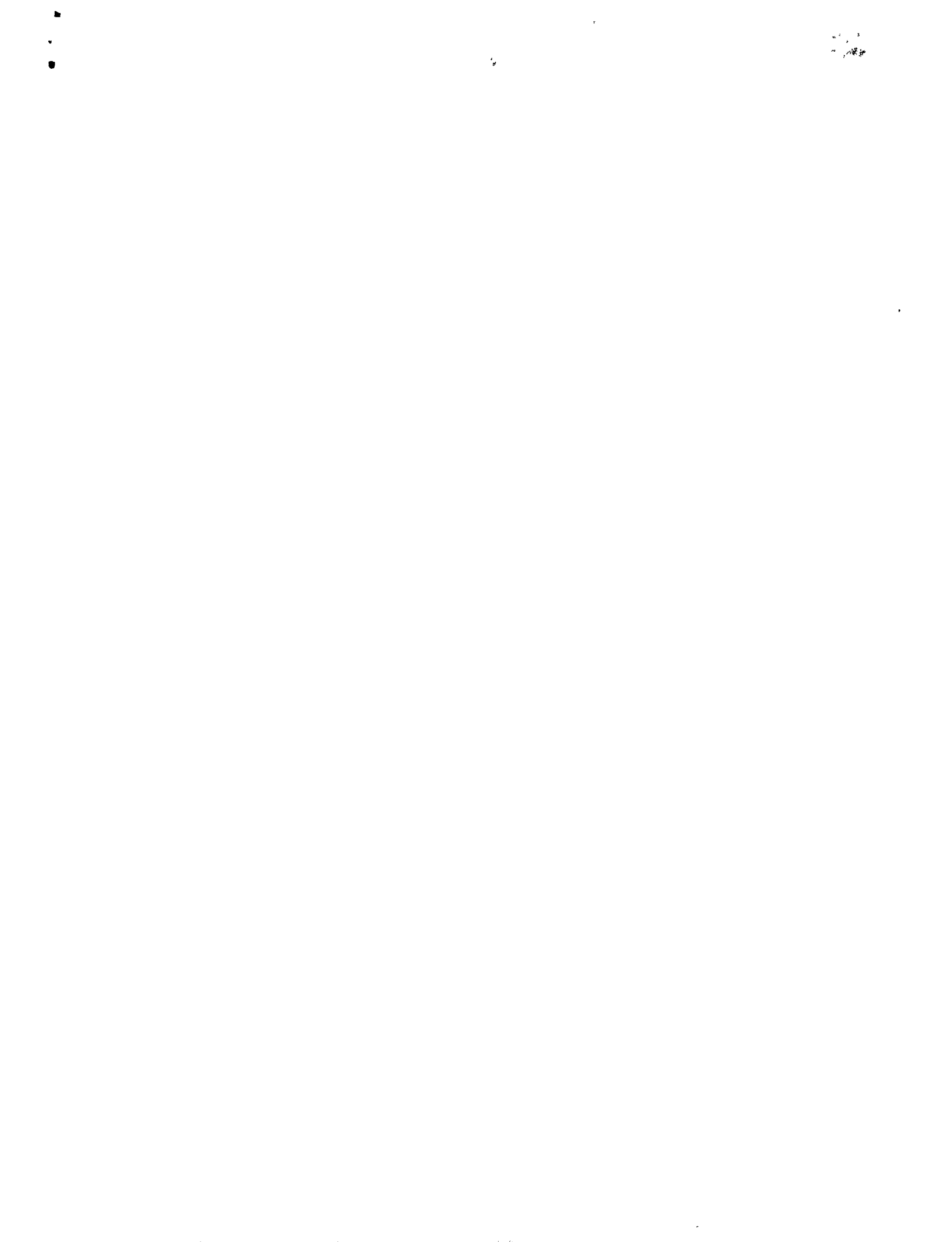
Response: The Department concurs.

Comments: It is Departmental policy that full-scale internal control reviews be conducted in a manner which would meet the OMB objectives. However, in many instances an internal control review at a level below a full-scale review is warranted. In these instances, agencies have omitted that phase of a full-scale review which would not have provided results commensurate with the resources required for the review.

Recommendation: The Secretary of Labor require the development of a comprehensive approach and related policy and guidance for conducting full accounting system compliance evaluations, including provision for testing manual and automated procedures, processes, and controls and periodically validating the accounting systems' inventory.

Response: The Department concurs.

Comments: During the period covered by your review, neither GAO or OMB provided any guidance on complying with Section 4 of the Federal Managers' Financial Integrity Act. The absence of this guidance by GAO or OMB contributed greatly to the Department's proceeding in reviewing its accounting systems without a formalized structure. DOL believes that, even without the formalized structure, all significant deviations from the Comptroller General's principles and standards were contained in our year-end report. The Department agrees a more formalized structure is necessary. Until specific guidance is received, establishment of a formalized structure would be premature. We are in the process of developing a more formalized interim process for evaluating accounting systems pending issuance of final guidance from GAO and OMB.



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