WRITTEN TESTIMONY OF
ELLIOT P. LEWIS
ASSISTANT INSPECTOR GENERAL FOR AUDIT
OFFICE OF INSPECTOR GENERAL
U.S. DEPARTMENT OF LABOR

BEFORE THE HOUSE COMMITTEE ON EDUCATION AND LABOR
SUBCOMMITTEE ON HEALTH, EMPLOYMENT, LABOR, AND PENSIONS
DECEMBER 7, 2010

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.