



DEC 8 1999

The Honorable Fred Thompson
Chairman, Senate Governmental
Affairs Committee
340 Dirksen
United States Senate
Washington, DC 20510

Dear Chairman Thompson:


This is in response to your September 22, 1999, letter requesting that the Office of Inspector General (OIG) identify the most serious management issues facing the Department of Labor. The OIG has identified the following areas that we consider to be vulnerable to fraud, waste, error, or mismanagement.

- Effectiveness of the Welfare-to-Work Initiative
- Accounting for ETA Grant and Contract Funds
- Quality of Program Results Data
- Implementation of the Workforce Investment Act (WIA)
- Security of Pension Assets
- Protection of Worker Benefit Funds
- Collection/Disbursement of Back Wages and Related Penalties
- Compliance with New Financial Management Requirements
- Stewardship Over DOL Information Technology Resources
- Accounting for Equity in Real Property

Enclosed is a detailed description of our concerns, including the status of previous recommendations.

Thank you for the opportunity to present our views on issues facing the Department of Labor. Identical letters are being sent to the other co-signers of your letter. If you need additional information or wish to have a detailed briefing, please contact me on (202) 693-5100.

Sincerely,

 Charles C. Masten
Inspector General

Enclosure

U. S. Department of Labor Top Management Issues

1. Effectiveness of the Welfare-to-Work Initiative

The Department's ability to provide effective training and employment services to help individuals transition from welfare dependency to self-sufficiency will be key to the success of welfare reform. The recently enacted Welfare-to-Work (WtW) program has been added to the arsenal of DOL services available to help severely disadvantaged individuals change their lives. The success of the program will hinge not only on the effectiveness of the Department's stewardship and the quality of services provided, but also on its ability to capture and report the results of its efforts on behalf of eligible individuals. In addition, with billions of dollars invested in this initiative it will also be critical for the Department to provide effective monitoring of the substantial dollars awarded to grantees for employment and training services.

The OIG conducted audits of numerous WtW grantees during the past year in order to assess their status, identify vulnerabilities, and recommend corrective action before funds are misspent. We found WtW implementation proceeding slowly in both competitive and formula grants. The OIG determined that formula grantees were proceeding slowly because of unforeseen or unconsidered factors when the States developed their service and outcome levels and spending estimates. If the current pace continues, the formula grant funds will not be spent within the mandated three-year period.

The WtW competitive grant program is an entirely new concept. We found that while the competitive grantees possessed adequate delivery capability, financial, and program vulnerabilities existed. It is not surprising that our audit identified vulnerabilities, particularly since this work was done during the early stages of program implementation. Some of these vulnerabilities included inadequate internal controls over cost limitations, inadequate management information systems, inadequate internal controls over financial reporting, lack of formal agreements with TANF agencies, lack of formal eligibility procedures, lack of written policies and procedures, and noncompliance with Work First and FLSA requirements. In addition, under the WtW competitive grant program, at least 70 percent of WtW funds must be spent on hard-to-employ individuals. During the course of the audit, many grantees stated that the eligibility criteria requiring the exclusion of individuals who have completed secondary school or earned a certificate of general equivalency are too strict and eliminate a significant number of hard-to-employ individuals from accessing services under the 70 percent provision. We have recommended to ETA that it reinforce its efforts to monitor grantee plans and program implementation schedules to ensure the most efficient and effective use of WtW funds.

2. Accounting for ETA Grant and Contract Funds

ETA is DOL's largest grant and contract awarding agency. In FY 1998, ETA awarded \$10.3 billion in grants and contracts. These funds pay for employment and training programs and services, as well as for the administration of unemployment insurance programs run by the States. My office has undertaken a number of efforts to help ensure more accountability over DOL grant funds. These proactive efforts include conducting audits and investigations that identify vulnerabilities and recommend corrective actions before funds are misspent, and providing technical assistance to grantees whenever possible.

The OIG has concerns in two specific areas: 1) management needs to ensure that ETA cost data is recorded promptly; and 2) that weaknesses previously identified relating to accounting for debt activity continue.

Regarding cost data, ETA abandoned the development of a new grants accounting and management system because it would not be completed by the required due date for Year 2000 compliance, and the existing system was not Year 2000 compliant. Procedures were developed to enter all grants activity directly into the Department's general ledger system. However, our FY 1999 financial statement audit (currently in process) found that significant numbers of cost reports have not been entered into the system. This is primarily due to costs received by ETA but not processed. However, it is to a lesser extent due to delays by grantees in providing reports to ETA. As a result, the year-end grant accrual (intended to record costs incurred by grantees but not yet reported to the Department) increased from approximately 35 percent of total grant costs to approximately 65 percent. Another deficiency identified is that of grant close-outs, which are conducted to complete a full accounting for the substantial dollars in each of the thousands of grants awarded by the Department.

Regarding accountability for debt activity, our major concerns are that the accounting system for ETA debts was not maintained current and that it does not allow for tracing transactions to source documents. These concerns are compounded by the fact that ETA is now responsible for awarding and monitoring millions of additional grant dollars for the Welfare-to-Work Program previously discussed.

3. Quality of Program Results Data

Important initiatives are under way to improve the results of Federal programs and operations. With passage of the Government Performance and Results Act (GPRA), Congress intended to create a management process whereby Federal agencies develop strategic plans, articulate program goals, allocate Federal resources to meet desired performance levels, and measure and report program results. Similarly, the Federal Accounting Standards Advisory Board's Statement of Federal Financial Accounting Standard Number 4 (SFFAS 4), which was fully implemented in Fiscal Year 1998, is aimed

at providing reliable and timely accounting for the full cost of Federal programs and activities. It will be vitally important for DOL to ensure that the performance and cost information generated be accurate and auditable in order for performance reporting to be credible. However, there continue to be a number of challenges faced by the Department in achieving the full accountability envisioned through these two measures. These are detailed below.

Linking Financial and Performance Data: Unlike the private sector where success is largely measured in terms of a bottom line, to determine the success of Government programs requires both financial and performance information. By linking this type of information, the Department and Congress can determine the value and future direction of Federal programs and achieve the accountability demanded by the public. However, most Federal agencies, including DOL, have not yet achieved this linkage. DOL currently does not have an integrated strategic management process in which program objectives in strategic plans, the resources appropriated for carrying out the programs, the costs of activities, and the performance results achieved are closely linked. To this end, the Department needs to ensure the successful expansion of financial accounting to include cost accounting to identify the full cost of specific programs and activities. The Department is currently developing a cost accounting system. Initially, it was performed at the DOL goal level. Eventually, cost information will be accumulated for specific activities and performance results. However, even with the best effort, it will take a few years before DOL will be able to achieve this linkage.

Data Limitations: Another challenge is the Department's limitations to access, or control the quality of, program results data that will be used to determine the attainment of its strategic plan goals. This includes difficulties associated with ensuring the quality of the myriad of data provided by states and other sources below the Federal level. It also includes ensuring that adequate internal controls exist over DOL financial and performance data systems. For example, OIG audits disclosed weaknesses in ETA's monitoring of the quality of data submitted by Job Training Partnership Act (JTPA) grantees and subgrantees. First identified in 1993, this issue continues to be reported as a material weakness in ETA's annual report under the Federal Managers' Financial Integrity Act (FMFIA). In response, ETA (in conjunction with OIG) developed a guide to review the quality of state management information system data. The 1999 FMFIA report will be published in April 2000. According to ETA, the agency is also working to ensure data validation is built into the performance accountability system being developed for WIA, which will replace JTPA on July 1, 2000.

In addition, two important tenets of GPRA are the requirements that agencies conduct program evaluations to determine program effectiveness and validation of performance data. In the employment and training area, it is particularly important to know whether programs have resulted in individuals becoming self-sufficient by obtaining long-term, unsubsidized employment at livable wages. Two important tools that may be used to this end are unemployment insurance and social security wage records of individual

program participants. However, the Department is limited in its ability to obtain such data for program evaluation and validation purposes. To enhance its ability to conduct program evaluation and validation in this and other equally important areas, the Department needs to have statutory authority to easily obtain and utilize these types of records as one way to determine or validate the results achieved for the substantial public investment.

4. Implementation of the Workforce Investment Act (WIA)

The Workforce Investment Act of 1998 (WIA), which becomes effective on July 1, 2000, will supersede the Job Training Partnership Act (JTPA). A significant feature of WIA is the establishment of one-stop delivery systems within each local workforce investment area. WIA designates certain entities as required one-stop partners and allows for additional partners, at local discretion. WIA requires that each local workforce investment board enter into memoranda of understanding with the partners to define how the one-stop system will operate in the local area and how the costs of the system and the services provided will be funded. However, cost funding and cost sharing present special problems in a one-stop environment. It increases the administrative burden of accounting for costs and benefits in a system where it is increasingly difficult to discern to which program the participants belong and who should be paying the cost of services. This is further complicated by a key principle of Federal grant accounting -- that costs may be charged to a program only to the extent that benefits are received by that program. WIA also limits administrative costs to 10 percent, half of what was allowed under JTPA.

In the last year, ETA and the OIG jointly arranged for surveys to reclassify and restate JTPA Program Year 1997 costs at 13 JTPA grantees using WIA regulatory definitions. We found that only two of the 13 would have been in compliance with the WIA 10 percent administrative cost limitation. This is of concern not only to the OIG, but also to ETA, because of unintended consequences that may result. The first is the risk that the WIA administrative funding and definitions may affect how local areas deliver services or account for costs. The second is that ETA may receive an inordinate volume of requests from local areas for waivers of the statutory cost limitation, potentially making the exception more common than the rule.

5. Security of Pension Assets

The security of pension assets is a priority of the Department and of the OIG. This includes ensuring that weaknesses, vulnerabilities, and criminal activity are identified and addressed. The following are two areas that we have identified as particularly problematic.

Pensions Plan Audits: For the past several years, through audits and our Semiannual Reports, the OIG has raised concerns regarding the way pension plans are audited under the Employee Retirement Income Security Act (ERISA). Specifically, ERISA exempts from audit coverage all pension plan assets that have been invested in institutions such as savings and loans, banks, and insurance companies that are already regulated by Federal or State governments. Because of this scope limitation, independent public accountants (IPAs) conducting audits of pension plans cannot render an opinion on the plan's financial statements in accordance with professional auditing standards. Nearly half of pension plan audits receive a disclaimer of opinion as a result of the limited scope exemption, which we believe should be repealed. The OIG has also recommended that IPAs and plan administrators be required to report serious ERISA violations directly to the Department to enhance oversight of plan assets.

Abuses by Pension Plan Service Providers: Private pension plans serve as an attractive target to organized crime elements, corrupt pension plan officials, and individuals who influence the investment activity of the pension assets. Recently, labor racketeering investigations involving the investment of pension plan monies that are jointly-administered by labor union representatives and management representatives (Taft-Hartley plans), have elevated the OIG's concern over the security of the assets in this segment of the pension plan universe.

OIG investigations have uncovered many criminal enterprises perpetrated by financial and investment service providers to the nation's pension plans. These investigations have revealed abuses by sophisticated investment advisors and pension plan administrators who have the opportunity and ability to structure complex financial schemes to conceal their criminal activity. The OIG is concerned that abuses by financial investment service providers can result in greater dollar losses because they typically provide investment or financial advice to more than one plan.

Based on recent investigative results and the fact that service providers typically control the investment of hundreds of millions of dollars of pension funds, the OIG has identified this area of the pension arena as especially vulnerable to organized criminal activity and abuse.

6. Protection of Worker Benefit Funds

The Department administers several programs and statutes designed to provide and

protect the benefits of workers. Protection of such benefits is critically important because such programs affect the lives of millions of workers and retirees and involve billions of dollars of taxpayer dollars. The OIG has identified serious vulnerabilities within three of the Department's major worker benefit programs.

Continued Proliferation of UI Fraud Schemes: As with any multi-billion dollar Federal benefit payment program, there are those who benefit from the Unemployment Insurance (UI) program illegally. An informal survey conducted of the State Employment Security Agencies (SESAs) disclosed that the majority of the SESAs have concentrated on investigative work involving single-claimant fraud cases rather than the more complex interstate schemes. Because of the large number of single-claimant cases, many States elect to direct their investigative resources into this area. That focus may ultimately increase a State's vulnerability to other fraud schemes, including fictitious/fraudulent employer schemes, internal embezzlements, manipulation of Standard Industrial Codes, as well as other expansive and complex fraud schemes being perpetrated against the UI program.

Through oversight of the UI program, we have identified a number of schemes used to defraud the program including fraudulent employer schemes, internal embezzlement schemes, and the fraudulent collection of UI benefits by illegal aliens using counterfeit or unissued social security numbers. These investigations have identified schemes which have resulted in substantial losses to the UI trust fund. Our investigations have disclosed that the ability to file electronic and mail claims presented these individuals with the opportunity to defraud multiple States from a single location. In addition, they were able to create unlimited false identities through the use of fraudulent or unissued social security numbers thereby creating an unlimited potential for filing false claims. The OIG is very concerned about the continued proliferation of these types of schemes against the UI program. We believe there is a need for increased training of State employees in fraud detection techniques, improved internal program controls, and improved enforcement.

- *UI Systemic Weaknesses Pose Continuing Problems:* In addition, a number of systemic weaknesses pose problems for the UI system. These include: loss of contributions due to the inability of States to search for hidden wages by employers who misclassify workers as independent contractors; increased vulnerability of the telephone initial claims system; loss of contributions due to the inability of States to audit large interstate companies; "shell" leasing companies which circumvent the payment of UI contributions; the selection process States use to audit employers; and the structural integrity in the reporting system of UI data from the States to UIS. With respect to our March 1999 final audit report on the evaluation of State field tax audit quality and the reporting of blocked claims audits, ETA has completed corrective actions on five of our eight recommendations. With respect to our March 1999 final audit report on the evaluation of State field tax audit quality and the reporting of blocked claims audits, ETA has completed corrective actions on five of our eight

recommendations. The remaining three are resolved but remain open pending implementation and documentation of certain actions.

Federal Employees' Compensation Act (FECA): FECA provides compensation and medical care for Federal employees who suffer job-related injuries, diseases or deaths. The OIG has been working with the Department to improve the cost-efficiency of the FECA program. Our September 1997 audit report on FECA medical provider payments concluded the Department can save millions each year by utilizing commercial code manipulation detection packages to screen for improper billings. The Department agreed with our recommendations and intends to lease a commercial software package. The Department has also initiated action to recover potential improper payments identified in our audit. An OIG recommendation from our audit of the FECA Special Benefits Fund Financial Statements for Fiscal Year 1992 was that the Office of Workers' Compensation Programs (OWCP) request automated wage data from the Social Security Administration on an annual basis to determine continuing eligibility for FECA compensation, instead of the labor-intensive manual procedure currently in use. ESA has asked for OIG's help in obtaining legislation to effect a data-sharing agreement. Toward that end, OIG is doing additional work in this area to quantify the potential savings to be realized through automated cross-matching with SSA records.

In addition, a 1996 OIG report, done in conjunction with the President's Council on Integrity and Efficiency, took a multi-agency look at the effectiveness of Federal civilian agencies' management of their FECA programs. The audit report, which summarized the results of audits undertaken by the Inspectors General of 13 agencies, disclosed that employing agencies generally needed to improve the management of their workers' compensation programs. The audits found employing agencies paid more in workers' compensation than was necessary and that injured employees sometimes experienced an interruption of their incomes. Recommendations addressed the need to improve returning injured employees to work, verifying FECA chargeback reports, and processing FECA claim forms.

Finally, OIG investigations continue to disclose the vulnerability of this program to fraud. Fraudulent activities include medical providers who: bill the Government for services that were not rendered, charge multiple times for the same procedure, bill for non-existent illnesses or injuries, or overcharge for services; and claimants who defraud the program by reporting false injuries, recover but continue claiming benefits, or do not report or under-report their outside employment income to OWCP.

The OIG has proposed a number of legislative recommendations to address some of the weaknesses of this program including: providing DOL with statutory authority to access social security wage records to identify claimants abusing the program; requiring a three-day waiting period before continuation of benefits can be received; reducing compensation levels that currently offer no incentive for claimants to go back to work; and establishing a mandatory retirement age, whereby FECA recipients who

reach a designated age would revert to benefit levels more consistent with the levels provided through Federal retirement.

- *Black Lung Trust Fund Deficit*: DOL administers a trust fund to provide disability benefits and medical services to eligible workers in the coal mining industry, when a mine operator cannot be determined liable for providing such benefits. The OIG is concerned with the escalating indebtedness of the Black Lung Disability Trust Fund. The Department's consolidated financial statements for Fiscal Year 1996 reflected that the trust fund was in debt \$5.1 billion to the U.S. Treasury. This indebtedness increased from \$5.5 billion in FY 1997, to \$5.9 billion in FY 1998, and at the close of FY 1999 stands at approximately \$6.3 billion.

The debt results from advances provided to the program. These advances, which have become an annual necessity for the trust fund, were originally obtained to fund benefit payments that could not be met by coal excise tax collections (the principal source of revenue to the fund). Currently, the excise taxes are sufficient to pay benefits and administrative costs; however, the trust fund must continue to borrow from the Treasury to pay the interest due on past advances. At the close of FY 1999, of the \$6.3 billion in cumulative advances, only \$2 billion was spent for benefit payments, with the remaining \$4.3 billion spent on interest. Since the trust fund has been unable to repay any principal on these advances, it must continue to borrow in order to pay the interest.

Management's annual projections of future receipts and outlays indicate that cumulative borrowings from Treasury could total \$32.3 billion (unaudited) or more by 2040. At this point, annual benefit payments by the fund arising under the Black Lung Benefits Revenue Act of 1977 are expected to be less than 10 percent of current benefit payments. However, based on legislation enacted in 1987, coal tax rates will be dropping by 50 percent after the year 2013. Therefore, the debt problem is compounded and, according to management's estimates, the excise tax collections by 2040 would cover less than 30 percent of the interest that is accruing and annual advances will exceed \$1.2 billion per year. The Department has acknowledged that if current operating conditions continue, a change in the statutory operating structure of the trust fund will be necessary to meet its obligations.

7. Collection/Disbursement of Back Wages and Related Penalties

In some circumstances, the Department assumes responsibility for distributing to workers back wages paid by employers who have been found to have violated labor laws. For a number of years we have raised concerns about the effectiveness of the Department's back wage collection and disbursement activities. We have raised our concerns in this area in our audits of the DOL consolidated financial statements, and two audit reports related to the Wage and Hour Division's Back Wage Collections and made recommendations for improvements. Specifically, these include: improving the accounting and collection of back wages and related penalties; improving the methods for locating and restoring back wages to the affected employees; and reverting undistributed amounts to the Treasury. The Employment Standards Administration has agreed to, and is acting on,

many of these recommendations. However, we believe full implementation, particularly of actions to strengthen the related accounting systems, is a multi-year task.

8. Compliance with New Financial Management Requirements

The Department has made great strides in financial management and has positioned itself to prepare timely and accurate annual financial statements, as required by the CFO Act and the Government Management Reform Act. This is most evident by the fact that the Department has received clean opinions on its financial statements since FY 1997. However, despite this progress, DOL still faces several significant deficiencies in its day-to-day accounting operations, primarily related to needed improvements in financial management system design.

The OIG is required by the Federal Financial Management Improvement Act (FFMIA) to assess the Department's financial management systems for compliance with a number of financial management and accounting requirements. In our FY 1997 audit report, we reported that seven DOL systems did not substantially meet one or more of these requirements. As of our FY 1998 financial statement audit (the most recently completed audit), five of the seven systems remain in noncompliance: Wage and Hour's Back Wage and Civil Monetary Penalties systems, MSHA's penalty tracking system, and Job Corps' real and personal property systems. Four of the systems are being replaced by new systems (Job Corps' real and personal property systems and Wage and Hour's Back Wage and CMP systems). Corrective action plans have been developed for MSHA's system for correcting FFMIA weaknesses. OIG will evaluate compliance with FFMIA during the FY 1999 audit for these five systems. The Department needs to make every effort to ensure actions are taken to correct the noted deficiencies in accordance with FFMIA required time frames (within three years of determination of noncompliance).

9. Stewardship Over DOL Information Technology Resources

The Department has taken steps toward the development of a new IT architecture, which is essential to ensure the Department and its agency systems will be able to seamlessly exchange data and information as well as communicate internally and externally to co-workers and customers. However, the IT investments pose a great risk because of their high-cost and importance to DOL's mission and since some previous efforts have failed. Recent developments, such as the widely publicized breaches of Government computer security and personal privacy, have focused the public on the importance and vulnerabilities of the IT environment. The Department is heavily dependent on IT resources to carry out its mission and daily operations. In addition, the Chief Information Officer must ensure effective stewardship over these critically important resources and identify and mitigate risks in order to avoid inflated budgets, cost overruns, delays, and failures.

10. Accounting for Equity in Real Property

While significant improvements have been made, continued oversight will be necessary to assure the adequacy of ETA's accountability over real properties, held by State Employment Security Agencies (SESAs), in which DOL has an equity interest. An audit issued in September 1997, found that DOL's equity had increased to \$381 million, or 30 percent, between 1988 and 1996. We found States had made significant changes (capital improvements, acquisitions, disposals, etc.) without ETA's knowledge. The \$381 million figure is based on actual costs and does not represent the fair market value of the property, which may be significantly higher. We concluded ETA's current operating procedures are insufficient to keep the inventory reasonably current, placing ETA at risk of not being fairly compensated when the properties are sold, disposed of, or put to other use. We made several recommendations to restore accountability over SESA real property.

Since assigning a staff person to provide oversight of regional office and SESA compliance with real property and procedures, ETA has made significant strides in enhancing accountability over SESA real property. ETA now has the capability to provide technical assistance to its regional office and SESA staff regarding real property issues. Inventories of SESA property are required to be completed by ETA regional office staff in a timely manner, and annual State certifications are expected to be completed by December 1999.