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GAO

Report to the Secretary of Agriculture

March 1988

INTERNAL CONTROLS

Food and Nutrition Service Lacks Effective Controls

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GAO
United States
General Accounting Office
Washington, D.C. 20548

Accounting and Financial
Management Division

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March 18, 1988

The Honorable Richard E. Lyng
The Secretary of Agriculture

Dear Mr. Secretary:

Enclosed is our report which describes our in-depth evaluation of the internal and accounting controls at the Food and Nutrition Service. Our report identifies several serious, fundamental internal and accounting control weaknesses covering a wide range of the Service's accounting operations. We believe these shortcomings are serious enough to warrant your attention.

We performed this review as part of our overall responsibility to review federal government accounting systems and also to assess actions taken in implementing the Federal Managers' Financial Integrity Act.

As you are no doubt aware, the Service has planned or implemented a number of actions to enhance and improve its systems, including a comprehensive corrective action plan. Ultimate resolution of these issues will continue to require management action for some time in the future.

We wish to thank the staff of the Service for its cooperation and positive attitude in dealing with the financial management problems discussed in this report. Copies of this report are being provided to the Inspector General and other interested parties.

This report contains recommendations to you. The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on these recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the report, and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

Sincerely yours,

Frederick D. Wolf
Director

Purpose

As part of GAO's work to examine the overall effectiveness of agencies' accounting systems in operation, GAO reviewed the accounting systems of the Department of Agriculture's Food and Nutrition Service. This is the second report GAO is issuing on the results of the review. GAO's previous report, Anti-Deficiency Act: Agriculture's Food and Nutrition Service Violates the Anti-Deficiency Act (GAO/AFMD-87-20, March 17, 1987), dealt with Anti-Deficiency Act violation issues and noted that additional problems in the accounting systems were found and would be included in a subsequent report. This report discusses those accounting systems problems.

Background

The Food and Nutrition Service's budget is one of the largest in the Department of Agriculture. The Service's fiscal year 1986 program appropriations amounted to $18.4 billion, which is about 31 percent of the Department's fiscal year 1986 appropriations. The Service's mission is to manage domestic food programs—the Food Stamp Program; Child Nutrition Programs; and Supplemental Nutrition Assistance for Women, Infants and Children Program. Over $10 billion is disbursed annually for food stamps redeemed by vendors and about $6.5 billion annually is financed by the Service through letters of credit to grantees for administrative and program expenses.

To effectively manage such large sums, Service officials must use good internal and accounting controls. The Congress, in passing the Federal Managers' Financial Integrity Act of 1982 (FMFIA), recognized the need for effective controls in helping to prevent fraud, waste, and abuse of federal funds. The act holds managers accountable for the correction of identified weaknesses and it requires annual agency reports on the status of agency internal controls and accounting systems.

Results in Brief

GAO's review identified several serious, fundamental internal and accounting control weaknesses covering a wide range of its accounting operations. Those weaknesses adversely affect the Service's ability to (1) manage its funds and assets, (2) ensure that payments are proper and correct, and (3) render a proper accounting in its external reports. Also, these weaknesses were not disclosed nor were corrective actions indicated, as required in the annual FMFIA report.

It will take a strong commitment on the part of the Secretary of Agriculture and the Service Administrator to install a disciplined internal control and accounting system. The Service Administration has advised GAO that several corrective actions have taken place and that a comprehensive plan to improve its internal control and accounting system has been devised.

Principal Findings

Internal Control Weaknesses

GAO's review identified several areas of internal control weaknesses, including undocumented and unauthorized transactions, incorrect and untimely transactions, inaccurate external reporting and ineffective action on previous audit findings. For example:

- Individuals, acting without authority and supporting documentation, were changing financial balances in the accounting records by millions of dollars. Such actions could cause appropriation records to be incorrect.
- The Service has a continuing major control problem in that 10 years after GAO first brought the matter to the Service's attention, it still lacks significant information it needs to help ensure that food coupon redemption funds are paid only to legitimate vendors; consequently, the risk of fraud is increased. During the period April 1985 through January 1986, Service records could not identify vendors who, as a group, received an average of $60 million a month in redemptions.

Improper Accounting Practices

The Service did not adequately account for letter of credit disbursements, advances receivable from grantees, and uncollectible accounts. For example, the Service's accounting system did not provide certain important information on bad debts to agency managers responsible for its accounts receivable, which exceeded $350 million, as of December 31, 1985. Also, important information on bad debts was not included in external reports.

Weak ADP Controls

Criteria used by the Service to define when a system change was significant were established at such a high level that important changes could be made without formal management oversight. For example, the development of a new accounts receivable subsystem which accounts for over $350 million in receivables did not meet the criteria and was not subjected to formal management oversight. GAO also found that the Service had lax documentation procedures, which resulted in a system that is essentially undocumented. Further, the Service does not have an operable plan for continuing ADP operations in the event a natural disaster occurs.

Weaknesses Not Disclosed

The Service did not disclose in its annual FMFIA report to the Secretary of Agriculture the many serious internal and accounting control weaknesses noted by GAO. Failure to do so may have unnecessarily delayed the initiation of a comprehensive corrective action plan. Also, lacking the necessary information, the Secretary was not in a position to fulfill his responsibility to report these weaknesses and the planned corrective actions to the President and the Congress.

Recommendations

GAO is making many recommendations to the Service Administrator which are designed to strengthen internal controls and improve accounting and ADP control practices.

Given the seriousness of these matters, GAO is also recommending that the Secretary of Agriculture direct the Administrator of FNS to submit a comprehensive plan for implementing the many recommendations made in the report. This plan should be approved and its implementation monitored by the Secretary.

Agency Comments

The Service has demonstrated its desire to make a strong commitment to improve its accounting and internal controls and has responded positively to GAO's recommendations by initiating a program to correct its financial management problems. It has devised a comprehensive corrective action plan with specific milestones and states that it has taken steps to better supervise financial activities, improve management over cash and accounts receivable, better disclose advances made to grantees, strengthen controls over ADP operations, require approval of changes to accounting records, and ensure that accounting transactions and systems changes are documented. Finally, the Service plans to improve its internal control evaluation process and to disclose control weaknesses to top management. (See appendix II.)

Contents

Abbreviations

ADP	automated data processing
FARS	Financial Accounting and Reporting System
FIPS	Federal Information Processing Standards
FMFIA	Federal Managers' Financial Integrity Act of 1982
FRB	Federal Reserve Bank
IG	inspector general
OIRM	Office of Information Resources Management
OMB	Office of Management and Budget
SF	standard form
TFS	Treasury Financial Statement
WCC	Washington Computer Center
WIC	Women, Infants, and Children

Introduction

Background

The Department of Agriculture's Food and Nutrition Service (FNS) manages domestic food programs, including the Food Stamp; Child Nutrition; and Supplemental Nutrition Assistance for Women, Infants, and Children (WIC) Programs. The Food Stamp program increases the purchasing power of eligible households by providing food stamp coupons for the purchase of food at retail stores. Individual states oversee the distribution of food stamps to recipients deemed eligible based on household size and income level. Child Nutrition programs provide cash and commodity meal subsidies through several child-oriented programs which include child care, school breakfast and lunch, and summer food service programs. The WIC program provides funds to the states for the provision of nutritious foods to low-income pregnant, post-partum and breast-feeding women, and to infants and children at nutritional risk. The Service also provides nutrition assistance for low-income households in Puerto Rico, covers states' administrative costs, and funds nutrition education and studies.

The Service's budget is one of the largest within the Department of Agriculture. Fiscal year 1986 appropriations totaled $18.4 billion, approximately 31 percent of total annual Department of Agriculture appropriations. Funds for many Service programs are provided by grants-in-aid financed by letters of credit.[1] Table 1.1 shows fiscal year 1986 appropriations.

Table 1.1: Food and Nutrition Service 1986 Appropriations

Dollars in billions

Appropriations	Amount	Percent
Food Stamp Program	$11.8	64
Child Nutrition Programs	3.9	21
Women, Infants, and Children (WIC) Program	1.6	9
Puerto Rico Block Grant	.8	4
Other appropriated funds	.3	2
Total	**$18.4**	**100**

The Service uses the Financial Accounting and Reporting System (FARS) to account for the billions in appropriated funds it expends annually. The FARS system, which is part of FNS's Program Accounting System, consists of seven accounting system components: three systems for disbursing program funds; a budget system for allocating funding; a grant

[1] The letter of credit process, which accounts for $6.5 billion in grant funds per year, allows the states to draw on established credit balances as needed to pay expenses associated with their grants. The process allows the government to hold funds until needed for state program expenses. See appendix I.

award system; an accounts receivable system; and a double-entry, general ledger accounting system. The FARS system obligates funds, liquidates obligations, produces grant documents, controls payables, maintains the general ledger, and produces financial reports.

The financial management function is decentralized among seven regions and the Service's headquarters. The Service headquarters' Accounting Division issues policies and procedures which govern the operational accounting system. The Service headquarters' Budget Division prepares apportionment requests based on amounts appropriated by the Congress, allocates funds based on Office of Management and Budget approved apportionments, and prepares reports on budget execution, in accordance with Office of Management and Budget (OMB) and Department of the Treasury requirements.

To ensure that financial transactions are legal, proper, and correct, the Comptroller General has established internal control standards and accounting principles and standards. These standards are contained in title 2 of GAO's Policy and Procedures Manual for Guidance of Federal Agencies (GAO manual).

The Comptroller General has established these internal control standards to be followed by executive agencies in establishing and maintaining systems of internal control, as required by the Federal Managers' Financial Integrity Act (FMFIA) of 1982 (31 U.S.C. 3512(b)). Internal controls should be designed to reasonably ensure that obligations and costs comply with applicable law; that all assets are safeguarded against waste, loss, unauthorized use and misappropriation; and that revenues and expenditures are recorded and accounted for properly.

A number of standards are essential to providing the greatest assurance that the internal control objectives will be achieved. These standards include adequate documentation, proper recording and execution of transactions, clear separation of duties, and qualified and continuous supervision.

Agency heads must also observe certain accounting system standards and requirements in establishing, maintaining, and reporting on their systems of accounting and internal controls, as required by 31 U.S.C. 3512. Subsection (a) of section 3512 requires the head of each executive agency to have systems of accounting and internal control which provide for complete disclosure of the financial results of agency activities; effective control over, and accountability for, assets for which the agency is responsible; reliable accounting results and reports; and suitable integration of agency accounting with Treasury's central accounting and reporting responsibilities.

These standards apply to all manual and/or automated systems of accounting and must be considered when agency heads report on the status of their accounting systems, as required by 31 U.S.C. 3512(c).

GAO Reported Anti-Deficiency Act Violation

In our report, Anti-Deficiency Act: Agriculture's Food and Nutrition Service Violates the Anti-Deficiency Act (GAO/AFMD-87-20, March 17, 1987), we found that the Service's Child Nutrition Programs violated the Anti-Deficiency Act (31 U.S.C. 1341) and, as of September 30, 1985, had a cumulative deficiency of at least $109.6 million. The Service indicated that this deficiency could be as much as $66.6 million more as of the end of fiscal year 1986.

The violation occurred because, since fiscal year 1983, the Service had been paying for meals provided as part of the Child Nutrition Programs in September of each fiscal year with funds from the subsequent year's appropriation, without the authority to do so. We concluded that since specific legislative authority for this procedure had expired in fiscal year 1982, the Service's actions violated the Anti-Deficiency Act, which provides that no officer of the government may authorize an expenditure or obligation exceeding an amount available in an appropriation or involve the government in an obligation for the payment of money before an appropriation is made, unless authorized by law (31 U.S.C. 1341 (1982)).

In our March report, we noted that the Service had other accounting system problems which we would report on separately. This report contains the findings referred to in that earlier report.

Objectives, Scope, and Methodology

Our review of the Service's accounting system is part of our continuing effort to examine the overall effectiveness of federal agencies' accounting systems in operation. The objectives of this review were to examine the Service's accounting operations to determine whether necessary controls, systems, and procedures are effective. The objectives of this report are to identify weaknesses in the Service's control over its internal controls and accounting systems and operations and to recommend corrective actions.

We conducted our work from October 1985 to August 1986. We reviewed key components of FARS, which maintains records on approximately $18.4 billion. We examined samples of transactions of fiscal year 1984 through 1986 program funds. We analyzed the flow of transactions and tested internal controls over assets, liabilities, disbursements, accounts receivable, and financial reporting to determine if they were in conformance with requirements. Further, we determined whether the operational systems captured, recorded, processed, and reported financial transactions in conformance with principles, standards, and other requirements and whether the internal and accounting controls were effectively implemented within the operating systems. When we identified system weaknesses, we examined a nonstatistical sample of transactions to determine whether the operational systems met internal control and accounting standards and requirements. Our examination of the automated portion of the system included checking documentation for accuracy and completeness, observing the accounting system software maintenance operations, and interviewing the Service's systems support staff at headquarters and at selected regions and officials at the Department of Agriculture's Washington Computer Center (WCC).

We conducted our review at four of eight locations which perform key accounting functions for the Service: Service headquarters in Alexandria, Virginia; the northeast regional office in Burlington, Massachusetts; the midwest regional office in Chicago, Illinois; and the southwest regional office in Dallas, Texas. Additionally, we reviewed food coupon processing at the Federal Reserve Bank Board in Washington, D.C.; the Federal Reserve Banks in Boston, Massachusetts; Chicago, Illinois; and Dallas, Texas; Service Headquarters in Alexandria, Virginia; and the Service's Computer Support Center in Minneapolis, Minnesota. Our work was performed in accordance with generally accepted government auditing standards.

Internal Control Weaknesses

Our review identified several internal control weaknesses, including undocumented and unauthorized transactions, incorrect and untimely transactions, and inaccurate external reporting. Proper control requires defined rules and adherence to established procedures. The Comptroller General has established accounting and internal control standards which are set forth in title 2—"Accounting"—of the GAO manual.

Internal control refers to the plan of organization and methods and procedures adopted by management to ensure that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data are obtained, maintained, and fairly disclosed in reports. Good internal controls are essential to achieving the proper conduct of government business with full accountability for the resources made available. These controls facilitate the achievement of management objectives by serving as checks and balances against undesired actions.

Undocumented and Unauthorized Transactions

To ensure that financial transactions are legal, proper, and correct, title 2 of the GAO manual requires that clear documentation of transactions be readily available for examination. Further, the Comptroller General's Standards for Internal Controls in the Federal Government requires that qualified and continuous supervision of accounting systems be provided. Such measures ensure that only legitimate entries are made in the system. Without such controls, the system becomes vulnerable to illegal expenditures or fraud.

We found several instances where Service personnel made significant, unsupported, and unapproved adjustments to accounting records. Such adjustments preclude management from ensuring proper use of funds, protection of assets, and reliable and accurate financial reporting. In one instance, records showed that in fiscal year 1984, the Child Nutrition Program obligations exceeded appropriations by $31.9 million as of September 19, 1985. When asked about the discrepancy, we were told that a recording error had been made and that it would be corrected.

Later we were told by a grants management section chief at one of the Service's regional offices that he had been instructed to correct the records, and that he had been given only one day to make the correction. The adjusting entry, dated September 30, 1985, reduced obligations of one state's account by about $41 million. The choice of the state was an arbitrary attempt to make a "quick fix" to reconcile the discrepancy.

During January 1986, the same section chief authorized additional adjusting entries, which reversed the earlier $41 million adjusting entry and reduced obligations in the accounts of six states by $34.5 million. The section chief could not identify any supporting documentation for the entries, and we found no evidence that the changes had been approved by a supervisor. In addition, the section chief could not explain why these changes were made. Therefore, we cannot determine whether the entries reflect accurate adjustments to transactions of the respective states.

In its November 6, 1987, response to our report, the Service indicated that it agreed the adjustments were erroneous, that the section chief involved had apparently failed to understand the guidance which headquarters staff had provided with regard to making adjustments, and that final adjustments for the transactions had been made by headquarters staff but had not been sufficiently documented in the record. (See appendix II.)

Also, very importantly, the Service informed us that the following corrective actions had been taken:

- a change to procedures has been made which requires written justification and supervisory approval on all adjustments similar to the ones described above;
- year-end instructions, which emphasize the need for proper documentation and approval of all accounting transactions, have been distributed to the Service's regional offices; and
- the Accounting Division has intensified its on-site reviews of regional operations during fiscal year 1987, visiting five of the seven regions, and plans to visit all seven regions during fiscal year 1988.

As another example of unsupported and unapproved adjustments, in 1986, Service personnel attempted to reconcile the fiscal year 1985 letter of credit subsystem disbursement balance with disbursements recorded in the automated general ledger. In order to make the two records agree, two Service employees—an accountant and a systems programmer—deleted the entire fiscal year's data in the general ledger and replaced it with disbursement information from the letter of credit subsystem. Service officials informed us that no supervisory approval was requested or given to delete the information in the general ledger.

In its response to our report, the Service agreed that neither the Director of the Accounting Division nor any high-level official had personally approved of replacing general ledger disbursement information with disbursement information from the letter of credit subsystem. Further, to ensure that this does not happen in the future, it has revised its procedures to require the Director's approval of all significant changes to accounting data. The Service also noted that the general ledger data has been retained in a computer file and that the headquarters' accounting staff is aware of the amount and cause of the differences between the general ledger and letter of credit subsystem.

Finally, supporting documentation was also lacking in a nonstatistical sample we made of nine year-end adjustments to Food Stamp program accounts for fiscal year 1985. We found that five of the adjustments did not have adequate documentation. These adjustments, including increases and decreases, amounted to $12.7 million in year-end food stamp obligations.

In its response to our draft report, the Service agreed that the adjustments were not documented, and, in subsequent discussions with Service officials, we were provided copies of a new standard journal format which requires both documentation and supervisory approval of transactions. The actions taken by the Service should help ensure that only proper changes are made to accounting records.

Incorrect and Untimely Accounting Transactions

To ensure that accounting information is useful, title 2 requires that transactions be reliably and promptly reported. Timeliness refers to the prompt reporting of financial information to its users when it will be of maximum benefit. Financial data should be recorded as soon as practicable after the occurrence of a transaction.

We found that millions of dollars in accounting transactions, rejected as being in error by the system, were being held in a suspense file for extended periods of time—in some cases about 1 year. Because the transactions were neither corrected nor posted to the accounting records in a timely manner, the Service was unable to finalize its financial records and determine the results of its financial operations.

Our analysis of transactions processed during May 6 through 12, 1986 indicated that an average of $206.7 million per day was not being processed because the transactions failed system edits. The Service was unable to explain why the transactions were rejected. These transactions were placed in a suspense file for extended periods. Approximately $191.9 million of these transactions represented the closing entries for fiscal year 1984 and consisted of adjustments to obligations and to obligational authority. There were no supporting documents to explain why these transactions remained in the suspense file and why the fiscal 1984 year-end closing process was incomplete 8 months into fiscal year 1986. The Service is therefore unable to determine if there are significant correctable errors and is unable to properly close its accounting records for fiscal year 1984.

The Service needs to take steps to ensure that rejected transactions are promptly researched, corrected, and posted so that accounts of the Service can accurately portray financial data.

In commenting on our report, the Service stated that the transactions were held in the suspense file to facilitate year-end closing of the books for fiscal year 1984. We were told that the general ledger system (FARS) was not fully implemented in 1984 and, therefore, was manually closed. Finally, we were told that the year-end closing process is currently automated.

We are pleased to learn that the automated closing process problems have been corrected. However, we believe that an automated general ledger must contain all entries, including closing entries.

Inaccurate and Unsupported External Reporting

According to title 2—"Accounting"—of the GAO manual, accounting information should be reliable. Information should be reasonably free from error and bias and faithfully represent what it purports to represent. The Treasury Financial Manual requires that executive agencies furnish the Secretary of the Treasury such reports and information relating to their financial condition and operations as the Secretary may require.

Unsupported Reports on Obligation Balances

We reviewed external reports submitted by the Service to Treasury and OMB on its financial status, including two year-end reports:

- The Year-end Closing Statement (TFS 2108). This report to Treasury presents closing balances for undisbursed funds, unfilled orders, payables, unobligated funds, and undelivered orders. Its closing balances should agree with amounts reported in the Report on Financial Position (TFS 220).

- The Year-end (Final) Report on Budget Execution (SF 133). This report to OMB provides current data on the status of each open account. Balances in this report must agree with amounts shown in the United States Government Annual Report. It is to be submitted as soon as possible after submission of reports on balances required by the Treasury Department, but not later than November 30.

Finally, title 7—"Fiscal Procedures"—of the GAO manual states that when obligations are estimated, the basis for the estimate and the computation will be documented. When the actual amount of the obligation is known, the appropriate adjustment is to be made. Our review of the above reports disclosed significant amounts not supported. The Year-end Closing Statement (TFS 2108) and the Final Report on Budget Execution (SF 133) prepared by the Service at the end of fiscal year 1985 were not fully documented because these reports included amounts that had earlier been certified by two of three regional offices as valid and correct, but which could not be supported by documentation.

We interviewed staff at the midwest and southwest regions to determine what procedures were followed during the year-end closing process. At the midwest region, we were told by the Director of the Regional Financial Management Program that amounts certified were based on telephone conversations with grantees in which they were asked if they would be expending all program moneys. He stated that these calls were not documented.

Regarding the southwest region, we were told that the obligated account balances in the general ledger were compared with the corresponding letter of credit authorization balances and that the letter of credit authorization balance was used to certify obligations of fiscal 1985 appropriations. We were told that this was done because regional personnel knew these amounts were more up-to-date than the obligations recorded in the general ledger. As for the prior year's appropriations, we were unable to determine the correct status, as there was no documentation to support the region's certification of the obligations.

In commenting on our report, the Service stated that its obligations were both accurate and properly certified on its fiscal year 1985 and prior year-end reports, and that it has documentation to support the certifications. Reexamination of the evidence we obtained during our review indicates that, in fact, the midwest and southwest regions did not have the documentation to support the certifications. As indicated above, the

Service has informed us that it has distributed specific year-end instructions to all regions to emphasize the need for proper documentation of all accounting transactions. We have reviewed these instructions, and, if they are effectively implemented, the certification of obligations should be properly supported.

Inaccurate Report on Financial Condition

The Service also prepares a Report on Financial Position (TFS 220) which it forwards to Treasury each year. This report to Treasury includes the assets, liabilities, and equity as of the reporting date. It requires disclosure of the valuation basis on which major categories of assets are reported, the nature of any significant restrictions on assets, the nature of any significant contingent liabilities, and any other significant information considered necessary to fully and clearly disclose financial position.

The Service's Report on Financial Position as of September 30, 1985, was in error for two reasons. First, advances to grantees were not reported because advances were not recorded in the general ledger. Proper accounting treatment would require that amounts advanced to grantees should be established and shown as an advance of funds and recorded as assets until such time as the Service has evidence that the amounts advanced have been expended for authorized program expenses. If not done, the Service's financial statements thus understate assets by the amount of the grant moneys advanced and not expended on authorized expenses. Similarly, liabilities are understated by any amount of expenses incurred and unreimbursed by grantees. Second, Service officials could not provide historic records documenting the $126.3 million allowance for uncollectible accounts appearing on the statement. The Service does not annually record an allowance for uncollectible accounts in its general ledger. (See chapter 4 for a detailed discussion of this matter.)

The Service needs to base its reports on a disciplined accounting process which uses accurate balances contained in its general ledger. Its reports must be complete, reliable, documented, and correctly certified, so as not to obscure Service, departmental, and congressional oversight.

In its reply to our report, the Service agreed to change its accounting procedures to

- account for and record an allowance for uncollectible accounts in its general ledger,

- record as advances letter of credit drawdowns made after the 25th of each month, and
- establish accounts receivable for all excess advances when they are detected.

Effective implementation of these procedures will help the Service to fully and clearly disclose its financial position.

Unresolved Audit Finding on Food Coupon Redemptions

The Comptroller General's standards for internal control include a standard for prompt resolution of audit findings. It requires managers to take prompt, responsive action on all findings and recommendations made by auditors. Responsive action is action which corrects the identified deficiencies. The resolution process is completed only after action has been taken that (1) corrects identified deficiencies, (2) produces improvements, or (3) demonstrates that the audit findings and recommendations are either invalid or do not warrant management action. Auditors are responsible for following up on audit findings and recommendations to ascertain that resolution has been achieved. Auditors' findings and recommendations should be monitored through the resolution and follow-up processes. Top management should be kept informed through periodic reports so it can ensure the quality and timeliness of individual resolution decisions. Corrective actions should be completed within established time frames.

We found that almost 10 years after being informed of problems with the control of food coupons, the Service still had not implemented measures to help ensure that amounts paid for the redemption of food coupons are traced to vendors. Without this information, the Service cannot be sure that only proper payments are made. In our 1978 report,[2] we pointed out that controls were needed to make sure commercial banks were accepting from vendors only those food coupons which should have been properly redeemed. In response to our report, the Service conducted a study and issued its report on November 20, 1981. It found that during fiscal year 1980, monthly coupon redemptions by vendors exceeded amounts vendors certified as the value of coupons being presented to commercial banks for redemption by an average of $14 million. The study noted that the absence of confirmation that all food coupons deposited are supported by redemption certificates "creates an atmosphere for potential fraud and abuse."

[2] Regulation of Retailers Authorized to Accept Food Stamps Should be Strengthened (CED-78-183, December 26, 1978).

Subsequently, the Service made changes to its monitoring system, which had originally been devised to keep track of redemptions at the vendor level. The system was revised to obtain and process information from commercial banks and the Federal Reserve that would link (i.e., establish an audit trail for) amounts redeemed with amounts shown on the vendors' redemption certificates.

The Department of Agriculture's inspector general (IG) issued a report on the revised system in December 1986. The report listed a wide range of adverse findings regarding the monitoring system used to track monthly food coupons redeemed by vendors. For example, the IG found that the system had not established the desired audit trail of food coupon redemption activity, and, therefore, it could not be used "to reduce waste and abuse" in redemptions.

Further, the IG reported that inaccurate and incomplete data had been entered into the system and that large balances had not been processed. The IG recommended actions to correct and reconcile information in the monitoring system and to strengthen controls in the redemption process. For example, the IG recommended that to strengthen accountability over the redemption process, the coupon amount according to three separate documents should be compared and that differences should be resolved.

We found that redemption amounts which cannot be accounted for have grown considerably since fiscal year 1980. Information we obtained from the monitoring system showed that average monthly redemption of coupons by banks exceeded amounts on vendors' certificates by $60 million for the period April 1985 to January 1986. This indicates a 330-percent increase over a 6-year period.

The Service, on March 12, 1987, advised the IG that his report confirmed its concerns. The Service believes that in the long run, in order to achieve a fully accountable system, a major redesign of the system is necessary. For the short term, Service officials state that they have taken steps to improve the performance of the monitoring system.

Regarding the delay in effecting corrective action, the Service noted, in its response to our draft report, the considerable logistical and technical difficulties involved in establishing a system to trace payments for food stamp coupon redemption to individual vendors and to reconcile such payments against authorized redemptions. The Service agreed with the above finding and advised us of a major initiative to install a new redemption system, which is tentatively scheduled to be tested on May 31, 1988, and implemented about January 1, 1989.

Conclusions

Accounting information has value only if it is reliable, timely, and accurate. The ability of an organization as large and diverse as the Service to produce data with those attributes is directly dependent on the climate of internal control in which the systems operate. The Service has failed to create and enforce acceptable controls. Our review disclosed several weaknesses, including:

- undocumented transactions,
- unapproved adjustments,
- inaccurate year-end reports, and
- a long-term unresolved audit finding on food stamp coupon redemptions.

Recommendations

In order to ensure that a disciplined internal control system is maintained, the Administrator of the Service should require that

- employees and their work be properly supervised,
- all accounting transactions be properly and fully documented,
- transactions be processed in a timely manner,
- accurate and fully supported financial reports be prepared and distributed, and
- audit findings and recommendations be promptly resolved.

Agency Comments and Our Evaluation

In responding to our report and recommendations, the Service advised us that it has established an Internal Controls Steering Committee, composed of senior officials. The committee intends to ensure consistency and objectivity in the application of internal control standards and principles, establish agency policies and activities, and oversee the Service's system of internal controls. The Service also plans to strengthen its internal control review process. (See appendix II.)

Regarding our specific recommendations, the Service indicated that:

- through changes in procedures and on-site visits to regions, it has taken steps to assure that employees and their work are better supervised;
- it has changed procedures and issued instructions to make sure all accounting transactions are properly and fully documented; and

- it will change its procedures in accounting for advances, accounts receivable, and allowances for doubtful accounts, which will result in more accurate and better supported financial reports.

The Service did not respond to our recommendation that it resolve audit findings and recommendations promptly. We believe that an effective audit resolution process is an essential internal control tool, and that the Service, in performing its enhanced internal control reviews, should make sure that audit findings and recommendations are promptly resolved.

Improper Accounting Practices

Our review of the Service's accounting operations disclosed several accounting and reporting problems, including improper accounting for letters of credit, unrecorded advances receivable, failure to establish an allowance for losses, and failure to record write-offs for uncollectible amounts. As a result, Service management cannot be certain that its accounting operations comply with the Comptroller General's accounting principles and standards and that they accurately disclose the results of the Service's financial operations.

Improper Accounting for Letter of Credit Disbursements

The Service funds most of its programs through grants which are financed through letters of credit to grantees amounting to about $6.5 billion each year. Under the letter of credit financing arrangement, funds are not to be permanently held by the grantee but are to be requested from the Service on an "as needed" basis. (See appendix I for a description of the letter of credit process.)

In order to properly control letter of credit disbursements, title 2 requires that they be recorded as advances to grantees until the Service knows the actual amounts of the program expenses incurred by the grantees. The advances should subsequently be reduced by the amount of program expenses shown in periodic reports submitted by the grantees. The Service, however, improperly records all letter of credit disbursements as program expenses when the disbursements are made.

We believe that since the Service does not establish advance accounts but instead improperly records letter of credit disbursements as expenses, Service management does not know, either during or at the end of the fiscal year, the amounts owed to or from the grantees who draw either too little or too much through the letter of credit process. These amounts are significant. For example, from information contained in grantee reports, we found that some grantees in the Service's midwest region drew $26.6 million more than was needed from their letters of credit to meet program expenses. Conversely, we found that other grantees in the region drew $28 million less than was needed. Since none of these amounts were recorded in the accounting system as payables or receivables, management lacked basic control over substantial assets and liabilities.

Failure to record payables and receivables can also preclude the disclosure of any improper adjustments to letter of credit cash balances. For example, we found, in reviewing a grant closeout adjustment, that a Service accountant made a change to letter of credit records which effectively reduced the amount the grantee would have to pay back to the government by $138,300. The change involved transferring a fiscal year 1980 letter of credit cash balance to fiscal year 1985. There were no records for the grant process or for expenses on this grant prior to 1983; therefore, we could not determine if the adjustment was correct. The accountant responsible for making the adjustment was unable to explain the basis for the adjustment and no documentation was available to support the entry. Also, no supervisory approval was evident. Lack of disclosure of this entry as an adjustment to accounts receivable may have precluded Service management from questioning the propriety of transferring the balance to fiscal year 1985.

In response to our report, the Service stated that documentation exists to support the amount in question. However, the Service has not provided us with any further documentation to review. Finally, the Service has indicated that transferring letter of credit balances from one year to another will no longer be permitted. This action should preclude any recurrence of the problem.

The Service's accounting treatment of letter of credit disbursements as expenses rather than advances also results in erroneous expenditure balances at year-end. Obligated balances recorded at year-end reflect amounts advanced and, therefore, need to be adjusted to reflect the expenses actually incurred during the year by the grantees. Instructions dated August 23, 1985, and October 4, 1985, which were provided to the regions from the Service's Accounting Division for reporting year-end closings, did not require them to adjust expenditures to actual expenses. Rather, they instructed the appropriate employees to review and reconcile obligations.

In order to properly manage and account for letter of credit disbursements, the Service needs to change its system to record advances to grantees as disbursements and to accurately record expenses against advances, thereby appropriately reflecting advances receivable and accounts payable.

In its response to our report, the Service cited reasons why letter of credit drawdowns should not be recorded as advances. Among these, it mentioned the burden which such a procedure would place on states to submit monthly information on expenditures so that advances could be liquidated in a timely manner. However, the Service recognizes that there is a need to better disclose advances and to control excess advances. It advised us that it plans or has taken the following actions:

(1) The Service has changed its accounting policy and now establishes accounts receivable for all excess advances that are detected through its cash management procedures both during the fiscal year, when requests for drawdowns are received, and during the grant-closeout process, when final obligations are reconciled with disbursements.

(2) The Service will change its procedures to recognize that some letter of credit drawdowns made the last week of the month may not be disbursed by some states until the first week of the following month. Therefore, letter of credit drawdowns made after the 25th of each month will be recorded as advances.

We believe effective implementation of these actions will result in better financial disclosure and better control over excess advances.

Unrecorded Advances Receivable

According to title 2, the acceptance of an assistance award from the federal government creates a legal duty on the part of the recipient to use the available funds in accordance with the terms and conditions of the assistance agreement. The award recipients are generally required to return to the federal government (1) the unused balances of advance payment awards and (2) funds improperly applied. Title 2 requires that at the termination of a grant, funds unused and/or improperly applied by the recipient be established as a receivable by the assisting agency.

The Service is not in compliance with this accounting standard. It does not record advances receivable in its accounting system and, therefore, cannot disclose amounts owed to it by the grantees.

We found that one grantee, over a period of 2 years, drew from the letter of credit system about $16.3 million over authorized expenses (as of the end of fiscal year 1985). This balance consisted of excess cash of about $9 million drawn in fiscal year 1984, and excess cash of $7.3 million drawn in fiscal year 1985. As long as the accounting system fails to record these amounts as receivables, there will be a lack of disclosure that such receivables exist. As the grantee continues to overdraw each year, the grantee will, in effect, maintain a long-term, interest-free loan of increasing size. If the Service established an advance receivable for this grantee, the amount owed could be disclosed and action could be taken to collect the funds owed to the Service.

As noted above, the Service has advised us that its procedures now require that excess advances be recorded as receivables. This action, if effectively implemented, will help avoid long-term interest-free loans and will help the Service manage and collect amounts owed to it.

Allowance for Uncollectibles Not Established

In May 1986, we issued a report[3] showing the clear need for agency officials to strengthen their efforts in ensuring that accounts receivable are aggressively managed and the need for accounting systems to provide current and accurate information on the status of debts. We believe that Service managers cannot properly manage an accounts receivable portfolio of the current magnitude ($350 million) without accounting information disclosing the success of their efforts in collecting amounts owed the government.

The Service's accounting system does not provide vital information on bad debts to agency managers responsible for its accounts receivable, which exceeded $350 million, as of December 31, 1985. For example, the Service does not record in its accounts an estimate of the amount of accounts receivable that it believes to be uncollectible. Matching an estimate of potential bad debts with actual losses is crucial to management control of assets and provides a means by which to judge the effectiveness of collection efforts.

Title 2 of the GAO manual requires that receivables be reduced by an allowance for uncollectible amounts and requires that such allowances be based on past experience. The estimated uncollectible amounts and procedures for determining the estimates are to be disclosed and recorded in the accounting system.

Despite the requirement in title 2, Service accounting procedures do not require that an allowance for uncollectible amounts be recorded in the accounting system. In reports filed with the Treasury as of December 31, 1985, the Service indicates that about $133 million was considered uncollectible. This amount was reported as an allowance for uncollectible accounts; however, it did not represent a balance of uncollectible accounts maintained in the Service's general ledger, nor was it based upon a study of historical data. When questioned regarding its estimation practices, a Service official could not disclose any historic basis to support the estimate of uncollectible amounts reported to Treasury.

[3] Debt Collection: Billions Are Owed While Collection and Accounting Problems Are Unresolved (GAO/AFMD-86-39, May 23, 1986).

The Service, in its response to this report, advised us that it agreed with this finding and will take the necessary steps to change its existing accounting procedure.

Write-Offs for Bad Debts Are Not Recorded

In reports to the Treasury, the Service did not report any bad debt expense. Given the nature of the accounts, many of which were established to collect amounts owed because of fraudulent acts, the amount of debts which should be written off and disclosed is, in all probability, substantial.

GAO standards require that accounts receivable amounts determined to be uncollectible be promptly written off. These requirements are necessary for reliable financial reporting of assets and losses.

We found that Service accounting procedures do not require that amounts actually lost through bad debts be accounted for on a systematic basis. When an account receivable is judged to be uncollectible, instead of recording the loss as a write-off, accounting personnel cancel the original recording of the account by reversing the original entry. For example, in the southwest region we reviewed 12 accounts determined to be uncollectible. In each case, the accounts were removed from the balance of accounts receivable by reversing the original recording process. A more acceptable accounting treatment would be for the Service to remove the account receivable by charging it to the allowance for uncollectible accounts. Service management could not adequately explain why basic procedures regarding accounting for uncollectible accounts were not used.

The Service's current procedure of reversing entries for uncollectible receivables effectively precludes actual loss information being used by management and, very importantly, it masks the disclosure of this important information in reports to Treasury and OMB.

In order to comply with the requirements of titles 2 and 4 of the GAO manual for adequate disclosure of both uncollectibles and losses, the Service needs to implement procedures to establish an allowance for uncollectible accounts and properly record losses as expenses.

In its response to our report, the Service said it agrees with the above finding and will take the necessary steps to change its accounting procedures.

Conclusions

Our review of the Service's accounting practices disclosed several accounting and reporting problems, including

- improper accounting for letters of credit,
- unrecorded advances receivable needed to identify unused balances of grant awards,
- failure to establish an allowance for losses, and
- failure to record write-offs for uncollectible amounts.

Given these problems in its accounting practices, Service management cannot demonstrate compliance with the Comptroller General's accounting principles and standards, and it cannot ensure that its financial reports accurately disclose the results of the Service's financial operations.

Recommendations

In order to ensure proper accounting, the Administrator should

- direct the headquarters' Accounting Division to record letters of credit as advances and to reduce the advances subsequently by the amount of program expense shown in periodic reports submitted by grantees,
- direct the headquarters' Accounting Division to record advances receivable in its accounting system, and
- direct the headquarters' Accounting Division to revise accounting procedures to require that an allowance for uncollectible amounts be recorded in the accounting system and that losses for bad debts be recorded as expenses against the allowance.

Agency Comments and Our Evaluation

The Service has responded to each of our recommendations, as follows:

(1) The Service has changed its procedures to require that excess advances be recorded as receivables.

(2) The Service plans to record, on a monthly basis, advances that it estimates as having not been expended by grantees.

(3) The Service will change its procedures to require that an allowance for uncollectible amounts and losses for bad debts be recorded.

We believe that these actions, if effectively implemented, will better account for, disclose, and control advances and receivables.

Weaknesses in Automated System Controls and Documentation

Our review of the Service's system in operation disclosed that the Service lacks necessary controls over changes being made to its accounting system and that it lacks documentation for changes made to the system. As a result, management cannot be certain that its policies are reflected in the accounting system operation or that the system complies with the Comptroller General's accounting principles and standards as well as standards for internal control.

Responsibility for accounting and budget operations is shared between the headquarters' Accounting and Budget Divisions, located in Alexandria, Virginia, and the accounting and budget operations located in the seven regions. For example, both headquarters' divisions and also the regions are responsible for entering transactions to FARS in accordance with their respective responsibilities for allocating and disbursing funds, awarding grants, and collecting receivables. Generally, accounting data are entered and retrieved through computer terminals in the regions and at headquarters. The data are then centrally processed at the Department of Agriculture's Washington Computer Center (WCC).

Inadequate Automated Data Processing System Controls

Adequate controls are essential for ensuring the reliability of and security over the data processed by computer-based systems. Service procedures require that a written request be made for all major system changes that will cost more than $100,000 or that require more than 6 staff years of effort and that such changes be approved formally by appropriate levels of management. A Service official told us that all other changes are made and coordinated between the individual desiring the change and the systems programmer. These lesser changes are not required to be formally reviewed and approved.

Our review disclosed that significant changes can be made to the automated system even though they do not meet the Service's criteria for "major" changes. This allows significant alterations to the system without the crucial control of management review and approval. Specifically, we found that the Service lacked controls to ensure that

- persons are restricted from modifying or creating computer programs with little or no review and
- separation of duties are adequate to provide for independent review and testing of system changes.

For example, the development of a new accounts receivable subsystem—one which accounts for over $350 million in receivables—did not qualify as a "major" change. Only two individuals were substantially involved in the systems change—the systems accountant, who provided general systems requirements, and a programmer, who in turn developed and coded the new system. The programmer was also responsible for coordinating testing of the system, and, upon implementation, the programmer was responsible for maintaining the system.

Because this system change was not subject to formal review and approval, there is no assurance that all necessary controls and other features that management might have required were included in the subsystem. Additionally, since there was a lack of separation of duties in that the change was not reviewed and tested independently of the programmer involved, the system is vulnerable to fraudulent manipulation—an unacceptable degree of risk.

Management should ensure adequate systems controls by participating in the approval and development process for the subsystem and should have ensured a separation of duties in accordance with GAO standards for internal control. Service management needs to strengthen its controls over systems modifications to ensure that all significant changes are subjected to supervisory review and approval. Additionally, the process for making changes to the system needs to provide for an adequate separation of duties.

The Service, in response to our report, agreed with the above finding and advised that it had issued written instructions to require the approval of the Director, Division of Accounting, for all significant changes to the automated system. Such approval will be needed for the initiation, testing, and implementation phases of the systems change.

Lack of System Documentation

The Department of Agriculture's information processing standards and Federal Information Processing Standards (FIPS) publication 38 require that ADP program maintenance documentation describe the operational system to include functional and data requirements; design specifications for system logic, input, and output; and decision tables and system flowcharts.

System documentation provides management with a reference point to assure that the system is working effectively and that assets are properly safeguarded. Further, good documentation facilitates ease and accuracy of program maintenance. Finally, good documentation may actually deter fraudulent manipulation of the system, which is usually easier to perform when there is little or no systems documentation.

We found that Service procedures do not require that written documentation describing all changes to the system be updated. As a result, the Service has an undocumented system. For example, there is no documentation for the Service's general ledger system—other than that provided by the vendor in 1982. Moveover, since 1982 there have been important changes, including the new accounts receivable subsystem discussed above, which have been made to the system without necessary written documentation. For instance, the original system was altered by substituting an automated data input process for the original manual input process. This important change should have been thoroughly documented and explained to identify the controls in place and to ensure accuracy of data processing and reporting. Given the lack of an effective documentation process, coupled with the ease with which individuals can make significant system changes, Service management has no assurance that only authorized changes can be made to the Service's system and records.

To ensure that only authorized changes are made, Service management needs to revise its procedures to require that all changes to the system be properly documented in accordance with Department of Agriculture requirements and federal information processing standards.

The Service, in response to our report, agreed in part with our finding. The Service said that the original general ledger software it obtained in 1982 was and remains fully documented. We agree that in 1982 the vendor provided documentation for the original general ledger system. However, we found, as demonstrated by the above example regarding the input process, that changes to the original general ledger system had been made without being documented.

Lack of Contingency Plan for ADP Operations

The Service has no contingency plan to continue ADP accounting operations in the event a disaster occurs and the Washington Computer Center (WCC) is unable to operate.

The departmental manual for ADP security and FIPS publication 31 state that contingency plans should be created and periodically tested. During 1985, the Service conducted a test of a backup plan which called for processing by a different Agriculture computer center. They were unable to get their programs to operate successfully, and after about 2 months of trying, dropped the effort. The Service then informed the Department's Office of Information Resources Management (OIRM), which is responsible for ADP operations within the Department.

At the time of our review, we were informed that no action had occurred. The Service would be unable to continue normal accounting operations if the WCC were unable to function. As a result, grantees could expend millions of dollars on federal programs without the Service's ability to ensure proper control over and accounting for federal funds. Moreover, the grantees would have no certainty as to when reimbursement from the Service would occur in the event of a disaster. The Service needs to develop a contingency plan for its ADP operations to ensure continued operation of its accounting system in the event a disaster occurs at the WCC.

In its response to our report, the Service agreed that it does not have a backup computer available to run its system should the Agriculture computer center become unable to operate. The Service indicated that it does send a backup copy of its accounting database to off-site storage each week. Although this is a prudent practice, it does not ensure the continuation of accounting operations. The Service advised it will pursue the implementation of a contingency plan with OIRM, which is researching ways to provide for contingency operations.

Conclusions

Our review disclosed weaknesses in the Service's accounting system controls and documentation. Specifically,

- The Service lacks controls necessary for ensuring the reliability of and security over the data processed by its computer-based systems in that significant systems changes were made without appropriate review and approval.
- Systems changes and tests were made by individuals responsible for system operations, thus violating the internal control standard for separation of duties.
- System documentation has not been updated to reflect all changes made to the system, resulting in an essentially undocumented accounting system.

As a result of these weaknesses, the Service cannot ensure the reliability and security of its financial data. Further, it cannot be certain that its policies are reflected in the accounting system operations or that the system complies with the Comptroller General's internal control standards and accounting principles and standards.

Recommendations

In order to ensure the reliability and security of the Service's financial information, we recommend that the Administrator direct that

- proposed system changes be submitted for formal management approval prior to implementation. (Criteria for determining when formal review and approval are necessary should include the nature of the proposed change and not solely the dollar amount or staff years of effort involved.),
- appropriate separation of duties be maintained to reduce the risk of error or fraud and to ensure effective checks and balances, and
- written documentation be updated to include all changes made to the system.

Additionally, the Administrator should request that the Director, OIRM, identify the difficulties encountered by the Service during its attempt to operate its backup plan and work with the Service to establish an operating contingency plan.

Agency Comments and Our Evaluation

The Service, in its response to our report (see appendix II), agreed that system changes should receive approval prior to implementation and it has issued written instructions requiring such approval by the Director of the Accounting Division. If these instructions are adequately implemented, only those changes authorized by top management will be effected.

The Service also agreed in part that the system lacks documentation, and, contingent on available resources, it plans to procure a contractor to document the undocumented parts of the accounting system. The Service stated that the original general ledger software procured in 1982 was and remains fully documented. However, as shown earlier in this chapter, we believe the general ledger is not fully documented, and, in taking corrective action, the Service must ensure that all changes to the system are adequately documented.

Regarding the recommendation to establish a contingency plan, the Service advised us that the Department's OIRM is researching ways to provide this capability and that the Service will pursue implementation of this plan with the Department.

The Service did not respond regarding our recommendation to maintain appropriate separation of duties. We believe that the Service should act on this recommendation to ensure effective checks and balances.

Secretary of Agriculture Must Act To Strengthen Financial Management at FNS

Our findings demonstrate significant internal control weaknesses and a lack of discipline in systematically enforcing fundamental internal and accounting procedures and controls at FNS. This is a serious problem for an organization which spends over 30 percent of the Department of Agriculture's appropriations.

The Secretary of Agriculture should be concerned with the wide-ranging nature of the deficiencies disclosed in this report. These deficiencies cover serious problems in accounting for obligations, disbursements, advances, bad debts, food coupon redemptions, automated systems changes, significant undocumented adjustments to official accounting records, undocumented systems, and inaccurate external reports. The wide scope of these deficiencies indicates a general breakdown in supervision and control of the Service's accounting functions.

The weaknesses in internal and accounting control were not disclosed as required in the Service's annual FMFIA reports to the Secretary of Agriculture. As a result, the Secretary was not in the position to fulfill his responsibility to identify and report on these weaknesses or to take appropriate corrective actions to ensure adequate systems of accounting and internal control.

Comprehensive Corrective Action Plan Needed

FMFIA reports are prepared to establish that agencies comply with standards for internal and accounting control and if not, to identify any material weaknesses and provide plans and schedules for corrective actions. The internal and accounting control weaknesses discussed in this report represent deviations from the Comptroller General's accounting principles and standards as well as standards for internal control. However, the Service did not disclose these weaknesses or any plans for corrective actions in its annual FMFIA reports to the Secretary of Agriculture. From 1984 through 1986 the Service reported that its systems were either in full compliance or in substantial compliance with the Comptroller General's principles and standards.

Failure to report the many deficiencies we noted, including weaknesses in internal controls, and accounting for obligations, disbursements, advances, and bad debts, may be the result of the Service's poor FMFIA review process prior to issuance of its reports. In a February 12, 1987, report, addressed to the Department of Agriculture's Director of Finance and Management, the inspector general noted that neither limited nor detailed reviews were consistently performed in sufficient depth to support a statement of assurance that systems complied with the Comptroller General's principles and standards. Service managers should have taken advantage of the act in identifying and initiating corrective action through an effective FMFIA review process.

Failure to disclose to the Secretary the serious weaknesses included in the above mentioned IG report may have delayed the initiation of a comprehensive corrective action plan. Given the many recommendations included in this report, it would be unproductive to implement them on a piecemeal or separate basis. There are many factors to consider before initiating corrective actions, such as the marshalling of resources to effect the changes, training personnel in new controls and accounting procedures, formulating a priority list of actions to be taken, and establishing key milestone dates. In short, a successful corrective action plan will require a comprehensive, integrated approach. With the information and recommendations contained in this report, the Secretary has a starting point for requiring such a plan from the Service.

Recommendations

We recommend that the Secretary of Agriculture direct the Administrator of FNS to submit a comprehensive plan for implementing the recommendations we have made in this report. This plan should be approved and its implementation monitored by the Secretary.

We also recommend that the Secretary direct the Administrator to improve FNS evaluations of its internal controls and accounting systems by performing them in sufficient depth to disclose all material weaknesses. Such weaknesses and planned corrective actions should be disclosed in the Service's annual FMFIA report.

Agency Comments and Our Evaluation

The Service, in its response to our recommendations, provided a plan for correcting the many weaknesses in its internal controls and accounting practices noted in our report.

Also, in its response to our report, the Service agreed that a thorough review of the accounting system as well as the FMFIA reporting process is in order. The Service advised us that its system does have several weaknesses, that its internal control evaluation process does not always detect these weaknesses, and that the weaknesses have not been highlighted to top management. The Service said it plans stronger FMFIA reviews beginning in fiscal year 1988. These reviews will cover all components of FNS's accounting system.

We believe the Service's positive response to our recommendations demonstrates its desire to make a strong commitment to improve its accounting and internal controls and to enhance its FMFIA reviews and reporting process. While the response was silent as to the role the Secretary of Agriculture would have in approving and monitoring the implementation of the plan, we were assured in a subsequent discussion with a Service official that the Secretary would remain involved in plans for corrective actions.

Letter of Credit Process

Food and Nutrition Service grant programs provide about $6.5 billion a year to the grantees through a letter of credit process. This process allows the grantees to draw on established credit balances, as needed, to pay expenses associated with their grants. It also allows the federal government to hold funds until the payments are made. Each of the Service's regions is responsible for awarding and managing grants using the FARS system. Regions also authorize and monitor letters of credit cash needs and approve individual cash draws.

The accounting procedures and controls over letters of credit are complex. In order to establish credit balances for the grantees, the Service's Accounting Division first provides letters of credit to Treasury with copies to the regions. Treasury enters the credit information into its letter of credit system. Service regions provide copies of the letters to the grantees. When it becomes necessary to pay grant expenses, grantees such as states notify their commercial banks, providing them with their letter of credit account number and an order to draw funds. A series of automated notifications follow in sequence from the commercial banks, to the Federal Reserve Banks (FRB) in their area, to the FRB in New York, to Treasury, and then to FNS. The Service's Accounting Division enters the requests to draw into its letter of credit subsystem for review and approval by the appropriate regions. If the requests are approved by the regions, Treasury is notified by the Service and electronically transmits the funds to the grantees. All of these actions occur within 1 day of the states' requests.

In order to properly control funds disbursed to grantees, title 2 requires that such amounts be recorded as advances (or as a charge to a restricted cash account). The advances should subsequently be reduced by the amount of program expenses shown in periodic reports which grantees submit to the Service during the year. The year-end balance in the advance account would serve as a basis for establishing the Service's advances receivable or accounts payable. Also, at year-end the amount of program expenses reported by grantees should be used to adjust expenditures reported by the Service.

Comments From Food and Nutrition Service

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

United States Department of Agriculture

Food and Nutrition Service

3101 Park Center Drive
Alexandria, VA 22302

Reply to Attn. of:

NOV 9 1987

Subject: Comments on Draft Report Entitled "INTERNAL AND ACCOUNTING CONTROLS: Food and Nutrition Service Lacks Effective Controls"

To: J. Dexter Peach, Assistant Comptroller General
Resources, Community, and Economic Development Division
General Accounting Office

See page 41.

Enclosed are our comments on your draft report entitled "Internal and Accounting Controls: Food and Nutrition Service Lacks Effective Controls" (see Attachment A).

See comment 1.

Thank you for your study of the Service's Program Accounting System (PAS). FNS is well aware of most of the problems or weaknesses cited in the draft report and has already corrected or is in the process of correcting most of them. In addition, in the more than 12 months since the audit ended and before the draft report was issued, FNS planned or implemented a number of actions to enhance its automated financial accounting system, improve its accounting procedures, and strengthen its internal control system.

See page 47.

I agree, however, that a thorough review of the PAS, as well as of our Federal Managers' Financial Integrity Act (FMFIA) reporting process, is in order, beginning with the areas you have identified. Such a review should detect and result in plans to correct any systemic deficiencies in the PAS and in our internal control evaluation procedures. The Service's comprehensive plan for correcting the weaknesses in internal controls and accounting practices noted in the draft report is contained in Attachment B.

Because of the short time given FNS to respond to the draft report, the plan as presented here, particularly with respect to target dates, should not be considered final.

In addition to addressing the specific findings contained in the report, the comprehensive plan provides for stronger FMFIA reviews beginning in Fiscal Year 1988. These reviews will be carefully planned to cover all components of the PAS, including adherence to GAO accounting policies, compliance with GAO and Office of Management and Budget regulations on internal controls, adequacy of written FNS accounting procedures, regional as well as headquarters applications of these procedures and controls over ADP applications. In addition, the plan provides for enhancements to our internal control evaluation process and automated accounting system.

J. Dexter Peach 2

Please direct any questions about this response to the Service's Deputy Administrator for Financial Management, Jack Radzikowski, at 756-3046.

Sincerely yours,

Anna Kondratas

ANNA KONDRATAS
Administrator

Attachments

Attachment A

Executive Summary

In general, the Food and Nutrition Service (FNS) agrees with many of the report's findings. FNS' Program Accounting System (PAS) does have several weaknesses, and its internal control evaluation process did not always detect these weaknesses. In addition, the annual Federal Managers' Financial Integrity Act (FMFIA) reviews performed by FNS did not highlight these weaknesses to top management.

FNS is well aware of most of the problems or weaknesses cited in the draft report and has already corrected or is in the process of correcting most of them. In addition, in the more than 12 months since the audit ended and before the draft report was issued, FNS planned or implemented a number of actions to enhance its automated financial accounting system, improve its accounting procedures, and strengthen its internal control system.

See page 48.

In accordance with GAO's recommendation, we have devised a comprehensive plan for correcting the weaknesses in internal controls and accounting practices noted in the draft report. Because of the short time given FNS to respond to the draft report, the plan as presented here, particularly with respect to target dates, should not be considered final. In addition to addressing the specific findings contained in the report, the comprehensive plan provides for stronger FMFIA reviews beginning in Fiscal Year 1988. These reviews will be carefully planned to cover all components of the PAS, including adherence to GAO accounting policies, compliance with GAO and Office of Management and Budget regulations on internal controls, adequacy of written FNS accounting procedures, regional as well as headquarters applications of these procedures and controls over ADP applications. In addition, the plan provides for enhancements to our internal control evaluation process and automated accounting system.

Without disputing the need for a comprehensive review of its accounting and internal control systems, FNS takes issue with several specific examples of weaknesses cited in the draft report. Comments on these findings are detailed below along with FNS' comments on the remainder of the report.

Comments on Specific Findings

Chapter 2: Internal Control Weaknesses

o Undocumented and Unauthorized Transactions

See comment 2.

-- Child Nutrition Obligations. The draft report cites an instance of an adjustment of Fiscal Year 1984 Child Nutrition obligations made by a regional section chief without proper justification or supervisory approval. FNS does not deny that this incident occurred. However, the section chief involved, who has since been transferred out of the accounting area, had failed to follow established procedures. In addition, headquarters accounting staff had for a period of several months before the Fiscal Year 1984 close-out given the section chief guidance on making the adjustment,which the section chief had failed to follow or, apparently, understand. Rather than ask for additional help, the individual made an incorrect and improperly documented entry, in violation of existing operating procedures. The final adjustment for this transaction was made by headquarters accounting staff but was not documented sufficiently in the record.

FNS has already implemented a change in procedure to require a written justification and supervisory initials on all similar adjustments. The Accounting Division has also distributed specific year-end instructions to the regions to emphasize the need for proper documentation and approval of all accounting transactions. In addition, in an effort to avoid recurrences of this and similar compliance problems, the Accounting Division intensified its on-site reviews of regional operations during FY 1987, visiting 5 of the 7 regions, and (resources permitting) plans to visit each region several times in FY 1988 and successive years.

See comment 3.

However, we must point out that AT NO TIME was there ever any possibility of an Anti-deficiency Act violation, as no legal or disbursable obligation in excess of the appropriation or allotment existed on FNS' official books. FNS would like the final report to delete any reference to a potential violation of the Anti-deficiency Act.

See comment 4.

-- General Ledger Replacement. GAO also cites as an example of undocumented and unauthorized accounting transactions an instance where general ledger records were replaced without supervisory approval. It is true that neither the Director of the Accounting Division at that time nor any higher-level official personally approved this decision, and as a result FNS procedures have been changed to require the Director's approval on all significant changes to Program Accounting System data or ADP applications. However, contrary to statements at the bottom of page 10 and the top of page 11 of the draft report, the erroneous data deleted from the general ledger were not destroyed but still exist on a computer file. In addition, headquarters accounting staff understands precisely why the ledger records had to be replaced. FNS would be happy to explain the technical necessity for the replacement and to furnish GAO with the amount of the difference between the original general ledger records and the letter-of-credit subsystem disbursement records which replaced them. **FNS would like the final report to delete any reference to any failure on the part of FNS officials to determine the exact amount of the ledger difference or to determine the exact cause of the difference.**

See page 13.

See comment 5.

-- Food Stamp Adjustments. The GAO draft report cites nine year-end adjustments to Food Stamp program accounts made for Fiscal Year 1985 which did not have proper documentation. FNS agrees that these transactions were not properly documented. FNS has since changed its Program Accounting System procedure to require both a detailed explanation and supervisory approval of all such adjustments.

2

o Incorrect and Untimely Accounting Transactions

See comment 6.

-- Suspense File Items. The GAO report states that timely accounting data was not available to FNS managers in part because "millions of dollars in accounting transactions, rejected as being in error by the system, were being held in a suspense file for extended periods of time--in some cases about one year." This was not the case. The transactions referenced in the report were a small group of FY 1985 year-end closing transactions held in a recycle or error file. These transactions were deliberately held in the recycle file to facilitate closing the automated FY 1985 general ledger. The recycle file has since been completely cleared out and the close-out process has been automated, which should prevent any recurrence of this "problem". We would be happy to explain the mechanics of the recycle file and/or the close-out program to GAO at their convenience. **FNS would like to see this example of internal control "weakness" deleted from the final report.**

See comment 7.

See comment 8.

-- Fiscal Year 1984 Close-Out. The draft report states that FNS' closing process for Fiscal Year 1984 was incomplete 8 months into Fiscal Year 1986. This was not the case. The Fiscal Year 1984 books were closed on time and all FY 1984 year-end reports were submitted in a timely manner. It is true that closing general ledger entries for Fiscal Year 1984 were done manually, as this process had not yet been automated (see comment on "Suspense File Items"). However, there is no requirement as far as FNS knows that the year-end closing process must be computerized to be valid. FNS will gladly furnish GAO evidence of its timely manual Fiscal Year 1984 close-out. **FNS would like GAO to delete from its final report any reference to a failure to close its Fiscal Year 1984 books on time.**

See comment 9.

o Unsupported Obligation Balances. The draft report states that significant amounts of obligations on final Fiscal Year 1985 FNS external reports, specifically the "Year-End Closing Statement" (TFS-2108) and the "Report on Budget Execution" (SF-133), were unsupported. Specifically, the report states that personnel in one region had entered estimates of obligations into PAS without sufficient documentation, while personnel in another had used letter-of-credit authorization balances rather than general ledger balances to certify year-end obligations. The draft report also states that "there was no documentation to support the [latter] region's certification of the obligations" for prior fiscal years. FNS obligations were both accurate and properly certified on its Fiscal Year 1985 and prior year-end reports, as well as on Fiscal Year 1986 reports, and FNS has documentation to support these certifications. **FNS would therefore like to see any reference to unsupported obligations or resulting inaccurate year-end reports deleted from the final report.**

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See comment 10.

-- "Report on Financial Condition (SF-220)" Errors. FNS agrees that treating all letter-of-credit drawdowns as expenditures rather than accounting for such drawdowns as advances is a technical violation of established GAO accounting principles. FNS adopted this accounting practice in 1980 after consultations with the Treasury Department, which advised FNS accounting staff that its then-new letter-of-credit system (the Treasury Financial Communications System, or TFCS) was designed to hold drawers to minimum immediate cash needs and that drawdowns could therefore be treated as expenditures. In support of this position, Treasury form TFS-5805, "Request for Funds," contains a certification to be completed by the drawer/requester which states in part "I also certify that the data reported is correct and that the amount of the Request for Funds is not in excess of immediate disbursement needs."

Relying on this certification, FNS has accounted for all drawdowns since 1980 as expenditures, on the assumption that state grantees treat the drawdowns as reimbursements for monies already spent or will spend the drawdowns within two or three days of receipt. It should also be noted that most FNS grants are entitlement grants payable on demand rather than project grants whose payments are subject to verification of work performed. In our opinion, therefore, accounting for such cash drawdowns as advances would serve little purpose. In addition, treating all drawdowns as advances would require the states to submit monthly information on expenditures to FNS to enable it to liquidate the advances in a timely manner. FNS feels that this requirement would be extremely burdensome on the states and would not be a cost effective mechanism for controlling drawdowns.

GAO appears concerned that, by failing to account for cash drawdowns as advances, FNS would also fail to identify and collect excess withdrawals by the grantees. It is apparently GAO's opinion that FNS can exercise proper cash management of state cash balances only by recording accounts receivable in its general ledger for any excess advances held by the states (and then presumably collecting the receivables). GAO apparently is not aware that FNS avoids the necessity of setting up and collecting such receivables by continually monitoring the states' cash balances, which are also certified on the TFS-5805, and routinely denying additional drawdowns to states which have excess cash on hand. FNS has been very aggressive in overseeing grantee cash management to ensure that letter-of-credit drawdowns are limited to immediate disbursement needs. FNS has issued a standard Cash Management Review Guide and our regional offices have applied the standard review procedures in all FNS programs. This concerted activity to improve grantee cash management has been one of this agency's major objectives for the past several years and has produced significant results in eliminating excessive and untimely drawdowns. In addition to its ongoing cash management activities, FNS performs a complete reconciliation of each grantee's actual expenditures against drawdowns when each grant is closed out. FNS therefore feels that it is meeting both its cash management responsibilities and GAO's Title 2 accounting standard without treating any of its drawdowns as advances.

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Although FNS believes that accounting for most drawdowns as advances is inappropriate, since drawdowns made the last week of each month are normally spent by the states before the month ends (and excess state cash balances are closely monitored), FNS recognizes that some drawdowns made the last week of the month may not be disbursed by some states until the first week of the following month. Drawdowns which have not been disbursed by the end of the accounting period may be considered advances. In recognition of this, FNS will change its accounting procedures to recognize letter of credit drawdowns made after the 25th of each month as advances (to be reversed the following month). FNS will continue to monitor grantee drawdowns aggressively to insure that grantees do not withdraw cash in excess of need.

See comment 11.

-- Allowance for Uncollectible Accounts. FNS agrees with this finding and will take the necessary steps to change its existing accounting procedure.

o Unresolved Audit Finding on Food Coupon Redemptions

See comment 12.

FNS agrees with this finding. However, FNS is disappointed that the draft report fails to mention the considerable logistical and technical difficulties involved in establishing a system to trace payments for food stamp coupon redemptions to individual vendors and to reconcile such payments against authorized redemptions. Such a system would require cooperation from Federal Reserve Banks, commercial banks and state agencies and would place a large paperwork and processing burden on those entities as well as on FNS resources. The enormous effort involved is the largest reason for FNS' failure to comply with this finding. However, the draft report also fails to mention a major FNS initiative to overhaul the Food Stamp redemption system which should eventually enable FNS to reconcile actual with authorized redemptions. **FNS would like to see its efforts in this area acknowledged in the final report.** To this end FNS would be happy to furnish additional details of this project to the GAO.

Chapter 3: Improper Accounting Practices

Most of this chapter of the draft report simply restates several of the findings delineated in Chapter 2 from the perspective of compliance with GAO accounting policies rather than from an internal control standpoint. We will limit our comments to three findings.

-- Letter-of-Credit Cash Balances. The draft report states that FNS changed letter of credit records to reduce by $138,300 the amount a grantee owed FNS. This was not the case. The change referenced in the report involved transferring, or "rolling over," an FY 1980 letter-of-credit cash balance to FY 1985. Rollovers, which FNS no longer permits, allowed states to apply against a subsequent grant cash found to be in excess of need for the current grant. It is not true that insufficient documentation existed for the rollover referenced in the draft report. PAS procedures required all rollover entries to be supported by

See comment 13.

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both the grant award document and an attached worksheet explaining the details of the rollover. These documents did, in fact, exist. However, the PAS procedures did not require that copies of these documents be attached to the document used to make the rollover accounting entry. It is true that allowing states to retain such excess cash distorted the expenditure balances reported for the years when rollovers were allowed. FNS has now changed its accounting policy and now establishes accounts receivable for all excess cash balances when they are detected, both during the fiscal year when the requests for drawdowns are received and during the grant close-out process when final obligations are reconciled with disbursements.

See comment 14.

-- Allowance for Uncollectibles Not Established. It is true that FNS had not established an allowance for bad debts in accordance with GAO-prescribed procedures. FNS has nearly completed a recalculation of its bad debt allowance and plans to adjust the unsupported amount currently on its general ledger by the end of December 1987.

See comment 15.

-- Write-offs of Bad Debts Not Recorded Properly. FNS agrees with this finding and will take the necessary steps to change its existing accounting procedure.

Chapter 4: Weaknesses in Automated System Controls and Documentation

o Inadequate Automated Data Processing System Controls

See comment 16.

FNS agrees with this finding and has already issued written instructions to require the approval of the Director, Division of Accounting, to request, test and implement all significant changes to the ADP system.

o Lack of System Documentation

See comment 17.

FNS agrees in part with this finding. FNS would like to point out that the original general ledger software (Computer Data Systems, Incorporated's Financial Accounting and Reporting System, or FARS) it obtained in 1982 was and remains fully documented and that FNS has not altered the original code of that system. The remaining half of the Program Accounting System is undocumented. FNS plans to document the undocumented parts of the system as resources become available.

o Lack of Contingency Plan for ADP Operations

See comment 18.

FNS agrees in part with this finding. FNS does send a back-up copy of the PAS database to off-site storage each week. However, FNS does not now have a back-up computer available to run the PAS should the USDA computer center become unable to operate. The Department's Office of Information Resources Management is researching ways to provide this capability. FNS will pursue this with the Department.

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Attachment B

Food and Nutrition Service Comprehensive Plan
to Identify and Correct Deficiencies
in the Program Accounting System

Actions	Milestones	Date
1. Improve monitoring of cash withdrawals by state grantees	- Continue direction to FNS regional offices to perform cash management reviews under standardized procedures of at least 2-4 grantees per region per year	12/31/87
	- Direct regional offices to perform followup corrective action reviews for any grantee previously identified with cash management problems or excessive cash on hand.	12/31/87
	- Issue PAS procedure to require accounting for cash withdrawals made after the 25th of each month as advances	3/31/88
	- Issue PAS procedure for establishing accounts receivable for excess advances	3/31/88
2. Prevent unauthorized food stamp coupon redemptions	- Pilot test of new redemption system	5/31/88
	- Implement new system	1/1/89
3. Improve debt collection practices	- Calculate proper bad debt allowance and enter into accounting system	12/31/87
	- Issue revised PAS procedure to require write-offs of uncollectible debts to the appropriate account	12/31/87

Food and Nutrition Service Comprehensive Plan
to Identify and Correct Deficiencies
in the Program Accounting System

Actions	Milestones	Date
	- Issue PAS procedure to require proper calculation of the bad debt allowance	12/31/87
4. Improve controls over ADP resources	- Begin process to procure a contractor to document the undocumented parts of the PAS (award of contract contingent on available resources)	9/30/88
5. Submit comprehensive Federal Managers' Financial Integrity Act reports		
a) FY 1987	- Include in FY 1987 report all valid material findings in the 9/10/87 GAO draft report as well as all findings which were the result of internal FNS reviews	10/31/87
b) FY 1988	- Perform additional or new vulnerability assessments, internal control reviews and related reviews as needed	10/31/88
	- Establish Internal Controls Steering Committee composed of senior FNS officials to ensure consistency and objectivity in application of internal control standards and principles, establish agency policies, direct principles, establish activities, and oversee FNS' system of internal control.	Completed
6. Implement enhancements to the Program Accounting System (PAS)	- Develop requirements analysis for upgrade/redesign of the PAS	1/31/88
	- Implement Standardized General Ledger	Completed

The following are GAO's comments on the Food and Nutrition Service Administrator's letter dated November 6, 1987.

GAO Comments

1. We have recognized the Service's plans and actions in this report.

2. Information presented was included in our report. See page 13.

3. Reference was deleted because it was included in a previously issued report, Anti-Deficiency Act: Agriculture's Food and Nutrition Service Violates the Anti-Deficiency Act (GAO/AFMD-87-20, March 17, 1987).

4. We included the Service's comments in our final report. See pages 13 and 14.

5. Information presented was included in our report. See page 14.

6. Service's explanation was included in our report; however, our conclusion remains unchanged. See page 15.

7. During subsequent discussions, Service officials agreed the correct year was 1984. The typing of "1985" was in error.

8. We included the explanation presented by the Service in our report. We maintain that at the time of our review, the automated general ledger had not been closed.

9. We reviewed both our audit evidence and the information presented by the Service and have found no new evidence to alter our final report.

10. The Service has proposed an alternative procedure of recording as advances amounts drawn after the 25th of the month. It has also implemented the policies of establishing advances for amounts discovered through both cash management procedures and grant close-out processing. These measures should provide a reasonable estimate of amounts owed to the Service as well as improved control over receivables.

11. Information presented was included in our report. See page 26.

12. Information presented was included in our report. See pages 19 and 20.

13. We have included the information in our report. See pages 23 and 24.

14. Information presented was included in our report. See page 26.

15. Information presented was included in our report. See page 26.

16. Information presented was included in our report. See page 29.

17. Information presented by the Service was included in our report. See page 30.

18. We have included the information in our report. See page 31.

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