

GAO

Testimony

Before the Subcommittee on Oversight and Investigations,
Committee on Education and the Workforce,
House of Representatives

For Release on Delivery
Expected at
12:30 p.m.
Monday,
December 6, 1999

**FINANCIAL
MANAGEMENT**

**Financial Management
Weaknesses at the
Department of Education**

Statement of Gloria Jarmon
Director, Health, Education, and Human Services
Accounting and Financial Management Issues
Accounting and Information Management Division



G A O

Accountability * Integrity * Reliability

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our review of the independent auditors' reports¹ on the Department of Education's financial statements covering fiscal year 1998. The Department's financial statements are important to the federal government because Education is the primary agency responsible for overseeing the more than \$73 billion annual federal investment in support of educational programs for U.S. citizens and eligible non-citizens. The Department is also responsible for tracking approximately 93 million student loans and 15 million grants as well as collecting more than \$150 billion owed by students. In fiscal year 1998, more than 8.5 million students received over \$48 billion in federal student financial aid through programs administered by Education.

As you know, audit results of agency financial statements are key indicators of the quality of the underlying agency financial data and the related systems used to compile that information. In March of this year, we reported on the results of our financial statement review of the fiscal year 1998 consolidated financial statements of the U.S. government.² Because of serious deficiencies in the government's systems, recordkeeping, documentation, financial reporting, and controls, we found that amounts reported in the governmentwide financial statements do not provide a reliable source of information for decision-making by the government or the public.

Similar outcomes were identified at Education. The results of the effort to audit the fiscal year 1998 financial statements for Education reveal that serious internal control and financial management system issues continue to plague the agency. Pervasive weaknesses in the design and operation of Education's financial management systems, accounting procedures, documentation, recordkeeping, and internal controls, including computer security controls, prevented Education from reliably reporting on the results of its operations. Education's independent auditors were unable to express an opinion (called a disclaimer of opinion) on Education's fiscal year 1998 consolidated financial statements. The reasons cited for the disclaimer for fiscal year 1998, also described as material internal control

¹Department of Education, *Fiscal Year 1998 Consolidated Financial Statements*, Ernst & Young LLP, November 1999.

²*Financial Audit: 1998 Financial Report of the United States Government* (GAO/AIMD-99-130, March 31, 1999).

weaknesses in the report,³ were (1) weaknesses in the financial reporting process and (2) inadequate reconciliations of financial accounting records. In addition, the independent auditors cited inadequate controls over information systems as a third material internal control weakness.⁴ These deficiencies prevented the independent auditors from being able to form an opinion on the reliability of the financial statements and represent material weaknesses in internal control. Similar deficiencies concerning financial reporting, reconciliations, and systems controls were reported by Education's Inspector General (IG) for fiscal year 1997.⁵ In addition, vulnerabilities in the Department's student financial assistance programs have led us since 1990 to designate this a high-risk⁶ area for waste, fraud, abuse, and mismanagement. As we reported in our high-risk series update in January 1999, audits by GAO and the Department's IG have found instances in which students fraudulently obtained grants and loans.

Background

Federal decisionmakers need reliable and timely financial information to ensure adequate accountability, manage for results, and make timely and well-informed decisions. However, historically, such information has not been available across the government. Agencies' independent auditor reports, IG reports, as well as our own work, have identified persistent limitations in the availability of quality financial data for decision-making. Major reforms, such as the Chief Financial Officers (CFO) Act of 1990, and later the Government Management Reform Act of 1994 and the Federal Financial Management Improvement Act of 1996 (FFMIA), set expectations for federal agencies to develop and deploy more modern financial management systems to routinely produce sound cost information.

³A material internal control weakness is a reportable condition that precludes the entity's internal controls from providing reasonable assurance that material misstatements in the financial statements or material noncompliance with applicable laws or regulations will be prevented or detected on a timely basis.

⁴In addition to these material internal control weaknesses, the independent auditors also reported four reportable conditions. Reportable conditions are matters coming to the auditors' attention that, in their judgment, should be communicated because they represent significant deficiencies in the design or operation of internal controls that could adversely affect the organization's ability to meet the objectives of reliable financial reporting and compliance with applicable laws and regulations.

⁵U.S. Department of Education, *Office of Inspector General Audit of Fiscal Year 1997 Consolidated Financial Statements*, June 15, 1998.

⁶*High-Risk Series: An Update* (GAO/HR-99-1, January 1999).

Toward that end, 24 CFO Act agencies have been required to annually prepare financial statements and have them audited beginning with those for fiscal year 1996. These audits have shown that many agencies face major challenges in generating reliable year-end financial information. Of the 24 CFO Act agencies, 12 agencies received unqualified audit opinions on their fiscal year 1998 financial statements, indicating that their financial statements were reliable in all material respects; 4 agencies received qualified opinions, indicating that at least one significant item on the financial statements was unreliable; 6 agencies, including Education, received disclaimers of opinion, meaning that the auditors were unable to determine on an overall basis if the financial statements were reliable; and 2 agencies received mixed opinions.⁷ Education, the last CFO Act agency to issue its fiscal year 1998 financial statements, released them on November 18, 1999, over 8 months later than the March 1, 1999, due date for audited statements.

For some agencies, like Education, the preparation of financial statements requires considerable reliance on ad hoc programming and analysis of data produced by inadequate financial management systems that are not integrated or reconciled. These systems problems often require significant adjustments to the financial statements. While obtaining unqualified or “clean” opinions on federal financial statements is an important objective, it is not an end in and of itself. The key is to take steps to continuously improve underlying financial and management information systems and internal controls as a means to ensure accountability, increase the economy, improve the efficiency, and enhance the effectiveness of government. The ultimate goal is for these systems to generate timely, accurate, and useful information on an ongoing basis, not just as of the end of the fiscal year.

More fundamentally, FFMIA requires that agency financial management systems substantially comply with (1) financial management systems requirements,⁸ (2) federal accounting standards, and (3) the *U.S. Government Standard General Ledger*⁹ at the transaction level. Of the 24

⁷One of these agencies received an unqualified opinion on its balance sheet and a disclaimer on the rest of its statements. The other agency did not prepare consolidated statements and received unqualified opinions on three of its components and disclaimers on the remaining two of its components.

⁸The financial management systems requirements have been developed by the Joint Financial Management Improvement Program, which is a joint and cooperative undertaking of the Department of the Treasury, Office of Management and Budget (OMB), GAO, and the Office of Personnel Management.

⁹The Standard General Ledger provides a standard chart of accounts and standardized transactions that agencies are to use in all their financial systems.

CFO Act agencies, financial management systems for 21 agencies, including Education, were found by auditors to be in substantial noncompliance with FFMIA's requirements during fiscal year 1998.

Education's fiscal year 1998 audit effort was conducted by Ernst & Young LLP, independent auditors contracted for by the Education Inspector General. We reviewed the independent auditors' reports during the last half of November 1999 and their workpapers on information systems. However, we did not review key workpapers supporting other material internal control weaknesses because they have not yet been made available to us. We shared a draft of this statement with Education officials, who provided technical comments. We have incorporated their comments where appropriate. Our work was conducted in accordance with generally accepted government auditing standards.

Education's Reporting Controls Are Inadequate and Its Financial Management Systems Do Not Comply With FFMIA

The independent auditors found that the Department does not have adequate internal controls over its financial reporting process to provide reasonable assurance that its principal financial statements are reliable. As a result, Education (1) was unable to prepare reliable statements and (2) could not support material amounts reported on its financial statements, including obligations, grant expenditures, and net position. These limitations in the financial reporting process of the Department's new accounting system¹⁰ contributed to the disclaimer of opinion on its fiscal year 1998 financial statements. The system's reported weaknesses included its inability to perform an automated year-end closing process and directly produce consolidated financial statements as would normally be expected from such systems. Because of these weaknesses, Education had to resort to a costly, labor-intensive and time-consuming process involving extensive and complex analyses and ad hoc procedures to prepare financial statements for fiscal year 1998. These system limitations contributed to the delay in Education submitting financial statements to the auditors and OMB.

The amounts produced by these efforts involved over 700 adjustments to develop the balances for the financial statements. The auditors reported that one of these adjustments, erroneously posted for \$550 million, would have resulted in a net difference in expenditures of \$1.1 billion if not corrected. In another instance, a \$400 million adjustment made by the Department was deemed to be unnecessary and needed to be reversed. The Department's inability to prepare reliable, year-end financial

¹⁰ED operated under a new accounting system—Education's Central Automated Processing System (EDCAPS)—in fiscal year 1998.

statements after extraordinary efforts is evidence that Education cannot provide reliable information about its operations on a day-to-day basis. Thus, decisionmakers, such as agency management and the Congress, cannot be assured that the information they are using is reliable. Department officials stated that they have recognized the seriousness of these problems and are working with a contractor to resolve them.

For fiscal year 1998, the independent auditors found that Education was not in compliance with FFMIA because it lacked adequate financial management systems, reports, and oversight to prepare timely and accurate financial statements. The independent auditors also reported that the Department did not comply with all of the requirements included in the Chief Financial Officers Act of 1990, as expanded by the Government Management Reform Act of 1994. Specifically, the Department did not submit fiscal year 1998 audited financial statements to OMB by March 1, 1999, the statutory deadline.

Education's Financial Accounting Records Were Not Reconciled Properly or Promptly

The independent auditors reported that Education did not properly or promptly reconcile its financial accounting records during fiscal year 1998. An adequate reconciliation provides assurance that processed transactions are properly and promptly recorded in accounting records and financial statements, which in turn facilitates management's ability to routinely analyze its financial condition and results of operations and to use that data in the course of daily operations. However, the Department did not adequately perform reconciliations and could not provide sufficient documentation to support its financial transactions.

For example, as indicated in fiscal year 1997 and again in fiscal year 1998, Education has not been able to identify and resolve differences between its accounting records and cash transactions reported by the Treasury for several years. Such reconciliations are required by Treasury policy and are analogous to companies or individuals reconciling their checkbooks to monthly bank statements. In fiscal year 1998, Education reported about \$45 billion in Fund Balance with Treasury accounts, but the independent auditors could not determine whether the amount was correct.

For the grantback account,¹¹ which is part of Education's Fund Balance with Treasury, Education's new accounting system showed a balance of almost \$400 million, some portion of which Education owed the Treasury,

¹¹The grantback account holds funds paid to recipients under a grant or cooperative agreement that were recovered from a recipient following a determination of a violation of law or of the grant or cooperative agreement. A portion of these funds is to be returned to the recipient when the violation has been corrected. Any amounts not returned to the grantee should revert to the Treasury.

as of September 30, 1998. Of this balance, over \$386 million represented several adjustments that had been accumulating since fiscal year 1993 that Education could not identify with any specific program or reconcile. When Education attempted to resolve the differences and determine what amount it should return to the Treasury, its estimates ranged from about \$15.4 million to over \$221 million. According to Department officials, Education is in the process of resolving these differences.

The independent auditors also determined that the transactions Education reported to the Treasury routinely differed from those reported in Education's general ledger throughout fiscal year 1998. The auditors found that Education made large adjustments, which it did not research or support, merely to force the records into agreement. In addition, Education did not reconcile its general ledger balance with its subsidiary debt collection system. Instead, Education made unsupported adjustments to the general ledger to align these records with amounts reported in its debt collection system. Furthermore, Education did not reconcile between the loans reported by its guaranty agencies¹² as assigned¹³ to Education and those recorded in its debt collection system. As a result, Education could not be assured that amounts reported for assigned loans receivable were accurate. Such practices are severely at odds with established financial management practices and reporting standards.

Many of these differences result from a lack of supporting documentation for proprietary accounts (such as cash) and budgetary balances, the failure to regularly perform formal reconciliations, and the serious problems with Education's accounting system. The lack of timely, thorough reconciliations makes it difficult if not impossible for Education to determine if operating funds have been properly spent or if reported amounts for operating expenses, assets, and liabilities are reliable. Without performing such reconciliations, Education has no assurance that its financial accounting records are accurate. The lack of appropriate reconciliations also affects Education's ability to ensure that it complies with the laws governing the use of its budget authority. Errors in these accounts may also affect the accuracy of various Education financial reports, including budget execution reports and information reported to the Congress.

¹²These agencies act as intermediaries between the government and the lender. They are responsible for reviewing student applications and approving loans, reviewing and paying claims to lenders when defaults occur, and collecting on defaulted loans.

¹³Under the Federal Family Education Loan Program, when the guaranty agencies have exhausted their collection efforts or a loan meets specific Education criteria (34 CFR § 682.409), all rights and title of the loan are permanently assigned to Education.

Information Systems Controls Are Inadequate

In connection with their review of Education's fiscal year 1998 financial statements, the independent auditors also conducted a review of information systems controls over Education's accounting and financial reporting systems. The Department places significant reliance on its financial management systems to perform basic functions, such as making payments to grantees and maintaining budget controls. Consequently, weaknesses in information systems controls could render Education unable to perform these vital functions or place Education's sensitive grant and loan data at risk of loss or misuse.

The independent auditors reported information systems controls as a material internal control weakness in Education's fiscal year 1998 financial statement report. Specifically, the independent auditors reported deficiencies in (1) authorizing and revalidating user access to Education's systems and effectively managing user identification and passwords, (2) providing adequate physical security for its computer facility, (3) monitoring and reviewing access to sensitive computer resources, (4) documenting the approach and methodology for the design and maintenance of information technology architecture, and (5) developing and testing disaster recovery plans to ensure the continuity of critical system operations in the event of disaster.

Continued weaknesses in these information system control areas place critical Education operations, such as financial management and sensitive loan and grant systems, at increased risk of unauthorized access and disruption. In addition, sensitive financial transaction data are vulnerable to inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction, possibly occurring without detection. For example, given the high volume of transactions that flow through Education's Grant Administration and Payment System (GAPS)—over \$20 billion a year—these weaknesses in the information systems controls increase the risk of misuse or loss of grant data. Effective information systems controls contribute greatly to the reduction of such risks.

The need to strengthen information system security in both the government and the private sector has been recognized over the past several years by a number of entities. Since 1994, we have issued dozens of reports on individual agency computer security weaknesses and made scores of related recommendations. In September 1996, we reported that poor information security was a widespread federal problem.¹⁴

¹⁴*Information Security: Opportunities for Improved OMB Oversight of Agency Practices* (GAO/AIMD-96-110, September 24, 1996).

Subsequently, in February 1997, in a series of reports to the Congress, we designated information security as a new governmentwide high-risk area.¹⁵ More recently, we reported¹⁶ that the nation's computer-based critical infrastructures are at increasing risk of severe disruption from varying sources. We also reported on cooperative efforts underway across federal agencies and among public and private sector entities and other nations to address this substantial risk.

Significant Efforts Will Be Needed To Resolve Education's Financial Management Issues

Education continues to be plagued by serious internal control and system deficiencies that hinder its ability to achieve lasting financial management improvements. While Education has planned and begun implementing many actions to resolve its financial management problems, it is too early to tell whether they will be successful. We recognize that Education's newly acquired financial management system does not meet current systems and financial reporting needs, that its financial management problems did not occur overnight, and that the task ahead of Education to fully correct these deficiencies will take a great deal of commitment and effort. We do, however, believe that serious internal control issues can be addressed in the near term through continued dedicated effort on the part of Education's management. It is critical that Education rise to the challenges posed by these financial management issues, because its success in achieving all aspects of its strategic objectives depends in part upon reliable financial management information and effective internal controls. It is also important to recognize that several of the financial management issues that have been raised in reports emanating from reviews of Education's financial statements directly or indirectly affect Education's ability to meet its obligations to its loan and grant recipients and responsibilities under law.

Mr. Chairman, this concludes my testimony. I would be happy to answer any questions you or other Members of the Subcommittee may have.

¹⁵*High-Risk Series: Information Management and Technology* (GAO/HR-97-9, February 1997).

¹⁶*Critical Infrastructure Protection: Comprehensive Strategy Can Draw on Year 2000 Experiences* (GAO/AIMD-00-1, October 1, 1999).

Contact And Acknowledgement

For information about this statement, please contact Gloria Jarmon at (202) 512-4476 or at jarmong.aimd@gao.gov. Individuals making key contributions to this statement included Chinero Thomas, Cheryl Driscoll, Anh Dang, and Meg Mills.

(916316)

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are \$2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. VISA and MasterCard credit cards are accepted. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 37050
Washington, DC 20013

or visit:

Room 1100
700 4th St., NW (Corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000 or by using fax number (202) 512-6061 or TDD (202) 512-2537.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (202) 512-6000 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

For information on how to access GAO reports on the INTERNET, send an e-mail message with "info" in the body to:

Info@www.gao.gov

or visit GAO's World Wide Web Home Page at

<http://www.gao.gov>

**United States
General Accounting Office
Washington, DC 20548-0001**

**Bulk Rate
Postage & Fees Paid
GAO
Permit No. G100**

**Official Business
Penalty for Private Use \$300**

Address Correction Requested

