UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

ACCOUNTING AND FINANCIAL
MANAGEMENT DIVISION

SEPTEMBER 30, 1982

B-209251

The Honorable Marjorie S. Holt
House of Representatives

Dear Mrs. Holt:

Subject: Constituent's Allegations of Accounting System Improprieties Leading to Undetected Overpayments of Principal and Interest at the Bureau of the Public Debt (GAO/AFMD-82-105)

On August 31, 1981, you transmitted a lengthy document by Mr. James F. Smith, Jr., a former Bureau of Public Debt employee, detailing his allegations of waste, fraud, mismanagement, and abuse of Federal funds within the Bureau. In summary, he alleged that (1) accounting and internal control system problems within the Bureau were permitting overpayments of public debt principal and interest to remain undetected, (2) information on the system problems was withheld by Bureau management when reporting to the Office of Management and Budget (OMB) on debt collection efforts, and (3) the interest on some types of public debt securities was not recognized on an accrual basis as required by law. As agreed with your office, we have reviewed these specific allegations and found that Mr. Smith had a reasonable basis for them, but we noted no evidence suggesting that Bureau officials deliberately reported false information on overpayment problems.

Mr. Smith's allegations of overpayments and their untimely detection related primarily to the Bureau's efforts to process principal and interest payment transactions for sales of Treasury bills handled by the Bureau rather than by banking institutions. Such transactions are controlled through a book-entry accounting subsystem called the selective automation system, which provides records of ownership of Treasury bills instead of the engraved certificates issued to owners. The subsystem is basically a manual one with accepted applications for Treasury bill purchases, or paper tenders, making up the book-entry accounts. Its primary automated feature is the ability to produce tapes used to issue Government checks for the principal and interest on security investments as they become due.

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A manual accounting system normally provides opportunities for error, especially when handling a high volume of transactions. The Bureau's subsystem has been handling an extremely high transaction volume in relation to its intended capabilities. Moreover, it has been beset with a series of design and internal control deficiencies that provide opportunities for undetected overpayments of public debt principal and interest. This condition was addressed by a Treasury bill committee formed on November 28, 1980, to study problems connected with the Bureau's book-entry subsystem. According to its report issued in June 1981, the subsystem lacked 57 of 98 features that are necessary to provide for effective accounting control. As an example, the report points out that:

--Consolidated accounts are not maintained for individual investors, and this has required additional paperwork to be generated to support individual transactions.

--Balancing mechanisms are not present in the system to ensure that transactions affecting one account, such as security sales, equal the amounts posted to other affected accounts, such as cash.

The report also notes that a number of internal control problems have persisted in the subsystem since the Bureau started operating it in 1979. As an example, the report said that technical and supervisory positions were not filled promptly and, when filled, proper skills and qualifications were not considered in the recruitment process. The study concludes that the subsystem, now accounting for about $16 billion of the over $1 trillion public debt, was "vulnerable to undetected errors, fraud, waste, and abuse." The report notes that the Bureau identified about $15.6 million in overpayments in fiscal 1980 and 1981 that are apparently attributable to the prevailing system and internal control problems. We understand that the Bureau has taken action to recover most of this amount.

The Bureau relies on a reconciliation process to identify any overpayments of principal and interest that might develop. Under the process, payment amounts are reconciled to authorized amounts for each security offering. When deficiencies are discovered, records are researched to establish if they relate to underpayments, overpayments, or erroneous postings. The process is essential because the Bureau's accounting system does not contain proper checks and balances over amounts recorded in the cash and securities payable accounts, which are the primary accounts affected by each security sale and redemption action.

We noted that, as alleged by Mr. Smith, the reconciliations were not being completed promptly, especially those related to Treasury bill offerings. To illustrate, in January 1982, one match showed an out-of-balance condition totaling $464 million for 156 Treasury bill offerings that were either redeemed or outstanding as of September 1981. Bureau officials researched various records to determine the reasons for the differences and, according to one official, the process to identify possible erroneous payments was not completed until April 1982, some 6 months after the cutoff for the activities being reconciled. Despite the problems, the reconciliation process has identified principal and interest overpayments to investors. For example, one reconciliation performed by the Bureau identified about $1,226,000 in overpayments. We understand that the Bureau has initiated action to recover that amount and has eliminated its backlog of Treasury bill reconciliations.

The delays in completing the reconciliations are attributable to many complex system problems, as well as the extensive time needed to research transactions through the Bureau's book-entry subsystem for Treasury bills. The subsystem does not provide the record identifications--the audit trail--necessary to trace transactions forward and backward as necessary to locate supporting documents. This condition normally necessitates very time-consuming efforts to locate paper documents and microfilm related to transactions. However, the Bureau's efforts are further complicated by inadequate procedures for safeguarding and filing records, and required documents have been, on occasion, misplaced, lost, mutilated, and destroyed.

We also noted that considerable time had elapsed before the Bureau identified the overpayments it made. As of June 30, 1981, over $246,000 in receivables from overpayments were recorded, and we found that an average of 425 days had elapsed since the overpayments were made.

For the amounts owed the Bureau, we confirmed that the system controls over recording receivables were weak, as alleged by Mr. Smith. For example, the system does not include procedures to ensure that amounts recorded in control and detail accounts agree. Consequently, at the end of each month, reconciliations are necessary to balance detail subsidiary records with each other and with the control accounts. On occasion, detail and control accounts contain balances suggesting the Treasury owes investors money, although receivable accounts should always have balances showing amounts owed the agency. Moreover, the detail and control accounts have frequently disagreed on the amounts of receivables that should be collected by the Bureau. For example, as of June 30, 1981, detail records of overpayments of Treasury bill principal and discounts maintained by one unit differed by over $450,000 from detail records maintained by another unit.

In response to a request from OMB, the Bureau reported all receivables recorded in its accounts but, in doing so, understated receivables resulting from savings bond adjustments. The account for such adjustments included all overpayments and underpayments to savings bond agents handling bond sales and redemptions for the Bureau. The account neither specifically identifies receivables due the Treasury nor payables due agents, because payments and collections are offset against each other in the account. Data were not readily available for us to estimate the amount of the account's understatement at the time of reporting to OMB, but available evidence suggests it could be sizeable. This condition was not mentioned in reports to OMB, as Mr. Smith alleged.

We noted that the Bureau's report to OMB did not indicate the age of receivables resulting specifically from (1) savings bond adjustments, (2) overpayments in redeeming securities, or (3) overpayments of interest on registered notes and bonds. This is the type of information that is traditionally included in reports dealing with accounts receivable. An OMB official advised us that the aging information should have been included in reports the Treasury submitted on its debt collection efforts, even though it was not specifically requested.

In its report to OMB, the Bureau did allude to reconciliation backlogs and weaknesses that were preventing the timely detection of overpayments and the recording of related receivables. Its presentation in the report, in our opinion, did not adequately disclose the severity of the Bureau's accounting system inadequacies and internal control weaknesses. Further, the report did not indicate the potential effect of these problems--that there may be many millions of dollars in undetected receivables. Thus, there appears to be some basis for concern about the adequacy of the Bureau's report on its debt collection efforts.

Finally, Mr. Smith alleged that, contrary to law, the Bureau was operating some of its interest accounts on a cash basis. We found this to be the case for those accounts handling (1) penalty interest earned by the Bureau on late cash remittances by savings bond sales agents, (2) interest earned by Government-managed trust fund activities, such as the Federal employees and the social security trust funds, and (3) interest earned by foreign investors on Treasury bills. Since 1956, the law (31 U.S.C. 66a) has required Federal agencies to use the accrual basis of accounting, which recognizes cost and revenue as they are incurred, rather than the cash basis, which recognizes financial activities only as payments are made or received.

Besides the legal requirement, the use of cash-based accountting by the Bureau has some specific undesirable consequences. First, it precludes the development of information on receivables necessary for aggressive action, especially to collect amounts of penalty interest assessed on late cash remittances by savings bond sales agents. In cases of interest owed by the Bureau to others, the use of cash-based accounting results in an understatement of the amount of public debt. The understatement could eventually result in the Bureau unknowingly exceeding the public debt ceiling, a condition that also violates law.

In total, Mr. Smith's allegations deal with some complex accounting system deficiencies that have apparently existed at the Bureau for some time. The Bureau's management has been and is taking some action to correct some of the system deficiencies. As an example, short- and long-range plans have been developed to overcome the deficiencies in the Bureau's book-entry subsystem for Treasury bills, and a top Bureau project is underway to make sure reconciliations are kept current. Also, some action has been taken to convert public debt interest accountability back to the accrual basis, and plans are underway to have savings bond adjustments accounted for properly. Yet, we believe other improvements may be needed in the Bureau's accounting system and related internal controls to bring about better accountability for public debt transactions.

We are presently monitoring, along with the Treasury Department's Inspector General, the Bureau's efforts to correct problems in its book-entry subsystem. We are also reviewing the system with emphasis on identifying any control problems related to sales and redemptions of securities by Federal Reserve banks. Our work will consider specific improvements needed to bring about better control over the public debt. Your office will be provided with copies of the reports we issue on this work.

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As requested by your office, we did not obtain official comments on this report from Bureau management or Mr. Smith. As arranged with your office, copies of this report are being furnished to the Department of the Treasury and will be made available to other interested parties upon request.

Sincerely yours,

W. D. Campbell

W. D. Campbell
Acting Director