

August 2000

FINANCIAL
MANAGEMENT

Review of Education's
Grantback Account



G A O

Accountability * Integrity * Reliability



B-285684

August 18, 2000

The Honorable Pete Hoekstra
Chairman
The Honorable Charlie Norwood
Vice Chairman
Subcommittee on Oversight and Investigations
Committee on Education and the Workforce
House of Representatives

You requested that we review the Department of Education's grantback account. As you requested, this report includes general information on the intended purpose of the grantback account; the annual grantback account balance since inception; and the grantback account balance as of December 31, 1999. You also requested that we evaluate how the grantback account has been used since inception; whether there is support for the transactions in the grantback account; whether the transactions in the grantback account are valid; and whether any federal laws have been violated by the existence and management of the grantback account.

Education provides grants for various education programs, such as postsecondary, special education, and vocational programs, and has over 150 appropriation accounts to fund its grant programs, over 16,000 grant recipients, and for fiscal year 1999 reported about \$30 billion in grant expenses.¹ Grant recipients meeting certain thresholds² are required by law to have audits (referred to as Single Audits³) which include tests of their compliance with requirements that have a direct and material effect on a

¹Education, established on May 4, 1980, is responsible for administering and accounting for various education grant programs and other loan programs under its charge.

²The requirements apply to grant recipients who annually expend federal awards of \$300,000 or more (or received awards of \$100,000 or more prior to June 1997).

³OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* – Revised June 24, 1997, issued pursuant to the Single Audit Act of 1984, P.L. 98-502, and the Single Audit Act Amendments of 1996, P.L. 104-156, sets forth standards for obtaining consistency and uniformity among federal agencies for the audit of states, local governments, and nonprofit organizations expending federal awards.

major program.⁴ If the Single Audits or other audits (such as those that Education might perform itself) identify certain noncompliance, recipients must repay Education the amount related to the noncompliance. If the grant recipient meets certain conditions, including correcting the noncompliance, Education may return up to 75 percent of the amounts recovered in the form of grantback payments. Ultimately, any remaining funds would be returned to the Department of the Treasury. In 1991, Education established a deposit fund with the Treasury to retain availability of funds needed to make grantback payments and account for the grantback activity. This deposit fund is referred to as the grantback account.

To provide the information you requested and address your specific questions, we evaluated Education's financial management system and manual internal controls over grantback activity and related funds control, and reviewed the actions already taken and planned by Education to address grantback account issues that we and other auditors have identified. On May 3, 2000, we briefed your staff on the results of our work. This report summarizes the information provided at that briefing. The attached briefing slides provide the detail on the results of our work and the information provided at the briefing. (See appendix I.) Also, these matters were included in our May 24, 2000, testimony on Education's financial management problems.⁵

Results in Brief

As a result of financial management system deficiencies, inadequate systems of funds control, and manual internal control weaknesses that we and other auditors have identified and the manner in which the grantback account was used, there is increased risk of fraud, waste, and

⁴A major program is a federal program identified in accordance with risk-based criteria prescribed by the Office of Management and Budget. 31 U.S.C. 7501(a)(12)(Supp.IV 1998).

⁵*Financial Management: Education's Financial Management Problems Persist* (GAO/T-AIMD-00-180, May 24, 2000).

mismanagement of grant funds. In terms of funds control,⁶ these deficiencies increase the risk that Anti-Deficiency Act violations could occur and not be promptly identified and reported. Because of these deficiencies, we were unable to determine whether any Anti-Deficiency violations occurred. The deficiencies identified at Education relate to the following five areas.

- **Pooling method of accounting for grant drawdowns.** Education's pooling method of accounting for grant drawdowns used prior to May 1998 contributed to out of balance conditions and the need for significant grant reconciliation efforts involving hundreds of millions of dollars. Using the pooling method, grant recipients with multiple awards were not required to match drawdowns to specific awards as the funds were withdrawn from a pool of grant funds. In accounting for these transactions, Education first relied on a complex formula (called "the algorithm") to approximate the actual expenditures for the specific grant awards and allocate the drawdowns. However, according to Education officials, the algorithm did not properly calculate the drawdown allocations, and contributed to differences between Education's records of grant activity and those of the recipients. In addition to the problems associated with the original allocation, Education officials told us that untimely reporting by some recipients of actual expenditures for individual grant awards also contributed to inaccurate data in Education's records.

⁶Agencies are responsible for implementing a system of funds control to manage the funds appropriated as required by the Anti-Deficiency Act (31 U.S.C. 1541) and as implemented by OMB Circular A-34 (as revised October 19, 1999). According to GAO's *Policy and Procedures Manual for Guidance of Federal Agencies*, the term "funds control" refers to control over use and management of fund appropriations to help ensure that (1) funds are used only for authorized purposes, (2) they are economically and efficiently used, (3) obligations and expenditures do not exceed the amounts authorized and available, and (4) the obligation or disbursement of funds is not reserved or otherwise withheld without congressional knowledge and approval.

- **General computer controls.** We testified in March 2000,⁷ that continued weaknesses in general computer controls, over key Education financial management systems,⁸ increase the risk of unauthorized access or disruption of services, and make Education's sensitive grant and loan data vulnerable to inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction, which could occur without being detected.
- **Extensive grant reconciliation efforts and funds control.** The grantback account balances between the fiscal year ended September 30, 1993, and December 31, 1999, ranged from a high of about \$698 million as of September 30, 1996, to a low of about \$314 million as of December 31, 1999. Although the grantback account was established to account for grantback activities, we found that about 95 percent of the activity in the account for fiscal years 1993 through 1999 was unrelated to such activities. Specifically, we found that Education (1) used the grantback account as a suspense account beginning in 1993⁹ for hundreds of millions of dollars of activity related to grant reconciliation efforts and (2) did not maintain adequate detailed records for certain grantback account activity by the applicable fiscal year and appropriation.¹⁰

⁷*Education Faces Challenges in Achieving Financial Management Reform* (GAO/T-AIMD-00-106, March 1, 2000).

⁸General computer controls are the structure, policies, and procedures that apply to an entity's overall computer operations and establish the environment in which application systems and controls operate. General computer controls include access controls, which are designed to limit or detect access to computer programs, data, equipment, and facilities to protect these resources from unauthorized modification, disclosure, loss or impairment.

⁹Suspense accounts are used by entities as temporary holding places for certain transactions until they can be cleared to the proper accounts. Sound financial management practices entail entities having appropriate controls over the suspense accounts including maintaining adequate detailed records of the transactions in the account, promptly investigating the transactions, and promptly transferring them to the proper accounts.

¹⁰Education's independent auditors similarly reported in fiscal years 1998 and 1999 that Education was using the account for adjustments related to reconciling differences of various appropriations that have accumulated since 1993, but Education could not readily determine to which appropriations the amounts in the grantback account belong. Detailed records are needed to have an adequate system of funds control and help protect against Anti-Deficiency Act violations.

In addition, Education used the grantback account to clear unreconciled differences in various grant appropriation fund balance accounts¹¹ and adjust certain appropriation fund balances to ensure that they did not become negative. For example, in 1999, Education made a \$111 million adjustment reducing the grantback account balance and increasing the balance of six appropriations to ensure that projected negative funds balances did not occur. A negative balance is an indicator of a potential violation of the Anti-Deficiency Act. For this adjustment activity, Education did not provide any documentation to show a direct correlation between the reductions to the grantback account for the adjustments and the initial increases made to the grantback account.

In October 1997 and January 2000, Education reviewed and analyzed the canceled grant appropriations accounts which resulted in \$293 million being returned to Treasury. However, Education's review and analysis was incomplete because it did not always consider adjustment activity that may have occurred between the time of the adjustment and the date of the review. Consequently, there is an increased risk that funds control deficiencies, including returning incorrect amounts to Treasury, could occur and not be promptly detected.

- **Inadequate supporting documentation for transactions.** We found that Education could not provide documentation to support the validity of certain activity in the grantback account.¹² For example, we found that for fiscal year 1996 and prior years, Education could not provide general ledger printouts supporting the adjustment activity totaling \$685 million recorded as net increases to the grantback account and documentation supporting the reconciliations of the grantback account's Fund Balance with Treasury. Also, we found that for 39 of the 92 actual grantback transactions we tested (with gross totals of about \$47 million and \$128 million, respectively), Education could not locate or provide any documentation supporting the validity of the

¹¹Education's auditors, in each year beginning with the fiscal year 1995 financial statement audit, have reported internal control weaknesses related to Fund Balance with Treasury reconciliations, including unexplained, unreconciled differences; improper and untimely reconciliations; and adjusting general ledger balances to agree to Treasury without adequately determining whether Education's or Treasury's records may have been correct.

¹²The Comptroller General's *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1) issued in November 1999 requires that all transactions and other significant events be clearly documented, the documentation be readily available for examination, and all documentation and records be properly managed and maintained.

transactions and could only partially support another 4 transactions (totaling about \$22.5 million). Further, Education could not provide documentation to support that the grant balances in the Education Payment Management System (EDPMS) at the time of conversion in May 1998 agreed with the beginning grant balances in its new Grant Administration and Payment System (GAPS), and that the true grantback activity in PAS at the time of conversion in October 1997 was properly transferred to the new general ledger system.¹³

- **Lack of adherence to and inadequacy of Education's policies and procedures.** Education did not consistently adhere to certain of its policies and procedures relating to obtaining (1) independent certifications of recipients' records in connection with its EDPMS grant recipient reconciliations and (2) supervisory approval of manually prepared journal entries. Also, in our review of Education's policies and procedures relating to GAPS recipient reconciliation adjustments, we found that such policies were not adequate to ensure the validity and accuracy of transactions.¹⁴ Specifically we found that, there are no requirements for (1) supervisory review and approval of requested recipient reconciliation adjustments, (2) staff who are responsible for processing adjustments requested by grant recipients to obtain and review applicable Single Audit Act reports, and (3) obtaining documentation from the recipients supporting the requested GAPS reconciliation adjustments, other than a letter signed by the recipient's Chief Financial Officer.

Education has taken or plans to take various actions to address the grantback account issues. For example, in part to eliminate problems caused by Education's pooling method, Education implemented GAPS to track grant disbursements by award instead of on a pooled basis. In addition, Education analyzed the portion of the grantback account balance at September 30, 1999, (approximately \$16.5 million) that represented actual grantback activity and, in March 2000, returned to Treasury about \$10 million.

¹³In accounting for its general ledger activity prior to fiscal year 1998, Education maintained the Primary Accounting System (PAS). On October 1, 1997, Education converted from PAS to the Financial Management Systems Software (FMSS).

¹⁴The Comptroller General's *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1) issued in November 1999 requires that internal control activities, including policies and procedures, be effective in helping ensure the validity of recorded transactions.

Further, Education has developed a plan and taken several key steps to eliminate the adjustment activity portion of the grantback account, such as returning additional funds to Treasury, contracting with Treasury for assistance in determining the appropriate accounting for the remaining funds in the grantback account, and transferring the adjustment activity balance to another account. The plan also stipulates that Education will reconcile GAPS and Education's general ledger by June 2000, and return to Treasury the remaining balance in the grantback account. However, the plan does not contain sufficient details and does not address when or how Education will complete these two actions. To assist Education management in addressing the matters we identified, this report contains four detailed recommendations. In commenting on a draft of this letter, Education indicated that it agreed with our recommendations and is implementing a detailed plan that addresses and corrects the matters we identified.

Scope and Methodology

To accomplish the objectives of the request, we performed the following procedures.

- Held numerous interviews and discussions with staff in Education's offices of the Chief Financial Officer, General Counsel, Inspector General (OIG), and the Budget Services Group to obtain an understanding of the (1) intended purpose and actual use of the grantback account, (2) information systems, and policies and procedures related to the activity recorded in the account, and (3) controls in place for the conversion from EDPMS to GAPS.
- Reviewed available information related to (1) Education's grant activity and use of the grantback account, including independent auditor reports (fiscal years 1995 through 1999), policy and procedure manuals and internal memorandums, and (2) controls in place for the conversion from EDPMS to GAPS and the results of the conversion procedures.
- Conducted walkthroughs of the various types of transactions that were recorded in the grantback account including actual grantback collections and disbursements, reconciliation adjustments, and return of funds to Treasury.
- Reviewed the Fund Balance with Treasury reconciliations for the grantback account for fiscal years 1997, 1998, and 1999.
- Tested a nonstatistical sample of 92 actual grantback transactions from a total of 477 transactions recorded in the account from fiscal years 1991 through 1999, to determine the validity of such transactions. Because there was an increased risk of invalid transactions related to

disbursements and credit adjustments, and there was a relatively small number of transactions, we selected all disbursements and credit adjustments. Because there was less risk of invalid transactions related to collections, we selected all collections greater than \$1 million. The results of this testing are not projectable to the transactions that were not tested.

- Selected a statistical sample of 38 adjustment transactions from a total of 187 transactions recorded in the account from fiscal years 1997 through 1999. We initially tested a sub-sample of 20 adjustments to determine whether Education could provide adequate documentation to support the validity of these transactions. Based on the test results on this sample, we did not expand our test to include the remaining 18 sample items.
- Reviewed GAPS recipient reconciliation files for (1) all adjustments to decrease drawdowns by more than \$1 million and (2) the largest adjustment to increase drawdowns.
- Reviewed EDPMS recipient reconciliation files for six recipients selected nonstatistically from the available files.
- Obtained and reviewed data files that contained the ending grant balances in EDPMS and the beginning grant balances in GAPS.
- Reviewed and discussed with Education's OIG the workpapers related to the OIG's Action Memorandum FIN-99-01 (GAPS Survey Review) issued in January 1999.
- Reviewed relevant laws and regulations, consisting of the Anti-Deficiency Act (31 U.S.C. 1341, 1342, 1349–1351, 1511–1519 (1994)), the account closing law (31 U.S.C. 1551-1558 (1994)), OMB Circular A-34 (revised October 19, 1999), the Treasury Financial Manual, and Section 459 of the General Education Provisions Act (20 U.S.C. 1234h).
- Reviewed the Single Audit Act guidance for recipients of Education grant program awards and interviewed 10 nonstatistically selected states' auditors to obtain an understanding of the scope of their audit work under the Single Audit Act related to Education's grant programs.

We performed our review in Washington, D.C., at the Department of Education from December 1999 through April 2000 in accordance with generally accepted government auditing standards. Prior to our May 3, 2000, briefing to the staff of the Subcommittee on the results of our work, we provided Education with copies of our detailed briefing slides, which contained recommendations to the Secretary of Education for review and comment. In a meeting with Education officials, we obtained their comments and incorporated them as appropriate. In addition, we requested comments on a draft of this report from the Secretary of Education.

Education's comments are discussed in the "Agency Comments and Our Evaluation" section of this report and included in appendix II.

Background

Agencies are required by OMB Circular No. A-127, *Financial Management Systems* (revised July 23, 1993) to maintain financial management systems encompassing automated and manual processes, procedures, and controls that process and record financial events effectively and efficiently, and provide complete, timely reliable and consistent information for decisionmakers and the public. As we testified in May 2000, Education's stewardship over its annual appropriations and the student loans for which it has collection responsibility has been under question as it has experienced persistent financial management weaknesses. Beginning with Education's first agencywide audit effort of its fiscal year 1995 financial statements, Education's auditors have each year reported largely the same serious internal control weaknesses, which have affected the department's ability to provide reliable financial information to decisionmakers both inside and outside the agency. One of these internal control weaknesses relates to Education not properly or promptly reconciling its financial accounting records and not being able to provide sufficient documentation to support some of its financial transactions. To prepare Education's fiscal year 1999 financial statements before the March 1, 2000, deadline, Education's financial staff and its contractors had to make significant efforts to work around the serious internal control and financial management systems weaknesses that continued to plague the agency.

In its report on Education's fiscal year 1998 financial statements, the auditor reported Education's use of the grantback account as an example of a reconciliation issue identified during the auditor's testing. In January 1999, Education's Office of Inspector General (OIG) issued a report¹⁵ on the results of its review of Education's process for reconciling the department's grant disbursement system with recipient records. The OIG reported weaknesses in management controls surrounding the reconciliation process and made recommendations for improvement.

¹⁵ *Survey Review of the Grant Administration and Payment System (GAPS) Reconciliation Process* (Action Memorandum FIN-99-01, January 28, 1999).

Pooling Method of Accounting for Grant Drawdowns

Education's pooling method of accounting for grant drawdowns used prior to May 1998 contributed to out of balance conditions and the need for significant grant reconciliation efforts. Education used a grant accounting and disbursement system called the Education Payment Management System that it modified from the Department of Health, Education and Welfare's system when Education was established as a separate executive branch department in 1980. EDPMS allowed grant recipients with multiple awards to withdraw funds from a pool of grant funds without being required to match the drawdowns to specific awards as the drawdowns occurred. This method of withdrawing funds is referred to as the pooling method.

In accounting for these transactions, Education first relied on a complex formula called the algorithm to allocate the drawdowns between awards. This method was supposed to approximate the actual expenditures for the specific grant awards. However, according to Education officials, the algorithm did not work properly after implementation of the 1990 account closing law's requirement to cancel appropriations generally 5 years after budget authority expires.¹⁶ Specifically, Education officials told us that the algorithm did not properly calculate the drawdown allocations between awards and this contributed to differences between Education's records of grant activity and those of the recipients.

After the original allocation of drawdowns, Education relied on recipient reporting (monthly or quarterly, depending on the grant type and award amount) of actual expenditures for individual grant awards as its basis for adjusting the disbursement transactions to the correct grant awards. However, in addition to the problems associated with the original allocation, Education officials told us that untimely reporting by some recipients also contributed to inaccurate data in Education's records, resulting in differences between Education's records and those of the recipients.

General Computer Controls

Education places significant reliance on its financial management systems to perform basic functions, such as making grant payments and maintaining budget controls. We testified in March 2000, that continued weaknesses in general computer controls increase the risk of unauthorized

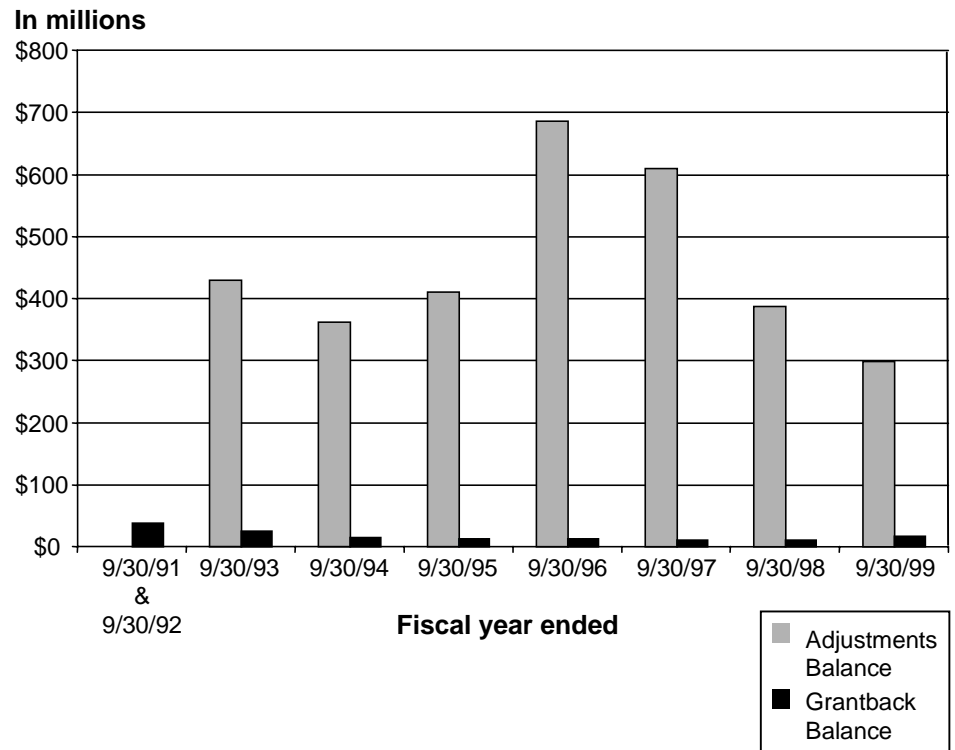
¹⁶31 U.S.C. 1552.

access or disruption of services and make Education's sensitive grant and loan data vulnerable to inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction, which could occur without being detected. In every year, beginning with the fiscal year 1995 financial statement audit, Education's independent financial statement auditors have reported weaknesses in Education's information systems controls, such as ineffective procedures for monitoring access to sensitive computer resources, and have made recommendations to Education to address such weaknesses.

Extensive Grant Reconciliation Efforts and Funds Control

Although the grantback account was established to account for grantback activities, we found that about 95 percent of the activity in the account for fiscal years 1993 through 1999 was unrelated to such activities. Figure 1 shows the grantback account balances by fiscal year, beginning in 1991.

Figure 1: Grantback Account Balances



Source: Data provided by Education's Office of the Chief Financial Officer.

Note: Balance as of December 31, 1999, was the same as of September 30, 1999.

Specifically, we found that, beginning in 1993, Education used the grantback account as a suspense account for hundreds of millions of dollars of activity related to grant reconciliation efforts affecting its appropriations that fund grants. We also found that Education did not maintain adequate detailed records for certain grantback account activity by the applicable fiscal year and appropriation that would allow it to promptly investigate the activity and transfer it to the proper accounts.

Education's grant reconciliation efforts impacting the grantback account included reconciliations between (1) Education's and recipients' records of grant disbursements, (2) certain proprietary and budgetary general ledger

accounts maintained by Education for each appropriation,¹⁷ and (3) Treasury's and Education's records of Fund Balance with Treasury accounts.

Education also used the grantback account to (1) clear unreconciled differences in various grant appropriation fund balance accounts and (2) adjust certain appropriation fund balances to ensure that they did not become negative. For example, in 1999, Education made a \$111 million adjustment, reducing the grantback account balance and increasing the balance of six appropriations to ensure that projected negative funds balances did not occur. A negative balance is an indicator of a potential Anti-Deficiency Act violation. For this adjustment activity, Education did not provide any documentation to show a direct correlation between the reductions to the grantback account for the adjustments and the initial increases made to the grantback account. Such documentation is needed as part of a funds control system to ensure compliance with the Anti-Deficiency Act, which requires agencies to investigate possible overobligations or overexpenditures and to report to the President and the Congress if they determine an overobligation or overexpenditure occurred.

While Education reviewed the grantback account activity in October 1997 and January 2000 for amounts related to canceled appropriation accounts, its analysis was not complete. For example, Education's review focused on three adjustments totaling approximately \$700 million (net) that increased the grantback account but did not consider whether the adjustments would have been increased or decreased for activity that occurred between the time of the adjustment and the date of the review. As a result of these reviews, Education returned approximately \$293 million to Treasury. However, such deficiencies in Education's analysis increase the risk that funds control deficiencies, including returning incorrect amounts to Treasury, could occur and not be detected promptly.

¹⁷Education is required, as are all agencies, to maintain proprietary and budgetary accounts in its general ledger. Proprietary accounts track assets and liabilities, whereas budgetary accounts track the status of budget authority. Proprietary accounts are self-balancing, as are budgetary accounts. In addition, there is a relationship between certain proprietary and budgetary accounts. For example, the sum of the proprietary accounts Fund Balance with Treasury, Advances, and Accounts Payable should equal the sum of the budgetary accounts Undelivered Orders, Funded Liabilities, and Unobligated Balances.

Inadequate Supporting Documentation for Transactions

We found that Education could not provide documentation to support the validity of certain activity in the grantback account, in part because (1) according to Education officials, about 200 boxes of accounting records were sent to off-site storage without being properly labeled so as to easily determine the contents when Education moved in October 1998, (2) records relating to certain transactions selected for our testing, which Education stated were stored at another agency's off-site storage facility, were not provided by the end of our fieldwork despite repeated requests by Education to obtain the records, and (3) Education did not maintain complete, detailed records from the discontinued accounting system when it converted to its new accounting system in October 1997.

Specifically, we found that for fiscal year 1996 and prior years, Education could not provide (1) general ledger printouts supporting the adjustment activity totaling \$685 million recorded as net increases to the grantback account and (2) documentation supporting the reconciliations of the grantback account's Fund Balance with Treasury. Also, we found that for 39 of the 92 actual grantback transactions we nonstatistically selected for testing (totaling in gross about \$47 million and \$128 million, respectively), Education could not locate or provide any documentation supporting the validity of the transactions and could only partially support another 4 transactions (totaling about \$22.5 million). In addition, for 14 of the 92 selected transactions, Education asserted that the transactions, which totaled \$160,734, were recorded to reverse duplicate postings of grantback collections. However, Education could not locate evidence to support that a duplicate posting had in fact occurred.

Education also could not provide adequate documentation for 6 of the 20 adjustment transactions we statistically selected for testing. One of the 20 adjustment transactions was a valid grantback disbursement for \$48,195, which was misclassified as an adjustment. As such, Education's analysis of the actual grantback activity, which was performed to determine the amount to be returned to Treasury, was incorrect. Further, Education could not provide documentation to support that the grant balances in EDPMS at the time of conversion in May 1998 agreed to the beginning grant balances in GAPS, and that the true grantback activity in PAS at the time of conversion in October 1997 was properly transferred to the new general ledger system.

Lack of Adherence to and Inadequacy of Education's Policies and Procedures

Education did not consistently adhere to certain of its policies and procedures relating to obtaining (1) independent certifications of recipients' records in connection with its EDPMS grant recipient reconciliations and (2) supervisory approval of manually prepared journal entries. Also, in our review of Education's policies and procedures relating to GAPS recipient reconciliation adjustments, we found that such policies were not adequate to ensure the validity and accuracy of transactions. For example, there is no requirement for supervisory review and approval of requested recipient reconciliation adjustments. Also, there is no requirement that staff responsible for processing adjustments requested by grant recipients obtain applicable Single Audit Act reports and review the audit results even though Education officials stated in a letter to us that Education believes the requested adjustments are valid because the recipients are subject to yearly audits (i.e., Single Audits). Further, there is no requirement to obtain documentation from the recipients supporting the requested GAPS reconciliation adjustments, other than a letter signed by the recipient's Chief Financial Officer.

We also found that Education does not require supervisory review and approval of monthly reports of outlays (Statements of Transactions – Standard Form 224) that agencies prepare and send to Treasury. These reports include information about which appropriations were charged for the outlays. Such information should be reviewed by a supervisor to identify inadvertent or intentional errors, such as charging disbursements to the grantback account instead of to the correct appropriation.

Actions Already Taken or Planned

Education has taken or plans to take various actions to address the grantback account issues. In part to eliminate problems caused by Education's pooling method, Education implemented a new grant disbursement system in May 1998 called GAPS. Under GAPS, Education tracks grant disbursements by award instead of on a pooled basis. However, for fiscal years 1998 and 1999, as mentioned previously, Education's independent auditors reported various weaknesses related to GAPS, including unreconciled differences between GAPS and Education's general ledger, processing of duplicate payments, and lack of formal policies and procedures to reconcile expenditure data between GAPS and Education's general ledger. Also, Education analyzed the portion of the grantback account balance as of September 30, 1999, (approximately \$16.5 million) that represented actual grantback activity and, in March 2000, returned to Treasury about \$10 million.

Further, after recently developing a plan to eliminate the adjustment activity portion of the grantback account, Education took the following key steps.

- In January 2000, Education decreased the grantback account (i.e., returned to Treasury) and increased Treasury's general fund account for \$146 million;
- Education contracted with Treasury in February 2000 for assistance in determining the appropriate accounting for the remaining funds in the grantback account; and
- Education transferred in March 2000 the adjustment activity balance from the grantback account to a deposit fund suspense account used for general purposes.

The plan also stipulates that Education will reconcile GAPS and Education's general ledger by June 2000 and return to Treasury the remaining balance in the grantback account. However, for these steps, the plan is not detailed enough for the individuals carrying it out to know specifically what actions to take to meet management's objectives. Also, the plan does not address when or how Education will complete the GAPS reconciliation project and account for adjustments resulting from such reconciliations. In this regard, we made recommendations to Education in our briefing slides. Education officials reviewed a draft of the briefing slides and told us that they agreed with our recommendations.

Conclusion

The financial management systems deficiencies, inadequate systems of funds control, and manual internal control weaknesses we and other auditors identified increase the risk of fraud, waste, and mismanagement of grant funds, as well as increased risk of noncompliance with the requirements of the Anti-Deficiency Act. It will take a sustained, high-priority effort by Education's top management to ensure that these persistent and long-standing problems are fully resolved and do not continue under its new systems.

Recommendations

In addition to the actions already taken or planned by Education, we recommend that the Secretary of Education direct the Acting Chief Financial Officer to develop and implement:

- A formal, detailed plan to eliminate the portion of the grantback account balance that was transferred in March 2000 to a deposit fund suspense account, including steps describing how Education will
 - complete the GAPS reconciliation project and account for adjustments resulting from such reconciliations;
 - implement adequate controls over its recipient reconciliations and Fund Balance with Treasury reconciliations, requiring that Education maintain detailed records by the applicable fiscal year and appropriation for any unreconciled differences transferred to suspense accounts until such differences are resolved; and
 - return to Treasury the remaining funds related to the adjustment activity that were transferred in March 2000 to a deposit fund suspense account, including a re-evaluation of the October 1997 and January 2000 reviews.
- Detailed policies and procedures to properly manage and maintain documentation and records (both on-site and in off-site storage facilities) related to all transactions and other significant events related to grant activity, including sound funds control practices to ensure compliance with the Anti-Deficiency Act.
- Detailed policies and procedures for performing GAPS recipient reconciliations, including requirements for
 - supervisory review and approval of GAPS adjustments,
 - review of applicable Single Audit results prior to making adjustments, and
 - obtaining summary level documentation from the recipients supporting the validity of the requested adjustments.
- Detailed policies and procedures requiring supervisory review and approval of Education's monthly Statements of Transactions – Standard Form 224.

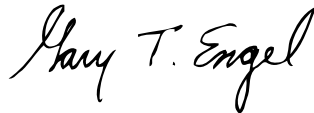
Agency Comments and Our Evaluation

In commenting on a draft of this report, Education agreed with our recommendations and stated that it is implementing a detailed plan it developed that addresses and corrects the deficiencies we noted in our report. Education also stated that our review was helpful in identifying areas where the department can improve its financial management practices. In addition, Education stated that it believes that it has sound funds control practices in place due to the implementation of GAPS, which maintains detailed transaction history data. We recognize that GAPS provides Education with improved information capabilities. In terms of funds control, however, the problems that we and other auditors have identified and the manner in which the grantback account was used,

increase the risk that Anti-Deficiency Act violations could occur and not be promptly identified and reported.

We are sending copies of this report and briefing slides to other interested Congressional parties, the Honorable Richard W. Riley, Secretary of Education; the Honorable Lorraine Lewis, Inspector General, Department of Education; and the Honorable Jacob J. Lew, Director of the Office of Management and Budget. We will make copies available to others upon request.

If you have any questions about this report or the briefing slides, please contact me at (202) 512-3406. Key contributors to this assignment were Christine Robertson, Bill Boutboul, James Douglas, and Suzanne Murphy.



Gary T. Engel
Associate Director
Governmentwide Accounting and
Financial Management Issues

Briefing to the Subcommittee on Oversight and Investigations, House Committee on Education and the Workforce

GAO Accounting and Information
Management Division

Review of the U.S. Department of Education's Grantback Account

Briefing to the Subcommittee on Oversight and
Investigations, House Committee on Education
and the Workforce

May 3, 2000

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GAO Objectives

- You requested that we provide information on the
 - intended purpose of the U.S. Department of Education's (ED) grantback account;
 - annual grantback account balance since inception; and
 - grantback account balance as of 12/31/99.

- You also requested that we evaluate
 - how the grantback account has been used since inception;
 - whether there is support for the transactions in the grantback account;
 - whether the transactions in the grantback account are valid; and
 - whether any federal laws have been violated by the existence and management of the grantback account.

GAO Background

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- Currently, ED has over 150 appropriation accounts to fund its grant programs, over 16,000 grant recipients, and for fiscal year 1999 reported about \$30 billion in grant expenses.
 - Grant recipients meeting certain thresholds are required by law (31 U.S.C. Secs. 7501 - 7507 (Supp. IV 1998)) to have audits (referred to as Single Audits) which include tests of their compliance with program-specific requirements.
 - If audits identify certain noncompliance, recipients must repay ED the amount related to the noncompliance.
 - If the grant recipient meets certain conditions, including correcting the noncompliance, ED may return up to 75 percent of the amounts recovered (referred to as grantback payments).

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GAO Background (cont'd)

-
- ED established a deposit fund with Treasury in 1991 (referred to as the grantback account), with OMB approval, in order to retain availability of funds needed to make grantback payments.
 - Prior to May 1998, ED maintained the Education Payment Management System (EDPMS) under which grant recipients' requests for disbursements were pooled. In May 1998 ED converted from EDPMS to the Grant Administration and Payment System (GAPS) which tracks grant disbursements by specific grant awards.
 - ED conducted separate efforts under EDPMS and GAPS to reconcile its records of grant disbursements to those of the recipients.

GAO Background (cont'd)

- Agencies are required to maintain proprietary and budgetary accounts in their general ledgers. Proprietary accounts track assets and liabilities, whereas budgetary accounts track the status of budget authority. Proprietary accounts are self-balancing, as are budgetary accounts. In addition, there is a relationship between certain proprietary and budgetary accounts. For example, the sum of the proprietary accounts: Fund Balance with Treasury, Advances and Accounts Payable should equal the sum of the budgetary accounts: Undelivered Orders, Funded Liabilities and Unobligated Balances.

GAO Scope and Methodology

-
- Held numerous interviews and discussions with staff in various ED offices and reviewed available information related to (1) ED's grant activity and use of the grantback account and (2) controls in place for the conversion from EDPMS to GAPS and the results of the conversion procedures.
 - Conducted walkthroughs of the various types of transactions that were recorded in the grantback account.
 - Reviewed the Fund Balance with Treasury reconciliations for the grantback account for FYs 1997, 1998 and 1999.
 - Reviewed and discussed with ED's OIG the workpapers related to the OIG's Action Memorandum FIN-99-01 (GAPS Survey Review) issued in January 1999.

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GAO Scope and Methodology (cont'd)

- Tested a nonstatistical sample of 92 actual grantback transactions from FY 1991 through FY 1999 and a statistical sample of 20 adjustment transactions from FY 1997 through FY 1999 to determine whether ED could provide adequate documentation to support the validity of these transactions.
- Reviewed various nonstatistically selected GAPS recipient reconciliation files and EDPMS “5 year cash on hand” recipient reconciliation files.
- Reviewed data files that contained the ending grant balances in EDPMS and the beginning grant balances in GAPS.
- Reviewed various relevant laws and regulations.

GAO Scope and Methodology (cont'd)

- Reviewed the Single Audit Act guidance for recipients of ED grant program awards, and interviewed 10 nonstatistically selected states' auditors to understand the scope of their audit work under the Single Audit Act related to ED's grant programs.
- Requested comments on a draft of these briefing slides from ED. ED's comments are discussed on the "Agency Comments" slide.
- Performed our review in Washington, D.C., at ED between December 1999 and April 2000 in accordance with generally accepted government auditing standards.

GAO Overview

- We found that
 - Although the grantback account was established for grantback activities, ED also used it as a suspense account for activity related to grant reconciliation efforts;
 - ED could not provide adequate supporting documentation for certain activity in the grantback account;
 - Because of internal control weaknesses, including lack of adequate documentation, we could not determine the validity of certain activity in the grantback account; and

GAO Overview (cont'd)

- ED did not maintain adequate detailed records for certain grantback account activity by the applicable fiscal year and appropriation, which is needed to have an adequate system of funds control and help protect against Anti-Deficiency Act violations.

- As a result of financial management systems deficiencies, inadequate systems of funds control, and manual internal control weaknesses that we and other auditors identified, there is increased risk of fraud, waste and mismanagement of grant funds, as well as increased risk of noncompliance with the requirements of the Anti-Deficiency Act.

GAO Financial Management Systems Deficiencies - Pooling Method

- ED's pooling method for disbursing grants contributed significantly to its problems with accounting for grant activity.
 - ED inherited a grant accounting and disbursement system that processed grant drawdowns on a pooled basis. Under this system, recipients with multiple awards drew funds from their pool of grant funds without being required to match the drawdowns to specific awards as the drawdowns occurred.

GAO Financial Management Systems Deficiencies - Pooling Method (cont'd)

- ED used a complex formula (called “the algorithm”) to allocate the drawdowns to awards. However, according to ED officials, the 1990 account closing law’s requirement to cancel appropriations (which for most accounts is five years after budget authority expires) significantly challenged the effective functioning of ED’s algorithm contributing to out of balance conditions in grant activity.
- ED relied on recipients’ reporting of actual expenditures for individual grant awards as its basis for charging disbursement transactions to the correct grant awards. However, untimely reporting by some recipients contributed to inaccurate data in ED’s records and differences between ED’s records and those of the recipients.

GAO Financial Management Systems Deficiencies - General Computer Controls

- General computer control weaknesses exist in ED's information systems, including those that process grant activity.
 - Since FY 1995, ED's independent financial statement auditors have reported weaknesses in ED's information systems controls, such as ineffective procedures for monitoring access to sensitive computer resources, and have made recommendations to ED to address such weaknesses.

GAO Financial Management Systems Deficiencies - General Computer Controls (cont'd)

- Also, we testified in March 2000 (Education Faces Challenges in Achieving Financial Management Reform, (GAO/T-AIMD-00-106, March 1, 2000) that continued weaknesses in information systems controls increase the risk of unauthorized access or disruption of services, and make ED's sensitive grant and loan data vulnerable to inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction, which could occur without being detected.

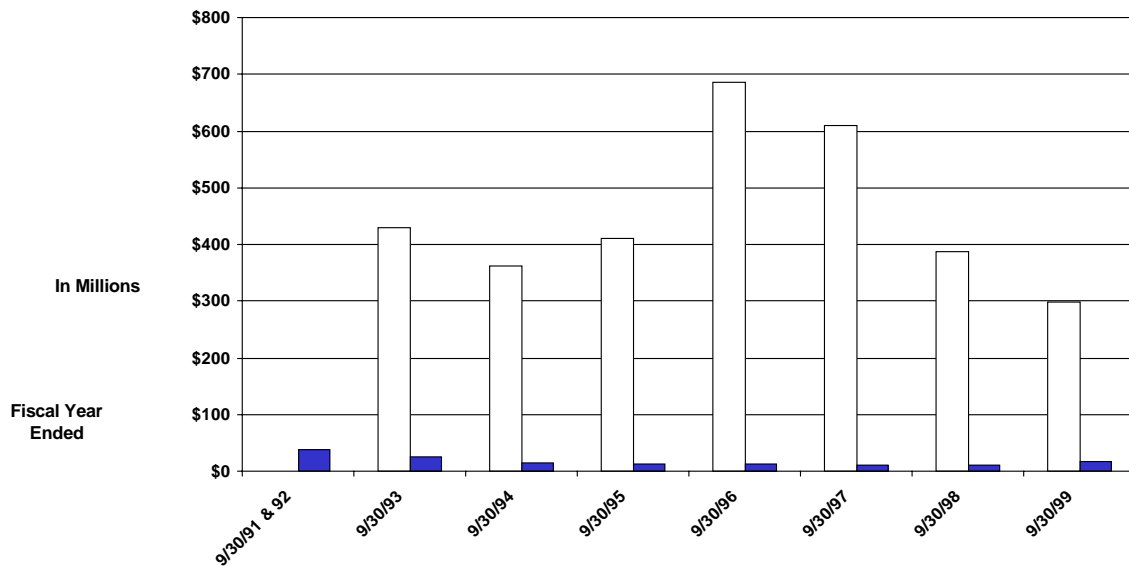
GAO Inadequate Systems of Funds Control - Suspense Account

- Although the grantback account was established for grantback activities, ED also used it as a suspense account for activity related to grant reconciliation efforts.
 - Various factors, such as untimely reporting by some recipients and weaknesses in ED's accounting systems and controls, resulted in many differences between recipients' and ED's records.
 - These problems also contributed to ED's internal proprietary and budgetary accounting records being out of balance.
 - ED has undertaken several reconciliation efforts in attempting to correct its accounting records and resolve the differences between recipients' and ED's records.
-

GAO Inadequate Systems of Funds Control - Suspense Account (cont'd)

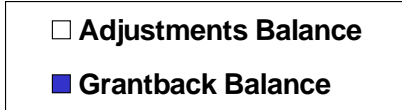
- Also, ED has periodically decreased the grantback account (i.e., returned to Treasury) and increased Treasury's general fund account for the portion of the funds in the grantback account that it attributed to cancelled appropriations.
- The portion of the grantback account related to actual grantback activity averaged less than five percent of the total account balance in every year starting in FY 1993, which, based on ED records provided to us, was the first year that ED used the grantback account for adjustment activity.

GAO Inadequate Systems of Funds Control -
 Suspense Account Grantback Account Balances (cont'd)



Note: Balance at 12/31/99 was the same as at 9/30/99.

Source: Data provided by ED's Office of
 the Chief Financial Officer.



GAO Inadequate Systems of Funds Control -
Suspense Account (cont'd)

- ED could not provide a listing of the grantees by name and amount that comprise the balance in the adjustment activity portion of the grantback account at September 30, 1999, because some activity was accounted for at the appropriation level, some was accounted for at the grant award level, and other activity was accounted for at the recipient level.
- Table 1 below summarizes by fiscal year the reconciliation adjustments and certain funds returned to Treasury recorded in the grantback account.

GAO Inadequate Systems of Funds Control - Suspense Account (cont'd)

Table 1
Reconciliation Adjustments and Funds Returned to Treasury
Activity Recorded in the Grantback Account by Fiscal Year
(\$ in Millions)

Fiscal Year	Proprietary ¹	GAPS ²	Returned to Treasury ³	Fund Balance with Treasury	Other ⁴	Fiscal Year Ending Balance
1993	360				70	430
1994					-68	362
1995	46				2	410
1996	294				-19	685
1997			-147	30	41	609
1998				-166	-56	387
1999		12		-111	9	297
Total	700	12	-147	-247	-21	297

Source: GAO analysis of ED's data.

¹ ED made net adjustments to its proprietary accounts to correct the out of balance conditions in its internal proprietary and budgetary accounting records mentioned previously. These adjustments are related primarily to the EDPMS "5-year cash-on-hand" reconciliations.

² This is a net amount comprised of \$20 million in adjustments to increase the recipients' available grant balances and \$32 million in adjustments to decrease the recipients' available grant balances. The adjustments were posted during fiscal years 1998 and 1999, and into fiscal year 2000; however, ED did not provide a detailed listing by date posted.

³ ED also returned \$146 million in January 2000. The amounts shown here as "Returned to Treasury" do not include actual grantback activity.

⁴ "Other" includes activity that we could not separately identify to the other categories because ED could not provide adequate supporting documentation.

GAO Inadequate Systems of Funds Control -
Suspense Account (cont'd)

- ED's independent auditors reported for FYs 1999 and 1998 that ED was using the grantback account for adjustments related to reconciling differences of various appropriations that have accumulated since 1993, but ED could not readily determine to which appropriations certain amounts in the grantback account belong.

GAO Inadequate Systems of Funds Control - Detailed Records

- ED did not maintain adequate detailed records for certain grantback account activity by the applicable fiscal year and appropriation, which is needed to have an adequate system of funds control and help protect against Anti-Deficiency Act violations.
- In the early to mid 1990s, ED conducted an EDPMS “5 year cash-on-hand” recipient reconciliation project that resulted in adjustments to ED’s records of recipients’ advance balances.
 - ED’s method of accounting for these reconciliation adjustments caused its records of proprietary and budgetary general ledger accounts to become out of balance.

GAO Inadequate Systems Funds Control - Detailed Records (cont'd)

- ED used the grantback account to record adjustments (called “sources and uses adjustments”) to bring its proprietary and budgetary accounts into balance. These adjustments generally resulted in increases to the grantback account’s fund balance.
- In the late 1990s, ED began its GAPS recipient reconciliation project that identified differences between ED’s and recipients’ records of drawdown balances.
 - For differences related to closed awards identified by the recipients, ED used the grantback account to make the adjustments requested by the recipients without knowing whether the amounts used directly related to the closed awards that had differences.

GAO Inadequate Systems of Funds Control - Fund Balances

- ED used the grantback account to (1) clear unreconciled differences in various grant appropriation fund balance accounts, and (2) adjust certain appropriation fund balances to ensure they did not become negative. A negative balance is an indicator of a potential Anti-Deficiency Act violation. Specifically, we found that
 - In 1998, ED recorded a \$166 million net adjustment as a reduction to the grantback account. This adjustment included
 - A \$30 million net adjustment to adjust ED's records of Fund Balance with Treasury accounts for unreconciled differences relating to over 20 appropriations.

GAO Inadequate Systems of Funds Control - Fund Balances (cont'd)

- A \$136 million net adjustment that ED asserted was to correct an error made in a prior period. However, as of the end of our fieldwork, ED did not provide adequate documentation to support that an error had in fact occurred.
- In addition, ED did not provide any documentation to show a direct correlation between this reduction and the initial increases made to the grantback account (primarily the “sources and uses adjustments” discussed previously).
- In 1999, ED made a \$111 million adjustment reducing the grantback account balance and increasing the balance of six appropriations to ensure that projected negative fund balances did not occur. However, ED did not provide any documentation to show a direct correlation between this reduction and the initial increases made to the grantback account.

GAO Inadequate Systems of Funds Control - Fund Balances (cont'd)

- Also, we found that ED had recorded this \$111 million adjustment twice, and is currently showing the amounts needed to correct the duplicate posting as a reconciling item on the Fund Balance with Treasury reconciliation for the grantback account.
- Since FY 1995, ED's auditors have reported internal control weaknesses related to Fund Balance with Treasury reconciliations, including unexplained, unreconciled differences; improper and untimely reconciliations; and adjusting general ledger balances to agree to Treasury without adequately determining whether, in fact, ED's records may have been correct.

GAO Inadequate Systems of Funds Control - Cancelled Accounts

- While ED reviewed the grantback account activity for amounts related to cancelled appropriation accounts, its analysis was not complete. Specifically, we found that
 - ED reviewed three adjustments that increased the balance in the grantback account to identify the portion of the adjustments that were in cancelled status. ED decreased the grantback account (i.e., returned to Treasury) and increased Treasury's general fund account for the cancelled portion of the adjustments.
 - The adjustments in FYs 1993 and 1995 totalled \$406 million (net), \$147 million of which ED returned in October 1997. The adjustment in FY 1996 was \$294 million (net), \$146 million of which ED returned in January 2000.

GAO Inadequate Systems of Funds Control -
Cancelled Accounts (cont'd)

- However, ED did not consider the effect of any account activity that occurred between the time the adjustments were made and when the reviews were performed.
- Also, when ED performed the second review, it did not consider balances remaining from the previous review to determine if any portion of these were in cancelled status and should be returned to Treasury.

GAO Manual Internal Controls Weaknesses - Supporting Documentation

- ED could not provide documentation to support the validity of certain activity in the grantback account.
- The following factors contributed to ED's inability to provide supporting documentation:
 - When ED converted to a new accounting system in October 1997, it did not maintain complete, detailed records from the discontinued accounting system;
 - When ED moved in October 1998, about 200 boxes of accounting records were sent to offsite storage without being properly labeled to easily determine the contents; and

GAO Manual Internal Control Weaknesses - Supporting Documentation (cont'd)

- Certain records relating to transactions selected for our testing, which ED stated were stored at another agency's offsite storage facility, were not provided by the end of our fieldwork despite ED's repeated requests to the agency to obtain the records.
- For FY 1996 and prior years, ED could not provide (1) general ledger printouts supporting the adjustment activity totaling \$685 million recorded as net increases to the grantback account, and (2) documentation supporting the reconciliations of the grantback account's Fund Balance with Treasury.

GAO Manual Internal Control Weaknesses - Supporting Documentation (cont'd)

- For 39 of the 92 actual grantback transactions we nonstatistically selected for testing (totalling in gross about \$47 million and \$128 million, respectively), ED could not locate or provide any documentation supporting the validity of the transactions, and could only partially support another 4 transactions (totalling about \$22.5 million).
- In addition, for 14 of the 92 selected transactions, ED asserted that the transactions, which totaled \$160,734, were recorded to reverse duplicate postings of grantback collections. However, ED could not locate evidence to support that a duplicate posting had in fact occurred.

GAO Manual Internal Control Weaknesses - Supporting Documentation (cont'd)

- ED could not provide adequate supporting documentation for 6 of the 20 adjustment transactions we statistically selected for testing.
- One of the 20 adjustment transactions was a valid grantback disbursement for \$48,195 which was misclassified as an adjustment. As such, ED's analysis of the true grantback activity which was performed to determine the amount to be returned to Treasury was incorrect.

GAO Manual Internal Control Weaknesses -
Supporting Documentation (cont'd)

- ED could not provide documentation to support that the grant balances in EDPMS at the time of conversion in May 1998 agreed to the beginning grant balances in GAPS.
- ED could not provide documentation to support that the true grantback activity in the Primary Accounting System (PAS) at the time of conversion in October 1997 was properly transferred to the new general ledger system.

GAO Manual Internal Control Weaknesses - Adherence to Policies and Procedures

- ED did not consistently adhere to certain of its policies and procedures relating to EDPMS “5 year cash-on-hand” grant recipient reconciliations.
 - ED’s polices and procedures required that recipients provide a certification by their independent certified public accountants (CPAs) that the recipient’s records of “cash-on-hand” balances were accurate when the adjustments requested by recipients exceeded \$25,000.
 - According to an ED official, ED did not always enforce this policy for state recipients because ED relied on the Single Audits performed of states’ financial records.

GAO Manual Internal Control Weaknesses -
Adherence to Policies and Procedures (cont'd)

- We found that of the 6 EDPMS recipient reconciliation files we selected nonstatistically and reviewed, 3 state recipient reconciliation files exceeding the \$25,000 threshold described previously did not contain the required certifications or anything to indicate that the Single Audit results were reviewed.
- ED's policies and procedures require that manually prepared journal entries to adjust the general ledger be reviewed and approved by a supervisor. However, we found that one manually prepared journal entry for \$289,108 in our sample of 20 adjustment transactions was prepared by a contractor and did not include any evidence of supervisory review.

GAO Manual Internal Control Weaknesses - Adequacy of Policies and Procedures

- ED's recipient reconciliation policies and procedures are not adequate.
- In our review of ED's policies and procedures relating to GAPS recipient reconciliation adjustments we found that
 - There is no requirement for supervisory review and approval of adjustments requested by grant recipients.
 - There is no requirement that staff responsible for processing adjustments requested by grant recipients obtain applicable Single Audit Act reports and review the audit results, even though ED officials stated in a letter to us that ED believes the requested adjustments are valid because the recipients are subject to yearly audits (i.e., the Single Audits).

GAO Manual Internal Control Weaknesses - Adequacy of Policies and Procedures (cont'd)

- For 1 of the 3 recipients noted above for which the certifications were missing, the reconciliation file contained an internal memorandum indicating that the recipient had been cited by its Single Audit Act auditors for violations of cash management of federal funds. Yet, there was no evidence that this had been considered in ED's decision to approve the recipient's requested adjustment for \$2.4 million to effectively increase the recipient's balance available for drawdowns.
- ED sent letters to the recipients stating that the Single Audit Act auditors would be required to test (1) whether grant expenditures agreed with information in GAPS and (2) recipient reconciliation adjustments. However, the 10 states' auditors that we contacted told us that the GAPS adjustments are not targeted for testing because the Single Audit Act guidance related to ED's grant programs does not specifically require such testing.

GAO Manual Internal Control Weaknesses - Adequacy of Policies and Procedures (cont'd)

- Also, these auditors stated that it is not possible for these adjustments to be selected for testing from the recipients' records because the adjustments were made in ED's records.
- ED's policies and procedures for processing GAPS adjustments were not sufficiently detailed to ensure the validity of the adjustments requested by recipients.
- There was no requirement to obtain documentation from the recipients supporting the requested GAPS reconciliation adjustments, other than a letter signed by the recipient's CFO.

GAO Manual Internal Control Weaknesses - Adequacy of Policies and Procedures (cont'd)

- For FYs 1999 and 1998, ED's independent auditors reported that ED has not yet developed formal policies and procedures to reconcile the expenditure data between its disbursement system (GAPS) and its general ledger, and made recommendations to ED to address this weakness.
- We also found that ED does not require supervisory review and approval of monthly reports of outlays to Treasury (Statements of Transactions - Standard Form 224).

GAO Actions Taken by Education to Address Grantback Account Issues

- In part to eliminate problems caused by the pooling method, ED implemented a new grant disbursement system in May 1998 called GAPS. Under GAPS, ED tracks grant disbursements by award instead of on a pooled basis. However, for FYs 1999 and 1998, ED's independent auditors reported various weaknesses related to GAPS, including unreconciled differences between GAPS and ED's general ledger, processing of duplicate payments, and lack of formal policies and procedures to reconcile expenditure data between GAPS and ED's general ledger.
 - ED analyzed the portion of the grantback account balance at September 30, 1999, (approximately \$16.5 million) that represented actual grantback activity and, in March 2000, returned to Treasury about \$10 million.
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GAO Actions Taken by Education to Address Grantback Account Issues (cont'd)

- After recently developing a plan to eliminate the adjustment activity portion of the grantback account, ED took the following key steps
 - In January 2000, decreased the grantback account (i.e., returned to Treasury) and increased Treasury's general fund account for \$146 million;
 - Contracted with Treasury in February 2000 for assistance in determining the appropriate accounting for the remaining funds in the grantback account; and
 - Transferred in March 2000 the adjustment activity balance from the grantback account to a deposit fund suspense account used for general purposes.

GAO Actions Taken by Education to Address Grantback Account Issues (cont'd)

- The plan also includes the following steps to be taken
 - Reconcile GAPS and ED's general ledger by June 2000; and
 - Return to Treasury the remaining balance in the grantback account.
- However, for the steps still to be taken, the descriptions are not detailed enough for the individuals carrying out the plan to know specifically what actions to take to meet management's objectives.
- Also, the plan does not address when or how ED will complete the GAPS reconciliation project and account for adjustments resulting from such reconciliations.

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GAO Recommendations

-
- In addition to the actions already taken or planned by ED, we recommend that the Secretary of Education direct the Acting Chief Financial Officer to develop and implement:
 - A formal, detailed plan to eliminate the portion of the grantback account balance that was transferred in March 2000 to a deposit fund suspense account, including steps describing how ED will
 - Complete the GAPS reconciliation project and account for adjustments resulting from such reconciliations;
 - Implement adequate controls over its recipient reconciliations and Fund Balance with Treasury reconciliations, requiring that ED maintain detailed records by the applicable fiscal year and appropriation for any unreconciled differences transferred to suspense accounts until such differences are resolved; and

GAO Recommendations (cont'd)

- Return to Treasury the remaining funds related to the adjustment activity that were transferred in March 2000 to a deposit fund suspense account, including a re-evaluation of the October 1997 and January 2000 reviews.
- Detailed policies and procedures to properly manage and maintain documentation and records related to all transactions and other significant events related to grant activity, including a requirement to properly label boxes sent to offsite storage facilities so that they are readily available for examination.

GAO Recommendations (cont'd)

- Detailed policies and procedures for performing GAPS recipient reconciliations, including requirements for
 - Supervisory review and approval of GAPS adjustments;
 - Review of applicable Single Audit results prior to making adjustments; and
 - Obtaining summary level documentation from the recipients supporting the validity of the requested adjustments.
- Detailed policies and procedures requiring supervisory review and approval of ED's monthly Statements of Transactions - Standard Form 224.

GAO Agency Comments

- In commenting on these briefing slides, ED generally agreed with our recommendations. ED's staff provided some technical comments, which have been incorporated as appropriate.

Comments From the Department of Education



UNITED STATES DEPARTMENT OF EDUCATION

THE DEPUTY SECRETARY

July 19, 2000

Mr. Jeffrey C. Steinhoff
Assistant Comptroller General
General Accounting Office
Washington, DC 20548

Dear Mr. Steinhoff:

We appreciate the opportunity to review and comment on the General Accounting Office (GAO) draft report entitled, "Financial Management: Review of Education's Grantback Account" (GAO/AIMD-00-228).

The Department believes that it has sound fund control practices in place. Particularly for grant programs, fund controls have never been stronger. The implementation of our Grants Administration and Payments System (GAPS) in 1998, gave us the capability for the first time to maintain detailed transaction history data at the grant award level. Under GAPS precise fund management controls direct transactions to the correct appropriation, which greatly reduces the need to make manual accounting adjustments.

Through the implementation of GAPS and continuous internal process improvements, the concerns voiced in your review are currently being addressed. Specifically the approach we are taking:

1. Assures full compliance with the Anti-Deficiency Act, eliminating any concern that funds might be drawn in excess of those appropriated and apportioned for any program;
2. Improves agency ability to reconcile cash and outlays rapidly and correctly;
3. Significantly improves agency capability to report outlays to the Office of Management and Budget and Congress on an appropriation and program level, as they require;
4. Improves our agency's capability to monitor recipients and provide oversight for the programs delegated to us by Congress; and
5. Increases the partnership between the Department and its recipients through our efforts to provide full assistance to recipients in resolving financial and program problems.

We have developed and are implementing a detailed plan that addresses and corrects the deficiencies you noted in your report. Our general strategies to address the specific recommendations in your report are outlined below.

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**Appendix II
Comments From the Department of
Education**

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Recommendation 1

That the Secretary of Education direct the Acting Chief Financial Officer to develop and implement a formal, detailed plan to eliminate the portion of the grantback account balance that was transferred in March 2000 to a deposit fund suspense account, including steps describing how Education will:

- Complete the GAPS reconciliation project and account for adjustments resulting from such reconciliations;
- Implement adequate controls over its recipient reconciliations and Fund Balance with Treasury reconciliations, requiring that Education maintain detailed records by the applicable fiscal year and appropriation for any unreconciled differences transferred to suspense accounts until such differences are resolved; and
- Return to Treasury the remaining funds related to the adjustment activity that were transferred in March 2000 to a deposit fund suspense account, including a reevaluation of the October 1997 and January 2000 reviews.

Response

The Department, working with the Treasury Department Center for Applied Financial Management has developed a detailed plan to accomplish the above items and other recommendations made in your review. We are currently executing this plan. Our target date for completion is November 2000. The plan is enclosed for your information.

The Department has put a considerable amount of effort into eliminating the need for adjustment reconciliation funds. These funds have been reallocated to appropriation accounts from our suspense account, which we eliminated at the end of June. During the months of July and August, the Department will perform a post validation of the process used to reconcile appropriation balances and reallocate funds previously held in the suspense account.

Moreover, the Department is in the final stages of its GAPS reconciliation project. Staff have reviewed the accounting for adjustments resulting from the reconciliation to ensure that the adjustments are well documented and have been approved by supervisory-level personnel. The resources used for the reconciliation project have been refocused on reducing the remaining 3 percent variance between our general ledger and GAPS. The Department expects this variance to be further reduced or eliminated by August 31, 2000.

The monthly reconciliation of balances with Treasury has improved data quality and helped the Department address weaknesses identified by its auditors, the Inspector General, and the GAO. In August 1999, we acquired a software tool from a company called CheckFree, which is used by many banks to accomplish this task. The tool has helped to automate much of the labor intensive process and greatly enhanced our ability to reconcile on a timely basis. During fiscal year 2000, the Department has been able to automatically match over 90 percent of its monthly reconciliation items using this tool. Items that are not matched using the software are manually

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researched. The tool also helps the Department's accountants in researching items, as it maintains detailed records by fiscal year and appropriation for unmatched transactions recorded by Treasury and/or the Department.

Recommendation 2

That the Secretary of Education direct the Acting Chief Financial Officer to develop and implement detailed policies and procedures to properly manage and maintain documentation and records (both onsite and in offsite storage facilities) related to all transactions and other significant events related to grant activity, including sound fund control practices to ensure compliance with the Anti-Deficiency Act.

Response

As indicated above, the Department has sound fund control practices in place because of the move to GAPS, which maintains detailed transaction history data. Management of grants at the award level greatly reduces the need to make manual accounting adjustments because precise fund management controls direct transactions to the correct appropriation.

Moreover, problems associated with obtaining documentation mislabeled during the Department's move in 1998, and data from our old accounting system prior to conversion to our new system were atypical. The Department does not anticipate that these problems will recur.

The Department's Office of the Chief Financial Officer has initiated a major undertaking to review and revise policies within the accounting operations area as needed. As appropriate, these revised procedures will stress the proper management and maintenance of documentation and records related to all transactions and other significant events related to that activity. We expect this effort to be completed by November 2000.

Recommendation 3

That the Secretary of Education direct the Acting Chief Financial Officer to develop and implement detailed policies and procedures for performing GAPS recipient reconciliations, including requirements for

- Supervisory review and approval of GAPS adjustments;
- Review of applicable Single Audit results prior to making adjustments; and
- Obtaining summary level documentation from the recipients supporting the validity of the requested adjustments.

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Response

We are in the process of developing policies and procedures for performing GAPS recipient reconciliations that will include supervisory review and approval of GAPS adjustments; review of applicable Single Audit results prior to making adjustments, as appropriate; and obtaining summary level documentation from the recipients supporting the validity of the requested adjustments. The policies and procedures will be completed by November 2000 or earlier. In the meantime, the Department is carefully reviewing recipient award adjustment requests on a case-by-case basis.

Recommendation 4

That the Secretary of Education direct the Acting Chief Financial Officer to develop and implement detailed policies and procedures requiring supervisory review and approval of Education's monthly Statements of Transactions -- Standard Form 224.

Response

The Department, working with PriceWaterhouseCoopers, prepared operating procedures which we are now using for the SF-224 process. The procedures build on the Department of Treasury Part 2 -- Chapter 5100, "Reconciling Fund Balance With Treasury Accounts" (T/L 588) and "Fund Balance with Treasury Reconciliation Procedures," a Treasury Financial Manual (TFM) supplement. Under the new procedures supervisory accountants will review and approve the Department's monthly Statements of Transactions -- Standard Form 224. Moreover, the Treasury Department has delivered four on-site training sessions for the Department's accounting staff on reconciling fund balances with Treasury. Work continues on reports and other aids to assist in the validation of SF-224 submissions to the Treasury Department using the recently implemented reconciliation software tool.

The GAO review has been helpful in identifying areas where we can improve our financial management practices and further mitigate problems that pooling created with regard to internal fund accounting.

Thank you for the opportunity to review the draft report.

Sincerely,


Frank S. Holleman III

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Penalty for Private Use \$300**

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<p>Bulk Rate Postage & Fees Paid GAO Permit No. GI00</p>

