“DEPARTMENT OF EDUCATION FINANCIAL MANAGEMENT”

HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT EDUCATION

OF THE

COMMITTEE ON EDUCATION AND THE WORKFORCE HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

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HEARING ON DEPARTMENT OF

EDUCATION FINANCIAL MANAGEMENT

THURSDAY, APRIL 3, 2001

HOUSE OF REPRESENTATIVES,

SUBCOMMITTEE ON SELECT EDUCATION,

COMMITTEE ON EDUCATION AND THE WORKFORCE,

WASHINGTON, D.C.

The Subcommittee met, pursuant to call, at 9:33 a.m., in Room 2175, Rayburn HouseOffice Building, Hon. Peter Hoekstra [chairman of the Subcommittee] presiding.

Present: Representatives Hoekstra, Tiberi, Norwood, Platts, Roemer, Scott, Holt, McCollum, and Sanchez.

Staff Present: Becky Campoverde, Deputy Staff Director; Pam Davidson, Professional Staff Member; Patrick Lyden, Professional Staff Member; Stephanie Milburn, Professional Staff Member; Deborah L. Samantar, Committee Clerk/Intern Coordinator; Jo-Marie St. Martin, General Counsel; Holli Traud, Legislative Team Assistant; Mark Zuckerman, General Counsel; Cheryl Johnson, Counsel/Education and Oversight; Maggie McDow, Legislative Associate/Education; and Joe Novotny, Staff Assistant/Education.

Chairman Hoekstra. A quorum being present, the Subcommittee on Select Education will come to order. We are meeting today to hear testimony on financial management at the Department of Education. Under Committee rule 12(b), opening statements are limited to the chairman and ranking minority member of the Subcommittee. Therefore, if other members have opening statements, they will be included in the hearing record. With that, I ask unanimous consent for the hearing record to remain open 14 days to allow members' statements and other extraneous material referenced during the hearing to be submitted in the official hearing.

Mr. Roemer. Without objection.

OPENING STATEMENT OF CHAIRMAN PETER HOEKSTRA, SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, DC

Chairman Hoekstra. Without objection, so ordered. I will start with my opening statement. I will keep mine short. I want to yield a little bit of time to our new vice chairman of the Subcommittee, Pat Tiberi. Under the structure of the Subcommittee this year, the vice chairman will have responsibility for oversight activities and with the work that we are going to be doing, working with the Secretary of Education. Pat will head up that effort. So we will be open to his comments this morning.

The hearing today builds off a hearing record that we have had over the last two to three years. The disappointing thing is that the situation continues to be much the same. The Department of Education still has not received a clean audit after failing audits in fiscal year 1998, 1999 and also a failed audit for the year 2000. We know about the size of the department, managing somewhere in the neighborhoods of 80 to $100 billion in direct expenditures plus the management of the loan portfolio. The Inspector General has made numerous recommendations over the last number of years about ways that this reporting and tracking within the department could be improved. Many of these items have been closed and some have remained open. Most notably, a request and requirement for a new accounting system, a system for reconciliation of accounts and systems information controls. Those have not been adequately addressed.

Just to summarize some of the areas of concern, for the year 2000, the year-end's statement work had to be pulled together manually. Again the department could not necessarily justify many of the manual adjustments. The department continues to be unable to balance its checkbook with the U.S. Treasury. Manual adjustments were made to force general ledger balances to match subsidiary records. Repeatedly, there have been recommendations to have a monthly reconciliation process, which I believe is still not being done.

Last year, the Inspector General released a report stating that the numerous control weaknesses in the department constituted "a significant threat to the security of education's information technology systems and the data they process." This finding has still not been addressed. The department still has not reconciled a count of its physical property to departmental records of its assets. In addition, duplicate payments have been a problem since, I believe, 1998. This problem occurred in the year 2000, totaling $154 million of duplicate payments.

GAO is doing a department wide audit that we are very appreciative of, but I think again they will share with us some results and some findings that we will not at all be excited about. Basically what we see is that when we have this kind of environment which lacks financial controls, we create an environment that does allow for illegal activity or criminal activity. We also know that when we created that environment over the last number of years or in some way let that kind of environment be, criminal activity did occur. The Inspector General has identified $1.9 million fraud in impact aid and the theft ring within the purchasing department, all of this within a time when the previous administration left vacant for the last 5 years the Assistant Secretary for the Office of Management. In addition, the department did not have a permanent Chief Financial Officer for the last 2-1/2 years. It is not a very pretty picture. The disappointing thing is it has not been a very pretty picture for the last 2-1/2, 3 years, and we will find out more today.

With that, I will just yield to my colleague Mr. Tiberi. Welcome to the Subcommittee and the responsibilities as vice chairman.

WRITTEN OPENING STATEMENT OF CHAIRMAN PETER HOEKSTRA, SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, DC – SEE APPENDIX A

OPENING STATEMENT OF VICE CHAIRMAN PATRICK TIBERI, SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, DC

Mr. Tiberi. Thank you Chairman Hoekstra. I am pleased to be here with you and the ranking member this morning, and thank you for coming as well.

The issues before us are very important, and I am pleased that you are here with us to discuss those important issues. I share many of your concerns, Chairman Hoekstra, and I am pleased to be with you on this Subcommittee. You have been a leader on these issues in the past, and I look forward to working with you not only today but in the future.

As the new kid on the block, so to speak, in coming out of the state legislature, I have certainly heard some of the concerns that many in my state have had. They come from both the superintendents as well as those at the Department of Education here in Washington, D.C. I am here to listen and learn, but make no mistake about it, field audits and the accounting system that we have today are unacceptable and I look forward to working with you, Chairman Hoekstra, and Mr. Roemer in making sure that we can identify those problems for the new Secretary.

As the chairman pointed out, though, one failed audit in the private sector would be unacceptable, and it is our responsibility to demand more of the department as it distributes over $100 million in loans annually. So I look forward to working with the Subcommittee and Committee as well as working with all of you to make sure that we get this situation under control.

Thank you, Mr. Chairman.

WRITTEN OPENING STATEMENT OF VICE CHAIRMAN PATRICK TIBERI, SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, DC – SEE APPENDIX B

Chairman Hoekstra. I would like to yield to my ranking member. Mr. Roemer has gotten to be a good friend over the last few years. He is also the ranking member on the Oversight Committee. This year we actually have some responsibility to pass some legislation out of the Subcommittee, as the jurisdiction has changed. We expect and are hopeful that we can move a juvenile justice bill. We are hoping and expecting we can move a reauthorization for the Corporation for National Service. The challenge is laid before us that we may also reauthorize the National Endowment for the Arts and other such things as the two of us may agree on over the next 23 months. I am looking forward to working with you.

OPENING STATEMENT OF RANKING MINORITY MEMBER, REPRESENTATIVE TIM ROEMER, SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, DC

Mr. Roemer. Thank you, Mr. Chairman. I too am looking forward to working with you. We have developed a good friendship over the last several years, even before we were chair and ranking member of this Subcommittee, and I look forward to continuing that friendship and that good bipartisanship and have a good working relationship. I also welcome Mr. Tiberi to the Subcommittee, and I look forward to his insights and his contributions to the Subcommittee as well. He is a new member and we look forward to the new energy and the new insights that hopefully come with that fresh outlook.

We don't have a new member here, and, Ms. Lewis, we are used to seeing you here and I welcome you and the other witnesses here today, and I will launch into my hopefully short opening statement so we can get into your comments.

Mr. Chairman, thank you for your wise opening statements, and I am interested in assuring that our tax dollars are being used wisely and the Department of Education's financial management practices are sound. This is the fourth hearing that we have had on this in the last 2 years, and I look forward to the day when these hearings are no longer necessary.

The Clinton administration was committed to working towards the clean audit and ridding the Department of Education of fraud and abuse. While the department declined to testify today, I hope that the Bush administration will continue their work with that same level of commitment. As the chairman said, I don't think he is going to let up because we have moved from a Democratic to a Republican administration, and I am certainly not going to change my very tough stand on the responsibility of Congress, being one of oversight and jurisdiction on these financial matters. I think we will both continue to look into these matters with due diligence and asking very tough questions.

I am pleased with some of the positive steps that have been taken. The cohort default rate on the student loans has declined for seven consecutive years and is now at a record low 8.8 percent. Collections on default loans have more than doubled from 1 billion in fiscal year 1993 to over 3 billion in fiscal year 1999. Data improvement and the national student loan data system have prevented the disbursement of as much as $1 billion in grants to ineligible students.

The department has also made some strides to improve its audit. I was pleased to see that this audit received a qualified opinion on all of its fiscal year 2000 financial statements. I look forward to hearing the testimony of today's witnesses to hear what the Department is doing to ensure that these opinions are clean opinions in next year's budget.

I understand that one of the reasons that they have yet to achieve a clean audit is because they are unable to automatically close their books. Accounts totaling billions are still for the most part manually reconciled. The Department of Education has purchased a new financial management computer system that I understand will not be fully implemented until later this year. I hope that our witnesses today will be able to report on the progress of having this implemented.

Mr. Chairman, again I look forward to working with you over the next two years. I look forward to working on juvenile justice issues, and on some educational issues. I know you and I worked on some charter school and teacher quality issues last year. I look forward to working with you on the reauthorization, the Americorps Program, and the Endowment for the Arts, and I think it is going to be a very productive and bipartisan year with that kind of agenda set out in front of us in our first hearing. I think with you and I looking at creative ways to approach some of the issues before us in this Select Education Subcommittee that there are probably a half dozen other issues we can work on and hold hearings on both in Washington, D.C., and, maybe, different select parts of the country as well.

With that, if my new member from the State of Minnesota, Ms. McCollum, is interested in making a short opening statement, I just want to take the time to welcome her and her energy and insight to this Subcommittee. I am delighted that she has selected this subcommittee as one of her two picks and look forward very much to working with her and listening to her suggestions as to what this Subcommittee can look into over the next couple of years. If you have an opening statement, we would be happy to enter that into the record at the appropriate time as well.

WRITTEN OPENING STATEMENT OF RANKING MINORITY MEMBER, REPRESENTATIVE TIM ROEMER, SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, DC – SEE APPENDIX C

Ms. McCollum. Mr. Chair, to my ranking member, Representative Roemer, no, I am just happy to be here and I am ready to go to school.

Mr. Roemer. Terrific. We like those short opening statements, too. And I welcome Mr. Scott to the Subcommittee, too. Mr. Scott, Bobby, has been a good friend of mine, has been on the Subcommittee the previous two years and we look forward to working with him as well.

Chairman Hoekstra. Thank you. Let me introduce the witnesses, but before I do, we talked to the department about testifying today. I think what Secretary Paige and some of the staff there indicated that they would like to get their hands on a little bit more, and they are going to be more than willing to testify in the next few months on their progress and their analysis of the situation. They are very much committed to getting a clean audit, but before we put them on the hook, we thought we would give them an opportunity to get a lay of the land and recognize some of the issues that may be in front of them. They are more than willing to come and they will be here in the next two or three months.

Mr. Roemer. I know, Mr. Chairman, when Secretary Paige was up here for one of the oversight hearings you already started grilling him and letting him know of your consistent interest in this issue, and we look forward to the administration and the department coming up before the Committee in the not too distant future.

Chairman Hoekstra. I only did that because I knew if I didn't you would. Let me introduce the witness. Mr. Jeffrey Steinhoff. He is the Managing Director for Financial Management and Assurance Division of the General Accounting Office. He is a certified public accountant and a certified government financial manager. Good morning, and welcome back.

Ms.Lorraine Lewis is the Inspector General of the U.S. Department of Education. She has also served as the General Counsel at the Office of Personnel Management and with the U.S. Senate Governmental Affairs Committee as General Counsel, Counsel and Assistant Counsel. Good morning and welcome back.

We also have Mr. Daniel Murrin. He is the National Director of Public Sector Services and a partner in the accounting firm of Ernst & Young. He is a certified public accountant and a certified government financial manager with over 20 years of experience in the public sector arena. Welcome. Good to see you again.

Mr. Steinhoff, we will begin with you. Your entire testimony will be submitted for the record. You know the drill. You know of the weak gavel, so if you go a little over 5 minutes that is not a problem, but if you could keep it close to 5 we would appreciate it. We begin with you.

TESTIMONY OF JEFF STEINHOFF, MANAGING DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE DIVISION, GENERAL ACCOUNTING OFFICE, WASHINGTON, DC

Mr. Steinhoff. Mr. Chairman, members of the Subcommittee, I am pleased to be here today to discuss education's vulnerability to improper payments and to comment on the importance of addressing the serious internal control and financial system weaknesses noted during this year's financial audit.

Internal control serves as a first line of defense against fraud, waste, abuse and mismanagement. Internal control is not something to be built in at the end, but must be part of the daily fiber of management. Mr. Chairman, the work we now have ongoing at your request, which builds on earlier work by the IG, has found control weaknesses that sharply increase education's vulnerability to improper payments and leave the door open to fraud and abuse. I will quickly highlight the four problems we have noted to date, but I will emphasize going in that our work is still ongoing and the bulk of our detailed transaction analysis has yet to be completed.

First, operation of duties is a fundamental internal control. Accounting 101. Currently 49 employees can issue hard copy checks for amounts up to $10,000 each. For our fiscal year 2000 over 19,000 such checks, valued at about $23 million, were issued. We have found, however, that 21 of the 49 employees can prepare, mail, and sign the check without involving anyone else. This leaves the system open to fraud and abuse.

We also found control weaknesses with electronic fund transfers through which billions are paid each year. While education has a policy that requires separation of duties, and we are talking big money here, there were no monitoring controls to ensure that this policy was being followed. We were also told that in fact on some occasions the policy is violated. The monitoring is an essential control. It is management's responsibility, especially when billions of dollars are at stake, and with EFT, money can move easily and quickly through the world's banking system.

Second, a key control over the use of government purchase cards is to review the cardholders' monthly payments statements. Similar to the problems the IG reported last year of the 676 multi-statements we have audited, to date 141, with charges of almost $17 million, these were not reviewed by an approving official as required. Credit cards are highly vulnerable to fraud and abuse. In June of last year, the DOD issued a fraud alert, stating that with the increased use in spending levels documented credit card abuse was increasing.

Third, we noted that audit trails that would help detect improper payments were lacking for payments totaling about $2 billion, including purchase cards and hard copy checks.

Fourth, we are in a technology age where our computer security has been referred to as the new frontier in fraud. It is open 24 hours a day seven days a week, a problem so serious government-wide that we put it on our "high risk" list in 1997. Beginning this year, Ernst & Young reported serious information systems weakness, and our ongoing work as well has found computer application controlling problems that must be immediately addressed.

We have discussed these four issues with education officials who have agreed to take corrective action on each issue. As our detailed work moves forward, we will be using computerized techniques, referred to as forensic auditing, to identify red attention flags that show that a payment may have been improper. Any such payments that don't look right, such as the use of a questionable Social Security number, will be researched and, if warranted, investigated for fraud. We plan to be in a position to report to you on the results of this work sometime this summer.

With respect to the work of Ernst & Young, we support their recommendations. As you will hear today, they reported again serious control and financial systems issues that really meant they could not issue an unqualified opinion. But frankly, fixing the underlying weaknesses and not the audit opinion itself is what is most important. The end goal of the CFO Act is that useful, reliable, timely information be available on an ongoing basis for decision-making and oversight. Also, we want to make sure adequate controls are in place and operating effectively.

A number of agencies to date have obtained clean audit opinions through significant, costly and time-consuming manual work similar to what education is now doing. This is commonly called heroic efforts. Obtaining an unqualified opinion must be combined with tangible improvements to the underlying systems and controls. Without such improvements, an unqualified opinion can serve to mislead the Congress and the American public and would become an accomplishment without much substance, a hollow victory.

Education's top management must view fixing the underlying problems, the systems and controls, and promoting excellence in financial management as a priority. Only in this way will they be able to provide the accountability that this subcommittee has been rightfully demanding over the past 2-1/2 years.

Mr. Chairman, your work and the work of this Subcommittee has been the catalyst to progress we have seen to date. Continued oversight will be needed to assure these things are followed through on. Mr. Chairman, this concludes my summary of remarks. I would be pleased at the appropriate time to respond to any questions you or members of the subcommittee may have.

WRITTEN TESTIMONY OF JEFF STEINHOFF, MANAGING DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE DIVISION, GENERAL ACCOUNTING OFFICE, WASHINGTON, DC – SEE APPENDIX D

Chairman Hoekstra. Thank you.

TESTIMONY OF LORRAINE LEWIS, INSPECTOR GENERAL, U.S. DEPARTMENT OF EDUCATION, WASHINGTON, DC

Ms. Lewis. Thank you, Mr. Chairman and members of the Subcommittee. Thank you for inviting me to testify today. The Department of Education has many serious financial management challenges that your Subcommittee, the Office of Inspector General, the firm of Ernst & Young and the General Accounting Office have identified over the years. Let me highlight some of these challenges.

First, Ernst & Young issued a qualified opinion on all of the department's fiscal year 2000 financial statements. This qualified opinion is due primarily to the department's inability to provide adequate documentation to support certain amounts and prior period adjustments and to inconsistent processing of certain transactions related to prior years. While this opinion represents an improvement over 1999, much work still remains.

Second, the report on internal controls identified three material weaknesses. These related to weak financial management systems and financial reporting, reconciliation, and controls surrounding information systems. The report also identified two reportable conditions involving credit reform, financial reporting, and the reporting and monitoring of government property and equipment.

The auditor's report on compliance with laws and regulations noted that the department was not in full compliance with the Clinger-Cohen Act or the Federal Financial Management Improvement Act.

In addition to the financial statements audit, my office has identified several other areas of concern within the realm of financial management. At the department's request, we reviewed its internal controls over the use of purchase cards and third party drafts or checks. We found that while the department has established procedures to ensure the financial integrity of these financial instruments, these procedures were not always current and were not always followed. For example, the important control of having an approving signature on the individual purchase card statement was not applied. Without that signature on each individual statement, the department has no assurances that a second pair of eyes has reviewed the purchases. We also found that before paying the combined statement, the department was not reconciling it with the statements from individual accounts.

We made similar detailed findings with regards to third party drafts.

In total, we issued 14 reports to principal offices of the department and a capping report to the deputy secretary in which we concluded that the department failed to fully comply with the applicable GAO standards on internal controls.

We made a total of 22 recommendations to the department. As the department implements these recommendations, it will strengthen its internal controls and reduce the risk of fraud, waste and abuse in these operations. We shared these reports and our work papers with GAO.

When we looked at the internal controls over properties that the department furnishes to contractors, we discovered problems with properly identifying and inventorying the government property. Similarly, with the process of paying contractors, we recommended several improvements in the controls, such as segregating the responsibility to review invoices from that of paying invoices.

We recently reported on duplicate payments the department made from the Grant Administration and Payment System, or GAPS. To date through our work and that of the department, 21 instances of duplicate payments have been identified, totaling more than

$250 million. We are still examining another nine transactions for approximately $6 million that are potential duplicate payments.

We have much ongoing work and I will keep this Subcommittee apprised of our findings. Clearly, the department has much work ahead. At a minimum the department must address the pending recommendations of my office and Ernst & Young.

I commend the Committee for its diligence in bringing these serious management issues to the public spotlight. I would be happy to respond to any questions that you have.

WRITTEN TESTIMONY OF LORRAINE LEWIS, INSPECTOR GENERAL, U.S. DEPARTMENT OF EDUCATION, WASHINGTON, DC – SEE APPENDIX E

Chairman Hoekstra. You want to come back? Don't you know the green light is still on? I think Mr. Scott has a question here for clarification.

Mr. Scott. Did I understand you? Did you say 13 payments? I thought I heard 21 payments. $21 million in duplicate payments.

Ms. Lewis. From May 1998 to September 2000, there are 21 instances that the department and we agree on. These total $250 million.

Chairman Hoekstra. That is what you heard.

Mr. Scott. A $10 million duplicate payment.

Ms. Lewis. I'm sorry, sir?

Mr. Scott. 21 instances totaling $250 million.

Ms. Lewis. Is the total of the 21 correct?

Mr. Scott. One instance would be $10 million?

Ms. Lewis. There are different amounts.

Mr. Scott. On average. These are duplicate payments?

Ms. Lewis. Yes, sir.

Chairman Hoekstra. Any more questions?   Does that make you feel any better now that you have clarified?

Ms. McCollum. Are you glad that you are here?

Chairman Hoekstra. Mr. Murrin, you are welcome.

TESTIMONY OF DANIEL J. MURRIN, PARTNER, ERNST & YOUNG, LLP, WASHINGTON, DC

Mr. Murrin. I thrive on positive feedback as well, so I will keep my remarks brief. Mr. Chairman, members of the Subcommittee good morning. My name is Daniel Murrin. I am the Engagement Partner for the Ernst & Young audit of the Department of Education. The Office of Inspector General engaged Ernst & Young to conduct the audits of the fiscal year 2000, 1999, and 1998 financial statements of the department. We have been asked to share with the Subcommittee our engagement scope, the results of fiscal year 2000 audit, including principal findings and weaknesses, and to comment on additional work that could be performed concerning the department's financial management. The findings for the fiscal year 2000 audit are as follows:

Ernst & Young issued a qualified opinion with respect to the five required financial statements. Concurrent with the issuance of a report, we issued a report on internal control that detailed three material weaknesses and two reportable conditions, with a total of 21 recommendations to assist the department in addressing its internal control deficiencies. Finally, we have issued a report on compliance with laws and regulations and cited noncompliance with the Federal Management Improvement Act and the Information Technology Management Reform Act.

We qualified our opinion on the statements because of the following matters: The accounting system as implemented has several limitations. These have been previously reported and they do impair the department's ability to analyze, develop and report financial information. To remedy this in the future, the department has purchased and is in the process of implementing a new accounting system. In addition, the controls, account analysis and reconciliation processes were not sufficiently developed and implemented to compensate for the weaknesses in the department's financial reporting processes.

During fiscal year 2000, the department processed a significant number of manual adjustments in an effort to correct errors from prior years and to correct deficiencies in the posting of current year transactions. While management made reasoned judgments intended to correct those balances, and this adjustment process does appear to have been a pragmatic solution, the department was unable to provide sufficiently definitive documentation to support the adjustments. The department was unable to provide adequate documentation to support certain amounts reported in that position included in the consolidated balance sheet, and prior period adjustments included the consolidated statement of changes in that position.

In addition, Ernst & Young issued a report on internal controls, documenting five reportable conditions, the first three of which were material weaknesses. The financial management systems and financial reporting needs to be strengthened, reconciliations need to be improved, controls surrounding information systems need enhancement, improvement of financial reporting related to credit reform is needed, and reporting and monitoring of property and equipment needs to be improved. As noted in our audit, continued focus from the department on improving financial management is needed.

We have been asked by the Subcommittee to make recommendations for improving the financial management of the department. The items I will identify are in addition to or an expansion of the procedures that were performed as part of our audit. We have recommended that the department conduct a review of the quarterly financial statements it intends to prepare for fiscal years 2001 and beyond to provide an early identification of departures from GAP.

Secondly, there are a number of reconciliation's with the department that should be performed periodically and subject to rigorous reviews and follow-ups. I would note that comment is particularly important while the financial management system is being improved and replaced.

Third, the department and OIG and GAO have ongoing efforts to identify potential duplicate or improper payments in order to assess the need for additional controls. Using the results of this process will aid the department in quantifying and resolving this critical area in safeguarding assets of the department. An independent review of the fixed asset inventory results the department has completed could be performed to ensure the process provided a complete and reliable inventory and to assess the significance of any issues identified.

Fifth, the department may benefit from independent confirmations of financial data with grant recipients at the reward level, and we will recommend that be conducted on a periodic basis.

Sixth, we have recommended that a detailed analysis of transactions flowing through the general ledger loan and subsidy related accounts and how they interact with the subsidy model be performed. We have noted in our audit report a number of items and areas where specific action can be taken by the department to further improve its financial management. We would emphasize the following two of those recommendations to yield sustained improvements.

First, we recommend that the department continue to assess the roles and responsibilities of each departmental office involved with the financial reporting process to ensure that the appropriate resources and tools are available to achieve the financial reporting objectives established by management. And second, we have recommended the department complete the implementation plan for the replacement of the general ledger software package and ensure the transition will occur in a timely and documented manner.

In addition, we have recommended that the department ensure the new general ledger software package will in fact meet it financial reporting needs. The department will need to give consideration obviously to both short and long-term needs.

The fiscal year 2000 result does reflect improvement from fiscal year 1999 and 1998; however, sustained commitment to improving internal controls and systems will be needed to demonstrate additional progress in fiscal year 2001 and beyond.

This concludes my testimony, and I will be pleased to answer any questions you may have.

WRITTEN TESTIMONY OF DANIEL J. MURRIN, PARTNER, ERNST & YOUNG, LLP, WASHINGTON, DC – SEE APPENDIX F

Chairman Hoekstra. Thank you. Let me just summarize, I think this testimony was in your statement, or your statement submitted for the record, Mr. Steinhoff. You talk about the department reported issuing over 19,000 third party drafts totaling approximately $23 million. That is on page five. Then you also talk about what are called the impact cards or the government credit cards for purchasing purposes, not the ones that a lot of employees have for travel, but that 36 individuals can charge $25,000 or more per month and two of those employees can charge up to $300,000 in a single month. Then you go and talk about trigger logs, Education has a trigger log for documented changes made to sensitive records, such as bank accounts, routing numbers and a payment history for grants and administrative payments to schools. However, the department lacks adequate trigger logs for other type of payments, including payments for contracting, third party drafts and purchase cards, which according to Education totaled about $2 billion in fiscal year 2000. And then later on in your testimony you talk about what else you found, for example, in invoice number 123. This is a third party draft. This is on page nine at the bottom of the page. For example, if invoice number 123 has already been entered into the system, an employee can add the letter A to this invoice number and issue another third party draft or other payment mechanism related to the invoice. The interesting thing was because they had a system in place to make sure they did not do duplicate payments, which is very ironic. They handle duplicate payments here. Now they come up with a system to, I guess, tamper with the invoice number and put on a suffix so they could go around their own department rules by breaking an invoice that might be $60 thousand. That would not be open for use by third party drafts and saying now if we add our own suffixes in we can make it work. Education officials told us that the use of multiple third party drafts to pay invoices greater than $10,000 was primarily a matter of convenience. You found this for what months were you auditing?

Mr. Steinhoff. We were looking at the 2-1/2 years that ended September 30, 2000. But there were certain transactions; for example, on the purchase cards, we have looked at for four months.

Chairman Hoekstra. Which months were those?

Mr. Steinhoff. For the purchase cards we looked at August 1998, January 1999, August 1999, and August 2000.

Chairman Hoekstra. Okay. And you found that that pattern continued for all of those months?

Mr. Steinhoff. Yes.

Chairman Hoekstra. Okay. Ms. Lewis, this is not new to you either, right? I think, as we have talked about some of what you are saying. I think Mr. Steinhoff also said this builds on the work that you have identified over the last number of years.

Ms. Lewis. Yes, sir, we did an office-by-office review of both the credit cards and the checks. We pulled two months of transactions, one in September of 1999 and one in

March of 2000. But in at least three offices we also found a situation where multiple checks were issued for amounts over $10,000, and we reported those directly to the heads of those offices as part of our larger set of recommendations in our final report. We have made a total of 22 recommendations to improve the internal controls situation for both of those programs.

Chairman Hoekstra. I think this is the disturbing thing to those of us on the Subcommittee, and you have submitted a number of recommendations for changes to the department.

Ms. Lewis. Yes.

Chairman Hoekstra. Mr. Steinhoff now goes in, finds out, and confirms what you have identified. We have followed Mr. Murrin's work that identified failed audits for three years. In many ways it starts to look like a third world republic that we are dealing with here. Issues that impact credit cards or credit cards to employees that say, "hey, you can purchase up to $3,000 and we are not going to have a thorough audit trail process to make sure that everything here is purchased for the department."

I think, Mr. Steinhoff, you said in a private sector company this would not be tolerated. They would go through a heroic effort to get to a clean audit because their shareholders would demand it and the IRS probably would demand it. It is just disturbing that these things continue year after year, and I think as a Subcommittee we can keep highlighting these but it is very, very difficult to go in and make the changes yourselves. And again this is an area that many of us will support somewhere in the neighborhood of a 6 to 8 percent increase. Some would want more for this department.

My red light is on. I will yield to Mr. Roemer.

Mr. Steinhoff. I want to add a thought to the heroic effort. In the private sector you would go through a heroic effort to close your books and have your audit within 3 to 5 days. We are talking 3 to 5 months here. This is not an acceptable situation.

Chairman Hoekstra. Thank you. Mr. Roemer.

Mr. Roemer. Thank you, Mr. Chairman. I have a couple quick questions for Ms. Lewis. One, in the fiscal year 2000 audit, two of the reportable conditions are, and I will read one of them, reporting and monitoring of property and equipment needs to be improved. We have talked about this several times. Without going into the details of the electronic theft problems that we have had in the Department of Education, it seems to me one of big difficulties there was the COTR issue, the fact that we had somebody wearing two hats at the Department of Education, where they are monitoring themselves in effect. Are we now comfortable that that this is not going to be continued? This practice of the COTR both distributing the checks and doing the oversight for themselves, and that the new administration, the new Department is aware of this management conflict and has either issued orders or is sensitive to this fact and is not going to allow this to be repeated?

Ms. Lewis. We definitely have briefed the new team; very focused briefings, very receptive to our work. We have identified the specific issue. We have made the recommendations through the years. We are currently in our own offices doing a review of the COTR situation, training, what kind of training is given, and if there are any problems in the program. So we will also be able to report anything we see there. Ultimately there is always room for improvement. We will be vigilant on this issue, and we will identify any problems we see and bring them to the attention of the department and Congress.

Mr. Roemer. I realize the department did not decide to testify today. Is the department here? Is there somebody from the department at the hearing somewhere? Way back there? And you are going to take the knowledge gleaned from this hearing back to the Department of Education so that we clean these situations up, I hope. I would welcome you to sit in the front row so that you are a priority for us. I understand why the department may not have wanted to testify, I certainly hope that these problems are addressed very quickly. These are not Democratic or Republican problems. These are problems of oversight and jurisdiction that we take very seriously.

I want to follow up, Ms. Lewis, on your testimony that stunned, I think, and surprised Representative Scott. One of the things that disturb me about this is you said in your testimony, before the analysis of the department, that the department had identified audits of duplicate GAP payments? The grant administration of payment system, totaling 198 million; is that correct?

Ms. Lewis. Correct.

Mr. Roemer. And then you, the IG, found an additional 13 instances that the department did not catch totaling another 55 million; is that correct?

Ms. Lewis. That is correct.

Mr. Roemer. Just let me. So we have 21 instances, 13 of which the department did not originally catch, totaling $253 million dollars; is that correct?

Ms. Lewis. Yes, sir.

Mr. Roemer. Okay. Go ahead.

Ms. Lewis. Just to clarify, an instance can represent an electronic payment to multiple payees. For example, one instance resulted in duplicate payments to 250 grantees, so when we talk about an instance we are talking about the electronic payments. In all of the situations the money was either returned by the grantees, contractors or universities.

Mr. Roemer. Or credited.

Ms. Lewis. Or credited to the account so, just to clarify on that point.

Mr. Roemer. Well, still, I think the fact that $253 million is sent out, whether it is inadvertent and human error and whether it is eventually recovered and credited. The fact that we almost need two audits to catch it; first, the department does an audit and they catch eight of them and then you do an audit and you catch an additional 13 instances. You are sending out millions and millions of dollars in these different cases from the department is something that greatly disturbs and concerns me. And I would hope that we pay even closer attention to this issue in making sure that it doesn't happen in the first place and we have ways the epartment catches it and we don't rely on the IG to have to catch it at the end of the game.

Are these payments to colleges for financial aid, to LEAs for education? Generally what are these payments?

Ms. Lewis. In large part they are grants to LEAs, SEAs and community-based organizations. There are also some contractor payments in the system. But the bulk of it represents grants.

Mr. Roemer. So tell me how an individual overrides a system. Is it that the SEA or the LEA contacts the Department and says "we didn't get our money, you owe us a million dollars," and then the individual overrides the system and sends out the money? Then we discover later that not only did they eventually get the first check, but they have got the second check that was overridden by one individual making this decision to placate the individual who was screaming about not getting the money on time?

Ms. Lewis. There are a variety of circumstances. In large part it is an Internet-driven draw down system, but there have been instances where the draw down was made by the grantee. A request can also come in through a telephone request into the help desk, and then that request could result in a second payment for the same purchase. There are also situations where we found that the transaction was sent to the Federal Reserve Bank on two occasions by the same person, a file was inadvertently submitted twice. We have had instances where the Federal Reserve Bank has notified us at the department of the problem. Frequently the grantee will notify the Department that there is a problem, and that they have received a second payment.

Mr. Roemer. How did you find it? Did you discover it or did the Reserve Bank bring it to your attention?

Ms. Lewis. We went back and compared data from the Federal Reserve Bank to the department's GAPS and in a very intensive fashion we compared the data to see if we found two identical payments on the same day or near to each other for similar amounts. And then we had a list of transactions and we provided them to the CFO's office, and the CFO's office researched the issue because to us it looked like an anomaly, potentially a duplicate payment. In a number of circumstances the department came back and confirmed, in 13 circumstances, yes, we all agreed it is a duplicate payment. We have another nine transactions where additional work needs to be done by us. We are going to go to the actual recipient. And because this was a data comparison without going to the actual recipient, that is where we are going to follow up on the other $6 million worth of payments that we identified in this recent IG report.

Mr. Roemer. One last question, Mr. Chairman. So in addition to the 21 that we have discovered, 13 of which you had to discover, that the Department never found out about, there are another six or seven that you still have to reconcile that may result in even more money?

Ms. Lewis. Yes, as I testified, there are nine more potentially for $6 million dollars in this same period.

Mr. Roemer. Thank you, Mr. Chairman.

Chairman Hoekstra. Mr. Tiberi.

Mr. Tiberi. Thank you, Mr. Chairman. I have just two quick questions. Mr. Steinhoff, in your testimony you say, to summarize, internal control and financial management weaknesses in education are not new. You go on to say that both you and the IG and Ernst & Young have reported serious internal control problems in the past. Our ongoing work is showing that the department in several cases is not taking advantage of available means to use or improve its controls over the review. Until education is able to correct its serious internal control and system deficiency, it will be hindered in its ability to achieve lasting financial management improvements. As a result, it will continue to face an increased risk of improper pavements.

You three have been at this a lot longer than I have. In asking this question, Mr. Steinhoff, my concern is what you are essentially saying is that the outlook based on the past couple of years is not good and that reforms have not been put in place in the department. My question to you is, why not, in your opinion?

Mr. Steinhoff. The pace of reform is not what we would like to see it be. We first reported the department is a high-risk area of the financial aid programs in 1990. The Congress has passed legislation, beginning with the Federal Managers Financial Integrity Act in 1981 that had placed responsibility for controls on managers. In 1990 the CFO Act and other acts following that. I think for the most part we have seen progress in the last 4 or 5 years. People have recognized across government that there is a need to really have proper financial management. But the progress has been slow, very slow, across government, and I think it just has not been given a sufficient priority.

As I mentioned in my summary, there is a lot of preoccupation with getting a clean audit opinion, which is important. That is an important milestone. That is something you have to strive to do. But there has been a lot of heroic effort, a lot of work done to derive numbers, and you have to step back and fix the underlying systems. education has had problems doing that. And the nature of the control problems that we have found and the IG has found shows to me a lack of an adequate priority being placed on those matters.

These things aren't rocket science. They aren't difficult. When you talk about separation of duties that is extremely fundamental, and those things should be in place. Any company would inspect that and the government should expect no less.

Mr. Tiberi. Mr. Chairman, if you would indulge me just one more question to follow up. Is it unusual for a department to have over 200 employees that have credit cards, some, a few, whose balances are allowed or whose limits are allowed to go over $10,000?

Mr. Steinhoff.

Mr. Steinhoff. I really haven't studied that across the board. I would not be surprised if there are other entities with similar numbers, especially entities like defense, who has huge numbers in terms of what they purchase. But we are looking as part of the ongoing work that Chairman Hoekstra requested, at those limits, and we are also going to benchmark against other places to see what kind of limits they have placed. What is of most concern to me here is that they just haven't been reviewing the actual credit card charges despite the fact that this is acknowledged as a high risk area and there have been problems before in this area.

Mr. Tiberi. Thank you.

Chairman Hoekstra. Mr. Scott. Ms. McCollum.

Ms. McCollum. Thank you, Mr. Scott. I am new, just recently elected, so I am trying to figure out some of this stuff. Now we know that there was a problem and we have asked the department to fix it legislatively. My question is have we given the department the tools that they need in order to implement it? I am looking through the Ernst & Young report and I am hearing, seeing and reading things saying that they have to do some comprehensive software change management. All those require money, they require time and training for employees to use it.

So one of my questions is, in your opinion, have we done our job in giving them the tools they need? And then the discussion about not having the segregated duties again goes back to is the department staffed in an efficient and effective manner so we do not have people doing job overlap or are people doing that because there was nobody else to do the work so it got assigned to somebody else and that really wasn't their original job responsibility? And if that is the case, what do we need to do to help the Department overcome these obstacles?

Ms. Lewis. The department really is in the best position to answer the question of what tools it needs, if any additional tools, or resources. I know Ernst & Young has made a recommendation as part of the internal control report to assess its resources and what other needs it has in its deployment of individuals. Ultimately, as Mr. Steinhoff has mentioned, it is a combination of the goal of a clean opinion and what I refer to as using the internal control report as the blueprint for fixing the management problems.

Ms. McCollum. Mr. Chairman, if I may ask you for your help and your guidance on this. Mr. Chair, I would be curious to know since this committee here, the Education and Workforce Committee, found out about these problems and actions have been taken to correct them, if the Department has come to Congress and asked Congress for help in getting software and making sure that they have the right people hired to do the right kind of job. These are very sophisticated accounting jobs at times, keeping track of things, if we have done what we need to do in order to turn this around.

Chairman Hoekstra. I think that Mr. Roemer will correct me if I am mistaken, but I believe that we have extended that offer to the department when they have testified here before, saying if there is any resources that you need, identify them to us. We will support them to the Appropriations Committee. I am not aware of a request having come in over and above the normal appropriations request that they have, where they have made special requests that have not been supported by Congress in the last 2 or 3 years. I think we have given them everything that they have asked for.

Ms. McCollum. Thank you, Mr. Chair.

Chairman Hoekstra. Mr. Roemer and I have sent bipartisan letters to get a CFO confirmed by the Senate in the process. I think we have tried to be supportive of what Secretary Riley has wanted in the past. I think we will have the same spirit with Secretary Paige..

Mr. Norwood. Thank you very much, Mr. Chairman. Mr. Murrin, you are with Ernst & Young. How long have you been working on this issue with the Department of Education?

Mr. Murrin. Our firm was first engaged to do the 1998 financial audit.

Mr. Norwood. A couple of years.

Chairman Hoekstra. I am not sure the mike is on. We couldn't hear the answer.

Mr. Norwood. Ms. Lewis, you are with the Department of Education, Inspector General. How long have you been working on this issue?

Ms. Lewis. I arrived in June of 1999, almost 2 years.

Mr. Norwood. Two years. And, Mr. Steinhoff, how about you? You are with GAO.

Mr. Steinhoff. I have been with GAO my entire career about three decades working in the financial management area. I was involved in working with Senators Glenn and Roth on the CFO Act. So I guess I have been involved with this in the beginning, not concentrating solely on this, but more broadly, on a government-wide basis.

Mr. Norwood. I want to ask a couple of questions that may be opinions, but you are here to give us your opinion. I am trying to understand how long you have been involved in this, and this tells us a great deal about what your opinion is.
You made a statement that the department had failed to follow internal controls of the GAO standards. Why?

Ms. Lewis. It shouldn't have happened. There is really no excuse for it.

Mr. Norwood. How big a deal is this?

Ms. Lewis. A big deal.

Mr. Norwood. How much money, and I want to ask each of you just your best guess, how much money is going to be lost in this whole process; taxpayer dollars?

Ms. Lewis. We have looked at that issue in terms of the larger issue of improper payments that GAO has been identifying. A large definition that includes restitution and civil settlements from investigative work from the Office of Inspector General for the last three years, what we call sustained disallowed costs from our audit work, and errors like the duplicate payments that I have just mentioned totaling from our semiannual reports is $450 million improperly paid. These are disallowed costs and costs that shouldn't have been expended or errors.

Mr. Norwood. Over what period of time?

Ms. Lewis. Three years, sir.

Mr. Norwood. Four hundred fifty million over 3 years?

Ms. Lewis. Yes, sir.

Mr. Norwood. Does that rise to the level of a scandal to any of you?

Ms. Lewis. It is a very serious problem.

Mr. Norwood. You wouldn't know it from the press. You wouldn't know it from the fact that C-SPAN is not here on a hearing that we are talking about programs as much as 450, 250 million taxpayer dollars flushed out the window.

You made another comment that Mr. Scott reared up on, and so did I, duplicate payments, 21 of them totaling $250 million. Now, tell me, any of you, why has the Office of the Chief Financial Officer not identified these amounts as duplicate? Why have they not done that?

Ms. Lewis. In eight of the instances the Office of Chief Financial Officer did identify the duplicate payments. Our audit work identified the other 13 instances.

Mr. Norwood. Why didn’t they?

Ms. Lewis. There is no excuse.

Mr. Norwood. There really isn't. Is that CFO still there at the Department of Education?

Ms. Lewis. The position has been vacant.

Mr. Norwood. Well, is the guy previously in jail or the girl or the lady, whoever? This is criminal, absolutely criminal. Are there still investigations going on now over in the department related to criminal activity?

Ms. Lewis. Yes, sir.

Mr. Norwood. Someone asked from this panel when did this Subcommittee get involved, and as I recall, what got our attention, ladies and gentlemen, was that some employee from the department was buying a $50,000 automobile. I think and you correct me, Chairman, if I am wrong, but I think that is when we first began to ask some very serious questions about this. So there are criminal investigations going on right now?

Ms. Lewis. Yes.

Mr. Norwood. Mr. Chairman, I will conclude with talking to the person from the Department of Education in the back of the room. I know I am not in charge, but if I were I would shut that department down and it wouldn't open back up until it straightened this mess out. A lot of people would need to be on leave while we had people in there who are honest.

Thank you, Mr. Chairman.

Chairman Hoekstra. Thank you, Mr. Norwood. As I have indicated, we have had a number of discussions with Secretary Paige. Mr. Roemer has highlighted that as well. Secretary Paige is well aware of the issues within the department and the focus on a bipartisan basis of this Subcommittee in getting those issues resolved as soon as possible.

Mr. Scott. Thank you, Mr. Chairman. Could somebody briefly explain what a third party check is?

Mr. Steinhoff. Do you want me to try? It is just really very similar to a personal check. It has a limit not to exceed $10,000. And it is made out and distributed just like a personal check.

Mr. Scott. Who is it made payable to?

Mr. Steinhoff. It is made payable to whoever you were paying. So it really permits the department to issue its own check without sending a payment tape to Treasury to make the payment.

Mr. Scott. Do other agencies have accounting systems?

Mr. Steinhoff. Yes.

Mr. Scott. Is there anything unique about the Department of Education that limits its ability to follow generally accepted accounting practices just like everybody else does?

Mr. Steinhoff. No.

Mr. Scott. You had a question about the number of employees. Are there enough employees there to do the job?

Ms. Lewis. The department is really in the best position to answer that question.

Mr. Scott. Well fully, no. Because you are looking at it and you have seen other agencies and you know what other agencies do and you know what generally accepted practices are and if they are doing this thing kind of home baked, in house, it ought to work. Why can't they, what is wrong? If there is nothing unique about the Department of Education, why don't they have the same software that other agencies of similar size, State, Federal, and local might have?

Ms. Lewis. They did buy a system in the mid-nineties that was deployed basically in 1998. The system did not work because it couldn't.

Mr. Scott. Did anybody else have the same software in the world?

Mr. Steinhoff. Let me answer that. The government has had immense problems implementing automated systems. This is a problem also in the private sector. But literally billions have been spent on information systems across government with very mixed results. Education put up a Cox package or an office shelf package back in the mid to late nineties. It did not work out well. They were not alone. Other agencies have had the same problem. They are still trying to dig out of that hole. It gets down to project management, which is oftentimes lacking on investments in IT, and it is something that is a government-wide issue.

Mr. Scott. State and Federal.

Mr. Steinhoff. I can't really speak for the State. I have heard stated that roughly 40 percent of all information systems projects in the private sector are stopped. Nike recently had one where they had invested $400 million and they just pulled the plug on it. So putting in IT systems is not easy work. It is tough project management work, and this oftentimes isn't done.

Going back to your issue about the people, this is a difficult matter because each department is structured somewhat differently. But I would submit myself that good internal control is synonymous with management control. It is the job of every manager every day.

Mr. Scott. If you have an agency that is not doing it, telling them to do it just seems to me not to be a productive response. You are to tell them what to do or show them what to do, or I think I am hearing that nobody can get this accounting thing straight. So if you have got an agency that is all messed up, they are not by themselves, which is_.

Mr. Steinhoff. It is a challenge.

Mr. Scott. It makes the response a little more difficult. Is there any reason why we can't start from scratch?

Ms. Lewis. The department has purchased a new system and we are monitoring. We have opened up an audit to monitor its implementation of that system. It is critically important for the department to plan, test, run parallel systems as necessary, ensure that the financial statements for this year are produced on a timely basis and be responsible for successfully implementing that system.

Mr. Scott. The problem with that is we are counting on the Department of Education to do this. The department has shown no capability of getting it done and you are asking them to do so. I mean, it would seem to me that a more reasonable response would be to say here is a package, it works in the Department of Commerce or the Department of Energy, do this, hire some of their people because they know how to work it, and this is how you get the job done. Having an agency that has shown no capability of getting the job done and telling them to do the job doesn't seem to be a very productive response.

Ms. Lewis. It is their responsibility. I think there are many experts and many sources of information. Each of us represents a very important source of information to draw on. But under the laws and under the appropriate models, it is the department's responsibility.

Mr. Scott. Does Secretary Paige have the accounting background to be able to direct all of this? I mean, since apparently you are putting all the burden on him.

Ms. Lewis. The Secretary has been very receptive, very keen to hearing about the problems, very actively interested and committed to putting the resources to hiring the talented staff, deploying the appropriate staff, having the right software, and having the right hardware. Ultimately these are the responsibilities of the CFO, who would report to the Secretary.

Mr. Scott. Did I understand the CFO? Has he or she been appointed and what is the status of that?

Ms. Lewis. Not yet. The position is currently vacant, and the persons in the CFO office continue to do the important work that they need to do, both for fixing last year's problems and looking to implement next year's program.

Chairman Hoekstra. Thank you. Just clarify a couple of comments, Mr. Steinhoff, you indicated Nike pulled the plug on a $400 million IT project. I am assuming that at the end of that fiscal year they will probably get a clean audit?

Mr. Steinhoff. Yes.

Chairman Hoekstra. With a line perhaps identifying $400 million that they will write off on a failed information technology project?

Mr. Steinhoff. That is right. Nike will produce financial information every day to manage their bills.

Chairman Hoekstra. The same thing; it is a complicated process but other people in the private sector do it every day. Chrysler merged with Daimler-Benz and so we are going to take accounting systems that could be very, very different from Chrysler and Daimler-Benz. At the end of the year they will have a unified accounting statement that will pass most likely the tests of an Ernst & Young?

Mr. Steinhoff. That is right. It is done every day. It requires very stringent project management. Congress passed the Clinger-Cohen Act a few years ago to lay out a structured approach to investing in IT, and if that were followed their opportunities would be much greater. But it must be managed well or in a few years from now they will be in the same position as they were before.

Chairman Hoekstra. And, Mr. Murrin, just to clarify that, it is an infrequent occurrence to have a Fortune 500 or a Fortune 5000 company to get the kind of opinion that you rendered to the Education Department; is that not correct?

Mr. Murrin. That is correct. And another thing that is actually almost as infrequent is having numerous material weaknesses and reportable conditions. Those are very, very rare in the private sector in very large companies. I would also say that companies do compete based on their financial management capability, which would imply that some of them do it very, very well and some of them do not do it as well. So you wouldn't necessarily hold up the private sector as always the paragon of virtue for all of this. There are cases where it isn't done as well.

Chairman Hoekstra. And I think the statement that you have made, Mr. Steinhoff, this is a symptom perhaps of other issues. I am not paraphrasing, but it highlights the emphasis or lack of emphasis that management may put on this area. It also may indicate other weaknesses, and I think those are my words. When you have got financial problems like this and you have got problems in your control systems like this, it may indicate that there may be other management weaknesses that would lead to the kind of problems that Ms. Lewis identified of $450 million dollars being mismanaged?

Mr. Steinhoff. Yes, especially since the businessmen are making loans and grants, a lot of financial transactions, and it really also gets down to the programmatic side of controlling and making sure taxpayer dollars are properly spent.

Ms. Lewis. And, sir, the amounts on the restitution and the civil settlements, primarily the fraud that we have investigated. The bulk of our investigative caseload relates to fraud perpetrated by third parties against the programs of the department; in our loan area and our Pell grant area. We do, of course, continue to have some internal cases as well. But primarily the bulk of that number relates to fraud being perpetrated by third parties against the department's programs.

Chairman Hoekstra. Good. Thank you.

Mr. Holt. Welcome to the Subcommittee.

Mr. Holt. Thank you. It is a pleasure to be here with you. And thank you. I would like to follow on Ms. Lewis' comment.

As the Chair has said, the number of $450 million over 3 years is a very large number, and I wanted to put that in perspective. What exactly do you include in the $450 million?

Ms. Lewis. Let me repeat that. We did make a recommendation last fall to the department that it should on its own develop an improper payment methodology taking the terms and the definitions that GAO has set forth. There continues to be a dialogue about what is in that large category of improper payments. So we have specifically recommended that the department on its own, either through the financial statements process or some other, create its own methodology and report it. That has not happened. From OIG, work that we report in a very public manner, and primarily we do that through our semiannual reports to Congress every six months, we added up the duplicate payment work, which states from May of 1998 to September of 2000, and as we reported in this recent report, the number is approximately $250 million of confirmed, identified duplicate payments. Then we took the category from our audit work which we call sustained disallowed costs, costs that we have identified as disallowed that the department concurred, and that number is, adding up from our audit work, is in the $100 million range. It is about $108 million.

Finally, in the area of our investigative work we report on restitutions, we report on civil settlements and civil judgments and fraud cases, and as I indicated, primarily that number relates to fraud perpetrated by third parties against our programs and operations, beneficiaries, and individuals. That number is again about $100 million. So it is a rough formula in these three large categories. That is how we have arrived to the $450 million approximately.

Mr. Holt. By improper pavements, I gather you mean payments without proper documentation?

Ms. Lewis. Well, GAO has issued a couple of key reports in this area. OMB has also been looking at the issue. Currently GAO seems to define an improper payment as either from inadvertent errors, payments for unsupported or inadequately supported claims, payments for services not rendered or to ineligible beneficiaries and, finally, payments resulting from outright fraud and abuse. As I say, there is a dialogue ongoing involving GAO and OMB and Treasury as to what is categorized as an improper payment.

Mr. Holt. Because as I look over in recent years the most celebrated abuses, electronic theft ring and false claims of disability or death, with payments in student loans or forgiveness of opportunity loans, the failure, the improper notification of Jacob Javits fellows, in almost every case it seems that there are improper procedures in the sense that if things were improperly documented mistakes wouldn't have been made if they were properly documented. But these in almost every case are not losses to the taxpayer. It makes it sound from your earlier statement that the taxpayers lost $450 million.

Now suppose, I guess we are looking over a 3-year period roughly here. So we are talking about half of a percent that is maybe improperly documented. But we are not even saying that we are losing that, taxpayers have lost that half of a percent, are we? As I look at this, you know, electronic theft, well, we are working, you are working to recover those funds. The duplicate payments through the grant administration and payment system, all funds were recovered. The Jacobs Javits fellowships, it cost taxpayers $4 million, not $400 million. So that actual loss to taxpayers may be a tiny fraction of a percent of the budget to the Department of Energy. Am I right?

Ms. Lewis. I think looking at the different categories and the duplicate payment category, as I testified, the monies were accounted for and returned or credited. Fraud cases involve persons being brought into the system to be held accountable. Whatever the amount of fraud occurs, ultimately there is a plea or an agreement or a court order as to what amount should be paid in restitution. Those restitutions may be ongoing and it is ultimately up to the individual to make those payments. Civil settlements, civil judgments, same thing. It is up to the persons to pay back into the system what they stole. And then finally in the audit area, the disallowed cost area, those are situations where the department concurs with the audit findings that those costs should not have been paid. There is a process where those being audited can appeal that finding, but it does require paying back.

Mr. Holt. In that 3 years period, how many million dollars do you think were lost to taxpayers; in other words, it was paid for services that weren't performed?

Ms. Lewis. I can't give you a total number and no one could ever give you a total number of how much fraud has occurred relating to the programs and operations of the department. That is why there is an ongoing dialogue about what is the category of improper payment, what is in that category. It could be errors, it could be unsubstantiated costs, it could be outright fraud or it could be payments to ineligible persons who then are going to be ordered to pay it back.

Mr. Holt. You are not saying that the $450 million was lost to taxpayers?

Ms. Lewis. Certainly I know in the duplicate payments arena that money was repaid or accounted for. Of the $250 million, we have accounted for those dollars.

Mr. Holt. So I want to put it in perspective. We are talking about a fraction of a percent of the department's budget here and, you know, I think in your testimony you should help us make that clear to people and put it in millions of dollars, and there are lots of things we can do to help kids if we properly account for the millions of dollars. But we do want to understand where the department stands relative to other departments and relative to private business, so that we will know what to expect and, you know, just how without a reasonable doubt to come down on them in what areas.

Thank you.

Ms. Lewis. Yes, sir.

Chairman Hoekstra. Thank you. I think he hit exactly the issue. I was very much surprised today when Ms. Lewis actually threw out a number as to what the potential waste, fraud and abuse might be. Because the problems that affect the instances, the duplicate payments, the lack of internal controls. I would think it would be very difficult to put a number on that. And the testimony today included payments for contract and third party drafts, purchase cards, which according to the Department of Education total about 2 billion. And what it says is the department lacks adequate trigger laws so they do not really know the data, and I think rather than what we are trying to do here it is exactly the amount. What we are trying to say is this is a department that manages about 80 to $100 billion per year and they are doing it with a third world country accounting system that we can't put a finger on it, and I hope that it is a whole lot smaller than it is bigger. But it is very difficult to say here it is, because Ms. Lewis right now is debating with the folks within the Department of Education as to whether there were nine occasions where there were duplicate payments or not. That should be fairly easy to do, you would think, to identify as to whether we have written these folks one check or we have written them two checks for the same thing.

I don't know how long you have been in negotiations with these folks. How long have you been negotiating this trying to identify whether the 6 million is duplicate or not?

Ms. Lewis. Since January, or so, I have sent over batches of information to ask for some responses. I don't know exactly when we identified the nine. Always part of our process is to provide the draft and provide the information and ask for a response.

Chairman Hoekstra. What they are dealing with, what these three folks are dealing with is you can't reconcile, or there is no monthly reconciliation with the Fed as to the amount of checks that the department says has been written verifies the amount that the Fed says has come through. Is that correct, Mr. Murrin, that they do not reconcile these amounts on a monthly basis?

Mr. Murrin. I don't think it is as simple as that at this point. In the past that has been the case. There have been some things that have been done within the department to do more reconciliation processes. I would say there is some debate as to whether they have gone as far as we would have them go in that process and we are going to be sitting down and meeting with them to really discuss and have a good discussion with what we mean when we say reconciliation and how all encompassing it is.

So there are some things. I would not indict them for not doing any monthly reconciliation. There are some controls that have been put in place to help in that process. But by and large, we would find that there are still many more things to be done to make it so you could still opine on the financial statements and see they are fairly stated.

Chairman Hoekstra. So I think that is the concern. When you are using these kinds of accounting systems, you are not quite sure exactly what the number is. All you know is these are the accounting policies and practices that are driving an 80 to $100 billion organization?

Ms. Lewis. About $40 billion of that runs through GAPS and another $40 billion runs through the contracting payment system. So we look to take two data bases and compare them in this May 1998 to September 2000 time frame, and we will continue to follow up using many of the same tools GAO does. We very much appreciate GAO's participation. The work we do together will continue to identify issues and problems and make recommendations. And every year we have a financial statements audit, so there is a lot of information to draw on. It is my understanding that Waterhouse Price-Coopers is assisting the department with its implementation of the Oracle system, the new system. So they are drawing on expertise and then obviously looking to use the folks in the CFO office to ensure the successful implementation of that system.

Chairman Hoekstra. Thank you.

Ms. Sanchez. I just came in at the very end, so I would like to hear some more.

Chairman Hoekstra. Okay. I will yield to Mr. Roemer.

Mr. Roemer. I would just like to make two points in conclusion. One is that I am a very, very passionate supporter of education in this country. And my very first act as a Member of Congress was to ask the then Speaker of the House Tom Foley to be a member of the Education Committee. I don't want to continue to be dragged into these oversight hearings for the next 2 years. I don't care if it is a Democratic administration or a Republican administration, I would rather deal with the substantive issues of class size, teacher quality, public school choice, charter schools, equal funding for education, the issues that I asked to address as a member of this committee. The fact that we have some huge problems with very deep depth and large scope is not going to deter me from getting to the bottom of this ongoing problem, and Mr. Hoekstra and I will continue to have these hearings until the problem is solved. There is bipartisan frustration and bipartisan determination to get to the bottom of this, and I hope we soon do.

My second point would be that; and I have made this point in this hearing twice now. I don't want to pick on the nice, I am sure talented gentleman back there in the fourth row of the hearing room here, but I would have been much more comfortable if the new administration would have said we are going to be active, not we are not going to answer questions today.

We are only 3 months into this administration. I would honor that. I would not grill them today about this problem. But I would feel more comfortable that the administration is sitting here with some of the institutional memory of this problem and going become to the department today to address this so that Mr. Norwood and Mr. Scott and other members of this Subcommittee aren't so upset about $253 million in duplicate payments, about ongoing death and disability claims and impact aid and criminal indictments and Jacob Javits fellowship problems, and electronic theft problems, and mailroom problems. We need to make sure that the administration, the new administration, three months into their administration, a quarter to a third way through the first budget in the first year, knows how seriously this Congress takes its jurisdictional oversight on these problems. And I know Mr. Hoekstra is determined, whether it is a Democratic or Republican administration, to get to the bottom of this.

I hope, Mr. Hoekstra, that we don't have to devote a lot more time. As you said in the beginning of this hearing, I would much rather be on reauthorizing the Americorps, or reauthorizing the Endowment for the Arts, on dealing with substantive and quality education questions. Let's get this Select Education Subcommittee on to the business of those types of topics, but I don't think we will let loose on this one until it is solved.

Thank you.

Chairman Hoekstra. Thank you. Mr. Tiberi.

Mr. Tiberi. Thank you, Mr. Chairman. I believe, Mr. Chairman, that Secretary Paige is the only appointee that has been actually appointed thus far from the new administration. I am not sure that anyone else would want any of those jobs after hearing this hearing today, and I look forward to working with the new administration in the department.

In your testimony, Mr. Steinhoff, in one part of it you mention, and all of you have mentioned, concerns about the internal controls of the department. But you mention specifically that you reviewed 776 purchase cardholders' monthly statements, and that thus far 141 of those accounts, or purchase cardholder accounts, valued at nearly 1 million, were not signed by an approving official indicating that the purchases were approved. You have also expressed concerns about check writing authority without oversight.

And, Ms. Lewis, glad to have you here, a fellow Buckeye. You mentioned to Mr. Norwood that there was an ongoing investigation. Do any of you know, and I know you can't comment on the investigation, if the concerns about the lack of oversight on the credit cards and the check writing authority. Do any of you know over the last several months if some of that has been reined in, that authority cards and check writing capabilities?

Mr. Steinhoff. To my knowledge, if it has, it has been the last few weeks. We met with the department officials, discussed our findings with them and they agreed to take corrective measures. But that was recently, the last week or so. So I would assume there is still problems.

Mr. Tiberi. To follow up on that, either to Ms. Lewis or Mr. Steinhoff, this is not a new enough problem, is it?

Mr. Steinhoff. No.

Mr. Tiberi. This has been going on for how long?

Mr. Steinhoff. Well, our review is covering 2-1/2 years and the IG's previous review covered about 2-1/2 years. So this is something that has been going on.

Mr. Tiberi. Anybody. In your review just of the credit card purchases, correct me if I am wrong, you found a million dollars of goods purchased without approval?

Mr. Steinhoff. That is right.

Mr. Tiberi. Thank you.

Chairman Hoekstra. Mr. Holt, do you have additional questions?

Mr. Holt. No more questions except to say that as we continue these, and both the chairman and the ranking member have said there will be more to come, please make an effort to put this in perspective. I don't want to come to these hearings to hear unsubstantiated horror stories. I would like to know what it is in perspective.

Thank you.

Chairman Hoekstra. Mr. Norwood.

Mr. Norwood. Thank you, Chairman. Ms. Lewis, let's go back to the $450 million and put it in perspective. What we are talking about there I believe is that amount of money that has been misplaced or lost?

Ms. Lewis. For example, the duplicate payment category, the $250 million, that has not been lost. That has been accounted for. The money has either been returned to the department or it was credited against the grantee's account.

Mr. Norwood. Are the books at the Department of Education so good that you know for sure there is not more than 450 million that has been lost?

Ms. Lewis. No one, sir, can give you a specific number.

Mr. Norwood. Is that because the books are in such disarray?

Ms. Lewis. Well, there are problems with the books of the department as identified in the financial statement report. Much of our work, our audit and inspection work is looking at the internal control environment. Are there internal controls? We frequently identify problems and we will say based on these conditions there is a risk of vulnerability to fraud, waste and abuse, and it is up to the department to take our recommendations and implement them to reduce that risk or eliminate that risk.

Mr. Norwood. So nobody then to your knowledge knows how high that number might really go? Now we are all in agreement of the $450 million. Perhaps some of it will come back into the Department. Some of it will come back into the department. What we do not know there is how much will it cost to get that back into the department, so it is very hard to know just how large this number goes. I will be honest, but if I were to go home and a taxpayer were to say to me what is going on in the Education Department and I were to say, oh, they have only lost half a percent, that constituent would be satisfied but if the constituent would say?

Mr. Holt. If the gentleman would yield?

Mr. Norwood. No, not right now, Mr. Holt.

If I would say $450 million has been displaced, yeah, we will get some back, we don't know what it will cost but there may be more than 450 million, I don't know anybody in my district that would be happy with that particular situation.

Mr. Murrin. You made a point that perhaps the private sector is not what we should look to get our systems in place. I want to make a point there, too. If the CFO in a private company loses money, what can happen there very quickly is that the stockholders can fire that CFO. If the next CFO comes in and doesn't improve the system and they continue to lose money, that company can go out of business. That is totally different than the Department of Education. Nobody can be fired, the company will never go out of business, because we will simply lose more American taxpayer dollars to prop it up no matter how bad it does.

So it is a considerable difference than what happens in the private sector than what we are allowing to go on here in the Department of Education.

And lastly, Mr. Chairman, I have one last question for Mr. Steinhoff. You have said you have been involved in this for a long time. Perhaps you were here during the Teapot Dome scandal. How much money was lost then?

Mr. Steinhoff. I am not quite that old, although my children might disagree.

Mr. Norwood. Does anybody have an idea how much money was displaced during that scandal? I can't remember and nobody back here can remember.

Mr. Steinhoff. I can't remember.

Mr. Norwood. I bet it wasn't as much. I will find out as soon as I get up from here. I bet it wasn't as much, Mr. Chairman, as has been lost, probably never to return, in the Department of Education. All I want us to do is recognize how bad this situation really is, particularly for the American taxpayer. It hasn't got anything to do with whether you are for or against education, whether you love the Education Department or do not. It doesn't have anything to do, in my mind, with anything that happens in the Department of Defense. This one agency is absolutely in disarray. And my concern, part of my concern is for the new Secretary. I know he is going to be real interested in this, Mr. Chairman. He is going to be interested in this day and night because he doesn't want the mess that was left him to spill over into his administration of the Department of Education.

I encourage all of you and all of us to do everything we possibly can to bring this to an end, and if an agency of the government can't do better than this, we need to be serious about some alternatives as to what can be done. The American people are totally intolerant of this kind of waste and, sadly in this case, fraud and most certainly inefficiency.

That red light turned out perfect, Chairman. Thank you, Mr. Chairman.

Chairman Hoekstra. Thank you, Mr. Norwood.

Ms. Sanchez.

Ms. Sanchez. It is a good thing my colleague Mr. Norwood isn't on the Defense Committee. There are real problems over there, if you want to go on a rampage.

Mr. Norwood. Four hundred fifty million is a real problem over here, too.

Ms. Sanchez. I would venture to say if you went to almost any CEO and they couldn't account for one half of a percent of what was going on in their $300 million business or their $500 million business or their $20 million business, they would feel pretty comfortable with that.

I have been in the boardroom. I have gone through a lot of audited statements. I have done a lot of performance audits on a lot of agencies and a lot of companies, and I do really believe we need to put this into perspective. I think what is important is how are we going to do it. Do we have the systems in place, are we getting the systems in place, are we getting it implemented so we can really catch up to what a lot of companies and a lot of other agencies are now doing. If we put the funds in towards the automated systems, we have balances and checks, and we are being able to account instead of reconciling the old way, ledger by ledger and by hand and longhand, and maybe if we are doing reconciliation month to month, then I feel a lot better about what is going on.

And I'm sorry I came in after most of testimony was given. But I guess my question would be in a nutshell, could you reiterate for me the implementation program and is that on schedule and are the auditors or whoever is working with that, if they are here, are they feeling comfortable about getting the system that is going to be able to account for how things are going over the department?

Ms. Lewis. There has been improvement. The end result has improved; two years ago it was a disclaimer. It is currently qualified. That is an improvement. For two years the financial statements were produced on time. The audits were delivered on time. That is an improvement. There is a purchase of a new financial system that the department must carefully implement, do the appropriate testing to ensure no disruption of producing this year's financial statements so they too can be audited. It is a very keen obligation, very high priority for the department.

In the last year there has been a very aggressive effort by the department to start to address the over 100 recommendations, over five years of the financial statements, dating all the way back to 1995. A year ago when we testified, the number of open recommendations was extremely high. Through a concentrated effort by my office and the department, corrective action plans were produced and we concurred on them. It is up to the department to implement correctly, but that was a very important effort and a real change in the department in terms of seriously trying to tackle these open audit recommendations. Last year, two times during the year, interim financial statements were produced. That is a very key development, and the department needs to continue to do that.

The department again can speak best for itself as to what it is doing and it needs. We will actively monitor it. We will report where we find problems and we will continue to make recommendations and then through our monitoring efforts continue to look, to follow up to see if corrective action actually has been taken.

Ms. Sanchez. Thank you. Maybe, Mr. Hoekstra, what we can do is give the department, the new department head, et cetera, a chance to feel what they have got there and maybe ask them to give us a milestone schedule so that we can monitor in a more easy way rather than have a hearing. We have a hearing, you know, but if we have a schedule of milestones that the department feels comfortable with to hit these issues of automated system, reconciliation, reconciling the statement on a month-by-month basis, et cetera, interim audit, inside audit, outside auditors, then that would probably be one of the best ways that we can keep abreast of what is really happening with respect to this. So I might say that might be one of recommendations we have when the department comes before us.

Did you need any time?

Mr. Holt. No.

Ms. Sanchez. I yield back. Thank you.

Mr. Roemer. Mr. Chairman.

Chairman Hoekstra. Yes, Mr. Roemer.

Mr. Roemer. Just to protect Mr. Steinhoff's integrity and youth, the Teapot Dome scandal took place in the early 1920's. And you would have to be in your seventies or eighties to have remembered that. So just to protect your three decades of service, not five decades of service, that you have mentioned before. And I believe the Teapot Dome scandal was related to the Harding administration in selling off properties for mining and other activities through bribes, and so it was very different from the kind of problems we have here.

I am sure you were not around and you are just an avid reader of history and that is how you know about it.

Chairman Hoekstra. I think it was because Mr. Norwood was here and he thought maybe somebody had testified. Norwood and Strom Thurmond were both here. Mr. Norwood tells us the Teapot Dome scandal was $300,000 plus.

Mr. Steinhoff. You have to adjust that for inflation.

Chairman Hoekstra. When you come back next time, you can give us a GAO adjusted for inflation number for Teapot Dome. I would like to thank you for being here. It is a persistent issue. I am hoping that we can get this resolved. We will be working with the administration. We will be working with them on various ways of monitoring their plans and the progress that they make against those plans over the coming month, and Mr. Roemer and I look forward to moving this Subcommittee on to other issues for what right now will be parallel tracks, that we have other business that we need to conduct. We will conduct that business and we will keep our eyes on this ball at the same time.

Thank you very much again for being here today. The Subcommittee will be adjourned.

[Whereupon, at 11:20 a.m., the subcommittee was adjourned.]

APPENDIX A -- WRITTEN OPENING STATEMENT OF CHAIRMAN PETER HOEKSTRA, SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, DC

Hearing of the Subcommittee on Select Education
Committee on Education and the Workforce
House of Representatives

"Financial Management at the Department of Education"

Opening Statement of Chairman Pete Hoekstra (R-MI)
April 3, 2001

Good Morning. Thank you all for coming here to discuss the results of the Department of Education's Fiscal Year 2000 audit report. This is the fourth hearing that we have held to discuss financial management at the department.

The situation, unfortunately, is much the same. The department still has not received a clean audit, after failing audits in Fiscal Year 1998 and Fiscal Year 1999.

The department distributes over $100 billion annually to those who educate our children and through loans to students in higher education. One failed audit would be unacceptable in the private sector. Company leaders would have a great deal of explaining to the stockholders of such a business. Any private entity that failed an audit three years in a row, and certainly any financial institution with a portfolio the size of the department's, would not be able to keep its doors open.

Likewise, the Department of Education must deliver the same level of financial stewardship for taxpayers' dollars that any of us would expect in the private sector.

The recently released audit reports five areas of financial management as problem areas. While the total number of reportable items was reduced from eight in the 1999 audit to five this year, the three most significant issues remain unresolved. These three are considered material weaknesses, or areas of major deficiency that could make a material difference on the financial statements, and also were reported in the department's 1998 and 1999 audits.

Why has the department failed its audit again, when the issues are not new? We continually have seen insufficient action in these major areas to address the problems.

According to the Inspector General, auditors made 139 recommendations in the past five years. Of these, 30 non-repeating recommendations remain open. Twenty-one additional recommendations are included in the FY 2000 audit report. While many have been closed, the most critical – a new accounting system, reconciliation of accounts, and information systems controls – have not been adequately addressed.

This committee has heard much about the current inadequate accounting system and general ledger. That system was put in place in 1998 at a cost of over $5 million, and department staff discovered it could not get the job done. So, the agency is in the process of replacing that system with a new accounting system. However, the new system will not be fully functional until October 2001. Therefore, I see little hope that the financial statements for FY 2001 will be any better than those for FY 2000. The statements will be in the same shape as this year's – pulled together manually.

This fiscal year, in the absence of a system that could automatically balance ledgers internally and with the Treasury Department, agency staff made numerous manual adjustments. The department was unable to justify or substantiate these manual adjustments through adequate documentation. While this effort to clean up the books dating back to 1992 seemed to be a practical approach, how do we, or any auditor, know they were correct without supporting documentation? I am interested to hear how Ernst & Young was able to give an opinion on the financial statements without this information.

The department continues to be unable to balance its checkbook with the U.S. Treasury. Manual adjustments were made to force general ledger balances to match subsidiary records. The audit reports repeatedly have recommended a monthly reconciliation process, which is not being done.

The agency still does not have adequate systems controls – something that seemingly should have been a high priority to address, given the amount of money that flows through the department's financial systems. This weakness has been reported each year since the department's first agency-wide audit in 1995. Last year, the Inspector General released a report stating that the numerous control weaknesses constitute a "significant threat to the security of Education's information technology systems and the data they process." It is astounding that this has not been addressed.

Also, at the end of last fiscal year the agency still had been unable to reconcile a count of physical property to departmental records of assets.

Without sufficient controls, the department has made additional duplicate payments to grantees. In FY 1999, we know that the agency issued more that $150 million in duplicate payments to grantees and contractors. For FY 2000, there were six known instances of duplicate payments totaling $154 million, including an item for $125 million in October 1999. In addition, the Office of the Inspector General just released a report that found four occurrences of duplicate payments, totaling an additional $38 million.

In addition to the department-wide audit that must be conducted annually under federal law, the General Accounting Office (GAO) currently is conducting a fraud audit of the department, at the request of this committee. GAO staff is looking for inappropriate payments in much more detail than the scope of the department-wide audit done by Ernst & Young would allow. While the staff's work is not complete, GAO is here today to share some of its initial findings regarding internal controls and the existing risks for waste, fraud, and abuse. I believe that we will hear disturbing news today that opportunity for fraud is prevalent at the agency.

I think it is useful to remember that internal control weaknesses already have allowed criminal activity to occur. First, in March 2000, $1.9 million in Impact Aid grant money intended for two South Dakota school districts was embezzled from the department. Stolen funds were used to purchase a 2000 Cadillac Escalade and a 2000 Lincoln Navigator. In addition, the funds were used to purchase property in Maryland. This vulnerability to fraud was highlighted in the FY 1999 audit but no action was taken by the department. Second, a theft ring involving collaboration between outside contractors and department employees stole more than $300,000 worth of electronic equipment and collected more than $600,000 in false overtime pay. The Justice Department is conducting the investigations. Although I know the staff of the Inspector General's office is limited in what they can tell us, I understand that two other investigations also are ongoing at this time.

How could the same problems occur year after year? The department clearly did not prioritize addressing evidence of gross financial mismanagement. The previous administration left vacant for the last five years the Assistant Secretary for the Office of Management. In addition, the department did not have a permanent Chief Financial Officer for the last two and a half years of the last administration. While career staff working in acting positions strove to make some improvements, several individuals were responsible for the duties of multiple full-time positions. This agency fundamentally lacked the leadership at the highest levels necessary to make needed changes. The message sent was that failed audits are acceptable and that responsible stewardship of taxpayers' dollars could wait.

Today we want to learn more about areas of vulnerability and how those areas best can be addressed. It is clear that the previous administration lacked a commitment to financial management. Now we have an opportunity to work with a new administration and a new secretary to get the department's books in order and put the proper systems in place to prevent waste, fraud and abuse.

At this time, I will yield to my friend and Ranking Member, Congressman Tim Roemer for any statement he may have.

APPENDIX B -- WRITTEN OPENING STATEMENT OF VICE CHAIRMAN PATRICK TIBERI, SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, DC

Hearing of the Subcommittee on Select Education
Committee on Education and the Workforce
House of Representatives

"Financial Management at the Department of Education"

Opening Statement of Patrick J. Tiberi (R-OH)
April 3, 2001

Thank you, Chairman Hoekstra. I'm pleased to be here this morning. The issues we have on the table are very important.

Thank you all for coming to discuss financial management at the Department of Education, and the fiscal year 2000 audit report. I look forward to hearing your testimony.

I share many of Chairman Hoekstra's concerns. As a new member of the House of Representatives, I'm here to listen and learn. But make no mistake – failed audits and accounting systems that don't work are unacceptable. I believe, as I'm sure many members of Congress and the public do that the Department of

Education must be accountable for taxpayer dollars it is entrusted with. As the Chairman pointed out, one failed audit would be unacceptable in the private sector. It is our responsibility to demand more of an institution that distributes over $100 billion annually in loans for higher education.

Again, I look forward to hearing from all of you about the problems we face, and how those can be fixed. I particularly look forward to working with the new administration and secretary to turn things around.

Thank you, Mr. Chairman.

APPENDIX C -- WRITTEN OPENING STATEMENT OF RANKING MINORITY MEMBER, REPRESENTATIVE TIM ROEMER, SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, DC

Statement of Congressman Tim Roemer
Subcommittee on Select Education
Hearing on "Department of Education Financial Management"
April 3, 2001

Mr. Chairman, like you, I am very interested in ensuring that our tax dollars are being used wisely and that the Department of Education's financial management practices are sound. This is the fourth hearing that we have had on this in the last two years, and I look forward to the day when these hearings are no longer necessary.

The Clinton administration was committed to working towards a clean audit and ridding the Department of Education of fraud and abuse. While the Department declined to testify today, I hope that the Bush administration will continue their work with that same level of commitment.

I am pleased with some of the positive steps that have been taken. The cohort default rate on student loans has declined for seven consecutive years and is now at a record low 8.8 percent. Collections on defaulted loans have more than doubled, from $1 billion in FY 1993 to over $3 billion in fiscal year 1999. Data improvement in the National Student Loan Data System has prevented the disbursement of as much as $1 billion in grants to ineligible students.

The Department has also made strides to improve its audit. I was pleased to see that this audit received a qualified opinion on all of it fiscal year 2000 financial statements. I look forward to hearing the testimony of today's witnesses to hear what the Department is doing to ensure that these opinions are clean opinions in next years budget.

I understand that one of the reasons that they have yet to achieve a clean audit is because they are unable to automatically close their books. Accounts, totaling billions, are still for the most part manually reconciled. The Department of Education has purchased a new financial management computer system that I understand will not be fully implemented until later this year. I hope that our witnesses today will be able to report on the progress of having this implemented.

Mr. Chairman, I look forward to working with you over the next two years on this and other issues. At this point, I'll turn it over to our witnesses.

APPENDIX D -- WRITTEN TESTIMONY OF JEFF STEINHOFF, MANAGING DIRECTOR, FINANCIAL MANAGEMENT AND ASSURANCE DIVISION, GENERAL ACCOUNTING OFFICE, WASHINGTON, DC

United States General Accounting Office

GAO

Testimony

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

For Release on Delivery

April 3, 2001

FINANCIAL MANAGEMENT

Internal Control Weaknesses Leave Department of Education Vulnerable to Improper Payments

Statement of Jeffrey C. Steinhoff
Managing Director, Financial Management and Assurance

GAO
Accountability * Integrity * Reliability

GAO-01-585T

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss our ongoing work on the Department of Education's payment processes, and how the existing internal control weaknesses we have noted thus far in our review make the Department vulnerable to improper payments. Improper payments include errors, such as duplicate payments and calculation errors; payments for unsupported or inadequately supported claims; payments for services not rendered or to ineligible beneficiaries; and payments resulting from fraud and abuse.

Since 1990, we have designated Education's student financial assistance programs as a high-risk area for waste, fraud, abuse, and mismanagement.[1] These programs remain at high-risk primarily because Education lacks the financial and management information needed to manage these programs effectively and the internal controls needed to maintain the integrity of their operations. Additionally, again this year Education was unable to obtain an unqualified audit opinion on its financial statements because significant financial management system and internal control weaknesses continue to impair the Department's ability to generate, analyze, and present reliable financial information. Given the billions of dollars in payments made by Education each year to recipients nationwide and abroad, these known deficiencies in controls over financial reporting, accounting, and information systems raise the risk that erroneous or fraudulent payments could make their way through Education's processes without being prevented or detected.

Because of these risks, you requested that we audit selected accounts at the Department that may be particularly susceptible to improper payments. In response to your request, we have initiated a body of work designed to (1) identify Education's payment processes, (2) determine what internal controls exist over these processes, (3) assess whether the internal controls provide reasonable assurance that improper payments will not occur or will be detected in the normal course of business, (4) identify additional controls that should be implemented to provide reasonable assurance that improper payments will not occur, and (5) use various computer auditing techniques to identify potential improper payments made by Education during the period May 1998 to September 2000. This ongoing work, which builds upon earlier work done by the Education Inspector General (IG), includes testing of grant and loan

[1] *Major Management Challenges and Program Risks: Department of Education*, (GAO-01-245, January 2001) and *High-Risk Series: An Update*, (GAO-01-263, January 2001).

payments to educational institutions and students, as well as payments to contractors, vendors and others in support of Education's operations totaling over $186 billion. We plan to use an automated approach, such as data base searches and other computer analyses, to identify unusual transactions and payment patterns and provide red flags that a payment may be improper.

My testimony today addresses the first phase of our work – assessing the internal controls over Education payment processes, as well as highlighting some of the findings from the fiscal year 2000 financial statement audit that was recently completed by an independent public accounting firm, Ernst & Young, under contract to the IG.

Let me first make a few comments on the importance of internal controls. Internal controls are a major part of managing an organization, serving as the first line of defense in safeguarding assets and preventing and detecting fraud, abuse, and errors. They consist of the plans, methods, and procedures used to meet missions, goals, and objectives. People are what make internal controls work. Internal control is not something to be built in at the end, but must be part of the daily fiber of management. The responsibility for good internal controls rests with all managers. The integrity and ethical values maintained and demonstrated by management plays a key role in the entire organization's ethical tone. By providing guidance for proper behavior, removing temptations for illegal, improper, or unethical behavior, and providing discipline when appropriate, management portrays a positive control environment, which is essential in achieving an agency's objectives.

During our analysis of the various payment processes,[2] we identified internal control weaknesses that sharply increase Education's vulnerability to improper payments. We classified the weaknesses into four broad categories, which are consistent with our *Standards for Internal Control in the Federal Government*:[3] (1) poor segregation of

[2] Consistent with your request to focus our audit on payment processes particularly susceptible to improper payments, we concentrated our efforts on the following payment processes: (1) grants and direct loans; (2) government purchase cards; (3) third party drafts; and (4) contract and purchase order payments. Grant and direct loans are processed by the Grant Administration and Payment System (GAPS), whereas the other payments are processed by the Financial Management System Software (FMSS).

[3] *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1), which was prepared to fulfill our statutory requirement under the Federal Managers' Financial Integrity Act, provides an overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement.

duties; (2) lack of supervisory review; (3) inadequate audit trails; and (4) inadequate computer systems' application controls. I would like to highlight some of the more significant weaknesses within each of these broad categories.

Poor Segregation of Duties

To reduce the risk of fraud and other improper payments, key duties and responsibilities associated with the payment process need to be divided or segregated among different people. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling the related funds. Segregation of duties is one of the most fundamental internal control concepts.

However, we found that some individuals at Education can control the entire payment process for certain types of transactions. For example, some Education employees can issue hard copy checks, known as third party drafts, without involving anyone else. Currently 49 Education employees can request blank checks. We found that 21 of these individuals can also access the system, generate a payment without prior obligation, print and sign the check, and submit it to the payee. The Department is thus vulnerable to the possibility of individuals using third party drafts to pay for personal expenses, without any physical or system controls in place to prevent or detect such an occurrence. These drafts can be issued for up to $10,000 each and in fiscal year 2000, the Department reported issuing over 19,000 third party drafts totaling approximately $23 million.

We also found inadequate segregation of duties related to the electronic transfer of funds through the Federal Reserve Bank (FRB) network to a payee's bank account. Electronic fund transfers are used primarily to disburse grants and loans to schools, states, local education agencies and others. These payments totaled over a reported $181 billion from May 1998 to September 2000 – the period covered by our ongoing review. Although Education has a policy that prohibits the same individual from creating, certifying, and electronically transferring funds through the FRB, some Education employees are capable of doing this without involvement from anyone else. During a walkthrough of this payment process at the Office of the Chief Financial Officer (OCFO), a staff member told us that one snowy day last winter, when she was the only person in the office who works on these electronic fund transfers, she created, certified, and transmitted the payment files that day. There was no preventive control that limited the employee from performing all facets of the electronic fund transfers. Compounding this, because the Department does not have the appropriate follow-up controls in place, such as a requirement that supervisors document their post-review and approval of these types of transactions, the Department may not detect unauthorized FRB transfers.

Lack of Supervisory Review

Basic control activities, such as approvals, authorizations, verifications, reconciliations, and maintenance of documentation, are an integral part of an agency's accountability for government resources and achieving effective results, including the prevention and/or detection of improper payments. However, we found that Education has serious deficiencies in its process for reviewing and approving purchases made with Government credit cards – called purchase cards.

As of October 30, 2000, approximately 230 Education employees had government purchase cards in their names. According to a Departmental directive, Education's policy is to use government purchase cards for authorized purchases of expendable goods and services costing $1,000 or less, such as supplies not available from the GSA Customer Supply Center. Generally, Education employees are limited to charging up to $10,000 per month. Some employees have higher limits; we found that 36 individuals can charge $25,000 or more per month, and 2 of those employees can charge up to $300,000 in a single month. This policy also requires a person, designated as an approving official, to perform a review of cardholders' monthly statements prior to submitting the statement for payment, to ensure that each purchase was made for official use and in accordance with established internal procedures. The approving official must sign the cardholders' monthly statements upon completion of the review process. In this case, the approving officials' review represents the principal internal control.

In order to determine whether Education is following its established policies, we selected 4 months of cardholder' statements to review for certain attributes, including approving official's signature. Of the 676 purchase cardholders' monthly statements that we have reviewed thus far, 141, valued at nearly $1 million, were not signed by an approving official indicating that the purchases were approved. We also noted that several of the types of purchases made by Education employees were items that could be used either for official business or for employees' personal needs, including computers, software, cell phones, and internet service. Education's own policy specifically lists computers as an item that should not be purchased with government purchase cards.

In June 2000, the Department of Defense (DOD) issued a Fraud Alert indicating that government purchase card use is increasing and along with the increase in spending levels there has been an increase in card abuse.

Specifically, the Fraud Alert noted that some cardholders have conspired with unscrupulous vendors, while others have relied on the naïve trust of their supervisors who may have been negligent in their review of purchases. DOD has identified several instances involving the fraudulent use of government purchase cards.

During fiscal year 2000, Education employees made over $8 million in purchases using their government purchase cards. Without proper review and approval for these expenditures, the Department provides employees the opportunity to improperly use the government charge cards without detection.

Inadequate Audit Trails

Sound internal controls also include creating and maintaining adequate documentation providing a means to trace transactions back to their origination – in other words, generating "audit trails." While audit trails are essential to auditors and system evaluators, they are also necessary for day-to-day operation of the system because they allow for the detection and systematic correction of errors that arise. The Joint Financial Management Improvement Program's[4] Core Financial System Requirements state that federal financial systems must provide certain crucial audit trails, including trails to identify document input, change, approval, and deletions by originator.

Education refers to some of its audit trails as "trigger logs." For some payments, Education has a trigger log for documenting changes made to sensitive records, such as bank account routing numbers and payment histories for grants and administrative payments to schools. However, the Department lacks adequate trigger logs for other types of payments, including payments for contracting, third party drafts, and purchase cards, which according to Education totaled about $2 billion in fiscal year 2000. For example, changing a payee's mailing address or adding new vendors to the list of authorized vendors are sensitive transactions that must be closely controlled. Education officials acknowledged this weakness and told us that they are currently developing and implementing more effective controls.

[4] JFMIP is a joint cooperative undertaking of the Office of Management and Budget, the Department of the Treasury, the Office of Personnel Management, and the General Accounting Office working with operating agencies to improve financial management practices through the government. Agencies must follow JFMIP's federal financial management systems requirements in order to meet the requirements of the Federal Financial Management Improvement Act of 1996.

Inadequate Information Systems' Application Controls

Rapid advances in information technology have highlighted the importance of internal controls related to modern computer systems. We have reported information systems security as a governmentwide high-risk area since 1997, most recently in January 2001.[5] In the past, the Education IG and Ernst & Young have reported serious information systems weaknesses. Later in my testimony I will highlight the information systems weaknesses Ernst & Young reported as part of the fiscal year 2000 financial statement audit. The Department places significant reliance on its automated systems to perform basic functions, such as making payments to grantees and maintaining budget controls. Consequently, continued weaknesses in information systems controls increases the risk of unauthorized access or disruption in 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.

As part of our ongoing review, we identified control weaknesses related to the automated payment system's computer applications. As discussed in our Internal Control Standards, computer application controls help ensure that transactions completed through computerized applications are valid, properly authorized, and completely and accurately processed and reported. Application controls include (1) programmed control techniques, such as automated edits, and (2) manual follow-up of computer-generated reports, such as reviews of reports identifying rejected or unusual items.

One such application control in Education's system is an edit indicating that an invoice number had already been entered into the system, which is designed to avoid duplicate payments. However, our review of one of Education's procedure manuals disclosed that the Department has created a procedure that allows employees to circumvent this control. This manual instructs Education employees to add a suffix to the invoice/voucher number when the system indicates that an invoice number has already been used. For example, if invoice number 123 has already been entered into the system, an employee can add the letter "a" to this invoice number and issue another third party draft or other payment mechanism related to the invoice.

During our work, we found that it is common practice for Education employees to use multiple third party drafts to pay for purchases in excess of the $10,000 limit imprinted on the blank drafts. Education officials told

[5] *Major Management Challenges and Program Risks: A Governmentwide Perspective*, (GAO-01-241, January 2001).

us that they use multiple third party drafts to pay invoices greater than $10,000 primarily as a matter of convenience. For example, when it is necessary to research a transaction, Education officials told us that it is more convenient to have their own check numbers and copies of the checks on hand rather than having to review records of payments from Treasury. This process of circumventing a key control, combined with the lack of segregation of duties I described earlier, further exacerbates Education's vulnerability to making improper payments. In addition, this negates the control of limiting third party drafts to $10,000.

Another example of an application control weakness at Education is the Department's failure to use computer generated management reports that are currently available. For instance, Bank of America, Education's contractor for government purchase cards, provides several management reports for monitoring the card's usage. One report that we reviewed showed the Merchant Category Codes [6] (MCC) used by each cardholder. Approving officials could use this report to identify unusual or unauthorized purchases. For instance, if a cardholder used his or her government purchase card to obtain a cash advance, which is prohibited by Education's policies, the MCC for this type of transaction would appear on the report next to the cardholder's name. Further, Bank of America can block specific MCCs to prohibit certain types of charges that are clearly not business related such as purchases from amusement parks and movie theaters. However, Education officials told us that they do not use this control because the Department relies on Approving Official's review of the cardholder's purchases.

The fact that Education does not review MCCs as a check on cardholder transactions or block certain MCCs, is particularly significant given the inconsistent supervisory review and the inherent risk of fraud and abuse associated with credit card purchases. Together, they mean that Education is not using preventive measures at its disposal – through the review of MCC codes or the blocking of certain purchases – or detective measures – the review and approval of purchases. Thus, the risk of improper payments is substantially increased.

[6]The Merchant Category Code relates to the types of supplies or services that a vendor provides. The MCC for the Government Purchase Card consists of 11 retail categories. Agencies have the ability to prohibit cardholders from purchasing certain supplies or services by blocking specific MCCs.

Fiscal Year 2000 Financial Statement Audit

Education's fiscal year 2000 audited financial statements were issued on February 28, 2001, before the March 1, 2001, deadline, and Ernst & Young's opinion on the financial statements improved over that of fiscal year 1999. Ernst & Young issued a qualified opinion[7] on all five of the fiscal year 2000 required financial statements. For fiscal year 1999, Ernst & Young issued qualified opinions on four of Education's financial statements and a disclaimer[8] on the Statement of Financing. Ernst & Young also reported that Education continued to have serious internal control and financial management systems weaknesses. Ernst & Young reported the following reasons for the qualification of its audit opinion:

- During fiscal year 2000, significant financial management weaknesses continued to impair Education's ability to accumulate, analyze, and present reliable financial information. Extensive manual adjustments enabled Education to partially compensate for, but did not correct, certain aspects of the material weaknesses in its financial reporting process.
- Education was unable to provide adequate documentation to support certain amounts reported in net position included in the consolidated balance sheet, and Ernst & Young was unable to perform other audit procedures to satisfy themselves that the net position amount was correct.
- Education inconsistently processed certain transactions related to prior years as fiscal year 2000 activity and was unable to provide Ernst & Young with adequate documentation that these manual transactions were properly reflected in the appropriate period.

In addition, Ernst & Young's report on internal controls for fiscal year 2000 included three material internal control weaknesses[9]—all long-standing from prior years. For the purposes of financial statement preparation, internal controls are to provide reasonable assurance that the financial

[7]Such an opinion is expressed when (1) there is a lack of sufficient competent evidential matter or there are restrictions on the scope of the audit that have led the auditor to conclude that he or she cannot express an unqualified opinion and he or she has concluded not to disclaim an opinion or (2) the auditor believes, on the basis of his or her audit, that the financial statements contain a departure from generally accepted accounting principles, the effect of which is material, and he or she has concluded not to express an adverse opinion.

[8]A disclaimer of opinion is expressed when the auditor is unable to obtain satisfaction that the financial statement is fairly presented and does not express an opinion.

[9]A material internal control weakness is used to describe a condition where an agency's internal controls do not reduce to a relatively low level the risk that errors, fraud, or noncompliance involving significant amounts may occur and may not be detected within a timely period by employees in the normal course of performing their assigned functions.

results reported are reliable, the agency is in compliance with laws and regulations, and performance reporting is reliable. When the design of internal controls is weak, errors, fraud, or noncompliance with laws and regulations may occur that elevate the weakness to a material internal control weakness.

The specific material internal control weaknesses cited by Ernst & Young for fiscal year 2000 were (1) weaknesses in the financial reporting process, (2) inadequate reconciliations of financial accounting records, and (3) inadequate controls over information systems. Specifically, Ernst & Young reported that:

- Education did not have adequate internal controls over its financial reporting process. Its general ledger system was not able to directly produce consolidated financial statements as would normally be expected from such systems. Because of this weakness, Education once again had to resort to a costly, labor-intensive, and time- consuming process involving manual and automated procedures to prepare financial statements for fiscal year 2000 as it had in previous years.

- Again, similar to previous years, Education did not properly or promptly reconcile its financial accounting records throughout fiscal year 2000 and could not provide sufficient documentation to support some of its financial transactions, specifically entries to correct prior year errors. In some instances, Education adjusted its general ledger to reflect the balance in its subsidiary records, without sufficiently researching the cause for differences.

- Furthermore, Education was not able to identify and resolve differences between its accounting records and cash transactions reported by the Treasury for the past several years. Reconciling agencies' accounting records with relevant Treasury records is required by Treasury policy and is analogous to individuals reconciling their checkbooks to monthly bank statements. Because most assets, liabilities, revenues, and expenses stem from or result in cash transactions, errors in the receipt or payment data affect the accuracy of the individual agency financial reports and various U.S. government financial reports, including data provided by agencies for inclusion in the President's Budget concerning fiscal year outlays. Further, the lack of effective reconciliations increases the risk of fraud, waste, abuse, and mismanagement of government funds.

- Ernst & Young's report discussed the seriousness of Education's computer systems weaknesses. Ernst & Young found that Education had not completed its corrective action plan to ensure that all mission critical systems had adequate security plans and that corrective actions were taken to mitigate known exposures. Additionally, Education had information systems control deficiencies in (1) monitoring and reviewing access to sensitive computer resources, (2) implementing a system software change management process, and (3) developing and testing a comprehensive disaster recovery plan to ensure the continuity of critical system operations in the event of disaster.

As a result, it took a lot of hard work by Education staff and costs for contractor assistance to develop the information needed for financial statements that were issued 5 months after the end of the fiscal year; information that should be but is not routinely available. Education needs to be able to generate reliable, useful, and timely information on an ongoing basis to ensure adequate accountability to taxpayers, manage for results, and help program and congressional decisionmakers make timely, well-informed judgements for day-to-day management and oversight. This is what the Congress was seeking when it enacted the Chief Financial Officers Act of 1990 and other financial reform legislation. While an unqualified audit opinion is an important milestone, it is not the end goal.

Obtaining an unqualified audit opinion must be combined with sustained efforts to improve underlying financial management systems and controls. As the Comptroller General testified on March 30, 2001,[10] if agencies (such as Education) continue year after year to rely on significant, costly and time-intensive manual efforts to achieve or maintain unqualified opinions without such improvements, it can serve to mislead the Congress and the public as to the true status of agencies' financial management capabilities. In such a case, an unqualified opinion would become an accomplishment without much substance. As we look ahead, it will be essential for Education to strengthen its financial reporting to make more meaningful information available to the Congress, other policymakers, and the American public.

To summarize, internal control and financial management weaknesses at Education are not new. Last year we testified three times about the financial management challenges faced by Education and the need to eliminate internal control weaknesses to reduce the potential for fraud,

[10] *U.S. Government Financial Statements: FY 2000 Reporting Underscores the Need to Accelerate Federal Financial Management Reform* (GAO-01-570T, March 30, 2001).

waste, and abuse at the Department[11] and Ernst & Young and the IG have reported serious internal control problems. Our ongoing work is showing that Education in several cases is not taking advantage of available means to use or improve its controls over the review, approval, issuance and recording of payments. In addition, the most recent financial statement audit disclosed continuing serious weaknesses over (1) the financial reporting process, (2) inadequate reconciliations of financial accounting records, and (3) inadequate controls over information systems. Until Education is able to correct its serious internal control and system deficiencies, it will be hindered in its ability to achieve lasting financial management improvements. As a result, it will continue to face an increased risk of improper payments.

In the next phase of our work, we will be employing various computerized techniques, referred to as "forensic auditing" techniques, to identify data anomalies that may be indicative of improper payments. These techniques include data base searches, file comparisons and computer matches, and other analyses to identify unusual transactions and unusual payment patterns. Using this approach we can identify questionable payments – for example payments to closed schools or to individuals with invalid social security numbers. We will research and, as needed, investigate any questionable payments to determine whether they represent simple data errors or are in fact improper payments or even fraud. We will be in a position to report to you on the results of this work sometime this summer.

In closing, Mr. Chairman, I want to underscore the importance of Education's top management giving priority to (1) addressing the problems preventing the auditors from being able to express an unqualified opinion on Education's financial statements, (2) having effective internal control, and (3) modernizing financial management systems.

Finally, I want to reiterate the value of sustained Congressional interest in these issues, as demonstrated by this hearing and those you have held in the past to oversee financial management reform at Education. Your work and that of the Committee over the past years to facilitate management improvements at Education have been a catalyst to the progress we have

[11] *Financial Management: Education Faces Challenges in Achieving Financial Management Reform* (GAO/T-AIMD-00-106, March 1, 2000), *Financial Management: Education's Financial Management Problems Persist* (GAO/T-AIMD-00-180, May 24, 2000), and *Financial Management: Financial Management Challenges Remain at the Department of Education* (GAO/T-00-AIMD-00-323, September 19, 2000).

seen to date and will be critical to ultimately solving the Department's serious long-standing internal control and financial management systems weaknesses.

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

Contact and Acknowledgment

For information about this statement, please contact Linda Calbom, Director, Financial Management and Assurance, at (202) 512-9508 or at *calboml@gao.gov*. Individuals making key contributions to this statement include Dan Blair, Anh Dang, Bonnie Derby, Cheryl Driscoll, Cary Frye, Kelly Lehr, Bonnie McEwan, Diane Morris, Brooke Whittaker, Doris Yanger, and Maria Zacharias.

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APPENDIX E -- WRITTEN TESTIMONY OF LORRAINE LEWIS, INSPECTOR GENERAL, U.S. DEPARTMENT OF EDUCATION, WASHINGTON, DC

Statement of Lorraine Lewis
Inspector General, Department of Education
Before The
Subcommittee on Select Education
Committee on Education and the Workforce
U.S. House of Representatives

April 3, 2001

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me to participate in today's hearing on the results of the audit of the Department of Education's (the Department) fiscal year 2000 consolidated financial statements. You asked that I also cover in my testimony (1) a comparison of the fiscal year 2000 audit findings to those of previous years, (2) the Department's efforts to remedy financial management and internal control weaknesses identified by auditors in previous years, (3) recommendations that the Office of Inspector General (OIG) has made to the Department to improve its financial management, and (4) our efforts to monitor the Department's implementation of these recommendations and those provided by outside auditors.

First, let me say that I commend the Subcommittee for its strong interest in these important matters and for the attention it has given to financial management at the Department.
The Department received a qualified opinion on all of its fiscal year 2000 financial statements. This represents a change from 1999, when the Department received a disclaimer of opinion on its Statement of Financing and a qualified opinion on the other four financial statements. In addition, this was the second year in a row where the Department submitted its financial statements and audit reports on time to the Office of Management and Budget (OMB).

OVERVIEW OF RESULTS OF FISCAL YEAR 2000 AUDIT

The audit of the Department's financial statements for fiscal year 2000 was conducted by Ernst & Young, LLP (E&Y). Under the terms of this engagement, E&Y issued a report on its opinion on the financial statements, a report on internal control, and a report on compliance with laws and regulations. The OIG monitored the progress and completion of the work to ensure it complied with Government Auditing Standards, issued by the Comptroller General of the United States. Copies of the auditor's reports are available on the Internet at www.ed.gov/offices/OIG/Areports.htm.

Financial Statement Opinion

E&Y issued a qualified opinion on the Department's Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing. A qualified opinion states that, except for the effects of the matter to which the qualification relates, the financial statements are fairly presented, in all material respects. E&Y qualified their opinion primarily because of the Department's inability to provide adequate documentation to support certain amounts and prior period adjustments reported in the financial statements and inconsistent processing of certain transactions related to prior years.

Report on Internal Control

There were three material weaknesses and two reportable conditions included in the Report on Internal Control. The material weaknesses cited were:

1. *Financial Management Systems and Financial Reporting Need to be Strengthened (Modified Repeat Condition).* The Department relies on a variety of work-around procedures to prepare its financial statements, including significant manual adjustments, due to deficiencies in the current general ledger system and the lack of a fully integrated financial management system. The Department was unable to provide sufficient documentation to support a significant amount of adjustments. In addition, the use of manual adjustments increases the risk that errors may occur.

2. *Reconciliations Need to be Improved (Repeat Condition).* The Department's performance of reconciliations in fiscal year 2000 was inconsistent and evidence of supervisory review of reconciliations was not always documented. Also, in some instances the Department adjusted its general ledger to reflect the balances per the subsidiary records, without sufficiently researching the cause for the differences.

3. *Controls Surrounding Information Systems Need Enhancement (Modified Repeat Condition).* The Department has not finalized the development, documentation, and testing of the disaster recovery plan. The Department also has not implemented comprehensive logging and monitoring controls and a system software change management process.

The following reportable conditions were cited:

1. *Improvement of Financial Reporting Related to Credit Reform is Needed (Modified Repeat Condition).* The Department needs a more effective process for preparing and reviewing the credit reform balances. The Department should more clearly define the roles and responsibilities of those involved in the estimation process and critically assess the estimates against actual data. It also should gather data that will facilitate better analysis of the impact of consolidated loans on the credit reform estimates.

2. *Reporting and Monitoring of Property and Equipment Needs to be Improved (Modified Repeat Condition).* The Department may not be capturing all items that it should capitalize. Unreconciled differences remain between the results of the inventory observation and the Department's records. In addition, the Department has not yet fully implemented inventory controls for property and equipment.

Report on Compliance with Laws and Regulations

The Report on Compliance with Laws and Regulations noted the Department was not in full compliance with the Clinger-Cohen Act. In addition, the Department's financial management systems did not substantially comply with the Federal Financial Management Improvement Act requirements.

COMPARISON OF FISCAL YEAR 2000 AUDIT FINDINGS WITH PRIOR YEARS

For fiscal year 1999, the Department received qualified opinions on the Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources and a disclaimer of opinion on its Statement of Financing. There were four material weaknesses and four reportable conditions included in the Report on Internal Control and three areas of non-compliance cited in the Report on Compliance with Laws and Regulations.

For fiscal year 2000, the Department received qualified opinions on all five financial statements, including the Statement of Financing. There were three material weaknesses and two reportable conditions in the Report on Internal Control. As shown in Attachment 1, some of the reported material weaknesses and reportable conditions in the Report on Internal Control declined for fiscal year 2000. In addition, the instances of non-compliance in the Report on Compliance with Laws and Regulations went from three in 1999 to two in 2000.

The Department made two improvements which facilitated the timely preparation of its year-end financial statements. It prepared interim financial statements for the periods ended March 31, 2000, and June 30, 2000. The Department also enhanced communication among the various offices by establishing a steering committee in support of the audit process and actively addressing open audit recommendations.

Over the years, underlying weaknesses in internal control have hampered the Department, and several weaknesses have appeared as repeat findings in the Report on Internal Control for fiscal years 1995 through 2000. Most notable among the recurring weaknesses are:

- financial reporting needs to be strengthened (fiscal years 1997 through 2000);
- reconciliations need to be improved (fiscal years 1995 through 2000); and
- controls surrounding information systems need enhancement (fiscal years 1995 through 2000).

EFFORTS TO ADDRESS FINANCIAL MANAGEMENT AND INTERNAL CONTROL WEAKNESSES

During fiscal year 2000, the Department actively addressed open audit recommendations. On March 1, 2000, we testified before the Subcommittee on Oversight and Investigations, House Committee on Education and the Workforce, and reported that a total of 139 recommendations had been made for the fiscal years 1995 through 1999 financial statement audits. At that time, 111 recommendations were open, 28 were closed, and 74 were non-repetitive. Since that hearing, the Department provided us with corrective action plans for these open recommendations.

Through the cooperative efforts of the Department and my office, 128 recommendations have closed and 11 remain open. The fiscal year 2000 financial statement audit resulted in 21 additional audit recommendations, bringing the total open audit recommendations to 32. Of these, 23 are considered non-repetitive.

RECOMMENDATIONS TO IMPROVE FINANCIAL MANAGEMENT

The financial audit reports, particularly the Report on Internal Control and the Report on Compliance with Laws and Regulations, provide the blueprint for addressing financial management issues. Many of the underlying systemic weaknesses included in the Reports on Internal Control and Compliance with Laws and Regulations are repeat conditions from fiscal year 1999 and earlier years. For example, because the systemic weaknesses with the Department's accounting system (initially reported in fiscal year 1998) continued into fiscal years 1999 and 2000, the Department utilized contractors and various automated tools to "work-around" the system's inability to produce a trial balance by reporting group or at the consolidated level.

The lack of a fully integrated financial management system can impair the Department's ability to accumulate, analyze, and present reliable financial information. Until the Department implements a new general ledger system, it will have to continue to perform "work-around" procedures to prepare financial statements, including significant manual adjustments, as opposed to producing system-generated financial statements in compliance with the Federal Financial Management Improvement Act. In addition, reconciliations are a key control to ensure the integrity of financial information. Similarly, system disaster recovery plans are necessary to help minimize operational disruption in the event of a disaster affecting the systems. The auditors have made a number of recommendations to address the material weaknesses and reportable conditions in the Report on Internal Control.

Other Reporting on Financial Management and Internal Controls

We have reported management challenges to Members of Congress since January 1998. Some of the earlier challenges related to delays and data integrity problems experienced in implementing Education's Central Automated Processing System (EDCAPS) and Grant Administration and Payment System (GAPS). Financial management was reported as a separate challenge in December 1999. This followed the disclaimer on the fiscal year 1998 financial statements.

On December 8, 2000, in response to requests from Senators Thompson and Domenici and Representatives Armey, Burton, and Kasich, my office provided updated information on the top ten management challenges facing the Department. Many of the issues were long-standing concerns known to the Department and upon which my office remains committed to monitoring. The first challenge dealt with correcting financial management problems. The problems were essentially the same as the results of the fiscal year 2000 financial audit.

In addition to the annual audit of the Department's financial statements, my office conducts a variety of other work which directly or indirectly relates to improvements in the Department's financial management practices. We have four other OIG operations — the Systems Internal Audit Team, Operations Internal Audit Team, Analysis and Inspections Service, and

Investigations Service — that contribute to this effort. Examples of work performed by these operations include:

Review of EDNet Security[1] – In July 2000, we issued a report assessing the security posture of the Department's primary network infrastructure, also known as the Department of Education Network (EDNet). EDNet is comprised of a telecommunications system and many connected resources, including large computers, Local Area Network (LAN) servers and printers. The Department's financial systems reside on this network.

We identified many areas where the Department can strengthen its security posture. These are summarized as follows:

- Formal security policies and procedures are not enforced, causing inconsistent security configurations of network devices and mid-range platforms.
- Configuration settings of network devices and mid-range servers allow excessive access to application-level network services, files, directories, and programs.
- Controls over external network access points must be improved to eliminate potential entry points for unauthorized intruders.
- The Department's overall security program must be strengthened to improve its incident response capabilities, incorporate the use of audit logging mechanisms, and implement a documented and tested contingency plan.

[1] Review of EDNET Security (ED-OIG A11-90018)

If controls over configuration settings for internal network servers, network devices, and external network access points are not improved, the Department's primary network infrastructure is vulnerable to internal and external threats. The Department generally concurred with our recommendations and has prepared a corrective action plan. As of March 28, 2001, the Chief Information Officer reported completion of actions on 10 of our 60 recommendations.

Audit of Controls Over Government Furnished Property to Contractors[2] - We recently issued the first of four reports on the Department's controls over equipment furnished to the Department's major student financial aid contractors. In the first report we found that one contractor did not comply with recordkeeping, reporting, and inventory requirements, and that government-furnished property was not properly identified. These weaknesses indicate that errors, irregularities, and other inefficiencies may occur, resulting in inefficient and/or ineffective performance. The contractor and the Department concur with our recommendations.

Improper Payments - Improper payments have become an area of concern throughout the federal government in recent years. In October 1999, the General Accounting Office (GAO) issued a report entitled Increased Attention Needed to Prevent Billions in Improper Payments. This report defines improper payments as those "...made for unauthorized purposes or excessive amounts, such as overpayments to program recipients or contractors and vendors." The report further states that improper payments can result from incomplete or inaccurate data used to make payment decisions, insufficient monitoring and oversight, or other deficiencies in agency

[2]Audit of Controls Over Government Property Furnished to Computer Sciences Corporation (ED-OIG A19-B003)

information system internal control weaknesses. In October 2000, GAO defined improper payments to include "...inadvertent errors, such as duplicate payments and calculation errors; payments for unsupported or inadequately supported claims; payments for services not rendered or to ineligible beneficiaries; and payments resulting from outright fraud and abuse."

The following recent OIG work has focused on various aspects of improper payments:

- Controls Over Contract Payments[3] - We issued a report last month assessing the Department's contract payment process and whether controls are in place to prevent and detect improper payments. We found that improvements are needed in controls over the invoice review process, segregation of duties, and the process for establishing vendor information in the Department's contract payment system. Based on our work, the Department lacks assurance that payments are proper. We made several recommendations to the Department to improve the controls. The Department generally concurred with our findings and agreed to take action on our recommendations.

- Internal Control Reviews over Purchase Cards and Third Party Draft Payments[4] - At the Department's request, we reviewed its internal controls over the use of purchase cards and third party drafts. We found that, while the Department has established procedures to ensure the financial integrity of the purchase card and third party draft programs, these procedures, were not always current and were not always followed in practice.

[3]Audit of Controls Over Contract Payments (ED-OIG A07-A0015)
[4]Results of the OIG Review of Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards (ED-OIG 2000-015)

The Office of the Chief Financial Officer (OCFO) administers both the purchase card and third party draft programs. Each principal office has purchase cardholders and authorized signers of third party drafts. We reviewed and tested controls in each principal office using GAO's Standards for Internal Control in the Federal Government. At the conclusion of each review, we met with the head of the office to discuss the results and actions they should take to improve controls. We issued 14 reports to principal offices between April 2000 and October 2000 (Attachment 2). Also, in October 2000 we issued a capping report to the Deputy Secretary identifying the most significant issues and provided recommendations to address those issues. These reports and supported workpapers were also provided to GAO.

An important control for purchase cards is the review and approval of individual purchase card statements by an approving official. This approval is evidenced by the approving official's signature. We found that this procedure was not being followed. We reviewed the purchase card statements in the files of the Financial Management Policies and Administrative Programs Group, within the OCFO, for September 1999 and March 2000. We found that in September 1999, the purchase card statement was either missing or the statement was not signed for 70 percent of the individual cards with balances. In March 2000, that figure was 48 percent. We also identified transactions lacking sufficient documentation. We were unable to trace some purchase card transactions to expenditures on reports from the Department's accounting system, EDCAPS. In some cases, transaction numbers were not listed on the statements. In other cases, the transaction numbers did not appear on the EDCAPS expenditure reports. We also found some transactions recorded with incorrect dollar amounts. Further, payment of the September 1999 and March 2000 purchase card bills was authorized without reconciling the monthly Department-wide statement to the individual principal office purchase card statements or to the Department accounting system. In addition, we identified and reported on cardholders without appropriate warrants and training.

Regarding third party drafts, the Department's policy states that a person with signature authority (an authorized official) cannot produce (print) a draft that he or she signs. During our review we identified six employees from five offices who serve both as authorized officials and data entry personnel. In addition, some principal offices were not maintaining logs of blank drafts, which are negotiable instruments. We also discovered that principal offices were not maintaining sufficient documentation to support individual third party draft transactions. In some cases, approval signatures were missing from claim documents or files were either missing or unavailable for our review. In other cases, the invoice amount did not match the amount of the draft. In addition, in three principal offices we identified use of multiple third party drafts to pay for purchases in excess of the $10,000 limit imprinted on the blank drafts as an internal control deficiency.

We identified transactions exceeding the $2,500 micro-purchase threshold that lacked appropriate documentation to demonstrate compliance with the Federal Acquisition Regulations. We also identified acquisitions that were split into multiple purchases, apparently to avoid the $2,500 micro-purchase threshold or spending limits of individual cardholders.

Our capping report included a total of 22 recommendations to the Department, grouped according to the Standards for Internal Control in the Federal Government. These were to (1) strengthen the control environment over the use of purchase cards and drafts, (2) provide for an assessment of the risks the agency faces from both external and internal sources, (3) strengthen control activities over the use of cards and drafts, (4) strengthen information and communication regarding the use of cards and drafts, and (5) strengthen monitoring over the use of cards and drafts. These recommendations will help safeguard against potential misuse or waste and ensure that purchase card transactions and third party drafts serve program needs. In November 2000, the Department provided a corrective action plan to address reported weaknesses.

- GAPS Duplicate Payment Analysis[5] - We recently issued a report identifying duplicate payments from the Grant Administration and Payment System (GAPS). This analysis, the first of a series focusing on the Department's payment processes, identified information in the GAPS database and Federal Reserve Bank records that could indicate duplicate payments. Before we began our analysis, the Department had identified eight instances of duplicate GAPS payments totaling $198 million that occurred during the period from May 11, 1998, to September 30, 2000. We found 13 additional instances of duplicate payments totaling approximately $55 million. The recipients returned all funds to the Department except for $2,175 that was kept by one recipient and deducted from its grant balance. We identified another nine GAPS transactions for approximately $5.9 million that could be

[5]Analysis of GAPS Duplicate Payments (ED-OIG A11-B0001)

potential duplicate payments. We will be following up on those payments. We made several recommendations to the Office of the Chief Financial Officer to identify and prevent duplicate payments. The recommendations focused on initiating or reviewing procedures to prevent duplicate payments, limiting drawdowns to authorized amounts, and making changes to bank accounts. The Department generally concurred with our recommendations and stated that it is in the process of addressing them.

- Drawdown Controls in GAPS[6] - We issued a report in September 2000, assessing whether the Department should implement additional controls to mitigate the negative effect of improper grant drawdown activity. The Department currently uses GAPS to provide funds to grant recipients. We found the potential for abuse of the grant delivery system. We recommended that the Department implement additional controls to detect and limit excessive drawdown transactions by grant recipients on a timely basis. In addition, we recommended that the Department provide project officers with guidance on establishing the appropriate control level (detective or preventive) for recipients in their program(s) once drawdown controls are implemented. Adoption of these recommendations will help the Department minimize the potential for GAPS payment abuse. The Department generally agreed with our recommendations and has plans to address them.

- Investigations[7] - In our September 19, 2000, testimony we indicated that we were conducting an investigation of individuals who, between 1997 and 1999, purchased and/or received electronic equipment paid for with federal funds for non-business related purposes and billed

[6] Audit of the Drawdown Controls in Grant Administration and Payment System (ED-OIG A03-80010)
[7] Information provided with respect to investigations is limited to what has been made a matter of public record.

the Department for overtime hours not worked. The total cost of this activity was in excess of $1.2 million over a three-year period. Since September, four additional people have pled guilty to theft of government property and conspiracy charges in connection with this investigation, bringing the total number of guilty pleas to seven.

We also indicated that my office and the Federal Bureau of Investigations are investigating the diversion of $1.9 million in Impact Aid grant funds wired into two unauthorized bank accounts. These Impact Aid funds should have been disbursed to two school districts in South Dakota. Nearly all the funds and property purchased with these funds were seized and forfeited to the United States and about $1.7 million was returned to the Department. Both cases are being supervised by the U.S. Attorney's Office of the District of Columbia.

MONITORING IMPLEMENTATION OF RECOMMENDATIONS

There are a variety of ways in which the OIG monitors and reports on the Department's implementation of our recommendations. First, the OIG reports in its Semiannual Report to Congress (SAR) all OIG audits issued in prior periods that were not resolved within the previous six months. The OIG also reports on the status of corrective actions. This reporting mechanism communicates to the Congress and the Department the status of prior OIG audits and recommendations. The OIG's reporting of unresolved audits and uncorrected recommendations is not limited to financial audits. It also includes audits of the Department's programs, computer systems, and internal management operations.

Since 1998, my office has provided the Congress a list of management challenges facing the Department. Eight of the ten challenges have been reported before. As indicated above, financial management was the first challenge listed in the most recent report. As part of that challenge we reported the status of corrective actions taken on financial statement audit recommendations.

Also, the OIG periodically plans for and performs audits of the Department's audit follow-up system. The general purpose of these audits is to obtain information, assure that the Department's audit follow-up system is functioning as intended, offer suggestions for improvement where applicable, and to assess if appropriate corrective actions have been taken. We currently have an audit follow-up assignment ongoing. The objectives of that audit are to:

- determine whether the Department's controls ensure that agreed-upon corrective actions have been taken; and
- verify whether select corrective actions have been implemented as stated in the Department's corrective action plans.

In addition, with respect to financial statement audits, the Government Auditing Standards indicate that auditors should follow up on known material findings and recommendations from previous audits. Our auditors disclose the status of prior year findings in a section at the end of the Report on Internal Controls. This section presents the previous year's material weaknesses and reportable conditions, describes the control issue, and indicates the status of the current audit.

It is, of course, the responsibility of the Department to ensure that recommendations are addressed and corrective actions implemented. OMB guidance on audit follow-up, Circular A-50, states that the agency head is responsible for designating a top management official to oversee audit follow-up, including resolution and corrective action. Agency management officials are responsible for providing timely responses to the audit organization and taking corrective action as agreed to. As GAO has stated, "Internal control serves as the first line of defense in safeguarding assets and in helping to detect and prevent waste, fraud and abuse."[8]

CONCLUSIONS

In summary, the Department has made progress. However, much work remains if the Department is to reach its goal of obtaining an unqualified opinion on its financial statements and eliminating internal control weaknesses and non-compliance with laws and regulations. We and E&Y have made numerous recommendations to the Department over the years to improve its financial management activities. The Department needs to remedy the underlying weaknesses in its accounting systems and financial management activities. Implementation of our recommendations will go a long way towards sound financial management in the Department. We will work closely with the Department and the Congress to monitor the Department's progress towards making necessary improvements.

Mr. Chairman, this concludes my statement. I would be pleased to respond to any questions that you or other Members of the Subcommittee may have at this time.

[8]GAO-01-104R, Education's FY1999 Financial Management Weaknesses, October 16, 2000, page 9

Attachment 1

Summary of FY 1999 Material Weaknesses and Reportable Conditions

Issue Area	Summary Control Issues	FY 2000 Status
Financial Reporting Needs to Be Strengthened (Material Weakness)	Significant weaknesses in the Department's financial reporting processes existed as a result of the EDCAPS general ledger software package, Financial Management System Software (FMSS).	Improvements Noted - Repeat Condition Material Weakness
Reconciliations Need to Be Improved (Material Weakness)	The Department did not perform proper or timely reconciliations of its financial accounting records.	Improvements Noted - Repeat Condition Material Weakness
Controls Surrounding Information Systems Need Enhancement (Material Weakness)	Improvements are required in security over financial systems and in disaster recovery capabilities.	Improvements Noted - Repeat Condition Material Weakness
Improvement of Credit Reform Reporting is Needed (Material Weakness)	The Department did not account for transactions in accordance with the Federal Credit Reform Act of 1990.	Improvements Noted - Considered a Reportable Condition
Documentation Supporting Obligations, Undelivered Orders and Unobligated Balances Needs to be Improved (Reportable Condition)	Balances reported in subsidiary records for allotments, obligations incurred, undelivered orders, and the unobligated balances of funds were inconsistent with balances reported on the financial statements.	Not Considered Reportable Condition - Issues Reported in the Management Letter
Communication and Coordination Efforts Need to be Improved for Financial Management (Reportable Condition)	The Department needs to improve its communication and coordination efforts among offices that are responsible for providing information in support of financial reporting.	Not Considered a Separate Reportable Condition - Integrated within other internal control issues as appropriate
Documentation Supporting Accounts Payable, Accrued Liabilities, and Expenditures Needs to be Improved (Reportable Condition)	The Department needs to improve its supporting documentation over liabilities and expenditures, subsidiary ledger system requirements, and refine the grant liability estimation methodology.	Not Considered Reportable Condition - Issues Reported in the Management Letter
Reporting and Monitoring of Property and Equipment Needs to be Improved (Reportable Condition)	The Department does not capitalize purchases of property and equipment and software. In addition, there are several internal control issues surrounding the Department's efforts in safeguarding and reporting property and equipment.	Improvements Noted - Repeat Condition Reportable Condition

Source: *The U.S. Department of Education, Audited Financial Statements, Year Ended September 30, 2000, Report of Independent Auditors,* Ernst & Young LLP (ED-OIG/A17-A0002, February 28, 2001).

Attachment 2

Listing of Reports Related to Purchase Cards and Third Party Drafts

A&I 2000 – 001	Results of the OIG Review of the Office of Vocational and Adult Education's Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 4/18/00
A&I 2000 – 002	Results of the OIG Review of the Office of Elementary and Secondary Education's Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 5/22/00
A&I 2000 – 003	Results of the OIG Review of the Office of Bilingual Education and Minority Languages Affairs' Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 5/23/00
A&I 2000 – 004	Results of the OIG Review of the Office of Management's Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 6/26/00
A&I 2000 – 005	Results of the OIG Review of the Office of Special Education and Rehabilitative Services' Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 7/19/00
A&I 2000 – 006	Results of the OIG Review of the Office of Chief Financial Officer/Office of Chief Information Officer's Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 7/26/00
A&I 2000 – 007	Results of the OIG Review of the Office of Civil Rights' Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 8/2/00
A&I 2000 – 008	Results of the OIG Review of the Office of Intergovernmental and Interagency Affairs' Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 8/18/00
A&I 2000 – 009	Results of the OIG Review of the Office of Educational Research and Improvement's Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 8/28/00
A&I 2000 – 010	Results of the OIG Review of the Office of the Secretary/Office of the Deputy Secretary/Office of Legislation and Congressional Affairs' Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 8/31/00

Attachment 2

A&I 2000 – 011	Results of the OIG Review of the Office of the Under Secretary's Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 9/19/00
A&I 2000 – 012	Results of the OIG Review of the Office of the General Counsel's Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 9/18/00
A&I 2000 – 013	Results of the OIG Review of the Office of Postsecondary Education's Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 9/19/00
A&I 2000 – 014	Results of the OIG Review of Student Financial Assistance's Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 10/5/00
A&I 2000 – 015	Results of the OIG Review of Internal Controls Over the Procurement of Goods and Services Using Third Party Drafts and Purchase Cards 10/13/00

The web address for obtaining these reports is: *http://www.ed.gov/offices/OIG/AIReports.htm*

Analysis of GAPS Duplicate Payments

FINAL MANAGEMENT INFORMATION REPORT

Control Number A11-B0001
March 2001

Our mission is to promote the efficient and effective use of taxpayer dollars in support of American education

U.S. Department of Education
Office of Inspector General
Washington, DC

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MAR 30 2001

MEMORANDUM

TO : Mark Carney
Office of Chief Financial Officer

FROM : Lorraine Lewis

SUBJECT : FINAL MANAGEMENT INFORMATION REPORT
Analysis of GAPS Duplicate Payments
Control Number A11-B0001

Attached is our subject final management information report that covers the results of our Analysis of GAPS Duplicate Payments. We received your comments concurring with the findings and recommendations in our draft report.

Please provide the Supervisor, Post Audit Group, Financial Improvement, Receivables and Post Audit Operations, Office of Chief Financial and the Office of Inspector General, Planning, Analysis and Management Services with semiannual status reports on promised corrective actions until all such actions have been completed or continued follow-up is unnecessary.

In accordance with the Freedom of Information Act (Public Law 90-23), reports issued by the Office of Inspector General are available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act. Copies of this audit report have been provided to the offices shown on the distribution list enclosed in the report.

We appreciate the cooperation given us in the review. Should you have any questions concerning this report, please call Jack Rouch, Director, Systems Internal Audit Team at (202) 260-3878.

Attachment

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-1510

Analysis of Grant Administration and Payment System (GAPS) Duplicate Payments

TABLE OF CONTENTS

EXECUTIVE SUMMARY

This report presents the findings of our Grant Administration and Payment System (GAPS) duplicate payments analysis. The objective of our analysis was to identify information in the GAPS database and Federal Reserve Bank (FRB) records that could indicate duplicate payments, which we define as two payments for the same purpose. Before we began our analysis, the Department identified eight instances of duplicate GAPS payments totaling $198 million that occurred during the period covered by this analysis, May 11, 1998, to September 30, 2000.

Analysis Results

We found 13 additional instances of duplicate payments totaling approximately $55 million. The recipients returned all funds to the Department except for $2,175 that was kept by a recipient and deducted from its grant balances. We identified another nine GAPS transactions for approximately $5.9 million that could be potential duplicate payments.

We identified four payments totaling approximately $339,000 that were paid to the wrong recipients in Fiscal Year 1999. We found 35 payments totaling approximately $18 million, including approximately $2.2 million in fiscal year 2000, which were not adequately explained by OCFO. We identified five instances in which ED posted duplicate increases in Pell grant authorizations to recipients' accounts. We found that the Department made payments to two frozen bank accounts associated with an alleged fraud scheme, and we identified six likely duplicate payments that occurred prior to the implementation of GAPS.

Recommendations

We recommend that the Chief Financial Officer:
1. Initiate procedures to actively identify and prevent duplicate payments,
2. Review the procedures for posting grant authorizations to ensure that recipient drawdowns are limited to the intended grant authorization amount, and
3. Review the procedures for changing bank accounts and removing bank account flags to ensure that payments are not sent to an incorrect bank account.

Future OIG Work Relating to GAPS Duplicate Payments

This analysis is the first of a series of projects focusing on the Department's payment processes. We will initiate a subsequent review of GAPS transactions that will include the nine potential duplicate payments and the other issues described above.

OCFO Response to Report

OCFO agreed to address our first recommendation in their corrective action plan addressing the recommendations made in the Report on Internal Control issued with the Department's fiscal year 2000 financial statements. OCFO also agreed to review the procedures referred to in the second and third recommendations and prepare written corrective actions to strengthen the procedures.

BACKGROUND

The U.S. Department of Education (ED) began deployment of a new core financial system in October of 1997. The system, known as the Education Central Automated Processing System (EDCAPS), is managed by the Office of the Chief Financial Officer (OCFO). EDCAPS consists of three major components:

- Grant Administration and Payment System (GAPS)
- Financial Management Systems Software (FMSS)
- Contracts and Purchasing Support System (CPSS).

GAPS supports grant planning and award management of ED programs, including discretionary, formula, fellowship, and block grants. GAPS also interfaces with other program office systems, referred to as program feeder systems, to process their obligation and payment data. The program feeder systems typically support planning, scheduling, and award processes performed by the program offices to manage their programs (for example, Impact Aid, Campus-Based, and Pell). GAPS controls payments for ED's programs, including payments for grants and direct loans and various other program-related obligations. This system serves as a subsidiary to the FMSS general ledger for program-related obligations, payments, and expenditures. GAPS interfaces with FMSS at the summary level for purposes of funds control and general ledger postings.

Payment requests from GAPS are transmitted to the Federal Reserve Bank (FRB) of Richmond, Virginia. The FRB, in turn, transmits payments to the recipients by either the Fedwire or Automated Clearing House (ACH) electronic funds transfer systems. Larger recipients generally use the Fedwire system and smaller recipients generally use the ACH system.

GAPS became operational on May 11, 1998, replacing the Payment Management System (PMS). A major feature of GAPS is the ability of grant recipients to request drawdowns over the Internet, which is how the majority of payments are requested. Recipients can also request funds over the telephone by calling the GAPS help desk and asking an ED employee or contractor to initiate a payment. The Department has established cash management guidelines that limit the amount of cash a grantee can hold to their immediate requirements. Once a grant award is established in GAPS, there is no system control that prevents a recipient from drawing excessive funds within the total authorized for the particular grant.[1] However, as part of the recipient's annual audit, an independent public accountant evaluates the recipient's compliance with the Department's cash management guidelines.

Before we began our analysis, the Department identified eight instances of duplicate GAPS payments totaling $198 million that occurred during the period covered by this analysis.

[1] Audit of Drawdown Controls in Grant Administration and Payment System: Control Number A03-80010, September 2000.

OBJECTIVE, SCOPE, AND METHODOLOGY

This analysis is the first of a series of projects focusing on the Department's payment processes. This report presents the findings of our analysis of GAPS payments. The objective of this analysis was to identify information in the GAPS database and FRB records that could indicate duplicate payments of program funds. Our analysis covered GAPS payment activity during the period from May 11, 1998, to September 30, 2000. We did not review GAPS processes or evaluate internal controls; nor did we review administrative payments made by other Department processes. We restricted our efforts to evaluating transaction documentation provided by the Department and the FRB.

Data Retrieval

To accomplish the above objective, we requested and received from OCFO the data dictionary describing the database table structure and data elements of GAPS. We then identified specific tables and data elements that support GAPS payment capabilities, and obtained related GAPS data for the period from May 11, 1998, to September 30, 2000.

We requested payment data from the FRB covering the same period. The FRB was able to provide tapes containing payment transactions (the "sender file") processed through Fedwire for the period of our analysis. The FRB also provided us with Fedwire funds transfers from recipients to ED (the "receiver file"). However, the FRB did not keep backup data supporting ACH transactions for the entire period of our analysis. FRB was only able to provide ACH payment transaction data covering the following periods:

- September 28, 1999, to December 8, 1999;
- December 14, 1999, to February 16, 2000; and
- August 8, 2000, to October 2, 2000.

Additionally, we accessed the GAPS help desk tracking system that documents resolution of help desk calls, including reports of duplicate payments received by recipients.

Analysis

FRB and GAPS data records were analyzed to identify duplicate payments. Specifically,

- FRB Fedwire and ACH records were queried for duplicate control numbers that may have resulted from a payment file being sent to the FRB more than once.

- FRB Fedwire records were queried for receiver file records which represent transactions transferring funds from a recipient to ED. Such transactions can result from returns of duplicate payments.

Analysis of GAPS Duplicate Payments

- FRB Fedwire records were queried for duplicate amounts to the same payee sent to different banks within a seven-day period.
- FRB Fedwire and available ACH payments were matched to GAPS payments to identify unrecorded or inaccurately recorded payments.
- GAPS payment request data was queried to identify requests for duplicate amounts to the same recipient within seven days where at least one requester for payment was an ED employee.
- GAPS payment request data was queried to identify duplicate requests for the same amount to the same recipient on the same day.
- GAPS help desk system was queried to identify potential duplicate payments.

We also traced previously identified duplicate payments to our query results to verify the sufficiency of our query selection.

Some of our queries involved a large number of transactions to evaluate. When this occurred, we established minimum dollar amounts to reduce the number of transactions requiring followup. We forwarded these transactions to OCFO and requested that they review the selected transactions to determine whether they represent improper payments. We also asked OCFO to provide documentation supporting their conclusions. Our first transmittal to OCFO was submitted November 14, 2000, and they responded November 28, 2000. A second request was submitted to OCFO on December 21, 2000, and they responded January 11 and January 17, 2001. Finally, a third request was sent to OCFO on January 10, 2001, and they responded January 19, 2001.

RESULTS AND RECOMMENDATIONS

OCFO's responses to our requests and to the draft report indicated 13 duplicate payments and 9 potential duplicate payments. We also found 4 payments to the wrong recipients and 35 payments that were not adequately explained by OCFO. Other analyses of the GAPS and FRB data identified duplicate increases of Pell grant authorizations and payments made to two frozen bank accounts associated with an alleged fraud scheme. GAPS help desk data identified six likely PMS duplicate payments.

Analysis of GAPS Duplicate Payments

Thirteen Duplicate Payments

Our review identified 13 instances of duplicate payments totaling approximately $55 million that occurred in fiscal years 1998, 1999, and 2000 that were not previously identified by OCFO. These instances occurred when OCFO submitted two payment requests to the FRB for a single drawdown, or the award showed up twice on the GAPS website. In OCFO's responses to our queries and to the draft report, it agreed these duplicate payments occurred. The recipients returned all funds to the Department except for $2,175 that was kept by a recipient and deducted from its grant balances. These duplicate payments are summarized below:

$19,000,000 - Oklahoma State University requested funds on January 7, 1999. In GAPS, there is a return posted on the same day as the request. The funds were returned on January 20, 1999.

$15,588,710 - A manual payment was made to Electronic Data Systems Corp. on May 8, 1998, because PMS was shut down for the conversion to GAPS. On May 15, 1998, OCFO entered the manual payment into GAPS to record it. This action created a payment request record, which was sent to FRB by mistake, creating a duplicate payment. The payment was requested back by OCFO the same day.

$13,688,178 - Pennsylvania State Dept of Education requested funds on October 19, 1999. In GAPS, there is a return posted per originator request on the same day as the request. The funds were returned on October 20, 1999.

$4,800,000 - Corporation for Public Broadcasting requested funds on July 28, 1999. In GAPS, there is a return posted on the same day as the request. The funds were returned on August 2, 1999.

$1,013,595.07 – North Carolina Department of Health and Human Services requested funds twice on March 16, 2000. The state confirmed the duplicate request and returned the second payment on the same day.

$774,216.14 - Connecticut State Department of Education requested funds on December 14, 1998. In GAPS, there is a return posted on the same day as the request. The funds were returned on December 23, 1998.

$101,055 - Duplicate payments were made to WestEd on September 14, 1998, because the award showed up twice on the GAPS website, according to OCFO. The recipient returned the funds on October 29, 1998.

$42,000 - A payment was transmitted to the Commonwealth of Virginia on November 10, 1998, and again on November 12, 1998. The error was found and FRB confirmed reversal of the second transaction on November 16, 1998.

$33,460.63 - Duplicate payments were made on June 5, 1998, for a grant to the California State University Sacramento Foundation. The duplicate payment resulted from two different bank accounts being established for the award. According to a help desk record, the second payment went to a bank account that did not belong to the grantee. Funds were returned June

8, 1998. OCFO states that GAPS has been modified to prevent grant mapping to more than one bank account.

$1,728 - Duplicate payments were made to Martin Luther College on September 3, 1998, because the award showed up twice on the GAPS website, according to OCFO. The funds were returned on September 10, 1998.

$1,175 - Duplicate payments were made to Wheatridge Beauty College on May 15, 1998, because the award showed up twice on the GAPS website, according to OCFO. The school chose to keep the duplicate funds for other expenditures.

$1,000 - Duplicate payments were made to Wheatridge Beauty College on May 15, 1998, because the award showed up twice on the GAPS website, according to OCFO. The school chose to keep the duplicate funds for other expenditures.

$13.60 - A payment to the State of Oklahoma was transmitted on October 12, 1999, and again on October 13, 1999. The error was found and FRB confirmed reversal of the second transaction on October 21, 1999.

Nine Potential Duplicate Payments

Our queries of the FRB and GAPS transactions and the subsequent OCFO review identified nine transactions for $5.9 million that could be duplicate payments. OCFO did not agree that the nine transactions were duplicate payments. In our followup to this analysis, OIG will attempt to confirm the validity of these transactions and identify the cause of any such duplicate payments. A discussion of the nine transactions follows.

Four Returned Payments Marked "Duplicate Entry"

We found four payments for approximately $3.4 million, including $319,000 in fiscal year 2001, that were returned by the recipients. GAPS records indicate the reason for the returns was "duplicate entry." OCFO did not determine the actual cause, but OCFO stated that "duplicate entry could have resulted from [the] recipient requesting funds twice by mistake or GAPS could have sent a duplicate payment." These payments are summarized below:

Recipient Name	Amount	Date of 1st Entry	Date of 2nd Entry
Developmental Services California Dept.	2,665,616.29	06/03/98	06/03/98
Florida A&M University	329,101.00	09/29/98	09/29/98
Education Mississippi State Dept.	319,185.22	10/31/00	10/31/00
Piedmont Technical College	117,755.64	04/13/99	04/13/99
Total	**$3,431,658.15**		

Three Returned Payments Identified by Recipients as Errors

A total of $2.3 million in payments were made to three recipients who received identical payments within seven day periods, including $964,000 in fiscal year 2000. The recipients returned the funds with explanations of "wrong amount," "received in error," and "wire sent in error." Moreover, the returns were incorrectly coded in GAPS to show that ED requested the return of funds instead of the recipient initiating return of the funds. OCFO has not determined whether these transactions were duplicate payments. These payments are summarized below:

Recipient Name	Amount	Date of 1st Entry	Date of 2nd Entry
Education New Jersey Dept. of	$1,076,701.00	10/01/98	10/01/98
Education New York Dept. of	963,687.00	09/11/00	09/12/00
Indiana University	241,393.00	06/22/98	06/24/98
Total	**$2,281,781.00**		

Two Returned Payments Identified by Recipients as Duplicate

Payments totaling $220,000, including approximately $93,000 in fiscal year 2000, were returned by the recipients, who identified them as duplicates. The New Jersey Department of Labor returned $126,751 on July 14, 1998, and the Tennessee Department of Human Services returned $92,951 on September 8, 2000. OCFO did not provide any additional evidence about these payments.

Other Matters

In the course of our analysis of duplicate payments we found four additional issues related to GAPS payment operations including payments to wrong recipients, payments returned that were not adequately explained, Pell grant authorizations entered twice, and payments made to two frozen bank accounts. We also identified six likely duplicate payments from the PMS system that were corrected after GAPS was implemented.

Four Payments to Wrong Recipients

Our review also identified four fiscal year 1999 payments totaling approximately $339,000 paid to the wrong recipients. Three of these payments were made because an incorrect DUNS number had been entered into GAPS. The DUNS number is a unique identifying number adopted by GAPS to distinguish among grant recipients. All three payments were returned. These payments are summarized below:

$293,034.96 - Funds due to Hydaburg City School District of Alaska (DUNS 174610147) were sent in error on August 1999 to the Alaska Department of Education (DUNS 157645995).

$15,669.94 - Funds due to Woodville Independent School District in TX (DUNS 087720769) were sent in error on March 25, 1999, to the University of Texas in Austin (DUNS 170230239).

$5,301.50 - Funds due to Woodville Independent School District in TX (DUNS 087720769) were sent in error on March 19, 1999, to the University of Texas in Austin (DUNS 170230239).

In addition, GAPS help desk records indicate a March 1999 payment was paid to the wrong school. When the funds were refunded, ED posted the refund to the wrong school's account.

$24,504 - Tri-City Barber School received a payment in March 1999 that was not requested. The money was intended for the Parents Union for Public School. Tri-City refunded the money. However, the refund was applied to Tri-City (thereby increasing Tri-City's available funds) instead of Parents Union.

Thirty-Five Payments Returned – Not Adequately Explained

We found 35 payments totaling approximately $18 million, including approximately $2.2 million in fiscal year 2000, which were not adequately explained by OCFO. The payments were returned by FRB to ED with reasons such as "unable to locate account," "unidentified," "per customer request," "wrong amount," "sent in error," "does not belong to beneficiary," and "name and account number do not agree." OCFO did not provide us with evidence to support the legitimacy of the payments. According to a recent GAO report, titled "Financial Management: Billions in Improper Payments Continue to Require Attention" (GAO-01-44), dated October 27, 2000:

> Improper payments include payments that should not have been made or were made for incorrect amounts irrespective of whether the agency had effective controls in place. Specifically, improper payments would include inadvertent errors, such as duplicate payments and calculation errors, payments for unsupported or inadequately supported claims; payments for services not rendered or to ineligible beneficiaries; and payments resulting from outright fraud and abuse.

These 35 payments could be improper. Additional testwork, involving contacts with the recipient, would be needed to determine the validity of these payments. See Attachment A for details.

Pell Grant Authorizations Entered Twice

During our review of help desk inquiries we identified five instances totaling approximately $615,000, including approximately $27,000 in fiscal year 2000 and $2,000 in fiscal year 2001, in which ED posted duplicate increases in Pell grant authorizations to recipients' accounts. GAPS staff processed three transaction batches twice, which produced these five instances. No duplicate payment or inappropriate drawdown resulted from these five instances. However, the three transaction batches may have included additional Pell grant authorization increases for other recipients, thereby increasing the Department's potential risk of over-disbursing. We recommend that OCFO review the procedures for posting authorizations to ensure that recipient drawdowns are limited to the intended grant authorization amount.

Analysis of GAPS Duplicate Payments

In our followup analysis, OIG will determine whether ED corrected the accounts of other recipients that were included in those batches, and we will review for any additional batches that were incorrectly posted. These authorization increases are summarized below:

Team Track ID	Award Number(s)	DUNS No.	Date Submitted	Amount
ED0005470	P063P984460	not listed	11/02/1998	$207,308.00
ED0005486	P063P984929	087256061	11/03/1998	378,879.00
ED0018072	P063P993780	091062695	09/11/2000	633.00
ED0018209	P063P003464	078776333	09/29/2000	26,100.00
ED0018318	P063P004369	083845131	10/16/2000	2,041.00
		Total		**$614,961.00**

Payments Made to Frozen Bank Accounts

In April 2000, the United States seized two bank accounts allegedly used in a fraud scheme against the Department. As a result, the bank froze those accounts so that no money could go in or out of them. During our GAPS analysis, one of our queries disclosed attempts to make grant payments to the frozen bank accounts in August 2000. Because the accounts were frozen, the payments were returned and were later forwarded to the correct grant recipients. We discussed the event with OCFO to determine the circumstances surrounding the attempted payments. While the bank account records were being maintained in GAPS for use as possible evidence, the bank account information had been flagged as "invalid" in GAPS to prevent payments to them. Department personnel, attempting to make authorized payments to the grant recipients, removed the flags in August 2000. Once the mistake was identified, the bank accounts were flagged again as invalid in GAPS. We recommend that the CFO review the procedures for changing bank accounts and removing bank account flags within GAPS to ensure that similar human errors are not repeated.

Six Likely PMS Duplicate Payments

Six payments, totaling approximately $2.0 million, appear to be duplicated from the PMS system that preceded GAPS. Although our analysis focuses on payments made by GAPS, we asked OCFO about these PMS payments because our analysis of help desk records indicated the payments were likely duplicates. In addition, these discrepancies were discovered during our analysis period. However, OCFO did not comment on these transactions because they were not GAPS payments. These payments are summarized below:

$1,600,000 - The University of Georgia had a duplicate drawdown on December 12, 1997. It sent a refund check to the Department, but the refund was credited to the University of Maine at Augusta, increasing Maine's available funds. Georgia alerted the GAPS help desk in October 1998, and an adjustment was subsequently made.

$309,882 - Texas Southern University received a duplicate payment in April 1998, and returned the funds in September 1998.

$33,613 – The Full Fell Center for the Recording Art made a duplicate drawdown of its Pell money on May 14, 1998. OCFO did not indicate whether these funds were returned.

$17,234 - The United States International University was sent a duplicate amount on June 28, 1998, which was not requested by the recipient.

$9,508 - The Ramapo College of New Jersey discovered a discrepancy on one of its awards, and sent a refund check to the Department on June 8, 1998.

$6,596 - Marin Beauty College had a refund check on January 22, 1999, which never cleared, and requested the amount be posted back in GAPS.

Department Actions

The Department's March 2000 report entitled, "Department-wide Objectives, 1999 Performance Reports and 2001 Plans," submitted under the Government Performance and Results Act (GPRA), includes the following statement:

> The Student Financial Assistance (SFA) program and the Office of the Chief Financial Officer (OCFO) have made some duplicate improper payments. The Department takes this issue very seriously and is working to enhance procedures to prevent any improper or duplicate payments.
>
> To improve the identification of improper payments, SFA and OCFO will be doing additional work with the offices that have monitoring and oversight responsibility for postsecondary institutions, lenders, and guaranty agencies. Procedure changes have been implemented in the OCFO to prevent duplicate payments.

On October 12, 2000, the Inspector General recommended that the Department "proactively develop its own approach or methodology for annually estimating improper payments." The development of an improper payment estimate could be a valuable GPRA performance indicator.

Future OIG Plans

Our analysis of GAPS payments was limited to the documentation available at the Department and FRB. In a number of cases, the Department was unable to provide information about payments beyond that available from FRB. In other cases, OCFO reviewed transactions and told us the transactions were not duplicates; however, it did not provide sufficient evidence to support this conclusion. As a result, we are unable to conclude on the propriety of a number of transactions selected by our queries. In addition, we gave priority to large payments when we selected our sample. We will initiate a subsequent review of GAPS transactions that will include the 9 potential duplicate payments, the 4 payments to the wrong recipients, the 35 payments not adequately explained by OCFO, the duplicate increases in Pell grant authorizations, the 6 likely PMS duplicate payments, and a number of payments for smaller amounts which were not submitted to OCFO for their review. This review will include contacting recipients to ascertain the circumstances surrounding selected payments.

Recommendations

We recommend that the Chief Financial Officer:

1. Initiate procedures to actively identify and prevent improper payments,
2. Review the procedures for posting grant authorizations to ensure that recipient drawdowns are limited to the intended grant authorization amount, and
3. Review the procedures for changing bank accounts and removing bank account flags to ensure that payments are not sent to an incorrect bank account.

OCFO RESPONSE TO REPORT

In their response to our draft report, OCFO acknowledged that they have additional work to do in this area. They confirmed that three payments initially identified as potential duplicate payments and another payment that was listed as not adequately explained were, in fact, duplicate payments. Furthermore, after OCFO responded to our draft report they were able to confirm another duplicate payment. We amended our final report to reflect these five additional confirmed duplicates. We also amended our final report to better distinguish potential duplicate payments (the subject of our analysis) from potential improper payments (a broader category).

One of the 13 duplicate payments resulted from a duplicate request by the recipient. OCFO is attempting to determine whether the other 12 duplicate payments resulted from a duplicate request by the recipient or a control failure within the Department's disbursing process. They said our first recommendation would be addressed in their corrective action plan to address recommendations made in the Report on Internal Control issued with the report on the audit of the Department's fiscal year 2000 financial statements. OCFO agreed to review the procedures referred to in the second and third recommendations and to prepare written corrective action steps to strengthen the procedures.

35 Payments Returned – Not Adequately Explained

	DUNS	Recipient Name	Total Amount	FY 2000	Date Returned
1	789173308	KY State Univ Mail Room	$29,882.00		02/22/98
2	604722629	American Intercontinetal Univ	$84,422.00		05/22/98
3	806782173	Education New York Dept of	$37,975.88		06/17/98
4	789173309	KY State Univ Mail Room	$590.00		06/30/98
5	807308788	New Jersey Dep of Labor	$71,985.00		08/21/98
6	024481876	Southast Ala Edcatn Otrach Llc	$6,000.00		09/01/98
7	011144198	Department of Family	$908,290.19		10/15/98
8	868853094	University of New Mexico	$138,550.00		10/19/98
9	004426771	University of Florida	$8,700,000.00		01/15/99
10	854811684	Government of the Federated States of Micrones	$2,838,831.00		01/27/99
11	157645995	Education Alaska Department	$2,100.00		02/09/99
12	174097410	County of Okaloosa	$1,500.00		02/15/99
13	001910777	Johns Hopkins University	$13,148.00		04/20/99
14	001910777	Johns Hopkins University	$37,517.00		04/20/99
15	001910777	Johns Hopkins University	$62,787.00		04/20/99
16	001910777	Johns Hopkins University	$2,480,085.00		04/20/99
17	929332658	West Virginia University	$6,390.00		04/23/99
18	075617902	Parkland College	$48,627.00		04/28/99
19	174097410	County of Okaloosa	$310.00		05/04/99
20	020657151	Research Foundation Suny	$115,495.00		07/21/99
21	031059210	ATI Enterprises Inc	$238,190.00		08/03/99
22	039240510	Microcomputer Technology Inst	$5,848.98		09/16/99
23	004426771	University of Florida	$352,000.00	$352,000.00	10/21/99
24	623751831	Florida A&M University	$319,961.00	$319,961.00	10/26/99
25	623751831	Florida A&M University	$942,727.00	$942,727.00	10/26/99
26	808346555	Department of EducationIiowa	$28,788.05	$28,788.05	10/26/99
27	878147602	Human Services Colorado Dept	$71,988.85	$71,988.85	11/03/99
28	183872878	County of Desoto	$24,620.16	$24,620.16	12/01/99
29	809791296	Social & Rehabilt Services	$188,761.00	$188,761.00	02/03/00
30	956153936	City of Lackawanna	$75,710.00	$75,710.00	04/12/00
31	826946337	Georgia Inst of Cosmetology	$12,028.00	$12,028.00	04/17/00
32	198636953	Staunton City School District	$92,500.00	$92,500.00	06/01/00
33	090059440	Idea Inc	$6,100.00	$6,100.00	06/05/00
34	614924181	Asm Beauty World Academy	$25.00	$25.00	08/16/00
35	063616700	Lac Courte Oreilles Tr	105,840.00	105,840.00	08/23/00
			$18,049,573.11	$2,221,049.06	

Attachment B

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER

MAR 20 2001

MEMORANDUM

TO : Lorraine Lewis
Inspector General

FROM: Mark Carney Mark Carney
Deputy Chief Financial Officer
Office of the Chief Financial Officer

SUBJECT: Draft Management Information Report: Analysis of GAPS Duplicate Payments (Control Number A11-B0001)

This memorandum provides a written response following our review of an Office of Inspector General (OIG) draft Management Information Report on an analysis of the Department's Grant Administration and Payment System (GAPS) duplicate payments. The objective of the OIG analysis was to identify information in the GAPS database and Federal Reserve Bank (FRB) records that could indicate duplicate payments; defined as two payments for the same purpose. This definition makes it more difficult to identify whether the control failure is on the part of the Department or the recipient. Moreover, as a period of time has elapsed since the occurrence, it is more difficult to ascertain the problem by means of interviewing recipients.

Although, we have more work to do in this area, our ongoing relationship with recipients allows us to mitigate much of the risk involved with duplicate disbursement transactions. Therefore, the Department recovered all of the funds referred to in the report as they were either returned or applied to recipient accounts. The net result was no loss to the Department.

With respect to the content of the report, prior to beginning your analysis, the Department identified eight instances of duplicate GAPS payments totaling $198 million that occurred during the period covered by the analysis, May 11, 1998, to September 30, 2000. In a meeting with your staff on preliminary findings of the subject report, OIG and OCFO staff agreed to group thirteen additional GAPS transactions for approximately $31.5 million as potential duplicate payments rather than potential improper payments.

Subsequent to the preliminary findings meeting, OCFO has partially completed research on items that could be duplicate or improper payments. My staff has confirmed that three of the thirteen GAPS transactions identified as potential duplicate payments were in fact duplicates. We are attempting to determine whether the recipient drew funds twice or a control failure occurred within the ED disbursement process. These transactions account for $24.6 million, or 78%, of the amount identified. The three transactions are:

Oklahoma State University	$19,000,000.00
Corporation for Public Broadcasting	4,800,000.00
Education Connecticut State Dept.	774,216.14

Attachment B

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Moreover, thirty-six payments totaling approximately $31.7 million are considered potential improper payments, including approximately $15.9 million in fiscal year 2000, which were returned by FRB to ED. One of the 36 payments, which the report said could be improper, was confirmed as a duplicate payment. This item accounts for 86% of the total amount included in the 36 payments. Again, we are attempting to determine whether the recipient drew funds twice or a control failure occurred within the ED disbursement process.

Pennsylvania State Dept Edu	$13,688,178.00

As a result of your analysis, the OIG made the following recommendations:

- initiate procedures to actively identify and prevent duplicate payments
- review the procedures for posting grant authorizations to ensure that recipient drawdowns are limited to the intended grant authorization amount, and
- review the procedures for changing bank accounts and activating inactive bank accounts to ensure that payments are not sent to an incorrect bank account.

OCFO is currently formulating a corrective action plan to address the recommendations made in the Report on Internal Control issued with the audit report for the Department's FY2000 financial statements. The first recommendation made above will be addressed in the corrective action plan. OCFO will review the procedures referred in the second and third recommendations and prepare written corrective action steps to strengthen the procedures.

Thank you for the opportunity to comment. We trust that you will consider this response in the preparation of your final report. Please contact me with any questions or concerns at 401-3892.

Attachment C

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APPENDIX F -- WRITTEN TESTIMONY OF DANIEL J. MURRIN, PARTNER, ERNST & YOUNG, LLP, WASHINGTON, DC

Written Testimony of Daniel J. Murrin
Partner, Ernst & Young
before the
Committee on Education and the Workforce's
Subcommittee on Select Education
of the U.S. House of Representatives
April 3, 2001

Introduction

My name is Daniel J. Murrin. I am the National Director of Public Sector Services for Ernst & Young LLP, a public accounting firm. I am the Engagement Partner for the Ernst & Young audit of the Department of Education. I have been in public accounting for over 20 years, with a specialty in the Public Sector - Federal government. The Office of Inspector General, for the Department of Education, engaged Ernst & Young to conduct the audits of the Department's fiscal year 2000, 1999 and 1998 financial statements for the purpose of satisfying the requirements of the Government Management Reform Act. We have been asked to share with the Committee the result of the fiscal year 2000 audit, including principle findings and material weaknesses, and to comment on additional work that could be performed concerning the Department's financial management.

My testimony will focus on the scope of our contract with the Office of the Inspector General, provide an overview of our audit and discuss in more detail the three reports issued as a result of an audit: (1) Report of Independent Auditors; (2) Report on Internal Control; and (3) Report on Compliance with Laws and Regulations.

Scope Of Ernst & Young's Contract With The Office of Inspector General

The Office of the Inspector General engaged Ernst & Young (E&Y) to conduct the audit of the fiscal year 2000 financial statements for the purpose of satisfying the requirements of the Government Management Reform Act (GMRA) of 1994. The following reports are required for a financial statement audit of a Federal agency: Report of Independent Auditors, Report on Internal Controls, and a Report on Compliance with Laws and Regulations. The scope of the work with respect to each of these reports is as follows:

- **Report of Independent Auditors** - Determine and report on whether the ***financial statements*** were presented in all material respects in accordance with the Office of Management and Budget (OMB) Bulletin No. 97-01, "Form and Content of Agency Financial Statements." OMB Bulletins require us to assess and the Department of Education to prepare the following statements: (1) Balance Sheet; (2) Statement of Net Cost; (3) Statement of Changes in Net Position; (4) Statement of Budgetary Resources; and (5) Statement of Financing. The audit is to render an opinion on these statements, which could result in a: (1) unqualified or clean opinion; (2) qualified opinion; (3) adverse opinion; or (4) a disclaimer of an opinion. See appendix A, which further details types of opinion.
- **Report on Internal Controls** - Determine and report, based on the work performed in our audit findings regarding whether the Department of Education's internal control structure provided reasonable assurance of achieving the internal

control objectives described in OMB Bulletin No. 01-02, "*Audit Requirements for Federal Financial Statements.*"[1] Internal controls are important to assure programs achieve intended results and that programs and resources are protected from waste, fraud, and mismanagement.

- **Report on Compliance with Laws and Regulations** - Determine and report on whether the Department of Education complied with applicable Federal laws and regulations which could have had a direct and material effect on the Principal Statements.

Overview of Audit Report

Ernst & Young issued a qualified opinion with respect to the five required financial statements. Concurrent with the issuance of our report, we issued a Report on Internal Control which detailed three material weaknesses and two reportable conditions, with a total of 21 recommendations to assist the Department in addressing its significant internal control deficiencies. We also issued a Report on Compliance with Laws and

[1] OMB Bulletin No. 01-02 sets forth the audit requirements for Federal Financial Statements. The Bulletin is designed to provide the necessary audit guidance in connection with the implementation of the CFO Act, as expanded by the Government Management Reform Act (GMRA) of 1994, and provides formal definitions for a number of technical terms and requirements used throughout the Bulletin and formalizes a number of significant CFO Act requirements including:

- Defines audit scope
- Provides agency IGs with primary responsibility for the execution of audits; allows the IG to provide for the execution of the audit by independent external auditors, and provides for audits to be performed by the Comptroller General of the United States (in consultation with the IG)
- Provides guidance on the IG's role, such as to:
  - Ensure that audits are performed and audit reports completed in a timely manner and in accordance with the requirements of this Bulletin. This responsibility pertains to audits conducted directly by IG staff and audits conducted by independent auditors under contract.
  - Provide technical advice and liaison to agency officials and independent external auditors.
  - Obtain or make quality control reviews of audits made by independent external auditors and provide the results, when appropriate, to other interested organizations.

Regulations and cited noncompliance with the Federal Financial Management Improvement Act, and the Information Technology Management Reform Act (Clinger-Cohen Act).

Guiding Standards For This Engagement

The engagement was to be performed in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States, Office of Management and Budget Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, and generally accepted auditing standards issued by the American Institute of Certified Public Accountants (AICPA).[2]

Timing of the Audit Process

Pursuant to the Government Management Reform Act, audited financial statements must be provided to OMB by March 1 of the fiscal year following the fiscal year under audit. To accomplish this objective, engagement planning would typically begin in mid-May of the year to be audited. Interim procedures would be performed

[2] According to the AICPA Statement of Auditing Standards (SAS) No. 1, as amended by SAS No. 78 and SAS No. 82: "*The objective of the ordinary audit of financial statements by the independent auditor is the expression of an opinion on the fairness with which they present, in all material respects, financial position, results of operations . . in conformity with generally accepted accounting principles . . . . These standards require him to state whether, in his opinion, the financial statements are presented in conformity with generally accepted accounting principles and to identify those circumstances in which such principles have not been consistently observed in the preparation of the financial statements of the current period in relation to those of the preceding period.*"

during the months of June through mid-August, with the auditors returning in mid-October after the Federal agency has closed its books. The year-end audit procedures are typically completed by January of the following fiscal year. The reporting phase of our audit was completed in February 2001 with issuance of our final reports. The Deputy Chief Financial Officer indicated that the Department concurs with the audit findings and related recommendations.

Report of Independent Auditors and Obstacles to a Clean Opinion

E&Y issued a qualified opinion with respect to the: (1) Consolidated Balance Sheet; (2) Consolidated Statement of Net Cost; (3) Consolidated Statement of Changes in Net Position; (4) Combined Statement of Budgetary Resources; and (5) Combined Statement of Financing for the year ended September 30, 2000.

There were several reasons to qualify our opinion on the statements mentioned above for fiscal year 2000.

During fiscal year 1998, the Department implemented a new accounting system and as noted in our Report on Independent Auditors for fiscal year 2000, 1999 and 1998, the accounting system, as implemented, has several limitations. The Department relies on a variety of work-around procedures to prepare financial statements, including significant manual adjustments, due to deficiencies in the current general ledger system and the lack of a fully integrated financial management system. This condition and others previously reported led to disclaimed opinions on the 1998 financial statements and on one of the

1999 financial statements; we also expressed a qualified opinion on the other four financial statements in 1999. The Department has purchased a new accounting system to address this weakness.

The internal control of the Department is evolving. During fiscal year 2000, the Department processed a significant number of manual adjustments in an effort to correct errors from prior fiscal years and to correct deficiencies in the posting of certain current year transactions to the existing general ledger system. Due to the condition of the available records, in some cases these adjustments were made based on the best available data. Management made reasoned judgments intended to correct the balances to conform to management's expectations based on what management believes the accounts should reflect. While this adjustment process appears to have been a pragmatic solution, the Department was unable to provide sufficiently definitive documentation to support these adjustments. The efforts of the Department, including emerging account analysis and reconciliation processes, have partially compensated for, but did not correct, certain aspects of the material weaknesses in the Department's financial reporting process in fiscal year 2000.

- The Department was unable to provide adequate documentation to support certain amounts reported in net position included in the consolidated balance sheet, and prior period adjustments included in the consolidated statement of changes in net position; nor were we able to satisfy ourselves as to these amounts by performing other auditing procedures. In addition, the Department inconsistently processed certain transactions related to prior years as fiscal year 2000 activity and was unable to provide adequate documentation that these manual transactions were properly reflected in the appropriate period. We were unable to obtain sufficient evidence or to otherwise satisfy ourselves that the Department's process to adjust its records to reflect the transactions in the proper period was fully effective in ensuring that certain costs and obligations reported by the Department were related to fiscal year 2000 rather than prior years activity; nor were we able to satisfy ourselves with respect to the adjustments to beginning obligated and unobligated balances.

Report on Internal Control

Ernst & Young issued a Report on Internal Control documenting five weaknesses as noted in Appendix B and in our report. The FY 2000 result reflects progress the Department has made in addressing issues raised in prior years, and reflects a reduction in aggregate significant comments from 8 in 1999 to 5 this year. The following were reportable conditions, the first three of which were material weaknesses:

- Financial Management Systems and Financial Reporting Needs to Be Strengthened (Repeat Condition - Material Weakness)
- Reconciliations Need to Be Improved (Repeat Condition - Material Weakness)
- Controls Surrounding Information Systems Need Enhancement (Repeat Condition - Material Weakness)
- Improvement of Financial Reporting Relating to Credit Reform Is Needed.

- Reporting and Monitoring of Property and Equipment Needs to be Improved

The three most serious of these weaknesses were related to accounting system's deficiencies, inadequate or not sufficiently timely reconciliations and, continuous effort needed to further address control weaknesses related to information technology and systems.

Report on Compliance with Laws and Regulations

The Report on Compliance with Laws and Regulations disclosed that the Department had not complied with the Federal Financial Management Improvement Act (FFMIA) of 1996, and the Information Technology Management Reform Act (Clinger-Cohen Act). The Report on Internal Control includes information related to the financial management systems and accounting standards that were found not to comply with the requirements, and presents relevant facts pertaining to the noncompliance and our recommendations related to the specific issues.

Summary Observations

There was some improvement when comparing the results of the fiscal year 2000 audit to the results from the prior years' audits. For example, the Department:

- Prepared interim financial statements for the periods ended March 31, 2000, and June 30, 2000.

- Audited financial statements were issued on time, March 1, 2001, as required by the Government Management Reform Act, confirming a deadline met for the first time for the FY199 financial audit.
- Removed a disclaimer of opinion for one financial statement.

Although the Department demonstrated some improvement, as noted in our Reports on Internal Control and Compliance with Laws and Regulations, and in the qualifying language of our opinion, continued focus within the Department on financial management is needed. The FY 2000 results were accomplished through considerable analysis, preparation and posting of numerous manual adjustments and manual and automated procedures to prepare financial statements. Sustained commitment to improving internal controls and systems will be needed to demonstrate progress in FY 2001 and beyond.

Observations

In your invitation for Ernst & Young to testify, you requested that we provide you with information on areas that may warrant further analysis and suggestions for additional work that could be performed concerning the Department's financial management. The items identified below are in addition to or an expansion of procedures that were performed as part of our audit.

- **Interim financial statements** – The Department has informed us that they intend to continue to prepare interim financial statements for fiscal years 2001 and beyond. We recommend that the Department consider conducting a review of the quarterly financial statements to provide early identification of departures from generally accepted accounting principles (GAAP), if any, that might impact the year-end financial statements, as well as any other issues that could be addressed on an interim basis. This practice of having the quarterly financial statements reviewed is followed by publicly-held companies. This recommendation is outside the scope of the annual financial statement audit that we have been engaged to perform, and therefore, does not encompass a review of interim financial statements in accordance with the AICPA Statement on Auditing Standards No. 71, *Interim Financial Information*.

- **Reinforce reconciliation efforts** – There are numerous reconciliations within the Department which should be performed on a periodic basis. As part of the interim financial statement reviews discussed above, the Department may benefit from having additional independent reviews of these reconciliations to improve the accuracy, completeness and timeliness of the reconciliations.
- **Study duplicate and improper payment issues** – The Department OIG and GAO have ongoing efforts to identify potential duplicate and/or improper payments in order to assess the need for additional controls to prevent occurrences of this nature in the future. Leveraging the independent reviews by the OIG and GAO to identify potential duplicate or improper payments and implementing any additional controls warranted as a result of these projects will aid in quantifying and resolving this critical area in safeguarding assets of the Department.
- **Inventory of Fixed Assets** – The Department has completed certain physical inventory activities for fixed assets. Upon completion of related reconciliation and research activities, an independent review of the inventory results could be performed

to ensure that the process provided a complete and reliable inventory and to assess the significance of any issues identified as a part of conducting the inventory.

- **Confirm Grant Data** – The Department may benefit from independent confirmations of financial data with grant recipients at the award level (such as available funds, obligations, and cash drawdowns). Confirmations would help ensure that the Departments records are in balance with internal records maintained by the grant recipients.
- **Review Subsidy Related General Ledger Accounts and Integration with the Subsidy Model.** – We recommend that detailed analysis of transactions flowing through the general ledger loan and subsidy related accounts and how they interact with the subsidy model be performed. An independent review of that process may facilitate a shared understanding of the roles of OCFO, SFA and Budget Services in analyzing the results of all aspects regarding the subsidy estimates, including cash flows projected and recorded from the loan programs.

We have noted in our audit reports a number of items where specific action can be taken by the Department to further improve its financial management. Two of the recommendations we emphasize are as follows:

- **Assess Organizational Structure** – We recommended that the Department assess the roles and responsibilities of each Departmental office (including OCFO, SFA, and Budget Service) involved with the financial reporting process to ensure that appropriate resources and tools are available to achieve the financial reporting objectives established by management. Such a review may include evaluating the recruiting, training and retention of accountants and financial management personnel.
- **Assess Financial System Requirements** – We recommended that the Department complete the implementation plan for the replacement of the general ledger software package and ensure that the transition will occur in a timely and documented manner. In addition, we recommended that the Department ensure that the new general ledger software package will meet its financial reporting needs. The Department will need to give consideration to both short-term and long-term needs.

Appendix A

Summary of Opinions Provided on the Financial Statements

In our Report on Independent Auditors, dated January 26, 2001, we rendered the following opinions:

Statement	Opinion
Balance Sheet	Qualified
Statement of Net Cost	Qualified
Statement of Changes in Net Position	Qualified
Statement of Budgetary Resources	Qualified
Statement of Financing	Qualified

Criteria for the Standard Audit Report and the Various Departures from the Standard Report

Unqualified Opinion

- The examination was conducted in accordance with generally accepted auditing Standards.
- The financial statements are fairly presented.

Unqualified Opinion

- The auditor refers to reliance on another independent auditor for performance of part of the audit.
- The auditor believes that departure from a promulgated accounting principle is justified to prevent a misleading statement.
- Consistency (change in accounting principle for which prior year financial statements are retroactively restated).
- The auditor emphasizes a matter.

Qualified Opinion

- Limitation on scope.*
- Departure from generally accepted accounting principles.*
- Consistency (change in accounting principle for which prior year financial statements are not restated).
- Uncertainty.*

* When one criterion is applicable to more than one type of report (e.g., limitation on scope – qualified or disclaimer, departure from GAAP – qualified or adverse), the materiality of the item should determine the type of opinion.

Appendix A

Adverse Opinion

- Departure from generally accepted accounting principles. *

Disclaimer of Opinion

- Limitation of scope.*
- Uncertainty.*
- Auditor not independent.

* When one criterion is applicable to more than one type of report (e.g., limitation on scope – qualified or disclaimer, departure from GAAP – qualified or adverse), the materiality of the item should determine the type of opinion.

Appendix B

Summary of Fiscal Year 2000
Report on Internal Controls

The chart below summarizes the current status of the prior year weaknesses, as well as any new weaknesses identified during the fiscal year 2000 audit

	Issue Area (and classification in 1999)	Summary Control Issues	FY 2000 Status
1.	Financial Management Systems and Financial Reporting Needs to Be Strengthened (Material Weakness)	Significant weaknesses in the Department's financial reporting processes existed as a result of the EDCAPS general ledger software package, Financial Management System Software (FMSS).	Improvement Noted – Repeat Condition Material Weakness
2.	Reconciliations Need to Be Improved (Material Weakness)	The Department did not perform proper or timely reconciliations of its financial accounting records.	Improvement Noted – Repeat Condition Material Weakness
3.	Controls Surrounding Information Systems Need Enhancement (Material Weakness)	Improvements are required in security over financial systems and in disaster recovery capabilities.	Improvement Noted – Repeat Condition Material Weakness
4.	Improvement of Credit Reform Reporting is Needed (Material Weakness)	The Department needs to improve management controls surrounding the calculation and reporting of loan liability activity and subsidy of estimates.	Improvement Noted – Considered a Reportable Condition
5.	Documentation Supporting Liabilities/Obligations was Insufficient (Reportable Condition)	The Department was unable to readily provide listings of outstanding accounts payable and accrued liabilities, as well as sufficient supporting documentation.	Not Considered Reportable Condition – Issues Reported in the Management Letter.
6.	Communication and Coordination Efforts Need to be Improved for Financial Management (Reportable Condition)	The Department did not adequately coordinate among offices to ensure responsibilities specific to financial reporting and support needed from the offices was sufficiently communicated.	Not Considered a Separate Reportable Condition. Integrated within other internal control issues as appropriate.
7.	Documentation Supporting Accounts Payable, Accrued Liabilities and Expenditures Needs to be Improved (Reportable Condition)	The Department needs to improve its efforts in maintaining and providing supporting documentation for accounts payable and expenditures.	Not Considered Reportable Condition – Issues Reported in the Management Letter.
8.	Reporting and Monitoring of Property and Equipment Needs to be Improved (Reportable Condition)	The Department needs to improve its reporting and monitoring of property and equipment.	Improvement Noted – Repeat Condition Reportable Condition

Reportable Condition - Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of internal control that, in our judgment, could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

Material Weakness - A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

ERNST & YOUNG LLP

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April 3, 2001

Honorable Pete Hoekstra
Chairman
The Subcommittee on Select Education
of the Committee on Education and the Workforce
Washington, DC 20515-6100

Dear Mr. Hoekstra:

I am submitting the following pursuant to the "Truth and Testimony" required by House Rule XI, Clause 2(g). My name is Daniel J. Murrin.

The Office of Inspector General, Department of Education, contracted with Ernst & Young LLP to conduct the fiscal year 2000, 1999 and 1998 financial statement audits. We are not representing any other governmental entity or any other private entity at this hearing.

As indicated in my resume, I am the partner on the following Federal government contracts:

- Department of Education
- U.S. Postal Service
- National Institutes of Health
- Centers for Disease Control
- Health Care Financing Administration
- Federal Communications Commission

On a separate note, Ernst & Young, for which I am a member of the partnership, also conducts a number of audit and advisory engagements in the Federal government arena.

I hope this letter satisfies the requirements of the Truth and Testimony. If you have any questions or we need to supply further information, please contact Mr. Lani Eko at (202) 327-6653.

Sincerely,

Daniel J. Murrin
National Director of Public Sector Services

Daniel J. Murrin
Ernst & Young LLP, National Director of Public Sector Services

A partner, certified public accountant and certified government financial manager, Dan has over 20 years of experience in the public sector arena. Prior to his return to Ernst & Young in October 1992 as a Partner, Dan was a Professional Accounting Fellow at the GAO for two years. His leadership in the implementation of government auditing standards and the CFO's Act is recognized in the federal financial management community. Dan has conducted courses in implementing the CFO's Act for GAO, the Association of Government Accountants Research and Education Foundation and Ernst & Young.

Mr. Murrin is a frequent speaker on issues impacting the public sector and serves on the Board of Governors of the Greater Washington Society of Certified Public Accountants and as the chair of the AGA National Research and Education Advisory Committee. He received his B.S. in Economics with highest honors from the Wharton School at the University of Pennsylvania.

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