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United States General Accounting Office
Washington, DC 20548

October 16, 2000

The Honorable John R. Kasich
Chairman, Committee on the Budget
House of Representatives

The Honorable Judy Biggert
House of Representatives

Subject: Department of Education: Status of Financial Management Weaknesses Reported in the Fiscal Year 1999 Financial Statement Audit

In response to your request and subsequent discussions with your offices, this letter analyzes the Department of Education's financial management weaknesses, which have been identified through the annual audit of Education's financial statements. You asked that we (1) analyze Education's financial management weaknesses in the context of possible program and budgetary implications based on the results of the audit of its fiscal year 1999 financial statements, (2) identify Education's corrective actions to address reported weaknesses, and (3) explain how Education prepared reliable fiscal year 1997 cost estimates for its loan programs and resolved the related reported material weakness in fiscal year 1998.

Education is the primary agency responsible for overseeing the more than $75 billion annual federal investment in support of educational programs for U.S. citizens and eligible noncitizens. Education is also responsible for collecting about $175 billion owed by students. In fiscal year 1999, more than 8.1 million students received over $53 billion in federal student financial aid through programs administered by Education.

Results in Brief

Education's fiscal year 1999 financial statement audit results disclosed continuing financial management weaknesses that prevented the agency from receiving a "clean" audit opinion. Four of the eight reported financial management weaknesses were classified as material internal control weaknesses.[1] These weaknesses existed generally because Education lacked an effective system of internal controls. An effective internal control system provides the framework for the accomplishment of

[1]A material internal control weakness is a reportable condition in which one or more of the internal controls does not reduce to a relatively low level the risk that errors, fraud, or noncompliance involving significant amounts may occur and not be detected in a timely manner by employees in the normal course of performing their assigned functions.

management objectives, accurate financial reporting, and compliance with laws and regulations. In addition, effective internal controls serve as checks and balances against undesired actions and, as such, provide reasonable assurance that agencies operate in a sound manner. The lack of good internal controls puts Education at risk of mismanagement, waste, fraud, and abuse.

The specific material internal control weaknesses cited by the independent auditors in its fiscal year 1999 audit deal with (1) the inability of the accounting system to perform a year-end closing process or produce automated consolidated financial statements, (2) the lack of proper or timely reconciliations of accounting records, (3) inadequate controls over information systems, including access to sensitive information, and (4) failure to transfer certain Federal Family Education Loan Program (FFELP)[2] unobligated balances to Treasury in accordance with the Federal Credit Reform Act of 1990 (FCRA).

Corrective actions undertaken by Education in response to these financial management weaknesses indicate that it is making progress in working towards financial accountability. Key corrective actions initiated in response to the material financial management weaknesses identified in its fiscal year 1999 financial statement audit include purchasing a new general ledger system, acquiring a software tool to help automate the reconciliation process, improving computer controls, and establishing a process to transfer certain excess FFELP funds to Treasury. Also, although the financial management weaknesses identified in its fiscal year 1999 audit are serious, it should nevertheless be recognized that in fiscal year 1999 Education made progress over fiscal year 1998 in terms of the audit opinion received. In fiscal year 1999, Education's auditors issued qualified opinions on four of the agency's five required financial statements and a disclaimer of opinion on the fifth statement, whereas Education had received a disclaimer on its fiscal year 1998 financial statements.[3]

Education's financial reporting weaknesses can be attributed primarily to several limitations of a new accounting system that Education implemented during fiscal year 1998. A significant limitation of the new accounting system was its general ledger system,[4] which, among other problems, was unable to perform an automated year-end closing process and directly produce consolidated financial statements, as required by Office of Management and Budget (OMB) Circular A-127 pursuant to the

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[2]FFELP (formerly known as the Guaranteed Student Loan Program) operates with state and private nonprofit guaranty agencies to provide loan guarantees and interest supplements through permanent budget authority on loans provided by private lenders to eligible students attending participating postsecondary schools.

[3]The auditor issues a disclaimer when a pervasive material uncertainty exists or there is a significant restriction on the scope of the audit. The auditor issues a qualified opinion when he/she concludes that the financial statements are fairly stated except for one of the following conditions for one or more major accounts: (1) limitation on audit scope, (2) failure to follow generally accepted accounting principles, and (3) uncertainty over whether certain information was fairly presented.

[4]A general ledger system provides a standard chart of accounts for recording financial transactions.

Federal Financial Management Improvement Act of 1996 (FFMIA).[5] Because of these weaknesses, Education had to resort to a costly, labor-intensive, and time-consuming process involving automated and manual procedures to prepare financial statements for fiscal year 1999.

Education's account reconciliation problems involved its Fund Balance with Treasury accounts and certain grant accounts.[6] There are many underlying reasons for these problems, including formal reconciliation procedures not being performed adequately or promptly throughout fiscal year 1999. For fiscal year 1999, Education adjusted its Fund Balance with Treasury account to agree with Treasury's records by a net amount of about $244 million without determining the causes of the differences. In other words, Education simply forced its records to agree with Treasury's records. Education had not been able to identify and resolve differences between its financial accounting records and cash transactions reported by Treasury. 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 disbursement 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, and mismanagement of government funds.

Education also did not perform routine reconciliations of its grant payments system with the general ledger. The auditors noted that reconciliations were not routinely performed because Education had not developed adequate policies and procedures for doing so. As a result, there was increased risk that material errors or irregularities could occur and not be detected on a timely basis. In addition, while no instances of improper payments were identified, we reported in August 2000[7] that there was increased risk of fraud, waste, and mismanagement of Education grant funds as a result of financial management system deficiencies, inadequate systems of funds control, internal control weaknesses, and the inappropriate manner in which the agency used one of its deposit funds. (This deposit fund, called the grantback account, was established to retain availability of funds needed to make grantback

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[5]FFMIA requires auditors for each of the 24 major departments and agencies named in the Chief Financial Officers Act of 1990 to include in their audit reports on the agencies' annual financial statements information to indicate whether the agencies' financial management systems comply with three requirements: (1) federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the *U.S. Government Standard General Ledger* (SGL) at the transaction level.

[6]Education records its budget authority in asset accounts called Fund Balance with Treasury and increases or decreases these accounts as it collects or disburses funds.

[7]*Financial Management: Review of Education's Grantback Account* (GAO/AIMD-00-228, August 18, 2000).

payments and account for grantback activity.[8]) For example, we found that beginning in 1993, Education inappropriately used the grantback account as a suspense account[9] for hundreds of millions of dollars of activity related to grant reconciliation efforts affecting its appropriations that fund grants. We made a series of recommendations which Education has targeted for implementation by November 2000.

In fiscal year 1999, Education's auditors also reported that Education had serious computer security deficiencies in (1) implementing user management controls, such as procedures for requesting, authorizing, and revalidating access to computing resources, (2) monitoring and reviewing access to sensitive computer resources, (3) documenting the approach and methodology for the design, selection, and maintenance of its information technology architecture, and (4) developing, documenting, and testing a comprehensive disaster recovery plan to ensure the continuity of critical information system operations in the event of disaster. Continued weaknesses in computer systems controls increase the risk of unauthorized access to or disruption of services and make Education's sensitive grant and loan data vulnerable to inadvertent or deliberate misuse, fraudulent use, improper disclosure, or destruction, which could occur without being detected.

In addition, during fiscal year 1999, Education did not transfer about $2.7 billion in unobligated balances in its liquidating account for FFELP loans to Treasury's general fund as required by FCRA. Further, Education did not sufficiently analyze the balances reflected on the financial statements to ensure that the FFELP balances agreed with relevant balances in the department's budgetary accounts. The auditors identified an unexplained difference of about $700 million for the liquidating account between the FFELP and budgetary accounts as of September 30, 1999. Because it did not properly account for and analyze its FFELP transactions and properly reconcile related accounting and budgetary accounts consistent with FCRA, Education could not be assured that its financial or budgetary reports were accurate.

Education has taken the need to improve its financial management systems and practices seriously and initiated various corrective actions in response to the material financial management weaknesses identified in its fiscal year 1999 financial statement audit. For example:

- In response to financial reporting weaknesses, Education is purchasing a new general ledger system. It plans to fully implement the new general ledger system

[8]If audits of grant recipients identify certain noncompliance, recipients must repay Education the amount related to the noncompliance. For some grant programs, if the grant recipient meets certain conditions, including correcting the noncompliance, Education may return up to 75 percent of the amounts recovered (referred to as grantback payments).

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

by August 2001 and to eliminate the current general ledger system by January 2002. Also, it is now using a new reporting tool to automatically produce all of its financial statements.

- In response to the auditors' findings on reconciliation weaknesses, Education has purchased a software tool to help enhance its ability to reconcile its account balances with the corresponding Treasury account balances on a monthly basis. In addition, in response to the auditors' finding of inadequate reconciliation of grant expenditures, Education has now developed policies and procedures to reconcile grant expenditures to the general ledger. According to Education officials, Education is in the final stages of reconciling its payments system to its general ledger system.

- In response to the information systems control weaknesses, Education officials stated that the department has developed and implemented a formal approach and methodology for designing and maintaining an entitywide security program technology architecture and has updated its security policies and procedures for its financial management systems to ensure that changing system security needs are reflected, access authorizations are documented, and access rights are revalidated periodically.

- In response to inadequate accounting for FFELP guaranteed loans, Education transferred the $2.7 billion to the Treasury in February 2000. Education officials stated that they believe the noncompliance with FCRA issue will be resolved for the fiscal year 2000 audit because they have developed and implemented detailed policies and procedures for transferring excess funds to the Treasury.

The effectiveness of these corrective actions will be determined as part of the fiscal year 2000 financial statement audit.

In fiscal year 1996 and in prior years, auditors had reported a material weakness relating to the preparation of reliable cost estimates for Education's loan programs. Federal accounting standards state that actual and expected costs of federal credit programs should be fully recognized in both budgetary and financial reporting. The primary deficiency cited by the auditors was that Education was not able to obtain complete and accurate student loan data from its systems to support its loan subsidy estimates. To address this deficiency, Education developed a temporary solution for fiscal year 1997 by using external loan data obtained from 10 of the larger federal student loan guaranty agencies.[10] By fiscal year 1998, Education had made significant progress in improving loan data quality in its National Student Loan Data System

[10]These agencies are state or private nonprofit entities that act as intermediaries between the government and the lender. They are responsible for reviewing student applications and approving loans, reviewing and paying claims to lenders when defaults occur, and collecting on defaulted loans.

(NSLDS)[11]–the basic source of historical data used to prepare loan liability estimates–by, among other things, performing reconciliations with guaranty agency systems data, improving data edits, ensuring complete data, and requiring audits of guaranty agency data submissions. Consequently, for fiscal year 1998, the auditors removed the material internal control weakness relating to the preparation of loan liability estimates from their audit report.

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 judgments to be used for day-to-day management and oversight. While Education has planned and begun implementing many actions to resolve its financial management problems, it is too early to tell how successful it will be. It is critical that Education rise to the challenges posed by its financial management weaknesses because its success in achieving all aspects of its strategic goals depends in part upon reliable financial management information and effective internal controls.

In commenting on a draft of this report, Education officials agreed that the draft accurately described the material internal control weaknesses discussed in the audit report on Education's fiscal year 1999 financial statements. However, the officials felt that the draft did not adequately reflect the extent of corrective actions that they have undertaken to improve the department's financial management. We have included in the report additional information on Education's efforts to correct its financial management weaknesses and recognized that Education has taken a number of steps to implement corrective actions. Whether these actions have been successful in addressing the reported weaknesses will be determined through the fiscal year 2000 financial statement audit, which is expected to be completed by no later than March 1, 2001.

Education officials also stated that they believed the report would be more balanced if it included discussion of the findings and conclusions included in several other GAO reports regarding various grant programs that suggest that the agency had followed sound financial management practices for those programs.[12] However, the issues discussed in those reports, and many others that GAO has issued on Education's various program activities, are beyond the scope of this audit, which focuses on the status of financial management weaknesses reported as part of the fiscal year 1999 financial statement audit.

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[11]NSLDS is a national database of individual loan-level information and grant data on aid disbursed under Title IV of the Higher Education Act of 1965, as amended. NSLDS contains data on the FFELP, Federal Direct Loan Program (FDLP), Perkins Loans, Federal Pell Grant Program, and overpayments from the Federal Supplemental Educational Opportunity Grant Program. These data are provided by guaranty agencies, schools, the FDLP servicer, and the department's Title IV systems.

[12]*Federal Education Funding Allocation to State and Local Agencies for 10 Programs* (GAO/HEHS-99-180, September 30, 1999) and *Education Discretionary Grants: Awards Process Could Benefit from Additional Improvements* (GAO/HEHS-00-55, March 30, 2000).

Background

Over the past 10 years, dramatic changes have occurred in federal financial management in response to comprehensive management reform legislation designed to provide a critical link between budgeting, financial reporting, and performance measurements. Specifically, the combination of reforms ushered in by (1) the Chief Financial Officers (CFO) Act of 1990, (2) the Government Management Reform Act of 1994, (3) FFMIA, (4) the Government Performance and Results Act of 1993 (GPRA), and (5) the Clinger-Cohen Act of 1996 will, if successfully implemented, provide the necessary foundation to run an effective, results-oriented government. Efforts to continue building the foundation for generating accurate financial information through lasting financial management reform are essential. Only by generating reliable and useful information can government agencies such as Education ensure adequate accountability to taxpayers, manage for results, and help decisionmakers reach timely, well-informed judgments.

OMB's implementation guidance for audited financial statements requires Education and other major federal agencies to receive three reports from its auditors annually: an opinion or report on its financial statements, a report on its internal controls, and a report on its compliance with laws and regulations. In understanding Education's financial management weaknesses and their program and budgetary implications, the independent auditors' report on internal controls is particularly important because it highlights the agency's material internal control weaknesses that increase its risk of mismanagement that can sometimes result in waste, fraud, and abuse.

Since the first agencywide financial audit for fiscal year 1995, Education's auditors have each year reported largely the same serious internal control weaknesses, which have affected its ability to provide reliable financial information to decisionmakers both inside and outside the agency. In both fiscal years 1995 and 1996, Education's auditors issued a disclaimer of opinion on the agency's financial statements—meaning that they were unable to express an opinion--due primarily to a material internal control weakness involving the lack of reliable and complete NSLDS data supporting the estimates of its loan guarantee liability. In fiscal year 1997, Education overcame this barrier and received an unqualified opinion. However, Education's auditors continued to report material internal control weaknesses. Education received another disclaimer of opinion for fiscal year 1998 due primarily to serious problems with its newly implemented accounting system.[13] Furthermore, Education issued its fiscal year 1998 financial statements more than 8 months after the March 1 statutory deadline. In fiscal year 1999, Education made progress over fiscal year 1998 when its auditors issued qualified opinions on four of the agency's five required financial statements and a disclaimer of opinion on the fifth statement. However, although progress was made, Education's auditors continued to report material

[13]Education operated under a new accounting system, Education's Central Automated Processing System, in fiscal year 1998.

internal control weaknesses in their audit report on the fiscal year 1999 financial statements.

Education provides grants for various education programs, such as postsecondary, special education, and vocational programs and has over 16,000 grant recipients. Grant recipients meeting certain thresholds are required by law to have single audits[14] or other audits (such as those that Education might perform itself). If these audits identify instances of noncompliance, grant recipients must repay Education the amount related to the noncompliance. However, for some grant programs, if the grant recipient meets certain conditions, including correcting the noncompliance, Education may return up to 75 percent of the amounts repaid in the form of a "grantback" payment to the recipient. Any remaining funds are to be returned to Treasury. Education established a deposit fund to retain amounts needed to make grantback payments to grant recipients and referred to it as the grantback account.

Scope and Methodology

To analyze Education's financial management weaknesses, we reviewed Education's fiscal year 1999 audit reports issued by its independent auditors and focused on the four material internal control weaknesses cited in its Report on Internal Controls. In addition, we identified internal control standards in our *Standards for Internal Control in the Federal Government*[15] and audit guidance for CFO agencies' financial statements issued by OMB.[16] To develop information on possible program and budgetary implications, we interpreted the results of Education's fiscal year 1999 audit reports, reviewed federal guidance for audited financial statements, and reviewed the independent auditors' report and workpapers. We also reviewed numerous reports we issued during the last few years that discuss governmentwide financial management weaknesses, such as information security problems, similar to those existing at Education.

To identify Education's corrective actions, we obtained and reviewed Education's corrective action plan, dated October 2, 2000, and interviewed Education officials about the current status of these corrective actions to resolve the reported weaknesses. However, as part of our review, we did not assess the effectiveness of these corrective actions, which will be assessed as part of the audit of Education's fiscal year 2000 financial statements. To assess how Education resolved past reported weaknesses in developing its loan liability estimates, we reviewed the audit reports from fiscal year 1995 through fiscal year 1999 and related GAO and Inspector General (IG) reports, and interviewed Education officials.

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[14]Single audits include tests of grant recipients' compliance with requirements that have a direct and material effect on a major program. A major program is a federal program identified in accordance with risk-based criteria prescribed by OMB. Single audits are performed of states, local governments, and nonprofit organizations that expend federal grants.

[15]GAO/AIMD-00-21.3.1, November 1999.

[16]*Audit Requirements for Federal Financial Statements*, OMB Bulletin No. 98-08, as amended, January 25, 1999.

We performed our review in Washington, D.C., between August 2000 and mid-October 2000 in accordance with generally accepted government auditing standards.

<u>Reported Material Financial Management Weaknesses Have Potential Program and Budgetary Implications</u>

Education's fiscal year 1999 financial statement audit results disclosed continuing financial management weaknesses that prevented the agency from receiving an unqualified audit opinion. Four of the eight reported financial management weaknesses were classified as material internal control weaknesses. A material internal control weakness is a reportable condition in which one or more of the internal controls does not reduce to a relatively low level the risk that errors, fraud, or noncompliance involving significant amounts may occur and not be detected in a timely manner by employees in the normal course of performing their assigned functions. The specific material internal control weaknesses cited by the independent auditors were (1) weaknesses in the financial reporting process, (2) inadequate reconciliations of financial accounting records, (3) inadequate controls over information systems, and (4) failure to transfer funds related to certain loan collections to Treasury in accordance with FCRA. The first three material weaknesses were also reported in the fiscal year 1998 report on internal controls. The fourth weakness was new for fiscal year 1999.

These weaknesses existed because Education's financial systems lacked strong internal controls, including appropriate policies and procedures. The CFO Act of 1990 calls for financial management systems to comply with internal control standards issued by GAO. Our *Standards for Internal Control in the Federal Government* states that internal control is an integral component of an agency's management that provides reasonable assurance that the following objectives are being achieved: (1) effectiveness and efficiency of operations, (2) reliability of financial reporting, and (3) compliance with applicable laws and regulations. Furthermore, the Federal Managers' Financial Integrity Act requires agency managers to conduct regular evaluations of management controls with special attention to accounting systems.

Education's financial management system problems and its range of internal control weaknesses hamper its ability to generate reliable, useful, and timely information on an ongoing basis to ensure accountability to taxpayers. Without strong internal controls, Education is also challenged in carrying out its responsibilities to manage for results and help congressional and program decisionmakers make timely and well-informed judgments. Internal control serves as the first line of defense in safeguarding assets and in helping to detect and prevent waste, fraud, and abuse. As federal policymakers and program managers continually seek to better achieve agencies' missions and program results, they seek ways to improve accountability. A key factor in achieving these outcomes and minimizing operational problems is the implementation of appropriate internal control.

Summaries of the material internal control weaknesses reported in fiscal year 1999 along with our analysis of the program and budgetary implications of these weaknesses follow. We provided similar information in our testimony before the Subcommittee on Oversight and Investigations, House Committee on Education and the Workforce in September 2000.[17]

Financial Reporting Weaknesses

For fiscal year 1999, as in prior years, Education did not have adequate internal controls over its financial reporting process. Education's financial reporting weaknesses can be attributed primarily to several limitations of a new accounting system that Education implemented during fiscal year 1998. A significant limitation of the new accounting system was its general ledger system, which was unable to perform an automated year-end closing process and directly produce consolidated financial statements, as required by OMB Circular A-127[18] pursuant to FFMIA.[19] Because of these weaknesses, Education had to resort to a costly, labor-intensive, and time-consuming process involving automated and manual procedures to prepare financial statements for fiscal year 1999. Specifically, Education used a software package that interfaced with the general ledger to produce financial reports by reporting group, transferred these reports to manual spreadsheets, and made numerous year end adjusting and closing entries to produce its consolidated financial statements for the department. Education will continue to experience difficulties in preparing timely, accurate financial statements until it successfully completes its efforts to improve its financial reporting process.

In one instance, Education's financial statements included a balance of approximately $7.5 billion for its cumulative results of operations. However, the majority of this amount, which pertains to FFELP, should have been reported as an amount to be transferred to Treasury rather than as cumulative results of operations. As a result of the independent auditors' work, the accounting records had to be adjusted to reflect the proper amount to be transferred to Treasury. However, after adjusting the accounting records, $800 million still remained in cumulative results of operations for which Education was unable to provide adequate support. When financial reporting errors like this occur and are not detected by Education's controls, there are increased risks that Education could inappropriately spend or retain funds that should be transferred to Treasury. However, we are not aware of any instances where Education spent funds that should have been transferred to Treasury. According to Education officials, the department has analyzed the

[17]*Financial Management: Financial Management Challenges Remain at the Department of Education* (GAO/T-AIMD-00-323, September 19, 2000).

[18]OMB Circular A-127, *Financial Management Systems*, references the series of publications, entitled Federal Financial Management Systems Requirements, issued by the Joint Financial Management Improvement Program as the primary source of governmentwide requirements for financial management systems.

[19]See footnote 5.

$800 million and determined the proper balance for the account. The department's analysis will be subject to testing during the fiscal year 2000 financial statement audit.

Education's approach of using various automated and manual tools to work around the accounting system's limitations in order to prepare annual financial statements is not consistent with the CFO Act's ultimate goal of federal financial systems that can generate reliable, timely information.

Inadequate Reconciliations

Education did not properly or promptly reconcile certain of its financial accounting records during fiscal year 1999 and could not provide sufficient documentation to support some of its financial transactions. There are many underlying reasons for Education's reconciliation difficulties, including inadequate reconciliation policies and procedures.

Weaknesses in Education's internal controls over the reconciliation process prevented timely detection and correction of errors in its underlying accounting records. Without reliable and timely data in its accounting records, the risk of fraud, waste, and mismanagement of funds is increased.

Education's financial statement auditors and we have reported instances in which Education adjusted its general ledger to reflect the balance in detailed records, without sufficiently researching the cause for differences. Examples related to Education's Fund Balance with Treasury accounts, grant expenditures, and grantback account are discussed below, along with program and budget implications.

Implications of Inadequate Reconciliations of Fund Balance With Treasury Accounts

As indicated in prior audits, Education has not been able to identify and resolve differences between its financial accounting records and cash transactions reported by Treasury. 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. For example, for fiscal year 1999, Education arbitrarily adjusted its Fund Balance with Treasury accounts, due to a difference between its general ledger and Treasury records, by a net amount of about $244 million. Education simply changed its records to agree with Treasury balances without determining the causes of the differences. Because Education had not been performing periodic reconciliations and discerning reasons for differences between its and Treasury's records on an ongoing basis, it could not determine which records, if any, were correct and relied only on Treasury's records. Until this problem is corrected, the integrity of certain of Education's financial data is questionable.

Because most assets, liabilities, revenues, and expenses stem from or result in cash transactions, errors in the receipt or disbursement data can 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, and mismanagement of government funds. Inaccurate receipt and disbursement data not identified as a result of timely reconciliations also can limit Education's overall ability to accurately measure the cost of its programs.

Implications of Inadequate Reconciliation of Grant Expenditures

Education did not perform routine reconciliations of its grant payments system with the general ledger. In its report on Education's fiscal year 1999 financial statements, the auditors stated that during their testing of grant expenditures, they found that Education had not performed this routine reconciliation process. The auditors noted that reconciliations were not performed because Education had not developed adequate policies and procedures for reconciling grant expenditures between its payments system and its general ledger system. As a result, there is increased risk that material errors or irregularities could occur and not be detected on a timely basis. This risk is significant to Education because it processes over $30 billion in grant transactions annually.

Given the high-dollar volume of grant transactions and the lack of adequate policies and procedures specific to the reconciliation of grant expenditures, the risk that material errors or irregularities could occur and not be detected on a timely basis increases significantly. Without reliable, useful, and timely information on grant transactions, program managers run the risk of making duplicate payments to grant recipients, not becoming aware on a timely basis of these payments, as well as unusual or questionable grant activity, and not making informed decisions on the best use of grant funds. Furthermore, the possibility of collecting duplicate payments declines as time passes and they remain uncollected.

Data on duplicate payments for fiscal years 1998 and 1999, provided to us by Education's CFO office, showed $47.5 million in duplicate payments in fiscal year 1998 and $566,403 in fiscal year 1999. These duplicate payments, including those identified by grant recipients, could have been identified earlier by Education if it had performed proper reconciliations. In addition, the department has reported as duplicate payments for fiscal year 2000 about $150.7 million, primarily to grantees. These duplicate payments were caused by manual and data input processing errors. Until Education implements an improved reconciliation process, exposure to these types of errors will continue. The IG stated that all of these duplicate payments have now been recovered by the department.

Implications of Weaknesses in Controls Over Education's Grantback Account

In our recent review of Education's grantback account, which is one of Education's Fund Balance with Treasury accounts, we found that Education had used this account to, among other things, clear unreconciled differences in other grant appropriation fund balance accounts and adjust certain appropriation fund balance accounts to ensure that they did not have negative balances. We reported in August

2000[20] that there is increased risk of fraud, waste, and mismanagement of grant funds as a result of financial management system deficiencies, inadequate systems of funds control, internal control weaknesses, and the inappropriate manner in which the grantback account was used.

Although the grantback account was established to account for grantback activities, we reported that about 95 percent of the activity in the account for fiscal years 1993 through 1999 was unrelated to such activities. While no instances of improper payments were identified, we found that beginning in 1993, Education used the grantback account as a suspense account for hundreds of millions of dollars of activity related to grant reconciliation efforts affecting its appropriations that fund grants. We also found that Education did not maintain adequate detailed records for certain grantback account activity by the applicable fiscal year and appropriation that would allow it to promptly investigate the activity so that it could transfer improperly recorded transactions to the proper accounts. Education's independent auditors similarly reported in fiscal years 1998 and 1999 that Education could not readily determine to which appropriations the amounts in the grantback account belonged. Detailed records are needed to have an adequate system of funds control and help prevent Anti-Deficiency Act violations.[21]

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

In our August 2000, report we made a series of recommendations to improve accounting for grantback funds. Education stated that it has prepared a detailed plan to address our recommendations.

<u>Inadequate Information System Controls</u>

In fiscal year 1999, Education's auditors reported that Education had information systems control deficiencies in (1) implementing user management controls, such as

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[20]GAO/AIMD-00-228, August 18, 2000.

[21]Anti-Deficiency Act violations include the obligation or expenditure of amounts exceeding the amount available in an appropriation or fund account.

procedures for requesting, authorizing, and revalidating access to computing resources, (2) monitoring and reviewing access to sensitive computer resources, (3) documenting the approach and methodology for the design and maintenance of its information technology architecture, and (4) developing and testing a comprehensive disaster recovery plan to ensure the continuity of critical system operations in the event of disaster.

Education relies significantly on its financial management systems to perform basic functions, such as making payments to grantees and maintaining budget controls. Consequently, continued weaknesses in information systems controls increase 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.

The information systems weaknesses highlight some of the computer security vulnerabilities, such as the lack of an effective process to monitor security violations on all of the Department's critical systems. A report issued by the department's IG in February[22] emphasizes the need for the department to focus on addressing its computer security vulnerabilities. In addition, earlier this year, the White House recognized the importance of strengthening the nation's defenses against threats to public and private sector information systems that are critical to the country's economic and social welfare when it issued its National Plan for Information Systems Protection.[23] In the aftermath of the attack by the "ILOVEYOU" virus, which disrupted operations at large corporations, governments, and media organizations worldwide, we testified[24] about the need for federal agencies to promptly implement a comprehensive set of security controls. We also recently reported[25] on the results of information security audits at federal agencies that show that federal computer systems are riddled with weaknesses that continue to put critical operations and assets at risk. These types of concerns led us, in 1997 and 1999 reports to the Congress, to identify information security as a high-risk issue.[26]

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[22] *Review of Security Posture, Policies, and Plans* (ED-OIG/A11-90013, February 2000).

[23] *Defending America's Cyberspace: National Plan for Information Systems Protection: Version 1.0: An Invitation to a Dialogue*, released January 7, 2000, the White House.

[24] *Critical Infrastructure Protection: "ILOVEYOU" Computer Virus Highlights Need for Improved Alert and Coordination Capabilities* (GAO/T-AIMD-00-181, May 18, 2000) and *Information Security: "ILOVE YOU" Computer Virus Emphasizes Critical Need for Agency and Governmentwide Improvements* (GAO/T-AIMD-00-171, May 10, 2000).

[25] *Computer Security: Critical Federal Operations and Assets Remain at Risk* (GAO/T-AIMD-00-314, September 11, 2000) and *Information Security: Serious and Widespread Weaknesses Persist at Federal Agencies* (GAO/AIMD-00-295, September 6, 2000).

[26] *High-Risk Series: Information Management and Technology* (GAO/HR-97-9, February 1, 1997) and *High-Risk Series: An Update* (GAO/HR-99-1, January 1999).

Inadequate Accounting for FFELP Loans

During fiscal year 1999, Education did not transfer unobligated balances in its liquidating account for FFELP loans to Treasury's general fund as required by FCRA.[27] Specifically, it did not return about $2.7 billion in net collections specific to its FFELP liquidating account to Treasury until February 2000. The liquidating account includes transactions for loans that originated prior to fiscal year 1992. Any unobligated balances in this account at fiscal year-end are unavailable for obligation in subsequent fiscal years and must be transferred to the general fund. Further, Education did not sufficiently analyze the balances reflected on the financial statements to ensure that the FFELP balances agreed with relevant balances in the department's budgetary accounts. As a result, the auditors stated that an unexplained difference of about $700 million existed between the FFELP liquidating account and the related budgetary accounts as of September 30, 1999. According to Education officials, the department has analyzed the $700 million unexplained difference and determined the proper balance for the accounts; however, we have not reviewed the adequacy of the department's analysis.

Because it did not properly account for and analyze its FFELP transactions and properly reconcile related accounting and budgetary accounts consistent with FCRA, Education could not be assured that its financial or budgetary reports were accurate. This lack of assurance that the financial or budgetary reports are accurate diminishes the potential that these reports will help the Congress and others determine how Education spent program funds.

Education Is Taking Actions to Correct Material Internal Control Weaknesses

Each year, following receipt of the annual auditors' report on the results of its financial statement audit, Education prepares a corrective action plan that is updated periodically throughout the year to address each reported financial management weakness and related recommendation by listing a proposed action for resolving the weakness. Education then provides its corrective action plan to the department's IG for review and concurrence. On October 2, 2000, as we were completing our fieldwork, Education submitted an updated fiscal year 1999 corrective action plan to the IG. Education told us that it had carried out the majority of the corrective actions. However, whether the corrective actions are sufficient to resolve Education's material internal control weaknesses will not be determined until the independent auditing firm assesses the effectiveness of these corrective actions as part of its audit of Education's fiscal year 2000 financial statements.

The following sections describe Education's planned and completed corrective actions for resolving the four material internal control weaknesses.

[27]The FFELP liquidating account includes collections from borrowers received by Education on defaulted guaranteed loans made prior to the effective date of the requirements of FCRA.

Actions to Address Financial Reporting Weaknesses

Education officials told us that they have taken actions to address all of the auditors' recommendations related to financial reporting weaknesses. Specifically, the auditors recommended that Education develop an implementation plan to replace the general ledger, ensure comprehensive reviews of the financial statements, update policies and procedures for generating trial balances and financial statements, update policies and procedures for preparing and reviewing adjustments, provide appropriate training to those individuals responsible for preparing and reviewing the adjustments, and ensure that unobligated balances in the liquidating account for FFELP loans are transferred to the U. S. Treasury in accordance with FCRA. Education has purchased a new general ledger system that it plans to fully implement by August 2001 and to eliminate the current general ledger system by January 2002. To facilitate the fiscal year 2000 consolidated audit, Education officials told us they prepared, analyzed, and provided to its auditors interim financial statements as of March 31, 2000, and June 30, 2000, using a new reporting tool that enables it to automatically produce financial statements from its existing reporting system.

Actions to Address Inadequate Reconciliation of Financial Accounts

In response to the auditors' findings, Education has purchased a software tool to help enhance its ability to reconcile its account balances with the corresponding Treasury account balances on a monthly basis. Education has also developed Web-based policies and procedures for reconciling its material accounts and programs. Additionally, in response to the auditors' finding of inadequate reconciliation of grant expenditures, Education has now developed policies and procedures to reconcile grant expenditures to the general ledger. According to Education officials, Education is in the final stages of reconciling its payments system to its general ledger system. With regard to the grantback account issues, Education advised that it has developed a detailed plan to address the recommendations made in our August 2000 report and expects to complete implementation of our recommendations by November 2000.

Actions to Address Inadequate Controls over Information Systems

According to Education officials, the department has developed and implemented a formal approach and methodology for designing and maintaining an entitywide security program technology architecture and has updated its security policies and procedures for its financial management systems to ensure that changing system security needs are reflected, access authorizations are documented, and access rights are revalidated periodically. The department informed us that it is finalizing a disaster recovery plan for Education's Central Automated Processing System, the accounting system Education implemented in fiscal year 1998.

Actions to Address Inadequate Accounting for FFELP Guaranteed Loans

Education returned the $2.7 billion to the Treasury in February 2000. Education officials stated that they believe the noncompliance with FCRA issue has been resolved because they have developed and implemented detailed policies and procedures for returning excess funds to the Treasury. According to Education officials, the department has analyzed the $700 million unexplained difference and determined the proper balance for the accounts; however, we have not reviewed the adequacy of the department's analysis. A review of this analysis will be performed as part of the fiscal year 2000 financial statement audit.

Education Addressed Previous Material Internal Control Weakness Related to Cost and Liability Estimates for Its Loan Guarantee Program

One of the largest dollar value line items in Education's financial statements is its liability estimate resulting from potential losses associated with its guaranteed loan program. Critical to determining this liability is a reliable database of historical loan performance information. Prior to fiscal year 1997, without accurate historical data, Education had no sound basis for supporting the reasonableness of its cost estimates. Consequently, when Education's auditors found that Education's NSLDS database was incomplete and inaccurate, they identified the loan cost estimation process as a material internal control weakness.

Because Education is a credit agency, it has been required to estimate the cost of its loan programs in accordance with FCRA and the Federal Accounting Standards Advisory Board's (FASAB) accounting standard for credit reform, Statement of Federal Financial Accounting Standards (SFFAS) No. 2, *Accounting for Direct Loans and Loan Guarantees*, as amended, since fiscal years 1992 and 1994, respectively. The FASAB standard established guidance for estimating the cost of direct and guaranteed loan programs as well as for recording direct loans and the liability for loan guarantees for financial reporting purposes. In its issuance of SFFAS No. 2, FASAB stated that actual and expected costs of federal credit programs should be fully recognized in both budgetary and financial reporting.

For fiscal years 1995 and 1996, when independent auditors conducted a departmentwide audit, data reliability concerns precluded these auditors from rendering an opinion on Education's financial statements. Education's chronic data systems deficiencies had hampered its ability to prepare financial statements that fairly presented the financial condition of its student financial aid programs. The primary deficiency was that Education was not able to obtain complete and accurate student loan data from its systems to support its loan subsidy cost estimates and related liability for loan guarantees.

Education temporarily overcame this barrier and received an unqualified opinion on its fiscal year 1997 consolidated financial statements by obtaining data from 10 of the larger guaranty agencies' systems and using these data to compute loan cost estimates. Although the data provided by the guaranty agencies supported the loan cost estimates in the fiscal year 1997 financial statements, the auditors reported that Education's ability to continue to prepare auditable loan cost estimates depended on establishing a reliable source of up-to-date historical loan data.

In fiscal year 1998, Education's auditors found that Education had corrected the long-standing significant internal control weakness related to its FFELP loan cost estimates. Education improved the quality of data in NSLDS by, among other things, working with guaranty agencies to reconcile their records with NSLDS and establishing automatic data edits of data submitted to NSLDS. In addition, as part of the guaranty agency audit process, its auditors reviewed whether information submitted to NSLDS was consistent with data from the guaranty agency's systems. According to an OIG report, Education also has undertaken other initiatives to improve the quality of data in NSLDS.[28] These initiatives include: performing on-site support visits to guaranty agencies and other data providers; working with the National Council of Higher Education Loan Programs to conduct training workshops for guaranty agencies, lenders, and servicers; and reviewing data quality issues with data providers and making systematic improvements in the data provider process. Fully populating NSLDS with historical data from guaranty agency systems and performing extensive reconciliations with guaranty agency systems has improved NSLDS' data quality.

In June 1999, about 5 months before Education issued its fiscal year 1998 financial statements, an Education contractor conducted a data quality assessment of NSLDS and reported that some data problems existed within NSLDS. However, the contractor also reported that the data anomalies were within a statistically tolerable range when the data were used for program oversight and financial subsidy estimate calculations. The contractor concluded that NSLDS provides Education with a valuable opportunity to recognize trends; develop detailed profiles, such as student, loan type, default, and collection profiles; establish performance benchmarks; and provide performance feedback to institutions based upon national statistics.

Because Education used improved data from its NSLDS to prepare the fiscal year 1998 FFELP loan cost estimates, Education's auditors reported this issue as resolved. Although these auditors qualified Education's opinion on its fiscal year 1999 financial statements for other reasons mentioned previously, they concluded that the data within NSLDS were reasonable and could be relied upon for purposes of estimating the cost of its loan programs.

According to Education officials, Education continues to focus on its data quality initiatives to further improve the data integrity of NSLDS. For example, Education has recently issued final Guaranty Agency Provider Instructions to agencies that more clearly define data requirements for NSLDS. Education also continues to provide technical assistance to its guaranty agencies.

Conclusion

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 congressional and program decisionmakers make timely, well-informed judgments. While Education has planned and begun implementing many actions to resolve its financial management problems, the effectiveness of these corrective

[28] *NSLDS Can Be Enhanced If Loan Principal and Interest Balances and Statuses Are Updated With Lender Data* (OIG Final Audit Report 06-70001, September 1998.

actions will be determined as part of the fiscal year 2000 financial statement audit. It is critical that Education rise to the challenges posed by its financial management weaknesses because its success in achieving all aspects of its strategic objectives depends in part upon reliable financial management information and effective internal controls.

We are not making any recommendations at this time beyond those already made by the financial statement auditors in their fiscal year 1999 audit report and those made in our August 2000 report on Education's grantback account. We will continue to monitor the auditors' and the OIG's assessments of Education's corrective action plan and its implementation.

Agency Comments

On October 13, 2000, we met with cognizant Education officials and obtained comments on a draft of our report. The officials agreed that the draft accurately described the material internal control weaknesses discussed in the audit report on Education's fiscal year 1999 financial statements. However, the officials felt that the draft did not adequately reflect the extent of corrective actions that they have undertaken to improve the department's financial management. Specifically, they stressed that they have taken corrective actions to address the majority of the weaknesses identified in the fiscal year 1999 and prior year audits, have implemented a number of internal controls, strengthened overall financial management, and are continuing to address the other weaknesses. We have included in the report additional information on Education's efforts to correct its financial management weaknesses and recognized that Education has taken a number of steps to implement corrective actions. Whether these actions have been successful in addressing the reported weaknesses will be determined through the fiscal year 2000 financial statement audit, which is expected to be completed by no later than March 1, 2001.

Education officials also stated that they believed the report would be more balanced if it included discussion of the findings and conclusions included in several other GAO reports regarding various grant programs that suggest that the agency had followed sound financial management practices for those programs.[29] However, the issues discussed in those reports, and many others that GAO has issued on Education's various program activities, are beyond the scope of this audit, which focuses on the status of financial management weaknesses reported as part of the fiscal year 1999 financial statement audit.

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As we arranged with your offices, unless you publicly announce its contents earlier, we plan no further distributions of this report until one week from the date of this letter. At that time, we will send copies of this letter to the Honorable Richard W.

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[29] *Federal Education Funding Allocation to State and Local Agencies for 10 Programs* (GAO/HEHS-99-180, September 30, 1999) and *Education Discretionary Grants: Awards Process Could Benefit from Additional Improvements* (GAO/HEHS-00-55, March 30, 2000).

Riley, the Secretary of Education; the Honorable Lorraine Lewis, Inspector General, Department of Education; Thomas P. Skelly, Acting Chief Financial Officer; James Lynch, Chief Financial Officer, Student Financial Assistance; and other interested parties. We will make copies available to others upon request.

If you have any questions about this letter, please contact me at (202) 512-8341 or McCoy Williams, Acting Director, at (202) 512-6906. Key contributors to this assignment were Cheryl Driscoll, Louis Schuster, and Maria Zacharias.

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