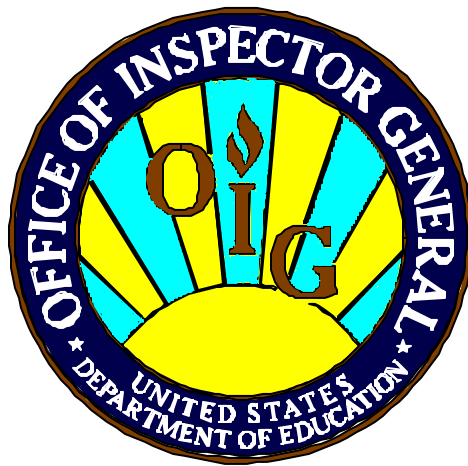

Audit of Controls Over Contract Payments

FINAL AUDIT REPORT



ED-OIG/A07-A0015
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
Kansas City, Missouri

NOTICE

Statements that management practices need improvement, as well as other conclusions and recommendations in this report represent the opinions of the Office of Inspector General. Determination of corrective action to be taken will be made by the appropriate Department of Education officials.

In accordance with the Freedom of Information Act (5 U.S.C. §552), 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.



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

MEMORANDUM

MAR 13 2001

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

From: Lorraine Lewis *Lorraine Lewis*

Subject: FINAL AUDIT REPORT
Audit of Controls Over Contract Payments
Control No. ED-OIG/A07-A0015

Attached is our subject final report. The objectives of the audit were to (1) determine the controls in place to prevent and detect improper contract payments, and (2) evaluate the effectiveness of these controls by testing the appropriateness of payments made. We received your comments, generally concurring with the findings but not all of the recommendations in our draft audit report.

Please provide us with your final response to each open recommendation within 60 days of the date of this report indicating what corrective actions you have taken or plan, and related milestones.

In accordance with the Office of Management and Budget Circular A-50, we will keep this audit report on the OIG list of unresolved audits until all open issues have been resolved. Any reports unresolved after 180 days from date of issuance will be shown as overdue in the OIG's Semiannual Report to Congress.

Please provide the Supervisor, Post Audit Group, Office of Chief Financial Officer and the Office of Inspector General, with quarterly 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 exemption 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 this review. Should you have any questions regarding this report, please contact Bill Allen at (816) 880-4024.

Attachment

Audit of Controls Over Contract Payments

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Audit of Controls over Contract Payments

Executive Summary

We reviewed the contract payment process to determine the controls in place to prevent and detect improper contract payments, and to evaluate the effectiveness of these controls by testing the appropriateness of payments made. We found that improvements were needed in the controls over the invoice review process, segregation of duties, and the process for establishing vendor information in the Department of Education (Department) contract payment system.

Improper payments have become an area of concern in the federal government. In October 1999, the GAO issued a report entitled, “Increased Attention Needed to Prevent Billions in Improper Payments.” This report defines improper payments as “...payments 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 information systems and weaknesses in internal control.”¹

In October 2000, GAO updated its work regarding improper payments. This report further defined improper payments as payments that, “...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.”²

We found that improper payments were made in 8 of 39 payments reviewed. This occurred because the invoice review process was not followed. Specifically, we noted the following:

- * Rates claimed were not supported.
- * Payments were made for periods beyond the contract period of performance.
- * Invoices were not adequately supported.

As a result, the Department lacks assurance that payments were proper. We recommend that the Chief Financial Officer (CFO) develop policies and procedures to ensure that

¹ United States General Accounting Office, Report to the Chairman, Committee on Governmental Affairs, U.S. Senate, October 1999, “Financial Management – Increased Attention Needed to Prevent Billions in Improper Payments,” Report No. GAO/AIMD-00-10.

² United States General Accounting Office, Report to the Chairman, Committee on Governmental Affairs, U.S. Senate, October 2000, “Financial Management – Billions in Improper Payments Continue to Require Attention,” Report No. GAO-01-44.

invoice review processes are followed, and establish an internal control monitoring procedure to periodically review payments for appropriateness.

We found that appropriate segregation of duties was not maintained in the contract payment process.³ In one instance, a Contracting Officer (CO) also performed the duties of a contract specialist on a contract, both approving and certifying invoices for payment. Some contract specialists relied on the Contracting Officer's Technical Representatives (COTR) to review invoices, rather than performing their own independent reviews. Some invoices were sent directly to the COTR or program offices, rather than to Contracts and Purchasing Operations so that payments could be tracked in accordance with prompt payment requirements. As a result, the risk of error or fraud is increased and the invoice payment process is weakened without the independent check of the appropriateness of the amounts to be paid. We recommend that the CFO ensure appropriate segregation of duties in the contract payment process.

The process for entering vendor information in the Department's contract payment system needs improvement. Staff who enter this information did not always obtain documentation from the vendors, but rather entered the data based on an electronic mail message from program or contracting staff. There was no second level of review to ensure the data received was reasonable, or that the information was accurately entered. While we did not find any errors in this area, incorrect vendor information could be entered, resulting in improper payments. We recommend that the CFO require documentation from the vendors be provided to staff entering this information into the payment system and that a review process be established to assess the reasonableness of data received and the accuracy of data entered.

The Office of the Chief Financial Officer (OCFO) generally concurred with our findings and agreed to either re-emphasize, implement or take under advisement the recommendations included in the report, except that the response indicates the OCFO believes there is adequate information available concerning the payment process without implementing additional policies and procedures. Further, the OCFO/CPO will reinforce existing procedures through continuous enforcement. To strengthen the internal control processes related to contracting, we maintain our position that the recommended control procedures should be implemented by OCFO. The full text of the OCFO response is provided as Appendix A.

³ ED's Administrative Communication System directive C:GPA:2-110 entitled, "Contract Monitoring for Program Officials," defines the following roles:

- * Contracting Officer – The Government's exclusive agent as a party to a contract and therefore the only party with the authority to enter into, administer, and terminate contracts and make related determinations and findings.
- * Contract Specialist – The Contracting Officer's designated representative in the contracting office who acts on behalf of the CO in most of the day-to-day administration of a contract.
- * Contracting Officer's Technical Representative – The program office representative responsible for monitoring programmatic or technical aspects of a contract and making recommendations to the Contracting Officer for necessary contract action.

Audit of Controls Over Contract Payments

Audit Results

We found that improvements were needed in the controls to prevent and detect improper payments. Specifically, we found that improvements were needed in the controls over the invoice review process, segregation of duties, and the process for establishing vendor information in the payment system.

During our audit, we also identified two related issues. In an expanded review of one of the contracts in our sample, we identified two errors that had not been detected by the Department – one duplicate payment and one invoice that was never paid. We also found that contract and program staff did not have independent records with which to validate the system-generated quantities included on some invoices and therefore had no assurance of their accuracy. The *Other Matters* section of the report contains additional information on these two issues.

Finding No. 1 – Invoice Review Process Did Not Prevent Improper Payments.

Improper payments were made in 8 of 39 payments reviewed (20%). We found that four payments included rates that were not supported, one payment was made for services beyond the contract term, and three invoices did not include complete supporting documentation. This occurred because program and contracting staff did not adequately review invoices prior to payment. Specifically, staff did not validate invoice amounts to price lists, verify rates or periods of performance to contract terms, review supporting documentation or require invoices with sufficient detail. While the total amount of inaccurate payments noted in our sample was not material, the Department of Education (Department) lacks assurance that payments were proper.

The U.S. General Accounting Office (GAO) issued “Standards for Internal Control in the Federal Government,” most recently updated in November 1999. GAO established five standards which define the minimum level of quality acceptable for internal control in the government and provide the basis against which internal control is to be evaluated. The five standards are control environment, risk assessment, control activities, information and communications, and monitoring.

Review of invoices prior to payment is an example of a control activity. GAO defines control activities as follows:

Control activities are the policies, procedures, techniques and mechanisms that enforce management's directives....They help ensure that actions are taken to address risks. Control activities are an integral part of an entity's planning, implementing, reviewing, and accountability for stewardship of government resources and achieving effective results.

The Department has issued guidelines on the invoice review process. The Departmental directive entitled, "Contract Monitoring for Program Officials," provides guidelines on the roles of the Contracting Officer (CO) and the Contracting Officer Technical Representative (COTR)⁴ in the invoice review process:

The CO is responsible for approving a contractor's invoice for payment, but only after review and advice from the COTR (as well as the CO's own analysis) concerning the contents of the invoice and the contractor's performance relative to what is being billed.⁵

A baseline practices guide entitled, "Contract Payment Procedures," issued by the Office of the Chief Financial Officer and Chief Information Officer (OCFO & CIO), provides the following additional guidelines:

The contract specialist reviews the invoice/voucher to ensure it is appropriate for payment and verifies if any amounts should be withheld. This may include checking that it includes all information needed to be a "proper invoice/voucher," it contains no arithmetical errors, costs billed were incurred and are allowable, or that required delivery or performance occurred.

The COTR performs a similar review of the invoice/voucher and completes and returns the invoice/voucher cover memo to the contract specialist within 5 days.⁶

Our audit found that improvements were needed in the invoice review process. Issues we noted could have been found by Department staff had they thoroughly reviewed the invoices. Examples of the issues noted in our review follow.

Rates claimed were not supported. One invoice included a line item that was billed at an incorrect rate. The master billing table for this contract also included the incorrect rate. This error was included in 11 monthly billings but was not noted by contract or

⁴ COTRs are now known as Contracting Officer Representatives (COR).

⁵ "Contract Monitoring for Program Officials," Departmental Directive C:GPA:2-110, dated January 12, 1987, Section XI, Paragraph C.1.b.

⁶ OCFO&CIO Contracts and Purchasing Operations Baseline Practices Guide, "Contract Payment Procedures," March 26, 1998 revision, pages 4 and 6.

program staff who reviewed the invoices. The Department was underbilled by \$3 per unit for this deliverable on the sample payment, and by a total of \$28.95 during our scope period. In another case, an invoice of \$725 was paid for \$726. While neither of these payment errors was material, thorough review of the invoices would have prevented these errors.

For two additional payments in our sample, the overhead and/or fee rates charged on the invoice did not agree with the rate in the contract. Contracting staff could not locate documentation to support either a change in the overhead rates or the fee charged. The change in overhead rates was not noted in the invoice review process.

Payments were made for periods beyond the contract period of performance. One invoice billed for services in April 1999. However, at that time, the period of performance for the purchase order was only through October 1998. The modification to extend the period of performance was dated in January 2000, several months after the sample invoice was paid and 15 months after the original period of performance expired. This invoice, and 12 others for this contract were paid beyond the period of performance prior to the execution of the modification.

Invoices were not adequately supported. One invoice included substantial documentation supporting costs claimed. However, several pages supporting costs of \$669,943 were not legible or were missing. Neither contract nor program staff reviewing the invoices noted this issue. Two other invoices for a cost-reimbursement type contract were not provided in sufficient detail to allow reviewers to judge the reasonableness, allowability and allocability of the costs. Since close-out audits of these contracts are not routinely performed, Contracts and Purchasing Operations (CPO) management had informally agreed to obtain sufficient detail as the invoices are paid to provide additional assurances of the appropriateness of invoiced amounts.

We presented the detailed results of our review to CPO management who agreed it is their practice that contracting staff should review invoices with sufficient detail to ensure compliance with contract terms.

Recommendation

We recommend the Chief Financial Officer:

1. Develop and implement policies and procedures to ensure that invoice review processes are followed by contract and program staff, including establishing an internal control monitor to review payments for appropriateness.

OCFO Response

OCFO generally concurred with Finding No. 1. OCFO stated that guidance is in place related to reviewing vouchers, invoices, and the payment review process, and that our recommendations were emphasized at a mandatory all-hands meeting of CPO staff on

January 23, 2001. OCFO stated that there is adequate information available concerning the payment process without implementing additional policies and procedures. Further, CPO will reinforce these procedures through continuous enforcement of OCFO procedures and internal control processes already in place.

Auditor Comments

While we agree that there are guidelines regarding the review and approval of vouchers and invoices, they were not followed. We maintain our position that OCFO should establish internal control procedures to assure that all staff and managers consistently follow these guidelines.

Finding No. 2 – Appropriate Segregation of Duties Was Not Maintained in the Contract Payment Process

Appropriate segregation of duties was not maintained in the contract payment process. Specifically, we found that a Contracting Officer was also performing the duties of a contract specialist. We also found that some contract specialists relied on the COTR to review invoices, and that invoices were sent directly to the COTR or Department program staff, rather than to CPO. This occurred because staff did not recognize the importance of segregation of duties in the payment system. As a result, the risk of error or fraud is increased and the invoice payment process is weakened without the independent check of the appropriateness of the amounts to be paid.

GAO's "Standards for Internal Control in the Federal Government" include segregation of duties as a control activity.

Segregation of Duties – Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any related assets. No one individual should control all key aspects of a transaction or event.

The Department's guidelines presented in Finding 1 prescribe the responsibilities of the CO, the contract specialist, and the COTR in the invoice review process. The involvement of these separate parties helps assure the appropriateness of payments made.

A Contracting Officer was also performing the duties of a contract specialist. For one contract reviewed with a significant number of payments, the same CPO staff member performed the functions of both the CO and the contract specialist – responsible for the initial review and approval, as well as the certification for payment, of invoices. This occurred partially because the CO was promoted from a contract specialist and his access in the payment system was not adjusted to remove the contract specialist

functions. Also, the CO stated that due to the volume of invoices processed on the contract, having two separate parties involved would be too time consuming.

Contract specialists relied on the COTR to perform invoice reviews. For two contracts reviewed, the contract specialists relied upon the COTRs to perform invoice reviews, rather than performing their own independent reviews in addition to the COTRs' reviews. Department guidelines clearly show that both the contract specialist and the COTR are to review invoices prior to payment as follows:

The contract specialist reviews the invoice/voucher to ensure it is appropriate for payment and verifies if any amounts should be withheld. This may include checking that it includes all information needed to be a "proper invoice/voucher," it contains no arithmetical errors, costs billed were incurred and are allowable, or that required delivery or performance occurred.

The COTR performs a similar review of the invoice/voucher and completes and returns the invoice/voucher cover memo to the contract specialist within 5 days.⁷

By relying upon the COTR to perform both reviews, the contract specialists are jeopardizing the purpose of the independent check to ensure payments are appropriate.

Invoices were sent directly to the COTR or program staff, rather than to CPO. For three payments reviewed, we noted that invoices were sent directly to the COTR or program staff, rather than to CPO. Two of these payments were the two cases presented above where the contract specialists relied upon the COTRs to review the invoices. The risk of error or fraud is increased when appropriate segregation of duties is not maintained. In order to ensure the appropriate segregation of duties, and timely reviews, invoices should be sent to CPO.

During the course of our audit, we presented the detailed results of our review to CPO management, who informed us that they had already initiated actions to ensure that the CO no longer has access to the contract specialist functions. In addition, they have initiated actions to remove these functions in the payment system from all Contracting Officers. As previously stated in Finding 1, CPO management also agreed that contracting staff should review invoices to ensure compliance with contract terms.

⁷ OCFO&CIO Contracts and Purchasing Operations Baseline Practices Guide, "Contract Payment Procedures," March 26, 1998 revision, pages 4 and 6.

Recommendations

We recommend that the Chief Financial Officer:

1. Ensure that Contracting Officers do not also perform the duties of contract specialists.
2. Ensure that the Contracting Officer's access to the payment system is corrected to prohibit access to the contract specialist screens.
3. Conduct a review to ensure that other Contracting Officers do not have inappropriate access to the contract specialist screens, thereby bypassing the segregation of duties intended in the system. If so, ensure that Contracting Officers are prohibited from access to contract specialist functions.
4. Emphasize to contracting staff the importance of segregation of duties in their functions and provide training as needed.
5. Ensure all contract invoices are addressed to CPO, rather than to COTR or program staff.

OCFO Response

Regarding Finding No. 2, OCFO stated that the recommended changes to segregate duties were initiated in July 2000, and that our recommendations were emphasized at a mandatory all-hands meeting of CPO staff on January 23, 2001. For those instances where a contracting officer may serve as the contracting administrator as well, another contracting officer or senior CPO contracting official will participate in the review and approval process. Further, OCFO will reinforce these procedures through continuous enforcement of OCFO procedures and internal control processes already in place.

Auditor Comments

If consistently followed, we agree that the OCFO strategy could provide the appropriate segregation of duties we recommended.

Finding No. 3 – Vendor Payment Information Entry Process Needs Improvement

Documentation from the vendors, including banking information where electronic payments are authorized, was not always provided to the OCFO staff entering the data in the contract payment system. Instead, program or contracting staff provided this information through an electronic mail message. There is no second level of review to ensure the data received appears reasonable or that the information was accurately entered into the payment system. This occurred because OCFO staff did not consider it necessary to provide original documentation from the vendor to staff responsible for entering the data. Although we did not find any errors in this area, the electronic mail

messages could contain inadvertent mistakes resulting in payment errors. Incorrect vendor information could be provided allowing improper payments.

Ensuring that accurate and appropriate information is entered into the payment system is an important internal control. Since payments are made to the Department's vendors based on this data, the Department could make improper payments. GAO's "Standards for Internal Control in the Federal Government," state that:

Internal control should be designed to provide reasonable assurance regarding prevention of or prompt detection of unauthorized acquisition, use or disposition of an agency's assets.

Improvements have been made recently in this process, as the number of staff who input this data has been reduced. However, further improvements are needed to ensure that the information is reasonable and accurate. CPO management stated that they were aware of this issue and are in the process of providing guidance to the Chief Financial Officer, including requiring original documentation from vendors to be provided to the staff member entering the payment data.

OCFO systems staff stated that plans are being pursued to match vendor file information with Dun and Bradstreet data. This will provide a higher level of assurance of the accuracy of the vendor data. However, they agreed that obtaining original documentation from the vendors would be preferable to the electronic mail messages.

Recommendations

We recommend the Chief Financial Officer:

1. Immediately ensure that original documentation from vendors be provided to staff who enter vendor data in the payment system.
2. Establish a review process for the initial data input to assess the reasonableness of the data received and to review the accuracy of the information in the payment system.

OCFO Response

Regarding Finding No. 3, OCFO notes that our review found no errors, yet determined that weaknesses exist. OCFO states that our recommendations were emphasized at a mandatory all-hands meeting of CPO staff on January 23, 2001. OCFO/CPO will prepare written guidance to reinforce its existing policy related to enforcing contract terms and conditions related to obtaining original documentation from contractors and providing this documentation to staff entering vendor information into the payment system. Further that OCFO will reinforce these procedures through continuous enforcement of OCFO procedures and internal control processes already in place. OCFO stated that the second recommendation related to this finding will be taken under advisement.

Auditor Comments

If consistently followed, we agree that the OCFO strategy could provide the appropriate level of control recommended. However, we maintain our position that establishing a review process for the initial input of vendor data is an important control that should be implemented.

Other Matters

Additional Payment Errors

During our review of contract payments, we noted one contract where duplicate payments were made during our scope period, but had been detected by contracting staff and offset against later payments. To ensure that all such errors were detected by the Department, we performed a review of all payments under this contract from its inception, October 1, 1994, through May 31, 2000. In total, we matched 940 payments totaling more than \$12 million in the Department's current and former payment systems to copies of invoices in the contract files.

In our expanded review, we found one duplicate payment of \$16,337.11 and one invoice for \$46,598.48 that was never paid. These errors were referred to CPO management who immediately initiated corrective actions.

System-Generated Quantities

One of the contracts in our sample included significant quantities of loans processed on the invoice that were calculated by the contractor's system. This system was tested by the Department when the contract first began in 1994, but has not been evaluated since. The COTR did not have any independent documents available with which to compare these quantities claimed on the invoices. As such, the Department does not have assurance that the quantities for which they are being billed are accurate. The COTR stated that he had recommended to the Contracting Officer that an independent review of the system be conducted. Contracting staff have been discussing this option, but no decision has yet been made. The Contracting Officer indicated that the Department has other contracts with similar billing systems that generate quantities processed and claimed on the invoices.

We encourage the Chief Financial Officer to authorize an independent review of this and other similar contractor systems to provide assurance that the amounts claimed are appropriate.

Background

Improper payments have become an area of concern in the federal government. In October 1999, the GAO issued a report entitled, “Increased Attention Needed to Prevent Billions in Improper Payments.” This report defines improper payments as “...payments made for unauthorized purposes or excessive amounts, such as overpayments to program recipients or contractors and vendors.” The report further states: “Improper payments can result from incomplete or inaccurate data used to make payment decisions, insufficient monitoring and oversight, or other deficiencies in agency information systems and weaknesses in internal control.”⁸

GAO updated this work in October 2000 and defined improper payments as payments that, “...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.”⁹

The Department of Education’s March 2000 report entitled, “Department-wide Objectives, 1999 Performance Reports and 2001 Plans,” for the Government Performance and Results Act (GPRA), includes a reference to improper payments. Presented under “Challenges to Achieving Our Objective” this reference states that:

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.

We performed this audit to assess the controls over the contract payment process.

⁸ United States General Accounting Office, Report to the Chairman of the Committee on Governmental Affairs, U.S. Senate, October 1999, “Financial Management – Increased Attention Needed to Prevent Billions in Improper Payments,” Report No. GAO/AIMD-00-10.

⁹ United States General Accounting Office, Report to the Chairman, Committee on Governmental Affairs, U.S. Senate, October 2000, “Financial Management – Billions in Improper Payments Continue to Require Attention,” Report No. GAO-01-44.

The payment system for contracts includes the Financial Management Support System (FMSS) component of the Department of Education's Centralized Automated Processing System (EDCAPS). Depending on the type of contract, the Contracts and Purchasing Support System (CPSS) component may also be involved. For the purposes of this report, we use the term "contract" to include procurement actions by either the CPO staff or staff designated with procurement authority within the individual program component. This includes both formal contracts and purchase orders. Depending on the type of contract, a CO, executive officer, contract specialist, COTR, and/or other program staff may be involved in the payment process.

In very general terms, invoices or vouchers for payment (referred to collectively as "invoices" in this report) are received and reviewed for accuracy and compliance with contract terms, entered into the FMSS and certified for payment. Once certified, payment information is provided to the U.S. Department of the Treasury where either an electronic payment or a check is provided to the contractor or vendor.

Audit Scope and Methodology

The objectives of the audit were to (1) determine the controls in place to prevent and detect improper contract payments, and (2) evaluate the effectiveness of these controls by testing the appropriateness of payments made.

To accomplish our objectives, we obtained an understanding of the controls in place at the Department over the contract payment process. We reviewed GAO *Standards for Internal Control in the Federal Government*, as well as Departmental guidelines and training manuals. We held discussions with officials in the OCFO, including staff in CPO, Financial Management Operations, and Financial Systems Operations. During our review of specific sample payments, we also held discussions with COTRs and other program staff as appropriate.

We relied extensively on computer-processed data extracted from the Department's payment systems. We used an extract of payment information from the Department's FMSS to determine the universe of contract payments made. We identified a total of 9,293 such payments totaling approximately \$1.2 billion, during our scope period, October 1, 1998, through March 31, 2000. From this universe, we selected a stratified sample as follows:

- * A judgmental sample of 9 payments over \$2.5 million. The universe contained 44 payments over \$2.5 million from eight different contracts. We judgmentally selected a sample of nine payments to include at least one payment from each contract.
- * A random sample of 30 payments from the entire universe.

Our sample of 39 payments represented \$37.6 million in payments, or 3.1% of the total value of the payments in the universe.

To evaluate the appropriateness of payments made, we matched a sample of payments to the hard copy invoices in the contract files, validated the mathematical accuracy of the invoices, compared rates and prices to contract terms, reviewed payment approvals by contract and program staff, verified the payee information with the Department's vendor files, and verified the amount disbursed with U.S. Department of Treasury records.

We also performed a limited review of additional payments for each contract sampled. We matched additional payments made during our scope period from the hard copy invoices included in the contract files to FMSS financial history reports and our universe of contract payments. In total, we matched the payment amounts for an additional 446 invoices.

As discussed in the *Other Matters* section of this report, we also reviewed all payments made to one contract during the period October 1, 1994, through May 31, 2000. In total, we matched 940 payments from the current and prior payment systems to copies of the invoices in the contract files.

We tested the accuracy, authenticity, and completeness of the FMSS payment data by comparing source records to computer data, and comparing computer data to source records. We also matched computerized data in FMSS with the payment amounts confirmed by the Department of the Treasury. Based on these tests and assessments, we concluded that data were sufficiently reliable to be used in meeting the audit's objectives.

We performed fieldwork at the Department of Education offices in Washington, DC, and at our offices in Kansas City, MO, during the period April 13, 2000, through August 2, 2000. We conducted the audit in accordance with government auditing standards appropriate to the scope of the review described above.

Statement on Management Controls

As part of our review, we gained an understanding of the Department's management control structure over contract payments, as well as its policies, procedures, and practices applicable to the scope of the audit. Our purpose was to assess the effectiveness of controls to prevent and detect improper contract payments.

Because of inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in the management controls. However, our assessment identified management control weaknesses that adversely affected the Department's ability to administer the contract payment process. These weaknesses are fully discussed in the *Audit Results* and *Other Matters* sections of this report.

Appendix A

Department's Response to the Draft Report



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF THE CHIEF FINANCIAL OFFICER



FEB -8 2001

MEMORANDUM

TO : William Allen
Regional Inspector General for Audit

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

SUBJECT: Draft Audit Report Control No. ED-OIG/A07-A0015, Audit of Controls Over Contract Payments

This memorandum provides a written response following our review of an Office of Inspector General (OIG) draft audit on the Department's contract payment process. The scope of the OIG audit was to determine the controls in place to prevent and to detect improper contract payments and to evaluate the effectiveness of these controls by testing a payment sample for appropriateness of payments made. In your report, you conclude that contract payments were generally accurate; however, you found that improvements were needed in the controls to prevent and detect improper payments. Specifically, you found that controls were needed in the invoice review process, that appropriate segregation of duties was not maintained in the contract payment process; and, that the process for entering vendor information in the Department's contract payment system needs improvement.

As a result of your findings, the OIG has made a series of recommendations. We would like to address each recommendation with an OCFO response and corrective action, where appropriate.

Finding No. 1 – Invoice Review Process Did Not Prevent Improper Payments.

The OIG found that improper payments were made in 8 of 39 payments reviewed. The OIG found that 4 payments included rates that were not supported, 1 payment was made for services beyond the contract term, and 3 payments were made without complete supporting documentation. As a result, the OIG made the following recommendation:

1. *Develop and implement policies and procedures to ensure that invoice review processes are followed by contract and program staff, including establishing an internal control monitor to review payments for appropriateness.*

OCFO/CPO has in place a document entitled: Contract Payment Procedures – An OCFO&CIO Contracts and Purchasing Operations “Baseline Practices Guide”. This document provides guidance to the contract specialist and COTR on reviewing invoices/vouchers as well as the payment review process. CPO has also documented corresponding contract payment procedures on the OCFO Procedures website. On January 23, 2001, CPO held a mandatory all-staff meeting. During this meeting, CPO management discussed the OIG recommendations regarding this issue.

CPO management impressed upon its staff the importance of strengthening the invoice review process by reminding staff to:

- Validate all rates billed against the contract payment/billing schedules for accuracy to include indirect rates and fee rates.
- Ensure that invoices paid are for services rendered within the contract term.
- Require all invoices under cost-reimbursement type contracts to include sufficient detail to allow reviewers to judge the reasonableness, allowability, and allocability of costs.

CPO management further referred staff to the Best Practices Guide and OCFO procedures on the contract payment process for further review. We believe that in addition to the Federal Acquisition Regulations (FAR), adequate internal information concerning the payment process is available without having to implement additional policies and processes. CPO management will reinforce these practices with its staff through continuous enforcement of the OCFO procedures and internal controls processes currently in place.

OCFO will take the OIG recommendation to establish an internal control monitor to review payments under advisement.

Finding No. 2 – Appropriate Segregation of Duties Was Not Maintained in the Contract Payment Process

The OIG found that a contracting officer was also performing the duties of a contract specialist in 1 of the contract payments reviewed. The OIG further found that in 2 instances, the contract specialists relied on the COTR to perform invoice reviews and for 3 payments reviewed, invoices were sent directly to the COTR or program staff rather than CPO. As a result, the OIG made the following recommendations:

1. *Ensure that the Contracting Officers do not also perform the duties of contract specialists.*
2. *Ensure that the Contracting Officer's access to the payment system is corrected to prohibit access to the contract specialist screens.*
3. *Conduct a review to ensure that other Contracting Officers do not have inappropriate access to the contract specialists screens, thereby bypassing the segregation of duties intended in the system. If so, ensure that Contracting Officers are prohibited from access to contract specialist functions.*
4. *Emphasize to contracting staff the importance of segregation of duties in their functions and provide training as needed.*
5. *Ensure all contract invoices are addressed to CPO, rather than to COTR or program staff.*

The OIG references the GAO's Standards for Internal Control in the Federal Government segregation of duties control activity. The OIG notes:

“Segregation of Duties – Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud. This should include separating the responsibilities for authorizing transactions, processing and recording them, reviewing the transactions, and handling any

related assets. No one individual should control all key aspects of a transaction or event.”

In response to segregating duties in the Department’s payment system, OCFO/CPO initiated action in response to OIG Recommendation No. 2 and No. 3 in July 2000 to remove contracting officer’s access to enter and edit invoice data in EDCAPS. Contracting officers are now granted with ‘read access’ and ‘report view’ only. The OIG was notified of this action in August 2000.

To the extent that Recommendation No. 1 addresses separating the role of the contracting officer and the contract specialist in authorizing, processing and recording, and reviewing transactions, we agree in part. The FAR defines the responsibilities of a contracting officer as one with the authority to enter, administer, or terminate contracts and make related determinations and findings. Contracting officers may bind the Government only to the extent of the authority delegated to them. The FAR however, does not recognize the role of a contract specialist. Due to the many functions performed by the contracting officer, a staff of contracting personnel is typically provided as support. These support personnel do not have authority to award contracts, and all of their work must be reviewed and concurred with by the contracting officer. Positions may include contract specialist, contract negotiator, contract administrator, price/cost analyst, and a procurement analyst. The role of a contracting officer has multiple functions that may be handled by one person or divided among several people. Latitude is granted within each Federal government agency to organize themselves according to internal priorities. The Department has established and defined the role of the contract specialist as a contracting officer designated representative who acts on behalf of the contracting officer in the pre-award process up to contract award and in most of the daily administration of the contract.

OCFO/CPO recognizes the importance of reaching a balance between the responsibilities of a contracting officer to the extent as authorized by his/her warrant, and maintaining proper internal controls to safeguard against error and fraud. To this end, CPO has established processes and controls whereby contracting officers assigned to contracts who may also serve as the contract administrator for that contract, engage in review and approval processes of contract actions that involve another contracting officer or a senior level contract official within the contracting officer’s supervisory chain.

On January 23, 2001, CPO held a mandatory all-staff meeting. During this meeting, CPO management discussed the OIG recommendations regarding this issue. CPO management impressed upon its staff the importance of strengthening the segregation of duties in the payment process by:

- Ensuring that staff takes steps to ensure that the same individual is not responsible for invoice review and the invoice payment approval.
- Stressing that CPO staff exercise independent judgment as to the adequacy of invoice payments without relying solely upon the COTR to perform invoice reviews.
- Stressing that CPO staff ensure that all invoices are sent directly to CPO rather than to the program staff.

CPO management further referred staff to the Best Practices Guide and OCFO procedures on the contract payment process for further review. CPO management will reinforce these practices with its staff through continuous enforcement of the OCFO procedures and internal controls processes currently in place.

Finding No. 3 – Vendor Payment Information Entry Process Needs Improvement

While the OIG found no errors, the OIG determined that weaknesses exist in how the OCFO staff enters vendor information that could result in inadvertent mistakes leading to payment errors. The OIG acknowledges that OCFO has made recent improvements by reducing the number of staff who input this data. The OIG however, makes the following recommendations to ensure that the vendor information entered is reasonable and accurate:

1. *Immediately ensure that original documentation from vendors be provided to staff who enter vendor data into the payment system.*
2. *Establish a review process for the initial data input to assess the reasonableness of the data reviewed and to review the accuracy of the information of the payment system.*

On January 23, 2001, CPO management held a mandatory all-staff meeting. During this meeting, CPO management discussed the OIG recommendations regarding this issue. CPO impressed upon its staff the importance of strengthening the invoice review process by:

- Reinforcing the policy that CPO staff enforce the standard contract terms and conditions for establishing where payments are to be made by obtaining original documentation from vendors and provide this documentation to staff that enter vendor data into the payment system.

OCFO/CPO will prepare written guidance to reinforce this policy. CPO management will reinforce these practices with its staff through continuous enforcement of the OCFO procedures and internal controls processes. OCFO will take the OIG Recommendation No. 2 under advisement.

Thank you for this opportunity to comment. We trust that you will consider this response in the preparation of your final audit report.

Audit of Controls over Contract Payments

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