



UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

APR - 6 2001

**MEMORANDUM**

TO: James Lynch  
Chief Financial Officer, Student Financial Assistance

Mark Carney  
Deputy Chief Financial Officer, Department of Education

FROM: Lorraine Lewis *Lorraine Lewis*

SUBJECT: MANAGEMENT LETTERS  
Student Financial Assistance  
ED-OIG/A17-B0004

Attached are the subject management letters prepared by Ernst & Young, LLP, as a result of their examination of the fiscal year 2000 financial statements for Student Financial Assistance (SFA). They contain suggestions to assist management in improving procedures and controls at the Department.

You have been designated as the action officials responsible for the resolution of the findings and recommendations in these letters. We have discussed the findings with you or appropriate members of your staffs at various times throughout the audit.

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

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

Please provide the Financial Improvement and Post Operation/Post Audit Group and the Office of Inspector General/Audit Services with quarterly reports on promised corrective actions until all such actions have been completed or continued follow-up is unnecessary.

**James Lynch**  
**Mark Carney**  
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In accordance with the Freedom of Information Act, products issued by the Office of Inspector General are available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act. Copies of these reports have been provided to the offices shown on the distribution list.

We appreciate the cooperation given us during the audit. Should you have any questions concerning the management letters, please contact me or Thomas A. Carter, Assistant Inspector General for Audit, at 205-5439 or 205-9327, respectively.

**Attachments**

**Distribution List:** Greg Woods – SFA  
Stephen Hawald - SFA  
Linda Paulsen – SFA  
Faye Harris – SFA  
Julie Bryant – SFA  
Terry Bowie – OCFO  
Danny Harris – OCFO  
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Tom Skelly – OUS  
William Graham – OUS

January 26, 2001

To the Inspector General  
U.S. Department of Education

In planning and performing our audit of the consolidated balance sheet, the related consolidated statements of net cost and changes in net position, and the combined statements of budgetary resources and financing of the Student Financial Assistance (SFA), a performance-based organization of the U.S. Department of Education (the Department), as of and for the year ended September 30, 2000, we considered its internal control to determine our audit procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control. We have separately reported in our report on internal control dated January 26, 2001 certain matters involving internal control and its operation that we consider to be reportable conditions or material weaknesses under standards established by the American Institute of Certified Public Accountants.

The following suggestions, which resulted from our consideration of internal control, are submitted to assist management in improving procedures and controls.

## **I. Financial Statement Preparation**

### *Manual Adjustment Log*

The Department's Office of the Chief Financial Officer (OCFO) was unable to provide a control log of all manual adjustments prepared and proposed for posting to its Financial Management System Software (FMSS) general ledger during fiscal year 2000. OCFO's procedures for processing manual adjustments indicate that a control log is used to track manual adjustments. We requested the log from four OCFO employees responsible for maintaining the log, but they never provided us with the documentation.

According to the Department's *Procedures for Processing and Documenting Manual Journal Entries*, "When the journal entry is prepared, the preparer will reserve a journal entry number from the log and enter the applicable information into the log. Information to be entered into the log will include: (a) the journal entry number; (b) the date the journal entry number was assigned; (c) the name of the preparer of the journal entry; (d) the appropriation; (e) the date the transaction was submitted for entry into the Information Engineered Financial Accounting and Reporting System, i.e. FARS; (f) the applicable workpaper reference(s); (g) a brief description of the journal entry, and (h) the status of the journal entry." In addition, "This log shall be maintained at the centralized filing system location."

The log serves as a control point for tracking manual adjustments processed during the year and can assist in determining whether all adjustments have been appropriately posted to the general ledger. During fiscal year 2000, the Department and SFA processed a significant number of manual adjustments. The lack of a properly maintained manual adjustment log increases the risk

that unsupported adjustments may be made or that valid adjustments may not be appropriately posted, which could result in misstatements in the financial statements. Because we were not provided with the log, we are unable to assess whether it is functioning as intended.

We recommend that SFA:

1. Coordinate with OCFO to implement and maintain a control log to ensure that all manual adjustments relating to SFA funds are supported and accounted for in SFA's records, and make the log available for inspection.

## II. Fund Balance with Treasury

### *Statement of Transactions Preparation Process*

OCFO's procedures for reporting SFA's Fund Balance with Treasury (FBWT) activities to Treasury can be improved. During our testing of OCFO's procedures for preparing the Statement of Transactions (SF 224), we found that the collections and disbursements transactions reported to Treasury via the SF 224 differed from transactions posted to the general ledger. OCFO prepared the SF 224 by using the data provided in the Government On-Line Accounting Link System (GOALS) and Cash Link, instead of the data in its general ledger. Therefore, the amounts reported on the Statement of Differences (FMS 6652) do not reflect true differences between balances in the general ledger and balances reported by Treasury in the Undisbursed Appropriation Ledger (FMS 6653).

A GAO report, Reconciliation of Fund Balances (GAO/AIMD- 97-104R), established guidance for use by auditors in determining the adequacy of an agency's procedures to reconcile FBWT. Part of these procedures is to determine if agencies adequately prepare the SF 224 by using the same detailed accounting records of collections and disbursement transactions that are used to prepare the agencies' financial statements. The guidance also states that differences reported by Treasury on the FMS 6652 should be researched and resolved and adjustments should be reported to Treasury and posted to accounting records in a timely manner (*i.e.*, monthly).

We recommend that SFA coordinate with OCFO to:

1. Modify the procedures used to record transactions to its accounting records for all Agency Location Codes (ALC) so that the SF 224 preparers can effectively rely on the accounting data from the general ledger and accurately report transactions to Treasury;
2. Perform monthly reconciliations of the general ledger to the FMS 6653 for all appropriations.
3. Research differences on the FMS 6652 and clearly document the resolution of the differences, including prior year differences; and

4. Post all correcting general ledger entries identified through the reconciliation process and communicate those entries promptly to Treasury via the SF 224.

### III. Direct Loans

#### *Timeliness of Loan Information from Schools (Repeat Condition)*

Loan disbursements from the advance account for direct loans are not reported to SFA on a timely basis. As of September 30, 2000, the advance account had a balance of approximately \$859 million, primarily representing funds drawn down by schools for which the loans have not yet been recorded. We obtained a download from the Loan Origination Subsystem (LOS) of all loan disbursements, cancellations, and adjustment records acknowledged by the LOS between October 1, 2000, and January 5, 2001, with a disbursement date on or before September 30, 2000. The net amount of disbursements in this file was approximately \$601 million, indicating that approximately \$258 million of loan disbursements made on or before September 30, 2000, had not been reported to SFA as of January 5, 2001.

We reviewed the time lag between the disbursement date (as recorded by the school) and the acknowledgment date (as recorded by the LOS) for all records in this download. Based on this review, we noted that the average time lag was 97 days, which exceeds the thirty-day requirement established by the Code of Federal Regulations (34 C.F.R. § 685.301).

We also noted that the schools reported approximately 20 percent of the loan data to SFA more than 60 days after the loan disbursement date. When schools do not report loan information to SFA in a timely manner, this increases the risk that loans are not recorded and serviced timely, borrower accounts in the servicing system are inaccurate, and interest revenue is not accrued promptly.

SFA has developed reports to assist in reviewing the outstanding advance balance at each school. Using these reports, staff at the Loan Origination Center can isolate those schools with the largest advance balances and work with the schools to ensure loan data is submitted timely.

We recommend that SFA:

1. Actively monitor schools' outstanding advance balances to identify schools with large balances.
2. Provide assistance to schools to ensure that all data needed to record the loans is transmitted to the LOS on a timely basis.
3. Consider placing schools that consistently violate the regulation on reimbursement status.

#### PAYFILE Differences (Repeat Condition)

When schools draw down funds for direct loans, the draw down transaction is originally recorded in the Grant Administration and Payment System (GAPS). The data is then transmitted to the FMSS and to the Loan Origination Subsystem (LOS). LOS then transmits the data to the servicer's general ledger (FARS) via the Central Data System (CDS). SFA noted differences between data recorded in the GAPS PAYFILE and FARS. Some differences were due to timing, and other differences were due to errors in the data transmission processes whereby some transactions were recorded twice in FARS and others were never recorded in FARS. Although the differences were isolated at the transaction level, as of September 30, 2000, all differences in FARS have not been corrected and some differences date back to fiscal year 1998.

We recommend that SFA:

4. Ensure that all manual adjustments required in FARS are promptly recorded.
5. Improve the fund draw down reconciliation process between all direct loan systems (GAPS, LOS, FARS, CDS and FMSS), and promptly research and resolve all reconciling differences.

#### *Loans Receivable, Interest Receivable, and Advance Account Reconciliations*

We tested a sample of the loans receivable, interest receivable, and the advance account reconciliations, and noted that some of the reconciliations lacked documentation of a supervisory review and approval. Without adequate supervisory review and approval, SFA could be exposed to increased risk that an error could occur and not be detected timely.

OMB Circular No. A-123, *Management Accountability and Control*, states, "Transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports. The documentation for transactions, management controls, and other significant events must be clear and readily available for examination."

We recommend that SFA:

6. Ensure that supervisory review and approval of all reconciliations is documented.

#### **IV. Loans Receivable**

##### *Debt Collection Service Sub-ledger Reconciliations (Repeat Condition)*

During our testing, we performed a roll forward of Debt Collection Service (DCS) balances, using a download of DCS data and the DCS sub-ledger. Through discussions with SFA, we were informed that SFA uses the sub-ledger to prepare the Treasury Report on Receivables (Schedule 9). We also noted that the sub-ledger data used in our roll forward did not agree with

the sub-ledger data used to prepare the Schedule 9. SFA had difficulty providing us with corresponding support between the Schedule 9 and sub-ledger.

In addition, we found that the amount of assigned loans confirmed by the guaranty agencies (GAs) and reported on ED Form 1130, *Guaranty Agency Quarterly/Annual Report*, does not agree to the Debt Management and Collection System (DMCS) records of loans which have been accepted by SFA. When the GAs assign loans, DMCS performs many edit checks on loan assignment data received. Errors often occur. For example, certain loan records are not accepted, and some files are entirely rejected because of timing differences between when the GAs submit the files and when they are accepted by DCS. Errors also occur when the GA does not adjust its records to agree with the data accepted by DCS and shown on the Data Load Report. This creates a difference in the amount reported by the GAs and DCS.

According to OMB Circular No. A-123, "Transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports. Proper reconciliation of accounts shall consist of identification of differences between general ledger balances, subsidiary ledger, and the detail. The reconciliation must include the timely processing (preferably in the following month) of the identified items constituting the difference between controlling accounts and the detail."

We recommend that SFA:

1. Reconcile DCS and its DCS sub-ledger in a timely manner (*e.g.*, monthly) and on a consistent basis.
2. Reconcile the assigned loans receivable detail in DCMS and the assigned loans reported by the GAs on Form 1130.
3. Reconcile ED Form 1130 on a quarterly basis. SFA should work with the GAs to create a reconciliation that could be beneficial to SFA and the GAs. SFA should work with the GAs to ensure they are properly handling (reporting and recording) files that are rejected by DCS.

#### *Unassigned Loans Reconciliation*

During our testing, we noted that the amount of unassigned loans for June 30, 2000, confirmed by the ten GAs selected for testing did not agree to the amount reported by these GAs on the ED Form 1130. In addition, SFA is not adequately enforcing its policy on timely submission of ED Forms 1130 by the GAs. When DCS receives the loans submitted by a GA, a Data Load Report is sent to the GA detailing the total principal, interest, and fees accepted by DCS and the date accepted by DCS. The GA sometimes does not adjust its records to agree with the Data Load Report. This overstates the amount for assigned loans, which inversely understates the amount for unassigned loans receivable. If the GA does not know the unassigned loans receivable balance, the GA can report different amounts for this time period.

During both our interim and year-end testing of unassigned receivables, we noted that GAs were not submitting their Forms 1130 timely. We were unable to obtain a September 30, 2000, Form 1130 by the end of our fieldwork for several GAs, even though the forms were due to SFA in December 2000. SFA did not enforce its policy regarding the Form 1130 in order to assist the GAs in transitioning to the new Form 2000, which was issued in fiscal year 2001.

According to OMB Circular A-123, "Transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports. Proper reconciliation of accounts shall consist of identification of differences between general ledger balances, subsidiary ledger, and the detail. The reconciliation must include the timely processing (preferably in the following month) of the identified items constituting the difference between controlling accounts and the detail."

We recommend that SFA:

4. Perform quarterly reconciliations for unassigned loans receivable between the Form 1130 (and the Form 2000, when implemented) and the unassigned loans that the GAs report, and monitor the amounts that the GAs report.

We recommend that SFA OCFO:

5. Monitor the GA reporting, in addition to Financial Partners (formerly known as FAOD or GLOS), in order to perform quarterly reconciliations.
6. Share in the responsibility to enforce SFA's policy on timely submission of GA information because the SFA OCFO, rather than Financial Partners, primarily uses the information reported.

## V. Monitoring

### *Monitoring of Guaranty Agency Reserve Funds*

We selected a sample of 10 GAs and confirmed the Federal Fund and the Restricted Recall Fund as of June 30, 2000. We were unable to match the confirmed balances to SFA records. It appears that SFA can only verify the GA reserve balances at year-end.

The Financial Reporting section (section F) of the Revised ED Form 1130 was implemented in fiscal year 1998 in order to track each GA's financial condition. This form will not effectively track the financial condition of the GAs if the reserve balances are not reported. SFA is in the process of replacing the Form 1130 with a new Form 2000.



We recommend that SFA:

1. Require that each GA report the Operating, Federal, and Restricted Recall Fund balances on the quarterly Form 2000. This will allow SFA to track the reserve balances throughout the fiscal year instead of only at year-end.

*Guaranty Agency Monitoring (Repeat Condition)*

We reviewed a sample of 17 GA Independent Public Accountant (IPA) audit reports and noted the following:

- Two GAs did not submit their IPA audit reports to the Census Clearinghouse within nine months of the fiscal year end for GAs with fiscal years ending after June 30, 1999;
- 11 IPA audit reports were not received by SFA in a timely manner from the Clearinghouse (within three weeks of receipt at the Clearinghouse);
- Two IPA audit reports were not received by Financial Partners from Case Management and Oversight (CMO) in a timely manner (within three weeks of receipt at CMO); and
- Five IPA audit reports did not report corrected items noted as corrective actions from prior year.

The Financial Partners Channel in SFA does not strictly enforce the deadline for submission of IPA reports.

With regard to GA audit reports for fiscal years beginning after June 30, 1998, OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, states, "The audit shall be completed and reporting required...submitted within the earlier of 30 days after receipt of auditor's report(s), or nine months after the end of the audit period, unless a longer period is agreed to in advance by the Federal agency that provided the funding or a different period is specified in a program-specific audit guide...."

We recommend that SFA:

2. Monitor the GAs' fiscal year-ends to determine when a report is due and check with the Clearinghouse to determine if the report was submitted by the due date. This will enable SFA to initiate follow-up action immediately.
3. Monitor the submission of the IPA reports to the Clearinghouse in order to become aware when it should be receiving a report.

*Lender Monitoring (Repeat Condition)*

During our testing of a sample of 30 Lender IPA audit reports out of a population of 357, we found that 12 of the 30 audit reports were not submitted to SFA within six months of the lender's fiscal year end.

Dear Colleague letter, LS-97-01, that transmits the U.S. Department of Education Lender Audit Guide, dated December 1996, states: "Audits are required annually and are to be completed and submitted to the Department of Education within six months after the close of the lender's fiscal year."

Late reporting may not alert SFA staff of findings in a timely manner, and therefore affects the ability to take corrective action, as soon as possible. This can result in inaccuracies on Form 799, *Lender's Interest and Special Allowance Request and Report*. If the amounts on the report are incorrect, SFA may overpay or underpay interest benefits or may not be collecting all of the origination fees due to SFA.

During our testing, we noted that SFA imposes penalties on lenders who do not submit their report by the six-month deadline. After the first notice is issued, any lender that does not submit the required report will receive a second notice stating that SFA will begin withholding interest subsidy and special allowance payments. SFA has the authority to grant extensions to lenders that submit reports late. Approximately 33 lenders were suspended in fiscal year 2000, 15 lenders received extensions, and 18 lenders were sent notices.

We recommend that SFA:

4. Enforce the requirements in the Lender Audit Guide for timely submission of audit reports.

## VI. Borrowings from Treasury

### *Late Submission of SF 1081s*

During our testing of interest expense and interest revenue for the Direct Loan program, we noted that the amounts on the calculation worksheets for cohort 2000 did not agree with the amounts on the SF 1081s. SFA did not submit a revised SF 1081 to Treasury to reflect a \$64 million adjustment to interest expense and interest revenue for cohort 2000 since the recalculations occurred subsequent to the deadline for the submission of SF 1081s to Treasury.

Pursuant to OMB Circular A-123, "Transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports."

We recommend that SFA:

1. Submit a revised SF 1081 to Treasury and implement procedures to report future adjustments to Treasury on a timely basis.

## VII. Title IV Student Financial Assistance

### *Certification of Schools*

In order to participate in any of the Title IV programs, SFA must certify an eligible institution of higher education. Certification is the process of reviewing an institution's financial stability and administrative capability to properly administer the Title IV programs. During our testing, we noted that one institution was not certified; therefore, the institution should not have received Title IV funding.

Pursuant to 34 CFR §§ 668.15 and 668.16, to begin and to continue to participate in any Title IV, Higher Education Act (HEA) program, an institution must demonstrate to the Secretary that the institution is financially responsible and is capable of adequately administering that program.

We recommend that SFA:

1. Ensure that all eligible institutions participating in the Title IV programs are properly certified in accordance with the applicable legislation and the Department's regulations.

### *Composite Score Calculation*

To ensure that Pell grants were administered in accordance with grant provisions and applicable general and implementing laws and regulations, we selected a sample of 15 schools that participated in the Title IV Pell grant program. During our testing, we reviewed the institutional folders to determine that grants were awarded to "financially responsible" institutions. An institution is deemed to be financially responsible based on its composite score and other requirements as required by 34 CFR § 668.15.

During our review, we noted that an institution's composite score was incorrectly calculated. Pursuant to 34 CFR § 668.172, SFA is required to calculate the composite score of each institution that desires to participate in Title IV programs in order to assist in determining whether the institution is financially responsible. The composite score is calculated by adding the weighted strength factor scores for the primary reserve, equity, and net income ratios. Both the primary reserve and equity ratios include the "amount due from owner" in the numerator.

We recommend that SFA:

2. Ensure that its employees are acquainted with the requirements for determining whether institutions can be certified to participate in its programs. In addition, supervisory reviews should be performed to reduce the possibility of errors in certifying institutions for participation in Title IV programs.

### VIII. Accrued Liabilities

SFA should improve its methodology for calculating the year-end Contractual Services, Administrative Services and Interagency Agreements accruals. To calculate the accruals as of September 30, 2000, the OCFO queried the general ledger for all expenses with transaction dates from October 1, 2000, to November 15, 2000, and for certain object class codes. The total of these expenses was recorded as a year-end accrual. Neither SFA nor OCFO reviewed supporting documentation for any of the expenses incurred in this period to ensure that the accruals were recorded in the appropriate accounting period. As a result, accrued liabilities may be misstated.

Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*, states, "When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of the goods. If invoices for those goods are not available when financial statements are prepared, the amounts owed should be estimated".

We recommend that SFA consider implementing one or both of the following methodologies:

1. Estimate amounts owed for goods and services received but not yet invoiced at year-end and submit the accruals and related supporting documentation to the Office of the Chief Financial Officer (OCFO) to be accrued at the fiscal year-end.
2. Review supporting documentation for all expenses recorded in the general ledger over a certain threshold (i.e. \$1 million) after fiscal year-end to determine the period of performance.

### IX. Management Discussion & Analysis (Modified Repeat Condition)

Congress enacted the Government Performance and Results Act (GPRA) of 1993 as a means to improve the management and accountability of Federal agencies. GPRA requires executive agencies to prepare multi-year strategic plans, annual performance plans, and annual performance reports. OMB Bulletin 97-01 requires agencies to report the performance measures in the overview section of the financial statements, and that these be consistent with the measures used by agencies as part of their GPRA implementation efforts. Management's display of performance information should include sufficient explanatory information to help readers understand the significance of the measures, the results and any deviations from goals or plans. SFFAS #15, *Management Discussion & Analysis (MD&A)*, establishes standards for preparing the MD&A of the financial statements. The MD&A should provide a clear and concise description of the entity and its mission, activities, and performance (among other items).

SFA significantly improved its MD&A from the prior year. They expanded the financial information covered by the overview, utilized charts and graphs, and compared actual results to

goals. SFA was very effective in discussing both the positive and negative outcomes of their performance measures. However, we did note areas for improving SFA's performance measures and the MD&A. In particular, it was difficult to understand which performance measures were considered most significant given the length of the MD&A. Some measures in the MD&A may not appear to be meaningful to an outside reader, for example, SFA's discussion about new office space. SFA is still refining its process to develop the MD&A and performance measures. FY 2000 is only the second year SFA has existed as a performance based organization.

SFFAS #15 states that the "MD&A must be concise if it is to be useful, so management must select the most important matters to discuss." Per OMB Bulletin 97-01, "the measures in the overview should be limited to the entity's most significant program and financial measures."

We recommend that SFA:

1. Be more concise in its MD&A in future years and focus on significant matters and measures so as to better direct the reader to the most important issues.

## **X. Loan Program Estimates**

### *Treatment of Consolidations*

SFA does not have significant history of repayment data or historical trend analysis available to support the assumptions used for defaults, repayments, and other actions taken for consolidated loans. While not readily quantified by SFA, the cash flows from consolidations appear to have played a significant role in the re-estimate process. Changes in these assumptions may have a significant impact on the estimate in the future as additional data is developed. However, the treatment of consolidations appears to be consistent with OMB guidance.

We recommend that SFA:

1. Monitor its collections to better assess the underlying assumptions related to consolidations for estimation purposes.

### *Reconciliation of the 799 (Lender System) to National Student Loan Data System (NSLDS)*

During our testing of the loan program estimates, we needed to obtain a certain level of assurance that the data in NSLDS was accurate and complete. To do this, we selected a sample of 15 lenders that submitted 799s to SFA. SFA ran queries for each of the lenders in our sample and submitted them to us for comparison. We compared the outstanding principal balance on the 799s to the NSLDS queries. Out of the 15 lenders selected, none of the 799s matched the NSLDS data. Furthermore, there was no consistency in the manner in which each difference was

found. While in aggregate we were able to conclude that the NSLDS program data could be used in the loan estimate process, the differences need to be researched.

SFA does not perform quarterly reconciliations between the National Student Loan Data System (NSLDS) to the ED 799 reports or the Lender System. However, there is an ongoing project to improve reporting of lender data in NSLDS.

OMB Circular No. A-123 states, "Transactions should be promptly recorded, properly classified, and accounted for in order to prepare timely accounts and reliable financial and other reports. The documentation for transactions, management controls, and other significant events must be clear and readily available for examination."

We recommend that SFA:

2. Perform on a sample basis, quarterly reconciliations between the NSLDS and the lender ED 799 reports, and fully describe, by lender or GA as appropriate, overarching reasons for any differences in transaction-level data posted as well as cumulative amounts.

#### *Schedule for Reconciling Subsidy Cost Allowance Balances*

Based on SFA's new methodology of reporting the loan program estimates, we reviewed SFA's Schedule for Reconciling Subsidy Cost Allowance Balances. The schedule includes the 2000 cohort's subsidy transfers, as well as the activity within the 2180 (Loan Liability) and 1399 (Allowance for Defaulted Loan Guarantees) general ledger accounts for fiscal year 2000. We tried to reconcile the activity within the general ledger to source documentation (*i.e.*, GAF/GAQ/Lender System, payfile), but we were unable to verify the general ledger activity.

In addition, we attempted to verify the cash flows within the Fund Balance with Treasury general ledger accounts to the payfile. We obtained assurance that all cash flows from the payfile are posted to the general ledger. However, we could not verify the cash flows by object class codes or by Common Accounting Number (CAN). The Object Class Codes/CANs are used to classify the type of transaction.

According to OMB Circular No. A-123, "Transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports." Proper reconciliation of accounts shall consist of identification of differences between general ledger balances, subsidiary ledger, and the detail. The reconciliation must include the timely processing (preferably in the following month) of the identified items constituting the difference between controlling accounts and the detail.

We recommend that SFA:

3. Perform quarterly reconciliations of the account 1399 – Allowance for Defaulted Loan Guarantees, and the account 2180 – Loan Liability. Reconciling these two general

ledger accounts would enable SFA to monitor the Federal Family Education Loan Program (FFELP) cash activity that flows through the general ledger's FFELP loan accounts, as well as monitor the activity within Fund Balance with Treasury.

## **XI. Statement of Financing**

Accrual-based measures used in the Statement of Net Cost differ from the obligation-based measures used in the Statement of Budgetary Resources. In order to understand these differences, information is needed to reconcile financial (proprietary) net cost of operations with obligations of budget authority. This reconciliation also ensures that there is a proper relationship between proprietary and budgetary accounts in the reporting entity's financial management system. The Statement of Financing is designed to report those differences and facilitate the reconciliation.

A large portion of Statement of Financing represents Obligations Incurred, which were \$52 billion at September 30, 2000. Significant adjustments were posted to the Obligated Balance Net-Beginning of the Period. We selected a sample of these adjustments made to the beginning balances. Since adequate historical records were not always available, in some cases adjustments were made based on the best available data and management's reasoned judgment as to the most likely cause of the discrepancies. As a result, we were unable to assess the reasonableness of these adjustments and the impact on the Obligations Incurred at year-end.

In addition, SFA had \$81 million as Costs that Do Not Require Resources in the Statement of Financing. We noted that the balance of this line is mainly prior period adjustments. As explained in the preceding paragraph, adequate records were not always available, so we were unable to assess the reasonableness of these adjustments and the impact on this line on the statement.

OMB Circular A-123 states "Transactions should be promptly recorded, properly classified and accounted for in order to prepare timely accounts and reliable financial and other reports. The documentation for transactions, management controls, and other significant events must be clear and readily available for examination."

We recommend that SFA:

1. Perform reconciliations at the financial statement level during interim in order to assess whether the relationships between assets, liabilities, costs, and budgetary balances are reasonable.

## **XII. Potential Improper Payments Estimation Process**

A number of agencies have or are developing routine processes to estimate and periodically report improper payments as one aspect of a program to demonstrate accountability and develop a performance measure for use in tracking program safeguarding activities. In some cases this information is reported in the notes to the financial statements, or in management's discussion

and analysis, in other cases it is available internally. These processes are evolving, and in many instances cover a subset of activity within the agency. In some instances, this approach, for example the presentation of Medicare improper payment estimates, is potentially more meaningful than presenting an estimate across all agency activities.

Within the Department and SFA, efforts have been made to merge available information regarding potential improper payment data for programs. Many ongoing activities by the Department and SFA inform this process, and develop data that can be used as a starting point in a discussion of the appropriate approaches to measure potential improper payments, meaningful subsets of programs for which such a measure might be cost effectively developed, and approaches to determining and meeting users (OMB, GAO, OIG and Congress) objectives in reporting this data. The diverse portfolio of Departmental and SFA activities complicates this process, with formula based grant programs potentially less susceptible to improper payments than programs that are individual recipient based, such as the loan programs. Tiers in the provision of services also impact the estimates, as in many cases guaranty agencies, lenders and schools play a significant role in determining eligibility and determining whether payments ultimately were proper.

The criteria in this area are evolving. Recent activity within the Office of Management and Budget to develop information in this area and congressional interest highlight the need to be proactive in meeting users needs—while also raising the potential that if the Department or SFA devote resources in this area their efforts may need to be modified over time as criteria are established. Nonetheless, on balance we believe the Department and SFA would be well served in playing an active role in determining the information that is meaningful and can be cost effectively gathered, and should consider developing a process to determine users needs in this area Department-wide, for SFA or for specific programs as appropriate. Initial efforts to pull together available information on improper payments are a good first step in the process to quantify a range of improper payments.

### **XIII. EDP Issues (Repeat Condition)**

As part of the audit of SFA's fiscal year 2000 financial statements, we conducted a general controls review of the information technology processes related to the significant accounting and financial reporting systems. OMB Circular No. A-130 requires: (1) standard documentation and procedures for certification and accreditation of systems; (2) records management programs that provide adequate and proper documentation of agency activities; (3) agencies to develop internal information policies and procedures and oversee, evaluate, and otherwise periodically review agency information resources management activities; and (4) agency plans to assure that there is an ability to recover and provide service sufficient to meet the minimal needs of users of the system noting that manual procedures are generally not a viable back-up option. As a result of the procedures we performed, we noted several issues included as Appendix A to this report. Appendix A is for internal use only. It contains sensitive computer security-related information. Public disclosure of this information would risk circumvention of the law. Recipients of Appendix A must not, under any circumstances, show or release its contents for purposes other



than official action. It must be safeguarded to prevent publication or improper disclosure of the information it contains.

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This report is intended solely for the information and use of the management of the Student Financial Assistance, the U.S. Department of Education and the Department's Office of the Inspector General, and is not intended to be and should not be used by anyone other than these specified parties.

*Ernst & Young LLP*

January 26, 2001