



UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

JUL 19 2001

MEMORANDUM

TO: Susan B. Neuman
Assistant Secretary
Office of Elementary and Secondary Education

FROM: Lorraine Lewis *Lorraine Lewis*

SUBJECT: FINAL REPORT: *Review of the Impact Aid Program Disbursement Process Within the U.S. Department of Education Office of Elementary and Secondary Education* (Audit Control Number: ED-OIG/S17-B0013)

Attached is a copy of the final report referenced above. We received comments from the Office of Elementary and Secondary Education concurring with the recommendations in the draft report and have included them as Attachment I of the final report.

You have been designated as the action official responsible for the resolution of the recommendations in this report. Please provide the Post Audit Group Supervisor - Financial Improvement and Post Audit Operations, Office of the Chief Financial Officer within sixty (60) days of issuance of this report with a Corrective Action Plan that builds on the actions you outline in your comments. Then provide the Post Audit Group Supervisor with quarterly status reports on corrective actions until all such actions have been completed or continued follow up is unnecessary.

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

We appreciate the cooperation given us and Ernst & Young, LLP, during the review. Should you have any questions concerning the report, please contact Mr. Todd Givens, Director, Financial Statements Internal Audit, at (202) 205-7945.

Attachment

Distribution List:

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To the Inspector General
U.S. Department of Education

This report presents the results of our review of the Impact Aid Program disbursement process within the U.S. Department of Education's (Department) Office of Elementary and Secondary Education (OESE). This review is part of a larger review of disbursement processes within the Department that was conducted by Ernst & Young, LLP (E&Y) at the request of the Office of Inspector General. The results of work will be provided to the Secretary.

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of the review were to determine the processes by which payments can be made by the Department and to assess the controls over the payments in those processes to determine if the controls are operating effectively.

To accomplish the review objectives, we obtained a detailed understanding of the Impact Aid Program, the Impact Aid System (IAS), and the control environment surrounding the Impact Aid Program disbursement process by attending presentations given by Department officials and conducting interviews with key Department personnel. We also reviewed policy and procedure manuals and Web site information relating to the Impact Aid Program and IAS. In addition, we reviewed audit reports and other products issued by the Department's Office of Inspector General, the U.S. General Accounting Office (GAO), and independent auditors. Walk-throughs of the Impact Aid disbursement process were then conducted to validate our understanding of the control environment, control objectives, and control techniques. A limited number of Impact Aid transactions were selected and tested to validate the disbursement process and to identify areas where internal controls could potentially be improved. Interviews and limited transaction testing were conducted between October 17, 2000, and March 30, 2001.

The work within OESE was limited to the Impact Aid disbursement process. An attachment provides a business process map detailing the Impact Aid disbursement process.

We conducted our work according to the American Institute of Certified Public Accountants Professional Standards for consulting services. These standards require the development of findings, conclusions, and recommendations determined by the objectives of the engagement. In conducting our work, we also compared the control environment to known industry established best practices appropriate to the scope of review described above. On April 4, 2001, the results of this review were discussed with members of the Impact Aid staff.

INTERNAL CONTROLS

Management is responsible for establishing and maintaining internal controls. In fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that: assets are

safeguarded against loss from unauthorized use or disposition; transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in conformity with accounting principles generally accepted in the United States; and data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information. Because of inherent limitations in any internal control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

The Federal Managers' Financial Integrity Act of 1982 requires GAO to issue standards for internal control in the government. Office of Management and Budget (OMB) Circular A-123, Management Accountability and Control, revised June 21, 1995, provides the specific requirements for assessing and reporting on controls.

Recently, other laws have prompted renewed focus on internal control. The Government Performance and Results Act of 1993 requires agencies to clarify their missions, set strategic and annual performance goals, and measure and report performance toward those goals. Internal control plays a significant role in helping managers achieve those goals. Also, the Chief Financial Officers Act of 1990 calls for financial management systems to comply with internal control standards, and the Federal Financial Management Improvement Act of 1996 identifies internal control as an integral part of improving financial management systems.

Rapid advances in information technology have highlighted the need for updated internal control guidance related to modern computer systems. The management of human capital has gained recognition as a significant part of internal control. Furthermore, the private sector has updated its internal control guidance with the issuance of Internal Control - Integrated Framework, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Consequently, in November 1999 GAO updated the standards for use in the government that provides the overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement.¹ The standards are effective beginning with fiscal year 2000 and the Federal Managers Financial Integrity Act reports covering that year.

Effective internal control helps in managing change to cope with shifting environments and evolving demands and priorities. As programs change and as agencies strive to improve operational processes and implement new technological developments, management must continually assess and evaluate its internal control to assure that the control activities being used are effective and updated when necessary.

¹*Standards for Internal Control in the Federal Government*, U.S. General Accounting Office (GAO/AIMD-00-21.3.1, November 1999).

BACKGROUND

Grants under the Impact Aid Program provide direct assistance to Local Education Agencies (LEAs) that enroll significant numbers or percentages of federally connected pupils - children who live on, or whose parents work on, federal property. The funds are intended to help LEAs meet the local costs of educating federally connected children, including those with disabilities.

The IAS is used to manage the awards, from application data-entry to the processing of obligation and payment files. Obligation and payment files are then transferred to the Department's Grant Administration and Payment System (GAPS) for final payment to LEAs through the Federal Reserve Bank. Effective June 19, 2000, changes affecting an LEA's bank account are handled by the Department's Office of Chief Financial Officer directly through GAPS. Fiscal year 2000 Impact Aid appropriations totaled approximately \$910 million.

LEAs request impact aid funds through an annual application process. Applications received are date stamped and reviewed for completeness. Critical application information is entered in IAS, an application number is assigned, and a receipt letter is then generated from IAS and sent, notifying the appropriate LEA that its application has been received.

A second screening process occurs where the application is again reviewed for completeness. Once all information has been received and a determination has been made, as to whether or not the LEA enrolls significant numbers or percentages of federally connected pupils, a draft letter is mailed to the LEA informing it of its eligibility status.

Prior to the disbursement of funds, the Program Operations Group within the Impact Aid Office validates the application information submitted by LEAs requesting funds. The validation process may include either a mail-in review or an on-site visit to the LEA to confirm student enrollment information and the processing of adjustments to originally submitted data. The frequency of the reviews are based upon the level of funding and are performed in some instances by the same individual year after year according to regional areas. Heavily impacted LEAs are reviewed each year whether or not significant changes were made to student enrollment information. Upon completion of the review, a report is prepared and sent to the LEA informing them of the results of the review. Records of scheduled and completed reviews are maintained manually.

After the accuracy of the data has been ensured by comparing the information entered in IAS to a hard copy of the application and consideration of any additional information received, an eligibility letter is prepared and an estimate is made of the total amount available to the LEA. Eligible applications are batched and an obligation and payment file is created and transmitted to GAPS for processing. Informal reconciliations are performed on total funded amounts in GAPS to the total funded amounts in IAS.

RESULTS

Based on the results of our review, we have identified several areas where enhanced controls and needed operational changes, if properly implemented, will reduce the risk of erroneous payments and manual intervention in the Impact Aid Program disbursement process.

Our review of this process disclosed that:

- The Impact Aid Office does not have a policy for rotating program analysts assigned to validate application information submitted by LEAs. Discussions with management indicated that, in some instances, the same analyst continually visits the same LEA year after year. Each analyst should be restricted to a specific number of consecutive visits to a LEA. A rotational policy would help reduce the potential for complacency and ensure a greater degree of independence by the analyst, and integrity of the enrollment statistics reported by each LEA.
- Heavily impacted LEAs are reviewed annually whether or not significant changes were made to reported student enrollment statistics. Reviews of heavily impacted LEAs in prior years could be rotated and completed on a less frequent basis. This would allow program analysts to place greater emphasis on significant enrollment changes.
- Data used to track and schedule past and future reviews is maintained on a handwritten log. This information, critical to the scheduling process, could easily be lost or misplaced. By maintaining information used to track and schedule LEA reviews electronically, the information could be more accessible and the risk of loss reduced.
- Reconciliations, comparing total funded amounts in IAS to total funded amounts in GAPS, are performed on an informal basis and are not documented. Formal reconciliations would provide a reasonable assurance that the amount of funding that goes to the LEA is accurate.

RECOMMENDATIONS

We recommend that the Assistant Secretary for Elementary and Secondary Education:

1. Establish a rotation policy for program analysts conducting reviews of LEAs.
2. Use a risk-based sampling approach to schedule program reviews of LEAs.
3. Maintain information used to track and schedule LEA reviews electronically as part of the IAS database.
4. Establish and perform formal reconciliations of total funded amounts and individual award amounts in IAS to amounts in GAPS.

DEPARTMENT'S RESPONSE

The Department agreed with the overall content of the report and concurred with the recommendations. The response describes actions already taken or currently underway, and additional actions that OESE plans to take by February 2002. These actions are responsive to the concerns expressed in the report, and a full corrective action plan will be developed by OESE, pursuant to follow up and resolution practices of the Department. The Department's response is included in this report as Attachment I.

This report is intended solely for the information and use of the management of the Department, OMB, Congress and the Department's OIG, and is not intended to be and should not be used by anyone other than these specified parties.

Attachments

Ernst & Young LLP

April 4, 2001
Washington, D.C.




UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF ELEMENTARY AND SECONDARY EDUCATION

May 21, 2001

MEMORANDUM

TO: Lorraine Lewis
Inspector General

FROM: Thomas M. Corwin 
Acting Deputy Assistant Secretary for
Elementary and Secondary Education

SUBJECT: Recommendations from Inspector General's Report:
*Review of the Impact Aid Program Disbursement Process
Within the U.S. Department of Education Office of Elementary
And Secondary Education*

This provides our responses to the draft report referenced above, which makes four recommendations for improving the operation of the Impact Aid Program. We appreciate the opportunity to comment on this report both now and while it was being developed. We also concur with each of the specific recommendations made by your office and plan the following actions.

Rotation policy for program analysts conducting reviews of LEAs – Beginning with applications for FY 2003, which will be received in January 2002, the Impact Aid Program will implement a rotation system so that each program analyst is assigned responsibility for an individual State for no more than three years. Senior analysts assigned to provide second-level review for applications from LEAs in those States will also be rotated every three years.

Risk-based sampling approach to scheduling program reviews of LEAs – Beginning with applications for FY 2003, received in January 2002, the Impact Aid Program will perform field reviews for most heavily impacted LEA applicants for section 8003(b)(2) funding on a rotating basis every three years. Annual field reviews will be conducted only for heavily impacted LEAs where the number of children reported on the LEA's application indicates that its child-count is within five percent of the threshold for eligibility under section 8003(b)(2).

Electronic tracking for LEA reviews – We will design and develop a function that can be added to the Impact Aid System (IAS) to record and track LEA review information. Our target date for implementing this IAS enhancement is February 2002, in time to track and record the FY 2003 application review cycle.

Formal reconciliations of total funded amounts in IAS and GAPS – We will explore with EDCAPS options for developing an automated reconciliation system between the two systems, with a possible target date for implementation in early 2002. In the meantime, we will begin a formal process of manually reconciling GAPS, FMSS, and IAS on the last business day of each month. The results of the monthly manual reconciliations will be reported by e-mail to all Impact Aid Program managers.

Thank you for the constructive recommendations from your review of the Impact Aid Program. You may contact Impact Aid Program Director Catherine Schagh at 260-3858 if you have questions about this response.