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ACCOUNTING SYSTEMS

HHS Grant Payment Operation Has Improved and Additional Corrective Actions Are Underway





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Accounting and Financial
Management Division

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The Honorable Otis R. Bowen, M.D.
The Secretary of Health and Human Services

Dear Mr. Secretary:

This report summarizes the results of our review of the Department of Health and Human Services' (HHS)¹ operations for making and controlling payments to grant recipients. We focused primarily on actions taken by the Department to correct serious problems which we identified in a 1979 report² and problems which HHS reported as material weaknesses in this area under the Federal Managers' Financial Integrity Act.³

HHS has made major strides in addressing the problems we cited in 1979 relating to the Departmental Federal Assistance Financing System (DFAFS). We believe HHS' Payment Management System (PMS), which replaced DFAFS in 1984 as the core of HHS' grants payment operation, represents a substantial improvement in making and controlling payments to grant recipients. Nonetheless, HHS itself has recognized in its Financial Integrity Act work that additional actions are necessary to further bolster internal controls for this operation and for PMS to fully meet the Comptroller General's accounting principles and standards. We agree. Although our review did not identify any additional problems, we confirmed that:

- PMS does not account for receivables due from grant recipients when they hold excess federal funds—an important internal control feature which would help ensure recovery of substantial amounts.
- Cash advances to some grant recipients are charged to HHS appropriations based on estimates that are not adjusted to reflect actual advances, which is necessary to accurately report information on amounts spent from appropriations.
- Inactive grants are not promptly closed out, thereby hampering prompt return of unused government funds.

¹Formerly the Department of Health, Education, and Welfare (HEW).

²HEW Must Improve Control Over Billions in Cash Advances (FGMSD-80-6, December 28, 1979)

³The Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512(b) and (c)) requires agencies to report material weaknesses in agency internal control and accounting systems to the President and the Congress each year, along with plans to correct the problems.

are electronically transmitted to PMS by Treasury. These requests are subject to a prepayment review whereby PMS, through edit and validation checks, determines the propriety of the requests. FAFD authorizes Treasury to pay those requests which pass the prepayment review. Payments made by the Treasury are then charged by FAFD to HHS appropriations to reflect cash advances to grant recipients. PMS reports these charges to the HHS operating divisions and Treasury. PMS also records cash disbursements by public assistance and general account grant recipients based on reports submitted by these recipients.

Lastly, with the exception of block grants, grants are closed out in PMS based on either annual or final expenditure reports submitted by grant recipients and accepted by the operating divisions. HHS is in the process of finalizing closeout procedures for block grants.

Objective, Scope, and Methodology

The objective of this report is to advise the Secretary of Health and Human Services on whether the Department's grant payment operation has adequate internal controls to ensure complete, accurate, and prompt processing of payments and accounting of cash advances made to grant recipients—thereby correcting (1) the internal control problems we cited in our 1979 report on DFAFS and (2) the material weaknesses related to grant payments cited by HHS in past Financial Integrity Act reports.

To identify and describe internal controls in PMS relating to the use of the Letter of Credit-Treasury Financial Communications System, we reviewed PMS system documentation and users' manuals, analyzed the system's internal control features such as PMS edit messages to approve payments or reject funds requests, and observed the system in operation. Through discussions with HHS officials and with program, data processing, and financial management representatives, we also confirmed our understanding of how the system is designed to operate.

To examine HHS' efforts to correct system weaknesses previously identified by GAO and HHS' inspector general, we analyzed the nature of these problems and determined whether internal control features in PMS resolved them. We reviewed inspector general reports and other studies relating to PMS. We also discussed HHS' corrective actions with agency officials.

excess cash. To solve this problem, a new format which requires recipients to report quarterly cash disbursements by individual grant award was developed in September 1981 and adopted by PMS.

FAFD reviews these reports to determine whether recipients are holding cash in excess of their immediate disbursements. If so, FAFD asks them to (1) refund any excess or (2) explain why a refund is unwarranted.

We examined selected cash disbursement reports and the process by which they are reviewed. In addition, we noted that during fiscal year 1986, grant recipients refunded over \$10 million which they agreed exceeded their immediate needs, based on FAFD's review of their disbursement reports.

- PMS has eliminated cash pooling for 83 percent of its grant payments. Under DFAFS, all cash advances were made from a "cash pool" representing grant funds made available from various appropriations. Grant recipients were not required to specify the grant against which the advances would be applied. Use of this cash pooling concept hampered operating divisions' funds control because accurate information for charging of payments to specific HHS appropriations was not available.

Under PMS, the cash pooling concept was eliminated for grant recipients funded by block grant and public assistance programs. In fiscal year 1987, these programs amounted to approximately \$43 billion, or 83 percent of the payments authorized by PMS. PMS now requires these grant recipients to identify the portions of their advance payments to be applied to specific appropriations when they request funds.

We verified that grant recipients are requesting funds in this manner and reviewed reports to the operating divisions that showed charges by appropriations.

What Additional Accounting and Control Features Are Needed?

While HHS' grants payment operations have improved considerably since PMS was implemented, some problems remain in accounting for and controlling these payments. Specifically, PMS does not account for substantial amounts of receivables due from grant recipients, cash advances to some grant recipients are charged to HHS appropriations based on estimates that are not subsequently adjusted, and return to the government of unused grant recipient funds is unnecessarily delayed because controls are not in place to ensure timely grant closeout. HHS has long been

Contributing to the above problem is the absence of explicit policy and procedures for recording receivables resulting from active grant recipients holding federal funds in excess of their immediate disbursement needs. FAFD officials told us that the main difficulty in establishing policy and procedures has been the uncertainty as to the appropriate time and amount at which these receivables should be recorded. We believe that a policy could be established which would require recording a receivable in PMS after FAFD determines that a grant recipient has excess federal funds and issues a notification to the recipient.

HHS has long recognized the need to account for receivables in PMS. At the close of our review, FAFD had begun, through manual records, to control receivables resulting from overadvances. FAFD officials told us that they plan to automate this process once an accounts receivable subsystem to PMS is developed and implemented.

The failure to account for receivables precludes management from having the information needed to assess the timeliness and effectiveness of collection efforts and to determine whether more aggressive efforts are needed. Moreover, by not accounting for all receivables, financial reports and other information produced by PMS and the Department are misstated. For example, we noted that FAFD reported receivables of about \$617,000 as of September 30, 1986, on its Report on Accounts and Loans Receivable Due From the Public.⁶ This, however, is significantly understated because receivables arising from expired grants alone amounted to about \$92 million according to a PMS-generated report during this period.

General Account Cash Advances Are Charged to Some HHS Appropriations Based on Estimates

As we discussed earlier, the "cash pooling" concept was eliminated for grant recipients funded by the block grant and public assistance programs. Cash pooling, however, is still used for the general accounts, which received nearly \$9 billion, or about 17 percent, of the fiscal year 1987 payments authorized by PMS. Consequently, for these accounts, HHS appropriations continue to be charged based on estimates which are not adjusted to reflect actual cash advances requested by grant recipients.

Specifically, for general accounts, the grant recipients' cash outlay plans are the basis for estimating amounts of cash advances to be charged to

⁶This is a key agency financial report which provides information to the Department of the Treasury for inclusion in governmentwide financial reports. Information such as this is relied on by the administration and the Congress in overseeing the government's fiscal activities.

Grant closeout should occur shortly after the grant expires and is initiated when grant managers in the HHS operating divisions receive the final expenditure reports from grant recipients. HHS grant closeout regulations state that grant recipients should submit a final expenditure report no later than 90 days after the grant expires. During the grant closeout process, grant management personnel must reconcile any differences between the recipient, the operating division, and PMS on the exact amount obligated and disbursed. Once this is accomplished, the operating division submits a closing entry to PMS, thereby closing the grant in PMS.

In our 1979 report, we noted about 52,400 inactive grants or loans which should have been closed in DFAFS. These included 35,700 loans or grants made by the Office of Education under the former HEW. However, our review showed that the number of inactive grants at HHS is considerably less since the inactive grants relating to the Office of Education were transferred to the Department of Education in 1983. Nevertheless, we found that many inactive grants remain unclosed at HHS.

Specifically, we noted that an FAFD analysis in June 1986 identified 4,527 grant awards whose performance period had expired December 1983 or earlier that needed to be closed. The majority of these grants (4,104) relate to the Office of the Secretary (which includes the Department's regional offices) and three organizational components within the Public Health Service (the Alcohol, Drug Abuse, and Mental Health Administration; Health Resources and Services Administration; and Office of the Assistant Secretary for Health). In addition, at our request, FAFD scanned the PMS data base as of August 24, 1987, and identified 2,037 open grants for which the performance period expired between January 1, 1984, and December 31, 1986. These inactive grants relate only to the Alcohol, Drug Abuse, and Mental Health Administration; the Food and Drug Administration (an organizational component within the Public Health Service); the Health Resources and Services Administration; and the Department's regional offices.

We also noted, however, that several operating divisions with a high number of inactive grants are attempting to address their grant closeout problem. Some specific examples follow.

- An HHS grant closeout task group, established by the Acting Deputy Assistant Secretary for Finance, in April 1986, to study the problem of inactive grants with outstanding cash advances for several years, found nonreceipt of the final expenditure reports as the primary reason for

Grant Payment Problems Cited in Financial Integrity Act Reports

HHS' Financial Integrity Act reports have disclosed that the Department has not implemented systems to account for receivables resulting from outstanding advances and to record payments made by general account grant recipients to its appropriations. The failure to correct these problems was characterized by HHS as a material weakness of PMS in its 1984 report. In 1985, HHS reported on the implementation status of the systems but did not discuss these problems in its 1986 report.

In addition, in its 1985 Financial Integrity Act report, the Department cited internal control material weaknesses in grant closeouts at the Health Resources and Services Administration. As we discussed earlier, this organizational component has made progress in correcting these weaknesses.

Timely corrective actions are key to strengthening grant payment and control operations. It is imperative that, under the act, the Department monitor progress in addressing the long-standing problems discussed in this report. To the extent that these problems remain uncorrected at the end of this calendar year, the status of efforts to resolve them should continue to be reported to the Secretary so he may determine whether additional resources should be spent on their completion and whether the status of their materiality has changed.

Conclusions

While HHS has made significant strides in addressing major weaknesses identified in our 1979 report on DFAFS, several long-standing problems in its grant payment and control operations remain uncorrected. Although the Department is solving the problems, historically it has been slow in implementing necessary corrective actions. To the extent the problems remain uncorrected at the end of the calendar year, their status should continue to be reported to the Secretary under the Financial Integrity Act. Furthermore, although the HHS operating divisions are attempting to address long-standing grant closeout problems, they need additional guidance and information on inactive grants from the Department.

Recommendations

To improve the overall grant closeout process, we recommend that the Secretary of Health and Human Services provide departmental guidance on closing out inactive grants when there are no final expenditure reports available. We also recommend that the Secretary instruct FAFD to provide the operating divisions with periodic PMS reports which list the inactive grants that should be closed.

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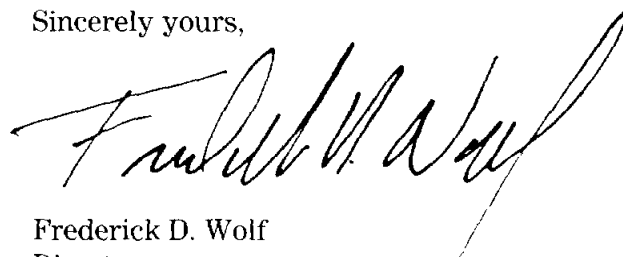
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We discussed the contents of this report with the Deputy to the Deputy Assistant Secretary, Finance, and members of his staff. They agreed with our recommendations. In addition, they made several comments to clarify or update information in our draft report. We incorporated these clarifications and updates in the report where appropriate.

As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations. You should send the statement to the House Committee on Government Operations and the Senate Committee on Governmental Affairs within 60 days of the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made over 60 days after the date of the report.

We are sending copies of this report to the Director of the Office of Management and Budget, the Secretary of the Treasury, interested congressional committees, and other interested parties. Copies will also be made available to others upon request.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Frederick D. Wolf". The signature is written in a cursive style with a large, sweeping flourish at the end.

Frederick D. Wolf
Director

grants not being closed. This task group, which focused on grants made within the Office of the Secretary,⁷ concluded that the policy which requires receipt of the final expenditure report before any attempt is made to close out the grant in the accounting records has no legal or regulatory basis. Thus, the task group outlined detailed explanations of the problems and the solutions to be followed for closing out inactive grants over 3 years old in the Office of the Secretary and distributed this guidance to its accounting office and the regional offices.

- The Alcohol, Drug Abuse, and Mental Health Administration, with the assistance of PMS, identified 1,028 inactive grants relating to the National Institute of Mental Health in June 1987. The grants management office within this organizational component authorized its accounting and finance office, in August 1987, to close selected inactive grants, such as grants with a balance of \$10 or less.
- The Health Resources and Services Administration has made progress in closing out some of its inactive grants. For example, its Bureau of Health Professions, using a November 1986 report provided by its accounting office, identified 450 grants that were ready for final closeout.

In our discussions with selected grants management personnel in the HHS operating divisions, they indicated that the grants closeout process would be further enhanced if they had written guidance on closing out inactive grants over 3 years old when there are no final expenditure reports. Some of these officials also indicated that it would be helpful to receive periodic reports from PMS that list inactive grants which should be closed.

Failure to promptly close out grants whose performance periods have expired can hamper FAFD personnel from promptly identifying and collecting amounts owed by grant recipients. For example, a January 1987 FAFD sample of 137 inactive grants (with an initial value of about \$95 million) disclosed that the average time interval between grant expiration and grant closeout was over 3 years. These grants involved receivables of about \$3.6 million. FAFD officials also told us that computer and record storage costs could also be reduced if inactive grants were promptly closed and removed from the PMS data base, but they could not quantify these savings.

⁷These grants are processed through either the Office of the Secretary's accounting system or PMS.

each HHS appropriation. PMS uses these plans to calculate the month-by-month percentages of cash advances to bill each HHS operating component, as well as to determine the amounts to charge each appropriation. These estimates are then reflected on monthly reports that FAFD submits to HHS operating divisions and Treasury. One of these reports, the Statement of Transactions, is the basic document Treasury and the operating divisions use to charge specific appropriation accounts with amounts advanced to grant recipients. These reports, however, may be misstated because charges to general account appropriations are based on estimates and not actual cash advances requested by grant recipients.

HHS has long recognized the need to provide information to the HHS operating divisions for their use in accurately and reliably charging appropriations. It, however, was slow in correcting this problem. A charging subsystem was initially scheduled for implementation in 1984, when PMS became operational.

HHS has developed, and began using in November 1987, an automated subsystem to PMS. This subsystem, which would make necessary adjustments to charges previously applied to HHS appropriations, would use actual cash disbursement data reported quarterly by grant recipients. Since this subsystem is in the early stages of implementation, we did not review it to determine whether it corrected the problem. However, HHS should monitor the system's operations through its Financial Integrity Act evaluations, as we discuss later in this report.

We believe it is critical that Treasury and the HHS operating divisions be provided accurate and reliable information for their use in charging specific HHS general account appropriations. This, in turn, allows operating divisions to produce accurate reports on the status of appropriations. Such reports are important tools for management use in monitoring whether more funds have been spent than appropriated—a violation of the law.

More Timely Grant Closeout Is Needed

Timely grant closeout—a critical first step in identifying and collecting potentially millions of dollars owed by grant recipients at the completion of their grants—continues to be a problem because many recipients do not submit final expenditure reports. The HHS operating divisions with the greatest number of unclosed grants, however, are attempting to correct this situation through actions such as issuing guidance on closing out an inactive grant when there is no final expenditure report and closing out an inactive grant with a minimal balance.

aware of these problems and has planned actions to correct them. To date, these plans have not been fulfilled.

Inadequate Accounting Control Over Receivables

Our review showed that at least \$86 million owed by grant recipients was not being properly accounted for because (1) PMS was not designed to account for receivables and (2) the Department lacks explicit policy and procedures for recording receivables resulting from grant recipients holding federal funds in excess of their immediate needs.

The Comptroller General's accounting principles and standards⁵ require that receivables be accurately recorded at the time events entitling collection occur and be accounted for as assets until they are collected, converted into other resources, or determined to be uncollectible. Control over receivables is especially important as they represent moneys due the government.

Receivables due to HHS from grant recipients can occur at expiration of grants when recipients possess federal funds in excess of final expenditures accepted by the operating divisions. Using a PMS-generated report, which listed amounts (which were adjusted to reflect accepted final expenditures) advanced to grant recipients and their corresponding obligational authority, as of November 10, 1987, we determined that there was at least \$86 million in outstanding advances that should have been accounted for as receivables.

In addition, receivables can occur when, in the case of active grants, FAFD determines that a grant recipient is holding federal funds in excess of its immediate disbursement needs. Our review of FAFD quarterly collection reports showed that in fiscal year 1986, over \$10 million was refunded to FAFD by grant recipients holding excess cash.

PMS, however, was not designed to account for the above receivables. For example, the system does not account for and control amounts owed by grant recipients resulting from outstanding advances. Specifically, PMS maintains no general ledger account showing the total amount of moneys owed by grant recipients holding excess federal funds. Further, subsidiary records showing the principal, interest, administrative costs, penalties due, and/or collections received are not maintained in PMS on the amounts owed by individual debtors.

⁵The GAO Policy and Procedures Manual for Guidance of Federal Agencies, title 2, contains the accounting principles, standards, and related requirements to be observed by federal agencies.

We did not verify the accuracy of cash disbursement information reported by grant recipients. We also did not determine whether funds were spent only for authorized purposes.

Our review was performed from April 1986 through September 1987, primarily at FAFD in Rockville, Maryland, and at HHS headquarters offices in Washington, D.C., in accordance with generally accepted government auditing standards.

How PMS Control Improvements Addressed Major Weaknesses

By introducing PMS into its operations for making and controlling grant payments, HHS has corrected three major internal control weaknesses highlighted in our 1979 report. These improvements are discussed below.

- The Letter of Credit-Treasury Financial Communications System payment method replaced the Letter of Credit-Federal Reserve Bank payment method for making most advances to grantees. Under DFAFS, grant recipients were generally paid through the Letter of Credit-Federal Reserve Bank method. This method required no prior FAFD review or approval, encouraged grant recipients to initiate early drawdowns and stockpile federal cash, and contributed to instances where federal cash advances exceeded recipients' individual grant authorizations. Under the Letter of Credit-Treasury Financial Communications System method, requests for funds undergo a prepayment review, enabling FAFD to either approve or disapprove the request before it is paid.

This review encompasses PMS automated edits which identify recipients who could have potential duplicate payments, exceed available fund authority, and/or have excess federal funds.

Our analysis of edit messages generated by PMS indicated that the above edits are in place to review recipient requests paid through the Letter of Credit-Treasury Financial Communications System method and are operating as intended.

- PMS requires grant recipients to report cash disbursements. Under DFAFS, grant recipients submitted reports on total expenditures, that is, cash disbursed plus other expenses incurred but not yet paid. These reports, therefore, could not be used to determine whether grant recipients held

Although the Department has efforts underway to address these weaknesses, postponed implementation dates have delayed HHS' attempts to make changes which would eliminate the problems. Completion of actions to improve accounting and control is necessary for HHS to know that its grant payment system is operating as intended.

In addition, HHS' inspector general has a detailed review of the PMS operation underway, including the grant closeout process. Consequently, additional problems may be identified in HHS' grant payment operation which may require the Department's prompt attention.

Background

PMS was developed over a 5-year period at a cost of about \$8 million and replaced DFAFS in 1984. During fiscal year 1987, PMS processed over \$52 billion for about 6,000 grant recipients. Approximately \$43 billion, or 83 percent of this amount, was paid to state and local governments under six block grant and two public assistance programs—Medicaid and Aid to Families with Dependent Children—which finance a wide variety of health and social service programs. The remainder, referred to as the general accounts, provides funds to educational, nonprofit, and other organizations, as well as to state and local governments for research and development, construction, and other assistance projects.

PMS is operated by HHS' Federal Assistance Financing Division (FAFD), a component of the Office of Financial Operations within the Office of the Assistant Secretary for Management and Budget. The system supports FAFD in its role as the Department's fiscal intermediary between HHS' six operating divisions¹ and its grant recipients.

The payment process begins when HHS operating divisions award grants. Grant awards are obligational authority, enabling PMS to make payments when requested by grant recipients. PMS validates and records award authorizations received electronically from the operating divisions.

The next step in the process occurs when PMS receives payment requests either directly from grant recipients or indirectly through the Department of the Treasury. About 98 percent of the dollar volume paid by PMS is through the Letter of Credit-Treasury Financial Communications System. Under this payment method, the grant recipients' payment requests

¹The HHS operating divisions are the (1) Office of the Secretary (which includes the Department's regional offices), (2) Family Support Administration, (3) Health Care Financing Administration, (4) Office of Human Development Services, (5) Social Security Administration, and (6) Public Health Service

