

**Memorandum**

JUN 8 1992

Date

From

Richard P. Kusserow
Inspector General

Subject

Report on Advance Payment System Used by the Indian Health
Service to Advance Cash to Contractors and Grantees
(A-06-90-00001)

TO

James O. Mason, M.D., Dr. P.H.
Assistant Secretary for Health

The attached final report summarizes the results of our audit of the Advanced Payment System (APS) used by the Indian Health Service (IHS) to advance cash to its contractors and grantees (contractor). Both IHS and the Division of Fiscal Services (DFS) of the Health Resources and Services Administration have responsibilities for controlling cash advances made under APS. Our audit of APS was performed to determine if: (1) cash advances were limited to the amounts necessary to meet the immediate needs of IHS contractors; and (2) adequate safeguards were provided over IHS cash advances.

We found that APS controls did not ensure that cash advances were limited to the immediate needs of IHS contractors. As a result, contractors routinely received excess cash. Since the Federal Government borrows to provide program funds to its contractors, excess cash advances result in unnecessary financing costs. We also found that contractors transferred IHS cash from designated bank accounts to non-IHS accounts until it was needed to pay for expenses incurred under IHS contracts. These actions violated the terms of agreement for special bank accounts. As a result, IHS could not accurately account for its cash advances by auditing the bank accounts and could not be assured that IHS cash was only used to fund IHS activities and programs. Therefore, an important safeguard was being bypassed.

The IHS reports showed that as of September 30, 1989, 33 percent of IHS' contracts had excess cash. Our review of 31 of IHS' 265 contractors disclosed that the amount of excess cash was significantly understated. Reports for these 31 contractors showed cash balances totaling \$892,000. However, bank records for these 31 contractors showed that \$6.3 million was actually on hand. The reports prepared by IHS were understated because: (1) IHS includes only active contracts in its reports; (2) contractors do not submit expenditure vouchers timely; and (3) APS' system of approval and

authorization is not always followed. The exact amount of excess cash on hand at all IHS contractors could not be identified because IHS records were not complete.

Under the terms of agreement for special bank accounts, contractors are required to deposit cash advances into a separate bank account and leave those funds on deposit until needed to pay expenses incurred under IHS contracts. The agreement further provides that the contractor not commingle IHS cash advances with any other funds. We found that 16 of the 31 contractors reviewed did not keep IHS cash in a special bank account as required. Several contractors told us that one reason they removed cash from the special bank account was to allow the use of IHS cash to fund non-IHS activities.

The routine advancement of cash in excess of contractors' needs and the need for improved reporting from both IHS and the contractors could meet criteria specified, by the Office of Management and Budget (OMB) for a material internal control weakness/nonconformance under the Federal Managers' Financial Integrity Act (FMFIA), Public Law 97-255. The OMB Circular A-123, which provides guidance on implementing FMFIA, states in part that weaknesses that significantly weaken safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets should be reported as material weaknesses. Further, OMB Circular A-127 states in part that weaknesses that prevent the agency's primary accounting system from achieving central control over agency financial transactions and resource balances should be reported as material nonconformances. These conditions could merit the attention of the Secretary of the Department of Health and Human Services, the Executive Office of the President, and the relevant congressional oversight committees.

In our draft report we made specific recommendations to address the problems with excess cash and inadequate safeguards. These specific recommendations assumed that IHS and DFS would continue to advance funds under the present system. We also recognized the possibility that the Public Health Service (PHS) would adopt a new payment system or use the Departmental Payment Management System. We considered that either of these alternatives, if properly implemented, could provide the control and safeguards needed over cash advances.

Officials at PHS generally concurred with our draft report's findings and recommendations, and concluded that the problems identified in the system used by IHS to advance funds to its grantees and contractors constitute a material internal control weakness. Also, PHS agreed that the Office of Inspector General recommendations are consistent with PHS and

Page 3 - James O. Mason, M.D., Dr. P.H.

IHS positions on the issues of fund control, financial reporting, and the need for adequate monitoring and oversight of self-determination grants and contracts. The PHS stated that the advanced payment function would be transferred to the Departmental Payment Management System.

Prior to the issuance of the attached final report, we became aware of plans for the Departmental Payment Management System to be transferred to PHS, effective March **18**, 1992. The Assistant Secretary for Management and Budget stated that the transfer of function provides an appropriate placement of the grants payment system on behalf of the Department.

We would appreciate being advised within 60 days on the status of corrective action taken or planned on each recommendation. Should you wish to discuss the issues raised by our review and recommendations, please contact me or your staff may contact Daniel W. Blades, Assistant Inspector General for Public Health Service Audits, at (301)443-3582.

Attachment

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REPORT ON ADVANCE PAYMENT
SYSTEM USED BY THE INDIAN HEALTH
SERVICE TO ADVANCE CASH TO
CONTRACTORS AND GRANTEES**



Richard P. Kusserow
INSPECTOR GENERAL

A-06-90-00001



Memorandum

JUN 8 1992

Date

From

R. Kusserow
Richard P. Kusserow
Inspector General

Subject

Report on the Advance Payment System Used by the Indian Health Service to Advance Cash to Contractors and Grantees (A-06-90-00001)

To

James O. Mason, M.D., Dr. P.H.
Assistant Secretary for Health

This report summarizes the results of our audit of the Advanced Payment System (APS), used by the Indian Health Service (IHS) to advance cash to its contractors and grantees (contractor). Both IHS and the Division of Fiscal Services (DFS) of the Health Resources and Services Administration (HRSA) have responsibilities for controlling cash advances made under APS. Our audit of APS was performed to determine if: (1) cash advances were limited to the amounts necessary to meet the immediate needs of IHS contractors; and (2) adequate safeguards were provided over IHS cash advances.

We found that APS controls did not ensure that cash advances were limited to the immediate needs of IHS contractors. As a result, contractors routinely received excess cash. Since the Federal Government borrows to provide program funds to its contractors, excess cash advances result in unnecessary financing costs. We also found that contractors transferred IHS cash from designated bank accounts to non-IHS accounts until it was needed to pay for expenses incurred under IHS contracts. These actions violated the terms of agreement for special bank accounts. As a result, IHS could not accurately account for its cash advances by auditing the bank accounts and could not be assured that IHS cash was only used to fund IHS activities and programs. Therefore, an important safeguard was being bypassed.

The IHS reports showed that as of September 30, 1989, 33 percent of IHS contracts had excess cash. Our review of 31 of IHS' 265 contractors disclosed that the amount of excess cash was significantly understated. Reports for these 31 contractors showed cash balances totaling \$892,000. However, bank records for 25 of the 31 showed that \$4.2 million was on hand. For the remaining 6, our review of the contractor's bank records showed that \$2.1 million was on hand, making a total of \$6.3 million at the 31 contractors. The reports prepared by IHS were understated because: (1) IHS includes only active contracts in its reports; (2) contractors do not

submit expenditure vouchers timely; and (3) APS' system of approval and authorization is not always followed. The exact amount of excess cash on hand at all IHS contractors could not be identified because IHS' records were not complete.

Under the terms of agreement for special bank accounts, contractors are required to deposit cash advances into a separate bank account and leave those funds on deposit until needed to pay expenses incurred under IHS contracts. The agreement further provides that the contractor not commingle IHS cash advances with any other funds. We found that 16 of the 31 contractors reviewed did not keep IHS cash in a special bank account as required. Several contractors told us that one reason contractors removed cash from the special bank account was to allow the use of IHS cash to fund non-IHS activities.

Prior to Fiscal Year (FY) 1991, APS had not been reviewed under the Federal Managers' Financial Integrity Act (FMFIA). The Public Health Service (PHS) views APS as a subsystem and looks to HRSA's DFS for the appropriate FMFIA coverage. As of September 10, 1991, DFS had completed reviews of financial operations in IHS' Aberdeen, Oklahoma City, and Portland area offices. These reviews disclosed major internal control weaknesses. For example, the review team reported that:

- o for the Aberdeen area office, the review team findings of the APS are consistent with the findings of the Inspector General. For 23 contracts reviewed, cash-on-hand as of January 31, 1991, exceeded expenses by \$2,456,187. The team noted that at the Treasury value of funds rate of 9 percent, the current rate at the time of the review, the annualized interest lost to the Federal Government was \$221,057.
- o for the Oklahoma City area office, the review team was unable to determine what expenses had been incurred by the contractors receiving funds through APS or the amount of cash the recipients had on hand.
- o for the Portland area office, there were excess cash problems and no written policies for reconciling or otherwise monitoring cash advances and expenditures.

The routine advancement of cash in excess of contractors' needs and the need for improved reporting from both IHS and the contractors could meet criteria specified by the Office of Management and Budget (OMB) for a material internal control weakness/nonconformance under FMFIA. The OMB Circular A-123, which provides guidance on implementing FMFIA, states in part that weaknesses that significantly weaken safeguards against waste, loss, unauthorized use or misappropriation of

funds, property, or other assets should be reported as material weaknesses. In addition, OMB Circular A-127 states in part that weaknesses that prevent the agency's primary accounting system from achieving central control over agency financial transactions and resource balances should be reported as material nonconformances. These conditions could merit the attention of the Secretary of the Department of Health and Human Services (HHS), the Executive Office of the President, and the relevant congressional oversight committees.

In our draft report, we made specific recommendations to address the problems with excess cash and inadequate safeguards. These specific recommendations assumed that IHS and DFS would continue to advance funds under the present system. We also recognized the possibility that PHS would adopt a new payment system or use the Departmental Payment Management System. We considered that either of these alternatives, if properly implemented, could provide the control and safeguards needed over cash advances.

Officials at PHS generally concurred with our draft report's findings and recommendations, and concluded that the problems identified in the system used by IHS to advance funds to its grantees and contractors constitute a material internal control weakness. Also, PHS agreed that the Office of Inspector General (OIG) recommendations are consistent with the PHS and IHS positions on the issues of funds control, financial reporting, and the need for adequate monitoring and oversight of self-determination grants and contracts. The PHS stated that the advanced payment function would be transferred to the Departmental Payment Management System. The complete PHS response to our draft report is contained in Appendix F.

Prior to the issuance of this final report, we became aware of plans for the Departmental Payment Management System to be transferred to PHS, effective March 18, 1992. The Assistant Secretary for Management and Budget stated that the transfer of function provides an appropriate placement of the grants payment system on behalf of the Department. A copy of the transfer of function agreement is contained in Appendix G.

BACKGROUND

Since 1955, PHS, through its IHS component, has been responsible for providing comprehensive health services to American Indians and Alaskan Natives. This responsibility has been carried out by developing and operating a health service delivery system designed to provide a broad spectrum of preventive, curative, rehabilitative, and environmental services.

Direct care is provided by IHS through the operation of hospitals, health centers and clinics. Further, IHS indirectly provides for health services through contracts and grants with American Indian and Alaskan Native organizations. The contracts and grants are administered by the IHS Headquarters Office in Rockville, Maryland and by IHS' 12 area offices. To ensure that sufficient funds are available for contractors to operate, IHS provides cash advances to its contractors.

The Code of Federal Regulations, 31 CFR 205.4, provides that cash advances be limited to the minimum amounts needed and timed to meet the actual immediate cash requirements of the recipient organization in carrying out the purposes of the approved contract or grant. Within IHS, cash-on-hand is considered excessive if it is more than the contractor will disburse within 30 days. However, regarding interest earned on cash advanced to contractors, the Indian Self Determination Act, Public Law 92-638, provides that tribal organizations will not be held accountable for interest earned on funds pending their disbursement.

Currently, IHS uses two different systems to advance cash to its contractors. For contractors receiving less than \$120,000 annually, cash is advanced directly by the IHS. Cash is advanced to contractors receiving \$120,000 or more annually through APS which is operated by DFS. Before APS, most IHS contractors were advanced cash under a letter-of-credit system.

Letter-Of-Credit

Prior to October 1, 1985, IHS contractors were advanced cash under a letter-of-credit system operated by DFS. Under the letter-of-credit system, contractors submitted payment vouchers to their commercial bank for transmission to the appropriate Federal Reserve Bank for approval and payment. Historically, however, IHS contractors operating under the letter-of-credit system did not report accurately and timely the amount of cash-on-hand.

In 1983, OIG reviewed the letter-of-credit system as operated by contractors of IHS' Oklahoma City area office. Our review concluded that IHS contractors: (1.) frequently drew down cash early in the contract period before it was needed; (2) did not consistently report the same amount of contract expenditures on both quarterly cash monitoring reports and public vouchers; and (3) did not file public vouchers in a timely manner.

An assessment of IHS' administration of the letter-of-credit system was performed by DFS in 1985. It concluded that the cash management objectives of the Department of the Treasury

(Treasury), OMB, and HHS were not being met. As a result, on October 1, 1985, DFS implemented APS.

Advance Payment System

Under APS, electronic fund transfers are used to deposit advances (usually biweekly) directly to the commercial bank account of the contractor. Schedules for cash advances are fixed at the beginning of the contract or grant period by the contracting officers. These schedules can be altered by the contracting officer, either unilaterally or at the request of the contractor. Under APS, unlike the letter-of-credit method, the contractor is not required to initiate each payment.

The APS was designed to ensure that the contractors received a continuous flow of cash from IHS. Schedules for cash advances are fixed at the beginning of the contract or grant period by the contracting officers. These cash advances are made automatically by DFS based on advance payment schedules signed and approved by contracting officers.

The DFS maintains control over the advances as authorized by IHS' area and headquarters offices. The DFS is responsible for scheduling payments with the Treasury, accounting for the advances paid, and providing special reports on the actual amount of advances paid as requested by contracting officers.

The Treasury advances cash by making electronic funds transfers directly to the commercial bank accounts of contractors. The Treasury also files daily and monthly confirmation reports with the DFS showing the amount of advances paid.

Reports by the Treasury showed that in FY 1989, cash totaling \$265,416,993 was advanced under the APS. These cash advances were made to 265 IHS contractors.

The IHS contract terms provide that the responsibility of the contractor is to keep the IHS cash advances in the special bank account until needed to pay for services provided under IHS contracts, and to submit timely public vouchers to claim contract costs.

Area office contracting officers are required to monitor the contractors' cash position and take the action necessary to limit the cash-on-hand to that amount needed to meet immediate cash needs. This can be accomplished by adjusting the advance payment schedule or requesting a refund from the contractor. The contracting officer prepares and uses the Reports on Quarterly Reconciliation of Advances and Expenditures for Contracts Paid Through the Advance Payment System (Quarterly

Reconciliation Reports) to monitor the cash position of the contractors.

OBJECTIVES, SCOPE AND METHODOLOGY

Our audit was performed in accordance with generally accepted Government auditing standards. The objectives of our review of APS were to determine if: (1) cash advances were limited to the amounts necessary to meet the immediate needs of the contractors; and (2) adequate safeguards were provided over Federal funds. To accomplish these objectives, we reviewed the contracting officers' reconciliations of cash advances and expenditures, cash advance records maintained by DFS and special bank accounts maintained by contractors as of September 30, 1989. We also reviewed IHS' September 1989 Quarterly Reconciliation Reports.

Our review of internal controls was limited to testing three significant internal controls of the APS. These included: (1) IHS' monitoring and adjusting of balances of cash advances held by contractors; (2) DFS' records of cash advanced to contractors; and (3) determining whether contractors kept IHS cash advances in special bank accounts. Our review did not include an assessment of the propriety of use of the funds that were advanced.

We selected 31 of 265 contractors for review. These contractors had a total of 376 contracts with IHS. For the 31 contractors, we reviewed 89 contracts. Six of the 31 contractors, with 12 contracts, were judgementally selected for detailed review to determine whether IHS' cash-on-hand was excessive and whether it was properly deposited and maintained in a separate bank account. These six contractors were advanced \$6,795,619 through electronic fund transfers during FY 1989. The cash reported on the Quarterly Reconciliation Reports was compared with cash accumulated by the contractors to assess the accuracy of the contracting officers' monitoring and reporting of cash-on-hand as of September 30, 1989. We also analyzed cash needs and compared cash-on-hand per IHS' records to our computation of the amount of cash that should have been on hand. Consistent with IHS instructions on determining cash balances, our computations of cash-on-hand consisted of ascertaining the total amount of IHS cash advanced and then deducting all IHS expenditures.

Finally, a sample of all cash advances made to 28 of the 265 contractors in FY 1989, was randomly selected and verified through bank confirmation letters to establish that the APS advances were received by the bank and deposited in a special bank account. In FY 1989, DFS advanced \$43,078,807 to the 28 contractors. Banks for 25 of the 28 contractors with advances totaling \$42,553,665 of the \$43,078,807 responded to

our confirmation letters. These 25 contractors had 77 contracts. Banks for 3 of the 28 did not respond to our confirmation letters despite our follow-up efforts.

Our review was performed during the period of January 1990 through July 1991. Work was performed at: IHS Headquarters and the Division of Fiscal Services located at Rockville, Maryland; the IHS area offices located at Oklahoma City, Oklahoma; Phoenix, Arizona; and Albuquerque, New Mexico; and the offices and banks of six contractors.

BASIS FOR CASH ADVANCES

The IHS did not limit cash advances to the immediate cash needs of the contractors. Instead, cash advances were based on a schedule of equal payments made over the period of the contract. Our sample results showed that most IHS contractors routinely obtained excess cash. We were not able to quantify the amount of excess cash nationwide because IHS records were incomplete and contractors did not always keep separate records identifying IHS cash and non-IHS cash.

Quarterly Reconciliation Reports

The Quarterly Reconciliation Reports used by IHS contracting officers to identify which contractors have excess cash were not reliable and did not show the complete cash position of the contractor. We found that certain practices were followed by IHS and DFS which significantly understated the reported cash position of the contractors.

- o The IHS includes only active contracts in its monitoring and reconciliation reports.
- o Contractors do not submit expenditure vouchers timely.
- o The formal system of approval and authorization of cash advances is not always followed by the contracting officer and DFS.

Although IHS reports showed that at September 30, 1989, excess cash had been advanced on 33 percent of the active contracts (See Appendix A), our review disclosed that the amounts of cash-on-hand were significantly understated. For 25 contractors, we identified 77 contracts and confirmed with their banks that as of September 30, 1989, \$4,222,815 was on deposit. However, IHS reported that these contractors had \$130,788 on hand at the same date, a difference of \$4,092,027 (see Appendix B). Further, the financial records for five of six additional contractors selected for our in-depth review showed that the Quarterly Reconciliation Reports were inaccurate (see Appendix C). Three of the five were so inaccurate they were misleading.

The reports for these six contractors showed that \$761,164 was on hand as of September 30, 1989. Our review of these contractors' records, however, showed that they had **cash-on-hand** totaling \$2,979,059, over \$2.2 million more than reported on the Quarterly Reconciliation Reports. Without accurate data, contracting officers cannot effectively limit cash advances to the amount needed for a maximum of 30 days.

Completed Contracts and Grants

Neither cash balances remaining on completed contracts nor any grants are included on the Quarterly Reconciliation Report. A major factor which affects the reliability of this report is that only active contracts are considered. Completed contracts are those where the period of performance has expired. However, many such contracts have large amounts of cash available, have work to be performed and have not been closed.

For the 6 contractors reviewed in depth, the Quarterly Reconciliation Report identified 12 active contracts with cash-on-hand totaling \$761,164. However, our review showed that the contractors actually had 23 contracts and grants with cash-on-hand totaling \$2,979,059, a difference of \$2,217,895. One report showed \$388,369 of cash-on-hand for one contractor, approximately a 34 day supply. Under IHS' 30 day criteria, this would have been considered excessive. The IHS procedures allowed the contracting officer to permit the contractor to retain the cash if the contracting officer believed the cash was necessary. In this case, the contracting officer considered the 34 days was not unreasonable and determined that no action would be necessary. However, the contractor's records showed that \$1,564,695 of cash was on hand, approximately a 136 day supply. The \$1,176,326 difference resulted because the report included only the cash balances for three active contracts and not the cash balances for all seven contracts and grants administered by the contractor.

Expenditure Vouchers

The late submission of contract expenditure vouchers by contractors also results in the Quarterly Reconciliation Reports being of little use for reporting cash-on-hand. The terms of the contract specify when expenditure vouchers are due. This is usually 30 days after the end of the month in which expenses were incurred. Historically, IHS has had difficulty in getting contractors to submit expenditure vouchers promptly. One of the primary reasons DFS replaced the letter-of-credit system with APS was the inability of contractors to submit timely expenditure vouchers. Under APS, however, the late submission of contract expenditure vouchers

continues to be a significant problem in controlling excess cash advances.

The late submission of expenditure vouchers also distorts the balances on the Quarterly Reconciliation Reports. The Quarterly Reconciliation Report procedures provide that only those cash advances which occurred on or prior to the date of the contractors' latest expenditure voucher are shown on the report. This is done to ensure that reported advances and expenditures cover the same period of time. According to IHS Headquarters and area office officials, if all advances made as of the date of the report were included, it would overstate the amount of cash-on-hand for those contractors who have not submitted expenditure vouchers for that same period of time.

Our review of the September 1989 Quarterly Reconciliation Reports showed that contractors had not submitted up-to-date expenditure vouchers for 154 of the 376 contracts included in the reports. Of these 154, 89 were listed as 1 month past due, 18 were listed as 2 months past due and 47 were 3 to 6 months past due. Since the Quarterly Reconciliation Reports include only the advances through the date of the last expenditure voucher received, we believe that the reports are of little use since neither advances made nor cash spent reflect the contractors' actual current cash status.

Processing of Cash Advances

Edit controls of the APS to detect and prevent excess advances were not effective. One such control was the manual matching of advances and obligations which was performed by DFS accounting clerks. The DFS is responsible for coordinating cash advances for IHS and ensuring that the total amounts advanced for each contract does not exceed the amount obligated. In our opinion, the matching exercise was not effective for determining the appropriate amount of a specific advance because it was performed after the advance was made. For that reason, an excess advance, though it may have been detected, could not be prevented. To be effective, the matching should be performed before advances are made.

Also, DFS accounting clerks routinely used accounting override codes to bypass computer edits when their matching exercise established that advances exceeded obligations. The edits were designed to detect when total advances exceeded the amount of IHS' recorded obligation. The edit and related exception reports could also be used to identify and prevent any additional unauthorized advances.

During the period of November 1, 1988 through September 30, 1989, DFS bypassed the computer edit for 8 percent of the cash advances made to contractors in one area office. In December

1988, DFS bypassed the computer edit for 49 percent of the cash advances for this area office.

The Deputy Director of DFS stated that the use of the override codes was considered routine and was not controlled by supervisory review. In our opinion the use of the override code was a signal that IHS' accounting records were out of balance. The Deputy Director indicated that research or review of each use of an override code would unnecessarily slow down advances to the contractors. The use of override codes without restriction only compounded the problem by allowing IHS and contractors to continue operating without addressing the problem of unreliable records. By allowing the routine use of the override code, the control provided by the obligation document was bypassed.

In addition to the problem of overriding the computer edit, DFS advanced cash without the advances being properly authorized. Phone calls and unsigned authorization documents were accepted in lieu of signed authorization documents. In such cases, cash advances would not be included on the Quarterly Reconciliation Report. This allowed advances to be made without the contracting officer's knowledge. We identified three instances where contractors received advances from DFS totaling over \$700,000, in which the system of authorization had been circumvented.

In the first instance, \$184,000 was advanced 7 months early. The contractor requested that the scheduled advance for September 1989 be made in February 1989. An accounting clerk in DFS accepted the telephone request and made the early advance without the required written authorization from the contracting officer.

In the second instance, DFS in 1987 made 13 unauthorized advances totaling \$263,000 based on 2 unsigned grant award documents. The advances on one grant were subsequently authorized. However, \$140,671 of the unauthorized advances for the second grant were uncollected at the time our field work ended. The advances were made up to 6 months before the grant award documents were signed by IHS Headquarters officials.

Finally, a contractor in May and June 1989 was overpaid approximately \$273,000, but the contracting officer knew nothing of the overpayment. The contracting officer stated that the overpayment occurred because DFS did not respond to several orders to stop advances which were filed by the contracting officer. He stated that he filed the stop orders because the contractor was receiving too much cash.

DFS personnel told us that they did not restrict contractors access to funds because they did not have confidence in IHS' financial records and did not want to create a hardship on the contractors by restricting the contractors access to the funds.

SAFEGUARDS OVER IHS CASH ADVANCES

Contractors transferred cash advances from designated special bank accounts to non-IHS accounts prior to needing the cash for expenses incurred under IHS contracts. These actions violated the terms of agreement for special bank accounts and resulted in an important safeguard being bypassed. Without the control provided by special bank accounts, IHS could not be assured that: (1) an accurate accounting of the use of its cash could be made by auditing the bank accounts; and (2) the IHS cash advances would only be used to fund IHS activities and programs.

Under the agreement for special bank accounts, contractors were required to deposit advances into a separate bank account and to leave those funds on deposit until needed to pay costs incurred under IHS contracts. The agreement provides that: (1) IHS maintain a lien on the balances in these special bank accounts; (2) the contractor not commingle IHS cash advances with any other funds; and (3) it be signed by the contractor, the bank and IHS.

To determine if the terms of the agreement were being followed, we reviewed 6 IHS contractors bank records and sent bank confirmation letters to the banks of 28 other contractors. None of the six contractors visited kept IHS cash separate in a special bank account as required. Banks for 25 of the 28 contractors responded to our confirmation letters. The bank confirmations showed that 10 of the 25 contractors did not keep IHS cash in a special bank account (see Appendix D).

Of the 31 contractors (6 reviewed in depth and 25 by bank confirmation letter), 16 did not keep IHS cash in a special bank account. Further, 9 of the 31 placed IHS cash advances in interest bearing accounts and 7 of the 9 commingled IHS cash contrary to the terms of the agreement.

The special bank accounts are intended to discourage contractors from using IHS cash for non-IHS activities and to facilitate control over the cash. When special accounts are not used other uses of the cash may occur and control is weakened as illustrated by the following example.

A contractor held over \$1.66 million of IHS contract funds and related program income in five bank accounts as of

September 30, 1989. This represented about 144 days of IHS cash requirements, considerably more than the 30 days allowed by IHS. None of the cash was in the special bank account. In fact, by December 5, 1989, a net transfer of \$1,077,400 had been made from one of the accounts to an investment pool of savings accounts involving 48 banks across the country earning interest for the contractor. The accounting records for this contractor showed that one of the five bank accounts should have had a balance of IHS cash totaling \$1,303,078 at September 30, 1989. The actual balance in this bank account, however, only totaled \$1,027,896, or \$275,182 less than the amount that should have been in the account. The contractor operated 25 non-IHS programs which had deficits totaling \$546,603. These deficits in non-IHS programs ranged from \$59 for a homeless assistance program to \$360,105 for bingo operations. Based on our discussion with contractor personnel and our review of the contractor's accounts, we believe that the contractor used IHS cash to fund its non-IHS activities.

Contractors in Oklahoma, Arizona and California told us that the use of excess cash to fund other program needs was one of the advantages of operating under APS. One contractor advertised this availability of excess cash as a means to attract new members to its association. The contractor stated that a selling point of this association was that, through APS, excess funds were accumulated which could be loaned to association members to help meet the cash flow needs of non-IHS programs.

Other Financial Controls

Other financial controls which could aid the contracting officers in their monitoring efforts were not included under APS. Under APS, contractors are not required to report the amount of cash-on-hand. The contractor is only required to notify IHS when it needs additional funds. Although required by HRSA's Accounting Manual at section 11-110-30, the APS does not require IHS finance offices to record outstanding advances on the general ledgers or age advance balances. These controls were dropped because historically contractors did not submit expenditure vouchers in a timely manner and IHS reports were not considered reliable. This resulted in the contracting officers having little information that they could use to supplement and verify IHS reports which they knew were often incomplete.

Although APS eliminated many of the financial controls inherent in the letter-of-credit financing methods used by IHS, DFS believed that the requirement for a special bank account provided IHS with assurance that: (1) an accurate

accounting could be made of the use of its cash by auditing the bank account; and (2) that IHS cash would not be used to fund non-IHS activities. Although the use of a separate bank account, in our opinion, does not prevent the use of IHS cash to fund non-IHS activities, it does provide a clearer accounting of IHS funds. We believe that compliance with the requirement for a special bank account will also aid IHS in the preparation of financial statements under the Chief Financial Officers Act of 1990.

CONCLUSIONS AND RECOMMENDATIONS

Contractor and IHS records are incomplete and inaccurate and do not provide sufficient information to allow IHS contracting officers to adequately monitor the amount of cash-on-hand at contractors. As a result, excess cash accumulates at contractors. This cash is frequently not maintained in designated special bank accounts, as required and is subject to being diverted to non-IHS activities. Although the scope of this review did not include an assessment of the propriety of the use of funds that were advanced, we noted what appeared to be at least temporary diversions of the funds from special bank accounts to bingo operations and other non-IHS activities.

The routine advancement of cash in excess of contractors' needs and the need for improved reporting from both IHS and the contractors could: (1) significantly weaken safeguards against waste, loss, unauthorized use or misappropriation of funds, property, or other assets; and (2) prevent the agency's primary accounting system from achieving central control over agency financial transactions and resource balances. Therefore, we recommend that PHS consider reporting this problem as a material internal control weakness or a material nonconformance under FMFIA. Further, we recommend that PHS assess the propriety of the use of funds advanced to the 10 contractors listed in Appendix B, and the 6 contractors listed in Appendix C, where cash was removed from special bank accounts. If funds are found to have been used for improper purposes, we recommend that PHS expand these assessments to include all IHS contractors required to maintain funds in special bank accounts.

In our draft report, we made specific recommendations to address the problems of excess cash and inadequate safeguards. These recommendations assumed that PHS would continue to use APS to advance funds to contractors. We also recognized in our draft report the possibility that PHS would adopt a new payment system or use the Department's Payment Management System. We considered that either of these alternatives, if

properly implemented, could provide the control and safeguards needed over cash advances.

AGENCY COMMENTS AND OIG EVALUATION

The PHS generally concurred with our draft report's findings and recommendations, and concluded that the problems identified in the system used by IHS to advance funds to its grantees and contractors constitute a material internal control weakness. Also, PHS agreed that OIG recommendations are consistent with the PHS and IHS positions on the issues of funds control, financial reporting, and the need for adequate monitoring and oversight of self-determination grants and contracts. The PHS stated that the advanced payment function would be transferred to the Departmental Payment Management System.

We agree with PHS regarding the use of the Departmental Payment Management System and believe this transfer is consistent with our recommendations. If properly implemented, we believe the changes proposed should alleviate the problems identified in this report. The complete PHS response to our draft report is contained in Appendix F.

Prior to the issuance of this final report, we became aware of plans for the Departmental Payment System to be transferred to PHS, effective March 18, 1992. The Assistant Secretary for Management and Budget stated that the transfer of function provides an appropriate placement of the grants payment system on behalf of the Department. A copy of the transfer of function agreement is contained in Appendix G.

We would appreciate being advised within 60 days on the status of corrective action taken or planned on each recommendation. Should you wish to discuss the issues raised by our review and recommendations, please contact me or your staff may contact Daniel W. Blades, Assistant Inspector General for Public Health Service Audits, at (301) 443-3582.

APPENDICES

APPENDIX A

Number of Active Contracts with
More Than 30 Days of Cash-on-hand
as of September 30, 1989

IHS Area Office	Number of Active Contracts	Active Contracts with More Than 30 Days Cash <u>on Hand</u>	Percent of Contracts with More Than 30 <u>Days Cash-on-hand</u>
Aberdeen	30	15	50%
Alaska	22	5	23%
Albuquerque	39	24	62%
Bemidji	40	10	25%
Billings	20	6	30%
California	42	6	14%
IHS Headquarters	1	1	100%
Navajo	2	1	50%
Nashville	21	7	33%
Oklahoma City	56	27	48%
Phoenix	55	16	29%
Portland	40	5	13%
Tucson	<u>8</u>	<u>1</u>	<u>13%</u>
Total	<u>376</u>	<u>124</u>	<u>33%</u>

Comparison of Cash in the Bank with Cash Levels per IHS
Quarterly Reconciliation Reports for 25 Contractors as of
September 30, 1989

Con- tractor	IHS Office	Total Advances FY 1989	Cash in the Special Bank Account	Number of Days of Cash Require- ments in Bank	IHS Moni- toring of Cash on Hand	Difference
* * *						
<u>IHS Cash Commingled</u>						
C	AN	\$12,024,366	\$1,799,318	51	(\$422,286)	\$2,221,604
T	AN	2,167,007	350,133	55	39,711	310,422
K	BI	1,139,789	84,234	25	33,000	51,234
J	CA	7,084,227	275,770	14	(228,000)	503,770
F	HE	755,690	36,977	17	19,146	17,831
S	NS	1,018,524	48	0	8,000	(7,952)
X	NS	4,374,912	1,070	0	296,000	(294,930)
L	OK	5,361,138	747,217	49	(2,544)	749,761
Q	PH	369,925	61,510	59	4,000	57,510
G	PO	364,558	55,666	51	(18,431)	74,097
		<u>\$34,660,136</u>	<u>\$3,411,943</u>		<u>(\$271,404)</u>	<u>\$3,683,347</u>
<u>IHS Cash Not Commingled</u>						
A	AB	\$ 864,108	\$ 122,924	49	\$ 98,000	\$ 24,924
B	AB	452,125	26,937	19	(6,000)	32,937
W	AL	13,104	5,503	7	1,000	4,503
U	AL	29,840	195	1	0	195
M	CA	116,776	2,987	7	13,000	(10,013)
E	CA	176,148	22,589	44	0	22,589
R	NS	875,406	112,056	45	198,000	(85,944)
Y	NS	1,590,600	142,217	32	145,000	(2,783)
H	OK	168,197	32,186	66	14,391	17,795
I	OK	279,755	38,685	41	9,132	29,553
P	OK	507,721	74,309	52	53,831	20,478
O	OK	624,213	60,387	32	18,259	42,128
V	PH	42,090	27,003	156	21,000	6,003
D	PO	424,800	4,899	4	(5,030)	9,929
N	PO	1,728,646	137,995	27	(158,391)	296,386
		<u>\$ 7,893,529</u>	<u>\$ 810,872</u>		<u>\$402,192</u>	<u>\$ 408,680</u>
Total		<u>\$42,553,665</u>	<u>\$4,222,815</u>		<u>\$130,788</u>	<u>\$4,092,027</u>

* See Appendix E for a listing of the contractors and IHS offices referred to in these columns.

Comparison of Cash-on-hand per IHS' Monitoring
Reports to Cash-on-hand per Audit
for Six Contractors

Con- tractor	<u>IHS' Records</u>		Number of Days of Cash Needs	Audit Computation Cash on Hand <u>09/30/89</u>	Number of Days of Cash Needs
	Average Monthly Expense	Cash on Hand <u>09/30/89</u>			
AA	\$345,795.92	\$388,368.55	33.7	\$2,590,955.05	224.8 <u>1/</u>
BB	9,824.26	9,795.25	29.9	26,229.49	80.1 <u>1/</u>
cc	126,594.85	17,000.00	4.0	22,797.60	5.4
DD	26,799.00	0.00	0.0	47,366.87	53.0 <u>1/</u>
EE	18,160.62	92,000.00	152.0	92,511.70	152.8
FF	<u>29,740.57</u>	<u>254,000.00</u>	256.2	<u>199,198.66</u>	200.9
Total	<u>\$556,915.22</u>	<u>\$761,163.80</u>		<u>\$2,979,059.37</u>	

* See Appendix E for the names of contractors referred to in this schedule.

1/ The Quarterly Reconciliation Report for these contractors was so inaccurate we considered it misleading.

Schedule Showing Which of 31 Contractors Deposited and
Maintained IHS Funds in Special Bank Accounts

<u>Contractor</u>	<u>IHS Cash Deposited Directly into the Special Bank Account</u>		<u>IHS Cash (Initially or Subsequently) Commingled</u>	
	<u>Yes</u>	No	<u>Yes</u>	No
*				
<u>Bank Confirmations</u>				
A	X			X
B	X			X
C		X	X	
D	X			X
E	X			X
F		X	X	
G		X	X	
H	X			X
I	X			X
J	X		X	
K		X	X	
L	X		X	
M	X			X
N	X			X
O	X			X
P	X			X
Q			X	
R	X			X
S			X	
T	X		X	
U	X			X
V	X			X
W	X			X
X	X		X	
Y	X			X
Subtotal	19	6	10	15
<u>Site Visits</u>				
AA		X	X	
BB		X	X	
CC	X		X	
DD		x	X	
EE		X	X	
FF		X	X	
Total Count	20	11	16	15

* See Appendix E for the names of contractors referred to in this schedule.

Schedule of IHS Offices and Contractors
Referred to in Appendices B to D

<u>IHS Office</u>	<u>Name</u>	<u>Location</u>
AB	Aberdeen Area Office	Aberdeen, SD
AL	Albuquerque Area Office	Albuquerque, NM
AN	Alaska Area Office	Anchorage, AL
BI	Billings Area Office	Billings, MT
CA	California Area Office	Sacramento, CA
HE	Headquarters	Rockville, MD
NS	Nashville Area Office	Nashville, TN
OK	Oklahoma Area Office	Oklahoma City, OK
PH	Phoenix Area Office	Phoenix, AZ
PO	Portland Area Office	Portland, OR
 <u>Contractor</u>		
A	Winnebago Tribe of Nebraska	Winnebago, NE
B	Devils Lake Sioux Tribe	Fort Totten, ND
C	Tanana Chiefs Conference, Inc.	Fairbanks, AK
D	Native American Rehabilitation Association of the Northwest, Inc.	Gresham, OR
E	United Indian Health Services, Inc.	Trinidad, CA
F	American Indian Health Care Association	St. Paul, MN
G	Confederated Tribes of Umatilla	Pendleton, OR
H	Pawnee Tribe of Oklahoma	Pawnee, OK
I	Inter Tribal Council, Inc.	Miami, OK
J	California Rural Indian Health Board, Inc.	Sacramento, CA
K	Northern Cheyenne Board of Health	Lame Deer, MT
L	Cherokee Nation of Oklahoma	Tahlequah, OK
M	American Indian Council of Central California, Inc.	Bakersfield, CA
N	Puyallup Tribal Health Authority	Tacoma, WA
O	Central Oklahoma American Indian Health Council, Inc.	Oklahoma City, OK
P	Dallas Inter-Tribal Center, Inc.	Dallas, TX
Q	Indian Alcoholism Counseling and Recovery House Program	Salt Lake City, UT
R	Narragansett Indian Tribe	Charlestown, RI
S	Poarch Band of Creek Indians'	Atmore, AL
T	Southcentral Foundation	Anchorage, AK
U	All Indian Pueblo Council, Inc.	Albuquerque, NM
V	Goshute Band Council	Ibapah, UT
W	Southwestern Indian Polytechnic Institute	Albuquerque, NM
X	Seneca Nation of Indians of New York	Salamanca, NY

Schedule of IHS Offices and Contractors
Referred to in Appendices B to D

Contractor

Y	Penobscot Indian Nation	Old Town, ME
AA	Creek Nation of Oklahoma	Okmulgee, OK
BB	Sac and Fox Nation of Oklahoma	Stroud, OK
cc	Indian Community Health Services, Inc.	Phoenix, AZ
DD	Salt River Pima-Maricopa Indian Community	Scottsdale, AZ
EE	Pueblo of Acoma	Acoma, NM
FF	Pueblo of Laguna	Laguna, NM

APPENDIX F - PHS COMMENTS TO DRAFT REPORT



DEPARTMENT OF HEALTH & HUMAN SERVICES

Public Health Service

RECEIVED
OFFICE OF INSPECTOR
GENERAL

Memorandum

Date . MAR 16 1992 1992 MAR 18 AM 9: 58

From Assistant Secretary for Health

Subject Comments on Office of Inspector General (OIG) Draft Report
"Report on Advance Payment System Used by the Indian Health
Service (IHS) to Advance Cash to Contractors and Grantees"

TO Inspector General, OS

Attached are the Public Health Service's (PHS) comments on the subject OIG draft report.

We concur with the report's recommendations.

In order to eliminate the problem of advancing funds to IHS grantees and contractor8 in excess of their needs, we plan to transfer the advance payment function to the Departmental Payment Management System. We will assess the propriety of funds advanced to 16 contractors who commingled the IHS contract funds with their other funds. We also agree that the problems identified in the system used by IHS to advance funds to its grantees and contractors constitute a material internal control weakness.

Our comments outline the actions planned or taken regarding the recommendat ions.

James O. Mason
James O. Mason, M.D., Dr.P.H.

Attachment

IG	<input checked="" type="checkbox"/>
PDIG	<input checked="" type="checkbox"/>
DIG-AS	<input checked="" type="checkbox"/>
DIG-EI	<input checked="" type="checkbox"/>
DIG-OI	<input checked="" type="checkbox"/>
AIG-MP	<input checked="" type="checkbox"/>
OGO/IG	<input checked="" type="checkbox"/>
EX SEC	<input checked="" type="checkbox"/>
DATE SENT	3/17

COMMENTS OF THE PUBLIC HEALTH SERVICE (PHS) ON THE OFFICE OF
INSPECTOR GENERAL (OIG) DRAFT REPORT "ADVANCE PAYMENT
SYSTEM USED BY THE INDIAN HEALTH SERVICE (IHS) TO ADVANCE
CASH TO CONTRACTORS AND GRANTEEES," A-06-90-00001

General Comments

The **OIG** audit of the Advanced Payment System (**APS**) used by **IHS** to advance cash to its contractors and grantees found that: (1) contractor/grantee and **IHS** records do not provide sufficient information to allow for adequate monitoring of cash **o n hand**, and (2) **APS** controls did not: ensure that cash advances were limited to the immediate needs of contractors and grantees.

To correct the deficiencies cited, the report contains 11 recommendations for **PHS**. **The** first eight concern the need for **PHS** to revise the current system for advancing cash to contractors and grantees. The remaining three concern the need for **PHS** to assess the propriety of the **use** of funds advanced to 16 contractors mentioned in the report, consider whether the problems identified in **this** report should be reported as a material internal control weakness, and evaluate alternatives for improving the current system of advancing funds to **IHS** contractors and grantees.

The **OIG** recommendations are consistent with the **PHS** and **IHS** positions on the issues of fund control, financial reporting, and the need for adequate monitoring and oversight of **self-**determination contracts and grants. We believe that a different approach to payments must be implemented in order to resolve the **excess** cash problem. **In** this **regard**, we have reached an agreement with **the** Office of the Secretary (**OS**) which calls for the transfer of the advanced payment function to the Departmental Payment Management System (**PMS**).

The transfer of the payment responsibility to **PMS** would obviate the need for the implementation of some of the recommendations that are associated with strengthening the **APS**.

Our comments on the recommendations follow.

OIG Recommendation

We recommend that **PHS**:

1. Include on the Quarterly Reconciliation Reports data for all advances, expenditures, and balances for active and inactive contracts and **grants**.

Comment

With the transfer of the payment function to PMS, these reports will no longer be required. PMS obtains data every quarter from the grantees and contractors it services. This includes information on funds advanced, costs incurred, and balances for all active and inactive contracts and grants.

OIG Recommendation

2. *Make* every effort to ensure that contractors submit expenditure vouchers timely; **however**, if contractors continually refuse to submit vouchers timely, **do not** make cash **advances**.

PHS Comment:

We concur. This recommendation has been in place since September 1989, when the quarterly reconciliation report was revised (see IHS Contract Policy Letter 89-5, dated September 1, 1989). IHS will ensure that the guidance provided for when and how a contractor should be removed from the APS and paid on a reimbursement basis is followed. This will be done until the payment function is assumed by PMS. The PMS provide mechanisms for penalizing contractors and grantees who do not provide the information required by that system.

OIG Recommendation

3. Include the contractor in the monitoring process by requiring the contractor to report for each contract and grant the amount of funds received, amount of funds spent, and the amount of funds **remaining on hand**.

PHS Comment

We concur. PMS includes contractors and grantees in the monitoring process. That system requires contractors and grantees to **provide** information on each award on a quarterly basis on funds **received**, spent, and remaining on **hand**.

OIG Recommendation

4. **Limit the use of APS edit** override codes to those situation³ that are justified in writing **and** approved by the appropriate supervisor.

PHS Comment

We concur. This is now being done. All payments are being made on the basis of approved obligation documents. The override is used to assign payments properly to individual contracts, if there has been a delay in recording the obligation.

Once the payment function is assumed by PMS, that system will only make advances on the basis of approved obligation documents as provided for in its policies and procedures.

OIG Recommendation

5. Ensure that all cash advances are authorized in accordance with established APS policies and procedures.

PHS Comment

We concur. This is now being done. However, once the payment function is transferred to PMS, the responsibility for authorizations of cash advances will be carried out by the organization responsible for the operation of that system.

OIG Recommendation

6. Reemphasize to contractors that IHS funds must remain in the special bank accounts until needed to operate IHS programs.

PHS Comment

We concur. IHS will take appropriate steps to ensure that this recommendation is implemented.

OIG Recommendation

7. Remove from APS those contractors that do not comply with the requirements of the Agreement for Special Bank Account and place them on a letter-of-credit system.

PHS Comment

We do not agree that contractors who do not comply with the special bank account agreement should go on a letter-of-credit system. This is because the letter-of-credit system was discontinued by the Department of Treasury in December 1990.

liowever, in situations where contractora cannot properly account for **funds advanced**, we will **consider** removing them from the APS and placing them on **an** after the fact reimbursement method.

Similarly, once the **payment** function is **transferred to** PMS, recipients of **IHS** funds who cannot account **properly** for funds **advanced** will be removed from the advanced payment **system and** placed on **an** after the fact reimbursement method.

OIG Recommendation

9. Require IHS finance offices to record cash **advances** on the official general ledger and age outstanding advances.

PHS Comment

We concur. HRSA and IHS will take appropriate steps to ensure that **this** recommendation is implemented.

OIG Recommendation

9. Consider reporting the routine advancement of cash in excess of contractors' **needs as a material internal** control weakness **or a** material nonconformance under the Federal Managers' Financial Integrity Act.

PHS Comment

We concur. We agree **that** the problems identified constitute a material internal control weaknesa. We believe that the transfer of the payment function to PMS will resolve the excess cash problem. We also believe that the problems indicate that closer monitoring **of contracta** and **recipients'** reporting requirements by **IHS** Area Offices is required. **IHS** Area Offices will increase their monitoring of the **IHS** awards **in** these areas.

OIG Recommendation

10. Assess the propriety of the use of funds advanced to the 10 contractors listed in Appendix B, and the 6 contractora listed in Appendix C, where cash **was** removed from **special** bank accounts. If **funds are found to have been used for** improper purposes, expand **these** assessments to include all **IHS** contractors who are required to maintain funds in special bank accounts.

PHS Comment

We concur. IHS will perform this assessment.

OIG Recommendation

11. Evaluate alternatives for improving the current system of advancing funds to IHS contractors.

PHS Comment

We concur. We plan to eliminate the use of the **APS** to advance funds to **IHS** contractors and grantees and transfer the function to PMS. OS has agreed to the transfer. We will be meeting with OS staff to develop the schedule and **steps** to be taken in order to use PMS to advance funds to IHS contractors and grantees.

APPENDIX G - TRANSFER OF FUNCTION AGREEMENT



FEB 20 1992

MEMORANDUM TO: James O. Mason, M.D.
Assistant Secretary for Health

FROM: *Kevin E. Moley*
Kevin E. Moley
Assistant Secretary for
Management and Budget

SUBJECT: Transfer of Function

With your agreement, it is my intent to transfer the Payment Management System to the Public Health Service. This function, which operates the Department's central grant payment system, is currently located within the Division of Federal Assistance Financing in the Office of Financial Operations.

I believe that this transfer provides an appropriate placement of the grants payment system on behalf of the Department. This agreement is effective upon your signature below. Details concerning actual dates of transfer and other fiscal and logistical matters will be worked out by our principal deputies.

AGREED: (Please work with Mr. Itteilag)

James O. Mason
James O. Mason, M.D.
Assistant Secretary for Health

MAR 18 1992

Date