

Statement of Lorraine Lewis
Inspector General
Department of Education

Before The

Subcommittee on Oversight and Investigations
Committee on Education and the Workforce
U.S. House of Representatives

On

The Department of Education's Financial Management

March 1, 2000

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Mr. Chairman and members of the Subcommittee, I am here today at your invitation to discuss the results of the audit of the Department of Education's (ED) fiscal year 1999 consolidated financial statements as well as those of Student Financial Assistance (SFA). I am accompanied by Mr. Steven A. McNamara, Assistant Inspector General for Audit. You asked that I also cover in my testimony how the results for fiscal year 1999 compared with reports on previous years, what corrective actions ED has taken in response to these reports and, finally, what improvements ED OIG has recommended and how we plan to monitor implementation of our recommendations as well as those of Ernst and Young.

Overview of Results of Fiscal Year (FY) 1999 Audit

The audits of ED's consolidated financial statements for FY 1999, and those of SFA, were conducted by Ernst & Young, LLP (E&Y) under contract with ED OIG. Under the terms of this engagement, E&Y issued reports on its opinion, internal control, and compliance with laws and regulations for both ED and SFA. The OIG monitored the progress and completion of the work to ensure compliance with Government Auditing Standards. The firm of E&Y performed in an

independent and exemplary manner and completed its work so the Department could meet the March 1st date of transmitting the audit to OMB.

E&Y issued a qualified opinion for both ED and SFA on the Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, and Statement of Budgetary Resources. E&Y disclaimed an opinion for both ED and SFA on the Statement of Financing. A complete copy of the auditor's reports are attached in their entirety as appendixes 1 and 2 respectively.

There were four material weaknesses and four reportable conditions included in the report on internal control. The material weaknesses were:

- Financial Reporting Needs to be Strengthened (Repeat Condition)¹;
 - Reconciliations Need to be Improved (Repeat Condition);
 - Controls Surrounding Information Systems Need Enhancement (Repeat Condition);
- and
- Improvement of Credit Reform Reporting is Needed (New).

The reportable conditions, the first three of which relate both to ED and SFA, were:

- Documentation Supporting Obligations, Undelivered Orders, and Unobligated Balances Needs to be Improved (Modified Repeat Condition);
- Communication and Coordination Efforts Need to be Improved for Financial Management;

¹ This was the first year that SFA was audited as a separate entity. Therefore, although control issues reported for both ED and SFA are the same, technically they do not represent repeat conditions for SFA.

- Documentation Supporting Accounts Payable Accrued Liabilities and Expenditures Needs to be Improved (Modified Repeat Condition); and
- Reporting and Monitoring of Property and Equipment Needs to be Improved (relates to ED only) (New).

The Report on Compliance with Laws and Regulations for both ED and SFA cited three areas of non-compliance with:

- The Information Technology Management Reform Act (Clinger-Cohen Act);
- The Federal Credit Reform Act of 1990; and
- The Federal Financial Management Improvement Act.

Qualified opinions on four of the statements is an important improvement over FY 1998, which were disclaimers of opinion on all five of ED's statements. This was the first year SFA's statements were audited. In addition, ED was able to issue its FY 1999 audited financial statements to the Office of Management and Budget by the March 1 deadline for the first time. This improvement was due to extremely hard work by ED's managers and staff, its contractors, and the auditors. Because the systemic weaknesses with ED's accounting system initially reported in FY 1998 continued into FY 1999, ED utilized contractors and various automated tools to "work around" the system's inability to close the books and generate financial statements. Until ED implements a new general ledger system it will have to continue to perform these "work arounds" as opposed to producing system generated financial statements in compliance with the Federal Financial Management Improvement Act.

Although ED was able to improve its position in regard to the opinion on the FY 1999 financial statements, many of the underlying systemic weaknesses included in the Reports on Internal Control and Compliance with Laws and Regulations are repeat conditions from FY 1998 and earlier years. As an ultimate goal, ED needs to remedy these underlying weaknesses in order to improve its overall financial management.

ED has made a number of improvements, such as preparing statements more timely for FY 1999. In addition, ED has begun an initiative to more actively monitor and address all open audit recommendations to ensure that effective corrective actions are taken. Much work remains to be done. My office will work closely with ED and the Congress to monitor the progress of these improvements.

Comparison of FY 1999 Audit Results with Previous Years

For fiscal years 1995 and 1996, ED received disclaimers of opinion on its financial statements, primarily due to the unreliability of the data upon which it based the estimate of the loan liability for the student loan programs. This amount had such a material effect on the financial statements that the inability to provide a reliable estimate precluded the auditors from expressing an opinion. To work around this data problem, an effort was begun in FY 1996 to obtain from the 10 largest guaranty agencies audited information that could be used to form the basis for the estimate. This effort, which took about 18 months, was not completed in time to affect the FY 1996 audit, but did enable ED to prepare a reliable estimate from audited data for its FY 1997 financial statements. In addition, ED was using its legacy system, which though old, was

sufficiently stable to successfully produce financial statements for FY 1995 and 1996. The combination of the reliable data for loan guarantees and the system capable of producing financial statements resulted in ED's receiving an unqualified opinion on its financial statements for FY 1997.

For FY 1998, ED was able to prepare reliable estimates of the liability for the loan programs from data in NSLDS and this material weakness was shown as corrected in the Report on Internal Control for FY 1998. This item, which for years had been the main barrier to receipt of an opinion, was corrected only to have the problems with the newly implemented accounting system result in disclaimers of opinion on all the statements. As noted above, for FY 1999, ED was able to use contractor support and automate certain tasks to work around these accounting system drawbacks, which enabled it to receive qualified opinions on all of its statements except the Statement of Financing for which it received a disclaimer.

Although the opinions on the financial statements have varied over the years, underlying weaknesses in internal control have continued to hamper the Department and many have appeared as repeat findings in the Report on Internal Control during the period from FY 1995 through FY 1999. Most notable among the recurring weaknesses have been:

- Need to Improve Financial Reporting (1997 through 1999);
 - Need to Improve Cash and Other Reconciliations (1995 through 1999);
 - Need to Improve Documentation for Obligations and Expenditures (1998 and 1999);
- and,
- Need to Improve Controls over Information Systems (1995 through 1999).

Overview of ED's Corrective Actions to Address Internal Control Weaknesses

When we testified before the Subcommittee on December 6, 1999, we reported that a total of 115 recommendations had been made for the FY 1995 through the FY 1998 reports. At that time, 87 remained open, of which 59 were non-repetitive. Since the FY 1998 report, which contained 28 recommendations, had only then been recently issued it was to be expected that those recommendations would not have been corrected. In the fiscal year 1999 Department-wide financial statement audit issued this week, another 24 recommendations have been made to the Department. Of the 139 recommendations relating to ED's financial statements, from fiscal years 1995 through fiscal year 1999, 111 are open, 28 are closed, and 74 are non-repetitive. ED has very recently provided us with corrective action progress reports for the financial statement audits for FY 1995 through FY 1998. We have not yet analyzed these reports to determine whether additional recommendations can be considered closed.

The primary improvements to financial management over this period have been the correction of weaknesses surrounding preparation of the loan liability estimate, and the preparation in FY 1999 of financial statements (for both the Department and SFA) in a more timely manner to meet the March 1 statutory deadline. In addition, ED was able to develop automated processes to enable it to work around system deficiencies in order to close its books and prepare the financial statements. Moving from all disclaimers to four qualified opinions, especially considering the formidable problems presented by the accounting system, represents progress along what promises to be a continuing and difficult journey towards improved financial management.

OIG Plans to Monitor Implementation of Recommendations

The OIG maintains an audit tracking system that monitors an audit report from date of issuance, through resolution, to implementation and completion of corrective actions. Resolution of an audit report is required within 6 months from report issuance. Resolution occurs when management has communicated its decision on the actions it plans to take. Management then is required to prepare a corrective action plan and report on the progress of actions taken semi-annually. The corrective action status reports are reviewed by OIG and the audit report is kept open in the tracking system until final actions have been taken. At that time, OIG closes the audit report for tracking in its system. In the interim, the statistics on audits open and overdue for resolution or corrective action are reported in the OIG's semi-annual report to Congress. To date, our tracking has been at the audit report level. We have begun work with the Department as part of an initiative to track at the recommendation level in order to provide more visibility and accountability of necessary corrective actions. It is our understanding that corrective action plans will be submitted by ED to OIG on a quarterly basis; the first plans are due as of March 31, 2000.

The long-term effort will focus on having a single centralized database with appropriate access and controls over the audit follow-up data. The data will be intended to meet the respective reporting requirements for all users (i.e., for the Department and OIG, Semiannual reporting, Federal Managers Financial Integrity Act reporting, and performance reporting). The OIG will continue its efforts to monitor audit report resolution through corrective action.

OIG Recommendations to Improve Financial Management

The primary source of recommendations to improve financial management has been from the audits of ED's financial statements. Other areas where we have performed work and made recommendations include the Grant Administration Payment System (GAPS), computer security, and property management.

We have done a series of reviews of GAPS, starting with a review of deployment readiness requested by ED and continuing with reviews of communications strategy, customer satisfaction, physical safeguards over refund checks, security over user ID's and passwords, reconciliations, and annual certification of expenditures.

IT Security

Last week we issued an audit report on the Department's security posture, policies and plans for its 14 mission critical systems. Our review revealed that the Department has significant control weaknesses including a lack of security plans and reviews for six mission-critical systems, no process to ensure resolution of identified security deficiencies and a lack of technical security training for many employees responsible for overseeing the Department's computer security. Through implementation of our 13 recommendations, the Department will be able to greatly enhance the security of its financial management and other systems.

Core Financial Management System Replacement

We have assisted in the process to procure a new general ledger system by providing the Department's OCFO with comments on the Draft Request for Information (RFI), and by providing OCFO with process-level comments on key stages of the evaluation -- evaluation of vendor responses, vendor demonstrations, and subsequent deliberations. As a result of some issues identified during our observation of the vendor demonstrations, we have also requested additional testing prior to final selection.

Property Management

From 1985 to 1998 ED OIG issued five reports covering the Department's property management controls. In our July 1985 report we stated that ED had weak controls over the safeguarding of office equipment and the recording of items received. In November 1994 ED OIG issued an Investigation Advisory Program Report that described deficiencies in the Department's property management and provided 21 recommendations for improvement. Ed OIG provided follow up reports in March 1997, October 1997 and November 1998 that concluded that weaknesses persisted. The Department has identified the issue as a material weakness in its annual Federal Managers' Financial Integrity reports since 1994. ED OIG recently provided management with an analysis of ongoing computer inventory management issues and a list of recommended controls that should be implemented. Ed OIG is also conducting a project to evaluate the Department's controls over procurement of products and services.

Mr. Chairman, that concludes my prepared testimony. Mr. McNamara and I will answer any questions you or the Subcommittee may have.