

KPMG

CORPORATION

FOR NATIONAL

 **S E R V I C E**

**Office of the Inspector General
Report Number 97-27**

Audit of the National Service Trust Fund

Fiscal Year 1995 and 1994 Financial Statements

January 15, 1997

**CORPORATION FOR NATIONAL SERVICE
NATIONAL SERVICE TRUST FUND**

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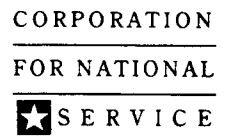
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Appendix B, Management's Response to Auditors' Report

Office of the Inspector General
Report 97-27

March 10, 1997

Harris Wofford
Chief Executive Officer
Corporation for National Service



Dear Senator Wofford,

We engaged KPMG Peat Marwick LLP to audit the Corporation's National Service Trust Fund financial statements for fiscal years 1995 and 1994. KPMG reports, and we concur, that the Corporation's internal controls were not adequate to ensure complete and accurate financial statements. In addition, the Corporation did not maintain adequate accounting records and other evidential matter in support of the Fund's service award liability, service award expense, and appropriations transactions. As a result of these conditions, KPMG is unable to express an opinion on the fairness of the accompanying financial statements.

KPMG is reporting material weaknesses in the Trust Fund System and the Trust Fund's financial records (including the Corporation's failure to properly reconcile the Trust Fund's fund balance and investment accounts with those maintained with Treasury). In addition, KPMG cites as a material instance of noncompliance with laws and regulations, the Corporation's failure to submit required Trust Fund reports to the Congress on a timely basis.

The Corporation's response is included as Appendix B to this report. In its response, the Corporation generally agreed with the findings and recommendations and stated that it was in the process of implementing corrective actions.

The Corporation has recently embarked on efforts to strengthen its management controls and to correct its accounting records. Correction of the management controls deficiencies reported herein and the Trust Fund's financial information reports is critical to achieving auditable financial statements for the Corporation. Therefore, receipt of a corrective action plan is essential. Under CNS' audit resolution system, that plan is due no later than June 16, 1997. Further, under Federal law (section 6009 of the Federal Acquisition Streamlining Act of 1994, as amended by section 810 of Public Law 104-106), final corrective actions must be completed by March 10, 1998.

A handwritten signature in cursive script, appearing to read "Luise S. Jordan", is positioned above the typed name.

Luise S. Jordan
Inspector General

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Washington, DC 20525
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Getting Things Done.
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Independent Auditors' Report

Inspector General
Corporation for National Service

We were engaged to audit the accompanying 1995 and 1994 financial statements of the National Service Trust Fund (Trust), a program within the Corporation for National Service (CNS). In connection with the engagement, we also considered CNS's internal control structure related to the Trust and tested CNS's compliance with selected provisions of applicable laws and regulations related to the Trust that could have a direct and material effect on its 1995 and 1994 financial statements.

These financial statements include only the activities of the Trust related to financing CNS educational awards. The statements do not include any other activities of CNS, including the operating and administrative costs of the Trust.

As a result of the engagement to audit the financial statements of the Trust for the years ended September 30, 1995 and 1994 we found:

- CNS did not maintain adequate accounting or member records on behalf of the Trust for educational awards during 1995 and 1994 and the records which were reconstructed subsequent to September 30, 1995 were not adequately supported by underlying documentation. Because of this and other related matters, which are discussed further in the following section, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion of the accompanying financial statements as of and for the years ended September 30, 1995 and 1994.

As a result of our consideration of the internal control structure related to the Trust, we found:

- Material weaknesses in the internal control structure related to:

Accounting records - CNS did not maintain general ledgers, detailed records and supporting documentation for transactions,

Trust Fund System - there were weaknesses in controls over changes to financial data maintained on computerized systems, and

Account reconciliations - CNS did not reconcile the Trust's fund balances with Treasury and investments accounts to Treasury records of activity.

As a result of our tests of compliance with laws and regulations, we found:

- CNS did not report Trust fund activity to Congress as required.

The results of our engagement to audit the Trust's financial statements, our consideration of the internal controls over financial reporting, our tests of CNS's compliance with laws and regulations related to the Trust, and our responsibilities, are discussed in the remainder of this report.

Opinion on financial statements

We were engaged to audit the accompanying statements of financial position of the Trust, a program within CNS, as of September 30, 1995 and 1994, the related statements of operations and changes in net position and statements of cash flows for the years then ended. These financial statements are the responsibility of CNS's management.

CNS did not maintain certain accounting records for the Trust during 1995 and 1994, particularly with respect to its fund balances with Treasury, investments and service award liability, thus requiring the reconstruction of these records subsequent to September 30, 1995. CNS did not have adequate internal controls over Trust financial and related records to ensure that the reconstructed accounting records were complete and accurate. Sufficient evidential matter in support of the recorded service award liability, service award expense, and appropriations transactions was not available. It was impracticable to extend our audit procedures sufficiently to determine the extent to which the financial statements for the years ended September 30, 1995 and 1994, may have been affected by these conditions.

Because of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying financial statements as of, and for the years ended September 30, 1995 and 1994.

Internal controls

We noted certain matters involving the internal control structure related to the Trust and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect CNS's ability to record, process, summarize and report financial data for the Trust consistent with the assertions of management in the financial statements.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level, the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters related to the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as described above. However, we noted the following matters (which are further described in Appendix A on pages 5 to 8) involving the internal control structure and its operation that we consider to be material weaknesses as defined above. These conditions were considered in determining the nature, timing and extent of the procedures to be performed in our engagement to audit the financial statements of the Trust for the years ended September 30, 1995 and 1994.

Accounting records - CNS did not maintain adequate financial records (general ledgers, detailed schedules and source documentation) for the Trust during the years ended September 30, 1995 and 1994.

Trust Fund System - CNS did not maintain a system of internal controls over financial and other information contained in the Trust Fund System database (educational award and membership detail) for the years ended during September 30, 1995 and 1994. The Trust Fund System database information (1) could not always be verified from or reconciled to external documentation of enrollment or certification of completion; (2) could be changed in the system without any evidence of approval or supporting documentation (audit trail); and (3) was not limited by system or other controls to prohibit certain types of incomplete or erroneous data entry.

Account reconciliations - CNS did not reconcile its fund balances with Treasury or investments with Treasury records during the years ended September 30, 1995 and 1994. Although, CNS employed a consultant who reconciled the activity, in total, as of September 30, 1995, CNS could not reconcile the activity by transaction, to determine which transactions required adjustment.

We noted other matters involving the internal control structure and its operation that we do not consider to be reportable conditions which we have reported to the management of CNS in a separate letter.

Compliance with laws and regulations

The results of our tests of compliance disclosed the following material instance of noncompliance that is required to be reported herein under *Government Auditing Standards*.

- In accordance with 45 USC National Service Trust and Provision of National Service Educational Awards, CNS was required to submit reports to Congress of Trust Fund receipts and expenditures not later than March 1 for the preceding fiscal year. CNS only recently submitted its fiscal year 1994 report to Congress in December 1996, and has not submitted its 1995 report.

Responsibilities

Management's responsibilities: The Government Corporation Control Act requires CNS to prepare financial statements on an annual basis. As part of that effort, CNS prepared financial statements for its Trust. CNS management has the responsibility for preparing the Trust's financial statements in accordance with generally accepted accounting principles, establishing and maintaining an effective internal control structure for the Trust, and complying with applicable laws and regulations.

In fulfilling these responsibilities, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute assurance, that transactions, including those related to obligations and costs, are executed in compliance with applicable laws and regulations that could have a direct and material effect on the financial statements; funds, investments, and other assets are safeguarded against loss from unauthorized use or disposition; and transactions are properly recorded and accounted for to permit the preparation of reliable financial reports in accordance with generally accepted accounting principles and to maintain accountability over assets.

Auditors' responsibilities: In planning and performing our engagement to audit the financial statements of the Trust, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of performing our engagement to audit the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of an evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of CNS's compliance with certain provisions of laws and regulations relative to the Trust. However, the objective of our engagement to audit the financial statements was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

This report is intended for the information of CNS's management and the Office of Inspector General. However, this report is a matter of public record and its distribution is not limited.

KPMG Peat Marwick LLP

January 15, 1997

Appendix A - Material Weakness

The following provides additional information on the material weaknesses identified in the independent auditors' report. We believe, in addition to implementing the detailed recommendations below, CNS should establish broad based policies and procedures for the management of the Trust including: budgeting, monitoring program enrollees, and monitoring financial information and program activity on a routine periodic basis.

Accounting records - CNS did not maintain financial records, including general ledgers, detailed schedules and source documentation for the Trust during the years ended September 30, 1995 and 1994. CNS originally planned to use its general ledger software program, Federal Success, to record transactions and integrate member educational awards information into the system. The Trust Fund System (discussed in the next section) became operational on September 15, 1995 and was not integrated with Federal Success. CNS reconstructed a general ledger for the Trust using Treasury transaction records on Quickbooks, a PC based software program, during 1996. The transactions consisted primarily of investment activity and disbursements of educational awards. Although detailed schedules as of September 30, 1995 and 1994 supporting account activity and ending balances for assets were prepared for most accounts during 1996, only a summary schedule, without supporting details, was prepared for the amounts recorded for the service award liability. CNS did not maintain documentation supporting service award liability information contained in the Trust Fund System.

Without accurate, complete, and timely accounting records and financial information, CNS management does not have reliable information for its decision making process.

We recommend:

- CNS maintain records on a contemporaneous basis.
- CNS establish monthly procedures that require the reconciliation of fund balances with Treasury and investments to Treasury activity.
- CNS establish a reconciliation procedure between Trust Fund System data (awards earned and disbursements) and monthly general ledger activity (regardless of whether integration is implemented). Documentation supporting reconciliations should be maintained.

Trust Fund System - CNS did not maintain a system of internal controls over financial and other information contained in the Trust Fund System database for the years ended September 30, 1995 and 1994. The Trust Fund System was created to maintain a database of Members' educational awards and includes, among other items, information on enrollment, status, education level, awards earned, completion dates, service hours completed, and amounts paid. The Trust Fund System database information: (1) could not always be verified from or reconciled to external documentation of enrollment or certification of completion; (2) could be changed in the system without any evidence of approval or supporting documentation (audit trail); and (3) was not limited by system or other controls which prohibit or limit certain types of incomplete or erroneous data entry. The following are examples of specific weaknesses in the Trust Fund System:

- There are no formal program change control procedures and no supporting documentation of changes with approval signatures.

- The Trust Fund System data administrator has direct access to the database, permitting changes to data with no “trail.” The data administrator also has complete access to the payment process, permitting changes to data with no “trail.”
- For those with access and ability to change data, the system does not automatically produce a report for review by persons other than those making the changes.
- There is no audit trail which shows user and associated data file access, including the time and date of occurrence.
- The same user may “login” onto the system more than once and have concurrent sessions, workstations do not automatically exit inactive users from the system after a specified period of time, and there are no parameters which limit the number of failed attempts at logging into the system.
- The enrollment and completion forms, which support data in the system, are not organized to permit easy access to the files and in many cases do not support the information contained in the Trust Fund System for individual members.
- In many cases, the data maintained on the Trust Fund System for individual members is not supported by source documentation. This included information related to hours worked, certifying officer, member name, and sponsoring agency.
- Sponsoring agencies’ most recent responses to the monthly membership roster information request are not maintained. This includes corrections by the sponsoring agencies to the system data.
- The enrollment forms are not pre-numbered or controlled. The access to enrollment forms is not restricted or controlled to determine the number of forms which were issued to an agency and the corresponding number returned. Any completed form can be entered and a member can be enrolled.
- There are no controls established to compare source document information scanned into the system to actual data maintained on the system.

Without system controls, such as those described above, a user (authorized or unauthorized) can access the system and alter data without proper approvals or authority.

We recommend:

- CNS establish system parameters which prohibit certain entries without approval (e.g., the system should not allow payment or awards to be earned without correct hours or certifying officer also entered).

- CNS implement an audit trail of certain transactions (e.g., changes to names, dates, payment amounts) to be automatically printed to a report on the system and set up procedures which include approval before processing for selected transactions and the periodic independent review of certain transactions or changes by the CFO office.
- CNS establish formal procedures for all types of changes to both the system and the data. These procedures should include documentation of changes and approvals required for changes.
- CNS implement system settings to: logout any user after three failed attempts, logout any users after 30 minutes of inactivity and prohibit more than one concurrent session.
- CNS establish a logical filing system for enrollment and completion forms which is maintained on a current basis.
- Enrollment forms be pre-numbered and/or controlled to prohibit data entry for unapproved forms.
- CNS establish a formal procedure of communicating and confirming system data to the sponsoring agencies, verifying responses (and making changes with appropriate documentation maintained) to system data, and maintaining the latest sponsoring agency response as external support for data on the system.
- CNS establish a quality assurance review section to perform limited site visits which include procedures to verify the data maintained on the system. Records of the site visits and corresponding system adjustments or changes should be maintained by CNS.
- CNS implement procedures to verify the accuracy of data scanned into the system and to prohibit duplicate entries.

Account reconciliations – CNS did not reconcile its fund balances with Treasury or investments with Treasury records of activity on a periodic basis during the years ended September 30, 1995 and 1994. Although CNS employed a consultant who reconciled the activity in total as of September 30, 1995, CNS did not reconcile individual transactions and balances in these accounts to Treasury records. Instead of recording transactions from source documentation, CNS constructed records to support its financial statements from Treasury statements of activity.

Without monthly reconciliations of fund balances with Treasury and investments, CNS management may make decisions regarding disbursements or investments based on erroneous information.

We recommend:

- CNS record transactions on a contemporaneous basis during the year.
- CNS implement monthly reconciliation procedures, including a review and approval process, for fund balances with Treasury and investments which provide for timely adjustments to both the financial records and Treasury records.
- CNS maintain copies of reconciliations on file.

**CORPORATION FOR NATIONAL SERVICE
NATIONAL SERVICE TRUST FUND**

Statements of Financial Position

September 30, 1995 and 1994

Assets	1995	1994
Entity assets:		
Intragovernmental:		
Fund balances with Treasury	\$ 207,153	\$ 700,447
Investments (note 2)	196,895,259	99,557,154
Interest receivable (note 2)	4,485,010	1,292,433
Prepaid interest	103,278	66,462
Total assets	\$ 201,690,700	\$ 101,616,496
Liabilities and Net Position		
Liabilities covered by budgetary resources:		
Service award liability (note 3)	\$ 136,326,000	\$ 78,341,951
Net position:		
Unexpended appropriations	50,541,994	20,203,324
Cumulative results of operations	14,822,706	3,071,221
Net position	65,364,700	23,274,545
Total liabilities and net position	\$ 201,690,700	\$ 101,616,496

See accompanying notes to financial statements.

**CORPORATION FOR NATIONAL SERVICE
NATIONAL SERVICE TRUST FUND**

Statements of Operations and Changes in Net Position

Years ended September 30, 1995 and 1994

	1995	1994
Financing sources:		
Appropriations expended	\$ 62,779,329	\$ 78,547,676
Investment income	11,751,485	3,071,221
Total financing sources	74,530,814	81,618,897
Service awards for enrolled members	62,779,329	78,547,676
Net results of operations	11,751,485	3,071,221
Net position, beginning of year	3,071,221	-
Net position, end of year	\$ 14,822,706	\$ 3,071,221

See accompanying notes to financial statements.

**CORPORATION FOR NATIONAL SERVICE
NATIONAL SERVICE TRUST FUND**

Statements of Cash Flows

Years ended September 30, 1995 and 1994

	1995	1994
Cash flows from operating activities:		
Investment earnings received (interest paid)	\$ 12,252,986	\$ (1,089,828)
Service awards paid	(4,795,280)	(205,725)
Net cash provided (used) by operating activities	7,457,706	(1,295,553)
Cash flows from investing activities:		
Purchase of investments	(125,510,000)	(253,310,000)
Receipts from sales/maturities of investments	24,441,000	156,555,000
Net cash provided (used) by investing activities	(101,069,000)	(96,755,000)
Cash flows from financing activities:		
Appropriations received	93,118,000	95,001,000
Appropriations rescinded	-	(1,250,000)
Contribution from National Civilian Community Corps	-	5,000,000
Net cash provided by financing activities	93,118,000	98,751,000
Net increase (decrease) in cash during the year	(493,294)	700,447
Fund balances with Treasury, beginning	700,447	-
Fund balances with Treasury, ending	\$ 207,153	\$ 700,447
Reconciliation of net additions to net cash provided (used) by operating activities:		
Net income	\$ 11,751,485	\$ 3,071,221
Add:		
Amortization of premiums and discounts and gains/loss on sales, net	3,730,895	(2,802,154)
Increase in service awards accrued	57,984,049	78,341,951
	73,466,429	78,611,018
Less:		
Increase in interest receivable and prepaid interest	(3,229,394)	(1,358,895)
Appropriated capital used	(62,779,329)	(78,547,676)
Net cash provided (used) by operating activities	\$ 7,457,706	\$ (1,295,553)

See accompanying notes to financial statements.

CORPORATION FOR NATIONAL SERVICE NATIONAL SERVICE TRUST FUND

Notes to Financial Statements

September 30, 1995 and 1994

(1) Summary of Significant Accounting Policies

Organization

The National Service Trust (the Trust), a fund within the Corporation for National Service (CNS), a wholly-owned government corporation, was created in 1994 by the National and Community Service Trust Act of 1993 (Public Law 103-82). CNS provides grants and other incentives to states, local municipalities and not-for-profit organizations to expand national and community service volunteer activities. The Trust receives appropriations through CNS to fund educational and similar awards made under National and Community Service Programs including Volunteers in Service to America (VISTA), Americorps, and National Civilian Community Corp. (NCCC) programs.

Reporting Entity

These financial statements include only the activities of the Trust related to financing CNS educational awards. Costs of administrating and operating the Trust are borne by CNS pursuant to the enabling legislation and accordingly are not included in these financial statements. The Trust is not subject to income tax.

Basis of Accounting

The Trust's financial statements were prepared under the accrual basis of accounting. The accrual basis of accounting requires recognition of the financial effects of transactions, events, and circumstances in the period(s) when those transactions, events, and circumstances occur, regardless of when cash is received or paid. The Trust also uses budgetary accounting to facilitate compliance with legal constraints and to keep track of its budget authority at the various stages of execution, including allotment, obligation, and eventual outlay.

Fund Balances with Treasury

The Trust does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by Treasury. The fund balances with Treasury represent no-year appropriated funds which are available to pay current and future service awards.

Interest Receivable

Interest receivable are amounts earned but not yet received on investments held at the end of each fiscal year.

Prepaid Interest

Prepaid interest is recorded when an investment is purchased between interest payment dates and is equal to the amount of accrued interest on that date.

(Continued)

**CORPORATION FOR NATIONAL SERVICE
NATIONAL SERVICE TRUST FUND**

Notes to Financial Statements

(1) Continued

Investments

By law, CNS only invests Trust fund balances in interest-bearing Treasury obligations of the United States. The Trust's investments are referred to as market-based specials, which are similar to government securities sold on the open market.

Treasury obligations including notes, bills, and bonds are carried at cost, adjusted for premiums and discounts. Premiums and discounts are amortized using the effective interest method over the life of the investments.

Service Award Liability

The service award liability represents education awards earned by program members for performing authorized community service activities. Service awards may be used by members to repay student loans, defray tuition costs, or pay interest forbearance costs on qualified student loans. Members have up to seven years to use earned education awards.

Financing Sources

The Trust may obtain funding through no-year appropriations, investment income, gifts, bequests, or similar contributions.

Appropriations are recognized as financing sources when the service award liability is incurred. Unexpended appropriations represent amounts available for future awards and are presented as net position in the financial statements.

Investment Income

Interest income is recognized when earned. Treasury notes and bonds pay interest semiannually, based on the stated rate of interest. Interest earned on Treasury bills is recognized at maturity.

Interest income is adjusted by amortization of premiums and discounts. The effective interest method is used to amortize premiums and discounts.

Use of Estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results will invariably differ from those estimates.

(Continued)

**CORPORATION FOR NATIONAL SERVICE
NATIONAL SERVICE TRUST FUND**

Notes to Financial Statements

(2) Investments

All investments held by the Trust are debt securities and are obligations of the U.S. government and include Treasury notes, bonds, bills, and one-day certificates. All investments are purchased with the intent and ability to hold them until maturity, and are reported at amortized cost.

The following was the composition of investments at September 30, 1995:

	Interest rates (range)	Maturity (range)	Par value	Unamortized premium (discount)	Carrying value	Market value	Unrealized gain/ (loss)	Accrued interest
Notes	4.25% - 9.375%	1-4.5 years	\$ 195,191,125	(950,407)	194,240,718	197,592,087	3,351,369	4,370,528
Bonds	11.5%	1 day to 1.5 years	2,633,000	21,541	2,654,541	2,639,319	(15,222)	114,482
			\$ 197,824,125	(928,866)	196,895,259	200,231,406	3,336,147	4,485,010

The following was the composition of investments at September 30, 1994:

	Interest rates (range)	Maturity (range)	Par value	Unamortized premium (discount)	Carrying value	Market value	Unrealized gain/ (loss)	Accrued interest
Notes	3.875%- 10.50%	1-5 years	\$ 93,239,000	2,571,014	95,810,014	93,678,785	(2,131,229)	1,139,746
Bonds	11.5%- 12.625%	7-60 days	3,516,000	231,140	3,747,140	3,701,232	(45,908)	152,687
Total			\$ 96,755,000	2,802,154	99,557,154	97,380,017	(2,177,137)	1,292,433

Investments held as of September 30, 1995, will mature as follows:

Within 90 days	\$ 11,833,506
91 days - 1 year	47,274,997
1 - 2 years	33,284,389
2 -3 years	40,108,652
3 - 4 years	43,693,894
4 -5 years	21,628,687
	\$ 197,824,125

(Continued)

**CORPORATION FOR NATIONAL SERVICE
NATIONAL SERVICE TRUST FUND**

Notes to Financial Statements

(3) Service Award Liability

Members participating in Trust programs are eligible to earn a service award to pay for qualified educational expenses. Members earn awards based on hours of community service work. Awards can be redeemed for a period up to seven years. The Trust also pays for forbearance interest on student loans during the time members perform community service work. The Trust records a liability for these service and similar awards based on actual awards earned for participants who have completed service and estimated amounts for participants enrolled in the program.

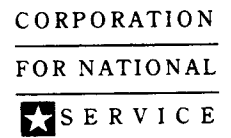
A service award liability is recorded at the time a member enrolls in the program. The liability for each member varies depending on their enrollment status, part-time or full-time. The Trust records the entire amount of the award less an estimated amount for participants who will not complete service and not earn an award.

The service award liability was comprised of the following as of September 30, 1995 and 1994 are as follows:

	1995	1994
Earned awards	\$ 58,311,000	\$ -
Estimated awards to be made	79,335,000	76,856,000
Estimated interest forbearance costs	3,475,280	1,691,676
Cumulative awards paid	(4,795,280)	(205,725)
	<u>\$ 136,326,000</u>	<u>\$ 78,341,951</u>

APPENDIX B

March 7, 1997



Luise Jordan, Inspector General
Corporation for National Service

Re: The 1994 and 1995 Financial Statement Audit of the
Corporation for National Service Trust Fund

Dear Ms. Jordan:

This letter is in response to the Corporation for National Service's (CNS) draft audit report submitted by the audit firm of Peat Marwick, LLP (KPMG). We appreciate the opportunity to respond to this draft report to provide subsequent readers of the final report a summary of the significant improvements being initiated by CNS in response to the audit findings and related recommendations. While the results of the audit, for the periods ending September 30, 1994 and 1995, do not fully reflect the outcome CNS would desire, the report provides a number of recommendations which CNS will use in conjunction with its own initiatives in developing and implementing necessary financial and operational control improvements.

The following represents our response to the audit recommendations provided:

Comments Contained in the Opinion Letter

The National and Community Service Trust Act of 1993 was enacted in September, 1993 and the Corporation was created in October of that year. During the next twelve months, the Corporation promulgated regulations to implement that Act, advertised and conducted a nation-wide grants competition, and issued grants to over 400 state and community based organizations. Within months of those grants being let, the Corporation enrolled over 20,000 members in national service programs. At the same time, the Corporation built an interim database to capture data from over 1,100 sites and built a permanent data system, which became operational on September 15, 1995, to manage the National Service Trust. It is this initial two-year period that is covered by the KPMG audit of the National Service Trust.

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Luise Jordan, Inspector General

March 7, 1997

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The audit highlights, in very helpful ways, the areas where the internal controls on the Trust operations were not adequate or could be improved. As will be seen in the material that follows, the Corporation already has taken actions to correct many of those deficiencies. Some of those actions were taken before the audit was conducted. In other instances, the Corporation has learned from the findings of the audit and is planning actions to correct the deficiencies.

Audit Responses

The following represents the Corporation's response to the individual recommendations proposed in the draft audit.

Accounting Records

1. **We recommend that CNS maintain records on a contemporaneous basis.**

CNS concurs with this recommendation and will establish accounting procedures providing for accounting transactions to be recorded and reconciled on a contemporaneous basis. Once established, these procedures will include all accounting activity. Further, management will establish a routine and planned review of the Service Award Liability calculation and will maintain the underlying data supporting the Award Liability calculation. This audit deficiency will be corrected for future audits providing both the financial management of CNS and external auditors the level of confidence in the financial records needed for financial statement purposes.

2. **CNS should establish monthly procedures that require the reconciliation of fund balances with Treasury and Investments to Treasury Activity.**

CNS will establish a process providing for the monthly reconciliation of both fund (cash) and investment balances with balances maintained by Treasury. These procedures will require that the detailed reconciliation of fund and investment be performed regularly and routinely rather than only in anticipation of an audit such as the one recently performed by KPMG.

Luise Jordan, Inspector General

March 7, 1997

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- CNS should establish a reconciliation procedure between Trust Fund system data (awards earned and disbursements) and monthly general ledger (regardless of whether integration is implemented). Documentation supporting reconciliations should be maintained.**

Management concurs with this recommendation and will develop formal procedures to ensure that a reconciliation is performed between the Trust Fund System data and the general ledger on a monthly basis. This process will continue in place to provide the required controls over input to the Trust Fund and Federal Success systems. Management will monitor and review this process and provide the necessary modifications or changes as appropriate.

Trust Fund System

- We recommend that CNS establish system parameters which prohibit certain entries without approval (e.g. the system should not allow payment or awards to be earned without correct hours or certifying officer also entered).**

Management concurs with this recommendation and is currently reviewing the Trust Fund's authorization policies in conjunction with improving the overall effectiveness of the internal control structure of the Trust Fund System (the System). Our review will include the introduction of input into the System, the development of changes to the System, and access to the System's data and files.

In program year 1996, CNS improved its certification process for its Enrollment and End-of-Term Forms. Each certifying official's name must appear in the System before a participant's form is processed. All End-of-Term forms are automatically screened to ensure that the Certifying Official has been authorized to sign the form, and has been pre-approved in the System. Similarly, any form which is received without the prescribed amount of service time is rejected automatically by the System to ensure that either the number of hours, or the number of days (in the case of VISTA Members) are properly recorded. Any deviation from these system parameters is followed-up by Trust Fund staff members.

We will continue to monitor these authorization policies to ensure that all transactions are properly recorded and approved.

2. **CNS should implement an audit trail of certain transactions (e.g. changes to names, dates, payment amounts) to be automatically printed to a report on the system and set up procedures which include approval before processing for selected transactions and the periodic independent review of certain transactions or changes by the CFO office.**

CNS Management concurs and will develop a system-generated audit trail to meet this critical need. This system audit trail will generate a monthly Transaction Register providing management of the Trust Fund the ability to monitor transactions ensuring they were authorized and appropriately recorded in the system. CNS plans to complete the development of this automated audit trail and establish control procedures by May 31, 1997 with final implementation to proceed subsequent to that date.

3. **CNS should establish formal procedures for all types of changes to both the system and the data. These procedures should include documentation of changes and approvals required for changes.**

Management concurs with this recommendation. As indicated above, we are currently conducting an over-all review of the System's internal control structure which will include authorization policies, segregation of duties and an assessment of the responsibilities and job tasks. In addition, we will review the application controls of the System to include input and output processing. The objective of this review is to improve the efficiency of the System, its controls, and to ensure that sufficient resources are allocated to this function. We anticipate that this review will be completed in June, 1997 with implementation to immediately follow.

4. **CNS should implement system settings to: logout any user after three failed attempts, logout any users after 30 minutes of inactivity and prohibit more than one concurrent session.**

CNS management has reviewed each of the recommendations and will respond to each individually. This recommendation covers two separate security areas -- the CNS Local Area Network and the Trust Fund Oracle application. There are different types of security options available for both environments. While these recommendations suggest that these options are readily changeable system settings for the Trust Fund (Oracle), several of them are not actually available within Oracle. To improve the level of security available within the Trust Fund system, the Corporation previously purchased a third party security program which allows for security settings which are not available within Oracle. The Corporation has implemented a number of these security related issues with this software and responds to each of the findings as follows:

- We agree that it is good policy to deny access to users after a specified number of attempts. At present, both the Windows NT LAN and the Oracle systems denies access after five failed log in attempts and we believe that to be adequate. Since both the Windows NT network and the Oracle server lock the account after the fifth unsuccessful attempt, the account can only be activated again after direct Office of Information Technology's staff intervention. When we analyzed setting this to a lower number, we concluded that doing so would increase the number of lock outs of proper users due to keyboard or memory errors, in turn, causing users not to have access to the system for an extended period of time.
- Log out any user after 30 minutes of inactivity — the Corporation previously considered this option as a network-wide application, but our review demonstrated that many of the CNS staff run multiple/simultaneous applications (e-mail, word processing, spreadsheets, etc.). Setting our Windows NT LAN for a half-hour automatic shut down creates a significant risk that a number of files in open applications could be corrupted by such a shut down. Therefore, we believe the risks of a Windows NT based automatic shut down outweigh the benefit of implementing such a shut down on a network basis.

On an Oracle basis, the security software allows us to limit this automatic shut down to Oracle only, so we are presently testing and evaluating this feature. The results of these tests will be considered by CNS management on a cost benefit basis. In the meantime, the importance of shutting down all financial applications whenever someone leaves their desk was covered in the mandatory annual computer security training. We believe this training has adequately informed all staff of their security responsibilities and it reduced the risk of financial systems being left open for up to one-half hour.

- The issue of limiting individual log-ons is also different between Windows NT networking and the Oracle server. While we agree that it would be ideal to limit individual logins within both Windows NT and Oracle, this is not currently a configuration option within either environment. In order to prevent unlimited sessions by a single user, OIT has set a limit of three sessions per user which would allow a staff member to both enter and edit records while running a report in the background. Setting the number of simultaneous sessions to less would require the staff to exit Oracle in order to run a report. It also would require rewrites of the system code that uses Oracle's multi-tasking efficiency. Should Microsoft, Oracle or a third party introduce software that would allow the Corporation to implement a limit of one login per user for both Windows NT and Oracle, we will definitely pursue and implement it, if possible.

5. **CNS should establish a logical filing system for enrollment and completion forms which is maintained on a current basis.**

Management concurs with this recommendation and in the short term, is examining methods to improve its current system. In addition, we are exploring other options to this system of filing, while remaining mindful of the practical and economic impact to the Corporation. We anticipate the completion of this examination by April 30, 1997.

6. **Enrollment forms should be prenumbered and/or controlled to prohibit data entry for unapproved forms.**

The Corporation's grants programs operate in a very decentralized manner with hundreds of grantees and ultimately over 1,100 operating sites. Recruitment and selection for these programs are the responsibilities of the grantees. We have studied the recommendation to use pre-numbered and controlled forms and do not believe it is practical or would enhance the control process. The Corporation would have to have a significant staff to administer and track controlled forms in our environment. As described elsewhere in this document, the Corporation, after the period covered by the audit, put in place a system whereby the project certifies the appropriateness of the enrollment and exit data and is provided an opportunity during the period of service to correct errors in that data. In subsequent commentary, we also have detailed actions which will improve the roster correction process. We believe that the new controls already implemented and the enhancements to the roster process will meet the concerns outlined in the audit.

7. **CNS should establish a formal procedure of communicating and confirming system data to the sponsoring agencies, verifying responses (and making changes with appropriate documentation maintained) to system data, and maintaining the latest sponsoring agency response as external support for data on the system.**

This process has been in place for some period of time. However, we have had difficulty in attempting to coordinate the submission of the data through the State Commissions to the sponsoring agencies and, in turn, to the large number of sites involved. In the future, CNS will prepare multiple copies of the existing Roster report and submit the document to both the sponsoring agencies and to the State Commissions, requesting that each of these organizations coordinate and submit any questions or proposed changes to CNS in a uniform and consolidated manner. Once that process is installed on a pre-planned basis (quarterly for the present), we will install a filing system to maintain this documentation in an organized manner, such that future audits will have an organized file of corrections to test for accuracy.

In addition, while the continuing and consistent review of the Trust Fund Rosters by the field will be an improvement to the present process, more remains to be done. To that end, a group of CNS employees will convene to review this and other procedures involving the field

interaction with the Trust Fund area in Headquarters. Again, we concur that improvements in the total flow of information and the process of revisions to Trust Fund detail needs to be enhanced in order to maintain a more complete and accurate file of data for the total program.

8. **CNS should establish a quality assurance section to perform limited site visits which would include procedures to verify the data maintained on the system. Records of the site visits and corresponding system adjustments should be maintained by CNS.**

CNS concurs with this recommendation and is in the process of implementing it along with a number of additional changes to our overall Corporate program for monitoring grantees. Under this enhanced program, CNS will establish a method by which key indicators of financial activity will be monitored leading to on-site visits if those indicators are outside defined parameters.

9. **CNS should implement procedures to verify the accuracy of data scanned into the system and to prohibit duplicate entries.**

CNS has reviewed the process currently being utilized in our scanning procedure to determine if duplicate entries are currently possible. We believe the current process which is being used for the most recent program year precludes multiple entries to the system. The system recognizes multiple enrollment forms via the social security number and rejects the second submission. Similarly, if we receive multiple end-of-term forms, the second submission is automatically rejected with subsequent review required. We will, however, continue to monitor the process to ensure that existing controls remain functional, and that any backlog in the reject processing cycle does not mitigate the process.

Account Reconciliations

1. **CNS should record transactions on a contemporaneous basis during the year.**
2. **CNS should implement monthly reconciliation procedures, including a review and approval process, for fund balances with Treasury and investments which provide for timely adjustments to both the financial records and Treasury records.**
3. **CNS should maintain copies of reconciliations in file.**

Luise Jordan, Inspector General

March 7, 1997

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CNS generally concurs with the control and procedural issues raised within the audit report. As outlined earlier in our response, CNS will review the recommendations, develop appropriate procedures to address the control issues raised and take the actions required to implement these procedures. Again, we appreciate the efforts of your organization and the opportunity to respond to this draft report.

Sincerely,


Donna H. Cunninghame
Chief Financial Officer