



MAR 9 1992

Memorandum

Date

From

Richard P. Kusserow
Inspector General

Subject

Review of Internal Controls Over the Third Party Draft
System in the Regional Administrative Support Center,
Region IV (A-04-91-00009)

To

Arnold R. Tompkins
Assistant Secretary for
Management and Budget

The attached final report provides you with the results of our audit of the internal controls over the third party draft (TPD) system in the Regional Administrative Support Center, Division of Finance, Atlanta, Georgia.

We estimate that payments of \$3.2 million were made through TPDs which were not within the guidelines of the Department of the Treasury or the Department of Health and Human Services policy. We found that the TPD internal control system was not documented, the separation of key duties was inadequate, access to TPDs and the supporting documentation was not limited, and accountability for blank drafts was not assigned. In addition, the internal control system did not ensure that TPDs were not used as payments for items that should be paid through a Treasury financial center or should not be paid on the supporting documentation. Because internal control weaknesses have also been detected in the TPD system at other locations, we believe additional departmental oversight is warranted.

In response to our draft report, your office generally agreed with our findings and recommendations. The response stated that the Office of Financial Operations has initiated actions to implement enhanced internal controls. Your office also plans to install a new Core Accounting System which should ensure that resources are adequately protected. The response is attached to the report as Appendix B.

We would appreciate receiving, within 60 days, comments on any additional action you take on this report. If you have any questions, please call me or have your staff contact John A. Ferris, Assistant Inspector General for Human, Family and Departmental Services Audits, at (202) 619-1175.

Attachment

Department of Health and Human Services

OFFICE OF
INSPECTOR GENERAL

REVIEW OF INTERNAL CONTROLS OVER
THE THIRD PARTY DRAFT SYSTEM,
REGIONAL ADMINISTRATIVE SUPPORT
CENTER - REGION IV



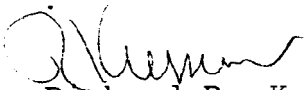
Richard P. Kusserow
INSPECTOR GENERAL

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Review of Internal Controls Over the Third Party Draft
System in the Regional Administrative Support Center,
Region IV (A-04-91-00009)

To

Arnold R. Tompkins
Assistant Secretary for
Management and Budget

This final report provides you the results of our audit of the internal controls over the third party draft (TPD) system in the Regional Administrative Support Center (RASC), Division of Finance (DOF), Region IV.

Our audit showed that DOF's internal controls for TPDs were inadequate. We estimate, based on statistical sampling, that for the period September 28, 1989 through November 30, 1990, payments of \$3,224,946 were made which were not in accordance with Department of the Treasury (Treasury) regulations or Department of Health and Human Services (Department or departmental) policy. The Assistant Secretary for Management and Budget (ASMB) officials believe that the Department's TPDs are used in compliance with Treasury regulations and are more economical and expedient than payments made through a Treasury financial center (TFC).

We found that the TPD internal control system was not adequately documented, the separation of key duties was inadequate, access to TPDs and the supporting documentation was not limited, and accountability for blank drafts was not assigned. In addition, the internal control system did not ensure that TPDs were not used as payments for items that should be paid through a TFC or should not be paid based on the supporting documentation.

We recommend that ASMB provide increased oversight of this system nationwide and DOF establish and implement internal controls that assure TPDs are controlled in accordance with applicable laws and regulations.

In response to our draft report, ASMB generally agreed with our findings and recommendations. The ASMB stated that the Office of Financial Operations (OFO) has initiated actions to implement enhanced internal

controls. The ASMB also plans to install a new **Core Accounting System** which should ensure that resources are adequately protected. The response is attached to the report as Appendix B.

INTRODUCTION

Background

The DOF performs accounting, fiscal, and budget services for the Department's regional staff and operating divisions. The DOF's fiscal responsibilities include issuing TPDs for travel vouchers, travel advances, vendor invoices, cash on deliveries, and emergency employee salary payments. The TPDs are check-like instruments drawn against and paid by nonfederal financial institutions. The TPDs are considered an alternate payment mechanism for imprest fund cash disbursements. Use of TPDs allows agencies to either reduce the cash balance held in their imprest funds or eliminate the use of cash completely. Drafts are intended to offer better cash management procedures, more flexibility and better internal control than cash imprest funds.

The Region IV DOF TPD system includes manual and computerized activities. Information from source documents is manually entered into the computer system. The computer automatically prepares the accounting entries and prints the payment information on blank drafts. The drafts' are signed by authorized DOF employees and forwarded to the payee. Supporting documents and copies of the drafts are manually filed for future reference.

The TPDs are subject to Treasury regulations for the use of imprest funds. These regulations state that imprest funds are to be used for only specific types of payments such as: small purchases; repair of equipment; postal fees; transportation tokens or passes; taxi fares; travel advances and reimbursement for travel expenses; public utility bills (if the location of the activity is so situated that cash payment is more efficient); and local drayage (movement of supplies or commodities within a recognized metropolitan area in which both the point of pick-up and delivery are located).

The regulations also state that TPDs are not to be used as a substitute for payments normally made through **TFC**.

The use of TPDs as a payment option began as a pilot program in 1983. The Department's Region IV DOF began issuing TPD payments on September 28, 1988; they were the second office in the Department to begin the TPD program.

Scope

Our review of internal controls over the TPD system was made in accordance with generally accepted Government auditing standards. The review was performed to determine if DOF's plan of organization, methods and procedures were adequate to ensure that: (1) TPDs as used were consistent with laws, regulations and policies, and (2) TPDs were safeguarded against waste, loss and misuse. We interviewed DOF personnel and observed aspects of the operation of the TPD computer system to identify the internal controls in effect for the TPD system.

We studied applicable documents regulating TPDs including:

Office of Management and Budget (OMB) Circular A-123 (A-123);

the General Accounting Office (GAO) Standards for Internal Controls in the Federal Government (GAO Standards);

Chapter 3000 of the Treasury Financial Manual and its supplement, the Manual of Procedures and Instructions for Cashiers;

the OFO's September 24, 1990 memorandum on TPD minimum requirements for internal controls; and

Parts 37.01 through 37.104 of the Federal Acquisition Regulations.

We discussed the use of TPDs with officials from the Treasury, Internal Revenue Service (IRS), and the Department. We also reviewed correspondence from the Office of the Deputy Assistant Secretary, Finance (DASF) concerning the issuance of TPDs and other correspondence to determine the Department and IRS positions relative to contract health care providers.

Additionally, we evaluated the results of the October 17, 1990 internal control review performed by DOF officials at the request of the DASF, the 1990 Federal Managers' Financial Integrity Act report, and findings identified by other auditors during reviews of Social Security Administration's TPD internal controls.

Substantive tests were performed to evaluate the effectiveness of the internal controls in preventing or detecting errors, including tests to determine whether TPD disbursements were properly authorized. We selected a statistical sample of 200 TPDs from a total of 15,587 pre-numbered drafts utilized during the period September 28, 1989 through November 30, 1990. The DOF did not maintain the data needed to readily determine the total amount of TPD payments made; therefore, we used the 200 sample items to estimate the universe of TPD payments. Our sample included \$79,000 of the estimated \$6.2 million in TPD payments made by Region IV, DOF. The improper TPD payments were projected to the population using the difference estimator.

Audit field work was conducted from December 1990 through February 1991 at the RASC, DOF office in Atlanta, Georgia. We met with OFO officials in Washington, D.C. on June 12, 1991 to discuss the results of our review.

RESULTS OF REVIEW

The Region IV DOF TPD system of internal controls is inadequate to assure that the objectives of internal control specified in A-123 are being accomplished. The DOF does not have written policies and procedures for issuing TPDs. The internal controls present in the TPD system lack adequate separation of duties and do not limit access to either the TPD computer system, the blank drafts, or the documents that support issued drafts. Additionally, DOF has not established accountability for the blank drafts used in the TPD system. The internal controls were not sufficient to prevent the issuance of TPDs for payments normally made through TFC or to assure that only adequately supported drafts were issued.

Seventy-five of the 200 drafts reviewed, totaling \$41,380, represented payments which were not allowable for TPDs under Treasury regulations. Some of these payments were allowable under departmental policy (see Appendix A). When projected over the population from which we selected our sample, the point estimate of the payments that were not allowable was \$3,224,946. At the 90 percent confidence level, the precision of this sample projection is +/- \$910,205.

TPD Internal Controls

The A-123 outlines the policies and standards to be followed by executive Departments and agencies in

establishing, maintaining, evaluating, improving and reporting on internal controls in their program and administrative activities. The A-123 requires that an agency's system of internal control be established and maintained in accordance with the standards prescribed by the Comptroller General. These standards require: clearly documented internal control systems with the documentation readily available for examination; separation of key duties and responsibilities for authorizing, processing, recording, and reviewing transactions; accountability for the custody and use of resources to be assigned and maintained; and limitation of access to records and resources.

The GAO standards define internal controls as the plan of organization and methods and procedures adopted by management to ensure that resource use is consistent with laws, regulations, and policies; that resources are safeguarded against waste, loss, and misuse; and that reliable data is obtained, maintained, and fairly disclosed in reports. Further, the GAO standards state that good internal controls are essential to achieving the proper conduct of Government business with full accountability for the resources made available. Good internal controls also facilitate the achievement of management objectives by serving as checks and balances against undesired actions. In preventing negative consequences from occurring, internal controls help achieve the positive aims of program managers.

In a September 24, 1990 memorandum to all RASC Directors, the Director, OFO specified that the TPD system should allow only the DOF Directors to sign TPDs with the responsibility being redelegated only to the senior accountants in the Division. This memorandum also requires a separation of duties which segregates the TPD manual system into: inputting of payee identification numbers; inputting and printing TPDs; approving, signing, and distributing TPDs; and clearing and reconciling drafts with the contractor.

Written Procedures

The DOF does not maintain written policies and procedures which document the controls in place for the TPD internal control system. A DOF official said that the computer system was developed from specifications provided by ASMB officials and that the system is maintained at Headquarters (HQ). This DOF official said that verbal discussion of the system's internal controls had been

held, but that the DASF had not provided documentation of the computer's internal controls to the regions. Additionally, the DOF official said that written documentation of the computer system's internal controls had not been requested. Initially, DOF did not believe that the manual portions of the TPD system needed internal controls other than those used for imprest funds because the TPD system was in an evolutionary stage and drafts were less vulnerable than cash. However, after a theft was discovered in another region, the DASF required the regions to develop written procedures for TPDs. A DOF official stated that written procedures developed by HQ and another region would be modified to meet the needs of the Region IV., DOF. At completion of our field work, final written procedures had not been issued for the manual operations of the Region IV TPD system.

Separation of Duties

An adequate system of internal controls would provide for the separation of key duties related to TPDs. The DOF has not assured that key duties and responsibilities for authorizing, processing, recording, and reviewing TPD transactions have been separated as required by A-123. Currently, 3 of the 11 DOF employees perform incompatible duties that encompass most of the manual activities required to process TPD payments. This lack of separation of duties weakens internal controls. For example, two DOF employees verify source documentation, input payee information, issue TPD's (including preparing the accounting information) and sign the drafts. A third employee verifies source documentation, inputs payee information and issues drafts (including preparing the accounting information). In addition, this employee approves drafts for payment to the contracted bank and reconciles the monthly bank statement. We found no compensating controls that would offset this lack of separation of duties.

A DOF official said that the current system allowed the work to be spread among a larger number of employees. Another DOF employee said that as the volume of TPDs increased, it was necessary that employees perform additional duties within the system.

The OFO memorandum of September 24, 1990 instructed the regions in TPD internal control procedures. However, corrective measures in Region IV were not addressed until subsequent to the completion of our field work in February 1991. The DOF initiated actions that could

correct internal control weaknesses that relate to the proper separation of duties and responsibilities. In a memorandum dated February 14, 1991, DOF indicated that TPD activities would be separated into three functional areas (Input of TPDs, Signature Authority, Clearing and Uploading) and that no one employee would be responsible for all three areas.

Access to and Accountability for Resources

The DOF has not established internal control procedures that limit access to the TPD computer system, blank drafts or supporting documentation. Further, DOF's system of internal control does not require that accountability for blank drafts be assigned. Currently, all DOF employees choose their own password but all passwords are known by one employee. Therefore, this employee has access to all passwords and could access the TPD system using the passwords of other employees. The system is equipped to allow for password changes; however, passwords are not routinely changed.

The DOF controls over TPDs neither limit access to nor require accountability for blank drafts. The blank drafts are stored in a room with the computer system and printer. The door to this room is locked at all times with the top half of the door open during office hours. Any person may enter the room by reaching over the door and opening it from the inside. Therefore, all DOF employees have access to the blank drafts and the system hardware. In addition, accountability for the drafts has not been assigned as required by GAO internal control standards.

Inadequate controls over source documents exist throughout the finance office. These source documents include TPD draft copies, travel vouchers and invoices. Travel vouchers and copies of the drafts are kept at employees' desks until the original draft clears the bank. The documents are then filed according to payee name. However, the filing system is not maintained in a readily accessible order. Some folders contain documentation for many different payees; this documentation is not in a systematic indexed order. Other source documents are kept in much the same manner, only filed in different areas of the office. All DOF employees have access to the source documents.

The DOF officials provided several reasons for the control problems identified during our review. First, DOF officials stated that each employee needed access

to the computer system and the source documentation to assure that questions concerning issued TPDs could be answered. These officials stated that the source documents did not need to be controlled until the drafts were issued. According to DOF officials, each clerk is responsible for securing the supporting documentation for their areas of responsibility. Further, Region IV, DOF requested that the system be modified so that employee access to the system could be limited, but the request was denied. The HQ officials felt that the current system would become obsolete with the implementation of the automated travel voucher system and that therefore, this type of modification was not cost effective. The DOF officials stated that the drafts are maintained on a continuous sheet and a theft from the sheet would be noticed. In addition, a DOF official stated that the bank would be responsible if the signature on a draft was forged. The official also explained that approximately 1 year's supply of drafts are stored in DOF and the supply is too bulky to store in the safe. In our opinion, adequate controls should be maintained to protect Government resources and preclude an assertion of DOF negligence should drafts be lost or misused.

TPD Payments

As a result of DOF's lack of control over the TPD system, the issuance of TPDs did not always conform to Treasury regulations. The TPDs were issued for transactions over the established dollar limit and for items that should be paid by Treasury. The TPDs were also issued based on supporting documentation which was not signed by an authorizing official whose signature was on file with DOF. Our review showed that 75 of the 200 TPD payments reviewed were not made in accordance with Treasury's TPD requirements, although a few are in accordance with departmental policies which conflict with Treasury requirements.

Split TPD Payments

Eleven of the 200 drafts reviewed totaling \$19,811 were issued, along with another draft to cover a transaction amount that was more than the Treasury limitation. In a letter dated July 3, 1989, Treasury approved a \$2,500 limit on each TPD. The DOF, however, issued more than one draft for transactions which totaled over \$2,500. A DOF official stated that DOF has no official authorization to split draft payments, but indicated that they were told by an OFO official to do so in order to

avoid time delays and improve service to departmental employees.

According to the DOF individual, on January 23, 1991, DOF was notified by OFO to discontinue the practice of splitting payments.

Contract Health Care Providers

The Treasury regulations do not permit use of TPDs in paying for personal services or paying invoices for contracts. Eight of the 200 drafts reviewed, totaling \$4,734, were issued to compensate health care providers under contract for services rendered in the Region IV health unit. We are concerned about these payments. The Department's Public Health Service, Division of Federal Employee Occupational Health, contracts with physicians and nurses to staff health units. The Region IV contractors' salaries are submitted to DOF twice each month using Form 1034, entitled Public Voucher For Purchases And Services Other Than Personal. The DOF subsequently issues TPDs in payment of these health care services. The DOF officials indicated that they considered these payments were for invoices and that the contracts were not personal services contracts. The DOF officials also stated that they were told by HQ to pay the contractors. Regardless of whether these payments were for personal services or in response to HQ instructions, we believe this use of TPDs is unallowable.

The IRS recently issued a final report in which they classified these contracts as personal services contracts. The Department is currently appealing the IRS's decision. The results of this appeal will resolve the issue concerning the type of services, personal or nonpersonal, that the health care provider contracts represent. If the IRS issues a final ruling that these are personal services contracts, then payments by TPDs would not comply with Treasury regulations.

The DOF officials stated that one of the main reasons for implementing the TPD system was to be able to pay the contractors and vendors.

We met with OFO officials on June 12, 1991 and discussed the use of TPD's to pay health care providers. We were told that it was a departmental policy to make these payments through the TPD system. Further, OFO officials said that OMB has been informed of this use of the TPD system. The OFO officials indicated that OMB

was considering removing TPD's from the imprest fund requirements and therefore eliminating the restriction on making TPD payments for invoices and personal services. The OFO officials also stated that, although this communication with OMB may have been documented, the documentation was not readily available.

Invoices

Fourteen of the 200 drafts reviewed, totaling \$2,931, were payments for invoices that were not made in accordance with TPD requirements. These payments would not have been made from cash imprest funds and, therefore, should not have been made using TPDs. A memorandum from the DASF, dated August 11, 1988, instructed DOF to pay vendor invoices that did not exceed the Treasury limitation of \$2,500. The DOF officials stated that they could not meet the requirements of the Prompt Payment Act without using TPDs.

In the June 12, 1991 meeting, OFO officials stated that it was departmental policy to pay invoices using TPDs. These officials indicated that it was much more cost effective to issue a TPD than it was to issue a Treasury check. Further, they indicated that significant time delays were experienced in making Treasury check payments because the regional system did not provide on-line data entry.

Authorized Signature Binders

Twenty-four of the 200 drafts reviewed, totaling \$6,538, had been authorized by an official whose signature was not in the DOF authorized signature binders. A DOF official stated that reviews of these binders were not always performed. The official stated that authorizing signatures are reviewed only if a travel voucher is selected for audit. Otherwise, DOF does not check to ensure that a duly authorized signature is contained in the authorizing signature space. We subsequently found that the officials whose signatures were not on file had been delegated signing authority, but the signature binders had not been updated.

Multiple Errors

Eighteen of the 200 drafts reviewed, totaling \$7,366, were issued with multiple errors or were not supported by adequate documentation. Two drafts totaling \$4,000 were issued to pay invoices and each draft was also part of a

split draft payment. The split payments were made to circumvent the Treasury requirement that limits the amount of TPD payments to \$2,500. Another draft issued for \$1,300 was used to pay for personal services and the approving signature was not included in DOF's authorized signature file. Twelve drafts totaling \$839 were used to pay invoices that were not supported by purchase orders and receiving reports. A DOF official stated that the twelve drafts were supported by a blanket purchase order but did not provide the purchase order for our review. Three drafts totaling \$1,227 were errors because there was no supporting documents for the drafts.

In addition to the findings identified during our audit, DOF officials also found weaknesses in the TPD internal control system. The October 17, 1990 DOF internal control report recommended that written procedures be developed which would include proper segregation of duties and assure that only legal, proper, and authorized payments were made. It also recommended that the computer system be modified to allow entry for query purposes only. The DOF officials stated that they were currently taking steps to comply with the recommendations in the internal control report.

Conclusions and Recommendations

Our audit showed that the TPD internal control system was not documented, the separation of key duties was not adequate, access to resources was not limited, and there was no assigned accountability for resources. In addition, the internal control system did not ensure that TPD payments were made in accordance with Treasury regulations.

We recommend that ASMB provide increased oversight of the TPD system nationwide and implement internal controls that assure TPDs are controlled in accordance with applicable laws and regulations.

We recommend that DOF:

1. Prepare written policies and procedures for the entire TPD system. Included in the internal control system should be an adequate separation of duties. These controls should ensure compliance with the internal control standards required under A-123 in that:

- all transactions are properly authorized;
 - transactions are not over the established dollar limit; and
 - payments are not made for personal services contracts and invoices.
2. Limit access to the computer system (e.g., preventing any one employee from access to all passwords), blank drafts, and source documents to authorized individuals who are accountable for the custody and use of resources.

ASMB Response and OIG Comments - TPD Internal Controls

In the written response to our draft report, ASMB officials generally agreed with our draft report findings. The response stated that OFO has initiated actions which resulted in the implementation of enhanced internal controls, which included: (1) issuing a Disbursements and TPD System Procedures Manual; (2) conducting in-depth, on-site reviews of the TPD systems in the Regions and at HQ; and (3) issuing instructions correcting internal control weaknesses related to proper separation of duties and responsibilities. An on-site review is scheduled for Region IV to identify and resolve any remaining TPD payment problems.

The ASMB also plans to install a new Core Accounting System which incorporates an automated payments schedule module. According to ASMB, this new accounting system will enhance internal controls and ensure that resources are adequately protected.

OIG Comments

The ASMB actions, such as providing instructions for the separation of duties, limiting access to resources, assigning accountability for resources and issuing written TPD policies and procedures, should strengthen internal controls over TPDs. We believe the indicated actions should be adequate to correct the deficiencies we identified. In conjunction with these enhancements in internal controls, ASMB should closely monitor the operation of the new Core Accounting System to ensure it produces the desired results.

ASMB Response and OIG Comments - TPD Payments

The ASMB agreed that the practice of splitting payments was not in accordance with departmental policy and

stated that Region IV was instructed to discontinue the practice.

The ASMB cited several reasons for using TPDs for items that the OIG believes should have been paid by Treasury check. According to ASMB, TPDs are more cost effective, they allow the Department to meet the requirements of the Prompt Pay Act, and they avoid time delays associated with making Treasury check payments. The ASMB further believes that time delays for certain types of vendor payments will be overcome with the implementation of the new Core Accounting System. In the interim, ASMB is planning to request that Treasury provide a policy clarification as to what types of payments can be made using TPDs.

In the written response, ASMB also stated that the issue of using TPDs to pay contract nurses has not been resolved. Although the IRS has ruled that the nurses are performing under personal services contracts, the Department plans to appeal the IRS decision.

In addition, ASMB believes that the type of services, personal or nonpersonal, the nurses perform is a procurement issue that is being addressed by ASMB's Office of Acquisition and Grants Management. Therefore, these payments should not have been characterized as inappropriate.

The ASMB agreed with our recommendation to limit access to the computer system, blank drafts and source documents to authorized individuals. In addition, OFO has issued written TPD System policies and procedures to all regional finance offices.

OIG Comments

The ASMB's justification for using TPDs to pay for items that should be paid by Treasury check appears to be reasonable. However, we still believe that TPDs should not be used to pay for items that are specifically prohibited by Treasury regulations. In addition to obtaining policy clarification from Treasury as to what types of payments can be made using TPDs, ASMB should also seek approval for regulatory changes needed to allow TPD payments for any costs where they can be used in a cost-effective manner with assurance that Government resources are adequately protected.

Page 14 - Arnold R. Tompkins

With respect to the use of TPDs to pay health care nurses and invoices, Treasury regulations do not currently permit the use of TPDs in paying for personal services contracts or invoices. Accordingly, we continue to believe such payment must be categorized as inappropriate. We agree that the results of the Department's appeal will resolve the health care nurse issue.

Please advise us within the next 60 days of any further actions taken on this report. Should you have any questions on the above, please call me or have your staff contact John A. Ferris, Assistant Inspector General for Human, Family and Departmental Services Audits; at (202) 619-1175.

UNALLOWABLE PAYMENTS MADE USING THIRD PARTY DRAFTS

<u>Type of Payment</u>	<u>No. of Payments</u>	<u>Amount of Payment</u>
Split TPD Payments	11	\$ 19,811
Contract Health Care Providers	8	4,734
Invoices	14	2,931
Authorized Signature Binders	24	6,538
No Supporting Documents	3	<u>1,227</u>
Subtotal	60	\$ 35,241
Multiple errors:		
Invoices and Split TPD Payments	2*	4,000
Contract Health Care Providers and Unauthorized Signatures	1*	1,300
Invoices and Unable to Provide P.O. or Receiving Reports	<u>12*</u>	<u>839</u>
TOTAL	<u>75</u>	\$ <u>41,380</u>

* These figures are included in the 15 Multiple error count.



FEB -7 1992

Washington, D.C. 20201

MEMORANDUM

DATE :
TO : Richard P. Kusserow
Inspector General

IG	<input checked="" type="checkbox"/>
PDIG	<input checked="" type="checkbox"/>
OIG-AS	<input checked="" type="checkbox"/>
OIG-EI	<input checked="" type="checkbox"/>
OIG-OI	<input checked="" type="checkbox"/>
AIG-MP	<input checked="" type="checkbox"/>
OGC/IG	<input checked="" type="checkbox"/>
EX SEC	<input checked="" type="checkbox"/>
DATE SENT	2/11

FROM *Asst*: Kevin E. Moley *Elizabeth M. James*
Assistant Secretary for
Management and Budget

SUBJECT : Internal Controls Over the Third Party Draft System in
the Regional Administrative Support Center, Region IV
(A-04-91-00009, Draft Report) -- Response

We are in basic agreement with your office's draft audit report that Region IV, Regional Administrative Support Center's (RASC) internal controls for the Third Party Draft (TPD) System were inadequate. However, we have taken steps to improve our procedures and therefore do not believe the magnitude of the current problems is as great as when the review was conducted. The Office of Financial Operations (OFO) has initiated several actions which have resulted in the implementation of enhanced internal controls to protect against fraud, waste and abuse.

The report made two basic recommendations concerning the internal controls over the Third Party Draft System. The first recommendation was to prepare written policies and procedures for the entire TPD System with sufficient controls to ensure compliance with the internal control standards required under OMB Circular A-123. The second recommendation was to limit access to the computer system, source documents, and blank drafts to authorized individuals who are accountable for the custody and use of resources.

As noted in the first recommendation, there were internal control weaknesses when Region IV started issuing TPD payments. To strengthen the internal controls over the TPD System, OFO has taken the following actions: issued a Disbursements and TPD System Procedures Manual; conducted in-depth on site reviews of the TPD systems in Region VII and at Headquarters due to the internal control problems encountered in Region VII in September 1990; conducted TPD internal control reviews of the remaining Regions in the first quarter of FY 1991 based on procedures developed from the initial 1990 reviews; issued instructions to

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Page 2 - Richard P. KUSSEROW

correct internal control weaknesses that related to the proper separation of duties and responsibilities. We also have scheduled an on site review of Region IV in the second quarter of this fiscal year to identify and resolve any remaining TPD payment problems. Additionally, the planned installation of the new Core Accounting System, which incorporates an automated payments schedule module, will enhance internal controls and provide management with greater assurance that resources are well guarded and protected.

We agree that the practice of splitting payments to avoid the \$2,500.00 Treasury limitation was not in accordance with HHS policy. Region IV was notified on January 23, 1991, to discontinue the practice.

The audit noted that certain TPD payments were in the category of "Unallowable Payments Made Using Third Party Drafts", and concluded these should have been paid by Treasury check. There are several reasons for using the TPD System for payment of small purchases: TPD payments are more cost effective: they meet the requirements of the Prompt Pay Act; and they avoid the time delays associated with making Treasury check payments. Time delays for certain types of vendor payments will be overcome with the implementation of the new Core Accounting system, thus making payments by Treasury check more time and cost effective. After the Core Accounting System becomes operational, we will reevaluate our options to ensure that we continue to utilize the most cost effective payment mechanism. However, in the interim we are planning to pursue policy clarification with Treasury.

An area that has yet to be resolved is the proper form for payments to compensate nurses under contract for services rendered in Region IV's Health Care Units. Recently, the IRS has issued a final report finding that the nurses are performing personal service contracts. HHS disagrees with this ruling and is now in the process of appealing the decision. The result of the appeal will resolve the issue concerning the type of services, personal or non-personal, the nurses represent. Since this is a procurement issue which is currently being addressed by the ASMB Office Of Acquisition and Grants Management, it is not proper to characterize such payments using TPD's as inappropriate.

We concur with the audit's second recommendation of limiting access to the computer system, blank drafts, and source documents to authorized individuals who are accountable for the custody and use of resources. OFO has developed and issued written TPD System policies and procedures to all ten Regional Finance Offices. These procedures, coupled with the planned installation

Page 3 - Richard P. Kusserow

of the new Core Accounting System, will provide additional internal controls and Departmental oversight. We will continue to evaluate the TPD System activities, instituting further improvements as necessary.

Should your staff have any questions or require additional information, please do not hesitate to have them contact Henry Leach at 245-0401.