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BY THE U.S. GENERAL ACCOUNTING OFFICE

Report To The Secretary Of Education

**First-Year Implementation Of
The Federal Managers' Financial
Integrity Act In The Department
Of Education**

GAO conducted a review of 22 federal agencies' efforts to implement the Federal Managers' Financial Integrity Act of 1982. The act was intended to help reduce fraud, waste, and abuse across the spectrum of federal government operations through annual agency self-assessments of their internal controls and accounting systems.

This report highlights the progress made and problems encountered by the Department of Education in its first year of experience with this new act. The report focuses on the Department's evaluation of internal controls, reviews of accounting systems, and the improvements being made as a result of identified problems.



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MAY 9, 1984

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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

HUMAN RESOURCES
DIVISION

B-202205

MAY 9, 1984

The Honorable Terrel H. Bell
The Secretary of Education

Dear Mr. Secretary:

This report presents the results of our review of the Department of Education's (ED's) efforts to implement and comply with the Federal Managers' Financial Integrity Act of 1982. Our review was part of a General Accounting Office assessment of 22 federal agencies' efforts to implement the act during the first year.

The Financial Integrity Act establishes a framework for improving the effectiveness of financial management in federal agencies. As you know, the act requires you to report annually to the President and the Congress on ED's compliance with internal control standards prescribed by the Comptroller General. Compliance evaluations are to be performed in accordance with internal control guidelines issued by the Office of Management and Budget (OMB). The act also requires you to report on whether ED's accounting systems conform to the principles and standards prescribed by the Comptroller General.

The OMB guidelines provide a basic approach to evaluating, improving, and reporting on internal controls. OMB recommends the following process as an efficient, effective way to perform the evaluations: (1) organizing the internal control evaluation process; (2) segmenting the agency to create an inventory of assessable units; (3) conducting vulnerability assessments to determine the risk of waste, loss, unauthorized use, or misappropriation; (4) reviewing internal controls; (5) taking corrective actions; and (6) reporting on the adequacy of internal controls and plans for corrective action.

ED's program for evaluating and reporting on its internal control and accounting systems has made progress during the first year of the act. There are a number of aspects of the program which have contributed to this progress, including:

- the establishment of implementation and maintenance of effective internal control systems as a mandatory critical element for all Senior Executive Service and merit pay performance agreements,
- the designation of the Deputy Under Secretary for Management as the official with overall responsibility for implementing the requirements of the act and the establishment of an Internal Control Steering Committee of senior level managers to develop policy guidelines for the program,
- the documentation of the vulnerability assessment process to show the criteria for performing the assessments and the rationale for computing the vulnerability ratings,
- the use of the results of the vulnerability assessment process to develop an internal control review plan which provided a broad base for evaluating internal control systems, and
- the development of departmental guidelines for assessing the conformance of ED's accounting systems to the principles and standards prescribed by the Comptroller General.

ED'S REPORTING UNDER THE FEDERAL
MANAGERS' FINANCIAL INTEGRITY ACT

Your December 23, 1983, report to the President and the Congress was developed in accordance with OMB guidelines and disclosed a number of material weaknesses in ED's internal control systems. These included problems in monitoring grant and contract activities, a large backlog of audit appeals administered by the Education Appeals Board, and an insufficient degree of assurance that only eligible institutions will receive funds from the National Direct Student Loan Fund. An attachment to the report provided descriptions of actions planned to correct the weaknesses identified (see app. II for a summary of the weaknesses identified by ED). Implementation of these actions should improve the effectiveness of ED's internal control systems.

ED'S INTERNAL CONTROL EVALUATION PROGRAM

While progress has been made in evaluating ED's internal controls, there are certain aspects of the process which ED needs to improve to provide a more meaningful basis for concluding whether its internal control and accounting systems meet the

objectives of the act (our specific findings and proposals for corrective action, with which ED agreed, are in app. I).

- ED's vulnerability assessment process identified some weaknesses for which we believe corrective action should have been initiated; however, all internal control weaknesses may not be corrected because ED's internal control directives require managers to develop corrective action plans and to document corrective actions taken only for weaknesses identified by internal control reviews. Further, ED's proposed follow-up system does not include specific provisions for tracking actions taken to correct weaknesses identified by the vulnerability assessment process. ED plans to require managers to develop corrective action plans for weaknesses identified by vulnerability assessments and to document corrective actions taken. ED also plans to include provisions for tracking implementation of all corrective action plans, including those for weaknesses identified by vulnerability assessments, in its proposed internal control follow-up system.
- The validity of the conclusions reached from the evaluation and testing of internal control objectives and techniques in ED's internal control reviews generally could not be determined for four of the five internal control review reports we examined because staff had not complied with the documentation requirements of ED's internal control review directive. Although ED provided a 12-hour training course on performing and documenting internal control reviews, less than half of the staff who performed the reviews had attended the training course. Also, although the Deputy Under Secretary for Management established an internal control Quality Assurance Committee, the Committee's activities during the first year did not include evaluation of reports for completed internal control reviews. ED plans to require all staff performing internal control reviews to attend training on how to perform and document the reviews. ED also plans to require the Quality Assurance Committee to evaluate the adequacy of individual reviews and the quality and completeness of recommendations for corrective actions.
- Although managers performing vulnerability assessments were asked to identify automatic data processing (ADP) systems used by their units, they were not required to assess the ADP controls for those systems in the vulnerability assessment process. ED's internal control review

reports also indicated a general absence of the assessment of ADP controls. When ADP controls are not adequately assessed, serious control weaknesses may not be detected. ED plans to task a team composed of its Internal Control staff, ADP staff, and Office of Inspector General ADP staff to develop specific criteria relating to ADP controls for use in internal control reviews. ED also plans to strengthen the policy role of its ADP organizations, as well as other aspects of ADP controls as they relate to vulnerability assessments and internal control reviews.

ACCOUNTING SYSTEMS

ED performed limited assessments of its accounting systems which disclosed material weaknesses in system design, production, and maintenance; however, ED's report to the President and the Congress did not contain an opinion on whether ED's systems conform to the principles, standards, and related requirements prescribed by the Comptroller General. While ED plans to conduct comprehensive accounting systems evaluations beginning in calendar year 1984, we believe that improvements are needed so that these evaluations will provide an adequate basis for a definitive statement in 1984 on the conformance of ED's accounting systems:

- ED's final inventory of accounting systems consisted of 19 systems; however, 2 systems were omitted from the inventory--the Regional Accounting System which provides accounting services to ED's regional offices and the Formula and Block Grants System. ED plans to revise its inventory to include the Formula and Block Grants System and ED's controls over the input of financial information to the Regional Accounting System, which is operated and maintained by the Department of Health and Human Services.
- The individuals who prepared reports on their assessments of the 16 accounting systems reviewed during the first year generally did not comply with the documentation requirements of ED's accounting system assessment guidelines. Although ED provided a training session on how to perform and document accounting system assessments, 21 of 23 individuals attending the session were not the designated individuals who assessed the systems for conformance. ED plans to continue its efforts to assure that all individuals who conduct accounting systems assessments receive training in the performance and documentation of those assessments.

--ED's accounting system assessment guidelines did not require testing the systems in operation, even though GAO's approval of agency accounting systems is dependent upon the outcome of such testing. ED plans to revise its accounting system assessment guidelines to require testing the systems in operation.

AGENCY COMMENTS

In commenting on a draft of this report, ED generally agreed with our findings, conclusions, and proposals and indicated that actions, as summarized above, will be taken to address our concerns (see app. III). Therefore, we have not included any recommendations in this report, but we plan to monitor ED's progress in these areas as part of our continuing reviews of federal agencies' implementation of the Financial Integrity Act.

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As ED makes further progress in implementing the internal control and accounting system requirements of the act and in correcting known weaknesses, and as it makes the improvements it has planned in response to our proposals, ED should have a more meaningful basis for concluding whether its internal controls and accounting systems meet the objectives of the act.

We are sending copies of this report to the Director, Office of Management and Budget, and the Chairmen and the Ranking Minority Members of the House Committee on Government Operations, the Senate Committee on Governmental Affairs, the House and Senate Committees on Appropriations, the Senate Committee on Labor and Human Resources, and the House Committee on Education and Labor.

Sincerely yours,



Richard L. Fogel
Director

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ABBREVIATIONS

ADP	automatic data processing
ED	Department of Education
FMS	Financial Management Service
GAO	General Accounting Office
HHS	Department of Health and Human Services
IG	Inspector General
MIS	Management Improvement Service
OIG	Office of Inspector General
OMB	Office of Management and Budget
RAS	Regional Accounting System

FIRST-YEAR IMPLEMENTATION OF THE FEDERAL MANAGERS'
FINANCIAL INTEGRITY ACT IN THE DEPARTMENT OF EDUCATION

INTRODUCTION

Responding to continuing disclosures of fraud, waste, and abuse across a wide spectrum of government operations, which were largely attributable to serious weaknesses in agencies' internal controls, the Congress in August 1982 enacted the Federal Managers' Financial Integrity Act, 31 U.S.C. 3512(b) and (c). The law is designed to strengthen the existing requirement of the Accounting and Auditing Act of 1950 that executive agencies establish and maintain systems of accounting and internal control in order to provide effective control over, and accountability for, all funds, property, and other assets for which the agency is responsible (31 U.S.C. 3512(a)(3)).

The General Accounting Office (GAO) believes that full implementation of the Financial Integrity Act will enable the heads of federal departments and agencies to identify their major internal control and accounting problems and improve controls essential to the development of an effective management control system and a sound financial management structure for their agencies. To achieve these ends the act requires:

- Each agency to establish and maintain its internal accounting and administrative controls in accordance with the standards prescribed by the Comptroller General, so as to reasonably assure that: (1) obligations and costs comply with applicable law; (2) all funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and (3) revenues and expenditures applicable to agency operations are recorded and properly accounted for.
- Each agency to evaluate and report annually on internal control systems. The report is to state whether agency systems of internal control comply with the objectives of internal controls set forth in the act and with the standards prescribed by the Comptroller General. The act also provides for agency reports to identify the material weaknesses involved and describe the plans for corrective action.
- Each agency to prepare a separate report on whether the agency's accounting systems conform to principles, standards, and related requirements prescribed by the Comptroller General.

--The Office of Management and Budget (OMB) to issue guidelines for federal departments and agencies to use in evaluating their internal accounting and administrative control systems. These guidelines were issued in December 1982.

--The Comptroller General to prescribe standards for federal agencies' internal accounting and administrative control systems. The Comptroller General issued these standards in June 1983.

The Department of Education (ED) was 1 of 22 federal agencies whose efforts to implement the act during the first year were reviewed by GAO.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of our review was to evaluate ED's progress in implementing the Financial Integrity Act and reporting on the status of ED's internal control and accounting systems. Because our first-year review was limited to an evaluation of the implementation process, we did not attempt to independently determine the status of ED's internal control systems or the extent to which ED's accounting systems comply with the Comptroller General's principles and standards.

Audit work was performed at ED headquarters in Washington, D.C., from July through December 1983 and at five regional offices in September 1983.

We met with ED officials having responsibilities for ensuring the act was implemented. We also reviewed documents provided by OMB and ED's internal control staff on departmental procedures for implementing OMB Circular A-123 and the act.

To obtain information on how ED organized and segmented its activities and conducted vulnerability assessments and internal control reviews, we interviewed managers and staff from several headquarters components and regional offices. Because OMB had stated that ED's implementation of the act was highly centralized, we concluded that the procedures for the process should be relatively uniform throughout ED. Accordingly, we chose not to visit the same components for each section of our work plan. Rather, we attempted to obtain representative views of the process from as many components as possible within the time constraints of our review. At the headquarters level, the primary focus of our review was on program components since program funding accounted for almost 97 percent of ED's fiscal year 1983 appropriation. These included:

- Office of Elementary and Secondary Education,
- Office of Postsecondary Education--Student Financial Assistance,
- Office of Vocational and Adult Education,
- Office of Bilingual Education and Minority Language Affairs, and
- Office of Special Education and Rehabilitative Services.

A secondary focus at the headquarters level was on administrative components in the Office of Management because of their involvement in such functions as grants, contracts, payroll, accounting, and training. These included:

- Administrative Resource Management Services,
- Personnel Resource Management Services,
- Financial Management Services, and
- Horace Mann Learning Center.

At the regional office level, we focused our work on five locations which would provide information on implementation of the process by regional offices which (1) had both large and small numbers of units identified by the process as highly vulnerable and (2) have specific responsibility for collection of delinquent student loans. These were ED's regional offices in Atlanta, Georgia; Dallas, Texas; Chicago, Illinois; San Francisco, California; and Seattle, Washington.

Our audit work included:

- interviewing the highest level official assigned responsibility for managing ED's internal control activities;
- obtaining and analyzing documentation related to the processes and results of activities designed to meet OMB's guidelines for evaluating, improving, and reporting on internal control systems;
- analyzing data pertaining to assessable units' responses to questions on ED's vulnerability assessment instrument; however, we did not assess the reliability of the computerized data base from which data for the analysis were extracted;

- interviewing officials who performed vulnerability assessments and internal control reviews; and
- interviewing officials assigned responsibilities for tracking, monitoring, and summarizing the internal control activities.

We performed our work in accordance with generally accepted government auditing standards.

OVERVIEW OF ED'S FIRST-YEAR
EFFORTS TO IMPLEMENT THE ACT

During the first year, ED developed a program for implementing the Financial Integrity Act which incorporated the approach recommended by the OMB Internal Control Guidelines for evaluating, improving, and reporting on internal controls. The act does not require the development of government-wide guidelines for accounting system conformance evaluations. ED developed its own guidelines and performed limited assessments of the conformance of its accounting systems to GAO's principles and standards.

Internal control systems

ED has developed a highly centralized program for evaluating and improving its internal controls. ED initiated development of its program in response to the issuance of OMB Circular A-123, dated October 1981. OMB later issued internal control guidelines in December 1982. These guidelines provide a basic approach to evaluating, improving, and reporting on internal controls. Although much of ED's internal control program was developed prior to the issuance of OMB's guidelines, the phases of ED's program parallel those of the process OMB considers as an efficient, effective way to perform the evaluations.

OMB recommends the following process: (1) organizing the internal control evaluation process; (2) segmenting the agency to create an inventory of assessable units; (3) conducting vulnerability assessments to determine the risk of waste, loss, unauthorized use, or misappropriation; (4) reviewing internal controls; (5) taking corrective actions; and (6) reporting on the adequacy of internal controls and plans for corrective action.

Organizing the process

ED has issued two internal control directives--Internal Control Systems, March 31, 1982, and revised November 15, 1982, and Internal Control Reviews, March 28, 1983. Both were distributed to supervisors and managers throughout ED. The first directive assigns responsibilities and discusses, in general terms, procedures for the development, maintenance, review, and improvement of the systems of internal control. The second directive provides detailed guidance for performing internal control reviews.

The Deputy Under Secretary for Management was assigned overall responsibility for both the implementation and review of internal controls. As the fifth ranking official in ED, the Deputy Under Secretary is at a sufficiently high organizational level to have the authority needed to direct and coordinate ED's internal control program. An Internal Control Steering Committee composed of senior level managers was established by the Secretary to develop policy guidelines for the program. The membership of this group generally provided for broad representation from the program and administrative components. In mid-September 1983, the Deputy Under Secretary established an internal control Quality Assurance Committee consisting of five senior level managers. The Committee reported directly to the Deputy Under Secretary.

ED's internal control systems directive assigned responsibility to the Director, Management Improvement Service (MIS), Office of Management, for directing the day-to-day internal control activities associated with implementing the act. MIS staff has been involved in the internal control process from its inception and has provided a degree of continuity to the process. ED's internal control systems directive assigns responsibility to component heads for the internal control systems within their organizations. The directive requires that the component heads (1) devote the resources necessary for conducting vulnerability assessments, (2) participate fully in the internal control reviews, and (3) assign Internal Control Contacts to provide coordination within their units for internal control activities. To provide incentives for the development of adequate internal controls, a mandatory critical element relating to internal control has been included in the performance agreements of all Senior Executive Service and merit pay employees. Training programs were developed for those performing vulnerability assessments and internal control reviews.

Segmenting ED

ED's inventory of assessable units was developed by dividing ED into 33 segments--23 for headquarters and 10 for regional offices. Each headquarters segment was referred to as a principal operating component. The headquarters and regional office segments were subdivided to develop ED's inventory of 661 assessable units. Each assessable unit was assigned a control number which assisted in identifying and tracking the unit through the vulnerability assessment and internal control review phases.

Vulnerability assessments

Vulnerability assessments were performed by the managers and/or staff of the unit being assessed. Six hours of training were provided to headquarters managers; 4 hours to regional office managers. For purposes of performing vulnerability assessments, the units were divided into three types--program, administrative, and regional office. Basic data forms, risk determination forms, and vulnerability assessment forms were used to develop information for each assessable unit on the subjects of general control environment, inherent risk, and preliminary evaluation of safeguards. Information developed through these forms was converted to a numeric score. On the basis of these scores, the 661 assessable units were classified as having vulnerability assessment ratings of high (177), medium (308), or low (176).

ED maintains files which include data on all aspects of the vulnerability assessment process, including

- a narrative description of the methodology employed in performing the assessments,
- the identity of the individual who performed each assessment,
- the identity of the organizational unit and person to whom the vulnerability assessment was reported, and
- completed basic data, risk determination, and vulnerability assessment forms and vulnerability scores for the units in ED's inventory.

The vulnerability assessment process was used as the primary basis for prioritizing selection of units to be scheduled for internal control reviews. In order to determine which units would be selected for internal control reviews, MIS internal

control staff considered vulnerability ratings, along with other factors, such as dollar value of program, newness of program, and known program and administrative deficiencies. This process led to the development of three "action agenda" of units recommended for internal control reviews--one each for program, administrative, and regional office units. The agenda were submitted to component heads for review and to the Internal Control Steering Committee for final approval. A total of 112 units was approved for inclusion in ED's action agenda. The units on the action agenda were considered, on a relative basis, to be the highest risk units in ED.

Internal control reviews

Of the 112 assessable units included in ED's action agenda, internal control reviews for 48 were completed in 1983; 13 were scheduled for 1984, 2 were deferred; and 46 were canceled. Recent GAO reports were substituted for three reviews. In addition to the internal control reviews completed during 1983 for the units on the action agenda, component heads voluntarily had their staffs perform internal control reviews for another 24 units during 1983 and added reviews for 4 more to the 1984 schedule.

The internal control reviews completed in 1983 provided a broad base for assessing ED's internal control systems. The reviews covered assessable units from 14 of the 23 headquarters components. The program units collectively controlled about 49 percent of ED's expected fiscal year 1983 appropriation.¹

To perform the internal control reviews, ED selected staff and/or managers of the units being reviewed and designed a 12-hour training course on how to conduct the reviews. Once completed, the internal control review reports were submitted to the MIS internal control staff.

Follow-up systems

ED is in the process of developing a system to manage the internal control process and track implementation of internal control findings and recommendations from a variety of sources, including internal control reviews, GAO and Office of Inspector General (OIG) audits, the President's Private Sector Study on Cost Control, and other departmental studies.

¹Based on data provided by the units during the vulnerability assessment process in 1982. Data on the actual fiscal year 1983 appropriated funding received by each assessable unit were not readily available.

Year-end reporting

ED's December 23, 1983, report to the President and the Congress was developed in accordance with OMB guidelines and disclosed a number of material weaknesses in ED's internal control systems. These included problems in monitoring grant and contract activities, a large backlog of audit appeals administered by the Education Appeals Board, and an insufficient degree of assurance that only eligible institutions will receive funds from the National Direct Student Loan Fund. An attachment to the report provided descriptions of actions planned to correct the weaknesses identified (see app. II for a summary of the weaknesses identified by ED).

Agency plans for 1984

As of December 1, 1983, MIS had prepared a revised draft of ED's Internal Control Review Program Plan for calendar years 1984, 1985, and 1986. The goal of this plan is to improve the overall effectiveness and efficiency of ED's internal control review program through: (1) the development of a long-term strategy for the operation of the program; (2) the establishment of an effective evaluation process which will include feedback obtained from a broad cross-section of ED managers, GAO, OMB, OIG, and other oversight activities; and (3) the improvement of information available to component heads in implementing the act's requirements. According to the plan, ED will take various actions to achieve these goals, including

- reducing the number of units in ED's inventory of assessable units,
- revising and simplifying the vulnerability assessment process, and
- establishing an automated data base for analyzing internal control data.

Accounting systems

The act did not require the issuance of government-wide guidelines for accounting systems conformance evaluations. ED developed its own guidelines and performed limited assessments of the conformance of its accounting systems to the Comptroller General's principles, standards, and related requirements. For the first year, ED established three objectives for evaluating its accounting systems--prepare a complete inventory of systems, identify weaknesses in the systems, and plan detailed reviews in subsequent years for systems not meeting the standards.

The Financial Management Service (FMS) within the Office of Management was tasked with developing guidance for the accounting system assessments, monitoring the organizational units' performance of the assessments, and developing a consolidated report on the results of the assessments. FMS distributed guidelines for performing the assessments on September 26, 1983. The guidelines included the policies and procedures for assessing each system, as well as documentation and report preparation requirements. The guidance on documentation states that the (1) methodology used must be fully described, (2) information gathered must be documented, and (3) conclusions reached must be supported.

ED developed an inventory of accounting systems as defined by GAO. ED initially identified 21 accounting systems operating in three components; however, further review resulted in (1) dropping five systems because they did not meet the GAO definition of an accounting system and (2) adding three systems which were initially overlooked. ED's final inventory consisted of 19 systems.

Limited assessments were performed for 16 of the accounting systems in ED's inventory. The assessments identified a number of material weaknesses in design, production, and maintenance aspects of the systems. For example, the Accounts Receivable System and ED Payments System do not provide reasonable assurance that the systems will classify, summarize, and report receivables and payments in a timely and accurate manner. After the assessments were completed, each system's degree of conformance to the Comptroller General's principles and standards was rated. Thirteen systems were judged to be in "Substantial Conformance." The remaining three systems were judged to be in "Partial Conformance." The assessment results, as well as improvement initiatives, were reported to the Deputy Under Secretary for Management. ED has enhancement efforts proposed or underway for 15 of the 16 systems assessed and plans to conduct comprehensive accounting systems evaluations beginning in calendar year 1984. FMS is developing a follow-up system to monitor implementation of the accounting system improvement initiatives.

OIG role

ED's internal control review directive states that the OIG has responsibilities including the review of ED's internal control review plan and the performance of the reviews to determine if ED's internal control evaluation activities assist adequately in fulfilling ED's obligations under the requirements of the applicable federal statutes. The OIG has been involved in these

phases of ED's internal control evaluation process. In addition, the OIG has been involved in implementing the act in other ways. For example,

- the Deputy Inspector General serves as an ex-officio member of the Internal Control Steering Committee,
- OIG's Director of Fraud Control was detailed to the MIS internal control staff which had day-to-day responsibility for implementing the vulnerability assessment process,
- OIG audit staff participated with program personnel in conducting six internal control reviews in 1983, and
- OIG conducted a limited review of ED's progress in implementing the act and submitted a letter to the Secretary summarizing the findings of the review.

ENHANCEMENTS NEEDED IN SUBSEQUENT
YEARS' EFFORTS TO EVALUATE AND
IMPROVE INTERNAL CONTROLS

We believe opportunities exist for ED to improve its program for evaluating and reporting on ED's internal control systems. All weaknesses identified by ED's vulnerability assessment process may not be corrected, since managers are required to develop corrective action plans only for weaknesses identified by the internal control reviews. Further, the validity of conclusions reached in the evaluation and testing steps of internal control reviews cannot be determined because staff generally did not document their analyses to address the specific factors listed in ED's directive. And, finally, although a substantial number of assessable units indicated use of automatic data processing (ADP) systems, ED's internal control evaluation process did not include a methodology for assessing ADP controls. As a result, the controls for these systems were generally not adequately assessed in vulnerability assessments or internal control reviews performed in calendar year 1983.

All weaknesses may not be
corrected and documented

ED's vulnerability assessment process identified some weaknesses for which we believe corrective action should have been initiated; however, ED's internal control directives require managers to develop corrective action plans and to document corrective actions taken only for weaknesses identified by internal control reviews. Further, ED's proposed follow-up system does

not include specific provisions for tracking actions taken to correct weaknesses identified by the vulnerability assessment process.

In general, vulnerability assessments are not performed for the purpose of identifying weaknesses for which corrective action is required before an internal control review is completed; however, OMB guidelines point out that problems or weaknesses requiring immediate corrective action may be observed during the performance of the vulnerability assessments. In such cases, the guidelines state that appropriate corrective action should be taken promptly and that such action should be documented.

ED's directive on internal control reviews requires that the weaknesses identified by internal control reviews, with plans for corrective action, be included in the internal control review reports submitted by components to the MIS internal control staff; however, the directive does not require managers to develop corrective action plans for weaknesses identified by vulnerability assessments or to submit documentation of actions taken to correct these weaknesses.

ED's vulnerability assessment process may identify specific weaknesses which are limited to a relatively small number of individual assessable units, as well as those which are more widespread in ED. For example, one of the questions on the headquarters vulnerability assessment forms asked assessors to evaluate the "Assumed Effectiveness of Existing Controls." Our review of responses to this question by the 409 assessable units in ED headquarters showed that 11 responded that the unit had "no existing controls" and 73 had "less than fully effective controls." Of the units with "no existing controls," only four received total scores which were high enough, according to ED officials, to require an internal control review. Further, of the 73 units with "less than fully effective controls," only 23 were scheduled for internal control reviews. One unit responding in November 1982 that the controls "were less than fully effective," was one of three units comprising the Guaranteed Student Loan Program. The program had a fiscal year 1983 appropriation of \$3.1 billion; however, this particular unit was not scheduled for an internal control review until calendar year 1984. As a result, although the controls have been acknowledged to be "less than fully effective," the unit could continue to operate with these controls for a year or more before an internal control review is completed and a corrective action plan is developed. Other examples of weaknesses identified by the vulnerability assessment process where we believe corrective action may be needed include the

--12 headquarters units which indicated that they had audit findings outstanding for more than 2 years and

--100 headquarters units which indicated that the unit's financial reports were inaccurate.

While the answer to one or two questions on forms used in the vulnerability assessment process does not automatically constitute a material weakness requiring immediate corrective action, we believe that more use can be made of these data. The answers to certain questions can be leading indicators of existing problems, regardless of the total score achieved in the vulnerability assessment process. ED should take advantage of the opportunity afforded by the process to identify, as early as possible, weaknesses which can be corrected without conducting an internal control review. Further, ED should require follow-up on the part of assessable unit managers when vulnerability assessments indicate weaknesses such as those cited above.

To manage the internal control process and monitor implementation of corrective action plans, ED is developing a system that will automate the documentation and tracking of internal control findings and recommendations from a variety of sources, including internal control reviews and OIG and GAO audit reports. There is no current provision, however, for the system to track implementation of weaknesses identified by vulnerability assessments.

Our draft report proposed that the Secretary of Education direct that:

--corrective action plans be developed for weaknesses identified by vulnerability assessments;

--actions taken to correct weaknesses identified by vulnerability assessments be documented; and

--provisions for tracking implementation of all corrective action plans, including those for weaknesses identified by vulnerability assessments, be incorporated into the proposed internal control follow-up system.

In April 10, 1984, comments on our draft report (see app. III for the full text of the ED's comments), ED stated that all of GAO's proposals relating to its vulnerability assessment process will be implemented. Because ED agreed with our proposals on vulnerability assessments, as well as the proposals in the remainder of this report, and has indicated that actions

will be taken to address our concerns, we have not included any recommendations in this report.

Evaluation and testing of
internal controls not
adequately documented

The validity of the conclusions reached from the analyses of internal control objectives and techniques in the evaluation and testing steps of ED's internal control reviews generally could not be determined for four of the five internal control review reports we examined because staff performing the reviews had not complied with the requirements of OMB guidelines and ED's internal control review directive for documenting their analyses. Only the report for the review in which the OIG participated as a cooperative effort with program staff was documented as required.

OMB's guidelines address documentation requirements in a general sense as they relate to all phases of the internal control process, including internal control reviews. The guidelines state that documentation should be maintained to provide a permanent record of methods used, personnel involved, key factors considered, and conclusions reached. The guidelines further state that such information is useful for reviewing the validity of conclusions reached. With respect to documentation, ED's internal control review directive is much more specific about what is required for each step of the review.

In the evaluation step, ED's directive requires an analysis of internal control objectives and techniques. Each analysis is to address the specific factors listed in the directive. For example, both internal control objectives and techniques are to be analyzed to determine the degree to which they contribute to the attainment of each of GAO's internal control standards. The directive requires the reviewer to prepare a "written, documented evaluation of the internal control objectives and techniques of each event of the event cycle(s)."²

As of November 18, 1983, ED had completed reports for 25 internal control reviews. Of these, we examined the reports for five reviews--four for reviews performed by managers of the units reviewed, and one for a review performed as a cooperative

²An event cycle is a recurring sequence of activities used to accomplish the objectives of a program or administrative function.

effort by OIG and managers of the unit reviewed. We could not determine the validity of the conclusions reached in the evaluation step in the four reports on reviews performed by unit managers because the required written analyses were not prepared. Although one of the four reports included a statement that the review considered GAO's internal control standards, the findings with respect to specific standards were not detailed. The other three reports did not mention GAO's internal control standards.

In the testing step, ED's directive requires that any or all of the events of each event cycle be tested to determine whether established control techniques are functioning as intended. The testing can be done through observation of the actual performance of the techniques, review of documentation of the performance of the events, and/or interviews of staff concerning the performance of the events. The directive requires the reviewer to prepare "written, documented evidence of the testing of a sampling of selected internal control techniques." Based on our review of the same five internal control review reports cited above, the findings for the four reviews performed by unit managers did not appear to have been based on testing which met the requirements of ED's directive. For example, one report contained no mention of testing, while another stated that control techniques could not be sampled because there was very little documentation available for review.

For the four reports we examined which did not meet the requirements of ED's directives, we requested supporting documentation for the evaluation and testing steps from the staff who performed the reviews. In all four cases, documentation had not been developed and/or maintained. One reviewer stated that he was not aware that written documentation should have been prepared to show the analysis of internal control objectives and techniques. Further, based on an examination of the documentation supporting 27 internal control review reports, the Inspector General stated in his letter to the Secretary on ED's progress in implementing the act that

"With three exceptions, there was almost a total lack of supporting documentation that described how the testing of internal control techniques was conducted."

Although the Deputy Under Secretary for Management established a Quality Assurance Committee, the Committee did not have a charter, and the role of the Committee was not clearly defined during the first year. Two members with whom we discussed the role of the Committee believe it was established to evaluate the

internal control review reports to determine whether they were adequate; however, these reviews were not made during the first year.

One reason evaluations of internal control objectives and techniques were not adequately documented may have been related to training. Instructional material provided for the 12-hour internal control review training course included ED's internal control review directive which specifies documentation requirements. Our review of training records for 89 individuals participating in the performance of internal control reviews indicates, however, that only 42 had attended training.

In the limited review of ED's progress in implementing the act, the OIG also found that almost half of ED staff performing internal control reviews had not attended training. In his letter to the Secretary on the review, the Inspector General stated

"We found that ICR's [internal control reviews] were performed with varying degrees of compliance with OMB and Departmental guidelines. This may have been due in part to the fact that 45 percent of the participating ICR team members did not receive ICR training."

Our draft report proposed that the Secretary of Education direct that:

- all staff performing internal control reviews be required to attend training on how to perform and document the reviews and
- the role of the Quality Assurance Committee be clarified and include evaluating internal control review reports to determine the adequacy of the reviews and the validity of management's conclusions.

In commenting on our draft report, ED stated that steps have been taken not only to assure that reviewers will be trained, but also that the training will occur close to the scheduled start of the internal control reviews. ED stated that the assignment and training of reviewers across the agency will be closely monitored. ED also stated that the Quality Assurance Committee will be required to evaluate the adequacy of individual reviews and the quality and completeness of recommendations for corrective actions.

ADP controls not
adequately assessed

Although managers performing assessments were asked to identify ADP systems used by their units, they were not required to assess the ADP controls for those systems in the vulnerability assessment process. ED's internal control review reports also indicate a general absence of the assessment of ADP controls. As a result, serious control weaknesses may not have been detected.

ED's internal control directives do not define a specific role for ED's ADP organizations (ADP management, systems security officers, and OIG/ADP audit personnel) in developing policy and monitoring implementation of the act. ED's directives establish an Internal Control Steering Committee to develop policy guidance for ED's internal control process; however, none of the eight senior level managers appointed to the Steering Committee was from ED's ADP organizations. Also, none of the original 23-member internal control staff overseeing the day-to-day implementation of the act through completion of the vulnerability assessments was from ED's ADP organizations.

OMB guidelines state that when ADP is utilized, the existence of appropriate controls should be considered when vulnerability assessments and internal control reviews are performed. During the vulnerability assessment process, 266 of 409 headquarters units responded that the unit used ADP systems.

ADP general controls were assessed at the component level during two functional workshops--one attended by administrative managers from the Office of Management, and the other attended by 16 of the 23 component-ADP liaisons. The administrative managers' ADP assessment contained seven general administrative topics. The component-ADP liaisons' ADP assessment used a 20-question instrument which went well beyond OMB guidelines, but was not all inclusive. For example, ADP organization and management and internal audit questions were not asked.

At the assessable unit level, however, ADP general and application controls³ were not assessed. Vulnerability assessment instruments used by all headquarters assessable units contained only one question related to ADP. The instrument asked the managers of the assessable units to identify any ADP systems used, but did not require an assessment of the existence of general and application controls for those systems.

We also found a general absence of the assessment of ADP controls in ED's internal control reviews. ED's April 1983 Internal Control Review Handbook, and its September 1983 revision, provide guidance for performing internal control reviews. The handbook's only mention of ADP appears in the section on analyzing the General Control Environment. In this section, ADP is listed as one of eight factors to consider in the analysis. The handbook states that when ADP is utilized, the reviewer should have an awareness of the strengths and exposures inherent in such a system and should determine whether appropriate controls are in place; however, no methodology for making this determination is provided, and no general and application controls are identified. Of the 20 internal control review reports we examined for assessable units which had indicated use of an ADP system, there was

- no mention of ADP in five reports,
- only a limited narrative of how the unit used the system in nine reports, and
- an assessment of some ADP general and application controls in six reports.

³General controls are those which apply to the overall management of the ADP function in an agency. General ADP controls have a direct effect on the quality of service rendered to ADP users and cover the processing of all ADP application systems. These controls, which affect most ADP hardware and application software systems, include (1) organizational controls for the ADP unit; (2) system design, development, and modification controls; (3) data center management controls; (4) data center security controls; (5) system software controls; and (6) hardware controls.

Application controls are those which are unique to each software application system. Application controls are intended to assure the quality of data origination, input, processing, and output.

Our draft report proposed that the Secretary of Education direct that a specific methodology be developed for considering ADP general and application controls.

In commenting on our draft report, ED stated that a team composed of the internal control staff, ADP staff, and OIG ADP audit staff will be tasked to develop specific criteria relating to ADP general and application controls. ED stated that these controls will be utilized in internal control reviews of assessable units using ADP. ED also stated that the policy role of its ADP organizations, as well as other aspects of ADP controls as they relate to vulnerability assessments and internal control reviews, will be strengthened.

IMPROVEMENTS NEEDED IN
EFFORTS TO ASSESS
COMPLIANCE WITH ACCOUNTING
PRINCIPLES AND STANDARDS

ED performed limited assessments of its accounting systems during the first year of the act; however, ED's report to the President and the Congress did not provide an opinion on the conformance of the accounting systems to the principles and standards prescribed by the Comptroller General. Improvements are needed in ED's assessment process so that ED has an adequate basis for a definitive statement in 1984 on the conformance of ED's accounting systems. For the first year's assessment, ED's inventory of accounting systems was not complete, and staff performing the assessments did not follow ED's guidelines. Moreover, ED's accounting system assessment guidelines do not require testing the systems in operation.

System inventory not
comprehensive

ED's final inventory consisted of 19 accounting systems; however, 2 systems were omitted from ED's inventory this year--the Regional Accounting System and the Formula and Block Grants System.

ED officials stated that the Regional Accounting System which provides accounting services to ED's regional offices was omitted from the inventory because it is operated and maintained by the Department of Health and Human Services. However, ED did include its payroll system, which is operated and maintained by the Department of the Interior. ED assessed the in-house controls over the payroll process to ensure accurate input data

were submitted to Interior and determine whether the system conforms with GAO's accounting principles and standards. ED should also assess the in-house accounting process of the Regional Accounting System to determine if controls are in place to ensure that accurate input data are submitted to the Department of Health and Human Services.

The Formula and Block Grants System, which is used to compute allotments to the states, was also omitted from ED's inventory of accounting systems. ED believed the system did not need to be assessed because of its limited function. We believe that since it meets GAO's definition of an accounting system, ED should include it on the inventory, assess the adequacy of controls, and ascertain whether it conforms to GAO's accounting principles and standards.

ED's assessment guidelines
not followed

Our review of the reports for the 16 accounting systems assessed during calendar year 1983 indicates that those who assessed the systems generally did not comply with documentation requirements specified in ED's accounting system assessment guidelines. For example,

--15 reports did not include the required description of all instances in which the system did not conform to GAO's accounting principles and standards,

--1 report did not provide the required explanations for "No" and "N/A" responses to the assessment checklist of principles and standards, and

--15 reports did not include the required reference to prior GAO and OIG audit reports.

One reason ED's documentation requirements were not met may have been related to training. For the first year's effort, ED distributed assessment guidelines during a training session. Although 23 individuals attended this session, 21 of those who received the training were not the designated individuals who assessed the systems for conformance.

Testing systems in operation
not required

ED's accounting system assessment guidelines for the first year did not require testing the systems in operation, even though GAO's approval of agency accounting systems is dependent upon the outcome of such testing.

Each executive agency is responsible for establishing and maintaining accounting and internal control systems which conform to the principles, standards, and related requirements prescribed by the Comptroller General. Effective April 18, 1983, GAO's review and approval of executive agency accounting systems became a one-stage process in which only operating accounting systems are reviewed for approval. A system is approved when the system in operation is tested and found to conform to the principles and standards. The purpose of the change was to make GAO's approval function more compatible with the Financial Integrity Act's emphasis on agency operating systems; however, for agencies reporting under the act on whether their accounting systems conform to the Comptroller General's principles and standards, we believe the change also emphasizes the need for the agencies to evaluate the conformance of their systems by testing the systems in operation.

ED's accounting system assessment guidelines required staff to review the conformance of the Department's system by completing a questionnaire which listed each principle and standard. The reviewers were directed to rely upon professional judgment and other review techniques to assess the system in relation to each principle and standard and to provide responses of "Yes," "No," or "N/A," as appropriate; however, the guidelines did not require reviewers to test the systems in operation.

Our draft report proposed that the Secretary of Education direct that:

- a comprehensive inventory of ED's accounting systems be developed,
- all staff performing accounting system assessments be required to attend training on how to perform and document the assessments, and
- ED's accounting system assessment guidelines be revised to require assessments to include testing the systems in operation.

In commenting on our draft report, ED stated that its inventory of accounting systems will be revised to include (1) the Block and Formula Grants System and (2) ED's controls over the input of financial information to the Regional Accounting System. ED also stated that its accounting system review guidelines will be revised to require testing of the systems in operation and that efforts will continue to assure that all individuals who conduct accounting system assessments receive training in the performance and documentation of those assessments.

MATERIAL WEAKNESSES REPORTED BY THE DEPARTMENT
OF EDUCATION AS REQUIRING CORRECTIVE ACTION

DEPARTMENT-WIDE WEAKNESSES

- There is a pervasive weakness of ED's operations involving the compliance monitoring activities of grants and contracts made by ED.
- The lack of written procedures for performing routine administrative and program processes within ED constitutes a material weakness.

PROGRAM-SPECIFIC WEAKNESSES

- Because of congressionally mandated set-asides for funding of Regional Education Laboratories and the Research and Development Centers under Sections 405(f)(1)(A) and (B) of the General Education Provisions Act, the National Institute of Education continues to have little control over the allocation of those funds.
- The backlog of audit appeals administered by the Education Appeals Board is too large and therefore constitutes a material weakness.
- In the Office of Management, accounting system controls, including the Accounts Receivable System and ED Payments System, do not provide reasonable assurance that the systems will classify, summarize, and report receivables and payments in a timely and accurate manner.
- In the Office of Postsecondary Education, unallowable activities have been funded in prior years because the provisions of the Allowable Cost Paper have not been applied consistently.
- Legislatively mandated set-aside funds for historically Black colleges and universities were not obligated in a timely manner, necessitating burdensome additional competitions and the need in fiscal year 1982 to request carryover authority from the Congress.
- There is an insufficient degree of assurance that only eligible institutions will receive funds from the National Direct Student Loan Fund.



UNITED STATES DEPARTMENT OF EDUCATION
WASHINGTON D C 20202

APR 10 1964

Mr. Richard L. Fogel
Director, Human Resources Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Fogel:

Thank you for the opportunity to comment on GAO's proposed report:
"First Year Implementation of the Federal Managers' Financial
Integrity Act in the Department of Education."

[See GAO note, p. 25.]

We appreciate the comments on Page 1 of the report which state that the Education Department's "...program for evaluating and reporting on its internal control and accounting systems has made progress during the first year of the act." We agree that we have made progress, in fact significant progress, in responding to the requirements of the Act.

It is my understanding that this evaluation is not only a review of performance against existing Federal law and standards, but also a review of relative progress among the 22 agencies GAO reviewed. When each of these agencies was reviewed last year by OMB, we were informed that our efforts were among the best in the Executive Branch. We hope that GAO will make available more detailed information on the relative performance of those Federal agencies which were the subjects of this review.

Even though ED's implementation of internal control requirements has been widely complimented and used as a model by several agencies, we acknowledge that there is room for improvement in our program. Accordingly, we welcome your comments and see them as an opportunity to examine our progress and make refinements to our internal control operations.

Your report has identified four major areas for improvement:

GAO RECOMMENDATION:

1. "The Secretary of Education direct that:
 - corrective action plans be developed for weaknesses identified by vulnerability assessments,
 - actions taken to correct weaknesses identified by vulnerability assessments be documented; and
 - provisions for tracking implementation of all corrective action plans, including those for weaknesses identified by vulnerability assessments, be incorporated into the proposed internal control followup system."

Mr. Richard L. Fogel - Page 2.

DEPARTMENTAL RESPONSE:

The recommendations, as stated above, are entirely acceptable to the Department, and will be implemented.

GAO RECOMMENDATION:

2. GAO recommends "...that the Secretary of Education direct that:

- all staff performing internal control reviews be required to attend training on how to perform and document the reviews and
- the role of the Quality Assurance Committee be clarified and include evaluating internal control review reports to determine the adequacy of the reviews and the validity of management's conclusions."

DEPARTMENTAL RESPONSE:

In some cases, individuals scheduled for ICR training failed to attend those sessions. In other cases, individuals trained to do internal control reviews were transferred to other organizations before the reviews were performed. The individuals who replaced the trained reviewers therefore, performed the internal control reviews with little or no previous training. We have taken steps to assure that reviewers will not only be trained, but that the training will occur close to the scheduled start date of the internal control reviews. We will also closely monitor the assignment and training of reviewers across the Department.

With respect to quality control, it is our intention to improve our internal control training in the areas of both required documentation and control techniques testing. The role of our Quality Assurance Committee will include the requirement to evaluate the adequacy of individual reviews and the quality and completeness of recommendations for corrective actions.

The Department accepts and will implement the GAO recommendations.

GAO RECOMMENDATION:

3. GAO recommends "...that the Secretary of Education direct that a specific methodology be developed for considering ADP general and application controls."

Mr. Richard L. Fogel - Page 3.

DEPARTMENTAL RESPONSE:

With respect to the conduct of internal control reviews, we concur with the recommendation, and will field a team composed of Internal Control Staff, ADP Staff, and IG ADP Audit Staff to develop specific criteria relating to ADP general and application controls. These controls will be utilized in internal control reviews of assessable units which use ADP.

Action will be taken to strengthen the policy role of Ed's ADP organization, as well as the other aspects of ADP controls as they relate to vulnerability assessments and internal control reviews. Specific attention will be given to the GAO recommendation that pertains to the consideration of ADP general and application controls.

We will also consider the answer to the vulnerability assessment question relating to ADP in our cross-cutting analyses.

The Department accepts and will implement the GAO recommendation.

GAO RECOMMENDATION:

4. GAO recommends "...that the Secretary of Education direct that:
 - a comprehensive inventory of ED's accounting systems be developed;
 - all staff performing accounting systems assessments be required to attend training on how to perform and document the assessments; and
 - ED's accounting system assessment guidelines be revised to require assessments to include testing the subsystems in operation."

DEPARTMENTAL RESPONSE:

The Department accepts and will implement the GAO recommendations. Specifically:

The Department of Education will review all accounting operations in order to develop a more comprehensive inventory of accounting systems. The Department of Education's controls over the input of financial information to the HHS Regional Accounting System (RAS) will be included in the ED inventory of accounting systems. We believe the responsibility for performing an accounting system review of the RAS rests with the Department of Health and Human

Mr. Richard L. Fogel - Page 4.

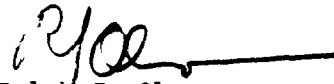
Services, since it is an HHS system. Some of the aspects of the Block and Formula Grants System were included in our review of the discretionary grants system. We will expand our inventory to include the Block and Formula Grants System.

The Department did require attendance at training sessions on performing an accounting system assessment. Of the 23 individuals who attended the initial training, 21 did not actually perform accounting system surveys. However, we did provide technical assistance to many of the individuals who performed the accounting system assessments. The Department will continue its efforts to assure that all individuals who conduct accounting system assessments receive training in the performance and documentation of those assessments.

ED's accounting system review guidelines will be revised to require testing of the systems in operation.

In conclusion, I want to emphasize that all the GAO recommendations are useful and will be implemented. In addition, I would like to express appreciation for the courtesy and insight of Ms. Kladiva and her staff in reviewing our process for implementing the Federal Managers' Financial Integrity Act.

Sincerely,



Ralph J. Olmo
Acting Deputy Under Secretary
for Management

GAO note: Page reference has been changed to correspond to page number in the final report.

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