

**RECENT IMPROVEMENTS OF
FINANCIAL MANAGEMENT PRACTICES AT THE
U.S. DEPARTMENT OF EDUCATION**

HEARING

BEFORE THE
SUBCOMMITTEE ON SELECT EDUCATION

OF THE
COMMITTEE ON EDUCATION AND
THE WORKFORCE

HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, DC, MARCH 12, 2003

Serial No. 108-8

Printed for the use of the Committee on Education
and the Workforce



86-422 pdf

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
FAX: (202) 512-2250 Mail: Stop SSOP, Washington, DC 20402-0001

COMMITTEE ON EDUCATION AND THE WORKFORCE

JOHN A. BOEHNER, Ohio, *Chairman*

THOMAS E. PETRI, Wisconsin
CASS BALLENGER, North Carolina
PETER HOEKSTRA, Michigan
HOWARD P. "BUCK" McKEON, California
MICHAEL N. CASTLE, Delaware
SAM JOHNSON, Texas
JAMES C. GREENWOOD, Pennsylvania
CHARLIE NORWOOD, Georgia
FRED UPTON, Michigan
VERNON J. EHLERS, Michigan
JIM DeMINT, South Carolina
JOHNNY ISAKSON, Georgia
JUDY BIGGERT, Illinois
TODD RUSSELL PLATTS, Pennsylvania
PATRICK J. TIBERI, Ohio
RIC KELLER, Florida
TOM OSBORNE, Nebraska
JOE WILSON, South Carolina
TOM COLE, Oklahoma
JON C. PORTER, Nevada
JOHN KLINE, Minnesota
JOHN R. CARTER, Texas
MARILYN N. MUSGRAVE, Colorado
MARSHA BLACKBURN, Tennessee
PHIL GINGREY, Georgia
MAX BURNS, Georgia

GEORGE MILLER, California
DALE E. KILDEE, Michigan
MAJOR R. OWENS, New York
DONALD M. PAYNE, New Jersey
ROBERT E. ANDREWS, New Jersey
LYNN C. WOOLSEY, California
RUBÉN HINOJOSA, Texas
CAROLYN McCARTHY, New York
JOHN F. TIERNEY, Massachusetts
RON KIND, Wisconsin
DENNIS J. KUCINICH, Ohio
DAVID WU, Oregon
RUSH D. HOLT, New Jersey
SUSAN A. DAVIS, California
BETTY McCOLLUM, Minnesota
DANNY K. DAVIS, Illinois
ED CASE, Hawaii
RAÚL M. GRIJALVA, Arizona
DENISE L. MAJETTE, Georgia
CHRIS VAN HOLLEN, Maryland
TIMOTHY J. RYAN, Ohio
TIMOTHY H. BISHOP, New York

Paula Nowakowski, Chief of Staff
John Lawrence, Minority Staff Director

SUBCOMMITTEE ON SELECT EDUCATION

PETER HOEKSTRA, Michigan, *Chairman*

JON C. PORTER, Nevada, *Vice Chairman*
JAMES C. GREENWOOD, Pennsylvania
CHARLIE NORWOOD, Georgia
PHIL GINGREY, Georgia
MAX BURNS, Georgia

RUBÉN HINOJOSA, Texas
SUSAN A. DAVIS, California
DANNY K. DAVIS, Illinois
TIMOTHY J. RYAN, Ohio

TABLE OF CONTENTS

OPENING STATEMENT OF CHAIRMAN PETE HOEKSTRA, SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, D.C..... 1

STATEMENT OF WILLIAM D. HANSEN, DEPUTY SECRETARY, U.S. DEPARTMENT OF EDUCATION, WASHINGTON, D.C. 5

STATEMENT OF THOMAS A. CARTER, DEPUTY INSPECTOR GENERAL, OFFICE OF INSPECTOR GENERAL, U.S. DEPARTMENT OF EDUCATION, WASHINGTON, D.C.... 14

STATEMENT OF LINDA CALBOM, DIRECTOR, DIVISION OF FINANCIAL MANAGEMENT AND ASSURANCE, GENERAL ACCOUNTING OFFICE, WASHINGTON, D.C..... 16

APPENDIX A -- WRITTEN OPENING STATEMENT OF CHAIRMAN PETE HOEKSTRA, SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, D.C. 23

APPENDIX B -- WRITTEN STATEMENT OF WILLIAM D. HANSEN, DEPUTY SECRETARY, U.S. DEPARTMENT OF EDUCATION, WASHINGTON, D.C. 27

APPENDIX C -- WRITTEN STATEMENT OF THOMAS A. CARTER, DEPUTY INSPECTOR GENERAL, OFFICE OF INSPECTOR GENERAL, U.S. DEPARTMENT OF EDUCATION, WASHINGTON, D.C. 37

APPENDIX D -- WRITTEN STATEMENT OF LINDA CALBOM, DIRECTOR, DIVISION OF FINANCIAL MANAGEMENT AND ASSURANCE, GENERAL ACCOUNTING OFFICE, WASHINGTON, D.C. Table of Indexes..... 47

Table of Indexes..... 65

HEARING ON RECENT IMPROVEMENTS OF
FINANCIAL MANAGEMENT PRACTICES AT
THE U.S. DEPARTMENT OF EDUCATION

WEDNESDAY, MARCH 12, 2003

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON SELECT EDUCATION,
COMMITTEE ON EDUCATION AND THE WORKFORCE,
WASHINGTON, D.C.

The subcommittee met, pursuant to notice, at 2:00 p.m., in Room 2261, Rayburn House Office Building, Hon. Peter Hoekstra [chairman of the subcommittee] presiding.

Present: Representatives Hoekstra, Porter, Burns, Hinojosa, Davis, and Ryan.

Staff Present: Kevin Frank, Professional Staff Member; Cindy Herrle, Senior Budget Analyst; Alexa Marrero, Press Secretary; Deborah Samantar, Committee Clerk/Intern Coordinator; Kathleen Smith, Professional Staff Member; Holli Traud, Legislative Assistant; Cheryl Johnson, Minority Counsel; Ricardo Martinez, Minority Legislative Associate, Education; and Joe Novotny, Minority Clerk/Staff Assistant, Education.

***OPENING STATEMENT OF CHAIRMAN PETE HOEKSTRA,
SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE ON
EDUCATION AND THE WORKFORCE, U.S. HOUSE OF
REPRESENTATIVES, WASHINGTON, D.C.***

Chairman Hoekstra. A quorum being present, the Subcommittee on Select Education will come to order.

We are meeting today to hear testimony on recent improvements of financial management practices at the U.S. Department of Education.

Under committee rule 12(b), opening statements are limited to the chairman and the ranking minority member of the subcommittee. Therefore, if other members have statements, they may be included in the hearing record. With that, I ask unanimous consent for the hearing record to remain open 14 days to allow members' statements and other extraneous material referenced during the

hearing to be submitted in the official hearing record.

Without objection, so ordered. Thank you.

This is the first hearing of the subcommittee for this session of Congress. I look forward to working with Mr. Hinojosa and the Democrats on the committee, and my colleagues on the Republican side of the aisle, to have a very effective subcommittee.

We have already passed two of the bills out of full committee that this subcommittee has jurisdiction over. I thank my colleagues on the other side of the aisle for supporting that legislation and already moving one bill through the House, and I think very soon moving the second bill through the House.

We will, I think, however, have some heavy lifting to do in terms of the Corporation for National and Community Service, and we hope that we can continue the past experience of trying to get that done in a bipartisan way. So I look forward to trying to make that happen.

The hearing that we have today I think has been a series of hearings over the last number of years, including beginning with the work on the oversight subcommittee, and then, under Mr. Boehner, when we reorganized jurisdictions and that, moving the responsibility for oversight for the financial performance of the Department of Education to the Subcommittee on Select Education.

But I think this is something like the eighth or ninth hearing over a period of five or six years.

The first thing I want to do is congratulate the Department of Education. We established a bar, not full accountability, because full accountability, as the President has talked about, is making sure that no child is left behind and that every child learns, and we will move and have assessments in that area over the coming years.

But the bar that was established a number of years ago was for an agency and a department that spends \$40 billion a year or has responsibility for \$40 billion a year at least give us some kind of assurance that the money is being spent and spent appropriately, or at least as appropriately as defined by accounting standards.

So, please, let's move to establish the threshold that we want a clean audit. And as we've found over the last couple of years, having inappropriate and inefficient control mechanisms within a department, we not only ended up with not having a clean audit; we also ended up, under both the Clinton administration and this administration, uncovering cases of waste, fraud, and abuse.

I applaud the management at the Department of Ed for taking the steps necessary to enable us to get to a clean audit and I'm sure there are other issues that need to be addressed. However, that goal that was established has been achieved and now we'll keep monitoring that measurement, but we can also start talking about other issues since we have reached this first critical and

important step.

Our first witness today is Deputy Secretary Hansen. I just know him as Bill. Congratulations, I know you guys have spent a tremendous amount of time and energy. The folks that work for you at the department have invested a significant amount of time and energy on getting to a clean audit, as well as doing all of the other things that you need to do there, including passing No Child Left Behind.

So congratulations for being able to run a number of parallel tracks and making sure that this issue, which is not a very glamorous issue, you don't get a lot of kudos for saying you got a clean audit; it is sort of expected.

But you grabbed the issue, you resolved the issue, and you have a clean audit. We had you guys up here and we had folks from the Clinton administration up here often enough, asking them why there was not a clean audit and when they were going to get it resolved. We only thought it appropriate for you to have the opportunity to share with us the success that you' have had and where you go from here.

With that, I will turn it over to my ranking member, Mr. Hinojosa.

WRITTEN OPENING STATEMENT OF CHAIRMAN PETE HOEKSTRA, SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, D.C. – SEE APPENDIX A

OPENING STATEMENT OF RANKING MINORITY MEMBER, RUBEN HINOJOSA, SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF REPRESENTATIVES, WASHINGTON, D.C.

Mr. Hinojosa. Thank you very much, Chairman Hoekstra.

I want to say good afternoon and welcome to all of our witnesses and our public attendees here today. This is my first hearing as ranking member of this subcommittee, and I am looking forward to working with Chairman Hoekstra during the 108th Congress.

I want to make some real improvements to the American educational system, and I know it can be done if we can work together.

The comments that he made about the clean audit, and I have learned about some of the problems that the past Administration had with actions taken by some people working in the Department of Education, and I was informed, by having listened to the folks from the Department of Justice, about those things that were done just because we probably did not have appropriate separation of accounting functions in the offices where the procurement and approval of vouchers and so forth were made.

So I hope that my getting involved in this position that I am in now, having a background in accounting and in business, a master's in business, I think that I can certainly be asking that there be accountability to us so that we can avoid those kinds of problems.

Last Congress, my predecessor, Congressman Tim Roemer, and the other Democrats on this Select Education Committee, took the position that oversight of Education Department financial management practices was very important and appropriate. We shall continue this year on that same premise.

I want to start out by recognizing the efforts of Secretary Paige in managing the Department of Education. He has been to my district. I have a good relationship with him, and I look forward to working with him and his staff.

With a large staff and huge budget, many problems could arise on various fronts on a daily basis. Today, however, we congratulate him on achieving a clean audit for the first time in a number of years, as our chairman stated earlier.

As we are all aware, the department failed to receive that clean audit, as he pointed out. The fiscal year 2000 audit reported a qualified opinion, and all these things that he has already mentioned I will skip over.

Today we will hear how some federal employees perpetuated waste, fraud, and abuse while discharging their duties in the department. We understand that a number of these non-federal individuals were also implicated in these actions.

On the larger scale, we will also hear about the success, as well as the continuing management problems regarding the student financial aid systems.

Our Democratic and Republican colleagues have been briefed by the Inspector General's office of the Department of Education prior to this hearing, and we all look forward to listening to the witnesses so that we may follow up with more specific questions.

Managing a \$50 billion grant and loan program on an annual basis brings tremendous challenges. Since 1998, both the Congress and the department have been more specifically focused on accountability.

The creation of the Office of Federal Student Aid, as a performance-based organization, has brought progress, as well as some growing pains. Today the General Accounting Office will note some success and I am sure will alert us to the areas that require some continued vigilance and sound management monitoring. The Inspector General's office will update us on specific cases and some issues that are yet to be resolved with these particular cases.

In closing, Mr. Chairman, I want to say that we Democrats look forward to hearing from our panelists and we also look forward to working with you and our Republican colleagues on other oversight matters.

I yield the balance of my time.

Chairman Hoekstra. Thank you. I didn't know you had an MBA. The department is in trouble with two of us with MBAs looking over your shoulder every day.

Like I said, our first witness is Deputy Secretary Hansen. Most of us know him as Bill. He is the chief operating officer for the Department of Ed.

Congratulations. We will submit the entire background on you for the record, and we will let you move forward with your testimony.

Welcome. Thanks for being here.

STATEMENT OF WILLIAM D. HANSEN, DEPUTY SECRETARY, U.S. DEPARTMENT OF EDUCATION, WASHINGTON, D.C.

Mr. Hansen. Thank you, Mr. Chairman, and thank you, Mr. Hinojosa, for your comments and observations.

First of all, I would like to thank this committee for its oversight responsibilities and its roles over the last several years. I think it is very instrumental in the achievements of where we are today, so thank you for your leadership and your oversight responsibilities.

I testified before this subcommittee a year ago and since then, I am very proud of the success that we have made in moving toward our management challenges.

Secretary Paige, just a couple of months after assuming office in 2001, discovered that there were some very serious management problems in the department. The first was that there had not been a clean audit in the department for many years.

The Inspector General and General Accounting offices had identified literally hundreds, in fact, we tabulated and there was over a thousand problems that needed immediate attention.

There were hundreds of thousands of dollars in false overtime that had been charged to the department by contractors and a theft ring inside the department that used several more hundreds of thousands of dollars to buy and then steal electronic equipment.

In addition, \$1.9 million in impact aid funds that were intended for school children in South Dakota had been diverted to buy real estate and luxury SUVs.

We also found that \$450 million was just simply missing, and there was widespread abuse of purchase cards in the department.

Even though these and other problems occurred prior to Secretary Paige coming to the department, he promised that one of his top priorities would be to identify and correct all of the management problems that were preventing the department from operating at its peak performance.

I am proud to say that the Secretary has kept his promise. Most importantly, the department has received its first unqualified or clean independent audit opinion since 1997 and only the second in its history. This is a critical milestone in our effort to address concerns surrounding the department's financial reporting, reconciliation of financial records, and control of all of our information systems.

I also proud to report that the Office of Management and Budget had given the department its seal of approval, as well. The department has received the highest progress score possible, green lights for each of the government-wide management improvement initiatives and program specific initiatives identified in the President's management agenda.

In addition, the fraud issues that plagued the department when the Secretary first arrived have been addressed. Four people have been arrested and indicted on federal charges for stealing the money that was intended for the school children in South Dakota. Nineteen other people have either pled guilty to federal charges or were convicted after a federal trial for their involvement in a massive theft ring, and we have located and accounted for the \$450 million in missing moneys.

These are all critical steps forward in our efforts to inject accountability into everything we do at the Department of Education. I am proud of the employees at the department who have worked with dedication and diligence to ensure that the taxpayers' hard-earned dollars are spent wisely and that our children in our nation's schools are served effectively.

The department reached this point by setting out to accomplish three short-term and six long-term goals.

Our short-term goals were to install new leadership in the financial and management areas of the department; to assemble a task force of career department leaders to identify and address the management issues; and, to solicit the counsel and advice of our external advisors.

The new leadership at the department is represented here. Jack Martin is our chief financial officer. This position had been left vacant for over three years before Jack got here about a year ago.

Bill Leidinger is our assistant secretary for management.

Chairman Hoekstra. You couldn't have done it without people from Michigan, right?

Mr. Hansen. First priority, sir.

Chairman Hoekstra. Jack is from Michigan.

Mr. Hansen. Bill Leidinger is our assistant secretary for management, who has also been here for about a year, and that position had been vacant for about five years.

Terri Shaw is our chief operating officer, she is sitting right behind me, of the office that Mr. Hinojosa mentioned, the performance based organization over in the student financial aid office.

It should also be noted that we have also installed and the Senate confirmed a new inspector general last fall. We have a new deputy inspector general that you will hear from later this afternoon, and, also, within the student aid office, we have a new CIO and a new CFO in that office. So we have really assembled a new team and I fully expect that the results that we have this year are just really the beginning of greater achievements into the future.

Also, now we have done this with the work of our career civil servants. The SWAT team that constituted the management improvement team consisted of all civil servants, and I think we plucked out the 12 brightest and most aggressive minds in the department to get these issues identified, so that when these folks got to the department, we were able to hit on all cylinders.

So I much appreciate the great work of our senior career executives at the department, as well.

Our long-term goals, as outlined on the chart over here, were, first and foremost, to get this clean opinion; second, to establish effective internal controls; to create a culture of accountability; to create a structure for measuring progress; to modernize our student aid delivery systems; and, to remove the student financial assistance programs from the GAO high risk list.

We have accomplished each and every one of these activities, except for the removal of the student financial aid programs off the GAO high-risk list. And I put a clock up there because there was a timing issue here. When GAO came out with their latest report at the end of January, it preceded us by a couple of weeks before our clean audit was out there, and we hope that this is the last significant barrier to getting off the GAO high-risk list.

In getting the clean opinion, we have implemented a very serious new financial management system with our Oracle federal financials. We have improved reconciliation analysis and reporting capabilities.

We prepared our financial statements on a quarterly basis for the first time, and we have improved communication within the department and with our auditors.

All of these efforts led to the first clean opinion in five years, but I also, Mr. Chairman, want to point out that this is the beginning. In fact, I would like to give three new goals for you today that we would be able to address hopefully this time next year.

First, is that we want to get our one remaining material weakness that was still on the audit, which was associated with reconciliation of our financial records, cleaned up.

We also want to issue our 2003 financial statements by November 15th of this year, which meets the new accelerated schedule one year early, and we are very much committed to that, and, also, to ensure that we do have another clean audit in FY-2003, as well.

On internal controls, we have issued a revised set of policies and procedures for purchase card and travel cards. The Office of Management and Budget has referred to the purchase card policies and procedures as one of the best practices for other agencies to consider.

We eliminated the use of third party drafts. We established specific annual targets for the reduction or elimination of erroneous payments.

We've developed new policies and procedures for our inventory process and conducted a nationwide inventory review, which resulted in our independent auditors removing this issue as a reportable condition in our recent audit.

We also have required all of our employees to take online internal control training and information technology security training.

In terms of achieving a culture of accountability, we have established a culture of accountability team, consisting of our senior and our career managers; developed a report that addressed our employees' concerns.

We've provided value-based ethics training for all of our managers, in addition to providing compliance-based ethics training. We provided training to our managers on how to develop performance standards and we are tying 100 percent of our performance agreements to our strategic plans, goals, and objectives.

In terms of modernizing the student aid delivery system, we have met our system modernization and integration goals for FY-2002. We have exceeded our default recovery target set for 2002, and we have proposed legislation, back in August of last year, that the Office of Management and Budget and the Secretary of Treasury jointly sent up to Congress with us to reduce the erroneous payments in the Pell Grant program.

In terms of getting the student aid programs off the high-risk list, this is an important priority for us. Secretary Paige met with Comptroller General David Walker in August of 2001 to try to make sure we had very firm goal posts, to know exactly what GAO was expecting from us to get off the high risk list, and we have had continued meetings and conversations with them and have exchanged letters and feel very comfortable about our working relationship with them and hope that we can get this achieved in the coming year.

Secretary Paige has said that the bottom line of all of this is to make sure that we have the confidence of the U.S. Congress, as you authorize our programs, and, also, the American public, as we administer our programs, especially laws like the No Child Left Behind law.

We want to make sure that no money that ought to be spent on children and on improving our education system is being wasted.

The number one priority of the department is educating our children and closing the achievement gap, so no child is left behind.

I believe that you will find our efforts over the last two years demonstrate our commitment to making the Department of Education a model agency of program and management excellence.

I will give you one more goal that we set for ourselves, and that is that this time next year, we hope that one of the objectives in our strategic plan of earning the President's quality award will be something that we can come and present to this committee that we have achieved.

Mr. Chairman, thank you for this opportunity. I look forward to answering any questions you might have.

WRITTEN STATEMENT OF WILLIAM D. HANSEN, DEPUTY SECRETARY, U.S.
DEPARTMENT OF EDUCATION, WASHINGTON, D.C. – SEE APPENDIX B

Chairman Hoekstra. Is that a monetary award?

Mr. Hansen. Is that what?

Chairman Hoekstra. A monetary award.

Mr. Hansen. Not for me.

Chairman Hoekstra. It's probably not for us, either. Bill, thank you. Also, thank you for highlighting the fact that the career folks at the department had much to do with bringing about this improved performance.

I think when we were going through this over the last couple of years with the different incidents, with fraud within the department, it's a small number of employees, but it cast a black eye over the entire department and all of the employees that are working there. And the number of indictments and convictions is more than what we would want it to be, but it is a small number compared to the number of folks and contractors that are working to implement the department, and I think you are absolutely right. All the employees now should share in the credit for the work that's happened over the last couple of years.

I really don't have any questions. I think the issue of the financial aid programs and moving those off the high risk, you and I have talked about that. We will hear some more testimony on that.

I think you are committed on getting that done. The nice thing is that you guys do have a performance record. I think you also stole our slogan from the State of Michigan. Have you ever

seen that one before? Promises made, promises kept. I think we've heard that one before, as well.

So we will, as Mr. Hinojosa said, continue working with you and anything that we can do legislatively to improve the performance. Sometimes the obstacles that you have for getting the performance that you want are there because we've made it more complicated and more difficult for you to do business than what might be practical.

So we are looking forward to working with the department, addressing these last outstanding issues, and then, most importantly, focus on the accountability of how the dollars are impacting the learning with our kids.

So that is the most important. But we have to pass this very important threshold. So congratulations.

With that, I will yield to Mr. Hinojosa.

Mr. Hinojosa. Mr. Chairman, I know that Secretary Hansen has to leave after his presentation. I wanted to ask him a question as it refers to my state and the Texas Education Agency.

Do you have any problem if I do that?

Chairman Hoekstra. That's fine. Absolutely.

Mr. Hinojosa. I was looking at the material that was given to us before the meeting and in the presentation that Thomas Carter makes and he makes reference to TEA. I served on the Texas State Board of Education for ten years and I am very familiar with TEA and the magnitude of the budget that they deal with.

But in that testimony, he makes reference to the problem to the expenditure of funds for students. Specifically, he mentioned that TEA could not report to the department how many children were served under priority of services, and, consequently, the department could not determine whether the \$53 million allocated to TEA had been used correctly.

Can you tell me the status of that?

Mr. Hansen. Yes, sir. The migrant education program in the department that oversees this activity asked for assistance from the Inspector General's office to help them identify compliance with the provisions, which is called the priority for services clause in the program.

The implementation of this clause has been a challenge in many states, not just Texas. There are others, as well. In fact, we have three other states that have identical problems that they are trying to work through.

The new language that was put in the Migrant Education Act, as part of the No Child Left Behind law that was signed into law a year ago, clarified the requirements and is helping to make the compliance by the states more straightforward, and we are working with the states in that

regard.

The department has been working with TEA, even before this audit was issued, to help them improve the sub-grant formula.

TEA has accepted the findings that the Inspector General has come up with and is moving forward to monitor its sub-grantees at the local education agency level and to obtain accurate counts of eligible children for funding formulas for the delivery of these services.

I think it needs to be noted that this 50 million was spent and it was spent on children. It just needs to be made sure what we're trying to drill down is to make sure it's been spent on the priority children that the law is calling for, and that is what we are working with the states to ensure.

Mr. Hinojosa. Then the last comment that I wanted to make, or question to you, is that, and I will be asking some of the members of the next panel.

In all the material made available to us, I never saw any references to what sanctions were directed at corporations for their participation in the fraud and abuse that the audits uncovered.

For example, the government received \$2 million from Verizon in compensation. However, was this to avoid the triple damages in a trial? Are they still your contractor, with no break in eligibility?

Mr. Hansen. We did enter, just about a month ago, into a settlement with Verizon for \$2 million, which we think was a very reasonable amount that was more than what was misused by their employees. So we feel very confident about the settlement agreement that we've reached with them.

I think it needs to be noted that this was, like Mr. Hoekstra said, about a couple of bad employees at the department. It was also about a couple of bad employees in Verizon.

All of the employees have been fired from Verizon, just like none of the employees that were part of this effort at the department are, any longer, working at the department; all of these employees either at Verizon or at the department have been convicted or sentenced for their respective roles in this.

So we, I think, have sent a very clear signal to Verizon with the settlement agreement that this will not be tolerated and there has been new control processes put in place to ensure that it never happens again.

Mr. Hinojosa. Well, I disagree with you. I think that had we gone to court, we could have gotten the 1 million in triple damages for what they did, which would have been 4 million, and that sure would have been good to put back into the coffers after all that has been uncovered.

The other thing that concerned me is that I saw where you did not remove them from eligibility of bidding on continuing services, and somebody who was as neglectful as this in their supervision and top management, who are responsible for those people working for them, should be made to understand that we are serious about spending the money on the children and that they should not be allowed to bid on continuing contracts, at least for a period of two to three years.

Why did you all not do that?

Mr. Hansen. Mr. Hinojosa, we felt that the punishment fit the crime in terms of the \$2 million settlement agreement, which, again, was double, which were the actual costs that were incurred, and we also felt that the company, as a whole, we've sent very strong signals with our new oversight working relationship with them that this will never happen again.

Any activities they do have with us, they do have to compete with the competitors for any future services with the department.

Mr. Hinojosa. Well, there are other federal agencies that take the position that I have taken, and that is that you remove them from eligibility, and that sends a very loud message to lots of other corporations that they had better pay close attention when they deal with the Federal government, and especially the Department of Education.

So I respect what you did and what the secretary approved as far as the punishment, but I do want to say that I disagree with not having removed them from the eligibility list of providers of services or goods.

With that, I think I'm going to stop my questions to the secretary.

Chairman Hoekstra. Thank you. The nice thing I like about Bill, when he hears a good suggestion, quite often it gets implemented.

That's not a bad suggestion.

Mr. Hansen. It's a good suggestion, sir. Thank you.

Chairman Hoekstra. And I would hope that the department would consider it as feasible. The Education and Workforce Committee has, over the past last number of years, have had issues about blacklisting. Where folks might be banned from access to government contracts based on the allegations of wrongdoing or violating OSHA, and we have never implemented anything like that and or tried to stop it.

But it may be appropriate to take a look at if there is a private sector organization that has been proven to violate and abuse the opportunity of doing business with the Department of Education or actually with the Federal government, that, for a period of time, they lose the opportunity to bid and participate in those contracts.

Mr. Hansen. We are not the repository of all good ideas. So we very much appreciate this advice and this counsel.

Chairman Hoekstra. That's why I'm sure when Bill comes back next year, they will have a new rule and regulation in place that they maybe don't do that anymore.

Mr. Hinojosa. Good. Then we won't have to take any action similar to what I am suggesting from the committee. But if you don't, we will.

Chairman Hoekstra. There was excitement just to get many of these things behind us, and now we can take a look at the policies and the practices that we need to put in place moving into the future.

Mr. Porter?

Mr. Porter. First, my congratulations and job well done. I do have a question.

How can the proposed IRS data match legislation assist the department in reducing the amount of improper payments in the student aid programs, and do you believe that there are any issues standing in the way of this becoming a law?

Mr. Hansen. Thank you for that question, congressman. In the 1998 re-authorization of the Higher Education Act, this committee put the authority into the act to allow us to use the IRS to crosscheck some of the income verification data elements that are on the student aid application.

Back in 1995 and 1996, there was a study done by the Inspector General and our program office that showed that there was a \$177 million in over-awards made because wrong income numbers were reported on the student aid application.

In 2001, in fact, we took a look at this again and think that the number is over \$300 million in erroneous Pell Grant payments. So this is a significant amount of money, and we want to make sure that the right students are getting the right amount of aid to go to college.

I think it should also be noted that the IG, in March of 2001, also demonstrated that there were 26 people charged in 23 separate criminal cases that fraudulently obtained more than \$2.6 million in federal grants, work study, and loans, and the way they did this was that they were using bogus tax forms to justify what they put on their student aid application.

So we think that this legislation is very important however, the authorization that this committee gave us in 1998 needs to be coupled with amending the tax code, as well, to allow the IRS to allow us to very carefully and surgically use this data as a cross-check, and we think this is very important.

It is embedded in the president's 2004 budget request, as well, to make sure that we can stop these erroneous payments in the Pell Grant program.

Mr. Porter. Thank you.

Chairman Hoekstra. Is that it?

Mr. Porter. That's great. Thank you.

Chairman Hoekstra. Boy, you got off easy today.

Mr. Hansen. Wait till next year.

Chairman Hoekstra. Wait till next year. No. Actually, like I said, congratulations on doing that. As we've talked about, we wanted to bring this to a close and deal with some of the other issues, and we want to get it on the record that you made a promise and you kept it.

So congratulations, and we will continue working on this and, also, some of the other issues that are out there, but take the message back to the secretary and to the careerists and all the other employees, thank you for getting the job done. We appreciate it.

Mr. Hansen. Thank you for your leadership, Mr. Chairman.

Chairman Hoekstra. Thank you. With that, we are ready for the second panel.

Let me introduce the second panel. First, we have Mr. Carter, who is the Deputy Inspector General of the U.S. Department of Education. He has served in a variety of staff and management positions with the Office of the Inspector General since 1985. Prior to serving at the department, Mr. Carter was with the Interstate Commerce Commission for 12 years as an auditor, cost analyst, and systems accountant.

We also have Ms. Calbom. Welcome. She is the Director of the Division of Financial Management and Assurance at the General Accounting Office, responsible for GAO's financial management work at many federal civil agencies, a certified public accountant and a certified government financial manager.

Welcome to the two of you. We are looking forward to your testimony and suggestions and ideas and your analysis of where we are. We'll begin with Mr. Carter. Thank you.

STATEMENT OF THOMAS A. CARTER, DEPUTY INSPECTOR GENERAL, OFFICE OF INSPECTOR GENERAL, U.S. DEPARTMENT OF EDUCATION, WASHINGTON, D.C.

Mr. Carter. Mr. Chairman and members of the subcommittee. I am pleased to provide the OIG's review on the status of financial management at the department, and I thank the subcommittee for this opportunity and for its continued focus on this important topic.

The department has made significant improvements in its financial management and progress toward the secretary's goal of accountability throughout the department's programs and operations.

Much work remains and we look forward to continuing our efforts to help the department improve and protect all of its programs and operations.

OIG has contracted for five years with Ernst & Young for the audits of the department's financial statements. For fiscal year 2002, E&Y noted that the department made progress in some areas of financial management, such as implementing a new general ledger system at the department level and a new financial management system within federal student aid.

E&Y also reported that the department has improved financial reporting related to credit reform. These improvements led the department to reach its goal of earning an unqualified opinion on its fiscal year 2002 financial statements. The auditor's report on internal control identified one, material weakness, financial management, reconciliations, and account analysis need to be strengthened, and, two, reportable conditions, improvement of financial reporting related to credit reform is needed and controls surrounding the information systems need enhancement.

The report on compliance with laws and regulations noted that the department's financial management systems did not substantially comply with the Federal Financial Management Improvement Act.

The department faces several critical challenges in continuing its progress in financial management. First, it needs to improve its processes for reconciliations and account analysis.

Having reliable financial data that is reported in interim and final financial statements must be the culmination of a rigorous and disciplined accounting process.

Second, the department needs to ensure it has the capacity to produce interim and final financial statements for OMB on an accelerated schedule.

As you heard, the department has established a goal for itself to meet the November 15 date in the year 2003 rather than 2004.

Finally, the department needs to improve controls to safeguard the security of its financial management systems.

Two other areas I would like to mention today are the importance of obtaining accurate data from program recipients and monitoring.

First, the accuracy of data. Performance and results are being increasingly linked to financial reporting and to budget and funding decisions at the federal and grant recipient levels. When program performance and results have financial consequences, there is a greater risk of improper reporting of performance information.

Therefore, having controls in place to reasonable ensure the accuracy and reliability of performance data used to measure program performance at the grantee level is critical to the financial management and performance of federal programs.

My formal statement contains several examples of our work in this area.

The second area is monitoring. We continue to focus attention on monitoring, an essential component of financial management and program success. Vigorous monitoring of programs and contracts help ensure that federal education dollars will be administered and used in the most efficient and effective manner.

Program visits and reviews of annual audits are critical for effective monitoring. The results of our audit work over the past few years show that the department needs to improve its monitoring of both internal and external programs and operations.

Again, my formal statement provides several examples.

In conclusion, to realize the secretary's goal of accountability, the department must continue its focus on financial management, system security, and increase its monitoring of programs and operations, and we look forward to continuing to contribute to this effort.

I would be happy to answer any questions.

WRITTEN STATEMENT OF THOMAS A. CARTER, DEPUTY INSPECTOR GENERAL,
OFFICE OF INSPECTOR GENERAL, U.S. DEPARTMENT OF EDUCATION,
WASHINGTON, D.C. – SEE APPENDIX C

Chairman Hoekstra. Thank you, Mr. Carter. We're going to wait for questions until Ms. Calbom has a chance to testify.

***STATEMENT OF LINDA CALBOM, DIRECTOR, DIVISION OF FINANCIAL
MANAGEMENT AND ASSURANCE, GENERAL ACCOUNTING OFFICE,
WASHINGTON, D.C.***

Ms. Calbom. Thank you, Mr. Chairman, and thank you, Mr. Carter.

As you know, in January, GAO issued our performance and accountability series on management challenges and program risks at major agencies, including the Department of Education.

The report for education focused on a number of management challenges and continued the high-risk designation for student aid programs.

You asked me to focus my testimony today on two areas in that report. These are the Department of Education's efforts to reduce fraud, waste, abuse, and mismanagement in its student aid programs, and, secondly, to improve its financial management to help build a high performing agency.

As Deputy Secretary Hansen just discussed, the Department of Education has spent significant time and effort in addressing these challenges and has been very successful in making real management improvements across the agency.

However, while the department has made significant progress, internal control and systems weaknesses remain both in the student aid program and in financial management overall that will require continued commitment and vigilance on the part of the department's management to resolve.

Let me first talk about the student aid programs. The Department of Education has faced four key challenges in this area. The first had to do with systems integration issues.

The department has spent millions of dollars to integrate and modernize its many financial aid systems in an effort to provide more information and better service to students, parents, institutions, and lenders. However, the department still needs to complete development of an institutional blueprint for how it will carry out these activities, which is commonly called enterprise architecture.

This is really the key to ensuring that you have consistent design and compatibility across the organization.

The second key challenge has been reducing fraud and error in student aid application and disbursement processes. As Mr. Hansen discussed, in a major effort to address this issue, the department has instituted pilot programs with the IRS to match income reported on student aid applications with federal tax returns and continues to work to achieve legislative action needed to implement these efforts on a broader scale.

The third challenge is minimizing and collecting defaulted student loans. Again, the department has made great strides in this area, but it needs to communicate its progress by issuing timely and complete performance reports to the Congress.

Finally, like other federal agencies, education must address serious human capital issues. In 2002, the department issues a comprehensive five-year human capital plan that outlines steps and time frame for improving human capital management, and it will be important that the department focus continuously on implementation of the plan to make sure they achieve the desired results.

Now, I'd like to talk a little bit about overall financial management. Weaknesses in the department's financial management and information systems have limited its ability to achieve one of its key goals, which is improving financial management to help build a high performing agency.

Significant progress towards this goal was made recently when the department received an unqualified, or clean opinion, as we say, on its financial statements. While this is a very important milestone for the department, significant internal control and systems weaknesses remain that must be addressed for the department to meet the end goal of timely, relevant, reliable information to manage the agency on a day-to-day basis.

The department has taken many actions over the last several years to improve its financial management and to address the weaknesses identified in previous financial statement audits.

The department auditors recently reported that several new processes were implemented during fiscal year 2002 to improve financial management and that a new general ledger system was installed, and these represent key steps in achieving the end goal.

However, the auditors also reported that inadequate internal controls continued to impair the department's ability to accumulate, analyze, and present reliable financial information.

While improvements were noted in the latter part of the fiscal year, the auditor reported that the department needs to place additional focus on reconciliation procedures, account analysis, and its financial reporting process.

This will be especially critical when, beginning with fiscal year 2004, the Department of Education and other major agencies will be required to produce audited financial statements within 45 days after the end of the fiscal year, compared to a 120 days currently, and, as Mr. Hansen stated, their goal is to implement that requirement this coming fiscal year.

In closing, I would like to commend Education management for their dedication and persistence in addressing major challenges related to student aid programs and financial management.

I would also like to encourage them to remain steadfast in their efforts to reach the end goal of producing timely, relevant, reliable information to efficiently and effectively management the agency and provide full accountability to stakeholders.

That concludes my statement. I'll be happy to answer any questions.

WRITTEN STATEMENT OF LINDA CALBOM, DIRECTOR, DIVISION OF FINANCIAL MANAGEMENT AND ASSURANCE, GENERAL ACCOUNTING OFFICE, WASHINGTON, D.C. – SEE APPENDIX D

Chairman Hoekstra. Thank you very much. We appreciate your testimony. Do you have any questions you would like to ask at this time?

Mr. Hinojosa. Yes. Mr. Carter, I remember seeing your testimony and you seem to have a great deal of knowledge about the migrant education programs in my State of Texas.

What are your thoughts about the moneys that you refer to there at TEA under the migrant program, since you did so much of the work?

Mr. Carter. Well, first of all, the credit for the knowledge of the program goes to the audit staff that was working on that audit, and I will pass on your compliment to them.

Basically, what we found, Mr. Congressman, was that we had no way of knowing to what extent that those funds were used for the high priority immigrant children.

The State of Texas had not put out procedures and they had not followed up down at the LEA level, and one of the results is, no doubt, it was then reported up through the various LEAs to the state Board of Education.

Consequently, the state was unable to report to the Department of Education on how many of these students received special care or special programs.

Now, what this doesn't mean is that immigrant children did not receive the benefit of the funds. It's just that those that were specifically targeted, we don't know to what extent they received a benefit.

Mr. Hinojosa. Was any part of that under the Head Start program, Head Start migrant children?

Mr. Carter. I can't answer that, Mr. Congressman. We can certainly get back to you on that.

Mr. Hinojosa. I know that there are some Head Start programs that are run through TEA. The biggest part of Head Start programs is run under HHS funding, and we have subcontractors that bid on those. They are non-profit organizations and they are the ones who manage the Head Start program for the lion's share of the children who are served.

But I would be interested, because there is a proposal that we're going to be looking at during re-authorization of Head Start on whether to leave it under HHS or to transfer it to the Department of Education, and it would be helpful for me to know if any of these moneys were for the Head Start migrant children.

If I could get an answer to that, I would like to have it in writing.

Mr. Carter. We will provide that, Mr. Congressman.

Mr. Hinojosa. I have no questions of Ms. Calbom, but I was pleased to hear the idea of developing and having by this coming year the enterprise architecture that would make sure that we have the steps to be able to have the controls, the business controls, and that there would be ongoing monitoring so that we could, I guess, avoid the same things that occurred in the past that are being corrected now.

I was very pleased about you calling those improvements milestones made in these first two years of Secretary Rod Paige's tenure and hope that that will be a continuing story throughout his

service as the Secretary of Education.

So, again, thank you for your report.

Mr. Porter [presiding]. Any additional questions?

Being the vice chairman and being a new member, I have a whole list of questions. So I will start over again at the beginning. Not really. I appreciate your testimony, but I do have a question, Mr. Carter.

You did touch upon, of course, the areas of waste, fraud, and abuse. What areas are the most susceptible, in your broad overview, and what more can we be doing to help?

Mr. Carter. Well, just looking at the size of programs, you would have to look at the federal student aid programs as being an area where certainly the dollars at risk would be greatest.

You, also, there, have a program there that, with the loan programs, for example, you're dealing with people who don't have a credit history, that often don't have jobs, and so on. So there is risk there.

There are very complicated programs. There are two loan programs covering millions of students over payment periods extending out many, many years.

There is also a lot of trust build into those programs. I just filled out a financial aid form myself and as I was going through it, it's just incredible how easy it would be, without an IRS match type program, to lie and basically steal from the program.

On the non-post-secondary education programs, the state and local, excuse me, the elementary and secondary programs, we do not get into a lot of compliance type of work there. We are starting to develop some concerns about the quality of the data that's being reported on those programs, because there are going to be decisions made on funding and when you have the money going one place or another based on performance, I think you do have to be concerned about the controls over how that data is being produced and used.

Mr. Porter. Thank you. Any additional questions? I would say the biggest challenge, and I know Mr. Hansen isn't here, but the biggest challenge is to do this again.

This is a great, great thing, I think, for the country, but we appreciate the testimony today and thank you all for being here.

I'd like to ask if there's anyone in the audience who has anything they would like to add today.

Hearing none, we will adjourn the meeting. Thank you all for being here.

[Whereupon, at 3:00 p.m., the subcommittee was adjourned.]

***APPENDIX A -- WRITTEN OPENING STATEMENT OF CHAIRMAN PETE
HOEKSTRA, SUBCOMMITTEE ON SELECT EDUCATION, COMMITTEE
ON EDUCATION AND THE WORKFORCE, U.S. HOUSE OF
REPRESENTATIVES, WASHINGTON, D.C.***

Opening Statement of Chairman Peter Hoekstra
*"Recent Improvements of Financial Management Practices
at the U.S. Department of Education"*
Subcommittee on Select Education
March 12, 2003

Welcome and good afternoon,

This is the first hearing of the Subcommittee on Select Education in the 108th Congress, and its topic is one of celebration. It's a time of new beginnings, with new members and a new ranking member, Mr. Hinojosa, joining the subcommittee. As chairman, I welcome each one of you to this subcommittee. I am also hopeful that this hearing marks a new beginning for the Department of Education, and one that can be sustained into the future.

Today's hearing marks the first time in a very long time that we can actually say with confidence that the Department of Education's books are in order. In fact, it is the first time since 1997, and only the second time in the Department's 23-year history, that such a claim could be made.

During the final three years of the Clinton Administration, the Education Department failed three consecutive annual audits, and an estimated \$450 million was lost to waste, fraud and mismanagement.

On January 17th, 2003, the independent auditing firm of Ernst & Young issued an unqualified clean opinion of the Department of Education's FY 2002 financial statements. This means that the Department's financial statements accurately reflect the financial results of the Department.

It also means that we have come a long way from the days when Department employees diverted \$1.9 million in Impact Aid funds from elementary school children in South Dakota, and instead, spent the money on Lincoln Navigators, Cadillac Escalades and real estate. A long way from the time when Department employees bilked the federal government out of thousands of dollars by using government purchase cards to buy furniture and draperies for their homes. And further still from the days when Department employees schemed with contractors in defrauding the government of over \$1 million in electronics equipment and false overtime charges for hours spent picking-up dry cleaning and buying crab cakes from Baltimore.

Nevertheless, this is not to say that we don't have room for improvement. We certainly do and we will discuss some of those areas today. But, it is to say that after eight Congressional oversight hearings spanning at least four years, the Department of Education is finally on the right track when it comes to the financial stewardship of taxpayer dollars.

2.5
R

The Department's comeback story should serve as reminder to us all that hard-earned taxpayer funds are just that – hard-earned – and that they should always be spent wisely and on the purpose for which they were intended.

However, I would like to note that we would not be able to tell this success story if it weren't for the leadership of Secretary Paige and his Management Improvement Team.

Nor would we be able to envision it without the hard work of our panelists: Deputy Secretary, Bill Hansen and his team – Jack Martin, Bill Leidinger, and Terri Shaw – the Inspector General's Office, and the General Accounting Office. Thank you all for your diligence.

I appreciate the leadership that Secretary Paige and Deputy Secretary Hansen have shown in changing the culture at the Department of Education and working to eliminate the waste, fraud, and abuse that have stolen resources away from this nation's children. This Administration has demonstrated its commitment to improving our children's education without squandering precious resources through bureaucratic mismanagement.

And with that, I would like to yield time to my new Ranking Member, Mr. Hinojosa, for his opening statement ...

26

L

***APPENDIX B -- WRITTEN STATEMENT OF WILLIAM D. HANSEN,
DEPUTY SECRETARY, U.S. DEPARTMENT OF EDUCATION,
WASHINGTON, D.C.***

**Testimony of William D. Hansen
Deputy Secretary, U.S. Department of Education
Before the
Subcommittee on Select Education
Committee on Education and the Workforce
United States House of Representatives
March 12, 2003**

Mr. Chairman and Members of the Subcommittee:

I would like to thank you for the opportunity to discuss the Department's progress towards improving financial management and instituting an improved culture of accountability. I would also like to thank you and other committee members for your continued efforts to help us to identify and address the Department's management problems.

I last testified before this Subcommittee one year ago, in April 2002. Since then we have continued to make significant progress towards overcoming our management challenges.

As you know, when Secretary Paige arrived at the Department of Education back in January 2001, he discovered that there were serious management problems. The Department had not received a clean audit opinion in years and there was not any expectation of one in the near future. Millions of dollars of grant money could not be accounted for. The Inspector General's Office and the General Accounting Office had identified hundreds of problems that needed immediate attention. Hundreds of thousands of dollars in false overtime had been charged to the Department by contractors and a theft ring inside the Department had used several more hundreds of thousands of dollars to buy and then steal electronic equipment; such as computers, cell phones, digital cameras, CD players, and even a 61-inch television. In addition, \$1.9 million in Impact Aid funds intended for schools in South Dakota had been diverted to buy real estate and luxury SUV's.

Even though these and other problems occurred prior to Secretary Paige coming to the Department, he promised that one of his top priorities would be to identify and correct all of the management problems that were preventing the Department from operating at its peak performance.

I'm proud to say that the Department has kept the Secretary's promise.

Most importantly, the Department has received its first unqualified or "clean" independent audit opinion since 1997 and only the second in its history. This is a critical milestone in our effort to address concerns surrounding the Department's financial reporting, reconciliation of financial records, and control over our information systems.

I am also proud to report that the Office of Management and Budget has recognized the Department's efforts by awarding it the highest "progress" score possible (green) for each of the government-wide management improvement initiatives and program-specific initiatives identified in the President's Management Agenda. In addition, OMB has recognized our improvement in the areas of e-government and faith- and community-based organizations by awarding us an improved "status" score on each of these two initiatives. We anticipate that our plans for management reform will result in continued "status" score improvements in all areas of the President's Management Agenda.

In addition, the fraud issues that plagued the Department when the Secretary first arrived have been addressed:

- Four people have been arrested and indicted on Federal charges for stealing the money intended for schools in South Dakota;
- Nineteen other people have either pled guilty to Federal charges or were convicted after a federal trial for their involvement in the massive theft ring:
 - o Thirteen of the nineteen have been sentenced to-date.
 - o Verizon Federal Systems entered into a \$2 million civil settlement with the Department of Education and Department of Justice on February 6, 2003 to settle federal claims on false overtime charges and improper electronic equipment purchases caused by their employees in conspiracy with Department of Education employees.
 - o The former Department employee and acknowledged ring leader of this group of 19 people, along with her husband, and three others are scheduled to be sentenced this month.

These are all critical steps forward in our efforts to inject accountability into everything we do here at the Department of Education. I'm proud of the employees at the Department who have worked with dedication and diligence to ensure that the taxpayers' hard-earned dollars are spent wisely and the children in our Nation's schools are served effectively.

The Department reached this point by setting out to accomplish three short-term and six long-term goals. These goals were established for the Department by Secretary Paige shortly after he took office.

Short-Term Goals

Our short-term goals were to:

- Install new leadership in the financial and management areas of the Department;
- Assemble a task force of career Department leaders to identify and address as many short-term management improvement recommendations as possible and develop a Blueprint to address longer-term and structural issues; and
- Solicit the counsel and advice of external advisors.

New Leadership

We were able to provide new leadership in the financial and management areas of the Department, when:

- The President appointed Jack Martin as Chief Financial Officer – upon his confirmation, Jack became the Department's first CFO in over 3 years;
- The President appointed Bill Leidinger as Assistant Secretary for Management – upon his confirmation, Bill became the Department's first Assistant Secretary for Management in over 5 years; and
- Terri Shaw came on board as the Chief Operating Officer of Federal Student Aid.

Task force of Career Leaders

We assembled a task force of career Department leaders by:

- Creating a temporary Management Improvement Team to look at management issues across the Department; and
- Subsequently making the Management Improvement Team a permanent part of the Department's structure within the Office of the Deputy Secretary.

Advice of External Advisors

We solicited the counsel and advice of:

- The Council for Excellence in Government to help identify management challenges; and
- The Private Sector Council and National Academy of Public Administration to help identify solutions to management problems.

Long-Term Goals

Our long-term goals were to:

- Obtain a clean audit opinion;
- Establish effective internal controls that address credit card abuses and duplicate payments and protect the Department's assets from waste, fraud, and abuse;
- Create a culture of accountability;
- Create a structure for measuring progress;
- Modernize student aid delivery; and
- Remove the student financial assistance programs from GAO's high-risk list.

Clean Opinion

In an effort to improve the financial management situation at the Department, we:

- Implemented a new financial management system in FY 2002 that meets Federal accounting standards;
- Improved reconciliation, financial management analysis, and reporting capabilities;
- Instituted preparation of financial statements on a quarterly basis;

- Improved communication between Federal Student Aid, the Office of the Chief Financial Officer, and Budget Service; and
- Improved communication with our auditors on matters related to credit reform and our subsidy estimating procedures.

All of these efforts led to the receipt of the Department's first clean audit opinion in 5 years. We are now setting new goals for ourselves – we will:

- Address the one remaining material weakness, which is associated with reconciliation of our financial records, that was identified in the FY 2002 financial statement audit report.;
- Issue our FY 2003 financial statements by November 15, 2003 – meeting the new accelerated schedule requirements one year early; and
- Obtain a clean opinion from our financial statement auditors for FY 2003.

Internal Controls

We have taken numerous steps to improve our internal controls, including:

- Issuing a revised set of policies and procedures for purchase cards – OMB has referred to these new policies and procedures as “best practices” for other agencies to consider;
- Issuing a revised set of policies and procedures for travel cards that includes a more specific outline of penalties associated with misuse;
- Eliminating the use of third party drafts;
- Establishing specific annual targets for the reduction and/or elimination of erroneous payments;
- Creating a new inventory system to track physical property; and
- Requiring all employees to take on-line internal control training and information technology security training and requiring all managers to attend a full day training session that addressed internal controls within the Department.

Culture of Accountability

We are creating a culture of accountability at the Department by:

- Establishing a *Culture of Accountability* team that worked with staff throughout the organization to develop a report that addressed concerns surrounding a variety of issues important to our staff including leadership and management issues, communication, work processes, skills gaps, and performance evaluations;
- Providing training to our managers on how to develop performance standards; and
- Tying 100% of our performance agreements to our *Strategic Plan* Goals and Objectives.

Measuring Progress

We have institutionalized a process whereby we can continue to measure our progress and address areas of concerns by:

- Creating the *Blueprint for Management Excellence*, which identifies the management challenges at the Department, embraces key features of the government-wide initiatives set forth in the President's Management agenda, and tracks our progress towards addressing the identified challenges – of the original action items in the Blueprint approximately 85% have been completed and/or closed, with the remainder being tracked for completion;
- Creating the Executive Management Team (EMT) that works to align ongoing management improvement efforts with the Department's *Strategic Plan*, maintain the focus on management excellence and accountability for results, and measure progress in implementing the *Blueprint for Management Excellence*; and
- Meeting weekly with the EMT, which consists of myself, the Assistant Secretary for Management, the Chief Financial Officer, the General Counsel, the Chief Information Officer, the Director for Budget Service, and the Chief Operating Officer of Federal Student Aid. Other Assistant Secretaries participate in the EMT meetings on a monthly basis to address management issues that affect the achievement of programmatic goals. The Inspector General serves in an advisory capacity.

Modernizing Student Aid Delivery

We have made significant progress in modernizing student aid delivery. We have:

- Met our system modernization and integration goals for FY 2002 by improving, combining, or retiring 5 systems in our efforts to improve the accuracy and integrity of student aid information;
- Exceeded our default recovery target set for FY 2002 and as a result, collected \$966.6 million in defaulted loans held and collected by the Department (and an additional \$1.6 billion on defaulted loans held and collected by the guaranty agencies); and
- Jointly proposed, with OMB and the Department of the Treasury, legislation that will reduce erroneous payments to students whose income has been improperly reported on their eligibility applications by allowing the IRS to match the income reported on Federal student aid applications with income tax returns.

Removal of Student Financial Assistance Programs from GAO's High-Risk List

The student financial assistance programs currently remain on GAO's high-risk list – something that appears to be an issue of timing rather than the progress that has been made by the Department. In August 2001, Secretary Paige met with Comptroller General Walker to identify the specific issues that needed to be addressed prior to removing the student aid programs from the high-risk list. We believe that by the end of last year, we had addressed each of the issues identified by GAO with the exception of the receipt of a clean audit opinion. GAO issued its most recent high-risk list in January 2003, just days before ED was able to announce that it had achieved a clean opinion for FY 2002.

Overarching Responsibilities

By achieving each of these short- and long-term goals we can focus on our overarching responsibilities for:

- Restoring the confidence of Congress and the public in the Department; and
- Making sure that no money that ought to be spent on improving the education of American children is wasted.

The number one priority for the Department of Education is educating children and closing the achievement gap so no child is left behind.

I believe you will find that our efforts over the last two years demonstrate our commitment to making the Department of Education a model agency of program and management excellence. One of our objectives in our Strategic Plan is to earn the President's Quality Award -- I hope to be able to tell you a year from now that we have accomplished that goal as well.

I would be happy to answer any questions you may have.

**U.S. Department of Education
President's Management Agenda**

	Baseline Sept 30, 2001	1st Quarter FY 2003
Government- Wide Initiatives	Status	Progress
Human Capital	●	●
Competitive Sourcing	●	●
Financial Performance	●	●
E-Government	●	●
Budget & Performance Integration	●	●

	Baseline Sept 30, 2001	1st Quarter FY 2003
Program Specific Initiatives	Status	Progress
FSA High-Risk	●	●
Faith & Community Based	●	●

Promises Made, Promises Kept

Short Term Goals

- ✓ Install new leadership
- ✓ Assemble Task force of career leaders
- ✓ Solicit counsel of external advisors

Long Term Goals

- ✓ Obtain clean audit opinion
- ✓ Establish effective internal controls that address credit card abuses and duplicate payments
- ✓ Modernize student aid delivery
- ✓ Create a culture of accountability
- ✓ Create a structure for measuring progress
- 🕒 Remove student financial assistance from the high risk list

Overarching Responsibilities

- ✓ Restore the confidence of Congress and the public in the Department
- ✓ Make sure that no money that ought to be spent on improving the education of American children is wasted in Washington.

I will demand the same kind of accountability and results of myself and of this Department that I would demand of any school. ~Secretary Paige, April 2001

**APPENDIX C -- WRITTEN STATEMENT OF THOMAS A. CARTER,
DEPUTY INSPECTOR GENERAL, OFFICE OF INSPECTOR GENERAL,
U.S. DEPARTMENT OF EDUCATION, WASHINGTON, D.C.**

**Statement of Thomas A. Carter
Deputy Inspector General
Department of Education**

**Before the
Subcommittee on Select Education
Committee on Education and the Workforce
United States House of Representatives**

March 12, 2003

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to provide an update on the status of financial management at the Department of Education (the Department) from the perspective of the Office of Inspector General (OIG). I would also like to thank the committee for its dedication to improving the management of the Department.

The Department has made improvements in its financial management and has taken significant steps toward establishing and maintaining a strong system of internal controls necessary for continued financial management improvements. The Secretary not only continues to emphasize the need to improve financial management, but also has dedicated considerable resources to this goal. We share the Secretary's commitment to improving financial management and accountability throughout the Department's programs and operations.

I will provide an overview of the results of the Fiscal Year (FY) 2002 financial statement audits and discuss some of our most significant additional work to help strengthen accountability in the Department.

I. Reports on the FY 2002 Financial Statement Audit

The OIG contracted with Ernst & Young, LLP (E&Y), for the audit of the Department's FY 2002 financial statements. This was the fifth year E&Y conducted the annual financial statement audit at the Department. E&Y notes in its audit reports that the Department made progress during FY 2002 in some areas of financial management control, such as the implementation of a new general ledger software package at the Department level and a new financial management system within Federal Student Aid (FSA). The Department also made progress during FY 2002 on financial reporting related to credit reform. For example, it improved financial statement disclosures, monitored key credit reform accounts, began a process to study key assumptions in the subsidy models, and participated with the Office of Management and Budget (OMB) in a Student Loan Audit Modeling Working Group.

A. Unqualified Opinion on Financial Statements

The Department reached its stated goal to earn an unqualified opinion on its FY 2002 financial statements. The unqualified opinion covered the Balance Sheet, Statement of Net Cost, Statement of Changes in Net Position, Statement of Budgetary Resources, and Statement of Financing. The effort exhibited by the Department's financial management staff in obtaining the opinion was substantial, but as indicated by the findings in the Report on Internal Control, much work remains to be done to achieve the Secretary's goal of creating a permanent culture of accountability.

B. Report on Internal Control

The auditor's Report on Internal Control identifies one material weakness and two reportable conditions. The material weakness cited is:

- *Financial Management, Reconciliations and Account Analysis Need to be Strengthened.*

During FY 2002, significant financial management issues continued to impair the Department's ability to accumulate, analyze, and present reliable financial information. Specifically, the Department was not able to successfully complete reconciliations and o types of account analysis on a timely basis. For example, for portions of FY 2002, the Department was not reconciling its Fund Balance with Treasury. Although improvements were noted during the year, certain unreconciled differences remained unresolved in FY 2002. The Department's performance of reconciliations in FY 2002 was also inconsistent. In addition, supervisory review and approval procedures over reconciliations did not appear to be adequate in all cases. For much of the fiscal year, the Department also experienced problems associated with the transition to a new financial management system implemented in FY 2002.

The Report on Internal Control cited the following two reportable conditions:

- *Improvement of Financial Reporting Related to Credit Reform is Needed.*

The Department needs to improve management controls surrounding the calculation and reporting of activity for the guaranteed loan liability, allowance for subsidy, and subsidy estimates. For example, E&Y found that the Department's analyses of these estimates and the underlying data indicate that, for certain data, the estimated amounts have consistently differed from actual amounts for several years. In addition, the Department does not have significant data or historical trend analysis for the effects on credit reform estimates of consolidated loans, which have significantly increased in recent years. In another example, the Department has historically used some of the Federal Family Education Loan (FFEL) program assumptions to calculate the credit reform estimates for the direct loan program, due to the lack of historical trend analysis for the direct loan program. However, the Department's analysis indicates that actual direct loan program trends differ from the estimates that are based on FFEL assumptions.

- *Controls Surrounding Information Systems Need Enhancement.*

The Department needs to implement and maintain an agency-wide security plan and strengthen controls over updating its network infrastructure to secure mission-critical systems against common security vulnerabilities and exposures. The Department also needs to establish clear lines of responsibility for information system security.

C. Report on Compliance with Laws and Regulations

The Report on Compliance with Laws and Regulations notes that the Department's financial management systems do not substantially comply with the Federal Financial Management Improvement Act (FFMIA) requirements. This is due to the weaknesses mentioned above dealing with financial management and systems security. Exclusive of FFMIA, the report discloses no instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

D. Challenges Ahead

Critical challenges remain to be resolved in order for the Department to prepare timely and accurate financial statements on an accelerated basis, and to continue improving its overall financial management.

First, as noted in the Report on Internal Controls, the Department needs to strengthen its financial management by improving its processes for reconciliations and account analysis. Having reliable financial data that is reported in interim and final financial statements must be the culmination of a rigorous and disciplined accounting process. This same process is also necessary to ensure that timely and reliable financial management information is available for decision makers. The Department needs to perform reconciliations and detailed account analyses of all significant accounts and programs adequately, consistently, and in a timely manner to ensure accurate and useful information is readily available to decision makers. Financial data should be critically analyzed, reviewed, and well understood by management.

Second, the Department needs to ensure it has the capacity to produce interim and final financial statements for OMB on an accelerated schedule. Beginning in FY 2003, unaudited financial statements must be prepared and submitted to OMB on a quarterly basis, no later than 45 days after the end of the reporting period. Beginning with the second quarter in FY 2004, agencies are required to prepare and submit quarterly unaudited financial statements 21 days after the end of each quarter, building up to the November 15th due date for the FY 2004 Performance and Accountability Reports. The Department has established a goal for itself to issue its FY 2003 financial statement on the FY 2004 accelerated schedule, or by November 15, 2003.

Third, the Department needs to improve controls to adequately safeguard the security of its financial management systems. We have identified information technology (IT)

security as a management challenge, and the Department also identified its IT Security Program as a material weakness in the FY 2002 Federal Managers' Financial Integrity Act report. The Department has made progress in strengthening controls over IT processes; however, continuous effort is needed to further address control weaknesses. Specifically, the Department needs to strengthen controls over updating its network infrastructure to secure mission-critical systems against common security vulnerabilities and exposures, implement comprehensive incident response procedures, establish clear lines of responsibility for information system security, and strengthen controls over critical financial and sensitive information to prevent unauthorized access and disclosure.

II. Financial Management Requires Accurate Data from Recipients

Performance and results are being increasingly linked to financial reporting, and to budget and funding decisions at the Federal and grant recipient levels. For example, OMB now requires each major Federal agency to issue its annual performance report, required under the Government Performance and Results Act, and its annual financial report, under the Chief Financial Officers Act, together in a single Performance and Accountability Report. Further, OMB assessed the performance of 234 Federal programs to help inform budget decisions in the FY 2004 President's Budget. Accurate and reliable data is also key to accurate implementation of the No Child Left Behind Act (NCLB), as that statute ties funding decisions to school performance.

When program performance and results have financial consequences, there is a greater risk of fraudulent reporting of performance information. Therefore, having controls in place to reasonably assure the accuracy and reliability of performance data used to measure program performance at the grantee level is critical to the financial management and financial performance of Federal programs.

The following two examples from our recent work illustrate this point.

Title I

We completed a joint audit with the General Accounting Office (GAO), the State Auditor's Office in Texas, the Auditor General's Office in Pennsylvania and the Controller's Office in Philadelphia to determine if States' Title I data were accurate, complete, valid, and timely. Accountability data measure compliance with Title I requirements used to determine whether schools are making adequate progress to improve and, under NCLB, will be the basis of funding decisions. We found a number of accountability issues that should be strengthened. For example, we found that States lack procedures and controls needed to develop and report reliable accountability information, including school improvement data.

Migrant Education

NCLB specifies that within programs that provide education for migrant children, children who are at risk of failing or whose education has been interrupted will receive

“Priority for Services.” The Consolidated State Performance Report to the Department’s Office of Migrant Education for every award year requires that States indicate the “count of students served who have a priority for services (those whose schooling has been interrupted and who are failing or at risk of failing to meet state standards).” We completed an audit at the Texas Education Agency (TEA) to examine the procedures used to identify these children. We found that TEA had not established or implemented appropriate procedures to identify and target migrant children eligible for Priority for Services. As a result of its lack of procedures, TEA could not report to the Department how many children were served under Priority for Services, and consequently, the Department could not determine whether the \$53 million allocated to Texas for this program was used correctly. TEA concurred with our recommendations and is implementing corrective action. We will be issuing three more State audits that have similar findings.

III. Strong Financial Management Requires Monitoring

Monitoring is an essential component for improving the financial management of, and accountability for, Federal education expenditures. Vigorous monitoring of programs and contracts helps ensure that Federal education dollars are administered and used in the most effective and efficient manner, and is vital to assuring program success. This monitoring should include program visits and reviews of annual audits. Our work has identified deficiencies in the Department’s monitoring of its programs and contracts.

Federal Student Aid Monitoring

FSA is responsible for the oversight of approximately \$50 billion dollars each year in the student financial assistant programs, which continue to be on GAO’s high risk list for fraud and abuse. FSA has selected “improving customer satisfaction” as one of its goals to measure its performance under its five-year plan that is required by the Higher Education Amendments of 1998 (HEA). An integral part of this goal is providing technical assistance to all customers. It is critical to the integrity and accountability of these programs for FSA to establish an acceptable balance between technical assistance and monitoring and enforcement.

During the last two years, we issued four audit reports that cited deficiencies in FSA’s oversight of schools, including a significant decrease in program reviews, lack of enforcement for schools’ untimely submission of annual compliance audit reports, inconsistent enforcement of the financial responsibility requirements, and an ineffective process for recertifying foreign schools’ eligibility to participate in the programs. In September 2000, FSA had agreed to increase on-site reviews at high-risk schools.

We also have initiated audits on nine guaranty agencies to assess the adequacy of the establishment of the Federal and Operating funds as required by the HEA. To date, we have issued six final audit reports finding that the Federal fund was short-changed ranging from \$1 to \$6 million. FSA concurred with our findings. None of the monetary findings had been reported by FSA, even though FSA had performed technical assistance

site visits at several guaranty agencies prior to our audits. In addition, outstanding issues regarding the Federal interest in non-liquid assets remain at several of the guaranty agencies. Our ongoing audits at the remaining three guaranty agencies have identified similar findings.

Office of Education Research and Improvement

Our audit evaluating the Department's process for identifying and monitoring high-risk contracts that support Office of Education Research and Improvement (OERI) programs found the Department did not always ensure compliance with contract terms and conditions, and did not follow established regulations, policies, and procedures in monitoring contracts. As a result of these shortcomings, the Department could not ensure that the contractors were meeting the terms of the contracts. We made several recommendations for improvement and the Department has stated that it is working to develop a comprehensive action plan to improve Department-wide contract monitoring, including OERI.

Special Monitoring Challenges

Annual audits conducted by independent auditors under the Single Audit Act (single audits) and the Higher Education Act (student financial aid compliance audits) are valuable tools available to the Department to monitor its program recipients. OIG works with OMB and the Department to provide updated guidance to auditors conducting both types of audits. The Department can use the information in these audits to evaluate the program recipients' internal controls over Federal funds and whether the funds are used in accordance with program laws and regulations. This information can also be used to identify potential problems -- recipients that may require additional monitoring and oversight, such as technical assistance, additional recipient reporting, and on-site monitoring. Our work continues to support our conclusion that the Department needs to ensure that these required audits are submitted, reviewed, and acted on in a timely manner.

For example, over the past several years, we have worked with the Department on special monitoring challenges presented by the Virgin Islands, Puerto Rico, and the Pacific Rim for Federal education programs. A common trend we noted at each of these entities was the failure of most of these grantees to submit timely single audits. Our audits, audits conducted by other Federal agencies, and single audits that were eventually provided, identified serious deficiencies in the grantee's ability to provide program services, including internal control weaknesses in the case of the Puerto Rico Department of Education (PRDE) that allowed for the embezzlement of millions of dollars in education program funds.

Our audit of PRDE and our joint investigation with the Federal Bureau of Investigation identified over \$30 million in contracts improperly awarded and an extortion scheme by which certain PRDE officials obtained more than \$4 million from PRDE contractors. Our work resulted in the Federal indictment of 17 individuals on various felonies,

including extortion, program fraud, and money laundering. Among those pleading guilty and receiving Federal sentences were the former Secretary and Associate Secretary of PRDE – twelve and eleven years, respectively, with an order to forfeit \$600,000 and to make restitution of \$4.3 million.

As a result of our work and that of the Department of Interior OIG, we identified serious financial management deficiencies in the Virgin Islands administration of Federal funds. Since 1984, the Virgin Islands either failed to submit a single audit or failed to submit one on time. As a result of the deficiencies identified, our Department declared the Virgin Islands a high-risk grantee, imposing special conditions on grants awarded to it, and in September 2002, signed a compliance agreement with the Virgin Islands that addresses numerous deficiencies.

We have issued two Alert Memoranda to the Department on the need to improve accountability for Federal funds to grantees in the Pacific Islands. We noted instances of fraud, waste, and abuse, including a theft of over \$640,000 that might have been detected and prevented with consistent oversight. We reported that most grantees in the Pacific Islands have not submitted all required single audits, or submitted them one or more years after they were due. Timely submission of these audits might have detected and prevented some problems at these entities.

III. Update on Certain Investigations

Telecommunications Case

Since 1999 we have been conducting an investigation of a major fraud scheme involving 19 individuals, including eight Department employees. Elizabeth Mellen, formerly the contracting officer's representative for the Department's contract with Bell Atlantic, has pled guilty to federal charges of conspiracy and theft of government property. This criminal activity involved ordering numerous items for herself and several family members, some of whom also worked at the Department. She also fraudulently authorized overtime pay for contractor employees who were part of this scheme. Ms. Mellen's action, and those of others, defrauded the government of more than \$300,000 in property which included computers, printers, scanners, cordless phones and a 61-inch television, and caused more than \$700,000 in false overtime to be charged to the Department.

All 19 of the individuals in this scheme have either pled guilty to Federal charges or been convicted after trial. To date, 13 of the 19 have been sentenced. Seven of the eight Department employees involved have either been removed from or have resigned their positions with the Department. On February 6, 2003, Verizon Federal Systems (the successor to Bell Atlantic) agreed to pay \$2 million to settle civil claims based on false overtime charges and improper electronic equipment purchases caused by its employees involved in the scheme.

Impact Aid

We investigated the illegal diversion of \$1.9 million in Impact Aid funds from two South Dakota school districts to two private banks in Maryland. An aggressive civil forfeiture action early in the investigation resulted in the diverted funds being frozen; \$1.7 million in Impact Aid funds has now been returned to the Department. Four individuals involved in this theft were indicted, and one of them pled guilty. We are continuing our criminal investigation of the illegal diversion of funds.

Purchase Card Fraud Case

Our ongoing investigation related to fraudulent purchase card use led to guilty pleas by two Department employees and three employees of vendors for the Department. These individuals admitted to conspiring to use government credit cards to purchase household furniture for the Department employees' personal use. The charging documents stated the vendor's employees concealed the true nature of these purchases by falsely invoicing the government for the purchases of office furniture. One of the vendor employees has already been sentenced.

In September 2002, a nine-count indictment was returned charging two former employees in the Quality Workplace Group of the Department's Office of Management with conspiracy, theft of government property, and witness tampering. In January 2003, one of the former employees pled guilty to conspiracy and awaits sentencing in April. The second pled guilty on February 21, 2003. Neither is currently employed at the Department.

The scheme, as set forth in the indictment, involved the fraudulent use of government purchase cards to obtain approximately \$163,000 in money, goods and services for the employees' personal benefit and the personal benefit of others, including purchasing furniture and draperies for their homes. The indictment also outlines the payments of over \$30,000 in kickbacks paid by vendors to the two former employees. The employees directed vendors to perform work at inflated prices and to provide them with the excess money. To conceal the theft, bogus invoices were created and the two former employees falsely certified that the charges were true and accurate to obtain payment.

IV. Conclusion

The Department has improved its financial management. For the Department to continue to improve, it must sustain its efforts. We look forward to continuing to work with the Department on its goal of improved financial management and accountability throughout Department programs and operations.

This concludes my statement. I would be happy to answer any questions you may have.

***APPENDIX D -- WRITTEN STATEMENT OF LINDA CALBOM, DIRECTOR,
DIVISION OF FINANCIAL MANAGEMENT AND ASSURANCE, GENERAL
ACCOUNTING OFFICE, WASHINGTON, D.C.***

United States General Accounting Office

GAO

Testimony
Before the Subcommittee on Select
Education, Committee on Education and
the Workforce, House of Representatives

For Release on Delivery
Expected at 2 p.m.
Wednesday
March 12, 2003

**DEPARTMENT OF
EDUCATION**

**Status of Efforts to
Address Major
Management Challenges**

Statement of Linda Calbom
Director, Financial Management and Assurance



GAO-03-531T

March 12, 2003

DEPARTMENT OF EDUCATION

Status of Efforts to Address Major Management Challenges



Highlights

Highlights of GAO's 2003 Testimony before the Subcommittee on Select Education, Committee on Education and the Workforce, House of Representatives

Why GAO Did This Study

In its 2002 performance and accountability report on the Department of Education, GAO identified challenges in, among other areas, student financial aid programs and financial management. The information GAO presents in this testimony is intended to assist Congress in assessing Education's progress in addressing and overcoming these challenges.

What GAO Recommends

GAO is not making new recommendations in this testimony, but past reports have made specific recommendations aimed at addressing some of these major management challenges.

What GAO Found

Education has taken steps to address its continuing challenges of reducing vulnerabilities in its student aid programs and improving its financial management, such as establishing a senior management team to address management problems, including financial management, throughout the agency. And, while Education has made significant progress, weaknesses remain that will require the continued commitment and vigilance of Education's management to resolve.

- **Reduce vulnerability of student aid programs to fraud, waste, abuse, and mismanagement.** Education has made considerable changes to address the ongoing challenges in administering its student aid programs. However, Education needs to continue to address systems integration issues, reduce fraud and error in student aid application and disbursement processes, collect on student loan defaults, and improve its human capital management.
- **Improve financial management.** Education has implemented many actions to address its financial management weaknesses. Significant progress was made recently when Education received an unqualified—or "clean"—opinion on its financial statements for fiscal year 2002. While this is an important milestone for the department, internal control and systems weaknesses remain that impede Education's ability to produce timely, accurate, and useful financial information for its managers and stakeholders.

History of Financial Management Weaknesses

Fiscal year	Audit opinion ^a	Material internal control weaknesses	Noncompliance with federal systems requirements ^b
1995	Disclaimer	Yes	N/A
1996	Disclaimer	Yes	N/A
1997	Unqualified	Yes	Yes
1998	Disclaimer	Yes	Yes
1999	Qualified	Yes	Yes
2000	Qualified	Yes	Yes
2001	Qualified	Yes	Yes
2002	Unqualified	Yes	Yes

Source: Auditors' reports for fiscal years 1995-2002.

^aAuditors issue unqualified opinions when the financial statements are presented fairly, in all material respects. Qualified opinions are issued when the financial statements are presented fairly, with exceptions that are specifically disclosed and described. Disclaimers of opinion are rendered when auditors cannot satisfy themselves as to whether the financial statements are presented fairly.

^bThese requirements became effective for fiscal year 1997.

www.gao.gov/DIR/DMR/TSAC/03-3317

To view the full testimony, click on the link above. For more information, contact Linda Calton at (202) 512-9508 or lcalton@gao.gov.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the major management challenges faced by the Department of Education, its progress in addressing them, and challenges that remain.

As you know, this January, we issued our Performance and Accountability Series on management challenges and program risks at major agencies, including the Department of Education.¹ The report for Education focused on a number of management challenges and continued the high risk designation for student aid programs. You asked me to focus my testimony on two areas in that report. These are Education's efforts to (1) reduce fraud, waste, abuse, and mismanagement in its student aid programs while continuing to ensure access to postsecondary education and (2) improve its financial management to help build a high performing agency. Education has taken steps to meet these challenges, such as establishing a senior management team to address management problems, including financial management, throughout the agency. And, while Education has made significant progress, including receiving a clean opinion on its fiscal year 2002 financial statements, weaknesses remain that will require the continued commitment and vigilance of Education's management to resolve. I will discuss Education's student aid programs and financial management in turn.

¹U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Education*, GAO-03-99 (Washington, D.C.: Jan. 2003).

Student Aid Programs

Ensuring access to postsecondary education while reducing vulnerability of aid programs to fraud, waste, abuse, and mismanagement is one of the key management challenges Education faces. Education helps millions of students enroll in higher education programs by providing for more than \$50 billion in grants and loans annually. The department is responsible for ensuring that these programs are efficiently managed, establishing procedures to ensure that loans are repaid, and preventing fraud and abuse. Since 1990, we have identified Education's grant and loan programs as high risk for fraud, waste, abuse, and mismanagement.

Both Education and Congress have made changes to address management challenges in the student financial aid programs. Congress established Education's Office of Federal Student Aid (FSA) as a performance-based organization in 1998. Its purpose is to increase accountability of officials, provide greater flexibility in management, integrate information systems, reduce costs, and develop and maintain a system that contains complete, accurate and timely data that can ensure program integrity. In 2001, Education established a Management Improvement Team (MIT) of senior managers to formulate strategies to address key management problems throughout the department. According to Education, MIT has developed a system to identify, track, and resolve audit and management issues both agencywide and in the student financial aid programs.

Education has faced challenges in four areas related to its grant and loan programs. These are (1) financial aid system integration issues, (2) fraud and error in student aid application and disbursement processes, (3) defaulted student loans, and (4) human capital management. I would now like to briefly discuss each of these challenges.

Education has spent millions of dollars to integrate and modernize its many financial aid systems in an effort to provide more information and better service to students, parents, institutions, and lenders. Effectively and efficiently investing in information technology requires, among other things, an institutional blueprint that defines in both business and technical terms the organization's current and target operating environments and provides a transition road map. Because Education did not have this blueprint, commonly called an enterprise architecture, we recommended in 1997 that the department develop an architecture and establish standard reporting formats and data definitions.² In September 2002, Education's Office of the Inspector General (OIG) reported that the department had made progress in taking specific actions to lay the groundwork for an enterprise architecture. Still, critical elements need to be completed, including integrating separate architectures into a departmentwide architecture and fully implementing common identifiers for students and institutions to use in departmentwide system applications. Education is planning to brief us shortly about the department's enterprise architecture and progress it has made. Also, in April 2002, we recommended that FSA and the department develop and include clear goals, strategies, and measures to better

²U.S. General Accounting Office, *Student Financial Aid Information: Systems Architecture Needed to Improve Programs' Efficiency*, AIMD-97-122 (Washington, D.C.: July 29, 1997).

demonstrate its progress in implementing plans for integrating its financial aid systems in FSA's performance plans and subsequent performance reports.³

With respect to modernization plans, we reported in November 2001 that FSA selected a viable, industry-accepted means of integrating its existing data on student loans and grants.⁴ FSA has made progress in implementing this approach for its Common Origination and Disbursement process, which includes the implementation of a common record that institutions can use to submit student financial aid for Pell Grant and Direct Loan programs. The ultimate success of this process, however, hinges on addressing serious postimplementation operational problems and helping thousands of schools implement the common record. Further, as we reported in December 2002,⁵ FSA has not completed a number of elements that are important to managing any information technology investment. These include determining whether expected benefits are being achieved and tracking lessons learned related to schools' implementation of the common record. We have recommended that FSA develop metrics, baseline data, and a tracking process for certain benefits expected from the system, and that they develop and implement a process for capturing and disseminating lessons learned to schools that have not yet implemented the common record. FSA has begun to act on both of these issues.

³U.S. General Accounting Office, *Federal Student Aid: Additional Management Improvements Would Clarify Strategic Direction and Enhance Accountability*, GAO-02-255 (Washington, D.C.: April 30, 2002).

⁴U.S. General Accounting Office, *Student Financial Aid: Use of Middleware for Systems Integration Holds Promise*, GAO-02-7 (Washington, D.C.: Nov. 30, 2001).

⁵U.S. General Accounting Office, *Federal Student Aid: Progress in Integrating Pell Grant and Direct Loan Systems and Processes, but Critical Work Remains*, GAO-03-241 (Washington, D.C.: Dec. 31, 2002).

Education has also faced challenges in ensuring that information reported on student aid applications is correct and that adequate internal controls are in place to prevent improper payments of grants and loans. The department has taken steps, in two pilot programs with the Internal Revenue Service (IRS), to match income reported on student aid applications with federal tax returns.⁶ To continue this income match and implement it on a broader scale, legislation to allow the IRS to release the information is necessary. Education has worked with the Department of the Treasury and the Office of Management and Budget to ask that the Congress enact such legislation. The department also verifies income information by asking 30 percent of applicants to provide copies of their tax returns to their student financial aid offices. In addition to strengthening its controls over student aid applications, we found that Education also needed to address institutions that were disbursing grants to ineligible students.⁷ The department has taken steps to analyze student data to identify high concentrations of students over 65 and eligible noncitizens at individual institutions to determine whether problems exist that warrant further review. These actions are encouraging, and if properly implemented, should improve controls over these payments.

A continuing challenge for Education and FSA is preventing and collecting defaulted student loans. While the national student loan default rate has decreased from 11.6 percent in fiscal year 1993 to 5.9 percent in fiscal year 2000, the cumulative amount of

⁶U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Education*, GAO-01-245 (Washington, D.C.: Jan. 2001).

⁷U.S. General Accounting Office, *Education Financial Management: Weak Internal Controls Led to Instances of Fraud and Other Improper Payments*, GAO-02-406 (Washington, D.C.: Mar. 28, 2002).

defaulted student loans has increased by almost \$10 billion over the same period. Education and FSA have implemented several default management strategies, such as establishing electronic debiting as a repayment option, and working with some guaranty agencies to set up alternatives to service and process claims for defaulted loans. Our analysis of FSA's internal documents indicated that for fiscal years 2000 through 2002, FSA met or exceeded many of the goals related to these strategies. However, neither Congress nor the public can determine whether FSA's default management goals have been met because Education did not prepare performance reports that conform to the requirements in the Higher Education Act. FSA's report to Congress on its performance in fiscal years 2000 and 2001 was not timely nor did it indicate whether or not FSA met established performance goals. We have recommended that Education and FSA prepare and issue reports to Congress on FSA's performance that are timely and clearly identify whether performance goals were met.⁸

Like other federal agencies, Education must address serious human capital issues, such as succession planning, because about one-third of Education's workforce is eligible to retire. In June 2001, we recommended that the department develop human capital goals and measures for its performance plans.⁹ In April 2002, we recommended that the department and FSA coordinate closely to develop and implement a comprehensive human capital strategy.¹⁰ Education added a specific objective to its strategic plan, and in

⁸U.S. General Accounting Office, *Federal Student Aid: Timely Performance Plans and Reports Would Help Guide and Assess Achievement of Default Management Goals*, GAO-03-348 (Washington, D.C.: Feb. 14, 2003).

⁹U.S. General Accounting Office, *Department of Education: Status of Achieving Key Outcomes and Addressing Major Management Challenges*, GAO-01-827 (Washington, D.C.: June 29, 2001).

¹⁰GAO-02-255, 26.

2002, issued a comprehensive 5-year human capital plan that incorporates FSA. This plan outlines steps and time frames for improving human capital management and specifies four critical areas where improvements should be made: (1) top leadership commitment, (2) performance management, (3) workforce skills enhancement, and (4) leadership and succession planning. It will be important that Education focus continually on implementation of the plan to achieve results.

Now, Mr. Chairman, I would like to discuss Education's financial management challenges and the progress they have made in addressing them.

Financial Management

Weaknesses in Education's financial management and information systems have limited its ability to achieve one of its key goals—improving financial management to help build a high-performing agency. Significant progress towards this goal was made recently when Education received an unqualified—or “clean”—opinion on its financial statements. Prior to this, with the exception of 1997, Education had not received a clean opinion since its first agencywide audit in 1995. While this is an important milestone for the department, significant management weaknesses remain that must be addressed for Education to meet its goal in this area.

Beginning with the department's first agencywide audit in 1995, Education's auditors have repeatedly identified significant financial management weaknesses. These

weaknesses included Education's inability to provide the auditors with sufficient evidence to satisfy themselves about the accuracy or completeness of certain amounts included in the financial statements, including billions of dollars of adjustments to amounts reported in previous years' financial statements. According to Education's auditor, these adjustments were to correct "unnatural account balances" or otherwise adjust balances to the amount management's analysis supported. The auditor reported that in many cases, the cause of the incorrect balances could not be definitively determined, and the adjusting entry prepared by management was a reasoned judgment of how to correct its accounts. Education's auditors have also consistently reported major internal control weaknesses related to financial management systems and financial reporting. These weaknesses included (1) the absence of a fully integrated financial management system, (2) deficiencies in financial management practices that require extensive analysis of accounts to resolve errors through manual adjustments, (3) the lack of a rigorous review of interim financial data for timely identification and correction of errors, (4) the inability to accumulate, analyze, and present reliable financial information in the form of financial statements, (5) the dependence on a variety of stopgap measures to prepare financial statements, (6) the insufficiency of compensating controls, such as top-level reviews to address and to seek to compensate for systemic control weaknesses, and (7) the lack of a review to identify and quantify improper payments. Education's auditors also reported that internal controls needed strengthening in numerous areas relating to Education's investment of millions of dollars in property and equipment.

Education has taken actions over the last several years to improve its financial management and to address the weaknesses identified. For example, during 2001, Education's MIT developed specific actions to address issues raised in previous financial statement audits. According to a MIT report on its accomplishments, Education began performing certain critical reconciliations on a monthly basis and began preparing interim financial statements, which helped identify areas needing further study. Education also improved its internal controls over property and equipment, and its auditor did not report this area as a weakness in fiscal year 2002. In addition, according to Education's auditor, during fiscal year 2002, the department implemented a new general ledger software package and FSA implemented a new financial management system to support their management information reporting needs. The auditor also reported that the department implemented several processes during fiscal year 2002 to improve its financial management, including

- convening the Accounting Integrity Board, the Audit Steering Committee, and the Accounting Assurance Group to plan, implement and manage quality accounting change control;
- establishing the Financial Statement Committee and continuing the Financial Statement Preparation Team and other special task force teams all of which are designed to improve the financial statement processes; and
- developing and implementing reconciliation work plans, policies and procedures, specialized teams and regular management reviews of the final work products as well as management review for process improvement.

While Education has made progress in addressing many of its weaknesses, in fiscal year 2002, the auditors again reported that significant financial management issues continued to impair the department's ability to accumulate, analyze, and present reliable financial information. These problems, in part, resulted from inadequate internal controls over Education's financial management systems and financial reporting process. The auditor also reported that weaknesses in the department's ability to report accurate financial information on a timely basis were due to deficiencies in certain of the department's financial management practices, including inadequate reconciliations and account analysis early in fiscal year 2002. The auditor added that issues associated with the transition to a new financial management system in fiscal year 2002 also contributed to the department's difficulties in these areas. While the auditor reported that it noted improvements in the latter part of the fiscal year, it reported that it continues to believe that the department needs to place additional focus on reconciliation procedures, account analysis, and financial reporting. Until these issues are fully resolved, Education's ability to produce timely, accurate, and useful financial information for its managers and stakeholders will be greatly impeded. In addition, beginning with fiscal year 2004, Education and other major government agencies will be required to produce audited financial statements within 45 days after the end of the fiscal year compared to 120 days for fiscal years 2002 and 2003. Education will need to continue to focus strongly on resolution of its financial management deficiencies in order to be in a position to meet these new reporting deadlines.

As we testified before this Subcommittee in April 2002, we identified other internal control weaknesses that make Education vulnerable to improper payments and lost assets.¹¹ In our testimony and related report,¹² we stated that for May 1998 through September 2000, weak internal controls over the (1) grants and loan disbursement process failed to detect certain improper payments, (2) third party draft processes increased Education's vulnerability to improper payments, and (3) government purchase cards resulted in some fraudulent, improper, and questionable purchases. We also reported that Education lacked adequate internal controls over computers acquired with purchase cards and third party drafts. Among other things, we found that computer purchases valued at almost \$400,000 were not recorded in Education's property records, and \$200,000 of that computer equipment could not be located.

In response to our work, Education made several changes to its policies and procedures to improve internal controls and program integrity. These changes were a step in the right direction; but in many cases, our follow-up work indicated that they had not been effectively implemented. In March 2002, we reported that vulnerabilities remained in all areas we reviewed, except for third party drafts, which were discontinued altogether.¹³ For example, we reported that Education developed a new approval process for its purchase card program; however, our testing of 3 months of purchase card statements under the new process found that over 20 percent lacked proper support for the items purchased. In October 2002, Education told us that new policies and procedures were

¹¹U.S. General Accounting Office, *Education Financial Management: Weak Internal Controls Led to Instances of Fraud and Other Improper Payments*, GAO-02-513T (Washington, D.C.: April 10, 2002).

¹²GAO-02-406.

¹³GAO-02-406, 30.

implemented and aimed at reducing the department's vulnerability to future improper use of purchase cards. These new policies and procedures relate to reviewing and approving purchase card transactions and providing related training. Further, the department told us that misuse of purchase and travel cards is now specifically included in the department's Table of Penalties with the desired effect of reducing misuse and abuse of government issued credit cards. Education also told us that it recognizes that reviewing and improving internal controls is an ongoing task and that it intends to remain vigilant in this area. These are positive steps that should help reduce the instances of improper purchases.

Finally, Education will need to continue its actions in addressing weaknesses in its financial management information systems. The Federal Financial Management Improvement Act (FFMIA) of 1996 requires agencies to institute financial management systems that substantially comply with federal financial management systems requirements, applicable accounting standards, and the federal government's *Standard General Ledger*. Every year since FFMIA was enacted, Education's auditors have reported that Education's systems did not substantially comply with the act's requirements. In previous years, the auditors reported that without a fully integrated financial management system, deficiencies in the general ledger system, deficiencies in the manual adjustment process, and the need to strengthen other financial management controls such as reconciliation processes, collectively impair Education's ability to accumulate, analyze, and present reliable financial information. In addition, according to Education's auditor, although the department implemented a new financial management

system during fiscal year 2002, issues associated with the transition to the new system contributed to difficulties in providing reliable, timely information for managing current operations and timely reporting of financial information to central agencies; therefore, Education still did not substantially comply with FFMIA's requirements.

Education also needs to address identified computer security weaknesses in its financial management and other information systems. In September 2001, we reported that Education had made progress in correcting certain information system control weaknesses.¹⁴ At the same time, we identified weaknesses in Education's systems that place critical financial and sensitive grant information at risk of unauthorized access and disclosure, and key operations at risk of disruption. We recommended that Education correct certain information system control weaknesses and fully implement a comprehensive departmentwide computer security management program. In response, Education stated that it had developed a corrective action plan and is taking steps to further strengthen and develop a more comprehensive information security program. In addition, Education's auditor reported that for fiscal year 2002, the department made progress in strengthening controls over its information technology processes, but needs to continue efforts to develop, implement, and maintain an agencywide risk-based information security plan, programs, and practices to provide security throughout the life cycle of all systems.

¹⁴U.S. General Accounting Office, *Education Information Security: Improvements Made, but Control Weaknesses Remain*, GAO-01-1067 (Washington, D.C.: Sept. 12, 2001).

In closing, Chairman, I want to reiterate that Education is taking actions and making substantial progress in addressing major challenges related to its student aid programs and financial management. At the same time, some very difficult issues remain that must be resolved before Education is able to produce relevant, reliable, and timely information to efficiently and effectively manage the department and provide full accountability to its stakeholders.

Mr. Chairman, this concludes my statement. I would be happy to answer any questions you or other members of the Subcommittee may have.

Contact and Acknowledgments

For information about this statement, please contact Linda Calbom, Director, Financial Management and Assurance, at (202) 512-9508, or Robert Owens, Assistant Director, at (202) 512-8579. You may also reach them by E-mail at calboml@gao.gov or owensr@gao.gov. Individuals who made key contributions to this testimony include Lisa Crye and Diane Morris. Numerous other individuals made contributions to the work supporting this testimony.

(190091)

TABLE OF INDEXES

Chairman Hoekstra, 1, 5, 6, 9, 10, 12, 13, 14, 16, 18

Mr. Carter, 14, 19, 20

Mr. Hansen, 5, 6, 7, 9, 10, 11, 12, 13, 14

Mr. Hinojosa, 3, 10, 11, 12, 13, 18, 19

Mr. Porter, 13, 14, 20

Ms. Calbom, 16