FIXING THE FINANCIALS: FEATURING USDA AND EDUCATION

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT EFFICIENCY AND FINANCIAL MANAGEMENT

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

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FIXING THE FINANCIALS: FEATURING USDA AND EDUCATION

TUESDAY, JUNE 10, 2003

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT EFFICIENCY AND
FINANCIAL MANAGEMENT,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:05 p.m., in room 2154, Rayburn House Office Building, Hon. Todd Russell Platts (chairman of the subcommittee) presiding.

Present: Representatives Platts, Blackburn, and Towns.

Staff present: Mike Hettinger, staff director; Dan Daly, counsel; Larry Brady, Kara Galles, and Tabetha Mueller, professional staff members; Amy Laudeman, clerk; Mark Stephenson, minority professional staff member; Jean Gosa, minority assistant clerk; and Cecelia Morton, minority office manager.

Mr. PLATTS. Good afternoon. A quorum being present this hearing of the Subcommittee on Government Efficiency and Financial Management will come to order. Today the subcommittee brings before it two executive departments, the Department of Agriculture and the Department of Education who have demonstrated significant progress on improving their overall financial management. I would like to thank the chief financial officers of those departments who are before us today as well as the leadership at the departments for their efforts.

You are to be congratulated on achieving clean audit opinions on your financial statements for fiscal year 2002. While clean audit opinions are certainly a goal that each of the Chief Financial Officer Act agencies shares, there are many of us who believe that a clean financial audit tells only a small part of the story. All too often we hear stories of agencies that achieve clean opinions only through last minute heroic efforts or recreating their books at the end of the year. This is not what Congress intended under the CFO Act. Obtaining a clean audit opinion should be a by-product of good year round financial management and not just a test that agencies try to pass at the end of the fiscal year.

USDA and Education have implemented real changes designed to improve the overall management of their agencies, and as a consequence, were able to obtain clean audits. USDA achieved a clean opinion by focusing on improving internal controls and accountability. They have retooled business and accounting processes and placed greater emphasis on data integrity, internal controls and getting results from their programs. While USDA has made enormous strides in improving financial management, the Forest Service a component of the USDA remains on the GAO's high risk list.

Department of Education has also made great improvement on managing its finances. Education learned from suggestions that were made on the previous financial audits and implemented solutions that addressed those suggestions. They now produce financial statements on a quarterly basis and utilize strategic planning. In addition, the Department installed and updated a financial accounting system and coordinated a management and improvement team who seeks areas of opportunities to improve financial processes and data integrity. However, there are still internal control concerns, especially in the area of student loan programs, which also need to be addressed. Today, we look forward to hearing about the improvements that have been made at the USDA and the Department of Education, the lessons that can be learned from the successes at these two departments, and the plans each of these departments has to overcome their remaining financial management challenges.

[The prepared statement of Hon. Todd Russell Platts follows:]

ONE HUNDRED EIGHTH CONGRESS

Congress of the United States

House of Representatives

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Opening Statement
Congressman Todd R. Platts
June 10, 2003

Today the Subcommittee brings before it two executive departments, the Department of Agriculture and the Department of Education, who have both demonstrated significant progress on improving their overall financial management. I would like to thank the Chief Financial Officers of those departments, who are before us today, as well as the leadership at these two departments for their efforts. You are to be congratulated for achieving clean audit opinions on your financial statements for fiscal year 2002.

While a clean audit opinion is certainly a goal that each of the Chief Financial Officer (CFO) Act agencies shares, there are many of us in Congress who believe that a clean financial audit opinion tells only a small part of the story. All too often we hear stories of agencies that achieve clean opinions only through last minute heroic efforts, or recreating their books at the end of the year. This is not what Congress intended under the CFO Act. Obtaining a clean audit opinion should be a by-product of good year round financial management and not just a test that agencies try to pass at the end of the fiscal year.

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The Department of Education has also made great improvement on managing their finances. Education learned from suggestions that were made on their previous financial audits and implemented solutions that addressed those suggestions. They now produce financial statements on a quarterly basis and utilize strategic planning. In addition, they installed an updated financial accounting system and coordinated a management improvement team who seeks areas of opportunities to improve financial processes and data integrity. However, there are still internal control concerns, especially in the area of student loan programs, which need to be addressed.

Today, we look forward to hearing about the improvements that have been made at the USDA and Department of Education, the lessons that can be learned from the successes at these two departments, and the plans each of them has to overcome their remaining financial management challenges.

Joining us today are The Honorable Ted McPherson, Chief Financial Officer at the Department of Agriculture and a native of Gettysburg in Pennsylvania's 19^{th} Congressional District; followed by The Honorable Jack Martin, Chief Financial Officer at the Department of Education; and Mr. McCoy Williams and Ms. Linda Calbom, Directors of Financial Management and Assurance at the General Accounting Office who will testify about financial management issues at the Departments of Agriculture and Education respectively. Thank you for coming and we look forward to your testimonies.

Mr. PLATTS. Joining us here today are Ted McPherson, Chief Financial Officer at the Department of Agriculture. And as I was pleased to disclose, first time you are before us, native of the 19th Congressional District, and glad to have you with us again. Followed by Jack Martin, Chief Financial Officer at the Department of Education, and Mr. McCoy Williams and Linda Calbom, Directors of Financial Management and Assurance at the General Accounting Office, who will testify about the financial management issues at the Department of Agriculture and Education, respectively. Nice to have both of you with us again as well. Appreciate all of you for coming and we look forward to your testimonies. Now yield to the ranking member, the gentleman from New York, Mr. Towns, for the purpose of making an opening statement.

Mr. TOWNS. Thank you very much Mr. Chairman. Let me thank you, Mr. Chairman, for holding this hearing today. In April, we began this series of hearings with the look at the consolidated financial statement of the United States. Today we will hear testimony regarding the Department of Agriculture and Education. Both agencies received clean audit opinions on their fiscal year 2002 financial statements for the first time in many years. And I want to congratulate Mr. Martin and Mr. McPherson for their efforts and also their staff. You have achieved an important milestone.

However, as I am sure all of our witnesses would agree, much work still remains to be done. Internal controls and financial management system weaknesses remain at the Department of Education that impede the agency's ability to produce timely and accurate financial information. Education also continues to make billions of dollars of adjustments to previous years financial statements for which auditors cannot identify a definite cause. Despite significant improvements, student financial aid at the Department of Education, which makes more than $50 billion a year in grants and loans, continue to be rated a high risk area by the General Accounting Office.

USDA faces problems with—similar to Education with internal controls and financial management systems, which have led some to question whether achievement of receiving a clean audit opinion can be repeated. With resources this year of 123 billion in assets and a budget of 72 billion, resolving the problem is critical. The Department of Agriculture and several of its bureaus and agencies have had longstanding and very complex financial management problems. While there is still clearly much more to be done, the Department has made some significant improvements and progress seems to be continuing.

Perhaps most important, the Department's transition from its outdated inadequate accounting system to the new foundation financial information system is complete and should go a long way toward addressing some of the Department's problems. Of particular concern at USDA is the Forest Service, which has been designated as high risk by GAO since 1999. I look forward to hearing from our witnesses about the progress that has been made and what steps we need to take to overcome the remaining barriers to sound financial management at USDA and Education. Thank you, Mr. Chairman. And again, let me thank you for holding this hearing. I think it's very timely. I yield back.

Mr. PLATTS. Thank you, Mr. Towns, we will now proceed to our witnesses and would ask that each witness and anyone who might be advising them during their testimonies to stand and raise their right hands and take the oath together, and then we will proceed to your testimony.

[Witnesses sworn.]

Mr. PLATTS. The clerk will note that all witnesses affirmed the oath and we will proceed directly to the testimony.

Mr. McPherson, starting with you, followed by Mr. Martin, Mr. Williams and Ms. Calbom. We appreciate the testimonies you presented to us ahead of time in writing. And we use 5 minutes as a rough gauge. With a more intimate setting here with the ranking member and myself, we're not going to stick to that 5 minutes, but if we can use that as a guideline that would be great.

Mr. McPherson if you would like to begin.

STATEMENTS OF EDWARD McPHERSON, CHIEF FINANCIAL OFFICER, DEPARTMENT OF AGRICULTURE; JACK MARTIN, CHIEF FINANCIAL OFFICER, DEPARTMENT OF EDUCATION; McCOY WILLIAMS, DIRECTOR OF FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GENERAL ACCOUNTING OFFICE; AND LINDA CALBOM, DIRECTOR OF FINANCIAL MANAGEMENT AND ASSURANCE, U.S. GENERAL ACCOUNTING OFFICE

Mr. MCPHERSON. Mr. Chairman and members of the subcommittee, thank you for the opportunity to continue to work together on improving financial management in the Federal Government. My written testimony details the valuable results we have produced in implementing sufficient internal control and data integrity to achieve the first clean audit opinion at the Department of Agriculture during fiscal year 2002. Rehabilitation of this environment is a continuing process of massive change, not an event. You have asked me to describe today the management changes we made that, in turn, resulted in USDA's first unqualified opinion on its financial statements.

George Bernard Shaw, the British playwright, believed great innovation starts with an unreasonable person. Four principles guide our unreasonableness in leading valuable change at USDA. First, we focus on real results by setting clear goals and achieving tangible value. For example, while improving internal controls leading to the first clean audit at USDA, we increased the referral rate on $364 million of loans eligible for Treasury cross-servicing to 96 percent from 14 percent the prior year. That one change alone results in as much as $300 million more each year of cash collections returned to the U.S. Treasury each year for the foreseeable future.

Second, we behave as owners in taking full responsibility to complete any task. Laser-like clarity of individual accountability or ownership is key to unlocking the natural strengths of bureaucracies. By substituting the behavior of owners in USDA's culture, we have created a bias to action for producing results, resourcefully using existing levels of funding and career civil servant staffing. Third, we operate at a constructively aggressive pace. Speed is important and usually contributes to better outcomes. To cut the time required to execute, I immediately inserted three hand-picked individuals with controller skills and one person with an outstanding background in information technology as catalysts. Each of these people understands internal control, data integrity, business processes and application of information technology. Perhaps most important, each of these individuals is interpersonally astute and knows how to make change by substituting successes for rhetoric.

Simultaneously, I injected a team of a dozen carefully selected practitioners, not consultants, in an intense assignment to perform deferred work that had accumulated over several previous years, such as clearing 6 million unreconciled cash items totaling several billion dollars and accounting for $10 billion of real and personal property. Fourth, we value leadership and talent individual excellence and collective success are attributes of most successful teams and talent will outperform methodology in many turn-around situations. Specifically, leadership and talent achieved 17 accounting systems conversions on time and within budget for all USDA agencies.

Leaders in challenging settings such as this are simply purveyors of hope, and hope becomes realty measured by how many other associates in an enterprise are recognized for significant achievements. This week, 18 career civil service leaders from my Office of the Chief Financial Officer and USDA agency Chief Financial Officers, are receiving the Secretary of Agriculture's Plow Award, as in many people are glad to harvest, few are willing to plow, the top recognition for employees of USDA.

Recently I had the pleasure of recognizing 600 associates throughout USDA and at the National Financial Center each individually for their valuable work in regard to financial management. One of our associates, Jesse King, is receiving the National Achievement of the Year Award from the Association of Government Accountants for the value he has added in controllership and accounting operations. So people are the only source of a sustainable competitive advantage and I believe in people, especially unreasonable people.

Thank you for the opportunity to work together. I look forward to listening carefully to what is important to each of you and participating in our discussion today.

Mr. PLATTS. Thank you, Mr. McPherson.

[The prepared statement of Mr. McPherson follows:]

STATEMENT OF

EDWARD R. MCPHERSON

CHIEF FINANCIAL OFFICER

UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SUBCOMMITTEE ON GOVERNMENT EFFICIENCY AND

FINANCIAL MANAGEMENT

OF THE

HOUSE COMMITTEE ON GOVERNMENT REFORM

TESTIMONY ON

IMPROVEMENTS MADE BY FEDERAL AGENCIES

IN FINANCIAL MANAGEMENT

June 10, 2003

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to continue to work together on improving financial management in the Federal Government.

My remarks today focus on the two elements specified in your invitation to me to testify today. First, I will describe briefly the valuable results we have achieved at the Department of Agriculture (USDA). Second, I will offer insights for your consideration about the management changes we made that in turn resulted in USDA's first unqualified audit opinion of its financial statements.

I. Valuable Financial Management Results at the Department of Agriculture

As context, at the Department of Agriculture I am responsible for the financial leadership of an enterprise which, were it in the private sector, would be one of the largest companies in the United States. With \$72 billion in annual spending, 112, 705 full time equivalent staff years, and \$123 billion in assets, the Department of Agriculture is exceeded generally in size in the private sector by only four companies – General Motors, Ford, Exxon and Wal-Mart – so we are roughly equivalent in size and diversity to lines of business like General Electric or Citigroup.

George Bernard Shaw, the British playwright, believed great innovation starts with an unreasonable person. USDA was fortunate to have such people at the Agriculture Department when I started in October 2001. The result these unreasonable people sought was to have sufficient internal control and data integrity to achieve the first clean, or unqualified, audit opinion ever at Agriculture. In every year since audits began to be conducted in 1991, the Office of the Inspector General was unable to express any opinion on Agriculture's financial statements because the value of assets, liabilities, budgetary resources, net costs and related items could not be determined. This outcome on an audit is termed a disclaimer. There are four categories of opinions expressed on financial audits – unqualified (clean), qualified, disclaimer, or adverse.

In short, Agriculture, one of the largest enterprises in America, had never produced timely financial statements free of significant errors or misstatements in its entire 140-year history. Just over a year later, in December 2002, Agriculture and all its agencies for the first time received a clean audit opinion from the Office of the Inspector General for fiscal year 2002. This valuable breakthrough was achieved using existing taxpayer funding by skilled career government executives and dedicated associates already in place. All that was needed was a little unreasonableness.

The results that culminated in achieving the goal of sufficient internal control and data integrity to receive a clean audit opinion, included:

- Revamping business, financial management and accounting processes and completing installation of a standard general accounting system requiring 17 major conversions.
- Determining the program cost or present-value cash flows of $100 billion in loans.
- Reconciling accurately and in a timely manner more than $100 billion in annual cash receipts and disbursements in 393 Treasury accounts.
- Intensely and effectively transforming the Forest Service's financial management activities.
- Correcting accounting deficiencies on $10 billion of real and personal property.
- Implementing a unified corporate controller organization that integrates

accountability for financial management processes and systems throughout the Department of Agriculture.

So, one can see massive changes are required to produce real results.

This work is on-going – improvements are a continuous process, not an event. There is always the prospect of unforeseen challenges and additional barriers to overcome.

Once rudimentary foundations are in place, even higher value comes from better management information and decision-making, more informed allocation of resources (as in President Bush's Management Agenda Budget and Performance Integration Initiative), and clearer accountability.

In addition, we also seek more cost-effective financial management and accounting operations over time as processes are further re-engineered and information technology is renovated and integrated.

II. <u>Insights On Management Changes We Made Resulting In USDA's First Unqualified Audit Opinion of Financial Statements.</u>

Four principles guide our actions to create valuable breakthroughs involving massive change. One, we focus on real results - while sound process is important, we are relentless in achieving tangible results. Two, we behave as owners in taking full responsibility to complete any task . Three, we operate at a constructively aggressive pace. Speed is important and usually contributes to better outcomes. Four, we value leadership and talent – individual excellence and collective success are attributes of most successful teams, and talent will out-perform methodology in many "turnaround" situations. Bureaucracies produce results with leaders who instill laser-like clarity of ownership, or individual accountability, and create change by substituting a value of success in place of rhetoric or business as usual. Immediate modest successes are fabulous substitutes for existing poor practices and give everybody something positive to talk about over the weekend. Leaders who challenge existing settings are simply purveyors of hope. Ultimately, people are the only source of a sustainable competitive advantage—and I believe in people.

Particularly effective in this instance are the leadership and talent of my partners at the Department of Agriculture, including Patricia Healy, deputy chief financial officer; Jesse King, corporate controller; Wendy Snow, associate chief financial officer, financial systems; Joe Marshall, associate chief financial officer, financial policy and planning; John Brewer, associate chief financial officer, financial operations; Jerry Lohfink, acting director, National Finance Center; and numerous outstanding branch managers and associates in our Controller Operations Division in New Orleans.

We all have received excellent support from Secretary Ann Veneman, Agriculture's subcabinet officials, agency administrators and their related finance, accounting and budget staffs, as well as personnel in the Office of the Inspector General. All these "unreasonable" people decided to have sufficient internal control and data integrity to receive the first clean audit opinion on behalf of the American taxpayer as part of President Bush's Management Agenda.

Mr. PLATTS. Mr. Martin.

Mr. MARTIN. Mr. Chairman and members of the subcommittee good afternoon. I would like to thank you for the opportunity to discuss the Department's improvements in financial management which resulted in the Department's first unqualified audit opinion of its financial statements in many years. 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. The Department of Education, Inspector General's Office and the General Accounting Office, had identified hundreds of problems that needed immediate attention before the Department could receive a clean audit. Secretary Paige 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 the Department is keeping 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. Earlier this year, Deputy Secretary Bill Hansen testified before the Subcommittee on Select Education, Committee on Education in the Workforce to discuss the Department's significant progress toward overcoming our management challenges.

While many challenges remain, we are proud of the progress we have made. From a financial management perspective, the Department of Education is a complex Federal agency. We have a high number of separate appropriations, over 200 to manage, consolidate and account for. We maintain the smallest number of FTE's while managing the third largest discretionary budget of cabinet level agencies. We must also manage multiple program types, such as Federal Family Education Loans and William D. Ford Direct Student Loans, revolving funds, grants and trust funds. Pell and direct loans have very complex accounting mandates under the Federal Credit Reform Act of 1990.

One of the most significant audit issues the Department addresses each year involves FFEL and Direct Loan program cost estimates. The Department's financial statements include cost estimates of total loans outstanding for these programs and anticipated losses stemming from loan defaults, discharges and other costs. Taken together, these programs involve a $280 billion portfolio and 22 million borrowers, making the Department one of the largest lenders and guarantors in the world.

Consistent with the Federal Credit Reform Act, cost estimates for these programs reflect the net present value of Federal cost associated with all projected future cash-flows, disbursements, repayments, interest, defaults, subsidy payments to loan holders and others for loans originated in each given fiscal year. We base program cost estimates on a complex set of econometric assumptions regarding interest rates and borrower behavior, given the size and complexity of these estimates as well as periodic fluctuations in the underlying variables, the Department's auditors devoted a significant portion of time reviewing the estimates and estimation process. I worked with auditors and the Department received its first clean opinion since 1997.

We also improved our financial management by setting out to accomplish three short-term and six long-term goals set by Secretary Paige shortly after he took office. 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. Long-term goals were to obtain a clean audit opinion. Establish effective internal controls that addressed 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.

Specific steps the Department took to reach the Secretary's objectives were: first, we updated our organization structure. My appointment as Chief Financial Officer gave the Department its first CFO in 3 years. We more clearly defined the roles and responsibilities of CFO management. And we made a concerted effort to recruit and retain talented accountants and financial management personnel. We also worked more cooperatively with the Office of Federal Student Aid CFO, who temporarily reported directly to the Department CFO, and the Department's Budget Service. Leadership from all three organizations ensured that the Department achieved its financial reporting objectives. We improved management of the audit process.

The Department has improved its audit and management process through implementation of several initiatives. A key initiative which significantly enhanced quality control was the creation of a single point of contact to manage the audit process. We replaced our financial systems. Last year the Department replaced its financial accounting system with the Oracle Federal financials. This new system enhances financial integrity by providing more timely, accurate and reliable financial information for managing the Department's programs. Education is the first Cabinet level agency to successfully implement Oracle Federal Financials department-wide. Under the new system, the Department produced financial statements directly from the accounting system for the first time and now continues to produce these financial statements on a monthly basis.

We strengthened reconciliation efforts. The Department performed reconciliations on a regular basis with regard to fund balances with Treasury; feeder systems to the general ledger; budgetary to proprietary accounts, accounts payable and related disbursements in transit; suspense accounts; and accounts receivable/ guaranty agency reserves. The Department benefited from having additional reviews of these reconciliations to improve the accuracy, completeness, and timeliness of the reconciliations. We improved monitoring and tracking of confirmed grant and guaranty agency data. The Department benefited from independent confirmations of financial data from grant recipients at the award level such as available funds, obligations and cash drawdowns, and FFEL loan receivable balances at the guaranty agency level. The Department completed GA loan portfolio reconciliations for the first time in a number of years. These two confirmation efforts helped ensure that the Department's and our partner's records were in balance. We performed ongoing reviews of the core financial aid eligibility system we call the National Student Loan Data System. The Department continued its ongoing efforts to review the accuracy of data in the National Student Loan Data System. NSLDS is a data base that includes loan level data for all student loans, 22 million.

The No. 1 priority of the Department of Education is to help educate children and close the achievement gaps so no child is left behind. Maintaining our financial management and integrity will help us create the culture of accountability necessary to ensure this priority is met. I believe you will find that our efforts over the last 2 years demonstrate our commitment to making the Department of Education a model agency of financial management excellence and to maintaining the level of effort it took to achieve our first unqualified opinion since 1997.

One of the 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 this goal as well. I would be happy to answer any questions you may have. Thank you for your attention.

Mr. PLATTS. Thank you, Mr. Martin.

[The prepared statement of Mr. Martin follows:]

Testimony of Jack Martin
Chief Financial Officer, U.S. Department of Education
before the
Subcommittee on Government Efficiency and Financial Management
Committee on Government Reform
U. S. House of Representatives
June 10, 2003

Mr. Chairman and Members of the Subcommittee:

I would like to thank you for the opportunity to discuss the Department's improvements in financial management, which resulted in the Department's first unqualified audit opinion of its financial statements in many years.

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. The Department of Education Inspector General's Office and the General Accounting Office had identified hundreds of problems that needed immediate attention before the Department could receive a "clean" audit.

Secretary Paige 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 is keeping 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.

Earlier this year, Deputy Secretary William Hansen testified before the Subcommittee on Select Education, Committee on Education and the Workforce, to discuss the Department's significant progress toward overcoming our management challenges. While many challenges remain, we are proud of the progress we have made.

From a financial management perspective, the Department of Education is a complex Federal agency. We have a higher number of separate appropriations, over 200, to manage, consolidate, and account for. We maintain the smallest number of FTEs while managing the third largest discretionary budget of Cabinet-level agencies. We must also manage multiple program types, such as Federal Family Education Loans (FFEL) and William D. Ford Direct Student Loans (DL), revolving funds, grants and trust funds. FFEL and DL have very complex accounting mandates under the Federal Credit Reform Act of 1990 (FCRA).

One of the most significant audit issues the Department addresses each year involves FFEL and DL program cost estimates. The Department's financial statements include cost estimates of total loans outstanding for these programs and anticipated losses stemming from loan defaults, discharges, and other costs. Taken together, these programs involve a $280 billion portfolio and 22 million borrowers, making the Department one of the largest lenders and guarantors in the world. Consistent with FCRA, cost estimates for these programs reflect the net present value of Federal costs associated with all projected future cash flows – disbursements, repayments, interest, defaults, subsidy payments to loan holders, and others – for loans originated in a given fiscal year. We base program cost estimates on a complex set of econometric assumptions regarding interest rates and borrower behavior. Given the size and complexity of these estimates, as well as periodic fluctuations in the underlying variables, the Department's auditors devoted a significant portion of time reviewing the estimates and estimation process.

Our work with the auditors paid off, and the Department received its first clean opinion since 1997. We also improved our financial management by setting out to accomplish three short-term and six long-term goals set by Secretary Paige shortly after he took office.

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.

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.

To meet Secretary Paige's short-term and long-term goals and infuse accountability into all aspects of our work, the Department:

<u>Assembled a Task Force of Career Leaders</u>

- Created a temporary Management Improvement Team to look at management issues across the Department; and

- Subsequently made the Management Improvement Team a permanent part of the Department's structure within the Office of the Deputy Secretary.

Sought the Advice of External Advisors
- The Council for Excellence in Government helped identify management challenges; and
- The Private Sector Council and National Academy of Public Administration helped identify solutions to management problems.

Established a Culture of Accountability
- Established a *Culture of Accountability* team who 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;
- Provided training to our managers on how to develop performance standards; and
- Tied 100% of our performance agreements to our *Strategic Plan* Goals and Objectives.

Measured Progress
- Created 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;
- Created the Executive Management Team (EMT) who work 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
- Meet weekly with the EMT, which consists of the Deputy Secretary, the Assistant Secretary for Management, the General Counsel, the Chief Information Officer, the Director for Budget Service, the Chief Operating Officer of Federal Student Aid and me. 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.

Specific steps the Department took to reach the Secretary's objectives were:

Updated our Organizational Structure – My appointment as CFO gave the Department its first CFO in three years. The Department more clearly defined the roles and responsibilities of OCFO's senior management, and made a concerted effort to recruit and retain talented accountants and financial management personnel. We also worked more cooperatively with the Office of Federal Student Aid's CFO and the Department's Budget Service. Leaders from all three organizations ensured that the Department achieved its financial reporting objectives.

Improved Management of the Audit Process – The Department has improved its audit management process through implementation of several initiatives. A key initiative, which significantly enhanced quality control, was the creation of a single point of contact to manage the audit process. The person designated by management is responsible for ensuring the clarity of the auditors' requests, consolidating data for the audit, and providing requested information to the auditors.

Another initiative was the Department's implementation of the following committee and subcommittees to focus on the audit's scope and the quality of information provided to the auditors:

- The Audit Steering Committee ensures that OCFO management is fully informed on critical audit issues. The Committee performs full and comprehensive reviews of information gathered by staff, and develops unified action steps based on sound decision-making practices.
- The Financial Statement Subcommittee and the Accounting Integrity Board are subcommittees of the Audit Steering Committee that convene weekly to discuss and analyze issues, and develop resolutions that are brought before the full committee for final determination.

Replaced our Financial Systems – Last year, the Department replaced its financial accounting system with Oracle Federal Financials. This new system enhances financial integrity by providing more timely, accurate and reliable financial information for managing the Department's programs. Education is the first cabinet level agency to successfully implement Oracle Federal Financials department-wide. Under the new system, the Department produced financial statements directly from the accounting system for the first time and now continues to produce these financial statements on a monthly basis.

To ensure that the Oracle system produced timely and accurate financial statements, the Department hired a CPA firm to conduct extensive pre- and post-production validation work. Immediately following conversion to the new systems, the CPA firm began work on a two-phase post-production validation (PPV) engagement to ascertain that the actual general ledger postings in the production system agreed with the expected results.

In addition, the firm tested the five financial statement reports to ensure that they were calculated and summarized correctly at all organizational levels. As a result of this work, the auditor determined that the Department's standard accounting transactions are now fully compliant with federal accounting standards. The Department's independent auditor confirmed this finding in its January 2003 report.

The Department has developed and implemented a plan for upgrading the Oracle Federal Financials Accounting system to the vendor's latest version, 11i. The plan allows the Department to both keep current with the vendor's software releases and, more importantly, to take advantage of the many improvements and fixes the vendor has placed in the new release.

In addition to the new general ledger, the Department implemented major upgrades to the Grants Administration and Payments System (GAPS) and the Contract & Purchasing Support System (CPSS). We also implemented a new travel management system called Travel Manager and a new note receivable package system called Nortridge.

Prepared Interim Financial Statements – The Department prepared interim financial statements to help identify potential problem areas as well as to provide programmatic information. The Department exceeded the Office of Management and Budget's (OMB) requirement for mid-year statements. The Department produced all five statements mid-year, and submitted four of them to OMB, one more than the three that were required. While quarterly statements are a new OMB requirement, for internal management purposes, the Department has implemented monthly financial statements and monthly management reporting protocols. The reporting protocols include grant and loan statistics, as well as other performance-based metrics. These reports will allow the Department to better integrate critical financial data into short- and long-term business decisions.

Strengthened Reconciliation Efforts – The Department performed reconciliations on a regular basis with regard to: (a) Fund Balances with Treasury; (b) feeder systems to the General Ledger; (c) budgetary to proprietary accounts; (d) accounts payable and related disbursements-in-transit; (e) suspense accounts; and (f) accounts receivable/guaranty agency reserves. The Department benefited from having additional reviews of these reconciliations to improve the accuracy, completeness and timeliness of the reconciliations.

Improved Monitoring and Tracking of Confirmed Grant and Guaranty Agency Data – The Department benefited from independent confirmations of financial data from grant recipients at the award level (such as available funds, obligations, and cash drawdowns) and FFEL loan receivable balances at the Guaranty Agency (GA) level. The Department completed GA loan portfolio reconciliations for the first time in a number of years. These two confirmation efforts helped ensure that the Department's and our partners' records were in balance.

Performed Ongoing Reviews of the Core Financial Aid Eligibility System (National Student Loan Data System) – The Department continued its ongoing efforts to review the accuracy of data in the National Student Loan Data System (NSLDS). NSLDS is a database that includes loan-level data for all student loans. The data are received from many entities that participate in the loan programs, such as guaranty agencies and institutions of higher education. Data from NSLDS are used as the basis for determining the loan liability in the financial statements. The Department also uses data from NSLDS to provide information for management analysis and decisions. Because the accuracy and completeness of NSLDS data are important for making informed decisions, efforts were focused on ensuring that NSLDS continues to be a complete and reliable source of information.

Improved Internal Controls – The Department took numerous steps to improve its internal controls. For instance, the Department:

- Issued a revised set of policies and procedures for purchase cards, which OMB has referenced as a "best practice," and urged other agencies to consider implementing;
- Issued a revised set of policies and procedures for travel cards that includes a more specific outline of penalties associated with misuse;
- Eliminated the use of third party drafts;
- Established specific annual targets for the reduction and/or elimination of erroneous payments;
- Created a new inventory system to track physical property;
- Required all employees to take on-line internal control training and information technology security training, and required all managers to attend a full day training session on internal controls, and;
- Implemented procedures to identify potential duplicate payments in grant programs and in Direct Loan programs.

In addition to these steps, the Department continues to work to resolve the material weaknesses reported under the Federal Managers' Financial Integrity Act (FMFIA). The Department is currently evaluating the progress made in implementing corrective actions and anticipates closing two material weaknesses (FSA Data Quality and Foreign School Recertification) and one material non-conformance (FFEL Systems) by the end of the third quarter of FY 2003. That would leave Information Technology Security as the only remaining material weakness. The Department is diligently working to implement corrective actions to improve Information Technology Security and anticipates downgrading it to no longer material by the end of FY 2003. These efforts are being monitored at the highest levels in the Department, including the Executive Management Team.

Resolved Problems with Monitoring and Accounting for Fixed Assets – The Department completed a comprehensive physical inventory count of all fixed assets, including furniture and fixtures. An independent review of the inventory results was performed to ensure that the process provided a complete and reliable inventory and to assess the significance of any issues identified as a part of conducting the inventory. Further, the Department will systematically conduct these reviews every year.

Implemented Corrective Action Plans – The Department developed and implemented corrective action plans (CAPs) for outstanding items from the FY 2001 financial statement audit. We also submitted the CAPs for the FY 2002 audit recommendations to our Office of Inspector General (OIG). In April 2001, there were 661 open recommendations from audits issued by GAO and the Department's OIG. As of June 2003, the Department closed all but 22 of these 661 recommendations. Additional recommendations continue to be made by GAO and OIG in this ongoing process, of course, but of the 661 original and 438 new management-related recommendations, the Department currently has 175 open recommendations that are contained in 56 audit reports. Of these 175, only 10 are from financial statement audits from the Department's independent auditors. The Department is working to ensure that it implements these remaining recommendations in a timely and efficient manner.

I am also proud to report that OMB 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 (PMA). We anticipate that our plans for management reform will result in continued status score improvements in all areas of the PMA. For the Second Quarter of FY 2003, the Department was awarded yellow for "status" scores on two of the government-wide initiatives (Human Capital and E-Government), and on both of the Department's program-specific initiatives. This represents an improvement over the First Quarter FY 2003 PMA Scorecard.

By achieving each of the short- and long-term goals set by the Secretary, we can focus on our overarching responsibilities for restoring the confidence of Congress and the public and making sure no money that ought to be spent on improving the education of American children is wasted.

The Department received its first clean audit opinion in five years due to the steps outlined above, in addition to the hard work and dedication of its staff. 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, under a plan based on meeting the new accelerated schedule requirements one year early; and
- Earn a clean opinion from our financial statement auditors for FY 2003.

The number one priority for the Department of Education is to help schools educate children and close the achievement gap so no child is left behind. Maintaining our financial management integrity will help us create the culture of accountability necessary to ensure this priority is met.

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 financial management excellence, and to maintaining the level of effort it took to achieve our first unqualified opinion since FY 1997. One of the 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.

Mr. PLATTS. Mr. Williams.

Mr. WILLIAMS. Mr. Chairman and members of the subcommittee, I am pleased to be here today to discuss the major financial management challenges faced by the U.S. Department of Agriculture, its progress in addressing them and challenges that remain. As you know, in January we issued our performance and accountability series on management challenges and program risks at major agencies, including USDA. The report for USDA focused on a number of major management challenges including enhancing financial management and continued the high risk designation for Forest Service financial management. For many years, USDA struggled to improve its financial management activities, but inadequate accounting systems and related procedures and controls hampered its ability to get a clean opinion on its financial statements. After 8 consecutive years of not being able to render an opinion, USDA's Office of Inspector General issued an unqualified, or clean opinion, on USDA's fiscal year 2002 financial statements reporting that significant progress had been made in improving overall financial management. To achieve this unqualified opinion, USDA made progress in its financial accounting and reporting in areas such as estimating its food stamp program receivables and improving its implementation of the Federal Credit Reform Act of 1990. Also, the Forest Service received its first-ever unqualified opinion on its fiscal year 2002 financial statements, which represents noteworthy progress from prior years when the OIG was unable to express an opinion.

To achieve this unqualified opinion, the Forest Service's top management dedicated considerable resources and focused staff efforts to address accounting and reporting deficiencies that had prevented a favorable opinion in the past. For example, during fiscal year 2002, the Forest Service formed a reconciliation strike team to resolve longstanding real and personal property accounting deficiencies. While we considered obtaining a clean opinion, a positive step, USDA and the Forest Service need to continue their efforts to address material internal control weaknesses that still exist. For example, USDA and the Forest Service need to continue to address the problems with their legacy systems to improve integration of the financial management architecture, make timely reconciliation of their property systems with the general ledger, and correct inconsistencies in their accounting processes.

As provided in the President's management agenda and by the Joint Financial Management Improvement Program principles, obtaining financial accountability goes far beyond an unqualified opinion on financial statements and includes measures such as financial management systems that routinely provide timely, reliable and useful financial information and no material internal control weaknesses or material noncompliance with laws and regulations and Federal financial management improvement act of 1996 requirements.

In closing, Mr. Chairman, I want to emphasize that USDA has made significant progress in addressing this major challenge relating to financial management and continues to do so. At the same time, before USDA is able to achieve and sustain financial accountability and produce relevant, reliable and timely information to effectively manage the Department, it and its component agencies, particularly the Forest Service, must resolve some very difficult issues. This concludes my statement and I would be happy to answer any questions that you or members of the committee may have.

Mr. PLATTS. Thank you, Mr. Williams.

[The prepared statement of Mr. Williams follows:]

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives

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DEPARTMENT OF AGRICULTURE

Status of Efforts to Address Major Financial Management Challenges

Statement of McCoy Williams
Director, Financial Management and Assurance

GAO
Accountability * Integrity * Reliability

GAO-03-871T

June 10, 2003

DEPARTMENT OF AGRICULTURE

Status of Efforts to Address Major Financial Management Challenges

GAO
Accountability·Integrity·Reliability

Highlights

Highlights of GAO-03-871T, a report to the Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives

Why GAO Did This Study

In its 2003 performance and accountability report on the Department of Agriculture (USDA), GAO identified challenges in, among other areas, USDA and Forest Service financial management. The information GAO presents in this testimony is intended to assist the Congress in assessing USDA'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 financial management challenges.

www.gao.gov/cgi-bin/getrpt?GAO-03-871T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact McCoy Williams at (202) 512-6906 or williamsm1@gao.gov.

What GAO Found

For many years, USDA struggled to improve its financial management activities, but inadequate accounting systems and related procedures and controls hampered its ability to get a clean opinion on its financial statements. After eight consecutive disclaimers, USDA's Office of Inspector General (OIG) issued an unqualified opinion on USDA's fiscal year 2002 financial statements, reporting that significant progress had been made in improving overall financial management. The Forest Service received its first-ever unqualified opinion on its fiscal year 2002 financial statements, which represents noteworthy progress from prior years when the OIG was unable to express an opinion.

To achieve its unqualified opinion, USDA made progress in its financial accounting and reporting in areas such as estimating its Food Stamp program receivables and markedly improved its implementation of the Federal Credit Reform Act of 1990. The Forest Service's top management dedicated considerable resources and focused staff efforts to address accounting and reporting deficiencies that had prevented a favorable opinion in the past.

While we consider obtaining a clean opinion a positive step, USDA and the Forest Service need to continue their efforts to address material internal control weaknesses that still exist. As provided in the President's Management Agenda and by the Joint Financial Management Improvement Program Principals, obtaining financial accountability goes far beyond an unqualified opinion on financial statements and includes measures such as financial management systems that routinely provide timely, reliable, and useful financial information and no material internal control weaknesses or material noncompliance with laws and regulations and Federal Financial Management Improvement Act of 1996 requirements. Therefore, before USDA and the Forest Service can achieve and sustain financial accountability, they must address a number of serious problems that USDA's OIG or we have reported.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the major financial management challenges faced by the U.S. Department of Agriculture (USDA), its progress in addressing them, and challenges that remain.

As you know, in January we issued our Performance and Accountability Series on management challenges and program risks at major agencies, including USDA.[1] The report for USDA focused on a number of major management challenges, including enhancing financial management, and continued the high risk designation for Forest Service financial management.

For many years, USDA struggled to improve its financial management activities, but inadequate accounting systems and related procedures and controls hampered its ability to get a clean opinion on its financial statements. After eight consecutive disclaimers of opinion,[2] USDA's Office of Inspector General issued an unqualified opinion on USDA's fiscal year 2002 financial statements and reported that significant progress had been made in improving overall financial management. For each of USDA's agencies that prepared separate financial statements for fiscal year 2002, the audit opinions were also positive. Specifically, unqualified audit opinions were issued on the financial statements of the Forest Service, Federal Crop Insurance Corporation/Risk Management Agency, Commodity Credit Corporation, the Rural Development mission area, and the Rural Telephone Bank. While we consider these clean opinions a positive step, some of these could not have been rendered without extraordinary efforts by the department and its auditors. Achieving financial accountability will require more than heroic efforts to obtain year-end numbers for financial statement purposes. Without reliable financial systems and sound internal controls, it is not possible to have sound data on a timely basis for decision making. Before USDA can achieve and sustain financial accountability, and thus be in a position to have reliable system-generated data as needed, it and its component

[1] U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of Agriculture*, GAO-03-96 (Washington, D.C.: January 2003).

[2] A disclaimer of opinion means that the auditor is unable to form an opinion on the financial statements. A disclaimer results when a pervasive material uncertainty exists or there is a significant restriction on the scope of the audit.

agencies, particularly the Forest Service, must address a number of serious problems that USDA's OIG or we have reported.

Today I will focus my testimony on USDA's efforts to improve its financial management and the Forest Service's progress toward achieving financial accountability.

USDA's Financial Management

In the past, USDA had several persistent weaknesses in internal control and in accounting and financial reporting that contributed to the OIG's inability to render an opinion on the department's consolidated financial statements. The OIG reported, among other things, that USDA was unable to:

- provide sufficient, competent evidential matter to support numerous material line items on its financial statements including accounts receivable, fund balance with the Department of the Treasury (Treasury),[3] and property, plant, and equipment; and
- estimate and reestimate loan subsidy costs for its net credit program receivables, rendering it unable to implement the Federal Credit Reform Act of 1990 and related accounting standards.[4]

The OIG also identified internal control weaknesses over USDA's security controls for information technology and financial management systems that do not always process and report departmentwide financial information accurately. Further, the OIG reported that many USDA financial management systems are not fully integrated with other USDA systems. These are some of the factors that required extraordinary effort to derive reliable financial information. Further, we reported in December

[3] USDA records its budget authority in asset accounts called Fund Balance with the Department of the Treasury and increases or decreases these accounts as it collects or disburses funds.

[4] *Accounting for Direct Loans and Loan Guarantees*, Statement of Federal Financial Accounting Standards (SFFAS) No. 2, as amended by *Amendments to Accounting Standards for Direct Loans and Loan Guarantees*, SFFAS No. 18.

2001 that USDA had not yet fully implemented certain key provisions of the Debt Collection Improvement Act (DCIA) of 1996.[5]

I will now elaborate on USDA's progress in correcting these problems and what challenges still remain.

USDA has taken actions over the last several years to improve its financial management and to address the weaknesses identified by its OIG and us. For example, in fiscal year 2000, Food and Nutrition Service was, for the first time, able to estimate its gross accounts receivable and related estimate of uncollectible amounts resulting from over-issued benefits in its Food Stamp Program. Further, for the first time since credit reform reporting requirements were implemented in 1994, USDA's lending agencies were able to estimate and reestimate loan subsidy costs for the department's net credit program receivables, which totaled about $74 billion as of September 30, 2001. Because of USDA's achievement in this area, along with that of other key lending agencies, this item was no longer a factor contributing to our disclaimer of opinion on the financial statements of the U.S. government.[6]

The OIG also noted that USDA made significant progress during fiscal year 2002 in reconciling its Fund Balance accounts with Treasury's accounts, thus enabling the OIG to validate this line item on USDA's fiscal year 2002 financial statements. However, the OIG continued to report this area as a material internal control weakness in fiscal year 2002 due to continuing deficiencies in USDA's reconciliation processes. For example, USDA had a large backlog of unreconciled items that needed to be researched and resolved. As a result, USDA adjusted its records to agree with the Treasury without reconciling the differences. Over $180 million (net) of year-end adjustments were not supported by transaction-level details.

[5] U.S. General Accounting Office, *Debt Collection Improvement Act of 1996: Department of Agriculture Faces Challenges Implementing Certain Key Provisions*, GAO-02-277T (Washington, D.C.: Dec. 5, 2001).

[6] U.S. General Accounting Office, *U.S. Government Financial Statements: FY2001 Results Highlight the Continuing Need to Accelerate Federal Financial Management Reform*, GAO-02-599T (Washington, D.C.: Apr. 9, 2002) and U.S. General Accounting Office, *Fiscal Year 2002 U.S. Government Financial Statements: Sustained Leadership and Oversight Needed for Effective Implementation of Financial Management Reform*, GAO-03-572T (Washington, D.C.: Apr. 8, 2003).

Further, USDA will need to continue its actions in addressing weaknesses in its financial management information systems. In its fiscal year 2002 audit report, the OIG stated that USDA made significant improvements in its overall financial management, such as implementation of a departmentwide standard accounting system, the Foundation Financial Information System (FFIS). At the same time, USDA must fundamentally improve its underlying internal controls, financial management systems, and operations to allow for the routine production of accurate, relevant, and timely data to support program management and accountability. Specifically, the Federal Financial Management Improvement Act (FFMIA) of 1996 requires agencies to institute financial management systems that substantially comply with federal financial systems requirements, applicable federal accounting standards, and the federal government's *Standard General Ledger* (SGL). Every year since FFMIA was enacted, the OIG has reported that USDA's systems did not substantially comply with the act's requirements. The OIG reported that the lack of compliance stems from USDA's many disparate accounting systems that are not integrated; material internal control weaknesses; and, as explained earlier, the inability to prepare auditable financial statements on a routine basis. For example, USDA and its agencies operate at least 80 program and administrative systems that support financial management. The longstanding problems associated with these legacy systems were caused, primarily, by the absence of corporate level oversight and planning when these systems were initially developed and upgraded. USDA needs to continue to address the problems with its legacy systems to improve integration of the financial management architecture, timely reconcile its property system with the general ledger, and correct inconsistencies in its accounting processes.

Additionally, the OIG continued to report that USDA's systems are not designed to provide the reliable and timely cost information required to comply with Statement of Federal Financial Accounting Standards No. 4, Managerial Cost Accounting Concepts and Standards. Specifically, the OIG's review of user fees disclosed that two USDA agencies were not including the full costs of their user fee programs when determining fees and thus, were not recovering the full costs of performing services for their individual programs.

Under the President's Management Agenda for improved financial management performance, agencies are expected to improve the timeliness, enhance the usefulness, and ensure the reliability of financial information. The expected result is integrated financial and performance management systems that routinely produce information that is (1) timely, to measure and effect performance immediately, (2) useful, to make more informed operational and investing decisions, and (3) reliable, to ensure consistent and comparable trend analysis over time and to facilitate better performance measurement and decision making. This result is key to successfully achieving the goals set out by the Congress in the Chief Financial Officers Act and other federal financial management reform legislation.

In addition, the Joint Financial Management Improvement Program (JFMIP) Principals have defined success measures for financial management performance that go far beyond an unqualified audit opinion on financial statements and include measures such as financial management systems that routinely provide timely, reliable, and useful financial information and no material internal control weaknesses or material noncompliance with laws and regulations and FFMIA requirements.[7] They also significantly accelerated financial statement reporting to improve timeliness for decision making and to discourage costly efforts designed to obtain unqualified opinions on financial statements without addressing underlying systems challenges.

The OIG reported that the Office of the Chief Financial Officer has developed plans to review USDA's legacy systems, and consolidate and update the systems to meet present accounting standards and management needs. Further, USDA's September 30, 2002, FFMIA Remediation Plan discussed a number of remedial actions that the department expects to complete by the end of fiscal year 2006.

Another financial management challenge for USDA is federal nontax delinquent debt collection. USDA reported holding $6.9 billion of federal nontax debt that was delinquent more than 180 days as of September 30, 2002. The Debt Collection Improvement Act of 1996 (DCIA) gave federal agencies a full array of tools to collect such delinquent debt. Among other things, DCIA provides (1) a requirement for federal agencies to refer eligible debts delinquent more than 180 days to the Department of the Treasury for collection action, and (2) authorization for agencies to administratively garnish the wages of delinquent debtors.

[7] FFMIA requires auditors, as part of CFO Act agencies' financial statement audits, to report whether agencies' financial management systems substantially comply with (1) federal financial management systems requirements, (2) applicable federal accounting standards (U.S. generally accepted accounting principles), and (3) federal government's SGL at the transaction level.

In December 2001, we reported that two USDA agencies, Rural Development's Rural Housing Service (RHS) and the Farm Service Agency (FSA) had failed to make DCIA a priority since its enactment in 1996.[8] Specifically, RHS had not implemented an effective and complete process to refer debts to Treasury mainly because of systems limitations, debt reporting problems, and lack of regulations needed to refer losses resulting from claims paid under its guaranteed single family housing loan program. FSA lacked effective procedures and controls to identify and promptly refer eligible delinquent debts to Treasury. Moreover, USDA had not utilized administrative wage garnishment to collect delinquent nontax debts. Consequently, opportunities for maximizing the collection of delinquent nontax debts as contemplated by DCIA were being missed.

USDA officials made a commitment in December 2001 to substantially improve the department's implementation of DCIA by December 2002. In November 2002, we testified that USDA had made progress in addressing previously identified problems.[9] For example, RHS began referring all reported eligible debt to Treasury. Further, FSA had developed an action plan to improve its process and controls for identifying and referring eligible debts to Treasury. However, at the date of our testimony, challenges remained that will require sustained commitment and priority from top management. For example, RHS still had to complete regulations to refer losses related to its guaranteed single family housing loans to Treasury and an automated process for such referrals, and FSA needed to complete actions needed to ensure that all of its eligible debt is promptly referred to Treasury. In addition, USDA needed to complete regulations that are required to implement administrative wage garnishment department wide and get all of its component agencies to begin using this debt collection tool to the fullest extent practicable. The OIG reported material noncompliance with the DCIA in its fiscal year 2002 financial statement audit report, reiterating the need for sustained commitment and priority by top management.

Now I would like to discuss the progress that the Forest Service has made toward achieving financial accountability and remaining challenges.

[8] U.S. General Accounting Office, *Debt Collection Improvement Act of 1996: Department of Agriculture Faces Challenges Implementing Certain Key Provisions*, GAO-02-277T (Washington, D.C.: Dec. 5, 2001).

[9] U.S. General Accounting Office, *Debt Collection: Agriculture Making Progress in Addressing Key Challenges*, GAO-03-202T (Washington, D.C.: Nov. 13, 2002).

Forest Service Financial Management

An area of particular concern within USDA continues to be the Forest Service. Historically, the Forest Service's financial management systems have not generated timely and accurate financial information for its annual audit and for effectively managing operations, monitoring revenue and spending levels, and making informed decisions about future funding needs for its program. In addition, the Forest Service has had long-standing material weaknesses with regard to its two major assets—fund balance with Treasury and property, plant, and equipment. In 1999, we first designated financial management at the Forest Service to be "high risk" on the basis of serious financial and accounting weaknesses that had been identified, but not corrected, in the agency's financial statements for a number of years.

The Forest Service received its first-ever unqualified opinion on its fiscal year 2002 financial statements, which represents noteworthy progress from prior years when the OIG was unable to express an opinion. To achieve its unqualified opinion, the Forest Service's top management dedicated considerable resources and focused staff efforts to address accounting and reporting deficiencies that had prevented a favorable opinion in the past. For example, during fiscal year 2002 the Forest Service formed a reconciliation strike team to resolve long-standing real and personal property accounting deficiencies. The property, plant, and equipment reconciliation team analyzed transaction data to identify inaccurate records and reconciled the general ledger to its supporting detailed records. In addition, the strike team, in cooperation with the USDA Office of the Chief Financial Officer, the USDA OIG, and consultants, worked to ensure that property documentation supported property records, inventories were complete, and property was valued correctly. Further, the team worked with USDA on modifications and enhancements to certain property feeder systems. Because the Forest Service property comprises 80 percent of the $4.2 billion line item on USDA's financial statements, the OIG was able to validate this number for its fiscal year 2002 opinion.

However, material deficiencies in the controls related to the accurate recording of property, plant, and equipment transactions remain. For example, the financial statement auditor reported instances in which recorded amounts did not agree with supporting documentation and inappropriate payroll expenses were included in property values instead of being recorded as expenses, resulting in an overstatement of property and an understatement of expenses. Further, the Forest Service did not have effective controls over the initial recording of acquisition costs, in-service date, and useful life of property items. Because the Forest Service did not require reviews of data input for property transactions by a supervisor, another independent person, or by automated system edit checks within property systems, certain property items were not recorded properly.

While the Forest Service made significant progress in fiscal year 2002 to reconcile its fund balance with Treasury accounts, the financial statement auditor noted significant control deficiencies in its reconciliation processes. For example, the Forest Service needs to research a large backlog of unreconciled items and take corrective actions. In order to bring the Forest Service's fund balance with Treasury accounts into balance with Treasury records as of September 30, 2002, the Forest Service recorded an adjustment of $107 million.

Although the Forest Service reached an important milestone by attaining a clean audit opinion on its financial statements, it has not yet proven it can sustain this outcome, and it has not reached the end goal, as envisioned by the President's Management Agenda for improved financial management and the JFMIP Principals, of routinely having timely, accurate, and useful financial information. The Forest Service continues to commit considerable resources to correcting its financial management weaknesses; however, much work remains. In our January 2003 high-risk update, we again designated financial management at the Forest Service as "high risk" on the basis of its serious internal control weaknesses.[10]

In closing, Mr. Chairman, I want to emphasize that USDA has made significant progress in addressing its major challenges related to financial management and continues to do so. At the same time, before USDA is able to sustain financial accountability and produce relevant, reliable, and timely information to effectively manage the department, it and its component agencies, particularly the Forest Service, must resolve some very difficult issues.

This concludes my statement. I would be happy to answer any questions you or other members of the subcommittee may have.

[10] U.S. General Accounting Office, *High-Risk Series: An Update*, GAO-03-119 (Washington D.C.: January 2003).

Contact and Acknowledgments

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Mr. PLATTS. Ms. Calbom.

Ms. CALBOM. Thank you, Mr. Chairman, Mr. Towns. As Mr. Williams just mentioned this January GAO issued our performance and accountability series which included the Department of Education as well as Agriculture and others. The report for Education focused on a number of management challenges, and as you were mentioning, 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 first Education's efforts to reduce fraud, waste, abuse and mismanagement in its student aid programs; and second, to improve its financial management to help build a high-performing agency.

As Mr. Martin outlined, 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 Education has made significant progress similar to Agriculture, internal control and system weaknesses remain in both the student aid program and with financial management overall that will require continued commitment and vigilance on the part of Education's management to resolve.

In the student aid program, education has faced challenges in four areas. The first continuing challenge relates to systems integration issues. 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. However, the Department still needs to complete development of an institutional blueprint for how it will carry out these activities. And this is commonly called an enterprise architecture. This is really key to ensuring that you have consistent system design and compatibility across the organization. The second challenge has been reducing fraud and error in student aid application and disbursement processes.

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 legislation needed to implement these efforts on a broader scale. The third continuing challenge is minimizing and collecting defaulted student loans. Education has made great strides in this area but needs to communicate its progress by issuing timely and complete performance reports to the Congress. And finally like other Federal agencies, education must address serious human capital issues. In 2002, the Department issued a comprehensive 5-year capital human plan that outlines steps and timeframes for improving human capital management. It will be an important that education focus continuously on implementation of the plan to achieve results.

I would now like to turn more specifically to financial management challenges. Weaknesses in Education'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 toward this goal was recently made when Education received an unqualified opinion on its financial statements.

And as many of us have already discussed today while this is an important milestone for the Department, significant internal control and system weaknesses remain that must be addressed for Education to meet the end goal of timely, relevant, reliable information to manage the agency on a day to day basis. Education has taken many actions over the last several years to improve its financial management and address the weaknesses identified in previous financial statement audits. Education's auditors recently reported that they have put in place several new processes during fiscal year 2002 to improve financial management and that a new general ledger system was installed. These are key steps in achieving the ultimate end goal.

However the auditors 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 the overall financial reporting process. This will be especially critical when beginning with fiscal year 2004, Education and other major agencies will be required to produce their audited financial statements within 45 days after the fiscal year compared to the 120 days currently.

In closing, Mr. Chairman, I would like to commend Education management for their dedication and persistence in addressing major challenges relating to the student aid programs and financial management. I would also like to encourage them to remain steadfast in their efforts to reach their end goal of producing timely, relevant, reliable information to efficiently and effectively manage the agency and provide full accountability to stakeholders. That concludes my statement, Mr. Chairman.

[The prepared statement of Ms. Calbom follows:]

United States General Accounting Office

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Testimony

Before the Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives

For Release on Delivery
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DEPARTMENT OF EDUCATION

Status of Efforts to Address Major Management Challenges

Statement of Linda Calbom
Director, Financial Management and Assurance

GAO
Accountability * Integrity * Reliability

GAO-03-872T

June 10, 2003

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Highlights

Highlights of GAO-03-872T, a testimony before the Subcommittee on Government Efficiency and Financial Management, Committee on Government Reform, House of Representatives

Why GAO Did This Study

In its 2003 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.

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

DEPARTMENT OF EDUCATION

Status of Efforts to Address 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 earlier this year 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

[a]Auditors 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.
[b]These requirements became effective for fiscal year 1997.

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.

Student Aid Programs

Ensuring access to postsecondary education while reducing vulnerability of student financial 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

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

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. As part of our review of the progress federal agencies have made to effectively develop, implement, and maintain their enterprise architectures, we are currently evaluating the management of Education's enterprise architecture efforts.

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.[3] 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 data 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,[4] FSA has not completed a number of elements that are important for 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 it develop and implement a process for capturing and disseminating lessons learned to schools that have not yet implemented the common record. FSA has begun acting on both of these issues.

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

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[2]U.S. General Accounting Office, *Student Financial Aid Information: Systems Architecture Needed to Improve Programs' Efficiency*, AIMD-97-122 (Washington, D.C.: July 29, 1997).
[3]U.S. General Accounting Office, *Student Financial Aid: Use of Middleware for Systems Integration Holds Promise*, GAO-02-7 (Washington, D.C.: Nov. 30, 2001).
[4]U.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).

applications with federal tax returns.[5] To continue this income match and implement it on a broader scale, legislation to allow 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 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.[6] The department has taken steps to analyze student data to identify high concentrations of students over age 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 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.[7] FSA's report to Congress on its performance in fiscal years 2000 and 2001 was not timely nor did it indicate whether 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

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[5]U.S. General Accounting Office, *Major Management Challenges and Program Risks: Department of* Education, GAO-01-245 (Washington, D.C.: Jan. 2001).
[6] U.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).
[7]The requirements are in the amendments to the Higher Education Act that established FSA as a performance-based organization. Pub. L. No. 105-244, Title I, § 101(a), 112 Stat. 1581, 1604-1610 (1998).
[8]U.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).
[9]U.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).

human capital strategy.[10] Education added a specific objective to its strategic plan, and in 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 Education has 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 earlier this year 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 try to compensate for systemic control weaknesses, and (7) the lack of a review to identify and quantify improper payments. Education's auditors

[10] U.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).

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 monthly 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 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; regular management reviews of the final work products; and management review for process improvement.

While Education has made progress in addressing many of its weaknesses, in fiscal year 2002, the auditor 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 focus more 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. According to Education's *Fiscal Year 2004 Annual Plan*, the department plans to implement this accelerated reporting date for its fiscal year 2003 financial statements—a year earlier than required. This action will be a good "test" of Education's new financial system and other financial management reforms.

As we testified before the Subcommittee on Select Education 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 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 *U.S. Government 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

[11] U.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.: Apr. 10, 2002).
[12] GAO-02-406.
[13] GAO-02-406, 30.

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.

In closing, Mr. 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 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.

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

Contact and Acknowledgments

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(190097)

Mr. PLATTS. Thank each of you for your testimonies and we will proceed to questions. Again, we'll use 5 minutes as a rough framework for the three of us who are here today. I guess Mr. McPherson and Mr. Martin, in reading your testimony, Mr. McPherson, yours was focused more on the personnel and kind of empowering the personnel to take the lead and I quote, "the unreasonable individual or person to get the job done." Mr. Martin, your testimony was on the personnel, but also more on the structural changes, internal changes. And we are certainly grateful for all of our public servants who are doing their best to serve the public. Given that the clean audit was the first in your 140-year history at the Department of Agriculture, and just the second for the Department of Education and the first clean audit in 5 years, what is your comfort level that the changes you have made will result in, say, 3 years from now if not all different personnel, but different personnel are there that the structural changes, internal controls, data integrity that we will have a continuation of a clean audit history and not be talking about once again, the first one in another 3 years or another one in 5 years, your comfort level that your changes are going to result in truly clean audits?

Mr. MCPHERSON. There are several factors that give me comfort in that regard. One, all except one of my direct reports are career civil servants so that leadership operating with the principles that we have implemented will sustain itself. Second, we have made progress in depth, meaning it is not a mile wide and an inch deep. We have changed business processes. We have changed to a common computing system by converting 17 agencies. We have reorganized the National Financial Center into lines of business with one separate line of business called the Controller Operations Divisions dedicated for the first time solely to performing work for the USDA agencies. So I think those rudimentary but fundamental changes are of a sustaining nature. We have not just gone for quick hits, but where we have made changes, we have done it so the process sustains itself.

Mr. MARTIN. We at the Department are currently producing very accurate monthly financial statements from our Oracle system. We push a button and we generate statements monthly. I think this system will permit us to continue as far as we can see into the future to be able to produce accurate financial statements. We also have revised and improved our reconciliation and account analysis procedures. We have numerous working groups in place that address specific account groups. So we think we have the structures in place for us to continue improving our reconciliation processes going into the future. And we have a very strong and committed staff of career civil servants. I believe that they are as serious about all of our changes and improvements as the political employees are.

So I am very confident that the Department of Education will be able to obtain clean opinions this year on an accelerated basis, and going forward in future years.

Mr. PLATTS. I hope we are accurate in those statements and I do commend you on the tremendous improvements you have made and your personal commitments to continuing that effort, and that it's not just for this year or next year, but a long-term change in the mentality that we don't go another 140 years without a clean audit. The OMB issued some new guidelines in May regarding a number of the issues under the President's Management Agenda, including financial management guidelines. And if both of you could comment on these new guidelines and how you think they'll impact you and what you are doing or perhaps not because you are already on track to fulfill these new guidelines?

Mr. MARTIN. I support the initiative. It gives us a deadline on which to focus the numerous actions on which we're already working; the accelerated November 15 deadline for audited statements; resolution of auditor identified integrity act; material weaknesses and internal control, particularly the material weakness related to IT security. We believe many actions will be successfully completed prior to the July 1, 2004 target date, for example, the foreign school recertification material weakness and the material data quality weakness and we are making a lot of strides in IT security.

Mr. MCPHERSON. I support the standards that have been set. We had already set a goal of reducing material weaknesses by 50 percent this year and eliminating them by 2004. We have adopted 1 year early the November 14 date for our Performance and Accountability Report. We have turned in quarterly statements in fiscal year 2003 in accordance with the OMB guidelines, in fact, a week or two early. So we seem to be on track for meeting the standards, all of which are very valuable and legitimate standards.

Mr. PLATTS. I now yield to the ranking member, Mr. Towns for the purpose of questions.

Mr. TOWNS. Thank you, Mr. Chairman. To you, Mr. McPherson, the Forest Service is an agency which was singled out by the GAO as needing significant improvements. In fact, it has been on GAO's high risk for the last 4 years. What are the root causes of the problems that the Forest Service has? Does senior management at these agencies give financial management a great enough priority or are the accounting systems inherently worse? Do they face structural or programmatic problems. What is really going on over there?

Mr. MCPHERSON. Congressman, my observations since coming on board, the root causes are the following: One, a lot of deferred work, meaning work that simply had not been performed in previous years, manifesting itself in a number of unreconciled cash items or not having performed current physical inventories on the property. That work was performed in 2002 to get current. The other things you mentioned, we have had excellent support from the leadership of the Forest Service starting with Under Secretary Mark Ray and the Chief of the Forest Service, Dale Bosworth, as my business partners in addressing these issues forthrightly and realistically.

You mentioned systems and systems are a root cause. Forest Service had converted to this standard general accounting system a few years ago. The remaining work relates to feeder systems and feeder systems involving the management of property, for example. So that is a remaining area of attention, the subsystems or the feeder systems that support accounting operations. Finally in the area of financial management, because the Forest Service is a decentralized organization with 32,000 employees in some 600 units in the field, we are looking for ways to concentrate knowledge, skill and process to take the excitement out of some of the accounting for Forest Service to make it simpler and to reduce some of the complexity.

I'll give you a specific. When I came aboard, Forest Service had 620 million account records, and I assure you there is no enterprise in the United States that has that many accounting records. Half of those are in a data warehouse, half of them are in the general accounting system. And it has to do with cost allocation and tracking of costs, and it is just an inordinate amount of complexity that does not bring with it additional value and accountability. So we have worked with the Forest Service to take out some of the unnecessary complexity. So those are some of the items.

Mr. TOWNS. You know I am trying to figure out and don't think I am not happy about it. I want you to know that I'm happy that you are able to accomplish this, but I am not sure as to how you did it. Did you use consultants or hire some new folks? Did they wake up—I mean the people that were there? I am trying to figure out how did you get to this point. I want you to know that I am happy you are there.

Mr. MCPHERSON. I appreciate both your happiness and your support. I started with helping people to believe it was possible. The first Forest Service meeting I had was with their leadership group in October 2001 shortly after I came aboard just prior to September 11 at the Shoreham Hotel over here. And I set the goal of sufficient internal and data integrity to get a clean audit in Forest Service for the year 2002.

The technical work really was taking their business processes that related to their financials, that is how do they reconcile cash, how do they maintain the accounting on property and reengineered those processes and perform work that had not been performed previously to bring them current. Along the way we reinforced that with the proper organizational structure and the proper staffing particularly at home office here in Washington, the central headquarters. There is work that needs to be done in the field in that regard. So, it really was being effective and being bold in the changes because what was there was not working properly and so we had to change it.

Mr. TOWNS. My time has expired. Thank you.

Mr. PLATTS. I would like to recognize the vice chair of the subcommittee, the gentlelady from Tennessee, Mrs. Blackburn.

Mrs. BLACKBURN. Thank you all for being here. I know Mr. Williams and Ms. Calbom have been with us before, and we appreciate that you come back and that you take the time to come before us. I have a series of questions that I want to ask, and Mr. McPherson and Mr. Martin, I am going to start with you and if we could kind of move these back and forth I would appreciate it.

First of all looking at FFMIA, does it really matter and do you see it as a help or a hindrance when you are choosing Federal management systems. And Mr. McPherson and Mr. Martin, if each of you would answer that.

Mr. MCPHERSON. I think it's helpful. I am not sure any document or one set of standards is a driver. I think the experience of people who have worked with accounting processes and chosen systems and implemented systems is as important. But I think it's helpful in setting common expectations but it by itself does not cause change.

Mr. MARTIN. I believe that FFMIA does indeed matter. It serves as a driver for agencies to become compliant with the U.S. Standard General Ledger and Federal accounting standards. It also sets high standards for systems security and integration. The Joint Financial Management Improvement Program testing establishes a floor for financial systems operability. However a JFMIP certificate does not convey compliance with FFMIA. It does however mean that the system has the ability, if configured and integrated correctly, to become FFMIA compliant.

For example, the standard general ledger chart of accounts, an agency's specific pro forma accounting entries, must be established in a new system by an agency. The collating structure established in the system must also enable staff to perform reconciliations of agencies specific feeder systems. The system must be able to handle data transformations and other types of summarizations. Reporting should be keyed off the general ledger and be produced with the push of a button. This often requires an agency to design complex report mappings that tie appropriations to statement line items. And this is especially true for the statement of net costs, which is tied to strategic initiatives that are agency specific.

Mrs. BLACKBURN. Thank you. Mr. Williams and Ms. Calbom, what immediate steps should USDA and Education take to be in compliance with FFMIA. What, in your opinion, are the immediate steps that they need to take? Mr. Williams.

Mr. WILLIAMS. I think Ted has hit on that point about the systems, subsystems, the feeder systems that the agency is in the process of reengineering, replacing, upgrading, etc. I think once the agency gets control or gets a handle on that particular control weakness then it will be headed in the right direction to address some of the weaknesses and noncompliance issues that the IGs reported in the past as far as the Act of 1996.

Ms. CALBOM. Education put in a new financial management system in 2002, the Oracle system, and it is designed to be compliant with FFMIA. The problem for fiscal year 2002 that was reported by the auditors really had a lot to do with some of the system's implementation issues and those kind of cascaded into other things, into reconciliations and some other problems. So hopefully, if the system is up and running, as it is supposed to be now, then we should see an improvement in that area once we go through the next financial statement audit for 2003.

Mrs. BLACKBURN. Now how extensive do you think the needed management reforms are? Do they need to go through all the field offices with this or is everything pretty much headquartered here and then what do you think the compliance will end up costing?

Ms. CALBOM. I would have no idea of the cost of the compliance. I think you are still talking about just FFMIA compliance? I think we are talking about really getting over some of the glitches that were experienced in implementing a new system. So the system is already in place, it is up and running, so hopefully if the glitches are cleaned up then you know they will be in compliance. But time will tell and the next audit will tell.

Mrs. BLACKBURN. Mr. Williams, same for you.

Mr. WILLIAMS. It's going to be a process in which, as stated earlier, if they get these systems in place, the agency did not get in this position overnight. It's going to take some time. I think USDA has got a strategic plan which lays out over the years what it intends to do to address the problems. And once it is implemented and those systems are modified, upgraded, etc., they should be able to be in compliance. Now what that will cost and whether the current timeframe that the agency's laid out is reasonable, only time will tell. I think the office has put procedures in place where they can go back and revisit the plan to make sure we are on track and people are being held accountable for various steps along the way. And as they go through that process, time will tell the success and getting compliant.

Mrs. BLACKBURN. And you do not have an estimation of what you think the time on the cost would be.

Mr. WILLIAMS. There's a plan that the office has put together, a remediation plan that calls for being in compliance by the year 2006. That is the current document. But what it will cost, I could not say at the current time.

Mrs. BLACKBURN. Thank you, sir. May I continue? Thank you, Mr. Chairman? The other thing, Mr. Williams and Ms. Calbom, I will come back to you on this, if the timeline and the benchmarks are not met, do you think it proper be appropriate to have a penalty in place, some type of penalty format for these—for the accountabilities, the stated accountabilities not being met or either with the dollars budgeted to bring this into compliance, if it is overbudgeted, there should be some penalties that are enacted there.

Ms. CALBOM. We haven't really assessed that issue and I wouldn't want to comment on that since we really haven't done any kind of a study to determine what the potential benefit of that type of a procedure would be.

Mrs. BLACKBURN. Mr. Williams.

Mr. WILLIAMS. I would like to focus more on the phrase of the word "accountability." I think we need to hold people accountable for what they are supposed to be doing in their jobs. But as Ms. Calbom said, as far as the penalty, we have not done an assessment to determine if there should be certain penalties for not meeting certain dates but there should definitely be some accountability.

Mrs. BLACKBURN. Mr. Chairman, just as I thought through this process as we go through this, I think that you know we hear repeatedly of—and I commend the departments and all involved for having time lines and for having stated goals, but I think it may be worth our efforts to look at possibly what would be a method for some penalties for not meeting accountability standards or time lines or projects that run on and continue to go over budget year after year and see if there is something that in so doing, if we can help these departments and these individuals who are managing through these situations to meet those time lines, and some way to incentivize that process.

Mr. PLATTS. I think what we're all after is that at the end of the day is having accountability, and how best to achieve it. I think within the administration, there certainly is that focus in how they are establishing their annual budget request and accountability and what they are requesting. And that certainly, at the end of the day, hits each of the departments. If you are not meeting timeframes and goals set that may be reflected in what the White House sends over and asks for your departments and how much faith you want to continue to have in putting additional dollars in the programs if you are not meeting what you have established as your ultimate goals.

Certainly, Ms. Blackburn, it is something that we are glad to continue to look at as a subcommittee and with your staff. Coming back when I asked earlier about where we are today and the focus with both departments and the structural changes and the employees being invigorated to achieve the clean audits, I would be curious in asking Mr. McPherson and Mr. Martin's their opinions that 3, 4 years from now, we will still see clean opinions based on changes we made for each of you and from GAO's perspective.

Your comment, Mr. Williams, is time will tell. As we sit here today, do you think the changes we have in place truly are going to have long-term lasting results, or are we going to continue to see the need for the heroic efforts?

Mr. WILLIAMS. Well, let me start with a concept that I like to talk about, and that is in developing internal control standards. We talk about setting the tone at the top and I think that is what Mr. McPherson has done. He set the tone at the top, that we will address these weaknesses, we will correct these problems. And I believe that if you look at some of the things that he has done and some of the things that he has underway—I will give you an example when the effort first started, USDA established having strike teams to address some of the these reconciliation issues, etc.

And if you look at that particular process, one of the things that we at GAO observed is that when the teams identify a problem in a particular area, rather than just correcting those specifically identified problems, the teams drilled down and tried to identify what are the root causes for this particular problem. And once you identify what the root causes of the problems are, then you put corrective actions and you correct those root causes, then you have set the stage for that problem not to occur again in the future. So I think things like that, if they continue with these types of projects and exercises, then things will be set in place so that regardless of who's at the top that the effort to achieve financial accountability should continue.

Mr. PLATTS. Ms. Calbom.

Ms. CALBOM. And I would agree with all those things. You know, one of the real key things is the systems, and frankly, the Federal Government, most agencies have been handicapped over the years because they have outdated systems that don't really do what they are expected to do, and that is to produce financial statements.

So it was kind of like putting together a patchwork of systems to try to prepare financial statements, and as I said it was just a handicap to begin with. Now with new systems being put in place that are designed to produce financial statements and the type of financial information that really is needed to manage, that is a tremendous hurdle that agencies like Education now have gotten over. But it's not just systems, though. You have to have processes and people too. You have to have the reconciliation processes in place. You have to have qualified people to do the work, and as Mr. Williams was saying, you've got to have the people at the top. You've got to have very, very senior management that is willing to put the resources into doing these kinds of processes and procedures on a consistent, systematic basis. Otherwise it can all fall apart again very easily.

Mr. PLATTS. Thank you.

Mr. McPherson, in getting to a specific example of using technology to have more accurate information and in this case deal with improper payments in 2002, the Department met the goal regarding the Food Stamps Program of now having 89 percent of the electronic transfer occur. My understanding, that has a huge benefit in the sense of eliminating wrongful payments.

My question actually was being at 89 percent, is there an ultimate goal to get to 98, 99? If not, what is the greatest hurdle to getting as close to 100 percent as possible so that there is less chance of inappropriate payments being made?

Mr. MCPHERSON. We expect the percentage to go up. The reason it should go up is that there are four entities that have not converted to electronic benefits, California being the largest. California is in the process of rolling out that system, implementing it. And then we also have Delaware and Iowa and Guam to go. So the percentage ought to go up, and you're absolutely correct, it is a major effective tool in reducing erroneous payments.

Mr. PLATTS. Taking that history with the food stamps and looking at the School Meals Program, my understanding is that there have been pilot programs to use similar type approaches with school meals. Could you give us some background in where we stand on those pilots and what have we learned from them and how we can maybe use that same knowledge from the Food Stamp Program with the School Meals Program?

Mr. MCPHERSON. There are some pilots going on in the school meals electronic commodity ordering system, which is a Web-based ordering—order control system, that I think over 50 agencies around the United States have—are piloting. So it is going well. I think it's too early to say the full results of all of that. But just a general statement. The more electronic controls, the checks and balances are better on all these sorts of delivery of cash. So it really has to do with the productivity of cash in any of these programs. So we expect that area to be fruitful as well. And as you may know, Under Secretary Eric Bost has had some good experience in this regard at the State level and has done a good job in regard to this work through the Department of Agriculture.

Mr. PLATTS. Thank you, Mr. McPherson. I'm going to ask one more question and then allow other committee members also. I think we're going to have a vote in the next 5 to 10 minutes. We'll try to get as many questions in before we need to break to go over so that we don't keep you here after that if that happens.

Mr. Martin, it's kind of a followup with the use of technology. As we use technology to have more accurate payments and keep better records and thus have a better understanding of our financial position, one of the issues that was addressed in previous audits for the Department of Education as well as by the GAO was the security of the information in your systems, and I wonder if you could update us on where you are and what you've done to try to improve the confidentiality of information in the Department's data systems.

Mr. MARTIN. We have a major IT security initiative taking place now. Our office, the Office of the Chief Financial Officer, working with the Chief Information Officer and Federal Student Aid, we have a plan in place, and we are directing that plan in addressing the IT security material weakness. We believe that we will have most of the issues related to that IT security material weakness resolved by the end of this year, a good share of those resolved by the end of the fiscal year and most all resolved by the end of the calendar year.

Mr. PLATTS. Is that something that you're sharing with or coordinating with GAO as far as their past concerns they've raised? Or I don't know if GAO has had a chance to look at that yet, what's being done.

Ms. CALBOM. We haven't been in to take a look at that recently. We will be going in to followup on some of our previous recommendations probably sometime this summer, which will be just a quick look to see what kinds of things have been done. You know, of course the IG has continued to report some additional weaknesses in this area, but I do know that the Department has some solid plans in place to address these issues.

Mr. MARTIN. And we are working with the IG in resolving these issues, Mr. Chairman.

Mr. PLATTS. Thank you.

Mr. Towns.

Mr. TOWNS. Thank you. Mr. McPherson, Federal credit agencies have been required to estimate the cost of their loan programs in accordance with the requirements of the Federal Credit Reform Act of 1990. Since fiscal year 1992, USDA was recently able to estimate their loan subsidy cost for its credit programs, which totaled about $74 billion. Why did it take so long to address this issue, and can we be assured that USDA will continue to be able to make reliable estimates?

Mr. MCPHERSON. I can't answer why it took so long because I wasn't there. I know that we made a big effort in 2001 to complete that work, and we were able to do it for the Rural Development Agency, which has about in nominal terms $70 billion. We have about $100 billion in total, and as you suggest, $74 billion on a present value basis.

So we made progress in Rural Development and got that behind us in 2001. Last year we were able to complete the work in the Farm Service Agency and the Commodity Credit Corp., so that was key to completing the clean opinion in that agency.

And it is sustainable. I've looked at those models myself in detail. I've looked at the people that operate them, and while it was a complex task, once achieved it should well sustain itself. In fact, we've been able to cut the time it takes to prepare those calculations from what used to take weeks to really a matter of days through automation. So I think that one—that breakthrough is behind us.

Mr. TOWNS. Thank you.

Mr. Williams and Ms. Calbom, do you feel that a lot of the problems is the fact that they have had improper technology or not adequate technology to be able to answer the questions that need to be answered in order to get information that was required? Could you sort of just comment on that? I know you've seen a lot of these and you've been there for quite some time, and I'm just curious as to this fact.

Ms. CALBOM. Are you speaking of the credit reform area or just in general?

Mr. TOWNS. In general.

Ms. CALBOM. In general?

Mr. TOWNS. Yes.

Ms. CALBOM. I think it's a combination of things. You know, like I said before, the systems that most of these agencies were using were not meant to develop this type of financial information. You know, in some cases we didn't have people in the right positions that were trained to do the work that they were being asked to do, and when you haven't asked anyone to be accountable for years and years and years and then all of a sudden we pass the CFO Act and then we're asking agencies to issue audited financial statements. Then we're asking them to be accountable, and you've got cultural issues there, systems issues, people issues, all kinds of things going on. And I think as everybody has mentioned, you know, when you're in a real deep hole, it's hard to get out, and many of these agencies were in a real deep hole. And many of them are starting to get out of that hole and to have accountability.

I think I can speak particularly to Education. I believe they've turned the corner on this. They're on the right track. It's just a matter of a little more time, particularly to demonstrate that this is sustainable and to clean up some of these remaining weaknesses that were left over from the last fiscal year.

Mr. WILLIAMS. For USDA I would agree with all of those points. I think you have a scenario there in which financial management was not a top priority in the past and you're talking about an organization that is decentralized and you would have people in the Northeast maybe accounting for transactions one way, people in the Northwest accounting for transactions another way, that decentralization not being a top priority.

A lot of times that information was incorrect, and when you bring all that information in together, you're basically not going to be able to produce reliable financial statements.

And I would like to add as far as USDA is concerned, I think it is also a top factor that a lot of their systems were, and in some cases these feeder systems that we're talking about are old and they need to be upgraded and in some cases just totally replaced. And I think the agency is on track to address this particular issue.

Mr. TOWNS. Right. Thank you very much. Let me ask, you stressed it a lot, Mr. McPherson, and, Mr. Martin, you also mentioned in your testimony, you praised the career civil servants who worked hard to enable the Department achieve a clean financial last year, and you point to these career employees as the main reason for continuing optimism for financial management improvements in the future.

Just how important are the career civil servants in achieving progress, and what lesson can other agencies learn from your experience?

Mr. MCPHERSON. I would say they are very important, and the lesson I learned is how underinvested we were, and are probably other Federal agencies, in training for those career civil servants. We just last week had 234 people come to Washington for 2½ days in a series of modules of very specific techniques, to include reconciliations, property, intercompany eliminations, a whole suite of knowledge that they need to do their jobs and to understand how all of that is integrated with the systems and so forth, and we had two career civil servants address those people as part of that curriculum. One was Don Hammond from Treasury. One was Joe Kull from OMB, very successful career civil servants. Joe Kull gave a very effective presentation that I asked him to do as to what he would look for if he were to hire anyone in that audience today, and he reflected on what one needs to be equipped with in terms of attributes and professional skills and so forth.

So that's a very valuable thing, just to invest in solid training for the people.

Mr. TOWNS. Right.

Mr. Martin, could you comment on? That is my final question.

Mr. MARTIN. Yes. When Secretary Paige took office, he formed a management improvement team that was comprised exclusively of senior level career employees. These employees developed the Secretary's Blueprint for Management Excellence, which laid the foundation for most of the improvements that were—that occurred at the Department of Education. So the career people were extremely important, and they continue to play a major role.

Mr. TOWNS. Thank you very much. Thank all of you. I yield back, Mr. Chairman.

Mr. PLATTS. Thank you, Mr. Towns.

Ms. Blackburn.

Ms. BLACKBURN. Thank you, Mr. Chairman. Ms. Calbom, following up on what you said about stopping digging when you're in a hole, coming out of Tennessee and the country music industry being near and dear to us there, I'll just let you know there is a great song by Randy Travis talking about stop digging when you're in a hole. So if you need something as an example, you can look that one up.

Let's see. And I'm sure if y'all gave me a chance, to our ranking member down there and others, I could think of a lot of other of our country songs out of Nashville or our blues songs out of Memphis that we could tie back into a lot of what we're talking about.

Mr. McPherson and Mr. Martin, Mr. Williams was speaking a moment ago about centralizing some of your operations, and I've heard you all talk about computer security and other different things. As you've gone through this process of becoming more technologically aware and having your systems be more of an integrated system, obviously it sounds like what you're doing from security to application, you are doing both a good bit of front-end and back-end work.

Now, my question to each of you is are you doing—how are you breaking this apart? Are you handling it in-house? Are you contracting it out? If you're contracting it out, what is the length of those contracts, and how much are you spending on an annual basis for those contracts?

Mr. MCPHERSON. Well, in our case, here's how we approach it. The first job was to implement a standard accounting system for discretionary spending, and we did 17 conversions to do that. That's kind of a middle level.

We have also in our architecture implemented a data warehouse and data marts that enable self service by our program agencies where people can write their own queries and manage their own information.

The remaining building block are these feeder systems that are old legacy systems that include integrated——

Ms. BLACKBURN. Just a moment there. On those feeder systems, are you—just for my understanding, when you build those, your port of entry, is it a—would it be a front-end Web-based system, or is it something they're logging—going straight into the back end on that data management?

Mr. MCPHERSON. Most of our interfaces are direct. We do not have a lot of Web-based accounting systems. My choice when coming was to finish what had been started. Our next migration will be to more of a Web-based system.

So we have warehouse architecture, and the emphasis is on feeder systems. And in our case feeder systems are large integrated acquisition systems, procurement systems. They could be property management for things like 22,000 buildings, 1,200 space assignments in 766 GSA buildings in over 400 cities and towns. So these are massive accounting operations.

In performing the work, we own it internally. We own the responsibility. I would not likely delegate that ownership externally. What we do is have business partners that have helped implement some of these systems, and we have project teams for a suite of the feeder systems.

Ms. BLACKBURN. And when you bring those business partners in line, is it a project until the completion of the project, or how are you writing those contracts?

Mr. MCPHERSON. Those contracts typically will be—could range from development and implementation to maintenance, and what we want to do is cut the time it takes to execute an implementation, some sort of system change, and then migrate aggressively to just an operating cost for maintaining it.

And my goal is to drive down the costs of this work, because my sense is instinctively it's too high across government, and it's too high in our case because of the labor-intensive manual processes that were allowed to accumulate over the years. So the replacement through technology has a cost saving as well.

Ms. BLACKBURN. How many outsourced contractors or outside contractors do you have—have you had working on those projects?

Mr. MCPHERSON. I would say for the core systems operated for headquarters in the lines of business, I'm going to say no more than a dozen, let's say, at the most as a guess. Now, remember through the National Finance Center we service 120 other Federal agencies, so I'm excluding that as it relates to payroll projects or the management of the recordkeeping for the Thrift Investment

Plan with $100 billion and 3 million customers there. But just for the accounting operations, it's not a lot, but it's very focused.

Ms. BLACKBURN. Mr. Martin.

Mr. MARTIN. We have an integrated platform called EDCAPS, or Education Central Automated Processing System, and this platform integrates all of our business processes, procurement, travel, our Oracle financial management system, all of the systems that we use on the—my side of the house. FSA, the Federal Student Aid, they also have a separate Oracle system and I think at least three contractors, Accenture I think being the largest contractor. Accenture has several subcontractors that they employ. We have one major contractor, IBM, now and I think they subcontract a good share of their work.

The precise dollar amount I would have to get back to the committee on.

Ms. BLACKBURN. If you could submit that for the record, I think that would be great, the amount of the IBM contract, the Accenture contract and then any of the others that have worked on building your system, the separate systems that are in there. I think that will be helpful to know.

May I ask one other question? Then I'll be through. OK. Mr. Martin, when your auditor is giving your internal control reports, would it be helpful to you all if they also issued to you opinions on your internal controls?

Mr. MARTIN. I believe those internal controls as presented satisfy all of the professional standards. So I don't see any additional utility with any more information in those reports.

Ms. BLACKBURN. Mr. McPherson.

Mr. MCPHERSON. I'd agree with that. I think there are perhaps things such as audit committees or things beyond just normal government practices that could be considered in addition, but I agree with what Jack says about that particular item.

Ms. BLACKBURN. Thank you, sir.

Mr. PLATTS. Thank you, Ms. Blackburn.

Mr. Martin, as one who about 2 weeks back made my last student loan payment from law school—and I'm actually waiting to get the statement back saying I'm completely paid off to celebrate. But I'm grateful for the Direct Student Loan Program, because my undergrad degree and my law school degree would not have been achievable without that assistance. So the integrity of those programs and all who participate who actually fulfill their obligations, that is something that I have a longstanding interest in. As I pay mine back, I want to be sure everyone else is paying theirs back.

And my understanding is that in the Office of Federal Student Aid, there has been some significant technology investments to improve the tracking of—whether it be the Pell grants or the Direct Loan Program. I wonder if you could update us on where that stands and what you envision for the improvements being made regarding the Office of Federal Student Aid.

Mr. MARTIN. Well, I think in terms of what we need to satisfy GAO, we've got material weaknesses that we need to improve related to IT security and other FMFIA material weaknesses.

Mr. PLATTS. And that relates to being on the at-risk list with GAO to satisfy their requirements to get off that risk list?

Mr. MARTIN. Right. Yes.

Mr. PLATTS. What's your timeframe you think as far as trying to satisfy the——

Mr. MARTIN. I think that where we'll be—you'll be reviewing probably in 2005, I guess?

Ms. CALBOM. Yes. Probably during fiscal year 2004 we'll be looking at what's been done in preparation for our high-risk assessment that we will be issuing in January 2005.

Mr. PLATTS. That was my followup, is the Department, in this case Department of Education, takes action to address issues that I guess result in being on that list. It's my understanding that the GAO—that your process has always been just a 2-year update, that there are not interim updates?

Ms. CALBOM. Yes. Our policy is to do it on a biennial basis. You know, part of the reason for doing that is that really allows time to demonstrate sustainability of the improvements that have been made. For example, with the Department of Education, they did get a clean opinion in 1997, but then they weren't able to sustain that and they weren't able to even repeat it until just recently. We've seen that with some other agencies as well. Transportation had that issue a few years back as well. So we want to give some time to make sure that, as we've been talking here today, that these are permanent type improvements.

The other thing is, GAO spends a lot of time and effort in doing those high-risk and performance and accountability series updates, and it is something that we think is a valuable thing to do for the Congress. But because it is such a big investment, we really want to limit that to a biennial-type process and not make exceptions on an agency by agency basis, because then we'd have everybody wanting to have an out of cycle assessment. So our policy is to stick with the biennial assessment.

Mr. PLATTS. But you will have ongoing interaction with the Department that—as they work to address the shortcomings you have identified, that they are on the right track as opposed to just waiting till you get to that next 2 years and——

Ms. CALBOM. Definitely. In fact, the Department has offered to provide us with a series of briefings on the improvements that have been made in the student aid programs and we definitely are going to take them up on that, because we want to be as up to date as we can be and offer advice as we go.

In addition, we have several ongoing jobs at the Department that really we do in order to build toward the high-risk update. As a matter of fact we're doing planning agency-wide at GAO right now to make sure that we've got a body of work planned for each of the areas that are currently on the high-risk list so that we're in a position to properly assess those, again, for the 2005 date.

Mr. PLATTS. OK. Thank you. Maybe a final area of specific inquiry, Mr. McPherson, with the Department of Agriculture is on the issue of debt, but I guess in a broad sense with your Department having—my understanding is about a third of all nontax debt or credit being issued by Agriculture. In the 2002 fiscal year you jumped from 14 percent to 96 percent in the eligible debt that was referenced—or referred to the Treasury cross-servicing program, I guess, that kind of resulted in such a significant result—or increase in the referral and what you see for the future in that type of action.

Mr. McPHERSON. It was a significant and invaluable improvement. About $300 million more in cash collections going to the Treasury than otherwise would have been the case. I think the issue is for us—the management of this hundred billion dollar loan portfolio in achieving the proper missions of the programs through the productive use of cash, and to manage those loans, I think there are four things that are important in addition to things like being good at collecting delinquent debts.

One is the transaction approval process, and so we've emphasized taking a close look at how those transactions are approved. Two is how those portfolios or cohorts are managed in terms of concentration of risk, early warnings and so forth. Three has to do with the systems, the use, the application of computing to run a loan portfolio, to manage a loan portfolio, and a lot of loan systems probably around the government need to be renovated. We have some of that work to do.

And then the fourth area is debt collection, credit reform, a whole other miscellaneous group of techniques and processes that are brought to managing that portfolio. And I think it's good to look at those aggregates where a lot of agencies have particular agencies or programs dedicated to lending. Any bank, private or public, is going to look at the whole portfolio and how it's managed, and I think that's where we have gotten some of our gains with more to come.

Mr. PLATTS. Is that work—the various stage at this point is all internal, or do you use outside——

Mr. McPHERSON. It's principally internal, and my role is sort of as a policy overseer. I'm not close to the customer. I don't own those portfolios. So my role is to influence how those are managed by Rural Development and the Farm Service Agency who have agency heads and under secretaries that own that work. But in tandem, in teaming, we all sort of speak the same language and are focused on some of these things that we think are most useful.

Mr. PLATTS. And actually your final statement there brings me to a final question for Mr. Martin and Mr. McPherson. Speaking the same language and one of the goals of this hearing and of having you testify is to shed some more light on the efforts you have made and the tremendous success you both have had with your Departments and your fellow colleagues at your Departments in having more financial accountability, is there a regular interaction between the two of you and your—kind of your colleagues in other Departments in the same positions that you share notes on a regular basis as what's working in my Department, what's not, and so that we aren't having to reinvent the wheel, per se, in each of the CFO agencies?

Mr. MARTIN. We have the CFO Council where many of these issues are discussed, and we have had I think two dinners of CFOs where we talk about issues that are affecting our respective Departments and where there are common interests. And we have working groups on—I think there is a working group that deals with issues related to implementation of the Oracle system, you know, where they meet periodically. I think it's either monthly or quarterly. So there is——

Mr. PLATTS. Not just at the CFO level but staff——

Mr. MARTIN. And below that, yes.

Mr. PLATTS. Great. Well, hopefully when you're meeting and your fellow CFOs get together, they're listening well when the two of you speak and taking good notes, and we will hope with time that we can get DOD to embrace the improvements as well given the size of that Department's challenges, but if no other questions——

Mr. TOWNS. I would like to just thank the witnesses, Mr. Chairman. Thank you very much.

Mr. PLATTS. Thank you, Mr. Towns, and we do appreciate all four of you for your time and effort, not just here today but in the preparation and material you shared and your willingness to continue to be great resources for the members of this subcommittee.

I'd also like to thank both the majority and minority staff members for their efforts regarding this hearing. It's clear that the agencies before us have put forth significant efforts to fix various serious financial management problems, and I commend each of you and your many, many staff persons who have put forth that effort in achieving the successes you have in both Departments. We look forward to hearing similar success stories from your financial management colleagues throughout the Federal Government as they learn from your examples and seek to meet the challenges before their Departments.

The record will be kept open for 2 weeks for any additional information to be submitted, and this hearing stands adjourned. Thank you.

[Whereupon, at 3:30 p.m., the subcommittee was adjourned.]

[Additional information submitted for the hearing record follows:]

Mr. Martin responses / Education

Additional Questions from Representative Blackburn

- *What was the greatest motivating factor that made your organizations strive toward getting clean opinions and getting your financial management in order? Was it the new administration and the focus that the President's Management Agenda has placed on improving financial management or some other factors?*

U.S. Secretary of Education Rod Paige made a promise to the President that he would make implementation of the President's Management Agenda the basis of getting our house in order, and I'm proud to say that we have. The Department leadership's desire to become effective stewards of the taxpayer's funds was and is a strong and influential factor in the success of our management plan. A major goal set under this plan as directed by the Secretary was to obtain an unqualified or "clean" auditor's opinion on our financial statements. Our Deputy Secretary has referenced our accomplishment as, "a clean opinion is not a perfect opinion." I believe this achievement is a crucial milestone that we have passed in our march toward creating a permanent culture of accountability and a world class, performance-based organization.

In addition to the financial audit results, the Office of Management and Budget recently issued the President's Management Agenda "scorecard," tracking management improvement in agencies government wide. OMB conferred upon the Education Department all "green lights" -- the highest rating -- for its progress in implementing management reforms. The seven green lights were the most of any agency. Obviously, we believe that the Scorecard is an important tool in helping us focus the Department's performance planning on financial management.

- *How valuable has the OMB's program assessment rating tool, the PART, been in getting program managers to develop performance information that can be used to evaluate the effectiveness of the program? Is the PART helping to put some teeth into the performance budgeting concepts that are behind the Government Performance and Results Act?*

The PART process has provided analysts and policy makers with a valuable tool for objectively assessing how successful program performance has been, and thus how well these programs are managed. A key aspect is using and enhancing performance measurement data. For example, we have established data for student aid and rehabilitative services programs that indicate these programs are particularly effective at meeting their defined missions. For other programs, such as elementary and secondary education, where our Federal contribution is only 8.4 % of the total spent nationally, it has been more challenging to develop comparable measures that support a more comprehensive evaluation of the effect of the programs. The emphasis of the PART process is focused on performance measures, so it is helping us identify the areas where we need to do a better job at determining how to measure success as well as developing better strategies for collecting data.

Information for the Official Record

- *Ms. Blackburn: How many outsourced contractors or outside contractors do you have – have you had working on those projects?*

  Mr. Martin: We have an integrated platform called EDCAPs, or Education Central Automated Processing System, and this platform integrates all of our business processes, procurement, travel, out Oracle financial management system, all of the systems that we use on the – my side of the house. FSA, the Federal Student Aid, they also have a separate Oracle System and I think at least three contractors, Accenture I think being the largest contractor. Accenture has several subcontractors that they employ. We have one major contractor, IBM, now and I think they subcontract a good share of their work. The precise dollar amount I would have to get back to the committee.

  Ms. Blackburn: If you could submit that for the record, I think that would be great, the amount of the IBM contract, the Accenture contract and then any of the others that have worked on building your system, the separate systems that are in there. I think that will be helpful to know.

The EDCAPS system is made up of four primary components: Financial Management Support System (FMSS), Contracts and Purchasing Support System (CPSS), Grant Application Processing System (GAPS), and a travel management system. All components except for GAPS use commercial-off-the-shelf (COTS) software solutions that are integrated and maintained as part of the overall architecture. This system provides financial management support to all of the Department's operating components, including providing the general ledger (FMSS), producing financial statement information and the underlying accounting information in support of those statements.

A component of IBM Corporation is the current contractor supporting the EDCAPS system. PricewaterhouseCoopers (PwC) was the provider of these services prior to IBM acquiring the consulting arm of PwC. IBM has subcontracts with Delta Solutions & Technologies, e-source Technologies, Broadpoint, IES, DTSI, Quality Software Services Inc., Telesis, ICCS, and CACI. Total contract costs for FY 2002 were $19.9 million dollars, of which $3.8 million dollars were for the implementation of Oracle Financials as the COTS software tool for the FMSS component, and $5 million dollars were to support the Oracle tool. 1st quarter FY 2003 support of Oracle including the final FY 2002 financial statement preparation was $1.2 million dollars.

FSA uses a separate financial management system (FMS) to provide financial management of additional student aid data besides what is provided directly to the Department's EDCAPS system. FMS also uses Oracle Financials as its base. Accenture is the primary support contractor for FMS. That support includes subcontract support from IBM, EDS, KPMG, Information Systems Consortium, and Bearing Point. FY 2002 costs were $15.1 million dollars and FY 2003 costs are $10.1 million dollars.

Fiscal Year 2003 Congressional Questions

OFFICE OF THE CHIEF FINANCIAL OFFICER

(Questions from Representative Marsha Blackburn)

Mr. (Platts):

Question 1: What was the greatest motivating factor that made your organizations strive toward getting clean opinions and getting your financial management in order? Was it the new administration and the focus that the President's Management Agenda has placed on improving financial management or some other factors?

Response: Leadership and talent were the greatest motivating factors that made the Department of Agriculture strive toward getting a clean financial audit opinion and getting our financial management in order. Leadership and talent of people made the massive changes needed to perform the deferred work necessary to accomplish our immediate goals of sufficient internal control and data integrity to merit the first clean financial audit opinion. These changes are a process of continuous improvement, not a completed event. The focus of the new administration through the President's Management Agenda on improving financial management is central to the motivation, dedication and accountability for USDA's people to achieve real results.

Question 2: How valuable has the OMB's program assessment rating tool, the PART, been in getting program managers to develop performance information that can be used to evaluate the effectiveness of the program? Is the PART helping to put some teeth into the performance budgeting concepts that are behind the Government Performance and Results Act?

Response: OMB's program assessment rating tool the PART is valuable as a catalyst in helping to transform USDA's budgeting and program performance accountability. The PART is a concise scorecard useful in communicating the overall effectiveness of individual programs and a department's portfolio of programs collectively.