DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date DEC 2 4 1991

From Richard P. Kusserow
Inspector General

Subject Follow-up Review of Unliguidated Obligation Balances in Successor-Merged Appropriation Accounts (A-12-91-00012)

To Kevin E. Moley
Assistant Secretary for
Management and Budget

The attached final report presents the results of our follow-up review of unliguidated obligation (ULO) balances in successor-merged appropriation accounts ("M" accounts).

Three of the four recommendations in our original report (A-12-89-00130) have been implemented. We found that in accordance with our earlier recommendation, the Department cited the system of reporting ULO balances to be a material nonconformance in the 1989 annual Federal Managers' Financial Integrity Act report. Also in response to two other recommendations, we noted a much greater effort is devoted to closing out contracts and grants, and the performance plans of cognizant personnel include a requirement to review ULO balances.

The fourth recommendation, however, was not effectively implemented. In our original report, we recommended that the Division of Accounting Operations (DAO) conduct and document the results of internal control reviews (ICRs) and the performance of annual reviews of ULO balances. Your office agreed with this recommendation, and the DAO.took action to reduce the Fiscal Year (FY) 1987 ULO balance (the audited amount in the original report) from $50 million to $10 million. However, at the time of our review, DAO staff had not adequately examined controls over "M" account operations. Instead, DAO performed a limited review of the linkages between subsidiary accounting systems and the primary accounting system; answered a systems-oriented questionnaire; and conducted an ICR of the Third Party Draft system. In our opinion, these efforts were not sufficient in character or depth to be considered an examination of controls over "M" accounts.

We also considered the effects of the recently enacted "M" account legislation (Public Law 101-510). The legislation will eliminate past "M" account problems through the phase out of these accounts. An orderly phase out requires that agencies maintain the fiscal year identity of "M" account balances. We observed that DAO had recorded "M" account balances in 1 fiscal year, only to later move them into their proper fiscal "M" account years. Although "M" account funds have been generally fungible, both the "M" year law and its implementing guidance from the Department of the Treasury and the Office of Management and Budget require that "M" account funds retain their fiscal year identity to effect an orderly phase out.

Your office generally concurred with the recommendations of our follow-up report and agreed to continue the review of ULOs (see Appendix). Please advise us, within 60 days, of any further actions taken or planned on our recommendations. If you have any questions, please call me or have your staff contact John A. Ferris, Assistant Inspector General for Human, Family and Departmental Services Audits, at (202) 619-1175.

Attachment

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

FOLLOW-UP REVIEW OF UNLIQUIDATED OBLIGATION BALANCES IN SUCCESSOR-MERGED APPROPRIATION ACCOUNTS

Richard P. Kusserow
INSPECTOR GENERAL

CIN: A-12-91-00012

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Memorandum

Date DEC 24 1991

From Richard P. Kusserow
Inspector General

Subject Follow-up Review of Unliquidated Obligation Balances in Successor-Merged Appropriation Accounts (A-12-91-00012)

To Kevin E. Moley
Assistant Secretary for Management and Budget

This final report presents the results of our follow-up review of unliquidated obligation (ULO) balances in successor-merged appropriation accounts ("M" accounts). The review focused on the recommendations contained in our earlier report on this subject (A-12-89-00130). The Department concurred with that report's four recommendations. Specifically:

- The system of reporting ULO balances should be cited as a material nonconformance in the Department's annual Federal Managers' Financial Integrity Act (FMFIA) report.

- The Division of Accounting Operations (DAO) should conduct and document the results of internal control reviews (ICRs) and annual reviews of ULO balances.

- The performance plans of responsible DAO officials should specify the accomplishment of an annual review of ULO balances.

- Grants and contracts should be closed out within prescribed time frames, usually 6 and 20 months, respectively.

The follow-up disclosed that: (1) the Department cited the system of reporting ULO balances to be a material nonconformance in the 1989 FMFIA report, (2) the balance in the "M" accounts we previously reviewed has declined from $50 million to $10 million, although DAO staff had not adequately examined controls over "M" account operations, (3) cognizant DAO staff performance plans include a provision for compliance with FMFIA requirements, and (4) departmental management has placed new emphasis on the closeout of contracts and grants.

INTRODUCTION

Backsround

The accounting for "M" accounts is prescribed by Title 31, Sections 1551 through 1557, United States Code (U.S.C.). The "M" accounts enabled agencies to pay valid bills for an indefinite period of time following expiration of the appropriation of funds. However, problems with the accounts have surfaced. As documented in congressional testimony last year, some agencies (other than this Department) used the funds to pay for services and products that may not have been contemplated in the original scope of work. In another instance of abuse, an agency had restored approximately $238 million in merged surplus funds on the basis of ledgers and estimates alone. The restoration was brought before the Comptroller General, who subsequently determined (in Comptroller General Decision B-236940, October 17, 1989) that the agency had to reverse the restoration because it did not have the source documents to support the request.

Practices such as these, coupled with the $100 billion magnitude of the "M" accounts Governmentwide, led Congress to pass Public Law 101-510, The National Defense Authorization Act for Fiscal Year (FY) 1991, on November 5, 1990. The Act includes a provision that revamped 31 U.S.C. 1551-1557 by specifying a strict timetable for the elimination of "M" accounts by September 30, 1993, and by restricting an agency's ability to restore merged surplus funds. Known herein as the "M" year legislation, the provision requires that beginning with the FY 1989 appropriation, generally an appropriation will be canceled after 5 years of being in an expired status. A consequence of the new law is that the documentation and review of ULOs--which in the past gave rise to "M" accounts--will become even more important because agencies may have to pay expired obligations out of current year appropriations.

Creation and Use of "M" Accounts

The "M" accounts consist of two kinds of accounts, "merged surplus" and "merged." At the end of an appropriation's period of availability for obligation, normally 1 or 2 fiscal years, the Department of the Treasury (Treasury) withdrew any remaining unobligated balance from the agency and converted it to surplus authority. Two years later, this balance would be transferred to "merged surplus" funds that had obligations placed against them that were later deobligated. To use merged surplus accounts, an agency had to first request a restoration from Treasury.

Merged accounts, as distinct from merged surplus accounts, arose after the same 3-4 year period. However, they were uniquely different in that merged accounts represented funds that had been obligated but not expended. The accounts could be cited for expenditure upon presentation of a valid invoice or expense report.

Scope of Work

We conducted the present review primarily as a follow-up to the earlier report. Accordingly, we designed our procedures to evaluate adoption of the report's recommendations by the Department. However, in recognition of the significant changes wrought by the "M" year legislation, we also performed a limited review of the activity in "M" accounts. The review was conducted in accordance with government auditing standards.

Work was conducted in the DAO, the Division of Contract Operations (DCO), and the Division of Grants Management, Washington, D.C., during the months of March through August 1991. We examined the change in FY 1987 ULO balances for the period September 30, 1987 to March 31, 1991. With the exception of the items discussed in the "RESULTS OF REVIEW" section, the transactions tested were in compliance with applicable laws and regulations. For the items not tested, nothing came to our attention to indicate that transactions were in violation of relevant laws or regulations.

RESULTS OF REVIEW

Reporting of the Original Material Nonconformance

We noted that the Department cited the system of reporting ULO balances to be a material nonconformance in the Department's 1989 FMFIA report to the President and the Congress. We had recommended this be done in our earlier report, and the ASMB concurred. For the FY 1990 FMFIA report, the Department indicated that this material nonconformance had been corrected. We have delayed work to substantiate this until DAO validates the effectiveness of the corrective action taken.

Annual Reviews of "M" Accounts

The basis for conducting annual reviews of "M" accounts is well established. Prior to the "M" year legislation, 31 U.S.C. 1554 required that "[t]he head of each agency shall review at least once a FY each appropriation..." The "M" year legislation in November 1990 specified that the "head of each agency shall establish internal controls to assure that an adequate review of obligated balances is performed..." The GAO Policy and Procedures Manual, Title 7, and the ASMB also require a review of "M" account balances.

In our earlier audit report, we noted that general ledger balances of FY 1987 "M" accounts were $50 million at September 30, 1987. Our follow-up review showed that at the end of March 31, 1991, DAO had reduced this balance to approximately $10 million. These figures represented "M" account balances for the FYs 1984 and earlier, for the Office of the Secretary (OS) and the former Office of Human Development Services (HDS), which is now a part of the Administration for Children and Families.

We also noted that DAO published a form for use by staff to document the reviews. However, DAO did not use this form because, according to DAO staff: (1) many of the items in the "M" accounts lacked original documentation so there was no point in recording the rationale for removing items from the accounts, and (2) the form was intended for use in documenting DAO's actions taken in response to the "M" year legislation. We believe that completion of the form, which appears well-designed, would have created a record supporting DAO's review of ULOs.

Internal Control Review of "M" Accounts

The performance of an ICR for "M" accounts was agreed to by the ASMB in adopting our earlier recommendation. When we sought to examine the review, we were told that none had been conducted.

However, in a later discussion with DAO staff, we were informed that their 1991 section 4 systems review included an evaluation of "M" account controls. When we examined this review, termed a "limited review" by DAO staff, we noted that it contained three elements: (1) transaction testing of the interfaces between subsidiary accounting systems and the OS/HDS accounting system, (2) a questionnaire covering the OS/HDS accounting system, and (3) an ICR of the third party draft system. Based on this examination, we determined that an adequate testing of controls for "M" accounts had not been documented.

To validate the adequacy of corrective actions taken to remove the material nonconformance for "M" accounts, we also believe the report should include a discussion of the merits of the controls in place, describe any observed need for additional controls, and identify factors such as management practices, policies, and laws which cause inefficiencies or waste. The report of review we examined did not adequately address these areas.

"M" Account Reviews in Performance Plans

Based on our review of the 1990 performance plans for personnel directly responsible for "M" account transactions, we determined that the requirement for a review of "M" accounts is adequately stated.

Contract and Grant Closeouts

We noted that both the contract and grant offices are continuing to place emphasis on the closeout of contracts and grants. Timely closeout is a critical step in the cycle of "M" account maintenance.

Over 3,000 contracts and grants have been cited for closeout because of increased management attention to this important step in the procurement cycle. The DCO has retained the use of a contractor to assist them in closing out completed contracts. The Office of Management Services (within the former HDS) has, since January 1991, begun submitting "Grant Closeout Certification" reports to DAO. The reports list grants that may be closed out, thus helping DAO to remove unnecessary account balances from the accounting records.

OTHER MATTERS

"M" Account Fungibility

In December 1990, DAO increased the recorded "M" account obligation balances for FYs 1982, 1983 and 1984 by $19.6 million. This amount actually reflected balances for FYs 1988 and earlier. The DAO staff explained that by recording this amount in "M" accounts for FYs 1982, 1983, and 1984, they could support a restoration request submitted to Treasury. In February 1991 DAO staff transferred this amount, less $140,000 which they had written off, to FY 1988 accounts. By May 1991, subsequent to our questioning of these transactions, DAO staff had cancelled $4.8 million, returned $14.4 million to FY 1984-FY 1987 accounts, and were reviewing the remainder of approximately $260,000. The DAO officials explained that they knew the correct fiscal year identities of the "M" accounts, and that our inquiry into the transfers did not cause them to reverse the "M" account transfers into FY 1988 accounts. We believe that despite the generally fungible nature of "M" account funds, both the "M" year law and its implementing guidance from Treasury and the Office of Managment and Budget require "M" year funds to retain their fiscal year identity.

CONCLUSIONS

The DAO has done much to correct previously identified deficiencies in the management of "M" accounts. The FY 1987 balances, used as a benchmark in this review, declined dramatically. Personnel who work with the "M" accounts were able to speak knowledgeably about the actions taken to reduce "M" account balances.

However, DAO needs to take steps to preserve the fiscal year identity of "M" year funds. This is necessary not only to effect an orderly phase out in accordance with the "M" year legislation, but also to guard against the use of current OS and former HDS fund balances to meet "M" account payment requirements. Closely related to the problem of fiscal year identity is the need to complete and document a review that will: (1) examine "M" account internal controls, and (2) validate removal of the "M" account material nonconformance from the FY 1990 FMFIA report.

RECOMMENDATIONS

We recommend that ASMB require DAO to:

- Better document annual reviews of its ULOs.

- Expand the system review to include an examination of "M" account internal controls, and to validate removal of the DAO portion of the "M" account material nonconformance from the 1990 FMFIA report.

ASMB Comments and Office of Inspector General Response

The ASMB provided written comments to our draft report on November 26, 1991 (see Appendix). The response generally concurred with the two recommendations. However, the ASMB felt two statements in the report require further explanation and clarification.

The ASMB believes that the Section 4 limited review of the OS accounting system conducted in FY 1991 validated the removal of the "M" account material nonconformance. Accordingly, the ASMB disagreed with the OIG statement "...DAO staff had not examined controls over "M" account operations." We continue to maintain that DAO staff have not adequately examined the controls over "M" account operations. An acceptable examination includes testing and documenting relevant controls. While the Section 4 review may have encompassed the OS accounting system, the scope and depth of the examination as related to "M" accounts were inadequate.

Included in the comments is a statement that the OIG is concerned that "DAO does not have appropriate controls in place to preserve the fiscal year identity of "M" year funds." Our concern is that DAO staff knowingly moved "M" year funds between fiscal years. We acknowledged that the accounting system had assigned a fiscal year identity to the "M" year fund balances; however, the control was circumvented by the DAO staff.

A reference to "departmental" fund balances in the "CONCLUSIONS" section of the report has been changed to read "OS and former HDS" fund balances.

APPENDIX

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of the Secretary

Washington, D.C. 20201

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PDIG ✓
DIG-AS ✓
DIG-EI
DIG-OI ✓
AIG-MP ✓
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EX SEC ✓
DATE SENT 11/26

DATE : NOV 26 1991

TO : Richard P. Kusserow
Inspector General

FROM : Kevin E. Moley
Assistant Secretary for
Management and Budget

Elizabeth M. James

SUBJECT: Follow-up Review of Unlig-uidated Obligation Balances in Successor-Merged Appropriation Accounts (A-12-91-00021)

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OFFICE OF INSPECTOR GENERAL
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We have reviewed the draft of the subject report forwarded to this office by your letter dated October 29, 1991, and our comments are provided below. We are appreciative of the changes that have been made to the report as a result of the various meetings between the auditors and Office of Finance staff members. There are, however, statements in the report that we believe require further explanation and clarification.

The major concern raised by OIG centers around the lack of adequate documentation to support the corrective action taken to remove the material noncomformance by the Division of Accounting Operations (DAO). Another concern of OIG's was that DAO does not have appropriate controls in place to preserve the fiscal year identity of "M" year funds.

The results of the corrective action taken in FY 1990 to remove the material nonconformance (review of unliguidated obligations in "M" Year accounts), as well as FY 1991 implementation of "M" Year Legislation, have been incorporated in the Section 4 Limited Review of the OS accounting system conducted in FY 1991. The test results are indicative of the actions taken by DAO to selectively remove unliguidated obligations in "M" Year accounts and specifically to cancel those obligations pertaining to FY 1984 and prior. The controls over "M" account operations are monitored regularly through various edits and validations as data is input to the system. Individual document control provides precise fiscal year identity of every document entered in the accounting system at all times. We, therefore do not agree with the statement ". ..although DAO staff had not examined controls over "M" account operations." However, we do agree with the observation that this needs to be formally documented and will formally document our actions in the future.

In the CONCLUSIONS section of the report, reference is made to "departmental" fund balances. We recommend that this reference be changed to "OS and former OHDS" fund balances.

We generally concur with the two recommendations cited in the report, and the continuation of our review of all unliguidated

Documentation in support of our revi'ew will be formalized to fully justify actions taken to retain, deobligate, and/or cancel unliguidated obligations in the accounting system.

If additional information is needed, please contact George Strader on 245-8085 or Garland Heare on 245-6388.