BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

HEW Must Improve Control Over Billions In Cash Advances

Due to deficiencies in HEW's management of Federal assistance advances to non-Federal organizations, assistance recipients held about $249 million in Federal money excess to their needs. This increases interest on the public debt by nearly $8.3 million annually.

The report discusses weaknesses which allow the cash to accumulate,including deficient procedures, inadequate accounting records, and ineffective fund controls. It also discusses the assistance financing system's other problems and points out that the Department has no authority to advance loan money.

The report recognizes the Department's ongoing efforts to redesign the system to include
ontrols, and recommends several
mprove those controls and to pro-
ieeded for management decisions.

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

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To the President of the Senate and the
Speaker of the House of Representatives

This report deals with substantial problems in the Department of Health, Education, and Welfare's management of cash advanced under grant, loan, and contract agreements with organizations outside the Federal Government. The Department's assistance management system employs a working fund concept under which money for advances is derived from many different HEW appropriations.

We recommend that the system operate as an independent cash management accounting activity and that the Secretary of HEW obtain congressional approval for handling loans and contracts through the system. We recognize that the system's problems affect many other HEW accounting systems.

Copies of this report are being sent to the Director, Office of Management and Budget and the Secretary of Health, Education, and Welfare.

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

HEW MUST IMPROVE CONTROL OVER BILLIONS IN CASH ADVANCES

D I G E S T

As of March 1978, the Department of Health, Education, and Welfare had advanced over $38 billion to about 14,000 non-Federal organizations through its Departmental Federal Assistance Financing System. Although the system was established to improve the Department's cash management, it allowed premature cash withdrawals because of poor organizational aspects and serious design deficiencies.

PREMATURE CASH WITHDRAWALS

The system uses two methods to advance cash to meet recipients' immediate needs:

--the direct Treasury check method allowing up to a 30-day cash balance, and

--the letter-of-credit method requiring a lower cash balance.

Despite Treasury Department regulations, the agreements for the advances did not always state that recipients should limit cash withdrawals to only immediate needs. Consequently, many recipients withdrew cash far in advance of need, and at the time of review, held an estimated $249 million in excess Federal cash. (See p. 10.) The public debt's interest could be reduced by about $8.3 million if the recipients' excess Federal cash were returned to the U.S. Treasury. (See p. 12.)

Letters of credit had not been extended to about 2,600 eligible recipients primarily because the system's staff was insufficient to handle this task. Letters of credit would allow recipients to operate with small or even no Federal cash balances, a condition that would further reduce public debt interest. The letters of credit should be extended

immediately to eligible recipients. (See pp. 12 and 13.)

The Department, like other Federal agencies, must prevent premature cash withdrawals from the Treasury because recipients' excessive Federal cash, in addition to increasing the public debt interest, also gives recipients a revenue-producing source. Any interest earned usually has to be returned for deposit in the U.S. Treasury. GAO recognizes that the Department innovated some techniques to prevent premature cash withdrawals, but much more must be done.

QUESTIONABLE ORGANIZATIONAL ASPECTS

While the current cash advance system operates as a working fund, it was authorized to manage advances against grants. There is no authority to handle loans and contracts through the fund. Because of the significance of the Department's loan programs, congressional approval should be obtained to make loan and contract advances through the system. This would give the Congress a chance to learn the extent of loan and contract advances made through the fund and to specify operational reports needed for its oversight. (See p. 19.)

Managers of the cash advance system primarily functioned as fiscal agents, or intermediaries between HEW agencies and recipient organizations, while personnnel in other Departmental units performed key cash management functions such as closing out agreements and recovering excess cash. Splitting responsibilities, in this case, was inefficient. (See pp. 21 and 22.)

According to Department officials only 59 employees handled the system's work. This meant that each employee had to handle advances to 333 organizations and could spend only 7 hours a year managing each one. Staffing was inadequate and may be the underlying cause of the many problems GAO noted. (See pp. 22 and 23.)

SYSTEMS DESIGN DEFICIENCIES

The system's $38 billion in advances was against about 190,000 grants, loans, and contracts awarded by the Department's various agencies. Since the Department advanced money without required information on the recipients' planned expenditures, the Department had no assurance that advances would be spent in accord with approved assistance agreements--or even used for authorized purposes.

Recipients reported that as of December 1977, they had exceeded authorized assistance by over $822 million on over 11,800 individual assistance agreements. (See p. 26.)

Also, the system design did not provide for the generation of data needed for effective cash management decisions. For example, system records did not show amounts advanced against specific grants even though such information could have been developed from available data. Instead the records only showed whether requested advances, plus past advances, exceeded recipients' total authorized assistance. (See p. 27.)

Perhaps, the most serious deficiency resulted when cash advances were not charged to specific appropriations. Consequently, the Congress had not been given accurate data on how the Department used its various appropriations. (See p. 31.)

GAO was not the first to note problems with the cash advance system. (See pp. 3 and 34.)

In discussing this report, Department officials said several actions were begun to eliminate the deficiencies reported. They said that to monitor the amounts of recipients' cash advances:

--Administrative grant procedures were corrected.

--Improvements were made in reporting and processing letter-of-credit transactions.

--Recipients' reported cash balance data was being recorded and used.

--A special unit was formed to manage the largest grant recipients' cash advances.

In addition, officials said that, as a result of an ongoing effort to extend letters of credit to all eligible recipients, since April 1978 HEW extended them to about 350 more recipients.

In November 1978, the Secretary approved the development of a revised grants payment control and cash management system. According to Department officials, the revised system is being designed to eliminate problems discussed in this report, such as duplicate transaction recording and inadequate staffing. However, the revised system is not scheduled to begin until October 1980 and, in the past, the Department has not promptly and effectively completed major efforts to improve its accounting systems. (See p. 34.)

On June 1, 1979, the Department's inspector general formally commented on this report. He agreed that serious weaknesses existed at the time of our review and also agreed with most of our recommendations. But his comments were extremely lengthy and attempted to show that this report

--did not recognize some of the Department's significant corrective actions and

--did not contain accurate statements on the seriousness of the system's weaknesses.

GAO evaluated the Department's position and found that no change to GAO's position was warranted. The Department's comments on GAO's recommendations are discussed in the report. Since improvements in HEW's cash advance system could substantially decrease public debt interest, GAO believes the Department should implement GAO's recommendations.

RECOMMENDATIONS

The Secretary of Health, Education, and Welfare should:

--Recover excess amounts of Federal cash held by recipients and where possible act to minimize premature cash withdrawals by (1) developing a control system to monitor recipients' cash balances and (2) specifying in agreements the conditions under which withdrawals can be made. (See p. 17.)

--Make sure letters of credit are extended to all recipients eligible to use that financing method. Work with the Treasury Department and Office of Management and Budget in getting States to remove legal and administrative impediments causing premature and excessive cash withdrawals and, when appropriate, use single letters of credit to do this. (See p. 17.)

--Obtain congressional approval to make loan and contract advances through the grants accounting system, assign that system all cash management responsibilities, and give it adequate staff to handle its work. (See p. 24.)

--Provide resources necessary to implement the revised system and assure that its design (1) provides for both detailed accounting records showing recipients' cash balances and a basis for controlling advances by specific appropriation and (2) uses an approach to charge advances to specific appropriations according to data from recipients. (See p. 36.)

--Have internal auditors investigate reports that advances were spent in excess of authorizations, and determine whether the Government should recover any money. (See p. 36.)

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ABBREVIATIONS

GAO General Accounting Office

HEW Health, Education, and Welfare

DFAFS Departmental Federal Assistance Financing System

CHAPTER 1

INTRODUCTION

The Department of Health, Education, and Welfare (HEW) provides Federal money to help finance programs of non-Federal organizations, such as public service programs of State and local governments, schools, and nonprofit medical research activities. Under its Departmental Federal Assistance Financing System (DFAFS), it makes cash advances to these organizations under grants, contracts, loans, and other financial arrangements. As of March 1978, HEW handled about $38 billion in outstanding advances to about 14,000 non-Federal recipients. In fiscal 1978, about 200 of the recipients received about 80 percent of the advances.

HEW's cash advances affect the amount of money the Treasury Department must borrow to cover the Government's operating costs. Because premature and excessive advances unnecessarily increase the Government's interest costs, the Treasury issued guidelines for all Federal departments and agencies on cash withdrawals from the U.S. Treasury. And, HEW developed DFAFS to help manage its cash advances to non-Federal organizations. Although DFAFS handles large amounts of advances, the system has not been submitted to the Comptroller General for review and approval.

CASH MANAGEMENT POLICIES

Treasury's Fiscal Requirements Manual for Guidance of Departments and Agencies and Treasury Circular 1075 contain policies on cash advances under Federal assistance programs. As stated in part 6 of that manual, the advances should be limited to the minimum necessary for the recipient's immediate disbursements.

Treasury's Fiscal Requirements Manual describes the different techniques that Federal agencies and departments may use to advance cash under their financial assistance programs. Basically these methods are the

--direct Treasury check method whereby agency officials request the U.S. Treasury to draw a check and

--letter-of-credit method whereby agency officials specify the amounts and timeframes so that organizations can withdraw funds as needed from a Federal reserve bank.

Direct Treasury check method

The direct Treasury check method should be used for recipients whose advances total under $120,000 annually. (Prior to December 1977, this total was $250,000.) Under this method, the organization files a request with HEW; then HEW examines the request and prepares a voucher for Treasury requesting payment. Treasury issues the check.

Letter-of-credit method

Because of the potential for reducing interest charges, Treasury's Fiscal Requirements Manual encourages using the letter-of-credit method. The manual specifically requires using that method when an agency expects to deal with a recipient for 1 year or more and advance the recipient over $120,000 annually. This method is more advantageous than the direct Treasury check method; organizations get frequent payments for readily ascertainable short-term needs without having to estimate (or overestimate) long-term needs. The processes' simplicity probably is its surest guarantee of success--it eliminates a number of laborious and time-consuming steps in the direct Treasury check method.

Under the letter-of-credit system, the recipient deals with the paying agent, a Federal Reserve Bank, via a local commercial bank thus eliminating many of the steps required in the direct Treasury check method. After the recipient receives either a Treasury check or a Federal reserve draft for credit to its checking account, the Federal Reserve Bank notifies HEW of the transaction.

DFAFS CASH MANAGEMENT RESPONSIBILITIES

HEW consolidated management of cash advances for most of its agencies and offices 1/ by establishing DFAFS. The consolidation was necessary because of control problems inherent in organizations receiving assistance from more than one HEW

1/These activities are the Office of the Secretary; the Office of Human Development; the Office of Education; the National Institute of Education; the Health Services Administration; the Food and Drug Administration; the Health Resources Administration; the National Institute of Health; the Center for Disease Control; the Office of the Assistant Secretary for Health; the Alcohol, Drug Abuse, and Mental Health Administration; the Health Care Financing Administration; and the Social Security Administration.

unit and because of the quantity of data associated with the awards. HEW also expected DFAFS to more fully utilize its computer resources.

DFAFS services HEW agencies and offices that provide Federal assistance to approximately 14,000 organizations. These services include maintaining records on amounts of

--financial assistance authorized to each organization,

--cash transferred from the Treasury to each organization, and

--cash disbursed by each organization.

DFAFS also advances cash to, and receives expenditure data from, organizations, and gives HEW units the transaction data for their accounting records.

DFAFS does not, however, negotiate terms and conditions under which HEW's agencies provide Federal assistance; this is done by the offices and agencies accountable for the programs.

EXECUTIVE BRANCH'S EMPHASIS ON CASH MANAGEMENT

In recent years, the Treasury has emphasized the opportunity to reduce the Government's interest cost by improving departments' and agencies' cash management. However, the departments and agencies, including some Treasury activities, have been slow doing this because they do not benefit directly from such savings.

The President recognized the need to promote better cash management in the executive branch. In September 1977, he directed the Treasury to advance cash by letter of credit throughout the executive branch, and 2 months later, he directed his Reorganization Project Staff on Federal Cash Management to study cash management policies and practices throughout the Federal Government.

In December 1978, the reorganization staff reported on agencies' cash management initiatives and achievements, and noted that the annual interest costs on the public debt had been reduced considerably. For example, the costs will be reduced by about $32.5 million from cash management improvements initiated by the Treasury Department. The report also notes that HEW is eliminating and recovering excess cash held by recipients. The various system problems mentioned in our report were discussed with DFAFS officials between January and September 1978. In a November 1978 memorandum (see appendix I), the Secretary of HEW acknowledged the major deficiencies discussed in this report, saying:

> "Our grants and financial systems are outmoded and use different computer technologies that cannot be made compatible. As a result, these systems cannot be integrated to eliminate many of the current deficiencies.
>
> "Our financial systems are not constructed to enable effective Departmental monitoring of HEW program activities, or to help managers in day-to-day decisionmaking on use of resources. Current procedures delay the recording of financial transactions and require expensive and cumbersome manual operations and 'cuff' records at all levels of operation."

The Secretary also directed that DFAFS be revised. The revised system is discussed in this report as are the extent of excessive cash held by recipients and the weaknesses which allowed the excesses to develop.

AGENCY COMMENTS

HEW's Inspector General formally commented on this report on June 1, 1979. He acknowledged the serious weaknesses in DFAFS and said that most of our recommendations had been or would be implemented. The Department's position on the recommendations is discussed whenever relevant in this report.

Although acknowledging the serious weaknesses, the Department's lengthy comments attempted to show that our report was based on outdated information and system procedures and that it did not recognize some of the significant corrective actions. For example, the comments implied that our findings were based on system procedures in effect in December 1976.

This position is unwarranted. Although our estimate of excess cash was based on amounts held on December 31, 1976, the data for this estimate was obtained in 1978. More current data could not be obtained from the recipients because of the seriousness of the same system weaknesses we reported. Moreover, these excesses were accumulated under some system procedures that were corrected in 1978 and others that are still in effect. Since this report recognizes the Department's corrective actions through December 1978, it presents current problems the Department must rectify including excess Federal cash held by recipients.

The Department's comments also attempted to show that our report was inaccurate and misleading about the seriousness of some system weaknesses. The comments included considerable information that conflicted with data supporting our findings. Because of this, we reevaluated the questioned data in our report and concluded that it was accurate. Conversely, we found the information in the Department's rebuttal data neither substantive nor relevant enough to warrant changing the report.

Because the Department's comments are lengthy, it was impractical for us to comment on disagreements. Although the HEW comments are not in the report, they are available upon request.

CHAPTER 2

ACTIONS NEEDED TO PREVENT PREMATURE

CASH WITHDRAWALS BY RECIPIENT ORGANIZATIONS

As specified by Treasury Department guidelines, HEW's regulations instructed recipients to make withdrawals from the U.S. Treasury no sooner than necessary so that they would operate with only a minimum Federal cash balance. These requirements, however, generally were not in the individual agreements with grantees, so many recipients withdrew Federal money long before needed.

We estimate that the premature advances allowed by DFAFS increased the Government's annual interest by at least $8.3 million because recipients had at least $249 million in excess cash. Moreover, HEW may have increased the government's interest costs by an undetermined amount by not using, nor encouraging certain States to use, the letter-of-credit method of financing.

In commenting on a previous draft of this report, HEW officials acknowledged that recipients were holding large amounts of excess Federal cash, and cited several corrective actions that were completed or in process. These actions are discussed later in this chapter.

CASH WITHDRAWN LONG BEFORE NEEDED

At the time of our review, HEW advanced cash to organizations by both the direct Treasury check and/or the letter-of-credit methods.

Direct Treasury check method

DFAFS advanced funds to most organizations by the direct Treasury check method. Many recipients we reviewed withdrew funds long before necessary and some even withdrew funds when they already had excessive Federal cash.

Treasury's Fiscal Requirements Manual states how to advance funds to organizations under the direct Treasury check method. It says these advances should be scheduled so that they are available to the organizations just prior to disbursement needs. It points out that this can be done by timing the Treasury checks with the monthly, biweekly, or other cycle by which recipients disburse cash.

HEW incorporated this guidance in its regulations on cash management and stipulated that advances by direct Treasury check method be requested at least monthly. The agreements authorizing the assistance, however, did not specify the timing cycle to be used in withdrawing funds from the Treasury and the recipients were not asked to submit planned disbursement schedules. Moreover, the grant agreements did not specifically instruct the recipients to comply with HEW regulations.

We noted that most organizations withdrew funds monthly or quarterly under the direct Treasury check method. HEW did not have data to establish whether advances or withdrawals were needed for immediate disbursements. Its only controls were verifications to see if the requested advance, plus prior advances, exceeded the total authorized.

HEW's records indicated that excessive Federal cash balances were held by recipients using the direct Treasury check method, but the records did not show the extent of the excesses due to the system problems discussed in chapter 4. We, therefore, selected 117 organizations receiving cash advances under this financing method and sent them questionnaires about their cash balances as of December 31, 1976. We also asked the organizations how long their cash balances would meet their disbursement needs. Seventy-seven of them answered. Using that information and DFAFS' records, we established that 39, or about 49 percent, of the recipients responding had withdrawn excess Federal money at least 3 months or more before needed. For example:

--One recipient had over $250,000 in Federal cash at the beginning of October 1976, and by December 31, 1976, its withdrawals had increased the balance to over $425,000. The recipient said that this cash would cover its disbursements for 90 days.

--Another recipient had about $145,000 in Federal cash at the beginning of October 1976, but withdrew enough over the next 90 days to increase its cash to over $270,000 after expenditures. The recipient said that this cash would cover expenditures for 30 days.

We established that 39 recipients had about $2.1 million in excess Federal cash as of December 31, 1976--after subtracting their January disbursements. We could not determine how much longer than 90 days the excesses existed because DFAFS's computer tapes had been erased. By reviewing recipients' records, however, we established that some had held excess cash for extended periods. For example, one recipient had about $118,000 in Federal cash at the beginning of July

1976. It withdrew enough during the next 9 months to increase its cash balance to about $195,000 by April 1, 1977--after paying $358,000 in expenses. The recipients' uncontrolled approach to withdrawing cash suggests that the excessive cash was always available.

Letter-of-credit method

HEW had extended letters of credit to about 2,100 organizations by the time of our review. The Department attempted to control advances under this financing method by using monthly or quarterly dollar ceilings, but many organizations continually withdrew larger amounts than necessary to bypass the arbitrary control system.

The letter-of-credit method provides the flexibility needed for organizations to operate with small or even no Federal cash balances. As stated in the Treasury's fiscal manual, the flexibility is provided by advanced authorizations to withdraw from $5,000 to $5 million. The recipients are instructed to withdraw funds no sooner than needed for disbursements. Within these limits, authorized withdrawals should be permitted as required to meet noncyclical expenses.

Although HEW emphasized to the organizations that total cash withdrawals be kept within the authorized ceilings, procedures did allow verbal requests for monthly ceilings to be revised to accommodate changed expenditure patterns. Such requests had to be justified in writing later.

HEW used monthly ceilings--one-twelfth of the annual amount authorized--to control withdrawals by most of the letter-of-credit recipients we reviewed. These ceilings encouraged withdrawals that were up to the limits and even generated excesses because ceiling changes had to be justified.

HEW required recipients to operate within their monthly ceilings until they proved they could manage cash effectively --neither withdrawing funds prematurely nor retaining excessive cash; then it placed them under quarterly ceilings which represented one-fourth of their total annual authorizations. (HEW officials could only explain the way the ceilings were set as being streamlined and falling within the Treasury's general guidelines.) However, the officials did not consistently judge effective cash management: Only one of 63 colleges and universities in our sample had a quarterly ceiling and it had an excessive cash balance of about $220,000 on December 31, 1976.

The ceilings eliminated the flexibility needed by organizations with irregular expenditure patterns, especially educational institutions, to operate with minimum Federal cash balances. Most universities and colleges have irregular expenditure patterns, making loans and grants to students at the start of each quarter or semester. Because of ceilings on letter-of-credit withdrawals, these institutions must either (1) get higher ceilings authorized for the month each term begins or (2) withdraw the maximum permitted under the ceilings each month so funds will be available when needed for loans or grants.

We found that about one-half of the 63 institutions we reviewed had higher ceilings for the month in which each academic term started. Some others, however, withdrew amounts specified in ceilings throughout the year so that funds would be available when needed. This latter practice resulted in Federal cash being withdrawn before necessary. For example, one university had a $700,000 ceiling for its cash withdrawals from January through March 1977 but expected to grant or loan over $900,000 in Federal cash to students in January 1977. Thus it withdrew over $200,000 from the U.S. Treasury by the end of December 1976 to cover this shortfall--even though the $200,000 wasn't needed until mid-January 1977.

HEW records indicated that recipients other than educational institutions also withdrew excessive Federal cash under letter-of-credit agreements. Since HEW's records did not show the extent of the excesses, we sent questionnaires to 113 of these recipients to obtain information on their cash withdrawal procedures. We also asked the amount of their cash balances as of December 31, 1976. Ninety-eight provided the requested data. Based on that information and DFAFS's records, we established that 14 of 52 letter-of-credit recipients with existing excess cash balances, or over 26 percent, withdrew large amounts of cash from the U.S. Treasury when they already had excess balances. For example:

--One recipient had over $500,000 in Federal cash on October 1, 1976, and by December 31, 1976, it had increased its Federal cash balance to over $850,000 after paying disbursements for the period. The recipient indicated that its December 31 cash balance would cover its disbursements for about 30 days.

--Another recipient increased its Federal cash balance from $550,000 to $650,000 between October 1, 1976, and December 31, 1976. The recipient indicated that its December 31 balance would cover expected disbursements for 15 days.

Organizations usually need no more than 3 business days' supply of Federal cash when obtaining advances under letters of credit but, under Treasury criteria in effect at the time of the excessive withdrawals, each transaction should have been for no less than $10,000. Based on amounts the recipients said they needed for the 3 days, or at least $10,000, we estimated that 52 recipients had over $14.6 million in excess cash. Many recipients normally withdrew and held excessive amounts of Federal cash throughout the year.

INADEQUATE EFFORTS TO RECOVER EXCESSES

As of March 1977, DFAFS was managing about $38 billion of HEW's outstanding advances to approximately 14,000 organizations. Based on our review, we estimated that recipients of HEW's assistance held at least $249 million annually in excess Federal cash.

For reasons discussed in chapter 4, HEW's records did not show the full extent of excessive Federal cash balances held by recipients. But the records did show some excesses and some premature withdrawals of money.

Extent of excesses

HEW did not require each organization receiving assistance to submit its disbursement patterns. Consequently, we could not determine precise amounts of Federal cash held in excess of recipients' immediate needs, but we estimated the total to be at least $249 million.

We estimated the excess cash balances on the basis of data from the 175 organizations which returned our questionnaires. (These 175 respondents were part of a sample randomly selected to ensure that their operation would represent 25 percent of the HEW recipients.) As shown below, excessive cash balances were reported by 91 of these respondents for the 90-day period ending December 31, 1976.

Method of advance	Number of respondents	Excess cash (millions)
Letters of credit	52	$14.6
Direct Treasury checks	39	2.1
Total	91	$16.7

Based on these respondents' excesses and our findings of no excesses for 84 other recipients, we projected the amount of excess Federal cash held by all recipients to be at least $249 million annually.

Our projections considered maximum cash needs of organizations (3 business days' worth of disbursements or at least $10,000 for recipients under letters of credit, or 30 days' worth of disbursements for recipients under the direct Treasury check method). Also, our projections considered the average time excesses actually were held by individual respondents.

HEW's procedures call for maximum cash needs to be considered in determining if recipients have excessive balances. However, many recipient organizations should be able to operate with even less than the maximum days we considered. For example, several recipients indicated that more frequent withdrawals would not hinder their operations. Also, some recipients indicated they were not restricted from operating under the checks-paid technique, under which no Federal cash balances are required because funds are transferred to the recipient's bank on the day recipient's checks are presented for payment.

Although HEW officials acknowledged that grantees had excess Federal cash balances, the officials estimated the idle balances at only about $93 million, considerably less than the $249 million we estimated.

In its December 1978 report, the President's reorganization project staff noted that HEW's estimate differed from our estimate. The report said the difference probably resulted from such factors as (1) the sampled recipients becoming more conscious of their Federal cash balances since our review, (2) the recipients underreporting their cash balances to HEW, and (3) DFAFS organizational and operational changes since 1976 which improved cash balance monitoring.

We agree that all of the factors mentioned in the report could have contributed to the difference. However, the HEW estimate was based on amounts reported by recipients and recorded in DFAFS' records. As discussed in various sections of this report, the amounts recipients reported were erroneous and this was compounded by DFAFS' delayed and erroneous recording. Thus, DFAFS' records were not a sound basis for estimating the excesses. By contrast, our estimate was based on amounts that recipients reported to us and we selectively verified.

DFAFS' efforts to recover excess cash

Recipient organizations normally gave DFAFS quarterly reports which showed cash balances at the quarter's beginning and end. The recipients also supported their withdrawals with cash requests or payment vouchers which contained information on cash balances. However, the quarterly reports did not disclose the extent of excesses, and HEW made no forceful effort to recover the excesses that were reported.

HEW officials apparently relied on recipients voluntarily drawing money as needed and returning excess cash. Officials said some recipients were called about their excessive cash when balances exceeded 7 days' disbursement needs for recipients under letters of credit, and 30 days' needs for recipients under the direct Treasury check method. HEW's regulations provided for cash advances to be terminated if a recipient persistently failed to maintain only a minimum cash balance. However, we saw no indication of this policy being enforced.

Officials said that they were modifying the system to identify cash excesses and to prevent future premature withdrawals. They also said they acted to encourage the return of excess balances and indicated that they emphasized controlling the largest recipients who receive over 85 percent of the advanced funds.

GOVERNMENT'S INTEREST COST INCREASED BY EXCESSES

The annual interest on the public debt could be reduced by as much as $8.3 million if the recipients' excess Federal cash were returned to the U.S. Treasury. We based this savings on the estimated $249 million in excessive Federal cash held annually by recipients.

If the excess were returned to the Treasury, we assumed the Government's borrowing could be reduced by the same amount. We computed potential interest savings using a weighted average of the prevailing annual rate of 6.36 percent for Treasury's short and long term borrowing. This weighted average was representative of the cost of borrowing the $249 million in excess cash that we identified.

LETTERS OF CREDIT NOT EXTENDED TO ALL RECIPIENTS

Although the Treasury instructs Federal departments and agencies to extend letters of credit to all eligible recipients, HEW had not extended them to over 2,600 of those eligible.

In December 1977, HEW advanced money under the direct Treasury check method to about 1,300 organizations whose advances aggregated over $250,000 annually. According to Treasury's Fiscal Requirements Manual and HEW's own regulations, such advances should have been by letter of credit.

HEW officials cited two reasons for not using letters of credit for these 1,300 recipients. One was that HEW did not know if the recipients' accounting systems could control withdrawals under the method. The other was that they had not ascertained if the recipients wanted to use that method. Some eligible recipients we interviewed said they had not been contacted by HEW about letters of credit and were unfamiliar with the procedures and eligibility. After we explained the advantages, one recipient became interested in the method and even requested permission to use it for its annual advances aggregating over $450,000.

HEW officials acknowledged that they had not adopted routine procedures to monitor use of letters of credit and had not required recipients to use that system when they met specific dollar criteria. The officials said they only would approve requests to use the method when they knew recipients had adequate systems to control advances. But DFAFS had no procedures for gathering information on recipients' financial systems, so data for decisions on the adequacies of the systems was not provided.

In December 1977, Treasury instructed Federal departments and agencies to extend letters of credit to all recipients whose annual advances totaled $120,000. Although this lower dollar criteria made about 1,300 more of HEW's recipients eligible to use the letters, by April 1978, not one of these recipients was doing so.

Since the letters of credit would allow the 2,600 recipients to operate with smaller Federal cash balances than presently, we believe that HEW should extend letters of credit to any eligible recipients.

PREMATURE WITHDRAWALS CAUSED BY STATE LAWS OR REGULATIONS

Besides the premature withdrawals and excesses under conditions previously discussed, some States' laws and regulations cause their agencies to make premature Federal cash withdrawals and thus hold excessive Federal cash. We believe the impact of such laws and regulations could be minimized if State agencies or local governments used single letters of credit. Although HEW encouraged the use of single letters of credit, we found that they were not extended to all the States they should have been.

In a 1975 report, we cautioned that many States had laws or regulations requiring their organizations to withdraw Federal funds from the Treasury before necessary. 1/ We also cautioned that, because of the separation of financial responsibilities in some states, withdrawn funds were not disbursed for several days. We said these conditions existed in at least 20 States and recommended undertaking a project to encourage State and local governments to remove legal or administrative impediments to effective use of letters of credit.

We directed our recommendations to the Secretary of the Treasury and the Administrator of General Services who shared responsibility for Federal cash management policies. Shortly after our report was issued, the Administrator was relieved of his responsibility for cash management and it was unclear as to which agency assumed the responsibility. Thus, as of April 1979, no one acted to have the legal and administrative impediments removed.

We reviewed withdrawals and disbursements of Federal funds in three States whose laws or regulations required Federal funds to be deposited in the State treasury before disbursement. According to Treasury's Fiscal Requirements Manual, the letters of credit for these States should have been governed by clauses in grants, or other financial agreements, that insisted the recipients comply with the Treasury's timing and minimum balance requirements. The recipients also should have been informed that noncompliance would cause revocation of the letters of credit. HEW did not meet these Treasury requirements.

Our review included two States in which letters of credit were issued to each State agency. We found that the legal and administrative impediments in these States contributed to poor cash management and encouraged recipients to prematurely withdraw and hold excessive amounts of Federal cash. For example:

--One State required its agencies to deposit their Federal cash advances in the State treasury. Sometimes this caused an over-40-day delay in disbursement. To illustrate: One State agency processed a $500,000-

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1/"Opportunities for Savings in Interest Costs Through Improved Letter-of-Credit Methods in Federal Grant Programs," (FGMSD-75-17, Apr. 29, 1975).

letter-of-credit payment voucher to its bank on January 17, 1977; the bank transferred the money to the agency on January 24; the money was deposited in the State treasury on February 9; and the agency re-deposited the money in its bank account on February 28. Thus, the money was not available to the agency until 42 days after it was withdrawn from the U.S. Treasury--during which time the State had the funds available for interest.

--Another State also required its agencies to deposit Federal cash advances in the State treasury. This created such delays in advances being made available to the State's educational institutions that the institutions withdrew money from the U.S. Treasury at least 30 days before needed. One institution withdrew advances in August and December that were not needed until September and January.

We did not attempt to determine the amount of excesses created by the States' legal or administrative impediments. However, based on review work in several States, we believe that the amounts would be sizable.

The third State in our review used the single letter-of-credit method with a central activity consolidating cash requirements of many organizations. This has the potential of reducing the recipients' cash balances and administrative costs as well as HEW's and the Treasury's administrative costs. And equally important, the single letter can mitigate or avoid the application of State legal and administrative impediments.

We found this State generally to be operating within Treasury criteria for single letter-of-credit users; it generally paid its agencies' expenditures within 2 days and operated with the minimum Federal cash balance required to do this. During the past 4 years, HEW encouraged the use of single letters of credit, but neither HEW, the Treasury, nor the Office of Management and Budget identified the States with legal and administrative impediments to letters of credit. We believe that the States with the impediments should be asked to use the single letters of credit.

AGENCY ACTIONS AND OUR EVALUATION

Because of the enormous amounts advanced to HEW grantees, the timing of HEW's advances can significantly affect the amount the Treasury must borrow to finance Federal operations. Premature advances should be avoided since they unnecessarily increase interest on the public debt as well as provide recipients with revenue-producing sources. However, unless exempt under the Inter-Governmental Cooperation Act of 1968, any interest earned on Federal advances usually has to be returned for deposit in the U.S. Treasury.

HEW was unsuccessful in controlling recipients' withdrawals. Establishing ceilings on withdrawals actually encouraged recipients to accumulate large excesses of Federal cash. As the recipients were not penalized for holding excesses, it was unreasonable to expect them to voluntarily return them.

We suggested, therefore, that HEW specify the terms and conditions of withdrawals and, as suggested by the Treasury, that HEW control withdrawals by using ceilings to consider each recipient's disbursement cycle and administrative lead time to obtain advances. Further, agreements should contain a provision specifying that advances will be stopped if a recipient persistently withdraws and holds excessive amounts of Federal cash. Of course, the provision should be enforced. Because of the advantages of letters of credit, we think HEW should extend this financing method to any eligible recipients.

We asked HEW to start encouraging State and local governments to remove legal and administrative impediments and to eliminate practices that cause excessive and premature withdrawals of Federal cash from the U.S. Treasury. Although legal and administrative impediments are the concern of all Federal agencies, we suggest that HEW, Treasury, and the Office of Management and Budget, take the lead in getting them removed. We believe that the single letters of credit are the best way to avoid the problems caused by these impediments.

In December 1978, HEW officials said they had initiated or completed a number of short range actions to provide the type of controls we suggested. Specifically they said:

--HEW amended its grant administration procedures to comply with Treasury and Office of Management and Budget requirements.

--HEW and the Treasury redesigned letter-of-credit payment vouchers to aid reporting of recipients' cash balances. Also arrangements were made for the Treasury to provide HEW with magnetic tape records of letters-of-credit vouchers.

--HEW is revising the system to capture and use cash balances information reported by recipients. The system revisions are discussed in chapter 4.

--HEW extended letters of credit to approximately 350 more recipients since April 1978 and is making a major effort to extend that advance method to all eligible recipients.

--DFAFS was reorganized with a special unit responsible for grants to the recipients with the largest cash advances. This unit will get required management information from newly devised reports.

These short range steps should reduce the amount of excess Federal cash held. However, we believe HEW must complete the corrective actions and initiate further measures to reduce the amount of excesses to an acceptable level.

RECOMMENDATIONS

Besides the actions already taken, HEW should:

--Finish developing a control system that would emphasize recipients' monthly disbursement plans and that would provide for monitoring of all recipients' cash balances.

--Specify in agreements the terms and conditions of withdrawals and advise the recipients that advances will be discontinued if abuses persist. Provide for enforcing the discontinuance.

--Recover Federal cash excesses held by recipients wherever feasible.

--Extend letters of credit to all recipients eligible to use them.

--Work with the Treasury and Office of Management and Budget to have States remove legal and administrative impediments that cause premature and excessive cash withdrawals. When appropriate, have States use single letters of credit.

AGENCY COMMENTS

HEW said it had or would implement all the recommendations except the one on the use of single letters of credit. The Department emphazied that such a financing method does not remove the impediments. Our report recognized this but explained that, in one State we reviewed, the single letter of credit minimized the impact. Also, our recommendation suggested the Department work with the Treasury and Office of Management and Budget to remove the impediments. HEW suggested that this recommendation also be addressed to the two agencies, but we feel we can accomplish the same objective, and require less work for the agencies involved, by leaving the present recommendation unchanged.

Since we and HEW do not basically differ on the role of the single letter of credit in bypassing State impediments, we believe HEW should implement that recommendation as well as the others.

CHAPTER 3

MANAGEMENT ACTIONS REQUIRED ON QUESTIONABLE

ASPECTS OF CASH MANAGEMENT SYSTEM

As part of HEW's continuing effort to improve cash management, it established DFAFS to advance money to recipients from the Department's many different grants, contracts, and loans. The financing system's objectives were to improve cash management within HEW and in non-Federal organizations which receive HEW cash advances. Despite the desirability of these objectives, HEW had no authority to advance money for loans through the system's fund and cash management responsibilities were not assigned to attain the objectives of a consolidated working fund. Also, DFAFS was not assigned enough people to make it viable. In December 1978, HEW officials told us the Secretary approved system changes that could correct the responsibility and staffing problems.

LOANS INCLUDED WITHOUT LEGAL AUTHORITY

A management fund similar to DFAFS should be authorized to help account for and administer advances against various financial agreements. The working account used by DFAFS was established by law to manage payments under grants, but not to pay the Department's loans.

DFAFS' advances are handled through the account established by the Treasury in accord with 31 U.S.C. 553. In part, this law states:

> "There is hereby established on the books of the Treasury an account or accounts without fiscal year limitation. There shall be deposited in such account, to the extent provided by the Secretary of Health, Education, and Welfare or his designee, all or part of <u>any grant awarded by the Secretary or any other officer or employee of the Department of Health, Education, and Welfare</u>. Payments of <u>any such grant</u> shall from time to time be made to the grantee from such account or accounts, subject to such limitations relating to fund accumulation as the Secretary may prescribe, to the extent needed to carry out the purposes of any such grant." (Underscoring added.)

This authorization, requested by HEW in 1965, was enacted as a part of the Mental Retardation Facilities and Community Mental Health Centers Construction Act Amendments of 1965

(Public Law 89-105). In mentioning the authorization in testimony in May 1965, a Department official referred to the account to be established as a repository for "grants from all parts of the Department of Health, Education, and Welfare." The official did not mention plans to use the account for loans then nor were such plans mentioned in other documents related to the authorization.

In accord with the Public Law, the Treasury established an account for the National Institutes of Health which had responsibility for grants. The account became known as the institutes' grant management fund, and by 1973 the fund had been expanded to handle grant advances of various HEW organizations.

In fiscal 1974, HEW formalized the fund expansion for handling payments to organizations under many of the Department's grants, contracts, loans, and other programs of an assistance-like nature. 1/ Since then HEW's agencies have transferred portions of their appropriations for grants, contracts, and loans to DFAFS. Under procedures governing DFAFS' operation, the amounts transferred become the authority to make advances without regard to fiscal year limitations or purposes of appropriations. In fiscal 1977, DFAFS received about $12.5 billion for advances, an amount projected to increase to about $28 billion by fiscal 1978.

As previously mentioned, the legislation clearly allows the Department to use a working fund similar to DFAFS for making advances against its grants. However, advances against contracts cannot be made unless authorized by the appropriation concerned or other law (31 U.S.C. 529). The Department's advances represent amounts to be repaid or accounted for by recipients. Certain advances that resemble loans should be accounted for differently than routine grant advances.

The Department plans to continue handling student loan advances through DFAFS in the future. For example, the system was used in fiscal 1979 to advance about $300 million for HEW's National Direct Student Loan Program. Since it may be advantageous and proper to handle the loans through DFAFS, we believe HEW should seek agreement to do so. This would give

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1/The criteria is very detailed to determine specific Federal assistance-like agreements to be managed by the fund. Generally, all grants except construction grants, may be included in the fund. Also, loans to recipient's revolving fund activities and advance payments on contracts may be included.

the Congress a chance to help set criteria for DFAFS and to provide instructions on the reports it needs on the system.

RESPONSIBILITIES ASSIGNED INCONSISTENT WITH FUND OBJECTIVES

Although DFAFS was established partially to improve HEW's management of cash advances, the system has been used only to make advances, recover excesses from premature withdrawals, and accumulate accounting data. Other HEW components performed key cash management functions, such as closing agreements and recovery of cash excesses. Sometimes splitting responsibilities is inefficient, and in this case, HEW employees failed to perform many of their cash management functions because of an apparent confusion over the split responsibilities.

At the time of our review, DFAFS employees worked primarily as fiscal agents, or intermediaries, between HEW agencies and recipient organizations; they processed requests for cash advances, had checks issued, and generated accounting data on the three areas of DFAFS' concern in managing cash advances--recipients' authorized funding, cash advances, and disbursements. With regard to responsibilities of personnel directly or indirectly involved with DFAFS, the system's user guide issued in October 1976 states:

> "DFAFS' functions as a total DHEW Federal Assistance Financing concept in the role of a fiscal intermediary between the DHEW agency awarding components and the recipient of Federal assistance-like programs. In this capacity, DFAFS basically provides cash in support of the recipients' program needs, receives expenditure data from recipients, and furnishes DHEW agencies with accounting transaction data for updating their accounting systems and for financial management of their program responsibilities."

The DFAFS user guide, issued in October 1976, said that DFAFS and the Department's agencies were responsible for cash management. For example, the guide said DFAFS was responsible for recovering excess cash from premature advances and depositing it in DFAFS accounts. But it said agencies were responsible for closing grant agreements and determining how much should be returned to DFAFS. This division of cash management created serious problems in closing grants or loans. For example, in March 1977, DFAFS dropped about 35,000 Office of Education loans and grants from DFAFS records and forwarded information on them to the Office of Education. DFAFS said it did this to reconcile its records with recipients' records. Office of Education officials said some of the loans and grants should not have been dropped but that they had no plans to determine which ones.

As of March 31, 1978, an HEW report showed about 52,400 inactive grants or loans which should have been closed. Included were loans or grants made by the Office of Education (35,700); the Health Research Administration (9,100); the Alcohol, Drug Abuse, and Mental Health Administration (2,000); regional offices (about 3,900); and other offices (1,700). HEW officials said they began a departmentwide effort to do this.

The division of responsibility also created difficulties in handling conditions such as high error rates in accounting data in the system, unreconciled differences in the system's and recipients' accounts, and delays in correcting identified errors. Also, DFAFS' records showed that the expenditures of advances exceeded authorizations by about $822 million for about 16,000 grants. Chapter 4 discusses control deficiencies that could allow such excess expenditures.

TOO FEW PEOPLE TO DO THE WORK

In 1975, an HEW task force reported that the 48 employees then assigned to DFAFS could not handle the system's workload. At the time of our review, DFAFS officials said they usually had about 59 employees. Yet, the 59 could not handle enough work to make DFAFS viable; this condition may be the cause of the many system problems we noted.

HEW formed a special task force in early 1975 to study DFAFS and consider how to make the system viable. The task force reported in October and November 1975 that DFAFS was severely understaffed. The task force said that DFAFS was operating with 48 employees although 53 were authorized. The task force reports did not say whether 53 employees would be adequate but, they did say DFAFS' reports and liaison personnel who were responsible for processing reports and general communications with recipients handled up to 1,100 grantee accounts per person.

The task force reports declared that when employees had to handle too many recipients, their efficiency was minimal. The reports also commented that inadequate staff created the following problems.

--Untimely and inaccurate analysis of recipients' expenditure reports, which caused recipients more work since prior adjustments were not reflected on subsequent reports.

--Weak management control over cash flow to the 14,000 recipients, which contributed to an increase in unbalanced cash accounts.

--Ineffective monitoring of letter-of-credit recipients, which resulted in late detection of infrequent drawdowns by recipients that contributed to excess balances of Federal funds.

DFAFS said that, since the reports, its reports and liaison staff was increased from 32 to 38 and was reorganized on a three-person team basis. Still, this resulted in each employee servicing about 333 organizations. The employees had to do the following to control recipients' withdrawals:

--Process advance requests for withdrawals under the direct Treasury check payment system.

--Review and process recipients' reports of disbursements from cash advances.

--Monitor excessive cash balances reported by recipients.

--Adjust letter-of-credit ceilings and monitor advances under them.

--Inform HEW agencies of any problems reported by the recipients.

An employee handling 333 accounts would have under 7 hours a year to devote to each. It is unreasonable to expect an employee to effectively perform the just-mentioned functions in 7 hours--especially considering that they should be performed several times a year.

According to the task force, many DFAFS' problems were due to inadequate staffing. We believe DFAFS is still understaffed and that attempts to operate it this way since its inception resulted in it never properly monitoring or controlling cash advances. DFAFS officials recognized the inadequate staffing and requested more employees.

AGENCY ACTIONS AND OUR EVALUATION

In a draft report reviewed by HEW, we concluded that the working fund aids accounting and improves administration of interagency functions, such as managing cash advances. We also noted that as previously operated, DFAFS offered some advantages, including reducing administrative costs and making cash advances quickly. The advantages, however, had been gained through not controlling advances from the Treasury.

DFAFS' principal advantage was that it was an entity in which the Department could consolidate all cash management functions, including collecting excess cash from recipients and closing out completed agreements. We concluded that to operate DFAFS as a complete cash management entity would require substantial increases in employees and computer utilization.

The draft recognized that the system also may be advantageous in managing advances under loan agreements and programs. If so, we suggested asking the Congress to approve such use of the system, an approach that would let HEW advise the Congress of the extent loans are made through the fund and allow the legislature to specify reports needed for oversight.

In response, HEW said it was replacing DFAFS with a grant payment control and cash management system. The new system should begin in October 1980, and will assume all cash management responsibilities related to assistance agreements handled by DFAFS. Some cash management personnel in the various HEW agencies will be assigned to the new system and the 1980 HEW budget included additional employees for the new system.

The planned changes to the departmental grant payment system, if fully implemented, should correct the problems cited. However, HEW must completely implement the system to adequately improve its cash management.

RECOMMENDATIONS

The Secretary of Health, Education, and Welfare should

--obtain specific congressional approval to handle loan funds through the grants accounting system;

--make sure the new system is used for all aspects of the cash management, such as collecting all excess advances; and

--provide the system with adequate staff.

HEW agreed to implement the last two recommendations and in an April 1979 legal opinion, acknowledged that DFAFS could only be used to make payments under grants or cooperate agreements (which are essentially grants). The opinion concluded that legislative authority would be needed if the Department wanted DFAFS to make payments under contracts or make loans.

HEW's comments on the report, however, disagreed with our recommendation to obtain the legal authority. The comments said the Department has authority to disburse money under three of its student loan programs. This position was based on the April 1979 legal opinion which, in part, said:

> "Although the purpose of the loan funds * * * is to make loans to students, the payments of Federal capital contributions to the fund are not loans. They are grants. The Federal Government does not lend money to either the institutions or the students under any of the three programs. Rather, it makes capital contributions to the funds. The institutions with which the Secretary or the Commissioner of Education have agreements make loans to students from the funds."

The legal opinion considered definitions in the Federal Grant and Cooperative Act of 1977 which distinguishes between procurement and assistance relationships. It concluded that under the loan program an assistance rather than a procurement relationship existed between the Government and the participating institution. We believe that even if the programs are properly characterized as grant programs, the three student loan programs should be treated as loans for accounting purposes. In fact, we told HEW in April 1979 that its accounting system must follow loan procedures for handling transactions of the National Direct Student Loan Program. Agency officials agreed with our position and are recording the advances as a loans receivable. Advancing money to make loans complicates accountability even if properly managed, because separate records are needed to account for funds until they are repaid or determined to be uncollectible. The agency must have complete control over advances to loan funds to protect the Government's investment.

The Department plans to continue using the advance payment system to disburse money under the three major student loan programs. We believe that congressional agreement should be sought concerning the system for making loan advances to educational institutions.

CHAPTER 4

IMPROVEMENTS NEEDED IN

ACCOUNTING FOR CASH ADVANCES

At the time of our review, DFAFS had serious weaknesses in accounting and data gathering, both of which affected the validity of data in all HEW accounting systems. HEW has started redesigning DFAFS to eliminate the weaknesses discussed in this chapter. However, HEW acts slowly to improve its accounting systems and was particularly slow in implementing the 1975 recommendations by the HEW task force.

FAULTY CONTROLS ALLOWED OVERSPENDING

HEW's cash management system should include controls to ensure that a grantee gets no advance above its authorized total. Under DFAFS, funds are advanced in good faith, and by December 1977, recipients reported that they disbursed $822 million of advances above their authorizations. Although required to do so, HEW had not determined whether the Government should recover this money.

Our Policy and Procedures Manual for the Guidance of Federal Agencies describes agencies' responsibilities in managing cash advances under Federal grants (2 GAO 16.8c). As pointed out in the manual, departments and agencies must see that cash advances do not exceed recipients' authorizations and that recipients use advances only as authorized. The manual also states that the Government may recover any improperly used advances.

DFAFS, which managed cash advances for about 190,000 grants and loans, provided for advances without considering the intended use of the money. DFAFS considered all advances as made from a "cash pool" of various HEW appropriations, and under this approach, recipients were not asked to specify grants or loans against which the advances would be applied. The advances were available for the recipients' immediate disbursements and DFAFS recorded only the total of each advance. DFAFS only control was to see if an amount requested plus prior cash advances exceeded the total authorized.

DFAFS relied on recipients' disbursement reports to see if advances were applied to grants in excess of authorizations. These reports were submitted monthly by a few recipients but quarterly by most, and an average of over 8 days elapsed before the reported data was recorded in DFAFS' records. The report format included authorized Federal assistance levels for each grant, contract, and loan.

As of December 1977, recipients' disbursement reports showed that the authorized assistance levels on over 11,800 individual grants, contracts, and loans had been exceeded by over $822 million. The DFAFS' User Guide gives two general reasons for expenditure levels exceeding authorizations:

--The recipients erroneously reported amounts for their share of expenditures along with the Federal share.

--DFAFS' records contained erroneous or incomplete data on authorized assistance levels.

DFAFS reports showed individual agreements for which recipients reported expenditures greater than authorized. HEW agencies responsible for the agreements were then instructed to determine why excesses were reported. Thus, recipients were required to explain any excessive expenditures in their reports to DFAFS, but this requirement was not enforced by the awarding agencies. DFAFS officials said that memos were sent regularly to the HEW agencies about grant authorizations problems.

We did not attempt to evaluate the effectiveness of HEW's efforts to establish the reasons for the reported excesses because that would have required extensive work. However, we did note that the number of agreements with excessive expenditures increased by about 2,800 between April and December 1977.

HEW procedures do not provide for its internal auditors to investigate excessive expenditures reported against individual agreements. However, since the controls over advances and excessive expenditures were inadequate and since improper use of advances is possible, we believe the internal auditors should investigate any excessive expenditures unexplained by HEW's data. DFAFS officials stated that HEW on-site auditors have access to the reports showing this problem.

ACCOUNTING RECORDS INADEQUATELY DESIGNED FOR CASH MANAGEMENT

Accounting records normally give management the basis for financial decisions, especially those on whether cash advances should be made. Because DFAFS' operational concept provided for advances to be controlled against the total assistance authorized for each recipient, the system's accounting records were not designed to show the cash advances against specific grants, contracts, or loans. Moreover, DFAFS was designed in a manner preventing prompt and accurate recording of accounting data and providing for duplication--that we normally discourage--within HEW accounting systems.

As a result, the DFAFS' accounting reports did not contain the correct or timely information necessary (1) for individual program managers to make sound decisions on cash advances or (2) to verify the accuracy of expenditure data that recipients reported for specific grants and loans.

Deficiencies in accounting records design

Our Policy and Procedures Manual emphasizes that accounting records should be detailed enough to satisfy management needs. DFAFS did not maintain up-to-date records on whether a recipient's specific grant or loan authorization was exceeded. Without such records, DFAFS could not decide on cash advance requests nor check the accuracy of recipients' expenditures.

HEW agencies gave DFAFS data on the amounts authorized under the agreements it makes advances against. This information was used to compute the total assistance authorized each recipient and was retained in DFAFS' accounting records, available for use in resolving problems with recipients' cash balances and expenditures reports. The information also was included on disbursement report forms DFAFS furnished recipients so that recipients could verify the authorization data. While this aided verification, it hindered cash management control.

In accord with DFAFS' cash pool concept, the system provided for recording each cash advance in the recipient's cash account which showed the total advances, less disbursements reported by the recipient.

Requests for cash advances contained information on disbursements against prior advances, but DFAFS did not record this information. Instead, disbursements, or reductions in cash advances, were recorded monthly or quarterly, depending on the size of the advances. DFAFS records did not show even approximate cash balances of recipients because of the recording timelag.

DFAFS recorded disbursements recipients reported on the forms that DFAFS supplied containing assistance data. Concerning this, our Policy and Procedures Manual (2 GAO 16.8) states that cash advance accounts should be reduced on the basis of acceptable reports from recipients; however, the manual does not preclude keeping detailed or subsidiary accounts of disbursements.

We encourage Federal agencies to maintain detailed records to provide data to management for control purposes.

Such records would have provided DFAFS with cash balances and a basis for verifying data reported by recipients. According to DFAFS officials, actual cash balance analyses were made for the 2,000 grantees receiving the largest advances since March 1978. The analyses considered the recipients' average cash balances and identified excessive cash withdrawals. We are uncertain how effective these analyses are since they rely on data from the reports in which there are inherent timelags.

<u>Timelags in recording accounting data</u>

Although the DFAFS operational manual recognizes that the system must provide for prompt recording of financial data, the system was designed to let months elapse before data is recorded. The system design allowed up to 1 week to elapse before authorization data was received by DFAFS from awarding agencies. This was how often HEW agencies sent such data tapes to DFAFS. Sometimes, however, the tapes were not complete and frequently the data was erroneous and was rejected. For example, the HEW agencies annually gave erroneous data on over 16,000, or 8.1 percent, of the approximately 190,000 loans, contracts, and grants that DFAFS handled; the HEW task force cited a similar error rate in November 1975.

Besides the delay in data recording, several months elapsed before transactions rejected by valid computer edits were corrected and recorded in DFAFS' records. For example, in June 1977, computer edits rejected data to reduce a recipient's authorization by $60.8 million because the reduction exceeded the recipient's total authorization. Six months later, the transaction had not been corrected and recorded in the DFAFS records.

The system also provided for advances to be recorded up to 12 days after made by the banks--a delay caused by a DFAFS' system deficiency requiring all advances against letters of credit to be recorded with a date of either the 5th, 16th, or 23rd of the month. DFAFS is changing the program to record all advances on the actual date on Treasury vouchers.

The system's design provides delays of up to 90 days before most recipients' disbursements are reported to DFAFS. Disbursements for some recipients of larger amounts were to be reported more frequently, but lagged up to 30 days--too long for the data to aid in adjusting the amounts of disbursements reported. Moreover, we noted that up to 38 days elapsed between receiving data and recording it. DFAFS said the delay had been reduced to 14 days by June 1978.

Duplication in accounting systems

As the DFAFS was designed and interfaced with other HEW accounting systems, detailed accounting data was passed between the systems. We generally discourage this type of duplication because it increases both the accounting workload and the opportunity for a high error rate.

Our Policy and Procedures Manual (2 GAO 8.7) contains technical requirements for accounting systems. In part, one section says:

> "As a general rule, transactions recorded in agency accounts should not be recopied even in summary form in the accounts of agencies at higher organizational levels. Instead, financial reports submitted by subordinate levels should be utilized in preparing summary reports."

DFAFS allowed accounting data to be recorded initially in either its records or those of the HEW agency involved--and then to be copied in the other's records. For example, HEW agencies initially recorded authorization data in their automated accounting records; after the data was accepted and posted to their systems, it was transmitted by magnetic tape to DFAFS for recording in its records. The data on recipients' disbursements worked in reverse; it was initially recorded in DFAFS records after relating amounts to specific appropriations using the first-in, first-out method of allocation. Then it was provided to the HEW agencies on magnetic tape.

This method of copying the data resulted in keeping two sets of accounting records and increased the chance of errors even though using the tapes in copying minimized errors somewhat. Also, the data in the tapes was subjected to DFAFS' edit routines that are different from those in other HEW accounting systems and, as previously mentioned, transactions rejected by the edits were not corrected promptly. Because of this and other problems of duplicate records, such as delays in transmitting the data between systems, significant differences existed between data in DFAFS accounting records and in HEW agencies' accounting records. For example, as of June 1977, DFAFS and HEW's Office of Education accounting records showed different authorized assistance levels for over 3,000 recipients.

One of the advantages of DFAFS operating as a working fund would be the elimination of the problems associated with duplicate systems. The fund could be allowed to accumulate and record all accounting data on advances, prepare summary reports on the status of advances, and transmit the reports to appropriate levels for fund control and management purposes.

SYSTEM OPERATED WITHOUT EFFECTIVE FUND CONTROLS

DFAFS made advances against obligation authority provided in the many different HEW appropriations which the Congress appropriated for specific purposes and periods, but did not maintain subsidiary records showing limits on advances against specified appropriations. Advances were charged to appropriations on the basis of forward planning estimates even though more precise data could have been used. As the estimates were never adjusted to show actual amounts, this approach distorted the Department's budget which showed that appropriations were spent as authorized and that expenditures did not exceed authorizations. This approach also provides chances for undetectable Anti-Deficiency Act (31 U.S.C. 665) violations, and equally important, negates the objectives of the Congress' review of HEW appropriations.

Subsidiary records not maintained

DFAFS was authorized to make advances from obligations that the HEW agencies recorded against their various appropriations. Although DFAFS operated as a working fund, it did not maintain the required subsidiary or detailed records to show the status or limitations on use of appropriations.

The Anti-Deficiency Act requires HEW to control its appropriations so that expenditures do not exceed authorizations and administrative allocations, and so that appropriations are used only as authorized. Our Policy and Procedures Manual (7 GAO 6.9) requires operations such as DFAFS to maintain separate subsidiary accounts for advances from different appropriations.

Another section of the manual (7 GAO 5.4) requires that records for fund control purposes show the status of each appropriation: the amount available for advances, the amount expended, and the amount remaining. DFAFS records did not contain this data, but it was constructed through a series of estimates that were never adjusted to actualities. As disclosed in the next section, DFAFS even gave HEW agencies estimates with which to control their obligations.

Fund control data developed using estimates

During the period of DFAFS' operation, the Congress provided HEW agencies with appropriations to carry out specific health, education, and welfare programs. The appropriations were for 1 year, meaning the funds could be obligated only during a specific fiscal year. Many times an appropriation was designated for specific assistance programs such as grant or loan programs.

As DFAFS was responsible for making advances, it was also responsible for telling HEW agencies and the Treasury the amounts advanced against each appropriation and the amounts recipients expended. DFAFS used an unsound method of estimating such amounts.

The agencies' cash outlay plans were the basis for estimating amounts of advances to be charged to each appropriation. These outlay plans contained amounts that DFAFS was expected to handle and DFAFS combined these amounts to get the total disbursement planned. Also, DFAFS used the plans to establish ratios which expressed the month-by-month percentages of cash advances to bill each agency. DFAFS then used a set of percentages from the agencies to determine the month-by-month amounts to charge each appropriation.

DFAFS used such estimates to determine all amounts reported on monthly statements it submitted to HEW agencies and the Treasury. One of these statements, the schedule of payments, is the basic document the Treasury and the agencies use to charge specific appropriations' accounts with disbursements. Because DFAFS used estimates, the statements did not provide reliable data.

The estimates could be used if they were the best basis available for determining the advances to be charged to each appropriation. However, better information could have been developed to relate cash advances to specific appropriations. For example, DFAFS advances cash to most recipients by direct Treasury check and under that method, receives monthly cash requests that could be modified to include data to relate advances to specific appropriations. Also, under letter-of-credit agreements, DFAFS receives copies of vouchers for its cash advances. According to Treasury's Fiscal Requirements Manual, the copies are provided so the agencies can record advances and make appropriate entries in their control and subsidiary accounts. Disbursement plan data for recipients using letters of credit should be available in DFAFS and it could be used with the information on the vouchers to relate the vouchered cash advances to specific appropriations.

DFAFS recognizes requirements for recipients to keep records of cash advance expenditures by specific HEW appropriation. DFAFS said recipients do report their expenditures monthly or quarterly and that it uses the reports to adjust the estimated charges against appropriations. However, DFAFS procedures for recipients to report disbursements do not support this.

Under DFAFS procedures, recipients were not required to relate their disbursements to specific appropriations, but rather to classify expenditures as either "project period awards" or "discrete awards." Discrete awards covered agreements that would be completed in a short time while the project period awards covered agreements over 1 year. When the recipients reported total disbursements against project period awards DFAFS prorated the amounts to specific appropriations using a first-in, first-out approach, meaning the expenditures were arbitrarily applied to the oldest appropriation with an unexpended obligation balance.

DFAFS' then reported the arbitrary amounts to HEW agencies for their accounting and fund control records. Finally, the agencies included these amounts in data sent to the Treasury, the Office of Management and Budget, and the Congress.

Besides the arbitrary classifications of disbursements, we also noted that some recipients, such as vocational schools, were not required to report disbursements to DFAFS. As already discussed, the recipients' reports contained many unresolved errors and DFAFS recorded the data too late to be useful. These conditions provide chances for Anti-Deficiency Act violations which would not show on records because the estimating and arbitrary allocation procedures would result in an overexpended appropriation being applied against an underexpended one. Also these conditions allow funds to be misspent or spent at the wrong time.

OUR EVALUATION AND AGENCY ACTIONS

In a draft report to HEW we said that DFAFS' operations must relate cash advances to specific appropriations. This is an elementary requirement to ensure reasonable control over how recipients use the advances. Also, such relating aids cash management decisions and is essential for fund control.

We also pointed out that detailed accounting, or subsidiary, records were necessary for cash management and fund control. We suggested detailed records as the basis for verifying data in recipients' records, especially disbursement data intended for DFAFS. To make the subsidiary records an effective control, we suggested that recipients relate amounts of cash advances requested to specific grant contracts or loan agreements. This could be done either on documents supporting the requests or on monthly disbursement plans.

As DFAFS used an unsound approach to estimate the amounts of cash advances that it charged against each individual appropriation, we said that approach distorted obligation and disbursement data that was included in budgets for congressional review. That approach also allowed funds to be used for purposes, and at times, other than those specified in appropriations. Because of these adverse conditions we suggested developing a more precise method to relate advances to specific appropriations using recipients' data.

We asked HEW to investigate the agreements for which recipients reported disbursements exceeding authorized assistance. Because of inadequate DFAFS staffing and the possibility of recovering some of the amounts involved, we asked HEW to have its internal auditors help in the investigation. We also suggested procedures for promptly investigating and resolving any future excessive disbursements.

In commenting on our suggestions, HEW said it planned to develop a new departmental grants payment control and cash management system. As previously mentioned, the plan was approved by the Secretary of HEW in his memo of November 7, 1978 (app. I) after the Department's own analyses found the same basic deficiencies we identified.

The revised system will not only eliminate duplicate recording but also, will keep detailed accounting records for any award paid, including fund control records. Only summary program information will be retained at the HEW agency awarding the grant. Under the new program, cash advances will be controlled by cash plans submitted by recipients. Until more detailed implementation is planned, we cannot be sure that the new system will contain everything necessary for effective management and fund control.

PAST DELAYS IN COMPLETING SYSTEM IMPROVEMENTS

HEW is comprehensively revising its accounting systems, including the system for cash advances, so that they will provide the data needed for effective management. In the past, however, HEW failed in such major efforts, especially in implementing recommendations to improve its centralized payroll system and its cash advance system.

Payroll system changes

In January 1969, we recommended that the Secretary of HEW assign high priority to redesigning the Department's payroll system. Since then, we issued a series of five reports on necessary payroll improvements. Some of the improvements related to deficiencies we reported in 1969 or HEW's internal auditors reported even earlier. It was not until 1977 that HEW acted on many of the recommendations, and the Department will not submit a system for our approval until fiscal 1980.

Cash advance system improvements

In 1975 an HEW task force began discussing DFAFS' problems and recommending improvements. DFAFS officials said most of the recommendations were implemented, but based on our review, the objectives of the recommendations were not met.

HEW began operating DFAFS in 1974, and immediately encountered serious problems with it. In 1975 a task force considered how to make the system viable. The task force's first report, in October 1975, discussed problems with practically every aspect of DFAFS. In November 1975, the task force declared that DFAFS was a perfect example of how not to organize a system--and made 128 specific recommendations to improve DFAFS. These recommendations related to practically all the system's functional activities, including assigning responsibility, staffing, training, recordkeeping, and reporting. The recommendations also covered functional activities of other HEW systems that affected DFAFS' operations.

Our review did not cover all DFAFS' functional activities on which the task force had made recommendations. It did, however, cover some of the more important ones and we found that many deficiencies we addressed had been addressed to some degree by the task force. For example:

--The task force reported that DFAFS had not extended letters of credit to eligible recipients. This deficiency still existed at the time of our review. (See p. 12.)

--The task force said that errors rejected by computer edits were not promptly corrected and reentered in DFAFS' records by HEW agencies. (See p. 29.)

--The task force said that no action was taken to establish the reason for recipients' reporting expenditures above authorizations for specific grants. This report shows that this condition has grown worse. (See p. 26.)

In February 1978, DFAFS officials said they implemented most of the task force's recommendations that they were able to.

RECOMMENDATIONS

We recommend that the Secretary of Health, Education, and Welfare:

--Provide resources to ensure that the new system becomes operational as scheduled, and monitor the redesign efforts to ensure fastest possible completion.

--Require the revised system to have adequately detailed accounting records that will show the cash balances held by recipients and contain data to control cash advances by specific appropriations.

--Develop a better approach to charge amounts of advances against specific appropriations, such as an approach that would use data recipients furnished to support payment requests.

--Require the Department's internal auditors to investigate disbursements reported in excess of authorizations, and to establish how much, if any, of the money should be recovered by the Government.

--Require the revised system to provide for promptly investigating and resolving excessive disbursements reported by recipients, for eliminating duplicative agency records, and for prompt reporting of Anit-Deficiency Act violations.

AGENCY'S RESPONSE

The Department generally agreed with our recommendations, but disagreed with the need to implement a portion of one of them.

The Department disagreed with our recommendation to control cash advances by specific appropriations and it presented data demonstrating how difficult this would be. We appreciate the difficulty but feel this must be done so the agency can ensure that expenditures are consistent with appropriations.

The Department characterized as desirable the development of a better approach for charging advances against appropriations and the use of internal auditors for investigating excessive fund use. HEW emphasized the problems in implementing these recommendations. We recognize the problems, but believe the actions are essential.

CHAPTER 5

SCOPE OF REVIEW

This review involved evaluating HEW's systems to manage cash it advances under Federal assistance programs to about 14,000 nongovernmental organizations. Because of this large universe, we used random sampling techniques to select the recipient organizations included in our review. Our statistical sample included 280 recipient organizations in four States--California, Illinois, Massachusetts, and New York--which have about 25 percent, or about 3,250, of the organizations receiving HEW assistance.

We sent questionnaires to our sample, requesting information on cash balances for specified periods and answers to questions that could be used to evaluate HEW's cash management practices. The questions related to matters such as the recipients' cash need in terms of days, their understanding of HEW's cash management systems, and their experience in getting data differences on records resolved. We visited about 10 percent of our sample to verify the accuracy and completeness of their responses.

Our review included work at HEW activities in Chicago and Washington, D.C. At these locations, we analyzed cash management policies and procedures and reviewed terms and conditions in grants and contracts under which advances were made. We also evaluated DFAFS procedures for (1) collecting and recording data, (2) advancing cash to recipients, and (3) preparing detailed disbursements records. In these analyses, we compared accounting data on recipient organizations' records with that on DFAFS' records and inquired about significant differences.

THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE
WASHINGTON, D.C. 20201

NOV 7 1978

MEMORANDUM TO: Heads of POCs and Education Agencies
Heads of OS Staff Offices
Principal Regional Officials

SUBJECT: Development of New Grant and Financial System

Many months of staff study of HEW's existing grants, accounting, and payment systems reveal basic limitations and recurring deficiencies that cannot be repaired through modification. We clearly need a fundamentally new approach to the interrelated tasks of grant management and financial accounting.

A number of major deficiencies in grant management and cash payment were discussed in my July 6 meeting with POC Heads. Many of you provided helpful suggestions for improvement. The Assistant Secretary for Management and Budget followed up with an examination of our grants and financial processes. His review disclosed the following:

- Our grants and financial systems are outmoded and use different computer technologies that cannot be made compatible. As a result, these systems cannot be integrated to eliminate many of the current deficiencies.

- Our financial systems are not constructed to enable effective Departmental monitoring of HEW program activities, or to help managers in day-to-day decisionmaking on use of resources. Current procedures delay the recording of financial transactions and require expensive and cumbersome manual operations and "cuff" records at all levels of operation.

- Across the Department substantial numbers of grants awards are issued with errors; we are not recording the amounts of awards accurately which leads to discrepancies between HEW and grantee records. Grantees in turn complain about the heavy burden we place on them to reconcile their records with ours because of HEW errors.

- The Department maintains duplicative systems for recording information on grants. This causes continual problems and wasted resources in keeping these records reconciled.

I am, therefore, approving the development and installation of a comprehensive, new grants and accounting system that will overcome these deficiencies. Over the next three years, I expect this system to fully integrate our grants and accounting systems and to take advantage of current technology to reduce operational costs.

More specifically, I am today directing initiation of the following actions:

- The Assistant Secretary for Management and Budget (ASMB) will expand the pilot computer accounting system now being developed for the Office of the Secretary for installation in all of the HEW agencies. This effort will include the development of a system for editing and recording computerized grant awards. I expect the pilot phase to be fully implemented in the Office of the Secretary by October 1979 and installed in all operating agencies during 1980 and 1981.

- The ASMB will also replace the Departmental Federal Assistance Financing System (DFAFS) with a Departmental Grants Payment Control and Cash Management System. I expect this new cash management system to be fully in place by October 1980.

- I have also authorized the ASMB to establish systems task groups, staffed predominantly from personnel in the POCs. These task groups will determine the systems requirements of each POC, develop procurement specifications, and participate in the detailed development and implementation of the systems.

- I have authorized the ASMB to obtain the necessary funds from POCs to support systems development efforts in fiscal 1979. The estimated total requirement for FY 1979 is $665,000.

- The ASMB will establish a permanent unit to control and maintain the new unified systems. This unit will be staffed from current financial systems and programming staffs of the ASMB and POCs that will no longer be required when the unified system is in place.

By November 15, the ASMB will provide you with details of the new systems and specific resource requirements to carry out the purposes of this directive. I have directed the ASMB to give me a report by December 31 on the initial phases of implementation, and to report quarterly thereafter on the status of this important initiative.

I am counting on your full support and cooperation with this initiative so that we may together demonstrate our ability to manage the resources entrusted to us by the Congress and the American people.

Joseph A. Califano, Jr.

Joseph A. Califano, Jr.

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