



Accounting and Information
Management Division

B-279139

April 30, 1998

Mr. Richard L. Gregg
Commissioner, Financial Management Service
Department of the Treasury

Subject: Internal Controls: Issues Regarding Disbursements

Dear Mr. Gregg:

We recently reported on the U.S. government's consolidated financial statements for fiscal year 1997 (GAO/AIMD-98-127, March 31, 1998). Our audit, done pursuant to the Chief Financial Officers Act of 1990, as expanded by the Government Management Reform Act of 1994, included testing the effectiveness of certain internal controls over federal disbursements processed by the Department of the Treasury's Financial Management Service (FMS). For fiscal year 1997, FMS reported processing over 856 million disbursements totaling about \$1.2 trillion. With several exceptions (the largest being the Department of Defense), Treasury makes disbursements for all federal agencies. The internal controls we tested related to the delegation and designation of Certifying Officers; the processing of checks, electronic fund transfers (EFT), and Fedwire disbursements; and selected claims and accounting functions.

The purpose of this letter is to advise you of internal control issues identified during our testing. We are suggesting improvements to internal controls related to the (1) documentation of delegation and designation of Agency Certifying Officers, (2) approval, review, and documentation of disbursements, (3) processing and documentation of check cancellations, and (4) posting of cancellation activities.

We performed internal control testing over delegation and designation of disbursing authority using a statistical sample of 45 federal Certifying Officers selected from the database managed by FMS' Administrative Services Branch (ASB). We further tested a nationwide statistical sample of 132 check and EFT disbursements at the six FMS Regional Financial Centers (Centers). In addition, another statistical sample of 132 Fedwire disbursements was tested at the two Centers that process Fedwire disbursements—Philadelphia and San Francisco. We also performed nonstatistical internal control test procedures for

selected time periods for claims activities and key accounting functions at all of the Centers.

Although the internal control matters we found are not material in relation to the federal government's fiscal year 1997 consolidated financial statements, we believe they warrant your attention. We provided FMS management with written descriptions of these matters and obtained their comments. FMS officials have informed us that FMS has or plans to take corrective actions to address these weaknesses. We plan to follow up on these matters during our audit of the federal government's fiscal year 1998 consolidated financial statements.

DOCUMENTATION OF DELEGATION AND DESIGNATION OF AGENCY CERTIFYING OFFICERS

Delegations of Authority to Designate Certifying Officers

The authority to expend agency funds and to certify the disbursement of such funds resides with the heads of federal agencies. The Treasury Financial Manual (TFM), Volume I, Part 4, Chapter 1100, Section 1120, defines the head of an agency to mean the head of an executive agency—that is, secretaries of departments, administrators of administrations, and commissioners of commissions. It can also include bureau heads and agency and/or bureau chief financial officers. The head of an agency makes this authority known to FMS through a process known as self-delegation. In Volume I, Part 4, Chapter 1100, Section 1135, the TFM requires that the head of an agency submit to FMS a self-delegation using form FMS 2958, Delegation of Authority, along with a self-designation letter bearing the agency's official seal. FMS uses these documents as a basis for validating all subsequent delegations and designations from that agency head to lower level agency officials.

In our sample of 45 Certifying Officers, who were designated by 36 different officials, we found inadequate documentation for 10 of the 36 related self-delegations of authority. Specifically, FMS did not have the required self-designation letter bearing the agency's official seal. For the 10 exceptions, ASB personnel stated that they used alternate procedures to verify the identity of the head of the agency; however, they did not document these procedures. Thus, ASB has no evidence that the identity of the head of the agency was verified.

For cases where alternate procedures are deemed necessary, we suggest that you direct the Assistant Commissioner for Regional Operations to prescribe the procedures that may be used and direct that their use be documented. Further, we suggest that a supervisor be required to review and sign off on all verifications.

Supervisory Review of Signature Verification

Certifying Officers are authorized to approve agency disbursements and are thus critical to the disbursement process. For this reason, FMS needs to closely control and monitor the process used to validate the delegation of authority to create Certifying Officers. In this regard, the Comptroller General's Standards for Internal Control in the Federal Government requires supervisors to systematically review staff's work to the extent necessary and approve it at critical points to ensure management objectives are met and errors or misunderstandings of procedures are detected.¹

As stated above, Form FMS 2958 is used to delegate the authority to designate Certifying Officers. Form FMS 210, Designation for Certifying Officer, is then used to designate specific individuals as Certifying Officers. ASB personnel are required to validate the signatures of the authorizing officials on Forms FMS 2958 and 210 using the Digital Signature Storage and Verification (DSSV) system. For the 36 Forms FMS 2958 and 45 forms FMS 210 that we tested, all of the authorizing officials signatures were validated by FMS personnel. However, supervisory review and approval of these validations—a standard internal control practice for such an important action—had not been carried out because there was no requirement to do so.

We suggest that you direct the Assistant Commissioner for Regional Operations to implement procedures to require that (1) a supervisor review the Forms FMS 2958 and 210 to make certain that the DSSV validations were properly performed and (2) the review be documented.

APPROVAL, REVIEW, AND DOCUMENTATION OF DISBURSEMENTS

Verification of the Agency Certifying Officer's Signature

Agencies use either the electronic or paper Form SF 1166 Voucher and Schedule of Payments (SF 1166 vouchers) signed by an agency Certifying Officer to

¹This requirement, along with proposed standards which supersede the standards GAO issued in 1983, are included in GAO's exposure draft Standards for Internal Control in the Federal Government (GAO/AIMD-98-21.3.1) issued December 1997. The Comptroller General's internal control standards are developed pursuant to the Federal Managers' Financial Integrity Act of 1982.

request that the FMS Centers disburse funds.² FMS procedures require the Centers to verify the Certifying Officer's signature on the paper SF 1166 vouchers using the DSSV system before processing the requested disbursement. Our sample of 132 check and EFT disbursements included three paper SF 1166 vouchers, one of which was processed by the Birmingham Center. There was no documentation to support the verification of the agency Certifying Officer's signature for this SF 1166 voucher.

Treasury's Field Operations Manual (FOM) contains operating procedures to be used by the Centers. Section 1131 requires the Centers to verify the agency Certifying Officer's signature before processing disbursements but does not require a supervisory or independent review of the verification process. As noted earlier, the Comptroller General's Standards for Internal Controls in the Federal Government require supervisors to systematically review staff's work to the extent necessary and approve it at critical points to ensure management objectives are met and errors or misunderstandings of procedures are detected.

Without proper supervisory controls over the verification of the Certifying Officer's signature, FMS lacks adequate assurance of the validity of the disbursement. We suggest that you direct the Assistant Commissioner for Regional Operations to implement procedures that require supervisors or independent persons to (1) review paper SF 1166 vouchers for signature verification prior to disbursing the payment and (2) document this review on the paper SF 1166 vouchers.

Progress Sheets

To control and track the processing of requested disbursements, the Centers use Form FMS 1691, Progress Sheet. The individual completing each specific task in the process is required to initial or sign the Progress Sheet. We found 23 of the 264 Progress Sheets reviewed (19 of the 132 check and EFT disbursements and 4 of the 132 Fedwire disbursements) were incomplete.

²Most payment requests are sent to FMS using the Treasury Electronic Certification System (ECS). In place of a manual signature, this system uses smartcards and personal identification numbers (PINs) to authenticate payment requests based on the encrypted keys assigned to each Certifying Officer and agency Security Administrator. We did not test the controls in the ECS application because FMS had ineffective electronic data processing general controls (i.e., policies and procedures that apply to an entity's overall effectiveness and security of operations and create an environment in which application controls and certain user controls operate). We will be reporting on this matter separately.

These 23 were found at the Chicago, Kansas City, Philadelphia, and San Francisco Centers. Specifically, we found no evidence on the 23 Progress Sheets that the initial processing steps had been completed, especially the comparison of the number and amount of requested payments, as shown on the SF 1166 voucher, to those processed by the Center, as indicated on the Progress Sheet. However, our testing disclosed that the payments had been disbursed as requested.

The Comptroller General's Standards for Internal Controls in the Federal Government require that documentation of transactions or other significant events be complete and accurate. These standards also require the transaction documentation to facilitate tracing the transactions or event and related information before it occurs, while it is in process, and through completion.

Without a fully completed Progress Sheet, the risk of an invalid disbursement increases because FMS has no assurance that the requested disbursement has been processed. To ensure that Progress Sheets are completed in accordance with FMS procedures, we suggest that you direct the Assistant Commissioner for Regional Operations to require Center supervisors or independent staff to (1) review Progress Sheets for completeness before disbursing the payment and (2) initial the form to document their review.

PROCESSING AND DOCUMENTATION OF CHECK CANCELLATIONS

Control of Returned Checks

Over 3 million undeliverable checks were returned to the Centers in fiscal year 1997. Because these checks are negotiable, they need to be safeguarded. At all the Centers but one, we observed that generally these checks were promptly marked nonnegotiable, processed under joint control, and adequately safeguarded. However, we observed inadequate handling of returned undeliverable checks at the Kansas City Center. Specifically, within the locked returned check processing room at the Kansas City Center, large volumes of negotiable returned checks were left in clear view and unattended during daily working hours. The negotiable returned checks were (1) not promptly defaced, (2) processed without joint custody and supervisory control, and (3) not locked in containers when not being processed, as required by the FOM, Sections 5100 through 5112. The Comptroller General's Standards for Internal Controls in the Federal Government requires that access to resources be restricted to reduce the risk of loss to the government.

Without adherence to the FOM requirements for handling returned undeliverable checks, FMS cannot be assured that the more than 166,000 checks returned to the Kansas City Center during fiscal year 1997 were adequately

safeguarded. We suggest that you direct the Assistant Commissioner for Regional Operations to enforce the FOM requirements to ensure these negotiable checks are adequately safeguarded.

Reconciliation of the Returned Check Cancellation

The reconciliation of the number of returned and other checks available for cancellation to the number of checks cancelled is essential to ensure that all the checks have actually been cancelled. We found that the Birmingham, Chicago, Kansas City and Philadelphia Centers did not fully reconcile the results of the returned check cancellation process. For example, some Centers reconcile the number of checks sent to be cancelled only to the initial processing reports, not the actual number of checks cancelled as reported by the automated check reconciliation report. In addition, some Centers were unable to provide documentation to support that a reconciliation process had actually taken place.

FMS procedures require clerks to initial the automated check reconciliation report signifying that all returned and other checks available for cancellation have been cancelled, but they do not describe how to perform or document this reconciliation. The Comptroller General's Standards for Internal Controls in the Federal Government requires that documentation of transactions or other significant events be complete, accurate, and facilitate tracing the transactions or event. In addition, these standards require written evidence of an agency's internal control objectives and techniques.

The Austin and San Francisco Centers also perform and document a manual reconciliation of the returned check cancellation process. Using the Austin and San Francisco Centers procedures, we were able to reconcile the returned check cancellation for selected dates at all the Centers, except at Chicago, where the supporting documentation was not adequate to perform the reconciliation.

If the Centers do not fully perform and document their reconciliation of returned check cancellations, FMS has inadequate assurance that all such returned checks have been properly cancelled. We suggest that you direct the Assistant Commissioner for Regional Operations to provide guidance in the FOM on how to fully perform and document the reconciliation of check cancellations. We believe this guidance can be based upon the manual reconciliation process used by the Austin and San Francisco Centers.

POSTING OF CANCELLATION ACTIVITIES

Posting of Cancellation Activities to the Receipts/Deposits Register and the General Ledger

Adherence to FMS-specified accounting procedures is essential to ensure that the posting of cancellation activities has been correct and can be traced. We found that the Kansas City Center was not following FOM guidance to record cancellation activities in the Receipts/Deposits Register and the General Ledger. Specifically, for May 1997, the month tested, the Center made

- premature postings to the check cancellation accounts because the required supporting Form SF 215, Deposit Ticket, was not used as the basis for the posting and
- net debit and credit postings to the check cancellation accounts instead of separately posting each debit and credit transaction.

FOM, Section 6241, requires use of the Form SF 215, Deposit Ticket, to support the entries to the Receipts/Deposits Register and to the General Ledger to record the weekly check cancellations. The Comptroller General's Standards for Internal Controls in the Federal Government requires that the documentation of transactions be complete and accurate. However, we found that rather than using the Deposit Ticket created on May 23, 1997, the Kansas City staff used summary information from the claims system to post to the accounts. Based on this summary information, the check cancellations we tested were prematurely posted to the week ending May 21, 1997.

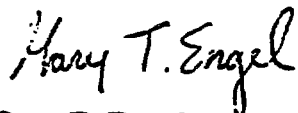
We also found that Kansas City was combining the debit and credit activity to this account into one net entry on the General Ledger, instead of separate entries as required in the FOM, Section 6241. The Comptroller General's Standards for Internal Controls in the Federal Government requires that the documentation of a transaction facilitate tracing the transaction. By combining the debit and credit entries, these transactions become more difficult to trace and research when necessary.

Since these postings were not made in accordance with FMS procedures, FMS had no assurance that the postings were correct. We suggest that you direct the Assistant Commissioner for Regional Operations to emphasize to the Centers the importance of proper posting to their accounts as required by FMS procedures.

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We appreciate the cooperation and assistance of FMS management and staff during our fiscal year 1997 audit. We are sending copies of this letter to the Department of the Treasury Deputy Inspector General and to interested congressional committees. Copies will be available to others upon request. If you have any questions, please contact me at (202) 512-3406 or Christine Robertson, Assistant Director, at (202) 512-9379.

Sincerely yours,



Gary T. Engel
Associate Director
Governmentwide Accounting and
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