

Testimony of Jack Martin
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before the
Subcommittee on Government Efficiency and Financial Management
Committee on Government Reform
U. S. House of Representatives
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Mr. Chairman and Members of the Subcommittee:

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

When Secretary Paige arrived at the Department of Education back in January 2001, he discovered that there were serious management problems. The Department had not received a clean audit opinion in years and there was not any expectation of one in the near future. The Department of Education Inspector General's Office and the General Accounting Office had identified hundreds of problems that needed immediate attention before the Department could receive a "clean" audit.

Secretary Paige promised that one of his top priorities would be to identify and correct all of the management problems that were preventing the Department from operating at its peak performance.

I'm proud to say that the Department is keeping the Secretary's promise.

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

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

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

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

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

Our short-term goals were to:

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

Our long-term goals were to:

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

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

Assembled a Task Force of Career Leaders

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

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

Sought the Advice of External Advisors

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

Established a Culture of Accountability

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

Measured Progress

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

efforts were focused on ensuring that NSLDS continues to be a complete and reliable source of information.

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

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

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

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

Implemented Corrective Action Plans – The Department developed and implemented corrective action plans (CAPs) for outstanding items from the FY 2001 financial statement audit. We also submitted the CAPs for the FY 2002 audit recommendations to our Office of Inspector General (OIG). In April 2001, there were 661 open recommendations from audits issued by GAO and the Department’s OIG. As of June 2003, the Department closed all but 22 of these 661 recommendations. Additional recommendations continue to be made by GAO and OIG in this ongoing process, of

course, but of the 661 original and 438 new management-related recommendations, the Department currently has 175 open recommendations that are contained in 56 audit reports. Of these 175, only 10 are from financial statement audits from the Department's independent auditors. The Department is working to ensure that it implements these remaining recommendations in a timely and efficient manner.

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

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

The Department received its first clean audit opinion in five years due to the steps outlined above, in addition to the hard work and dedication of its staff. We are now setting new goals for ourselves. We will:

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

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

I believe you will find that our efforts over the last two years demonstrate our commitment to making the Department of Education a model agency of financial management excellence, and to maintaining the level of effort it took to achieve our first unqualified opinion since FY 1997. One of the objectives in our Strategic Plan is to earn the President's Quality Award. I hope to be able to tell you a year from now that we have accomplished that goal as well.

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