

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

THE NATIONAL SECURITY EDUCATION PROGRAM

Report No. 95-311

September 22, 1995

Department of Defense

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Acronym

ASD(S&R) Assistant Secretary of Defense (Strategy and Requirements)



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884



September 22, 1995

MEMORANDUM FOR ASSISTANT SECRETARY OF DEFENSE (STRATEGY
AND REQUIREMENTS)
DIRECTOR, NATIONAL SECURITY EDUCATION
PROGRAM

SUBJECT: Audit Report on the National Security Education Program (Report
No. 95-311)

We are providing this audit report for review and comment. The audit was required by the Chief Financial Officers Act of 1990. We considered management comments on a draft of this report in preparing the final report.

DoD Directive 7650.3 requires that all unresolved issues be resolved promptly. Therefore, we request that the addressees respond to the final report. See each finding for the required responses.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Harrell D. Spoons, Audit Program Director, at (703) 604-9575 (DSN 664-9575) or Ms. Dianna J. Pearson, Audit Project Manager, at (703) 604-9576 (DSN 664-9576). See Appendix F for the report distribution. Audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 95-311
(Project No. 5RF-2005.01)

September 22, 1995

The National Security Education Program

Executive Summary

Introduction. Public Law 102-183, "Intelligence Authorization Act for Fiscal Year 1992," December 4, 1991, established the National Security Education Program (the Program) and the National Security Education Trust Fund (Trust Fund). The Program awards scholarships, fellowships, and grants for students to train in foreign languages and international fields critical to the Nation's interest. The Trust Fund provides the resources for the awards. Public Law 102-183 authorized a Trust Fund corpus of \$150 million for FY 1992. Public Law 103-178, "Intelligence Authorization Act for Fiscal Year 1994," December 3, 1993, directs that the Trust Fund unappropriated amount in excess of \$120 million be transferred to the U.S. Treasury and that interest earned during the preceding fiscal year be available for awards and expenditures for FYs 1995 and 1996.

Audit Objectives. The objective of the audit was to evaluate the organization and function of the National Security Education Program; controls over grants, scholarships, and fellowships; contracting actions; and related management controls.

Audit Results. The National Security Education Trust Fund exceeded the authorized balance. The Trust Fund corpus was about \$18.3 million in excess of the authorized balance, and future interest income will be overstated because the interest income would be computed based on a Trust Fund balance that exceeds the amount allowable (Finding A).

The Director, National Security Education Program, awarded scholarships and fellowships for studies in countries that had not been designated as critical to the Nation's interest and incurred disproportionately high program costs in comparison to the awards made. The Director awarded about \$3 million dollars from the Trust Fund for those studies. Also, about 40 percent of the Program's FY 1994 expenditures was for administrative costs (Finding B).

Accounting records did not support the expenditures presented on the financial statements, and operating procedures would not have detected unauthorized claims made against the Trust Fund. As a result, the FY 1994 financial statements are understated by \$0.2 million, and, more seriously, the potential exists for unauthorized Trust Fund expenditures to go undetected (Finding C).

Recommendations, if implemented, will reduce the Trust Fund corpus by about \$18.3 million to comply with Federal law, and provide recomputed amounts for awards and expenditures and undetermined potential monetary benefits by reducing administrative costs for the Program (see Appendix D). Further, better management controls should improve the accuracy and reliability of the Trust Fund financial records.

Summary of Recommendations. We recommend reducing the Trust Fund to the authorized balance and transferring about \$18.3 million to the U.S. Treasury, designating countries deemed critical to the Nation's interest, and reducing administrative costs for the National Security Education Program. We also recommend recomputing the amounts available for awards and expenditures and establishing management controls for the Trust Fund and the Program.

Management Comments. The Assistant Secretary of Defense (Strategy and Requirements) partially concurred that the Trust Fund balance was in excess of the authorized balance, stating that the Public Law that directed the decrease had been superseded. Also, the Assistant Secretary partially concurred that the Board had not identified critical countries and stated that the Board provided guidance for a broad focus rather than identified specific critical countries or areas of study. Further, the Assistant Secretary nonconcurred that Program administrative costs were excessive, stating that costs were high because all award amounts were not shown in the analysis. Finally, the Assistant Secretary concurred that accounting records did not support expenditures reflected on the FY 1994 Financial Statements and implemented actions to improve management controls. See Part I for a summary of management comments and Part III for the complete text of the comments. The Director, National Security Education Program, did not provide comments on a draft of this report.

Audit Response. The public law that effected an additional reduction of the National Security Education Trust Fund did not include language superseding previous congressional action. Therefore, compliance with each public law is mandatory. Also, awarding Trust Fund dollars without identifying critical countries and areas of study violates congressional mandate. The audit scope was limited to FY 1994. Therefore, only awards and expenditures applicable to FY 1994 were included in the analysis of Trust Fund expenditures.

We ask that the Assistant Secretary of Defense (Strategy and Requirements) and the Director, National Security Education Program, provide comments on the final report by November 22, 1995.

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Part I - Audit Results

Audit Background

Origin of the National Security Education Program. In responding to concerns that worldwide changes related to economic competition, regional conflicts, terrorist activities, and weapon proliferations posed new threats to international stability, Congress determined that the national security and economic well-being of the United States will depend on its citizens knowing the languages and cultures of other countries. To ensure American undergraduate and graduate students are adequately prepared to meet the challenges posed by increasing interaction among nations, Congress enacted Public Law 102-183, "Intelligence Authorization Act for Fiscal Year 1992," December 4, 1991. Public Law 102-183 established the National Security Education Trust Fund (Trust Fund), the National Security Education Board (the Board), and the National Security Education Program (the Program).

Purpose of the National Security Education Program. The Program provides resources, accountability, and flexibility to meet the national security education needs of the United States, especially as those needs change over time. The purpose of the Program is to:

- o increase the quantity, diversity, and quality of the teaching and learning of foreign languages, area studies, and other international fields that are critical to the Nation's interest;
- o produce an increased pool of applicants for work in Federal Departments and Agencies with national security responsibilities;
- o expand, in conjunction with other Federal programs, the international experience, knowledge base, and perspectives on which U.S. citizenry, Government employees, and leaders rely; and,
- o permit the U.S. Government to advocate the cause of international education.

Management of the National Security Education Program. Public Law 102-183 delegated responsibility for the Program to the Secretary of Defense. Responsibility for the Program was further delegated to the Assistant Secretary of Defense (Strategy and Requirements) (ASD[S&R]), Office of the Under Secretary of Defense for Policy. The ASD(S&R) provides policy direction for the Program with the assistance of the Board. The ASD(S&R) also serves as chair of the Board. The ASD(S&R) and the Board advise the Secretary of Defense on:

- o criteria for awarding scholarships, fellowships and grants;
- o dissemination of information on the Program;
- o qualifications for students desiring scholarships or fellowships and for institutions of higher education desiring grants;
- o review of the administration of the Program required under Public Law 102-183;
- o recommendations on critical countries that are not emphasized in other U.S. study-abroad programs;
- o critical areas not receiving enough emphasis within academic disciplines; and,
- o methods of encouraging students who receive awards to work for the U.S. Government after graduation.

A group of advisors, consisting of 28 members from higher education, provide advice to the ASD(S&R) and the Board and serve as liaison between higher education and the U.S. Government. A program director, authorized a staff of 15 Federal civil service employees, manages the day-to-day operation of the Program and supports the Board's operation. The Program relies on commercial contractors for the selection of award recipients and distribution of awards.

Status of the Trust Fund. Public Law 102-183 authorized a Trust Fund corpus of \$150 million. Public Law 103-178, "Intelligence Authorization Act for Fiscal Year 1994," December 3, 1993, reduced the Trust Fund balance from \$150 million to \$120 million, but allowed amounts already appropriated for expenditures. Before Public Law 103-178 was enacted, \$20 million had been appropriated for expenditures. Therefore, including the \$120 million, as of December 3, 1993, the authorized Trust Fund balance was \$140 million. However, the September 30, 1994, balance was about \$158.3 million.¹

¹Based on the Chief Financial Officers Annual Financial Statement issued March 1, 1995, the asset balance of the National Security Education Trust Fund as of September 30, 1994, was \$158,317,771.

Audit Results

Audit Objective

The objective of the audit was to evaluate the organization and functions of the National Security Education Program; controls over grants, scholarships, and fellowships; contracting actions; and related management controls. Details on scope, methodology, and the management control program are in Appendix A. See Appendix B for a summary of prior coverage related to the audit objective, Appendix C for other congressional action affecting the Program, and Appendix E for the organizations visited or contacted during the audit.

Finding A. Reduction of the National Security Education Trust Fund

The National Security Education Trust Fund corpus exceeded the authorized balance because management for the National Security Education Program did not comply with a statutory requirement to reduce the Trust Fund corpus. As a result, the Trust Fund corpus was about \$18.3 million in excess of the authorized balance. Additionally, future interest income, planned for awards and expenditures, will be overstated because interest income would be computed on a Trust Fund balance that exceeds the amount allowable.

Trust Fund Reduction Authorization

Intelligence Authorization Act Reduced the Trust Fund. Public Law 103-178, "Intelligence Authorization Act for Fiscal Year 1994" (the Act), section 311, December 3, 1993, reduced the Trust Fund balance with the following:

(a) REDUCTION OF AMOUNTS IN TRUST FUND. - The amount in the National Security Education Trust Fund established pursuant to section 804 of Public Law 102-183 (50 U.S.C. 1904) in excess of \$120,000,000 that has not been appropriated from the trust fund as of the date of enactment of this Act shall be transferred to the Treasury of the United States as miscellaneous receipts.

As of December 3, 1993, Public Law 103-50 and Public Law 103-39 had each appropriated \$10 million, authorizing a Trust Fund balance of \$140 million. On September 30, 1994, the Trust Fund balance was about \$158.3 million, or about \$18.3 million in excess of the authorized balance (see Appendix D).

No Action Taken to Reduce the Trust Fund. The program director believed that the reduction in the Trust Fund corpus was not mandatory and contended that any requirement to reduce the Trust Fund corpus should be promulgated in an appropriation act. Because the reduction was not required by an appropriation act, the program director did not initiate action to effect the transfer as required by the Act.

Reducing the Trust Fund was Determined Mandatory. The Deputy General Counsel, Inspector General, opined that the Act directs the transfer of the excess funds in the Trust Fund to the U.S. Treasury as miscellaneous receipts and that

Finding A. Reduction of the National Security Education Trust Fund

no further congressional action is necessary. Also, the Act is not subject to passage of a future appropriations act, which is necessary to make the funds available for obligation, but is not necessary to reduce amounts available.

Interest Income Determines Expenditure Levels. The Act authorized the interest earned on the Trust Fund for the preceding year to be available for expenditures for FYs 1995 and 1996. If the Trust Fund balance is in excess of the authorized balance, the interest income computed on the incorrect Trust Fund balance will be overstated, and the amount available for awards and expenditures will be incorrect. Consequently, the Program office runs the risk of spending more than Congress authorized.

Recommendations, Management Comments, and Audit Response

A.1. We recommend that the Assistant Secretary of Defense (Strategy and Requirements) reduce the National Security Education Trust Fund balance in accordance with provisions of Public Law 103-178, "Intelligence Authorizations Act for Fiscal Year 1994," and transfer about \$18.3 million² to the U.S. Treasury as miscellaneous receipts.

The Assistant Secretary of Defense (Strategy and Requirements) Comments. The Assistant Secretary of Defense (Strategy and Requirements) partially concurred with the Finding that the Trust Fund exceeded the authorized balance. The Assistant Secretary stated that the House Permanent Select Committee on Intelligence originated legislation that was adopted by Congress in December 1993 and resulted in a reduction in the Trust Fund. The Assistant Secretary of Defense believes that the subsequent congressional action in April 1995 (Public Law 104-6, "Emergency Supplemental Appropriations and Rescissions for the Department of Defense to Preserve and Enhance Military Readiness Act of 1995; Mexican Debt Disclosure Act of 1995," April 10, 1995) to further reduce the Trust Fund by \$75 million encompassed the December 1993 reduction. The April 1995 reduction has been implemented.

The Assistant Secretary of Defense (Strategy and Requirements) stated that the audit report miscalculated the amount of the overstatement of the Trust Fund by

²After subtracting the authorized balance of \$140 million from the September 30, 1994, balance of \$158,317,771, the exact overage amount is \$18,317,771.

Finding A. Reduction of the National Security Education Trust Fund

\$1.8 million because the audit team used an estimation of the Trust Fund balance as of December 3, 1993, instead of the actual balance. The overstated amount is \$16.5 million instead of \$18.3 million.

Audit Response. We do not consider the management comments to be responsive. We agree that Public Law 104-6 rescinded \$75 million from the Trust Fund. However, Public Law 104-6 does not contain language to show that the \$75 million rescission encompasses the action required by Public Law 103-178. Therefore, compliance with requirements of Public Law 103-178 is still mandatory.

Computation for the Trust Fund excess balance is based on the balance as of September 30, 1994. Because the Program staff did not initiate action to reduce the Trust Fund corpus to \$120 million as required by Public Law 103-178, interest continued to accrue on the \$150 million balance. The interest and the amount in excess of the authorized balance must be turned in to the U.S. Treasury as miscellaneous receipts, as required by Public Law 103-178. We request that the Assistant Secretary of Defense (Strategy and Requirements) reconsider his position in response to the final report.

A.2. We recommend that the Director, National Security Education Program, recompute the interest income available to support FYs 1995 and 1996 National Security Education Program operations based on the reduced National Security Education Trust Fund corpus.

Audit Response. The Director, National Security Education Program, did not respond to a draft of this report. Therefore, we request that the Director, National Security Education Program, provide comments on the final report.

Finding B. Administration of the National Security Education Program

The Director, National Security Education Program, awarded scholarships and fellowships for foreign study in countries that had not been designated as critical to the Nation's interest. Also, the administrative costs of the Program were disproportionately high in relation to distributed educational awards. The countries had not been designated as critical, and administrative costs were excessive because neither the ASD(S&R) nor the Board identified countries that qualify for Trust Fund awards and because the ASD(S&R) had not established performance goals for the Program. As a result, the Director, National Security Education Program, awarded about \$3 million from National Security Education Trust Fund to students to study in countries of their preference rather than in countries that had been designated as critical to national interests. Also, about 40 percent of the Program's FY 1994 expenditures was for administrative costs.

National Security Education Program

Program Implemented Without Board Guidance. The Program staff began screening students for FY 1994 awards in FY 1993, before the Board was officially formed. As a result, the Program staff had no guidance on which foreign country studies the Board would recommend as critical to the Nation's interest. Based on input from the group of advisors and representatives from higher education, the Program staff opened competition to undergraduate- and graduate-level students who wanted to go to any area of the world, except Western Europe. In the absence of a defined list of countries critical to the Nation's interest, the Program staff allowed students to select countries for foreign study.

ASD(S&R) and National Security Education Board Guidance on Selection of Critical Countries. Public Law 102-183 requires that Trust Fund resources be used for foreign study critical to the Nation's interest as determined by the Board. The Board has met twice (May 1994 and October 1994) since the Program was established. At both meetings, the Board recommended excluding Mexico from student awards, because both the Spanish language and the country of Mexico have been emphasized in other study-abroad programs. The Board did not identify countries that should be designated as critical to the Nation's interest. Notwithstanding the Board's recommendation to exclude Mexico, the program director awarded about \$143,000, consisting of 21 scholarships, totaling more than \$115,000, and 6 fellowships, totaling more than \$27,000, for studies in Mexico (see Tables 1 and 2, respectively). Furthermore, because none of the countries for

Finding B. Administration of the National Security Education Program

which students received awards had been identified by the Board as critical to the Nation's interest, Congress has no assurance that the \$3 million distributed as scholarships and fellowships meets the intended purpose of the Program.

Scholarships and Fellowships. Table 1 shows the countries for which students received scholarships for foreign study and the number and amount of the scholarships per country. Table 2 shows the countries for which students received fellowships to study and the number and amount of the fellowships per country.

<u>Country</u>	<u>Number of Awards</u>	<u>Amount of Awards</u>	<u>Country</u>	<u>Number of Awards</u>	<u>Amount of Awards</u>
Argentina	1	\$ 12,000	Kenya	4	\$ 47,800
Bolivia	1	8,000	Madagascar	1	16,000
Brazil	7	40,750	Mexico	21	115,200
Cameroon	3	21,500	Morocco	3	21,500
Chile	2	15,250	Nepal	3	26,275
China	11	57,850	Niger	2	9,600
China (People's Republic of China)	15	105,225	Poland	4	33,625
Colombia	1	9,100	Romania	1	6,350
Costa Rica	8	38,600	Russia	32	233,730
Czech Republic	5	48,800	Senegal	6	42,550
Dominican Republic	11	67,175	Singapore	1	12,000
Ecuador	5	33,750	South Korea	2	16,400
Egypt	8	91,400	Taiwan	7	55,900
Ghana	4	21,000	Tanzania	3	26,000
Greece	4	26,900	Thailand	4	22,500
Hong Kong	1	12,500	Tunisia	2	6,000
Hungary	3	31,200	Turkey	1	3,500
India	4	29,100	Ukraine	1	14,800
Indonesia	2	11,300	Uzbekistan	1	6,500
Israel	7	58,810	Venezuela	1	2,500
Ivory Coast	1	4,200	Vietnam	1	6,750
Japan	52	534,950	Zimbabwe	2	10,450
Kazakhstan	2	13,450			
Subtotal	158	\$1,292,810	Subtotal	103	\$ 735,930
Total	261	\$2,028,740			

Finding B. Administration of the National Security Education Program

Table 2. Fellowships for Foreign Study

<u>Country</u>	<u>Number of Awards</u>	<u>Amount of Awards</u>	<u>Country</u>	<u>Number of Awards</u>	<u>Amount of Awards</u>
Argentina	1	\$ 6,100	Malawi	1	\$ 3,700
Argentina and Venezuela	1	10,325	Mali	1	8,333
Balkan States	1	7,830	Mexico	6	27,496
Brazil	6	60,958	Morocco	2	5,956
Bulgaria	1	4,100	Morocco - North Africa	1	4,591
Chile	2	14,200	Nepal and Thailand	1	9,000
Chile, Mexico	1	10,000	Nigeria	1	8,000
China	8	35,484	Pakistan	1	3,300
China, Mongolia	1	5,750	Peru	2	9,780
China, Taiwan	1	6,015	Philippines	1	5,000
Costa Rica	4	15,198	Poland	4	28,652
Cote D'Ivoire	1	10,300	Romania	2	3,913
Czech Republic	5	22,890	Russia	15	105,945
Ecuador	1	3,700	Russia, Ukraine	1	1,100
Egypt	2	19,492	Siberia	1	8,000
Ethiopia	1	6,800	Slovenia	1	5,400
Georgia	1	7,000	South India	1	8,675
Honduras	1	6,300	Syria	2	14,180
Hungary	1	10,000	Syria and Jordan	1	7,000
India	3	32,050	Taiwan	2	7,870
Indonesia	4	23,200	Thailand	1	14,000
Israel	2	22,206	Turkey	3	30,467
Japan	15	131,334	Turkmenistan and Uzbekistan	1	4,030
Japan, China, Russia	1	4,872	Ukraine	1	13,900
Japan, Korea, China	1	6,642	Uzbekistan	2	20,953
Japan and China	1	4,838	Uzbekistan and Central Asia	1	10,432
Kazakhstan	2	9,039	Uzbekistan and Kazakhstan	1	13,075
Kenya	1	10,600	Vietnam	3	20,420
Latin America	1	4,200	West Bank	1	6,903
Latvia	2	7,505	Zambia	1	4,400
Lithuania	1	6,502	Zimbabwe	1	1,074
Macedonia	1	4,335			
Subtotal	75	\$ 529,765	Subtotal	63	\$ 415,545
Total	138	\$ 945,310			

Finding B. Administration of the National Security Education Program

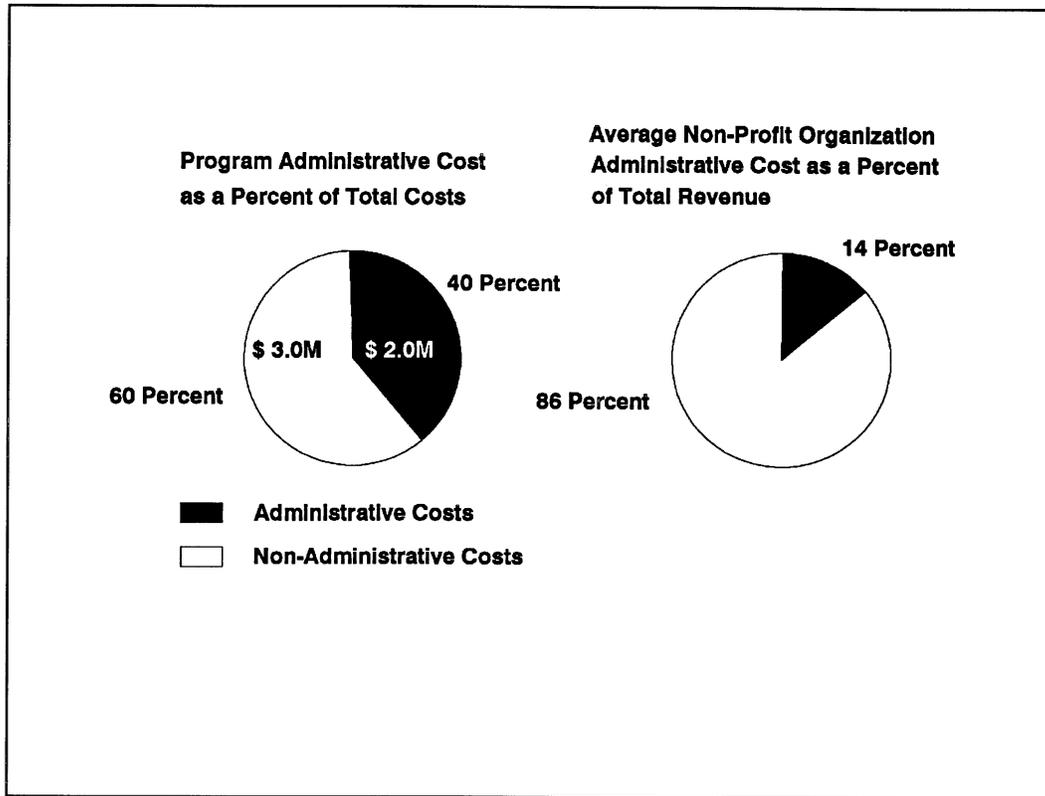
National Security Education Program Administrative Costs

Total Program Costs. FY 1994 expenses for the Program totaled about \$5 million. Of the \$5 million, the Program staff spent \$3 million for awards and \$2 million for administrative costs. The \$2 million represents about 40 percent of total Program costs. Table 3 shows total FY 1994 costs for the Program.

<u>Awards</u>	<u>Amount (millions)</u>
Scholarships	\$ 2.0
Fellowships	<u>1.0</u>
Total	\$ 3.0
<u>Administrative Costs</u>	
Contract Services	\$ 1.0
Salaries and office expenses	<u>1.0</u>
Total	\$ 2.0
Total Program Costs	\$ 5.0

Administrative Cost Comparisons. To determine the reasonableness of administrative costs for the Program, we evaluated the 1994 Combined Federal Campaign catalog to determine the costs incurred by nonprofit organizations for administering their programs. Although the administrative cost is expressed as a percentage of total revenue for those organizations, we believe the ratio can serve as a basis for comparison with the Program's administrative costs. Of the 2,261 Combined Federal Campaign organizations reviewed, the average ratio of administrative costs to revenue was about 14 percent. Also, within the 2,261 organizations, 125 had administrative costs in excess of 25 percent. The Combined Federal Campaign catalog documented that each organization with administrative costs of 25 percent or more is working to reduce those costs to less than 25 percent. The figure below shows the comparison of administrative costs for the Program to administrative costs for nonprofit organizations.

Finding B. Administration of the National Security Education Program



Comparison of Administrative Costs for the Program to Costs for Non-Profit Organizations

Summary

The program director distributed awards although neither the ASD(S&R) nor the Board identified areas of emphasis for foreign language study or designated countries as critical to the Nation's interest, as required by Public Law 102-183. In the absence of a decision from the Board on critical areas, the program director allowed students to justify criticality of countries for study. The countries and international issues that are critical to the Nation's interest must be identified if the Program is to serve its statutory purpose.

The administrative costs for the Program were 40 percent of the total expenses for FY 1994. In comparison to the administrative costs incurred by nonprofit organizations, the Program's administrative costs are excessive. The

Finding B. Administration of the National Security Education Program

ASD(S&R) should adopt cost reduction as an organizational goal of the Program and develop performance measures to aid in achieving cost reductions.

Recommendations, Management Comments, and Audit Response

B.1. We recommend that the Assistant Secretary of Defense (Strategy and Requirements):

a. Identify countries critical to the Nation's interest for foreign language study.

The Assistant Secretary of Defense (Strategy and Requirements) Comment. The Assistant Secretary of Defense (Strategy and Requirements) partially concurred with the finding that the Director, National Security Education Program, awarded scholarships and fellowships for study in countries that had not been designated as critical to the Nation's interest. The Assistant Secretary stated that the Board concluded that it was premature to designate specific critical countries and instead provided broad guidance for both the merit review process and the candidate students.

Audit Response. Public Law 103-183 requires that the Board develop criteria for awarding scholarships, fellowships, and grants and recommend critical countries and areas for foreign study to the Secretary of Defense. Awarding scholarships, fellowships, and grants without complying with those requirements violates congressional mandate. The Assistant Secretary provided a list of countries that the working group recommended to the Board as critical, but the Board had not taken action to designate the countries as critical. Therefore, we request that the Assistant Secretary provide a completion date for designating countries and areas critical to the Nation's interest for purposes of the Program.

b. Establish organizational goals and performance measures to achieve reduced administrative costs for the Program.

Audit Response. The Assistant Secretary of Defense (Strategy and Requirements) did not comment on establishing organizational goals and performance measures to reduce administrative costs for the Program. We evaluated administrative costs for the Program by comparing its administrative costs to Combined Federal Campaign nonprofit organizations' administrative costs because the Trust Fund has an endowment feature. Further, we believe that the Program staff should strive to reduce administrative costs as have nonprofit organizations instead of replicating seemingly high administrative costs of programs deemed similar to the Program. Therefore, in response to the

Finding B. Administration of the National Security Education Program

final report, we request that the Assistant Secretary provide the actions to be taken and completion dates for establishing organizational goals and performance measures to reduce administrative costs for the Program.

B.2. We recommend that the Director, National Security Education Program, award scholarships and fellowships only to those students who are studying languages and countries that have been designated as critical to the Nation's interest.

Audit Response. The Director, National Security Education Program, did not respond to the draft report. Therefore, we request that the Director, National Security Education Program provide comments on the final report.

Finding C. Management Control Program for the National Security Education Trust Fund and Program

The management controls for the Trust Fund and the Program were not adequate to accurately account for expenditures made from the Trust Fund because the Director, National Security Program, had not established an effective management control program for the Trust Fund or the Program. Also, the Program staff had not reconciled financial documentation or determined the validity of Trust Fund expenditures. As a result, the FY 1994 financial statements are understated by \$0.2 million, and, more seriously, the potential exists for unauthorized Trust Fund expenditures to go undetected.

Requirements for Management Controls

Office of Management and Budget Circular No. A-123 Requirements. Office of Management and Budget Circular No. A-123, "Management Accountability and Control," requires Federal agencies to develop and implement a system of management controls to reasonably ensure that missions will be accomplished. Management controls are the organization, policies, and procedures used to ensure that:

- o programs achieve the intended results;
- o resources are used consistently with the mission and are protected from waste, fraud, and mismanagement;
- o laws and regulations are followed; and
- o reliable information is obtained, maintained, reported, and used for decision making.

Management Controls for the Trust Fund. The program director had not established reconciliation procedures for the Trust Fund. As a result, the Program staff had not reconciled source documents on expenditures to Washington Headquarters Services trial balances or to feeder reports that had been used to prepare FY 1994 financial statements. Lack of reconciliation procedures increased the risk of errors and could permit unauthorized claims against the Trust Fund to go undetected. Because the Program staff had not

Finding C. Management Control Program for the National Security Education Trust Fund and Program

reconciled financial information, the expenditures reported on the financial statements were understated by \$0.2 million. In response to inadequate reconciliation procedures for FY 1994, the program director established procedures to verify Trust Fund expenditures for FY 1995. Although the Director, National Security Education Program, prepared a 1994 Annual Statement of Assurance for the Trust Fund, the statement did not identify the understatement of the financial statement expenditures or the lack of procedures for reconciliation of Trust Fund expenditures.

Management Controls for the Program. The program director had not established effective management controls over Program operations. The Program staff relied on Washington Headquarters Services and the Defense Finance and Accounting Service for accounting and financial reporting, but did not have a signed memorandum of agreement defining the services that those organizations would provide.

Memorandum of Agreement. The ASD(S&R) initiated a memorandum of agreement with the Under Secretary of Defense (Comptroller), Washington Headquarters Services, the Defense Finance and Accounting Services, and the Program to define the responsibilities of each organization with respect to the financial operations of the Trust Fund. The memorandum of agreement was to be effective when signed by all parties. However, the memorandum of agreement was never signed by all parties. The absence of a valid agreement specifying the responsibilities of each party impaired the ability of the Program staff to provide effective accounting documentation to support Trust Fund expenditures. For example, the Under Secretary of Defense (Comptroller) was to establish fiscal policies and procedures that govern administration of the Trust Fund. Because those policies and procedures were not established, the Program staff neither reconciled Trust Fund expenditures to feeder reports, used to prepare the financial statements, nor adequately documented Trust Fund disbursements. In addition to understating the financial statements by about \$0.2 million, Program staff had not maintained adequate documentation for payment records supporting Trust Fund expenditures. A memorandum of agreement clearly delineating the responsibilities of each participating organization should improve accountability over Trust Fund expenditures.

Validity of Expenditures. The Program spent about \$2 million of the Trust Fund for administrative expenses during FY 1994. We were unable to determine from Program financial records whether the expenditures were valid because the payment records contained no description of services provided. To adequately account for Trust Fund expenditures, the records must, at a minimum, include an invoice that describes products or services, a verification of receipt of the products or services, and a confirmation of payment. Also, requests for divestments of the Trust Fund to cover expenditures showed the

Finding C. Management Control Program for the National Security Education Trust Fund and Program

amount requested, but did not show what the Trust Fund paid for or why the expenditure was needed. Further, the requests for divestments exceeded the amount actually required to meet expenses because the program director did not consider discounts allowed when divestments were requested.

Procedures to Verify and Reconcile Expenditures. Improved procedures to verify expenditures should provide greater validity to the FY 1995 financial statements. In addition to verifying expenditures, the Program staff needs to reconcile expenditures and Trust Fund divestments with Washington Headquarters Services reports that are used to prepare the financial statements. Reconciliation is required to verify the accuracy of accounting information for Trust Fund expenditures maintained by both locations and to enhance the reliability of the data reported in the financial statements.

Approval Authority for Expenditures. According to Program files, a former employee is the approval authority for expenditures and certification of travel. Upon the former employee's retirement, the Deputy Director became the approval authority for expenditures. The program director neglected to update approval records and did not apprise personnel at Washington Headquarters Services of the change in approval authority for expenditures. However, the Washington Headquarters Services continued to honor expenditures against the Trust Fund without current approval authority on file.

Summary

The program director has implemented verification procedures for FY 1995 that should improve accountability over Trust Fund expenditures. However, a memorandum of agreement delineating the accounting and reporting responsibilities of the Under Secretary of Defense (Comptroller), the Washington Headquarters Services, the Defense Finance and Accounting Service, and the Program is needed to verify that all required financial records and reports are maintained. Further, the program director should establish procedures to reconcile financial records, maintain appropriate documentation of financial transactions, and update approval authority for expenditures. Improved management controls are required to enhance the operational effectiveness of the Trust Fund and the Program.

Finding C. Management Control Program for the National Security Education Trust Fund and Program

Recommendations, Management Comments, and Audit Response

C.1. We recommend that the Assistant Secretary of Defense (Strategy and Requirements) expedite the signing of the memorandum of agreement with the Under Secretary of Defense (Comptroller), Washington Headquarters Service, the Defense Finance and Accounting Service, and the National Security Education Program to document responsibilities for financial operations of the National Security Education Trust Fund.

The Assistant Secretary of Defense (Strategy and Requirements) Comments. The Assistant Secretary of Defense (Strategy and Requirements) concurred with the finding on management controls and stated that a detailed accounting and reporting system has been put in place that will include a thorough record of all Trust Fund expenses. The records now include detailed justification for all expenses from the Trust Fund, including dates of requests for divestments, and reconciliation of accounts with data provided by Washington Headquarters Services.

Also, the Program staff has initiated an inquiry into the reasons the memorandum of agreement was not completed. A memorandum of agreement that clearly delineates the responsibilities of each participating organization, specifically the Washington Headquarters Services and Defense Finance and Accounting Service will be coordinated and completed by the Program staff.

C.2. We recommend that the Director, National Security Education Program, establish procedures to reconcile amounts shown in source documents to trial balances and feeder reports provided for the financial statements; to maintain documentation of financial transactions; and to update approval authority for National Security Education Trust Fund expenditures.

Audit Response. The Director, National Security Education Program, did not respond to the draft report. Therefore, we request that the Director, National Security Education Program, provide comments on the final report.

Part II - Additional Information

Appendix A. Scope and Methodology

Scope

Organizations and Functions. We evaluated the organization and functions of the National Security Education Program; controls over scholarships, fellowships, and grants; and related management controls for FY 1994. To evaluate the organization and functions of the Program, we reviewed mission statements, public laws, the proposed memorandum of agreement, position descriptions, contractor statements of work, and supporting documentation for National Security Education Trust Fund expenditures for FY 1994.

Use of Computer-Processed Information. We evaluated the reliability of computer-processed information used for financial statement feeder reports by comparing amounts to source documents. Expenditures had not been reconciled against reports used for the financial statements. Therefore, the computer-processed information was not always reliable. As a result, FY 1994 financial statement expenditures were understated by \$0.2 million.

Audit Period, Standards and Locations. This program audit was performed from October 1994 through March 1995 in conjunction with the audit of the National Security Education Trust Fund Financial Statements for FY 1994 (Report No. 95-180 issued April 24, 1995). The audit was made in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary. Appendix E lists the organizations we visited or contacted.

Methodology

We reviewed public laws to determine statutory requirements for the Program. Also, we reviewed Program staff responsibilities and contract statements of work to determine how the Program functions. Further, we reviewed the proposed memorandum of agreement to determine the nature and extent of accounting support required by the Program and the Trust Fund. Finally, we reviewed payment records to determine adequacy of documentation for Trust Fund expenditures and to evaluate management control programs for the Program and the Trust Fund.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of Management Control Program. We evaluated the Program's management control structure, including implementation of the management control program for the Trust Fund and the Program, to obtain an understanding of the management control policies and procedures and to assess the level of control risk relevant to all significant cycles, classes of transactions, and account balances. Specifically, we reviewed the adequacy of management controls over Trust Fund expenditures and reporting. Also, we reviewed the proposed memorandum of agreement to determine support the Program should have received in managing the Trust Fund. We also reviewed the result of any self-evaluation of those management controls.

Adequacy of Management Controls. In spite of the conditions noted in the findings, the management controls were considered adequate as they applied to the primary audit objective.

Adequacy of Management's Self-Evaluation. The program director evaluated procedures and recognized weaknesses in documenting payment records. Therefore, the program director established procedures to verify Trust Fund expenditures for FY 1995.

Appendix B. Summary of Prior Audits and Other Reviews

Office of the Inspector General, DoD, Report No. 95-180, "The National Security Education Trust Fund Financial Statements for FY 1994," April 24, 1995, expressed a qualified opinion on the financial statements. The opinion was qualified because the Trust Fund balance was overstated by about \$18.3 million.

Office of the Inspector General, DoD, Report No. 94-153, "Principal Financial Statements of the National Security Education Trust Fund-FY 1993," June 30, 1994, expressed an unqualified opinion on the principal financial statements for the Trust Fund.

Office of the Inspector General, DoD, Report No. 94-007, "National Security Education Trust Fund Accounting Records," October 19, 1993, states that a system of controls to record obligations and liabilities in the Fund accounting records had not been established. Management concurred with the recommendation to establish a system of controls. The Washington Headquarters Services agreed to establish an account for operational expenses for the Fund.

Office of the Inspector General, DoD, Report No. 93-143, "Principal Financial Statements of the National Security Education Trust Fund-FY 1992," June 30, 1993, expressed a qualified opinion on the principal financial statements of the Trust Fund. The qualifying factor was the nondisclosure of an accounting procedure that categorized expenses incurred, in the amount of \$418,487 for FY 1992, in doing the business of the Program as nonoperational expenses.

Appendix C. Other Matters of Interest

Public Law 104-6, "Emergency Supplemental Appropriations and Rescissions for the Department of Defense to Preserve and Enhance Military Readiness Act of 1995; Mexican Debt Disclosure Act of 1995," April 10, 1995, rescinded \$75 million from the National Security Education Trust Fund. The Defense Finance and Accounting Service has reduced the Trust Fund by that amount and is awaiting instructions from the Office of Management and Budget concerning disposition of the funds. However, the program director has taken no action to comply with Public Law 103-178 that requires \$18.3 million be returned to the U.S. Treasury as miscellaneous receipts.

Appendix D. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
A.1.	Compliance with laws and regulations. Reduces Trust Fund corpus to comply Public Law 103-178.	About \$18.3 million can be put to better use by returning it to the U.S. Treasury.
A.2.	Compliance with laws and regulations. Recomputes interest income available to finance annual Program operations based on a reduced Trust Fund corpus.	Undeterminable. Funds put to better use will depend on the amount available for awards after interest is computed on the correct Trust Fund balance.
B.1.a.	Compliance with laws and regulations. Identifies countries and areas of study eligible for awards from the Trust Fund as required by Public Law 102-183.	Nonmonetary.
B.1.b.	Economy and efficiency. Increases the amount of funds available for scholarships, fellowships, and grants by reducing administrative costs.	Undeterminable. Funds put to better use will depend on the amount of the reduction of administrative costs.
B.2.	Compliance with laws and regulations. Ensures that the Trust Fund subsidizes studies of countries and languages that are critical to the national interest as required by Public Law 102-183.	Nonmonetary.
C.1.	Management Controls. Documents an agreement on services that will be provided in support of the National Security Education Trust Fund.	Nonmonetary.

Appendix D. Summary of Potential Benefits Resulting From Audit

Recommendation Reference	Description of Benefit	Amount and/or Type of Benefit
C.2.	Management Controls. Improves the reliability of financial records pertaining to Trust Fund divestments and expenditures.	Nonmonetary.

Appendix E. Organizations Visited or Contacted

Office of the Secretary of Defense

Under Secretary of Defense for Policy
Assistant Secretary of Defense (Strategy and Requirements), Washington, DC
National Security Education Program, Washington, DC
Under Secretary of Defense (Comptroller), Washington, DC
Washington Headquarters Services, Washington, DC

Department of the Army

Defense Supply Service of Washington, Washington, DC

Defense Organization

Defense Finance and Accounting Service, Defense Accounting Office, Cleveland Center,
Arlington, VA

Non-Defense Federal Organization

Department of Health and Human Services, Philadelphia, PA

Non-Government Organizations

Academy for Educational Development, Washington, DC
Institute of International Education, Washington, DC
Johns Hopkins University, National Foreign Language Center, Washington, DC
Lexia Exchange International, Palo Alto, CA

Appendix F. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Policy
Assistant Secretary of Defense (Strategy and Requirements)
Director, National Security Education Program
Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant to the Secretary of Defense (Public Affairs)
Director, Washington Headquarters Services
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Auditor General, Department of the Navy

Department of the Air Force

Auditor General, Department of the Air Force

Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Logistics Agency
Director, National Security Agency
Inspector General, National Security Agency

Appendix F. Report Distribution

Non-Defense Federal Organizations

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division, General
Accounting Office

Chairman and ranking minority member of each of the following congressional committees
and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
Senate Select Committee on Intelligence
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal Justice,
Committee on Government Reform and Oversight
House Committee on National Security
House Permanent Select Committee on Intelligence

Part III - Management Comments

Assistant Secretary of Defense(Strategy and Requirements) Comments



STRATEGY
AND
REQUIREMENTS

ASSISTANT SECRETARY OF DEFENSE
2900 DEFENSE PENTAGON
WASHINGTON, D.C. 20301-2900



16 AUG 1995

MEMORANDUM FOR INSPECTOR GENERAL

SUBJECT: Draft Audit Report on the National Security Education Program (Project No. 5RF-2005.01)

I appreciate the opportunity to provide comments on the Draft IG Audit Report of the National Security Education Program (NSEP). The objective of the NSEP, established by the National Security Education Act (P.L. 102-183) and signed by President Bush in December 1991, is to address the future national security and economic competitiveness of the U.S. by increasing our national capacity to deal effectively with foreign cultures and languages. Since its inception, the NSEP has awarded 612 scholarships to U.S. undergraduates for study abroad, 292 fellowships to U.S. graduate students to integrate important foreign languages and area studies into their curriculum, and nine grants to institutions of higher education to develop programs for study of languages and areas important to the national interest. The NSEP, as exhibited by the number of awards to date, is a program which has successfully gone from inception to full operation in less than three years. Recognition of this significant achievement and of the Program's success in meeting its legislated objectives are notably missing from the Draft IG Audit Report.

More importantly, from my perspective, the Draft IG Audit Report suffers from a lack of analytical rigor, comparisons which indicate a lack of familiarity with the Program's objectives or a bias against the Program, and an inadequate understanding of how NSEP Trust Fund assets are disbursed. My specific comments and recommendations are contained in enclosure (1) to this memorandum.

In preparing these comments and recommendations to the Draft IG Audit Report, I have directed my staff to provide alternate analysis in areas where we take exception to the findings in your report, in addition to explaining why we disagree with the findings. While I acknowledge that there are areas in the Draft IG Audit



Assistant Secretary of Defense(Strategy and Requirements) Comments

Report on which we agree, the areas on which we disagree and the importance various oversight agencies place in reports from your office militates strongly in favor of ensuring that IG reports are accurate and fairly presented. As such, I would appreciate your attention to the issues raised in this memorandum and ask that they be carefully considered prior to the publishing of the Final IG Audit Report on the National Security Education Program.



Edward L. Warner, III

Assistant Secretary of Defense(Strategy and Requirements) Comments

Addressal of Findings
on Draft DoD IG Audit Report
on the National Security Education Program

Finding A. Partially concur. This Finding indicates that the National Security Education Trust Fund (NSETF) "exceeded the authorized balance because management for the National Security Education Program did not comply with a statutory requirement to reduce the Trust Fund corpus. As a result the Trust Fund corpus was overstated by about \$18.3 million. Additionally, future interest income...will be overstated because interest would be computed on an incorrect Trust Fund balance."

Comments and Discussion on Finding A. The House Permanent Select Committee on Intelligence (HPSCI) originated legislation which was adopted by the Congress in December 1993 and resulted in a reduction of the NSETF to \$120,000,000. Informal discussions within OSD questioned whether an authorizing committee (the HPSCI) could decrement a trust fund whose authority to obligate funds was controlled by the appropriations committees. Consensus was never achieved and action to return money to the U.S. Treasury was not undertaken. Although program administrators were cognizant of the HPSCI's action, the first definitive reading that the NSEP was likely to be obligated to return funds to the U.S. Treasury was from the DoD IG during the conduct of this audit in early 1995. Subsequent Congressional action in April 1995 to further reduce the NSETF by \$75,000,000 encompassed the December 1993 reduction. This April 1995 reduction was immediately implemented by the NSEP staff. Consequently, the NSEP is now in compliance with both Congressionally mandated reductions in the NSETF.

Additionally, the NSEP Staff believes the Draft IG Audit Report miscalculates the "overstatement" of the NSETF by \$1,772,217 through the use of an approximation of the NSETF balance on 3 December 1993 vice the actual balance of the trust fund on that date. An explanation of the methodology used by the NSEP staff to develop their figures is provided at Tab A.

Finding B. Administration of the National Security Education Program. Each sub-finding within Finding B is addressed below.

Assistant Secretary of Defense(Strategy and Requirements) Comments

Sub-finding 1. "Program Implementation Without Board Guidance." The Draft IG Audit Report concludes that "the Program staff had no guidance on which foreign countries the Board would recommend as critical to the Nation's interest." The Draft Audit Report states that "the Program staff allowed students to select countries for study."

Comments and Discussion on Sub-finding 1. Partially concur.

A. As discussed above, the NSEP is a new program, having just been established in late 1991. In preparation for the initial awarding of scholarships to undergraduates, fellowships to graduate students, and grants to institutions for academic year 1994, the solicitation process took place in parallel with the establishment of the National Security Education Board (NSEB). It is important to note, however, that no NSEP scholarships, fellowships, or grants to institutions were awarded prior to the first meeting of the NSEB in May 1994 at which time the Board reviewed and accepted the approach recommended by the NSEP Staff for use during academic year 1994 where scholarships, fellowships and grants were awarded based on a merit-review process without designation of critical countries (although study of Western Europe was precluded since Western European representation in U.S. institutions of higher education already met national requirements). The May 1994 NSEB meeting also addressed the issue of designation of critical countries for NSEP awards to be disbursed in academic year 1995. The consensus of the Board was that it was premature to designate specific critical countries and in lieu of such designation a "thermostat concept" would be adopted through which broad guidance on critical countries could be provided to both the meritreview process and candidate students by the Board.

B. A careful reading of both 1994 NSEB meeting transcripts relating to designation of critical countries indicates the complexity of this issue and the conscious decision by the Board that, at this early point in the life of the Program, such specific designation of critical countries would be premature. It is important to note that at the October 1994 NSEB meeting, the Board agreed that continued work in identifying critical countries was needed and that the Working Group to the NSEB, the NSEP Staff and the NSEP Group of Advisors look at various refinements to the "thermostat concept."

Assistant Secretary of Defense(Strategy and Requirements) Comments

This work continues and is an agenda item at the October 1995 NSEB meeting.

2. Sub-finding 2. "ASD (S&R) and National Security Education Board Guidance on Selection of Critical Countries." The Draft Audit Report asserts the following: (a) the Board recommended excluding Mexico from student awards; b) the Board did not identify countries that should be designated as critical ... ; and (c) because none of the countries for which students received awards had been identified by the Board as critical to the Nation's interest, Congress has no assurance that the \$3 million distributed meets the intended purpose of the Program."

Comments and Discussion on Sub-finding 2.

A. "Excluding Mexico." Nonconcur. The IG Audit Team was provided with the full transcripts from both 1994 meetings of the NSEB. While the efficacy of including Mexico as an area of study under NSEP was discussed at the October 1994 Board meeting, there is no implicit or explicit recommendation from either Board meeting that would support the exclusion of Mexico as a country for study under the auspices of NSEP.

B. "Identify critical countries." Partially concur. The rationale is identical to that used in sub-finding 1, above.

C. "Congress has no assurance that ... the program meets the intent of the legislation." Nonconcur.

1. Although the Draft IG Audit Report does not provide any explanation of methodology used to derive the data which supports this conclusion, it is apparent that the Audit Team decided to include in its analysis only those awards where funds were disbursed prior to the end of FY 94, September 30, 1994. The Draft IG Audit Report fails to take into account that the NSEP is not a fiscal year program; it does not draw on annually appropriated funds and its entire structure, other than fiscal year accounting and reporting, is calendar- and academic-year based. Thus, while the program actually awarded \$5M for 312 scholarships and 173 fellowships in academic year 1994, the Draft IG Audit Report only credits the NSEP with disbursing \$3M for 261 scholarships and 138 fellowships (those academic year 1994 awards whose funds were

Assistant Secretary of Defense(Strategy and Requirements) Comments

actually disbursed in FY 94). The Audit Team's decision to count only those awards actually disbursed in FY 94 as opposed to counting all the awards made for academic year 1994 leads to a considerable under statement of the number of countries being studied under the auspices of the NSEP.

2. In order to provide a more meaningful analysis, the NSEP Staff has plotted numeric and geographic data from academic year 1994 scholarships and fellowships against countries designated as high interest areas by Federal government agencies in the May 1994 *NSEB Working Group Report to the NSEB*. Although the NSEB made a conscious decision not to use the Working Group's data to formally designate critical countries during the initial years of the program (in favor of the "thermostat concept" described above), comparing academic year scholarships and fellowships against this data from Federal agencies clearly shows that money expended by this program does meet the intent of the legislation and that the program is successfully targeting curricula that is under-represented in U.S. academia.

3. It is strongly recommended that you look closely at the NSEP Staffs alternative analysis (at Tab B) which directly refutes the Draft IG Audit Report that "Congress has no assurance that ... the Program meets the intent of the legislation."

Subfunding 3. National Security Education Program administrative costs are excessive. Nonconcur.

Comments and Discussion on Subfunding 3. Based on the Draft IG Audit Report of \$2 million in estimated administrative costs during FY 94 and the \$7.5M awarded under the auspices of NSEP in academic year 1994, only 21% of total program costs were administrative in nature, not the 40% contained in the Draft IG Audit Report. Also inappropriate is an administrative cost comparison between an educational program like NSEP and the charity organizations which make up the Combined Federal Campaign. Clearly a more appropriate comparison would be to another educational program, like the Truman or Fulbright Scholarship Programs.

A. As discussed above in subfunding 2, the methodology apparently applied by the Audit Team to this analysis is to count as

Assistant Secretary of Defense(Strategy and Requirements) Comments

expenditures only those funds that have been disbursed during FY 94 (those academic year 1994 scholarship and fellowship recipients who have already had their awards disbursed). This methodology presents an incomplete and inaccurate accounting of program costs and benefits since awards made in 1994 are for academic year 1994, a period which extends well beyond the end of FY 94 on 30 September 1994. Additionally, the Draft IG Audit Report fails to take into account that administrative costs included considerable expenses related to startup of a new program. This is never addressed in the Draft IG Audit Report. It is common for financial audits to amortize costs for such items as furniture, ADP, etc., over a longer period of time and to not treat them in the same way as recurring costs when analyzing the ratio of administrative to program costs.

B. The administrative cost comparisons presented on page 10 of the Draft IG Audit Report are also inappropriate and misleading. The Audit Team used, as a benchmark, costs incurred by non-profit organizations who participate in the Combined Federal Campaign. The Audit Report never addresses why this comparison is appropriate. Typically, administrative cost comparisons are undertaken among similar types of organizations. In addition, cost comparisons usually control for such attributes as size of the organization. The Draft IG Audit Report fails to recognize not only the startup costs referenced above, but the reality that economies of scale influence administrative costs.

C. Organizations with missions similar to that of NSEP exist, and the Audit Team is urged to seek such data from programs like the Fulbright Program and programs sponsored by the Harry S. Truman Scholarship Foundation and the James Madison Memorial Fellowship Foundation. The NSEP staff has undertaken its own comparison between its program and the Harry S. Truman Scholarship Foundation. Data on that analysis is provided at Tab C. A review of the data indicates that the administrative costs associated with the Truman Scholarship Program account for 38% of total program costs, a number which favorably reflects on the administrative costs associated with NSEP, particularly when arrayed against the NSEP's actual administrative cost rate of 21%.

D. Comparison of NSEP costs against those of other similar programs is strongly encouraged. It is also recommended that the comparison of NSEP administrative costs to those of nonprofit organizations in the combined federal campaign be deleted.

Assistant Secretary of Defense(Strategy and Requirements) Comments

Comparisons with organizations whose missions are entirely different from NSEP are inherently biased and produce an unwarranted negative impact on the Program.

Finding C. Concur.

Comments and Discussion on Finding C. Concur with basic findings concerning management controls for the National Security Education Trust Fund and Program.

A. A detailed accounting and reporting system has now been put into place that will include a thorough record of all expenses from the Trust Fund, including dates of requests for disinvestment and reconciliation of accounts with the data provided by Washington Headquarters Services, and detailed documentation of payment records supporting all Trust Fund expenditures.

B. All records now include detailed justification for all expenses from the Trust Fund.

C. The NSEP Staff has initiated an inquiry into the reasons why the Memorandum of Agreement (MOA), discussed on page 14 of the Draft Audit Report, was not completed by all parties. A memorandum of agreement that clearly delineates the responsibilities of each participating organization, specifically WHS and DFAS, will be coordinated and completed by the NSEP Staff.

Audit Background Correction: In the "Audit Background" on page 3, the Draft IG Audit Reports states the NSEP director is assisted by a staff of 13 Federal civil service employees. At no time during the administration of the NSEP has the staff included 14 employees. While the Program began with an authorization of 15 billets, the highest number of Federal civil service employees on the staff at any point in time has been nine. The NSEP is currently operating with eight employees.

Assistant Secretary of Defense(Strategy and Requirements) Comments

CALCULATION OF POTENTIAL OVERSTATEMENT OF NATIONAL SECURITY EDUCATION TRUST FUND (TAB A)

P.L. 102-178, the FY 1994 Intelligence Authorization Act signed December 3, 1993, Sec. 311 states: "(a) Reductions of Amounts in the Trust Fund.--The amount in the National Security Education Trust Fund established pursuant to section 804 of Public Law 102183 (50 U.S.C. 1904) in excess of \$120,000,000 that has not been appropriated from the trust fund as of the date of the enactment of this Act shall be transferred to the Treasury of the United States as miscellaneous receipts."

The Trust Fund was established in the amount of \$150,000,000 in August 1992 pursuant to section 804 of P.L. 102-183. An OSD General Counsel interpretation of the legislation indicated that Congressional authority (in the form of language included in an appropriations act) was needed in order to expend resources from the Trust Fund. Such authority, totaling \$20 Million, was granted by Congress on two occasions prior to the December 3 reduction: \$10 Million on July 2, 1993 (P.L. 103-50) and \$10 Million on November 11, 1993 (P.L. 103-139). Also, by December 3, 1993, \$7,400,983 had been earned in interest and added to the Trust Fund while \$873,000 in obligations had been expended from the Trust Fund.

According to P.L. 102-178, before calculating the potential overstatement of the Trust Fund and determining the possible interest implications of the reduction of the Trust Fund to \$120,000,000, a reconciliation of the adjustments to the Trust Fund must be made. This calculation is described below and illustrated in the table that follows.

Starting with the \$150,000,000 corpus, compute the interest earned by the Trust Fund prior to December 3 (\$7,400,983) and add this to the Trust Fund balance. Then subtract from the Trust Fund all obligations (\$873,000) incurred prior to December 3. Finally, subtract the \$20,000,000 in spending authority authorized by Congress to arrive at a Trust Fund balance of \$136,527,983. Only after these adjustments are made can the Congressionally mandated threshold of \$120,000,000 be applied to the Trust Fund balance and the appropriate reductions be calculated. When this is done, the actual reduction is no more than \$16,527,983 as shown in the table below.

Assistant Secretary of Defense(Strategy and Requirements) Comments

<p>\$150,000,000 <u>+ 7,400,983</u> \$157,400,983 - <u>873,000</u> \$156,527,983 - <u>20,000,000</u> \$136,527,983 <u>-120,000,000</u> \$ 16,527,983</p>	<p>August 1992 pursuant to PL 102-183 Interest earned as of Dec 3, 1993 when PL 103-178 was signed Total Amount in the Trust Fund, including interest Obligations as of December 3, 1993 Actual Balance of Trust Fund on December 3, 1993 Congressional Appropriations before Dec. 3, 1993 Amount above \$120M available Threshold established by PL 103-178 Amount of actual reduction to comply with PL 103-178</p>
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An alternative analysis is also possible. It is not clear that the reductions mandated in P.L. 103-178 include interest earned on the Trust Fund. If the interest earned as of December 3, 1993 is exempted from the reductions, the amount of the actual reduction should be \$9,127,000.

P.L. 104-6, the FY 1995 Emergency Supplemental and Recission Act, signed on April 10, 1995 makes this issue a moot point. The Act stated "Of the funds made available under this heading (National Security Education Trust Fund) in Public Law 102-172, \$75,000,000 are rescinded." I believe that the \$75 million reduction made to the Trust Fund on April 27, 1995 encompasses the mandate of P.L. 103178. It will only be necessary to recompute the interest from December 3, 1993 to April 27, 1995 on that part of the Trust Fund that is deemed to be overstated (either \$16,527,983 or \$9,127,000). We have formally requested an opinion from the DoD General Counsel on this issue.

Assistant Secretary of Defense(Strategy and Requirements) Comments

ANALYSIS OF DISTRIBUTION OF SCHOLARSHIPS AND FELLOWSHIPS TO
CRITICAL COUNTRIES AS DESIGNATED BY THE NATIONAL
INTELLIGENCE COUNCIL AND DEPARTMENT OF COMMERCE
(TAB B)

Tables I and 2 array the number and percentages of scholarships and fellowships against those countries designated as critical in the May 1994 Working Group Report to the NSEB. The analysis is quite conservative and draws, for purpose of example, on only those countries identified by the National Intelligence Council and the Department of Commerce as high priority areas of study. The list of countries could be expanded even further by including other countries identified by other agencies, as referenced in the Working Group Report.

The results of the analysis are conclusive and contradict the findings of the Draft IG Audit Report. More than 75% of all undergraduate scholarships and 88% of graduate fellowships were awarded for study of countries identified as critical. In virtually all cases, the highest number of students are studying in and about the most critical countries identified by the Working Group: Russia, Japan, and China.

Using the same conservative list of critical countries identified above, an analysis was conducted on how the \$2.5 million for each of the programs, scholarships and fellowships, was allocated. The amount for each country was then summed and compared to those countries identified as critical. The results of this analysis, again, dispute the findings of the Draft IG Audit Report. At the undergraduate level, \$1,846,495, or 74%, of the \$2.5 million was allocated for study in these countries; at the graduate level, \$2,362,800, or 94%, of the \$2.5 million was allocated for study in these same countries. Additionally, a further breakdown of awards indicates that over one-third of the funds for each program (and in the case of undergraduate scholarships, 43%) were allocated to study in one of the three most critical countries identified above: Russia (including the Newly Independent States), Japan, and China.

ADMINISTRATIVE COST COMPARISON BETWEEN THE NATIONAL
SECURITY EDUCATION PROGRAM AND THE TRUMAN SCHOLARSHIP
FOUNDATION
(TAB C)

The NSEP Staff obtained a copy of the 1994 Truman Foundation Annual Report which includes a Fiscal Year 1994 Financial Statement (attached). The mission of the Truman Foundation is comparable to NSEP for purposes of assessing costs. The Annual Report states that "the mission of the Harry S. Truman Scholarship Foundation is to offer opportunities for America's best and brightest college students to prepare for careers in public service. The Foundation does this through its selection process, grants, and the development activities for Truman Scholars..." The Truman Foundation and Trust Fund, which supports all activities of the Foundation just as the National Security Education Trust Fund supports all NSEP activities, was established in 1975.

Most noteworthy in the Truman Foundation's financial statement is the following: total expenses in the fiscal year of \$2,662,561. Included in this amount is \$1,660,683 in scholarship awards. Administrative costs therefore account for \$1,001,878 of the total program costs or 38%. Clearly, NSEP administrative costs compare quite favorably to costs experienced by the Truman Foundation.

HARRY S. TRUMAN
SCHOLARSHIP FOUNDATION



1994
ANNUAL
REPORT

FOR
THOSE
WHO
WANT
TO
MAKE A
DIFFERENCE

Assistant Secretary of Defense(Strategy and Requirements) Comments

**TRUSTEES
AND OFFICERS**
(As of September 30, 1994)

HON. ELMER B. STAATS
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Former Comptroller-General of the
United States and Director of the
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HON. IKE SKELTON
Vice-Chairman
United States House of
Representatives (MO)

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**C. WESTBROOK
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Secretary of the United States
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LOUIS H. BLAIR
Executive Secretary

C. JUDY REED
Administrative Officer

TONJI WADE BARROW
Staff Assistant

DEBORAH NAGY
Staff Assistant

**AIDA ORENSTEIN-
CARDONA**
Resident Truman Scholar

Financial Statement

(for fiscal year ending September 30)

	FY1993	FY1994
INCOME		
Gifts and Donations	\$18,040	\$0
Interest Income	\$6,943,382	\$2,999,230
Credit towards Expenses	\$28,000	\$28,066
TOTAL INCOME	\$6,989,422	\$3,027,296
ASSETS (Par Value)		
	\$53,032,170 *	\$53,523,118**
EXPENSES		
Scholarship Awards	\$1,685,644	\$1,660,683
Contracted Services for Scholar Development	\$377,766	\$147,296
Contracted Services for Admin. Support & Scholar Selection	\$190,727	\$230,763
Personnel Costs & Benefits	\$279,741	\$301,866
Travel for Scholars, Finalists, Staff & Transportation of Things	\$184,187	\$156,263
Rent	\$44,715	\$45,802
Printing, Equipment & Supplies	\$69,768	\$98,656
Communications, Postage & Misc Expenses	\$29,659	\$21,232
TOTAL EXPENSES	\$2,862,207	\$2,662,561

ANALYSIS OF TRUMAN SCHOLAR STATUS

	FY1993	FY1994
Number of Scholars Selected	82	79
Number Receiving Support	305	316
Number Deferring Support	171	130
Number Foundation Support Complete	997	1106
Total Number of Scholars Selected since 1977	1473	1552
Future Funding Obligations to Active and Deferred Scholars	\$8,129,335	\$9,490,640
Scholarship Support Paid Since 1977	\$23,035,631	\$24,696,314

* Consists of U.S. Treasury Bills \$960,000 par; U.S. Treasury Notes 08/15/92 @6 3/8% \$41,000,000 par; U.S. Treasury Bonds 07/31/97 @5 1/2% \$10,000,000 par; \$1,272,170 cash in account.

** Consists of U.S. Treasury Bills 10/20/94 @4.3% \$905,000.00 par; U.S. Treasury Bills 11/17/94 @4.56% \$1,315,000 par; U.S. Treasury Notes 08/15/02 @6 3/8% 41,000,000 par; U.S. Treasury Bonds 07/31/97 @5 1/2% 10,000,000 par; \$323,118 cash in account.

Assistant Secretary of Defense(Strategy and Requirements) Comments

ANALYSIS OF "CRITICAL" COUNTRIES IN NSEP UNDERGRADUATE SCHOLARSHIPS: 1994 AWARDS

Country of Study	Number	Percent	Designated Critical?
Argentina	4	1%	✓
Bolivia	2	1%	
Brazil	10	3%	✓
Cameroon	3	1%	
Chile	5	2%	✓
China	31	10%	✓
Colombia	2	1%	✓
Costa Rica	15	5%	
Czech Republic	5	2%	✓
Dominican Repub	14	4%	
Ecuador	7	2%	
Egypt	5	2%	✓
Ghana	4	1%	
Greece	4	1%	
Guatemala	2	1%	
Hong Kong	1	1%	✓
Hungary	4	1%	✓
India	4	1%	✓
Indonesia	4	1%	✓
Israel	7	2%	✓
Ivory Coast	1	1%	
Japan	54	17%	✓
Kenya	5	2%	✓
Korea, South	2	1%	✓
Kyrgyzstan	2	1%	✓
Madagascar	2	1%	
Mexico	24	8%	✓
Morocco	4	1%	✓
Nepal	4	1%	
Niger	2	1%	✓
Paraguay	2	1%	
Poland	4	1%	✓
Romania	1	1%	✓
Russia	39	12%	✓
Senegal	7	2%	
Singapore	1	1%	
South Africa	1	1%	✓
Taiwan	6	2%	✓
Tanzania	4	1%	
Thailand	4	1%	✓
Tunisia	2	1%	
Turkey	2	1%	✓
Ukraine	2	1%	✓
Uzbekistan	1	1%	✓
Venezuela	1	1%	
Vietnam	3	1%	✓
Yemen	1	1%	
Zimbabwe	3	1%	

"Critical" is defined as a country specifically identified in the *Working Group Report to the National Security Education Board* as a high priority area of study.

Assistant Secretary of Defense(Strategy and Requirements) Comments

ANALYSIS OF "CRITICAL" COUNTRIES IN NSEP GRADUATE FELLOWSHIPS*

Country of Study	Number	Percent	Designated Critical?
Argentina	2	1%	✓
Balkans	1	1%	✓
Bolivia	2	1%	
Brazil	7	4%	✓
Cambodia	1	1%	
Chile	3	2%	✓
China	12	7%	✓
Costa Rica	4	2%	✓
Cote d'Ivoire	1	1%	
Cuba	1	1%	✓
Cyprus	1	1%	
Czech Republic	5	3%	✓
Ecuador	2	1%	
Egypt	1	1%	✓
El Salvador	1	1%	✓
Ethiopia	1	1%	✓
Georgia	1	1%	✓
Honduras	1	1%	✓
Hungary	1	1%	✓
India	7	4%	✓
Indonesia	8	5%	✓
Israel	2	2%	✓
Japan	24	14%	✓
Jordan	1	1%	✓
Kazakhstan	2	1%	✓
Kenya	1	1%	✓
Latin America	1	1%	✓
Latvia	2	1%	✓
Lithuania	1	1%	✓
Macedonia	1	1%	✓
Malawi	1	1%	
Mali	1	1%	
Mexico	7	4%	✓
Mongolia	1	1%	
Morocco	3	2%	✓
Nepal	1	1%	
Nigeria	1	1%	✓
Pakistan	1	1%	✓
Peru	3	2%	
Philippines	1	1%	✓
Poland	4	2%	✓
Romania	2	1%	✓
Russia	20	12%	✓
Senegal	1	2%	
Siberia	1	1%	✓
Slovenia	1	1%	✓
Syria	1	1%	✓
Taiwan	2	1%	✓
Thailand	4	2%	✓
Turkey	3	2%	✓
Turkmenistan	1	1%	✓

* "Critical" is defined as a country specifically identified in the *Working Group Report to the National Security Education Board* as a high priority area of study.

Assistant Secretary of Defense(Strategy and Requirements) Comments

Ukraine	2	1%	✓
Uzbekistan	5	3%	✓
Vietnam	4	3%	✓
West Bank	1	1%	✓
Zambia	1	1%	

Audit Team Members

This report was prepared by the Readiness and Operational Support Directorate,
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