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BEFORE THE
SUBCOMMITTEE ON ENERGY, NUCLEAR PROLIFERATION,
AND GOVERNMENT PROCESSES
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

ON
INTERNAL FINANCIAL CONTROLS IN
FEDERAL AGENCIES' ACCOUNTING SYSTEMS

Mr. Chairman and Members of the Subcommittee:

We are pleased to participate in your oversight hearings on the need to improve internal control systems in the Federal Government. These deficiencies may be costing taxpayers hundreds of millions of dollars annually. More than ever before, citizens and public officials are asking questions about financial management and about the adequacy of financial control over governmental operations. With increasing costs of Government operations and the national debt over 1 trillion dollars, the public has a right to be concerned about how efficiently Government operations are being carried out.

Federal officials can restore the public's confidence in Government operations by improving the Government's financial management systems, including budgeting, accounting, and internal controls. Reliable internal control systems should be at the very core of management's effort to achieve or maintain a high level of accountability and confidence in Government. We believe internal

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control systems--properly conceived, soundly based, and effectively monitored--are essential for achieving good accountability.

But many agencies' internal control systems are not the result of systematic planning. They are the product of many program and administrative changes made over the years. Many of these changes have not been made in a coordinated manner. Even in cases where systems have been planned, we find too often that agencies have either allowed them to become outdated or have changed parts of them without considering how this change affects the entire system.

Our audit efforts in the past few years have disclosed numerous instances where Government agencies are operating internal control systems susceptible to fraud, waste, and abuse. Our work has indicated that most fraud, waste, and abuse occur because internal controls are either not in place or are not followed. Weak internal control systems often provide opportunities for financial loss, and some employees take advantage of such opportunities. About 2 months ago, an employee of a small Federal agency pleaded guilty to defrauding the Government of over $500,000, simply by having checks issued to himself.

Fraudulent acts are occurring annually in the absence of effective internal controls. In a GAO report released last year, we cited that Federal agencies had experienced thousands of cases of known fraud within a 2-1/2 year period. Two-thirds of these cases involve monetary losses. We have estimated that between $150 and $220 million was lost in this 2-1/2 year period. Although it is important to continue to identify such cases, management's primary concern should be to construct systems of internal control that will prevent, or at least decrease, the likelihood of fraud.

Effective internal control systems have long been recognized as an essential part of a Federal agency's operation. These systems consist of all measures used by agencies to safeguard resources against fraud, waste, and abuse; ensure accurate and reliable accounting and operating data; encourage compliance with applicable policies and laws; and promote efficiency and economy in operations.

GAO evaluates agencies' internal controls in two ways: (1) we review, on a limited basis, operating and administrative controls at selected agencies' field offices, and (2) we review, on a more comprehensive basis, agencies' central accounting systems and major subsystems.

First, I'd like to discuss our limited reviews of agencies' operating and administrative controls at agencies' field offices. These reviews have uncovered many internal control deficiencies over the years. In 1980, we reported to the Congress and agency heads a pattern of deficiencies in all major aspects of accounting--recording receivables and obligations, collecting debts, and making disbursements. We identified these deficiencies from our work at 11 agencies. Although we sent the report to <u>all</u> agency heads to provide them the opportunity to identify and correct similar weaknesses, our current work at nine additional agencies has disclosed the same pattern of deficiencies. We have provided this Subcommittee with charts summarizing the types of problems found at the 245 field offices that we reviewed in 20 Federal agencies.

The second way we review internal controls, which involves a more comprehensive review of agencies' central accounting systems and subsystems, has also disclosed deficiencies. We found problems with agencies' controls over the receipt and disbursement of money as well as their administrative controls to safeguard resources and promote adherence to policies and laws.

A major problem we frequently find is that many Federal agencies are operating outdated, poorly designed accounting systems. To illustrate, our September 1982 report on the Bureau of Indian Affairs' system pointed out that personnel were not following procedures, and automated system features were confusing and overly complicated. Because of these problems, we concluded that the Bureau had lost accountability for hundreds of millions of dollars of grant, contract, and trust funds made available to improve the livelihood of Indian people.

Within the Bureau of Public Debt's central accounting system, an essentially manual subsystem has been used to process principal and interest payments for outstanding Treasury bills serviced by the Bureau rather than by banks. In reporting on the subsystem's problems, we noted a series of design and internal control deficiencies providing opportunities for overpayments. The subsystem also had inadequate procedures to ensure that all overpayments are detected. The subsystem's primary controls were designed to identify overpayments after they occur--instead of before. Even those procedures for identifying overpayments were deficient. Within a 2-year period, the Bureau identified $15.6 million in overpayments which could have been prevented by a better designed system.

We also found deficient internal controls over such highly vulnerable areas as bond stock and negotiable checks. As an example, the Department of the Treasury has authority to issue replacement checks after receiving claims filed for loss, theft, or nonreceipt of original checks. But it devised no appropriate procedures to handle duplicate payments when both an original and replacement check were cashed. Instead, it simply established an account receivable on its books when the responsible administrative agency did not provide funds for the replacement check. Because appropriate action was not taken to recover the receivables, they continued to accumulate to more than $100 million at the end of fiscal 1982.

In yet another example, we found that the Bureau of Public Debt has a weak system of internal control over unissued bond stock with a face value of several billion dollars, and poor procedures for handling proceeds from the sale of savings bonds through over 44,000 agents. The control problems have contributed to an undetermined amount of bond stock shortages that could eventually result in some monetary losses. These shortages are caused by theft, inadvertent destruction of stock, and other unexplained losses.

Controls over remittance of bond proceeds were also found lacking. We are recommending a number of improvements to provide better controls over; (1) the issuance of blank stock, (2) inventories in possession of agents, and (3) remittance of bond sale proceeds. Unfortunately, the Treasury Department disagrees with our report, because it believes that actual monetary losses have been too small to justify extensive internal controls.

Some Federal agencies operate systems where the risk of erroneous payments is extremely high. For example, the Office of Personnel Management's system, which handles payments to retired Federal employees, overpaid about $98 million during a 3-year period ending in September 1980. Although OPM has recovered a substantial portion of these overpayments, it might have avoided some of the overpayments if better controls had been used to prevent dual payments and promptly identify deceased beneficiaries.

Not all the major problems we find are caused by outdated systems. We found that the Department of Agriculture's National Finance Center, which consolidated their accounting functions, did not have adequate controls to ensure bills are paid on time; thus the Federal Government incurred unnecessary interest costs. We also noted a control problem in one of its major subsystems which disburses more than $500 million annually. The subsystem had ineffective procedures for verifying vouchers submitted for payment. To illustrate the subsystem's high risk for fraudulent payments, Agriculture's top officials agreed with our plan to submit 10 bogus payment vouchers. The vouchers were approved for processing, and checks were mailed to the fictitious individuals and companies we created. We then returned the checks to Finance Center officials. While we generally support agency efforts to consolidate accounting operations because they lower costs, it is important that such systems have strong internal financial controls to avoid fraud, waste, and abuse.

As my testimony highlights, we are a long way from having agencies operate effective internal control systems in the Federal Government. However, the Financial Integrity Act, which the President signed in September, is a most important first step in putting the Federal Government's financial management house in order. It was certainly farsighted of the Senate Governmental Affairs and House Government Operations Committees to recognize the need for this legislation, which was also responsive to the recommendations contained in our 1980 internal control report mentioned earlier.

As one of our major responsibilities under the act, we will soon publish internal control standards to guide the agencies in establishing and maintaining good systems. Also, OMB is about to issue guidelines to heads of agencies to use in evaluating their internal control systems. GAO and OMB have been working together on these efforts. In addition, we believe that the inspector general community will have a very important role under this new legislation. We will be working closely with them to help ensure that agencies develop and maintain good systems of internal control.

As you know, the act requires agencies to annually report the state of their internal control systems to the Congress and the President, including their plans to correct internal control weaknesses. We intend to review the agencies' reports and plans and keep this Subcommittee and the Congress advised of our findings. It is important for all of us to keep in mind, Mr. Chairman, that developing good plans is one thing, but to carry them out successfully will take money, skilled people, and, most importantly, a sustained commitment by both the executive branch and the Congress.

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This concludes my testimony, Mr. Chairman. My associates and I will be happy to answer any questions.