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STATEMENT OF
ELMER B. STAATS
COMPTROLLER GENERAL OF THE UNITED STATES

BEFORE THE

SENATE COMMITTEE ON APPROPRIATIONS SEN 00300

ON

[GAO EFFORTS RELATED TO THE PROBLEM OF
FRAUD IN THE GOVERNMENT]

Mr. Chairman we appreciate the opportunity to appear here today to discuss the status of GAO's efforts to prevent fraud, abuse, waste and error in Government programs, as well as some other subjects relative to good management of Governmental funds and programs.

As you know, fraud prevention and detection represents only one of the many issues covered in the more than 900 reports and special studies issued by our office in fiscal year 1979. These reports resulted in an estimated savings to the Government of \$2.6 billion, and additional savings from management improvements in operations and effectiveness of Government programs and activities that cannot be measured accurately.

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Our recent emphasis on fraud prevention and detection is one such area. This effort originated in 1976 with a special inquiry into the Government's ability to combat fraud. We specifically wanted to ascertain whether Federal agencies had instituted effective policies and procedures for combating fraud. The resulting report, issued in September 1978, was entitled, "Federal Agencies Can, and Should, Do More to Combat Fraud in Government Programs." In it we pointed out that while no one knows the magnitude of fraud and abuse against the Government, all indications are that it is a problem of critical proportions. It is hidden within legitimate undertakings, and usually goes unreported and undetected.

Shortly after our report was issued, I established a Task Force for the Prevention of Fraud to perform a three-fold mission: DLG03979

- establish the scope of the overall problem of fraud and other illegal activities against the Federal Government, and highlight where the existing procedures for dealing with fraud are inadequate. This portion of the Task Force activities has been termed our "overview" assessment.
- operate a nation-wide, toll-free hotline which can be used by citizens anywhere in the country to report instances of fraud in Federal programs.
- conduct "vulnerability assessments" within a few selected agencies. This involves development of a risk profile of the susceptibility of agency programs to fraud and other illegal activities.

OVERVIEW OF FRAUD AND ITS CAUSES

The first of these three efforts, our overview assessment, deals with known instances of fraud, its causes, and actions taken by management to prevent its recurrence. In this review, we are asking the question, "Why did fraud occur?" We are identifying the kinds of illegal activities that are occurring, and at what cost, and determining what means are available for prevention and detection. We want to know whether the fraud has occurred because agency control systems have failed. We also want to know what legal and administrative remedies were taken and, conversely if none were taken, why they were not. We are working with a universe of more than 130,000 cases of fraud and other illegal activities alleged from October 1976 through March 1979 in 21 departments and agencies. We have taken a statistical sample of some 5,000 cases and are incorporating the information on these cases into a computerized data base. In addition, we have been tracking selected cases through the systems in each agency to develop information on the types of control problems occurring and the areas needing attention.

Based on information obtained by us to date, it is clear that wide variety of Federal programs and activities are affected. Cases of fraud involve many areas, including:

--Payroll

--Loan Guarantees

--Theft of Equipment

--Educational benefits programs

NATION-WIDE HOTLINE

The second area undertaken by the Task Force is the operation of a nation-wide hotline. During the course of a December 1978 hearing before the Legislative Branch Appropriation Subcommittee, Senator Sasser suggested the establishment of a hotline telephone. We announced the number in January 1979, and after the first 12 months of operation had received more than 14,000 calls and had written up over 7,500 allegations. Many of the calls that were more appropriately the concern of other Federal agencies or State or local officials were referred but not written up. We try not to be ombudsmen, but with this type of operation, it is not always possible to avoid this role.

Computer analysis of trends of the calls is currently in process and the followup on these hotline leads has begun. Additional calls are being received daily, and will be handled by the same process.

In our initial screening of the 7,500 cases a geographic breakdown based on 5,160 allegations believed to be substantive shows that calls have been received from all 50 States, the District of Columbia and a few overseas locations. California had the highest rate of substantive allegations with 582, while Vermont and Wyoming had only 4 and 3 respectively. Washington,

D.C., (second highest) had 350 followed by Virginia with 265, New York with 247, and Texas with 245. While we know that the incidence of calls is somewhat a function of population and media coverage, it is too soon to tell what if anything the geographical distribution of complaints can tell us.

Furthermore, almost all Government entities are affected. The Department of Health, Education and Welfare (HEW) is the highest with over 1,000 substantive allegations including the Social Security Administration with 698 allegations. HEW is followed by the Department of Defense with 858. The next highest are the Department of Labor with 403 and the Department of Housing and Urban Development with 376.

In 64 percent of the cases, the informant wanted to be anonymous. Only 28 percent of the informants were Federal employees. Federal Government employees involvement is alleged in 37 percent of the cases. The majority of allegations (63 percent) are against Federal contractors, grant recipients, and corporate or individual recipients of Federal financial assistance. Additional statistics regarding hotline activity for the past year are provided for the record in an attachment to my statement.

The allegations being reported cover a wide range of abuses-- theft, private use of Government property, working-hour abuses, improper financial transactions, improper expenditure of grant

funds, cheating on benefit eligibility, and payment of bribes or kickbacks. The amount of money involved in these allegations varies, but the dollars involved, as we see it, are less important than what all this does in terms of destroying people's confidence in the operations of government.

I want to emphasize that GAO's interest is in the financial and management systems used to account for funds to determine whether the Government's fraud prevention efforts are adequate. We prefer to work with agency Inspectors General to get individual cases investigated. As of January 15, we had referred over 3,500 cases to the Inspectors General for investigation or audit.

We are monitoring the results of the Inspectors General work in order to develop profiles of fraudulent activity and agency actions to prevent it from occurring. This information will aid our evaluation of internal and management controls necessary to prevent fraud.

VULNERABILITY ASSESSMENTS

Our third effort, vulnerability assessments, is what we call our effort to estimate the susceptibility of agencies and their programs to fraud and abuse.

The concept of vulnerability assessments is an important one. Out of a concern that the Government be managed well and free from fraud, waste, and error, the President on December 13, 1978, sent a memorandum to the heads of executive departments

and agencies asking them to identify programs and activities deemed most vulnerable and to deliver to him by January 31, 1979, a planned approach for preventing and dealing with these problems. Due in part to the short time they were permitted by the President, efforts to do this by agencies we audited were incomplete. The vulnerability assessment portions of the plans they submitted were not in the depth they need to be to really evaluate the internal controls over tasks and functions being performed.

In making our own vulnerability assessments, we evaluate the adequacy of internal controls over major administrative and program-related tasks to determine whether someone could or has abused or misused Federal assets. To protect Federal funds and other assets adequately, departments and agencies must have preventive controls over tasks being performed as well as after-the-fact controls, such as internal auditors who test the systems of internal control to provide assurance to top management that programs and funds are being administered and performed correctly.

Based on our work, we believe that all of the agencies visited are vulnerable to fraud and abuse. This is because Federal headquarters, regional offices, and other field locations and grantees have inadequate internal controls over their operations. As a result, there is insufficient assurance that Federal funds spent at these locations are spent for the purposes

intended. In fact, during our testing of selected internal control systems, we found Federal funds and equipment that had been abused and misused at most locations visited.

The problems that could occur or have occurred because of the lack of adequate internal controls over particular tasks that must be performed are serious. Some of the more significant ones we have noted at the Federal level and at the grantee level are:

- Excessive Cash
- Payroll Fraud
- Improper Use of Grant Funds

THE NEED FOR MORE EFFECTIVE AUDIT

I would now like to briefly discuss two reports which are outside the fraud area but which directly impact on the effectiveness of Federal audit efforts and on the prudent management of appropriated funds.

The first report, issued in October 1978, addressed the issue of the Federal manager's responsibility to resolve audit findings. It disclosed that poor systems for resolving auditors' findings could be costing the Government hundreds of millions annually. Of a reported \$4.3 billion in unresolved audit findings, we estimate that 80 percent of this amount involves potential recoveries--including what grantees and contractors either spent for purposes not authorized by Federal laws and regulations or could not support as charges

to the Government. The remaining 20 percent involves potential savings in operating costs. In addition, the review showed that resolution frequently drags out for years. Moreover agency officials often resolved findings in the grantees' and contractors' favor without adequate explanation, even though the auditors' findings appeared to be valid.

Progress has been made to solve the problem. OMB has worked with agency representatives to correct the situation and revised its policy guidance along the lines of our recommendations. In November 1979, OMB revised its Circular A-73 to establish a 6-month time limit on audit resolution, procedures for resolving major disagreements between audit and program officials, semi-annual reports to agency heads, and periodic evaluations of audit followup systems. The Office also revised its Circular A-88 to provide for audit followup at educational institutions.

While we are unable to comment on the extent of improvement, information from OMB, the Inspector General Offices, and other Government organizations indicate the amount of unresolved findings has been reduced. A number of agencies informed us that they have implemented new systems for tracking and controlling auditors' findings.

Although progress has been made, there are indications that more has to be done before effective systems are fully implemented. OMB has stated that it is still pressing agencies for

implementation of its new policy changes. Agency officials recently informed us that some improperly resolved audit cases discussed in our report remain unchanged. We inquired about the status of a sample of 13 cases involving approximately \$16 million in questioned costs, and found that 8 cases totalling over \$15 million were not resolved or reevaluated. For example, we reported that an EPA administrator rejected an audit finding questioning \$454,000 in Federal grants and contracts because the amount questioned was not broken down by individual projects. On January 30, 1980, an EPA official stated that the Agency has not yet resolved the finding or analyzed the documentation the grantee submitted on the case.

We consider this area very important and are concerned about whether improvements have gone far enough. Accordingly, we have plans to review the Executive Departments' progress in improving their audit resolution systems.

The second report, issued in June 1979, discussed problems involved in grant auditing. It disclosed that the existing audit approaches cost time and money. Unnecessary costs result from duplication of effort and from performing audits too often of grants which are too small to warrant more than an occasional audit. In addition, the audit focus is often too narrow to be effective in preventing unauthorized expenditures and the loss of public funds. In our

report, we noted that the Government can lose millions of dollars through gaps in audit coverage.

An important point is that the current methods of auditing grants does not afford grants the full protection of audits. Our review of the audit experience of 73 grant recipients during fiscal years 1974 through 1977, disclosed that 80 percent of the recipients' \$3.7 billion in Federal funds was not audited by or on behalf of the Federal agencies. Even when audits of Federal funds are performed the audit focus is too narrow to be effective. This is because auditors concentrate on individual grants rather than the total grant funds received by a recipient and cannot be sure whose funds or assets they are reviewing. Such narrow audits are unlikely to reveal whether funds have been improperly transferred between grants or programs.

The basic recommendation in our report is the need for a single audit of all grants that a single entity has. Such an audit, among other things, would test the grantee's system for complying with Federal restrictions on the use of the funds and related matters, but a detailed audit of each grant would not be made. Any Federal auditor could review such an audit and rely on it if he felt the single audit had been properly performed.

There has been improvement in this area. GAO in cooperation with the Intergovernmental Audit Forum and various Federal agencies has taken the lead in developing an audit guide--"Guidelines for Financial and Compliance Audits of

Federally Assisted Programs"--for comprehensive financial and compliance audits of multi-funded grant recipients. State and local auditors as well as Federal auditors have participated in the development of this guide. OMB has revised its policy guidance (Circular A-102) to require the single audit and the use of this guide in performing such audits of State and local Governments. Much remains to be done before the single audit concept is fully implemented, but we believe this concept, when implemented, will help to reduce fraud, abuse and error in Federal assistance programs.

This concludes my statement; my associates and I will be pleased to answer any questions you may have.