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UNITED STATES GENERAL ACCOUNTING OFFICE

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STATEMENT OF

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UNITED STATES GENERAL ACCOUNTING OFFICE

BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

ON S. 2633

A BILL DESIGNED TO STRENGTHEN
THE FEDERAL AUDIT FUNCTION IN THE TERRITORIES



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INTRODUCTION

Mr. Chairman, we are here today at your request to comment on S. 2633. With me is Mr. Charles W. Culkin, Jr., Project Manager from our Far East Branch in Honolulu, Hawaii, and Mr. Richard N. Ruprecht, of our Office of General Counsel, who assisted in drafting the legislation.

My testimony today will summarize the major recommendations in our March 25, 1982, report "The Federal Audit Function in the Territories Should Be Strengthened" (AFMD-82-23) and discuss how S. 2633 would accomplish them. You may wish to include our report as part of the record for this hearing.

BACKGROUND

Our report recommended, among other things, that the audit functions of the U.S. Government Comptrollers in American Samoa, Guam, the Northern Mariana Islands, the Virgin Islands, and the Trust Territory of the Pacific Islands be transferred from the Department of the Interior's Office of the Assistant Secretary for Territorial and International Affairs (OTIA) to the Office of the Inspector General, and that certain responsibilities, notably the preparation of an annual financial report, be transferred to the local territorial governments.

S. 2633 would accomplish these recommendations with the following:

- The audit authority and resources of the U.S. Government Comptrollers for the territories would be transferred from OTIA to the Office of the Inspector General, Department of the Interior, for the purpose of establishing an organization which will maintain a satisfactory level of independent audit oversight in the territories. Incident to this transfer, some functions which are no longer deemed appropriate are omitted. The territorial organic acts and other legislation which heretofore provided for the Government Comptrollers are amended to reflect the transfer.
- The Governors of American Samoa, Guam, the Northern Mariana Islands, and the Virgin Islands, and the chief executives of the Marshall Islands, the Federated States of Micronesia, and Palau would be required to (1) prepare, publish, and submit a comprehensive annual financial report; (2) arrange for an independent audit of the comprehensive annual financial report; and (3) submit to the Congress, the Secretary of the Interior, and the cognizant Federal auditors a written statement of actions taken on Federal audit recommendations within 60 days after the issuance of the audit report.

We believe these changes are essential to strengthen financial management over Federal monies provided to the territories. As discussed in our report, the territories have had longstanding problems in their financial management systems. Because of these problems and the substantial amounts of Federal financial assistance provided to the territories, continued Federal audit oversight is needed; however, it should to be made more independent and effective. More Federal technical assistance, and the assumption of increased responsibility by the territories for financial management, would further improve audit effectiveness. Accordingly, we strongly urge enactment of S. 2633.

I would now like to briefly mention some of the specific problems addressed by the bill.

TRANSFERRING THE AUDIT AUTHORITY AND
STAFF OF THE COMPTROLLERS IN ORDER
TO ACHIEVE INDEPENDENCE

In our report we recommended that Congress enact legislation to transfer the U.S. Government Comptrollers' audit authority and staff from OTIA to the Office of the Inspector General, Department of the Interior, for the purpose of establishing an independent organization which will maintain a satisfactory level of audit oversight in the territories. This recommendation is based on our finding that the independence of the Comptrollers currently is impaired by actual and perceived conflicts of interest arising out of their organizational alignment within the Department, out of personal relationships, and from external sources.

The Comptrollers are not organizationally independent because they do not report to the highest possible level within the

Department of the Interior and they are not located outside the line management function under audit. Although the organic acts, other laws, and a Secretarial Order place the Comptrollers under the general supervision of the Secretary of the Interior, they report to the Deputy Assistant Secretary of the Interior (Operations), Office of Territorial and International Affairs (OTIA), through a Director, U. S. Government Comptrollers, who in turn reports to the Assistant Secretary of the Interior, OTIA. The effect of this is that OTIA has line management responsibility as well as audit responsibility for territorial matters. Our report points out situations that indicate the Comptrollers' independence has been impaired by their organizational position within OTIA.

Second, we stated in the report that personal impairments, such as the establishment of close personal relationships between auditors and territorial officials and the auditing of programs by the same individuals who provide technical assistance on these programs, may have affected the Comptrollers' ability to work and to report findings impartially.

Third, we noted that the Comptrollers' independence has been further impaired by external factors including restricted access to records and information, limited staff resources, and delayed territorial government responses to audit reports.

We believe transferring the Comptrollers' audit function from OTIA to the Office of the Inspector General would eliminate some of the impairments to the Comptrollers' independence. In addition, we believe the audit function would be enhanced under the Inspector

General. As part of a professional audit organization, the audit function would receive the professional level of technical guidance and direction required to effectively carry out an audit operation. The Inspector General would be able to provide the necessary oversight, review, and assistance in developing comprehensive audit plans; following up on audit findings and recommendations; ensuring compliance with audit standards; determining audit staff resources; providing audit staff training programs; developing audit staff rotation programs; and recruiting qualified audit staff.

We also believe that under such a transfer some of the personal impairments would be eliminated while others could be substantially reduced. Most importantly, auditors would no longer have to audit territorial programs and operations on which they had provided technical assistance, because program operating responsibilities are prohibited under the Inspector General Act [5 U.S.C. App. § 9 (Supp. III, 1979)]. In addition, close relationships with territorial officials could be substantially reduced by having the Inspector General institute a program of rotating auditors periodically. Such a program would enable the audit staff to broaden their professional auditing experience and training.

Finally, we believe most external impairments to audit independence would also be eliminated if the Comptrollers' audit function were transferred to the Inspector General.

We noted in our report that two of the three Comptrollers and Interior's Inspector General concurred with our position that the audit function would be more independent and effective

if it were under the Inspector General. Our position is further supported by the President's Transition Team report on OTIA, which also recommended that the Comptrollers' audit function be transferred to the Inspector General.

Part(b) of section 1, 2, and 3 of S. 2633 implements the recommended transfer by amending the relevant organic acts and public laws relating to Guam, the Virgin Islands, the Northern Mariana Islands, and the Trust Territory of the Pacific Islands to eliminate the existing provisions for the government comptroller and insert three new sections defining the authority to be conferred upon the Inspector General, Department of the Interior. The new language provides that a satisfactory level of audit oversight independent of the local government and the Office of Territorial and International Affairs be maintained in the territories, but it allows the Inspector General discretion in making audits and reports. The language is designed to prevent the Inspector General from completely diverting the audit resources transferred herein but stops short of specifying staffing levels and audit frequency. It is stated that the authority granted by this language shall extend to all activities of the government and shall supplement and not diminish the existing authority conferred upon the Inspector General by the Inspector General Act of 1978. In order to carry out these provisions, the new language also provides for the transfer of personnel and funds from the Offices of the Government Comptrollers to that of the Inspector General, Department of the Interior. Section 4 of S. 2633 would give the

Inspector General the same authority over American Samoa, effectively superseding the Secretarial Order under which the Office of the Government Comptroller for American Samoa is currently administered.

A second measure aimed at enhancing the independence of the Comptrollers is to relieve them of the legal obligation to provide reports at the request of the territorial Governors and High Commissioner. As presently written, the applicable laws could compromise the independence of the Comptrollers by creating the appearance that they are under the authority of the territorial Governors and High Commissioner, particularly if they require the Comptrollers to report on politically sensitive issues. S. 2633 would delete this statutory requirement.

We do not believe that any express provision is needed to allow territorial officials to suggest potential audit areas.

PREPARING ANNUAL FINANCIAL REPORTS
AND CONDUCTING AUDITS THEREOF

Two other recommendations contained in our report were to require the local territorial governments to (1) prepare, publish, and submit a comprehensive annual financial report in conformance with standards of the National Council of Governmental Accounting within 120 days of the close of the fiscal year to the Secretary of the Interior and the Congress, and (2) arrange for an independent audit of the comprehensive annual financial report in conformance with generally accepted government auditing standards for governmental units.

The first of these recommendations was based on our finding that a large portion of the limited audit resources available is devoted to preparing a legislatively mandated "annual report

of the fiscal condition of the government." We found that the nature and purpose of the report is ill-defined and its production is not timely. It is, therefore, of little value to users.

Currently, the Comptrollers report annually on their "review" of the territorial governments' financial statements. However, these reviews consist principally of inquiries of territorial officials and analytical procedures applied to financial data. The scope of this review, however, is much narrower than that required for an "examination" conducted in accordance with generally accepted government auditing standards, the objective of which is to express an opinion on the financial statements taken as a whole. An examination includes such steps as a review of internal controls and tests of financial transactions; however, the Comptrollers usually do not perform these audit steps, primarily because of inadequate recordkeeping by the territorial governments. As a result, they do not and cannot express an opinion on the financial statements presented in their annual reports.

Our second recommendation regarding the annual financial report is based on our belief that the audit of the report should also be the responsibility of the territorial governments, not the Comptrollers. Therefore, we have recommended that the annual report be audited by independent auditors, rather than being prepared and audited by the Comptrollers.

Part(a) of sections 1, 2, and 3 of S. 2633 would amend existing statutory provisions, and in the case of American Samoa enact new legislation, to require that local territorial governments prepare such reports and provide for such audits.

RESPONDING TO FEDERAL AUDIT RECOMMENDATIONS

Another recommendation contained in our report was that Congress require the territorial governments to submit to the cognizant Federal auditors, the Secretary of the Interior, and the Congress a written statement of actions taken on Federal audit recommendations within 60 days of the issuance date of the audit report.

While professional audit standards advocate establishing formal procedures to ensure consistent followup on audit report recommendations, the Comptrollers have not done this. The lack of a formalized system has led to infrequent report followup. Accordingly, the Comptrollers do not know whether territorial governments have implemented promised improvements.

The Comptrollers agreed that formalized audit followup systems should be developed. However, they stated that such systems would be more effective if the territorial governments were required to respond in writing to the audit recommendations within a specified time frame. At present, only the Governor of American Samoa is required to respond in writing to audit findings and recommendations.

Part(a) of sections 1, 2, and 3 of S. 2633 would require the territorial governments to report on actions taken pursuant to any Federal audit recommendation within 60 days of the audit report issuance. We believe that such a requirement would help the Federal auditors and the territorial governments improve the economy and efficiency of territorial operations and ensure better accountability over Federal and local funds.

CONTINUING AUDIT OVERSIGHT UPON TERMINATION OF
THE TRUSTEESHIP OF TTPI

Upon termination of the trusteeship agreement under which the United States has administered the Trust Territory of Pacific Islands, which includes the Northern Mariana Islands, the Comptroller will no longer have authority to conduct audits of those governments. In view of the substantial Federal assistance which the Northern Mariana Islands and the new governments of the Marshall Islands, the Federated States of Micronesia, and Palau will receive in future years and the serious financial management problems these governments are currently experiencing, we believe that a continued Federal audit presence is needed.

The Congress has already approved a covenant whereby the Northern Mariana Islands will become a U. S. territory and its people U. S. citizens (Public Law 94-241). The covenant will not become fully effective, however, until the trusteeship agreement is terminated. When the trusteeship ends and the covenant becomes effective, the United States will retain the authority to enact legislation affecting the territory. However, section 503(a)(3) of the covenant provides that certain existing U. S. laws will then become inapplicable. The law providing the Comptroller's audit authority in the Northern Mariana Islands (48 U.S. 1681b) is among those to terminate; and no provision has been made to continue Federal audit oversight in the territory.

S. 2633 addresses this problem by expressly providing that section 502(a)(3) of the covenant will not act to terminate the provisions relating to Federal audit oversight.

Mr. Chairman, this concludes my statement. We have a detailed analysis of the bill which we ask be accepted for the record. Also, we would like to call your attention two technical amendments to the bill, which is included in the detailed analysis provided to the Committee prior to this hearing. We will be pleased to answer any questions you or other members of the Subcommittee may have.