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UNITED STATES GENERAL ACCOUNTING OFFICE  
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STATEMENT OF  
DONALD L. SCANTLEBURY, DIRECTOR  
ACCOUNTING AND FINANCIAL MANAGEMENT DIVISION  
AND CHIEF ACCOUNTANT OF THE UNITED STATES  
GENERAL ACCOUNTING OFFICE  
BEFORE  
THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS  
ON THE NEED TO PREVENT FRAUD AGAINST  
THE FEDERAL GOVERNMENT

*Comments were presented*  
I am pleased to be with you today to discuss the serious problem of fraud against the Government and how it can be prevented. Since the beginning of calendar year 1979 we have had a 3-pronged effort underway to help prevent fraud against the Government.

The first of these efforts, and probably the most well known, is our operation of a nation-wide, toll-free hotline which can be used by citizens anywhere in the country to report instances of fraud in Federal programs. So far, we have referred almost 6,000 allegations for agency follow up.

Our second effort, vulnerability assessments, is an evaluation of the susceptibility of agencies and their programs to fraud and abuse. In doing our vulnerability assessments, we test the

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adequacy of internal controls over major administrative and program-related tasks to determine whether someone could, or has, abused Federal assets. To date, we have completed vulnerability assessments at the Department of Labor, Community Services Administration, and Naval Material Command. At all three of these agencies we found problems which make them vulnerable to fraud.

In our third major effort, we have been evaluating a statistical sample of identified fraud cases at 21 Federal agencies to determine the extent and characteristics of identified fraud in Federal programs. As part of our work, we also evaluated selected cases to see if internal control failures had allowed fraud to occur.

At a recent press conference you announced the release of the first of a 3-volume report we were issuing on the results of our evaluation of a statistical sample of more than 77,000 fraud cases identified by Federal agencies over the 2-1/2 year period from October 1, 1976 to March 31, 1979. Our review showed that the losses in the 77,000 cases totaled between \$150 and \$220 million. This is probably just the tip of the iceberg, since these losses are attributable only to known fraud and other illegal activities investigated by the 21 agencies reviewed. It does not include the cost of undetected fraud which is probably much higher given the poor state of controls over how Federal money is spent. In this regard, a recent study by the Merit Systems Protection Board showed that Federal employees who observed fraud in their agencies frequently

did not report it, primarily because they believed nothing would be done about it.

The estimated losses also do not include cases involving Federal funds where State and local jurisdictions had primary investigatory responsibility. These would include most Medicaid, Aid to Families with Dependent Children, and many Food Stamp cases. Losses in these types of cases are probably high. For example, a few years ago we estimated that the Federal government may be losing as much as \$300 million a year to people cheating on food stamps.

Although the Federal agencies involved planned to recover between 20 and 29 percent of their losses through court-ordered restitutions or administrative actions, we believe that actual recoveries are much lower. For example, in one case we looked at an embezzler was allowed to repay \$16,000 in stolen funds over a 65-year period.

We believe that dollar losses due to fraud may, in some respects, be less serious than the intangible costs. Fraud undermines the integrity of Federal programs and makes people lose confidence in public institutions. This occurs when members of the public believe that individuals can commit illegal acts without fear of prompt, or possibly any, Federal action. Such perceptions, whether valid or not, can result in the view that such activities are the norm.

*GAO conducted a study and it showed*  
Our study showed that close to 30 percent of the fraud cases identified involved Federal employees. I would like to add that

these Federal employees represented only four-tenths of one percent of the total Federal workforce in the 21 Federal agencies we reviewed. Thus, the vast majority of Federal workers, well over 99 percent, were not involved. Other individuals and organizations committed about 40 percent of the frauds. In the rest of the cases, agencies were unable to identify suspects.

Thefts accounted for almost half the fraud cases and false statements about a quarter. The rest of the cases covered a wide variety of fraudulent activities including extortion, forgery, kickbacks or bribes, and non-performance of contract terms.

Federal agencies referred close to 13,000 fraud cases to the Department of Justice for prosecution. However, only about 40 percent of these were actually prosecuted. Thus, less than 10 percent of the over 77,000 cases identified by agencies were actually prosecuted.

Agencies may take certain administrative actions against individuals and organizations involved in fraud. For example, agencies can fire, suspend, or transfer Federal employees, and can suspend or debar contractors from doing business with the Federal government. However, we found that agencies did not always take available administrative actions against those committing fraud. In fact, in 22 percent of the cases, no administrative or legal action of any kind was taken. When agencies did act it was often to remedy a specific situation, not to deter others from doing the same thing. For example, agencies quit doing business with contractors or grantees in only 13 percent

of the cases involving these types of organizations. In 22 percent of the cases involving contractors or grantees the administrative action was sending them a warning letter.

We recognize that the Department of Justice cannot prosecute every case referred. This makes it even more important that Federal agencies take effective administrative actions when warranted. Along these lines, we believe that civil fine authority could be a useful enforcement tool for agencies in those cases where Justice does not take some type of legal action. The Department of Justice is currently drafting legislation that would give Federal agencies such authority. We have not had an opportunity to review and comment on the legislative proposal being drafted by Justice. However, we endorse the concept of giving agencies the authority to levy civil monetary penalties.

Detecting fraud and punishing the culprits is obviously important. Even so, we believe the key to combating fraud is preventing it from happening in the first place. During our review of fraud in Federal agencies we found many instances where the controls needed to prevent fraud were either inadequate, not followed, or nonexistent. While internal controls cannot prevent all fraud, we believe many frauds might have been prevented if good control systems had been in place. For example,

--A DOD employee allegedly embezzled almost \$2 million in CHAMPUS program funds over a 3-year period. This act was possible because internal controls were inadequate,

allowing one individual to control all aspects of claim adjustments as well as function as the officer certifying and approving the claim payments.

--A General Services Administration employee established a fictitious company to which he paid over \$300,000 for services never performed. This act was made possible by a multitude of internal control problems.

--A Social Security Administration employee collected over \$3,200 in fraudulent overtime payments by adding overtime hours to documents used for pay purposes. This scheme, again, was successful because the individual had complete control over such documents and distributed the related paychecks.

--An Assistant Manager at a GSA self-service store allegedly stole \$168,000 in merchandise. He was able to do this because of a lack of separation of duties, inadequate supervision over his activities, and poor internal review.

Once fraud is allowed to occur, the Government fights a losing battle because losses are seldom recovered and the perpetrators are seldom effectively punished. When it comes to fraud, the old axiom "an ounce of prevention is worth a pound of cure" is most appropriate. Therefore, it is important that Federal managers put sufficient emphasis on building systems of internal control that will prevent fraud.

Internal controls are checks and balances over all fiscal and managerial activities of an organization. Examples, of

internal controls are separation of duties so that one individual does not completely control a financial transaction; physical security measures that protect Government property, funds and records; and verification and reconciliation procedures built into an activity to assure that transactions are handled properly. I would like to make it clear at this point that the same controls needed to prevent fraud also will prevent waste and error which are probably much more serious problems.

The Accounting and Auditing Act of 1950 specifically requires the heads of executive agencies to establish and maintain effective internal administrative and accounting control systems. The same act requires us to approve the agencies' accounting systems and we have regularly advised agencies that their systems will not be approved unless they have effective internal controls.

Despite the fact that existing law requires Federal agencies to maintain effective internal controls, I believe that most Federal agencies are operating systems that are vulnerable to physical losses and waste of Federal money as well as fraudulent or otherwise improper use. Our efforts to approve Federal agencies' accounting systems provide an insight into the extent of inadequate systems now existing. At the present time, we have approved about two-thirds of the Governments 300 plus accounting systems but a third of the Federal agency accounting systems which control over 50 percent of the Federal budget remain unapproved.

Even when we have approved accounting systems, widespread weaknesses often exist. This is because some agencies never

implement the system we approve, while others allow the controls within their approved systems to deteriorate over time. Deterioration of controls is frequently the result of management's failure to properly monitor their systems through such activities as approval of procedural changes and supervision of employees performing specific control functions.

As a result, even though the law requiring agency heads to establish and maintain effective control systems has been on the books for three decades, we have today's situation in which the Government's financial operations are generally held in low public esteem.

We believe that internal controls can be made more effective by strengthening existing law. The Congress is considering two pieces of legislation that would require greater accountability by heads of Federal agencies for the effectiveness of their organization's systems of internal financial control. The Financial Integrity Act of 1981 (S. 864) and the Federal Managers' Accountability Act of 1981 (H.R. 1526) would require agency heads to undertake annual evaluations of their organizations' internal control systems and report the results of such evaluations to the Congress and the President. We would participate in this process by providing guidance for conducting the examinations and by reviewing the results. We strongly support such legislation and believe it would contribute a great deal to promoting the development of adequate internal control systems in the Federal Government for the following reasons.

First, it would require agency heads to undertake annual evaluations of the adequacy of their organization's systems of internal control. Such evaluations are essential to identifying the areas needing remedial action. We can only assume that, had agency heads made such evaluations in the past, they would have acted on their own to initiate the many corrective actions needed.

The legislation would also require agency heads to report the results of such evaluations. Any material weaknesses in controls would have to be identified and the plans and schedule for remedying those weaknesses described in detail. This requirement can only have the effect of motivating agency heads to get their internal control systems in order.

The requirement for the annual evaluations and reports recognizes the dynamic nature of the internal control environment. Federal agencies are inherently subject to a number of changing conditions which, over time, impact the effectiveness of their control systems. These include such things as normal personnel turnover, changes in agencies' missions and responsibilities, reorganizations within the agencies, and technological and data processing advances. Therefore, regular periodic evaluations are essential to assess the impact of changing environments on internal control systems, and the subject legislation provides for this.

In short, we believe fraud can flourish in an environment where controls are not properly implemented or enforced. We believe agencies should emphasize fraud prevention, rather

than simply pursuing it once it occurs. Prevention is especially important since only a low percentage of suspects are prosecuted and agencies often fail to take effective administrative actions against those who commit fraud.

This concludes my prepared statement. My colleagues and I will be pleased to try to answer any questions you may have.