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WHITE COLLAR CRIME IN GOVERNMENT
--HOW WE ARE COMBATING IT

Good morning ladies and gentlemen. It is a pleasure to be with you again here at your fifth annual conference. I also had the pleasure of speaking at your conference in 1977 and at that time I spoke on "Developments in Accounting, Auditing, and Financial Management in the Federal Government." My subject today is a little different but the focus is still on accounting and auditing. The answer to what can we do, and what are we doing, to combat white collar crime is better accounting and auditing.

White Collar Crime is Not New

White collar crime is not something new. It has been with us since civilization matured and money was created. In some countries fraud and corruption and other forms of white collar crime are almost a way of public life. (Fortunately, this has not been the case in the United States. While white collar crime has persisted, it has been the exception, not the rule.) In recent years, however, white collar crime seems to have blossomed. It has by no means become a way of life, but it may be a lot more prevalent than many of us would

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like to believe. We need to take tough and aggressive action now to quickly reverse this trend before it permeates our society and becomes a way of public life.

White Collar Crime in
Government is a Serious Problem

The extent of fraud against the Federal Government is not known. Hidden within apparently legitimate undertakings, it can go undetected and/or unreported. Opportunities for fraud, however, are tremendous when you consider the number of Federal programs, the large number of people involved in spending and controlling the monies, and the size of the annual budget-- currently over \$600 billion, a large portion of which is disbursed in the form of grants, contracts, and payments to individuals.

Although we do not have good data on the extent of white collar crime in government, we do have enough information to know that it is a serious problem, that it seems to be growing, and that it needs to be stopped.

Publicized Illegal Acts

Many white collar crimes against the Federal Government have been widely publicized. Among Federal agencies, the General Services Administration (GSA) has received the most publicity. However, GSA is not alone. Illegal acts have been reported in many other Federal agencies.

One well publicized fraud case involved the Department of Transportation. As you may recall, in 1977 an employee of the

Department's Urban Mass Transportation Administration was charged with embezzling \$800,000. He was a low-level employee in the accounting department; however, he was responsible for preparing public vouchers which listed the names, addresses, and amounts owed individuals, grantees, and contractors. After preparing the vouchers, the employee would forward them to the certifying officer for verification of authenticity and correctness. Next, the vouchers were submitted to the Department of the Treasury where checks were prepared and mailed to the payees shown on the vouchers. The employee knew that the certifying officer did not closely check the vouchers before signing. He also knew that the vouchers didn't have the customary markings that prevent additional entries. Apparently he simply added his own name to the legitimate payees on the vouchers, sometimes before signature and sometimes afterward.

Because the amounts listed on the vouchers were charged to legitimate accounts, the embezzlement might not have been detected if an alert bank employee had not questioned the sizable Federal checks this individual was depositing in his personal account--checks that ranged from \$55,000 to \$315,000. Before he was caught, the individual used much of the money to buy several Lincoln Continentals and to make personal loans to friends at the office. One humorous but ironic twist to the affair is that he purchased a topless bar of which the

government became the temporary owner until the employee was convicted and the government could sell the evidence.

A more recent case of fraud was reported in the Social Security Administration. An employee was charged with issuing about half a million dollars in disability payments to non-existent beneficiaries. The employee was responsible for computing the amounts due to qualified recipients of disability benefits, then making up computer orders for payment of the benefits. The employee is accused of taking genuine account numbers and creating fictitious beneficiaries on computer tapes. Because the system operates on account numbers and not names, the Social Security computer accepted the instructions and issued the checks as programmed. It is also alleged that the employee subsequently ordered the computer to erase all records of the transactions. Evidence of the scheme was first uncovered when a Philadelphia bank questioned the deposit of a U.S. bond by an accomplice.

The sad part about this case is that it might have been prevented. We had previously examined other Social Security payment systems and had told management that the controls were weak and fraudulent payments could be made.

Computer Related Crimes

This appears to be an unprecedented computer fraud scheme. But we know of many other computer related crimes in the Federal Government. In a report we issued in 1976,

we identified 69 instances of improper use of computers in Federal programs. Over \$2 million was lost through fraud. In addition to the dollar loss, the privacy of individuals on whom agencies kept records was violated. Contrary to popular opinion, we have found that most cases of fraud do not involve sophisticated use of computer technology. They are uncomplicated acts which were made easy because management controls over the systems were inadequate.)

Our current work confirms that improper and fraudulent use of computers is continuing. For example, a District of Columbia man was recently charged with embezzlement for allegedly directing a scheme to obtain \$45,000 in paychecks while he was a pay clerk for the Military District of Washington. He allegedly programmed a computer to print out a total of 35 illegal checks drawn on accounts from various military agencies. Three accomplices who cashed the checks shared 50 percent of the proceeds. We do not yet know the outcome of this case.

Federal Agencies have Numerous Cases
of Alleged Fraud and Illegal Acts

So far I have been mentioning individual cases of white collar crime. Regrettably, there are thousands of recorded cases. (In a review now underway, we have been astonished to find a total of 130,000 alleged cases of fraud and related types of illegal acts against 21 major agencies in the 2-1/2 years ended March 31, 1979.) Individual losses ranged from

under \$100 to over \$1 million. Some involved Federal employees while others involved grantees, welfare recipients, and contractors. Very little information on these cases is available to Washington-level managers, so we had to go to field offices to get the information we needed.

One sample case involves an alleged \$1.8 million embezzlement of medical care funds. The Federal Government provides financial assistance for medical care rendered by nongovernment hospitals and doctors to eligible military personnel and their dependents who do not have access to Government medical facilities.

Because of inadequate internal controls in the processing of claims sent to the Federal Government for reimbursement, a Department of Defense administrator in one foreign country was able to falsify over 3,300 claims forms which he then certified as correct. Later, the claims were paid in full.

The administrator was responsible for processing and approving claims received from providers of medical services. He would review the claim form to ascertain whether the charges were correct and whether the beneficiary was authorized to receive the care. The administrator also served as the certifying and approving officer for all the claims and, as such, prepared another form which certified the correctness of the claim and approved it for payment. Both forms were then forwarded to the Federal Finance and Accounting

Office which issued a government check and sent it by registered mail to the address shown on the claimant's form.

In his position, the administrator was able to instruct hospitals to submit claim forms which left part of the form blank--the address, the cost of the service, and sometimes the authorized provider's signature. In completing the forms, the administrator claimed inflated amounts and listed mailing addresses that he controlled. He then forwarded these forms to the Finance and Accounting Office. Once the checks were delivered to his mailboxes, he cashed the checks, paid the hospitals the actual cost, and kept the rest of the money.

A thorough investigation revealed that the administrator was able to commit the alleged fraud because he was the only person receiving and adjudicating the claims submitted. He was also the sole certifying and approving officer for all claims, thereby eliminating the standard double check which should be done before submitting the claim for payment. The investigation revealed other management control weaknesses, including

- weak supervision over the administrator,
- no verification by the Finance and Accounting Office of claimants' mailing addresses, and
- no onsite audit to determine if established procedures existed and if they were being followed.

The administrator was indicted in November 1979, but both he and most of the money have disappeared.

Another sample case involved crude oil deliveries made to a Navy facility under a Defense Logistics Agency contract. The Defense Logistics Agency purchases billions of dollars worth of fuel a year for DOD and certain civil agencies. Former contractor employees alleged that a private company was shorting the Government on shipments to a Navy facility. The Naval investigative service and the FBI investigated, but unfortunately could not determine the dollar loss or identify any suspects because contractor shipments were not adequately measured.

These shipments were made under a standard contract negotiated by the Defense Fuel Supply Center of the Defense Logistics Agency. The contract specifications did not spell out controls that should be used to assure that fuel is received but merely stated that quantities must be verified by shore receiving tank measurements. Controls, in this instance, were virtually nonexistent. There were no measurements taken before and after delivery. The only measurement taken of the contents of the storage tank was by dip stick at 24-hour intervals. Since the storage tank at this facility has a 2-million gallon capacity, an inaccuracy of as little as one-quarter inch in the dip stick measurement could mean a variance in oil quantities on hand of between 7,000 and 15,000 gallons.

Another example, illustrating problems associated with Federal educational programs, is a case where a financial

aid officer of a vocational school allegedly embezzled about \$100,000 in Federal funds. According to an HEW regional official, one of every four proprietary schools that were monitored in that region by the former Office of Education had problems with missing Federal funds--that is, possible embezzlement. An HEW headquarters official told us that HEW reviewers had found indicators of possible fraud in about 80 percent of their reviews of student financial aid programs.

Various Actions Have Been and Are Being Taken to Stop White Collar Crime

A number of actions have been taken and are being planned by the Congress, the President, and Federal agencies to deter, and hopefully prevent, fraud and waste in Federal programs. There are five actions which I consider particularly important.

These are:

1. Establishment of Offices of Inspector General in 14 major departments and agencies.
2. The President's creation of an executive group to combat fraud and his related requirement for departments and agencies to assess their vulnerability to fraud, waste, and error.
3. The Department of Justice's program to combat economic crime and expand its training program.
4. Our General Accounting Office Government-wide study of fraud and abuse.

5. The proposed passage of legislation that would require agency heads to report on the adequacy of their internal controls.)

Establishment of Inspectors General

The Congress took a significant step in combating fraud when it created the Offices of Inspector General--now 15-- within the major departments and agencies administering Federal programs. The Inspectors General report directly to the head of their department or agency and are required to furnish semiannual reports on their activities to the Congress. Among regular audit duties, the Inspectors General are responsible for

- searching out and detecting fraud and abuse,
- investigating identified or alleged cases of fraud and abuse,
- protecting "whistleblowers," and
- recommending policies to prevent fraud and abuse.

President's Requirement for Agencies to Assess Vulnerability to Fraud and Abuse

On December 13, 1978, the President sent a memorandum on the subject of Federal fraud and abuse to the heads of executive departments and agencies. In that memorandum he asked agency heads to identify programs and activities they deemed most vulnerable to fraud and to deliver by January 31, 1979, a planned approach for preventing and dealing with problems of fraud, waste, and error in these programs and activities.

This was certainly a step in the right direction, but due to the short time allowed, these assessments were probably too superficial to identify specific internal control weaknesses. This is our conclusion after reviewing the assessments prepared by agencies visited by GAO auditors.

Executive Group to Combat Fraud
and Waste in Government

Following up on the results of agency assessments, the President created in May 1979, The Executive Group to Combat Fraud and Waste in Government. Committees chaired by an Inspector General have been formed in four substantive areas:

1. Audit and information systems.
2. Legislation on fraud and abuse and related Inspector General responsibilities.
3. Development of policies for investigation and prosecution.
4. Internal training, staffing, management and organization.

The group is supported by staff supplied by the Department of Justice and the Office of Management and Budget.

Actions Taken by the
Department of Justice

The Department of Justice has taken a number of steps to help Federal agencies identify and investigate fraud. We have not yet evaluated the effectiveness of these actions, but two seem to be of particular value.

Economic crime enforcement program

Justice has created a program within its criminal division aimed at economic crime enforcement. Over the next 2 years, Justice anticipates creating approximately 27 economic crime units containing some 150 prosecutors. These prosecutors are to assist Federal investigative groups in departments and agencies to orient their resources toward the discovery of fraud and white collar crimes.

Improved training

Justice also reports that it has made improvements in the training it provides agency personnel.

--It has expanded its existing 1-day fraud "mini-course" to include agency auditors as well as Federal agency investigators.

--It has assisted the interagency auditor training program in developing a 3-day fraud awareness course. The interagency auditor training program provides training to State and local government auditors as well as Federal auditors.

--It has assisted the Federal law enforcement training center in establishing a 2-week course on white collar crime designed specifically for auditors.

GAO's Government-wide Study

Those of us in the General Accounting Office have long been concerned about fraud, waste and error in government programs. We are convinced that more attention must be

devoted to stopping white collar crime so that the likelihood of recurrence can be reduced.

In 1976 we made a special inquiry into the Government's ability to combat fraud. We pointed out in our report, issued in September 1978, that Federal agencies know little of the problem and need to do much more to prevent and detect fraud. We found that

- false claims were submitted for benefits and services,
- false statements were made to induce contracts or secure goods and services,
- public employees were sometimes bribed or otherwise corrupted, and
- false claims were made for payment of goods and services that were not delivered.

Because of the problems noted in our September 1978 report, I established a special task force for prevention of fraud and abuse in January 1979. My direction to have the task force concentrate on prevention was deliberate.

As important as detection of fraud and abuse are detect-
ion should not be our primary concern as managers. Our efforts should be devoted to constructing systems of internal control that will prevent fraud and abuse and decrease the likelihood of error and waste. When it comes to fraud and abuse, the old axiom "an ounce of prevention is worth a pound of cure" is most appropriate.

For a moment let us examine some of the benefits of preventing white collar crime. First is the obvious advantage of reducing expenditures. Fraud and abuse always cause an outflow of the dollars that managers are supposed to use sparingly. To the extent we prevent fraud and abuse with good management systems, we stem this source of unauthorized expenditures and thus carry out our stewardship responsibilities more effectively.

However, the loss of dollars--important as that may be--is not the only cost of fraud and abuse. Equally important is the toll in human suffering that occurs when fraud and abuse, or even sometimes errors, are discovered. While it is true that some perpetrators of fraud and abuse are hardened criminals, a great many become criminals when opportunities which they are not strong enough to resist are presented to them. When such persons are caught, they suffer humiliation, lose their jobs, and frequently are alienated from friends and family. In short, their lives are ruined. They often go to prison--which results not only in a high cost in human suffering but a high dollar cost in apprehending the offenders, bringing them to trial, and feeding and clothing them while they are prisoners.

It is far, far better to make it so difficult to commit fraud that it rarely is done. Internal controls are the answer. They are the first line of defense against fraud, abuse, and error. Opportunities to commit fraud and abuse

usually present themselves when internal controls that should eliminate such opportunities have not been established; or, if established, have fallen into disuse. If, by establishing good internal controls, we can remove the temptation to commit fraud and abuse we have served not only the organization but also the employee who may be a potential abuser. Even errors can cause extreme embarrassment and, if serious enough, may threaten a person's employment.

Three-fold Mission of the Task Force

I gave the special task force for prevention of fraud and abuse a three-fold mission. First, the task force was to offer citizens, nationwide, a toll-free number, which we refer to as the "Hotline," to call and report, anonymously if they so desire, instances of fraud or wrongdoing. Secondly, it was to establish the scope of the problem of fraud and other illegal activities against the Federal Government, and reveal areas where existing procedures for dealing with fraud are inadequate. This portion of the task force's activities has been termed the "overview assessment." Last, the task force was to conduct an expanded assessment of the adequacy of internal controls at four departments and agencies --the Department of Labor, Naval Material Command, and the Community Services Administration. This phase was labeled "vulnerability assessment."

Based on the task force's work to date, we believe that all the agencies visited are vulnerable to fraud and abuse

because Federal headquarters, regional offices, and other field locations, as well as grantees, have inadequate internal controls over their operations. In testing selected internal control systems, we found Federal funds and equipment had been misused at many locations.

We believe that the reason internal control systems are in a state of disrepair is that top management has not devoted sufficient attention to assuring that controls over tasks and functions which lead to the delivery of these funds and services are effective. Because of top management's insufficient concern for internal controls, middle management reflects this same indifference. And the indifference is passed down to internal audit staffs which have spent little time evaluating the adequacy of internal controls over all agency functions. Furthermore, when internal auditors have reported weaknesses in controls only over the portion of a task or program audited, management has often dismissed these findings as unimportant. This attitude not only precludes corrective action but also reduces the audit staff's concern for internal controls.

Lest I be accused of not considering cost, I want to add here that all controls must be weighed in terms of cost effectiveness. Overcontrol is certainly a possibility. However, from what our audits have disclosed, I doubt that most government agencies have much to worry about in that regard--at least for the immediate future.

Our task force's work is nearly finished, and I believe the results of this work can make a substantial contribution to the Federal Government's efforts to minimize fraud and abuse. The task force will report the results of its audits to the Congress and those results will be made public.

Our work has shown that many agencies share common internal control weaknesses which may indicate the seriousness of the lack of internal controls Government-wide. For this reason, we plan to issue a standard audit package to the heads of all departments and agencies for their use in evaluating their own internal control systems.

Proposed Legislation for Agency Heads
to Report on Internal Controls

This leads me to a related action that is being proposed. A bill is currently being drafted for the Federal Government which closely parallels the principles of the foreign corrupt practices act. Essentially, it would require agencies to report on the adequacy of their internal control system. Having seen the efforts of the private sector to improve corporate accountability, we support the objectives of the legislation currently being considered.

What Must Still be Done?

Although many positive steps have been taken and are planned for improving internal controls in the Federal Government, much remains to be done. Present internal controls

still cannot prevent or even really minimize the opportunity for fraud and abuse.

The temptation to employees to violate the system must be removed. Top management must instill in all of its employees an awareness of the need to adhere to good internal control procedures and must maintain high ethical standards to serve as an example to its employees. When employees can sense the trust that management has placed in them, they will be less likely to succumb to fraud's temptations and more aware of and sensitive to others' violations of standards. Therefore, management must see that all responsible officials cooperate in following established procedures. If necessary, it must set up new controls. Management must also see that the personnel resources necessary to keep controls effective are devoted to the task.

Top management also must take the lead in making sure that its auditors concentrate on internal controls. We have always advocated a balanced total audit effort for the government--balanced between evaluations of agency programs and evaluations of internal controls. Now auditors within the Federal agencies must increase the time and resources they spend auditing internal controls.

Better Accounting and Financial Reporting is Needed Too

There has been much in the media to the effect that society's confidence in government is eroding. The widespread

belief is that government should and must be run much more efficiently. Establishing and maintaining strong systems of internal control by Federal agencies can go a long way toward achieving responsible government by minimizing fraud and abuse and by identifying errors that have plagued so many Government programs.

But more is needed. Taxpayers need to know that government programs and services are run economically and are achieving what society expects of them. They can be given this knowledge by a combination of good accounting and internal controls and good financial reporting. Government accounting today is not attuned to providing useful information for taxpayers. Accounting is performed primarily for the benefit of internal management and financial reports are nonexistent or incomprehensible.

Actions Being Taken to Improve Government Accounting

There are some new initiatives underway to develop better accounting and reporting principles for government. At the Federal level, we in GAO are reexamining our accounting standards which Federal agencies are to follow. At the State and local level, action is underway to establish a Government Accounting Standards Board to set accounting standards for State and local governments. In addition, the Financial Accounting Standards Board and the National Council on Governmental Accounting have somewhat overlapping initiatives underway.

These initiatives to improve accounting and financial reporting stem from a number of familiar events. In the private sector they have been spawned from the effects of inflation on financial reports, the collapse of companies, the discovery of fraudulent activities in certain corporations, and the payoffs to foreign officials. In State and local government they have been spawned from the financial crises of several major cities, most notably New York where the crisis was directly related to the accounting and budgeting practices it followed. But New York is not alone.

When the District of Columbia wanted to borrow its own money--instead of borrowing from the U.S. Treasury as it had historically done--we in the General Accounting Office and a major accounting firm agreed that the city's accounting system was so poor that its financial statements could not be audited. A major redesign of that system is now in progress. There have been problems in other cities as well--problems which at least in part have been attributed to poor accounting.

Inflation has had its effect upon governmental accounting too. The rise in taxes that has resulted from the inflation we have been experiencing is of concern to all responsible government officials. Moreover, the spectre of the "proposition 13" and "balanced budget" syndrome hangs over the whole country and concerns legislators and government officials everywhere. From our vantage point, this concern seems to

have heightened public interest in how governments set priorities for spending the money they collect. This inevitably means a concern with accounting and financial reporting as well as budgeting.

An additional spark that inspired efforts in the Federal sector was a consolidated financial report on the Federal Government by Arthur Anderson and Co. which showed in 1975 a huge unfunded liability. Arthur Anderson recommended that consolidated financial statements for the Federal Government be prepared annually. The Department of Treasury took on this effort with our help and has issued sample consolidated statements for the past 4 years. Unfortunately, Treasury's enthusiasm for continuing this effort has considerably diminished. Thus efforts to resolve certain conceptual problems in preparing consolidated statements for such a unique entity as the Federal Government are proceeding slowly.

GAO's Initiative

The General Accounting Office is required by law to establish accounting principles and standards for the Federal Government. In a continuing effort to improve financial management, we have begun an effort to reexamine from the ground up our present accounting and financial reporting requirements. Our first task is to establish a conceptual framework. We define this as the framework that encompasses accounting theory. It consists of two levels: (1) the objectives and (2) the fundamentals. Fundamentals are concepts that serve

as guidelines for determining standards. The conceptual framework provides the basis for establishing practice requirements. After determining the objectives, our second task is to establish the practice requirements. These are the accounting and reporting standards and the operational criteria for applying the standards. An example of operational criteria are the methods for determining depreciation.

On February 29, 1980, we issued an exposure draft covering the first level of our conceptual framework. This is the "Objectives of Accounting and Financial Reporting in the Federal Government." Copies have been distributed for comment to Federal agencies, a wide cross-section of members of the accounting profession, and other interested persons and organizations in the financial community. Comments were due by April 21. We have, however, received and granted many requests for extension.

Efforts Underway by the
FASB and the NCGA

The Financial Accounting Standards Board and the National Council on Governmental Accounting have similar efforts underway. The Financial Accounting Standards Board, or FASB, is involved in establishing a conceptual framework for accounting and financial reporting for business enterprises. In addition, the FASB is preparing an exposure draft which would set forth the objectives of financial reporting by nonbusiness organizations.

The National Council on Governmental Accounting, which is more commonly referred to as the NCGA, has initiated a dual approach to meeting the current needs in governmental accounting and financial reporting.) NCGA received a Federal grant to develop a conceptual framework for State and local governments. NCGA is also involved in a joint effort with the Council Of State Governments to develop an inventory of current State accounting principles and preferred practices. With the output from these two efforts, the NCGA intends to revise its statement entitled "Governmental Accounting and Financial Reporting Principles."

Creation of a Government
Accounting Board

Additionally, action is underway to establish a Government Accounting Standards Board to set accounting and financial reporting standards for State and local governments. It would be the counterpart to the FASB for government and would assume the responsibility heretofore exercised by the NCGA.

Creation of this Board has been spurred by two actions. One is the intrusion of the FASB into the government arena. The other is a bill introduced by Senator Harrison Williams called the State and Local Government Accounting Act. This act provides for a federally funded 11-member institute to set State and local government accounting and financial reporting standards.

As it is presently being discussed, the Government Accounting Standards Board would be structured similarly to the FASB. It would have 11 trustees and a 5-member board. The board would be responsible for setting standards. The trustees would be responsible for raising funds and selecting the board members.

I favor creation of the Government Accounting Standards Board and I am actively involved in trying to get it created.

We in the Federal Government have a great interest in the financial reporting of State and local governments because we rely on their accounting systems to give us information on how they spend Federal grant and revenue sharing funds. Our principal goal concerning State and local accounting is to see that a high degree of credibility and usefulness of financial reports is achieved. Jurisdictional disputes which could cause irreconcilable problems must be avoided so that all interested parties can work together toward an end we all hope to attain. That end is more meaningful financial reporting that shows how efficiently and effectively government programs are operated.

Conclusion

We in GAO are concerned with bringing greater credibility to all levels of government. One of the primary ways to achieve this is to provide effective financial management systems which give managers sound information on choices they have to make in financial matters and provide effective

internal controls that will prevent fraud and illegal use of property. Government at all levels needs modern accounting systems that give both managers and taxpayers useful information on how efficiently and effectively services are delivered. Government units also need good systems of internal control that are strongly policed to see that controls do not fall into disuse.