



# Profits and Results With Integrity

**Different Cultures, Common Values and Shared Challenges**

Association of Certified Fraud Examiners' Annual Conference  
Las Vegas, Nevada  
July 12, 2004

**The Honorable David M. Walker**  
Comptroller General of the United States

# Webster's definition

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## Fraud –

deceit, trickery, intentional  
perversion of truth to induce  
another to part with something  
of value or to surrender a legal  
right

**Improper payments** – not in accord with fact, truth, or right procedures; not regularly or normally made; not suited to the circumstances or end result

# SAS 99—Consideration of Fraud in a Financial Statement Audit

- The auditor is responsible for planning and performing the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.
- The auditor should specifically assess the risk of material misstatement of the financial statements due to fraud and should consider that assessment in designing the audit.
- Management is responsible for the prevention and detection of fraud.

# Yellow Book Requirements for Fraud

- **Fraud** is a type of illegal act that involves obtaining something of value through willful misrepresentation. (Yellow Book, footnote 83, par. 7.21)
- Fraud risk assessment is an ongoing process throughout the audit (i.e., planning, staffing, engagement execution, reporting)
- Auditors should exercise professional skepticism at all times.

# Yellow Book Requirements: Reporting Fraud

## Auditors Report

- When auditors conclude, based on evidence obtained, that fraud either has occurred or is likely to have occurred, the auditor should include that information in the audit report.

## Direct Reporting

- Auditors should also report fraud directly to outside parties when
  - The audited entity is required by law or regulation to report such fraud to an external party, such as an IG or a state attorney general AND
  - The audited entity has not done the required reporting after receiving the information from the auditor.

# Yellow Book Requirements: Reporting Fraud

## Involvement of Other Authorities

- Laws or regulations may require the auditor to promptly report indications of certain types of fraud to law enforcement or investigative authorities.
- In cases where other authorities are also involved, the auditor should consult with the other authorities or legal counsel to determine whether public reporting of the fraud by the auditor would compromise any ongoing legal or investigative proceedings.
- Auditors should limit their public reporting to matters that would not compromise other legal or investigative proceedings.

# Strategic Perspectives of GAO and OIGs

We both maximize government performance and ensure accountability

## GAO

- Government-wide scope
- Horizontal and longer range issues
- Proportionately more audits, evaluations, policy analyses
- Renders opinion on consolidated financial statements
- Performance/Accountability and High Risk List
- Fraudnet activity and related referrals

## OIGs

- Agency scope
- Tactical and immediate issues
- Proportionately more investigations
- Audit agency financial statements
- Management challenges lists
- “Front line” in fighting fraud, waste, abuse, and mismanagement

# What Role Does GAO Play in Preventing Fraud?

- GAO's Office of Special Investigations (OSI) uses investigative techniques to supplement normal audit approaches even though the audit may not be considered criminal in nature.
- In conducting its work, OSI's overall responsibility is to investigate cases of potential fraud and abuse.
- OSI identifies the reasons why and how fraud happens and recommends ways to improve government programs

# Examples of GAO Reports and Testimony Identifying Fraud

- DOD Travel Cards: Control Weaknesses Led to Millions of Dollars in Waste, Improper Payments, and Fraud
- Internal Control Weaknesses at DOD Led to Improper Use of First and Business Class Travel
- Medicare: CMS Did Not Control Rising Power Wheelchair Spending.
- Vendor Pay: Some DOD contractors Abuse the Federal Tax System with Little Consequence
- Private Health Insurance: Employers and Individuals Are Vulnerable to Unauthorized or Bogus Entities Selling Coverage
- Observations on the Oil For Food Program
- Health Care: Consultants' Billing Advice May Lead to Improperly Paid Insurance Claims
- Internet Pharmacies: Hydrocodone, An Addictive Narcotic Pain Medication, is Available Without a Prescription Through the Internet
- Financial Management: Billions in Improper Payments Continue to Require Attention.
- Medicare Improper Payments
- Private Banking: Raul Salinas, Citibank, and Alleged Money Laundering

# Accountability Environment

- The credibility of auditing and financial reporting has suffered in the last couple of years as a result of the accountability failures in the private sector.
- Forces that led to the corporate scandals and audit failures include:
  - individual and corporate greed
  - inadequate corporate governance system
  - ineffective regulation of the accounting and auditing profession
  - financial managers and advisors working to achieve certain reporting results and focusing on the legal form versus the economic substance of the transactions
  - auditors and financial professionals doing what was minimally required and actively fighting tighter standards
  - confusion over whom the auditors work for
  - auditors delivering services to clients that impaired independence

# Current Reforms

- The Sarbanes-Oxley Act of 2002 included reforms in corporate governance and the accounting profession intended to
  - improve corporate financial reporting and internal control
  - strengthen audit committees
  - change the relationship between the auditor and client
  - improve auditor independence
  - provide additional auditor assurance over internal control
  - provide oversight and regulation for auditors of publicly traded companies
- Reforms are currently being implemented, and final impact is still uncertain.

# Sarbanes-Oxley Act Provisions with Implications for Government

## New audit standards and oversight—PCAOB

- Audit committees with defined responsibilities
- Specific communications between auditors and audit committees
- CEO and CFO certification of financial reports
- Enhanced disclosures of off-balance sheet transactions
- Code of ethics for senior financial officers
- Management attestation on the effectiveness of internal control over financial reporting
- Auditor opinion on the effectiveness of internal control over financial reporting

# Selected Government Accountability Issues

## Leading by Example

- **Definition of success in financial management**
  - Clean opinion on financial statements
  - No major control weaknesses
  - No major compliance issues
  - Systems that produce timely, accurate, and useful financial and management information
- **Scope of audit**
  - Internal controls (current)
  - Compliance matters (current)
  - Performance and projection information (future)
- **Additional issues**
  - FASAB restructuring
  - Accelerated financial reporting
  - Enhanced performance and accountability reporting
  - Audit/financial management committees
  - Auditor independence

# Keys to Success for Any System

## **INCENTIVES**

For people and institutions to do the right thing

## **TRANSPARENCY**

To provide reasonable assurance that people and institutions will do the right thing because someone is looking

## **ACCOUNTABILITY**

If people or institutions don't do the right thing

# Contributing Elements for Success

Investor Trust and Public Confidence – Stock Price Growth and Public Markets

## Corporate Examples

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### Incentives

- Independent, qualified and adequately resourced boards
  - Executive compensation arrangements
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### Transparency

- Accounting and reporting
  - Proxy voting on employee securities
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### Accountability

- Enforcement of laws
- Oversight (e.g., auditors and regulators)

# Contributing Elements

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## Government Examples

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### Incentives

Rule of law  
Civil Service  
Checks and balances

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### Transparency

Financial disclosure  
Due process  
Free press

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### Accountability

Enforcement of laws  
Oversight  
Independent judiciary

# Contributing Elements

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## SAI Examples

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### Incentives

Independence

Resources

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### Transparency

Protocols

Public reporting

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### Accountability

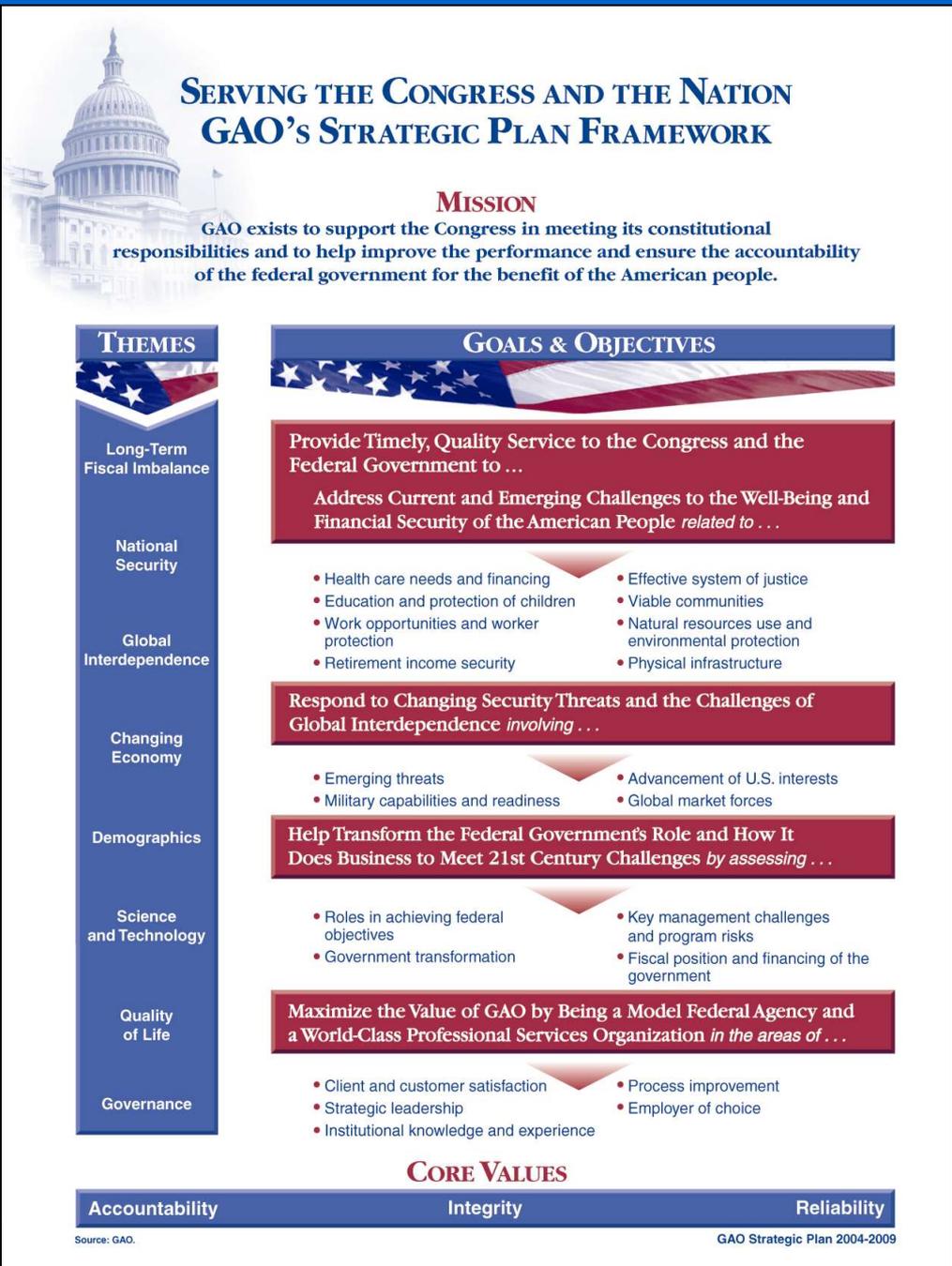
Enforcement of access rights

Peer review

# Evolving Challenges for SAIs

- Public expectations of government are changing:
  - Zero tolerance for corruption
  - Desire for enhanced results and improved responsiveness
  - Selected trends and challenges that have no boundaries
    - Long-Term Fiscal Imbalances
    - National Security
    - Global Interdependence
    - Changing Economy
    - Demographics
    - Science and Technology
    - Quality of Life
    - Governance

# GAO's Strategic Plan



# Selected Key Concepts for GAO

## MISSION

Improve performance and assure accountability, both for today and tomorrow

## MEANS

Oversight, insight, and foresight

## METHODS

Leading by example and promoting best practices

- Observing protocols
- Employing a constructive engagement approach with entities we audit and evaluate
- Partnering with fellow accountability and selected “good government” organizations

# Possible SAI Roles



# GAO's High Risk List

## High Risk Areas

## Designated High Risk

### Addressing Challenges in Broad-based Transformations

Protecting Information Systems Supporting the Federal Government and The Nation's Critical Infrastructures	1997
Strategic Human Capital Management*	2001
U.S. Postal Service Transformation Efforts and Long-Term Outlook*	2001
Implementing and Transforming the New Department of Homeland Security	2003
Modernizing Federal Disability Programs*	2003
Federal Real Property*	2003

### Ensuring Major Technology Investments Improve Services

FAA Air Traffic Control Modernization	1995
IRS Business Systems Modernization	1995
DOD Systems Modernization	1995

### Providing Basic Financial Accountability

DOD Financial Management	1995
IRS Financial Management	1995
Forest Service Financial Management	1999
FAA Financial Management	1999

### Reducing Inordinate Management Program Risks

Medicare Program*	1990
Collection of Unpaid Taxes	1990
DOD Inventory Management	1990
Student Financial Aid Programs	1990
HUD Single-Family Mortgage Insurance and Rental Assistance Programs	1994
Earned Income Credit Noncompliance	1995
DOD Support Infrastructure Management	1997
Medicaid Program*	2003
Pension Benefit Guaranty Corporation Single-Employer Insurance Program*	2003

### Managing Large Procurement Operations More Efficiently

DOD Weapon Systems Acquisition	1990
Department of Energy Contract Management	1990
NASA Contract Management	1990
DOD Contract Management	1992

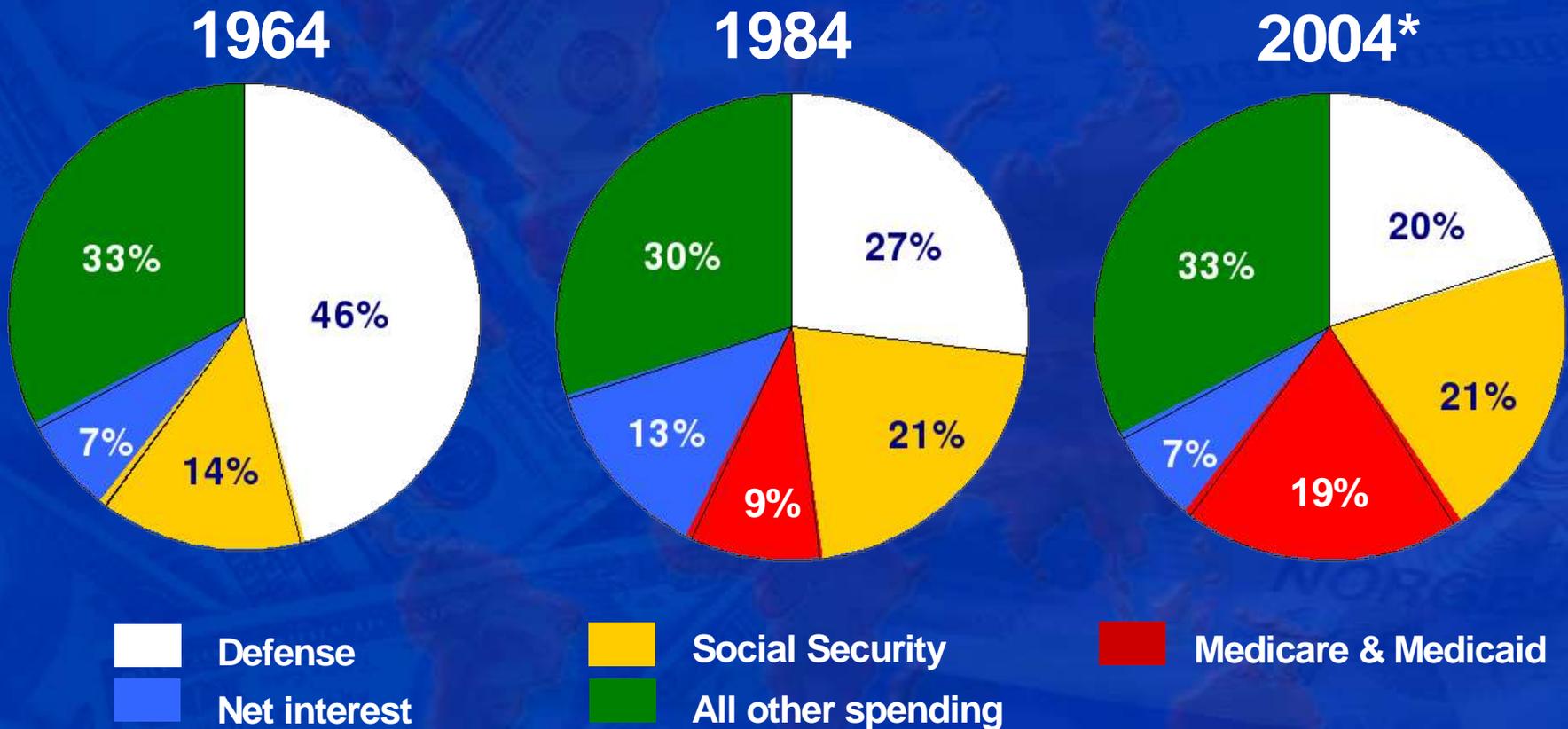
\*Additional authorizing legislation is likely to be required as one element of addressing this high risk area.

# The Case for Change

**Government is on a “burning platform,” and the status quo way of doing business is unacceptable for a variety of reasons, including:**

- Past fiscal trends and significant long-range challenges
- Rising public expectations for demonstrable results and enhanced responsiveness
- Selected trends and challenges having no boundaries
- Additional resource demands due to recent terrorism events in the United States
- Government performance/accountability and high risk challenges, including the lack of effective human capital strategies

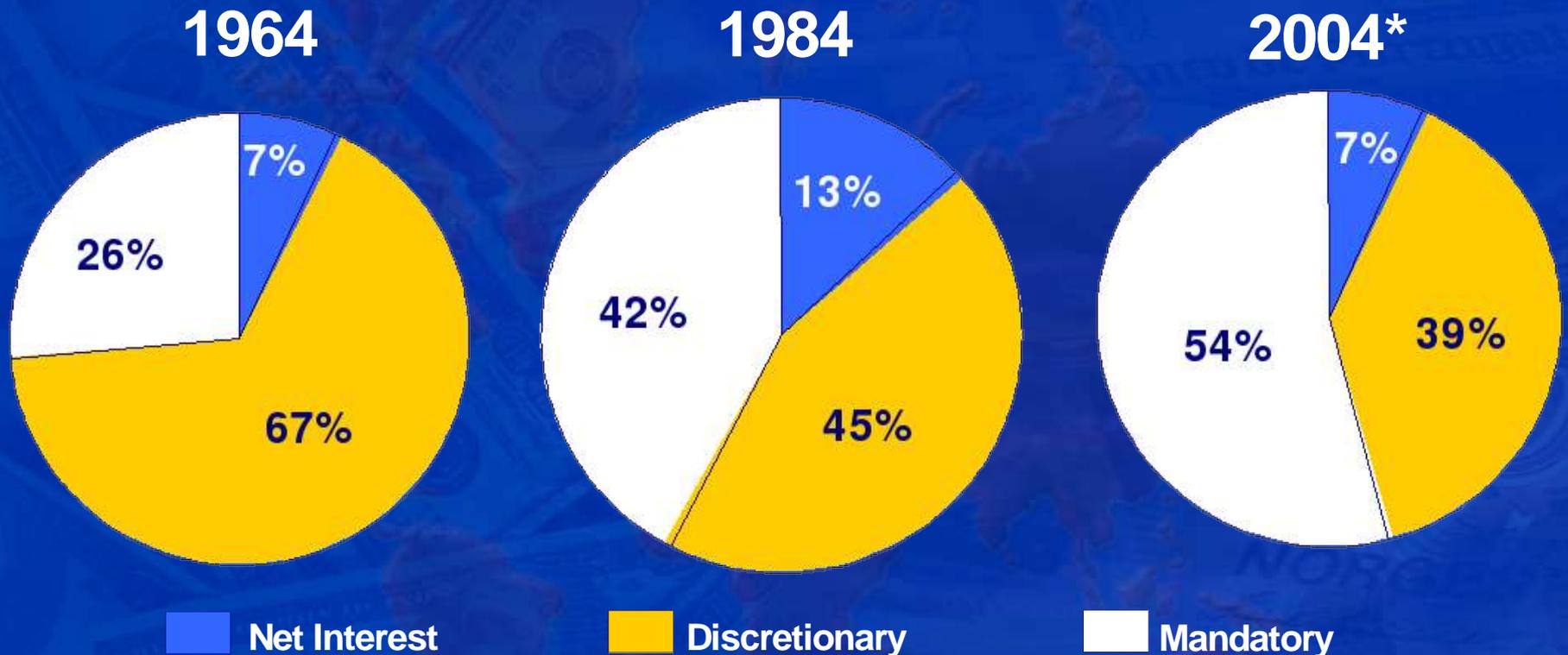
# Composition of Federal Spending



\*Current services estimate.

Source: *Budget of the United States Government, FY 2005*, Office of Management and Budget.

# Federal Spending for Mandatory and Discretionary Programs



\*Current services estimate.

Source: *Budget of the United States Government, FY 2005*, Office of Management and Budget.

# Selected Fiscal Exposures: Sources and Examples

(End of 2003)<sup>a</sup>

Type	Example (dollars in billions)
Explicit liabilities	Publicly held debt (\$3,913)
	Military and civilian pension and post-retirement health (\$2,857)
	Veterans benefits payable (\$955)
	Environmental and disposal liabilities (\$250)
	Loan guarantees (\$35)
Explicit financial commitments	Undelivered orders (\$596)
	Long-term leases (\$47)
Explicit financial contingencies	Unadjudicated claims (\$9)
	Pension Benefit Guaranty Corporation (\$86)
	Other national insurance programs (\$7)
	Government corporations e.g., Ginnie Mae
Implicit exposures implied by current policies or the public's expectations about the role of government	Debt held by government accounts (\$2,859) <sup>b</sup>
	Future Social Security benefit payments (\$3,699) <sup>c</sup>
	Future Medicare Part A benefit payments (\$8,236) <sup>c</sup>
	Future Medicare Part B benefit payments (\$11,416) <sup>c</sup>
	Future Medicare Part D benefit payments (\$8,119) <sup>c</sup>
	Life cycle cost including deferred and future maintenance and operating costs (amount unknown)
	Government Sponsored Enterprises e.g., Fannie Mae and Freddie Mac

<sup>a</sup> All figures are for end of fiscal year 2003, except Social Security and Medicare estimates, which are end of calendar year 2003.

<sup>b</sup> This amount includes \$774 billion held by military and civilian pension funds that would offset the explicit liabilities reported by those funds.

<sup>c</sup> Figures for Social Security and Medicare are net of debt held by the trust funds (\$1,531 billion for Social Security, \$256 billion for Medicare Part A, and \$24 billion for Medicare Part B) and represent net present value estimates over a 75-year period. Over an infinite horizon, the estimate for Social Security would be \$10.4 trillion, \$21.8 trillion for Medicare Part A, \$23.2 trillion for Medicare Part B, and \$16.5 trillion for Medicare Part D.

Source: GAO analysis of data from the Department of the Treasury, the Office of the Chief Actuary, Social Security Administration, and the Office of the Actuary, Centers for Medicare and Medicaid Services.

Updated 3/30/04.

# Another Way to Think About These Numbers

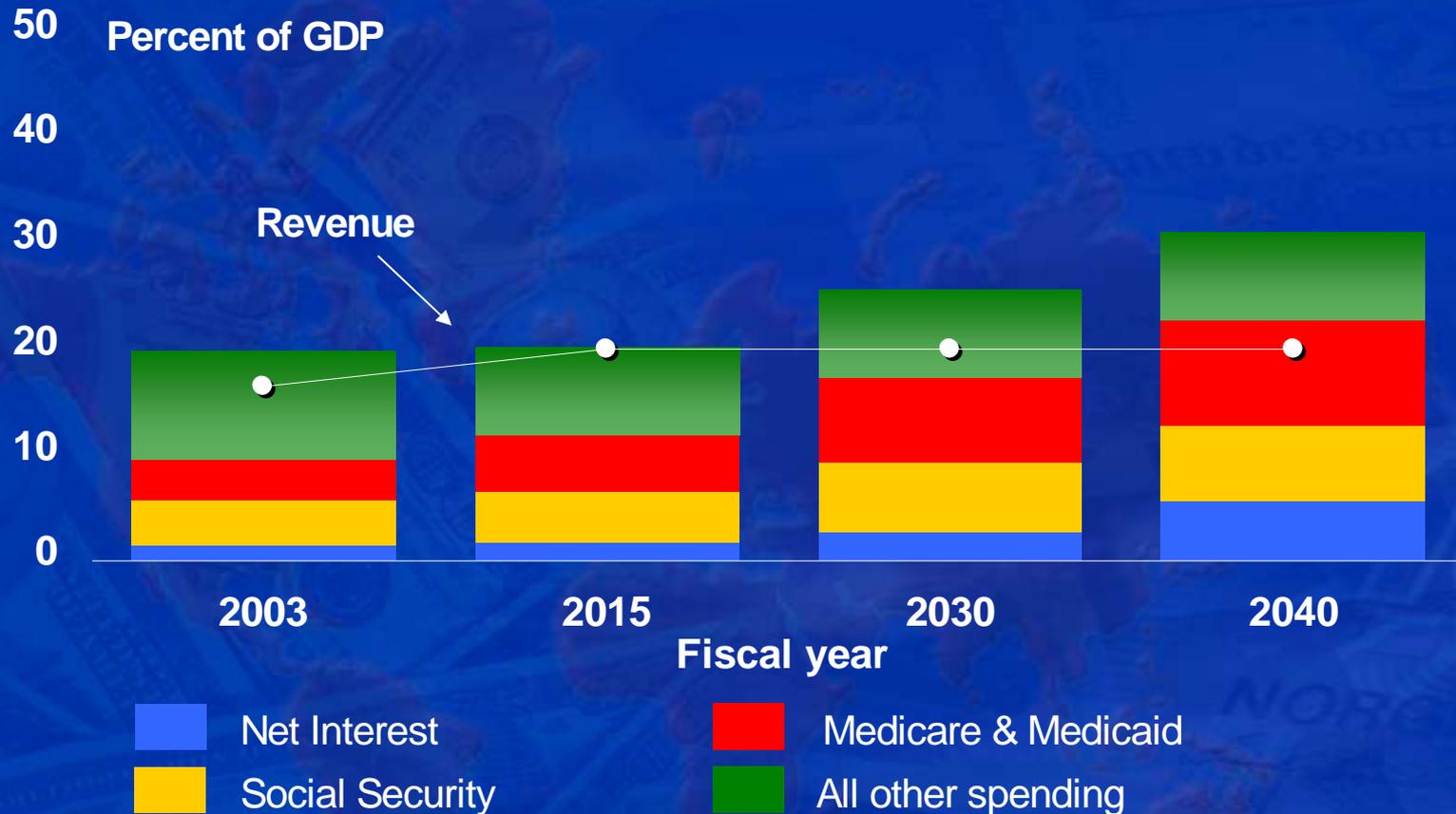
## As of the End of FY 03

- Debt held by the public—\$3.9T
- Trust fund debt—\$2.9T
- Gross debt—\$6.8T
- Gross debt per person—about \$24,000
- If we add everything on the previous slide that is not included in gross debt, the burden per person rises to over \$140,000. Alternatively, it amounts to a total unfunded burden of more than \$40 trillion in current dollars, which is about 18 times the current annual federal budget or more than 3 ½ times the current annual GDP.

Note: The calculations only consider a 75-year horizon for Social Security and Medicare.

# Composition of Spending as a Share of GDP

## Under Baseline Extended

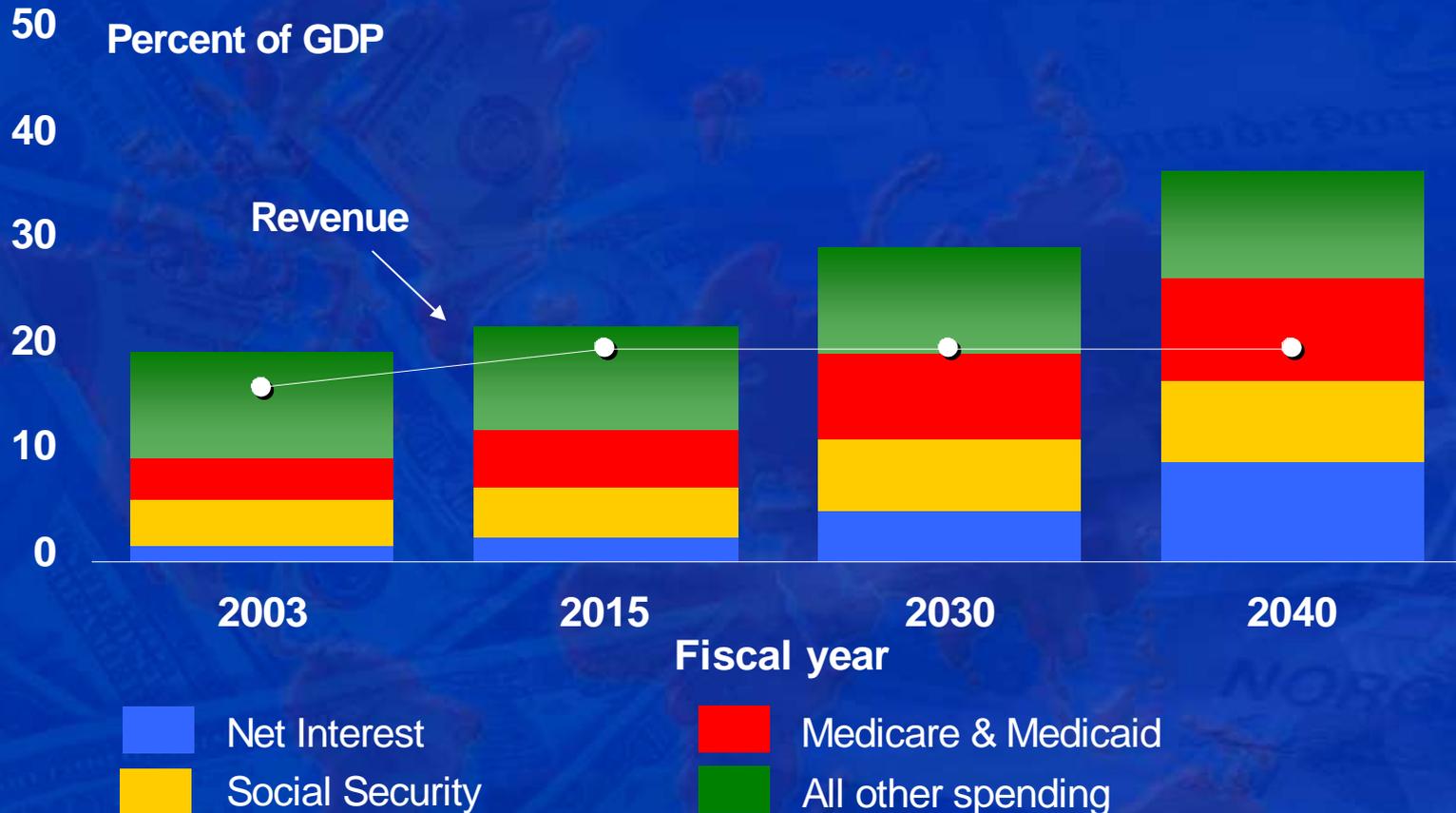


Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant.

Source: GAO's March 2004 analysis.

# Composition of Spending as a Share of GDP

Assuming Discretionary Spending Grows with GDP after 2004

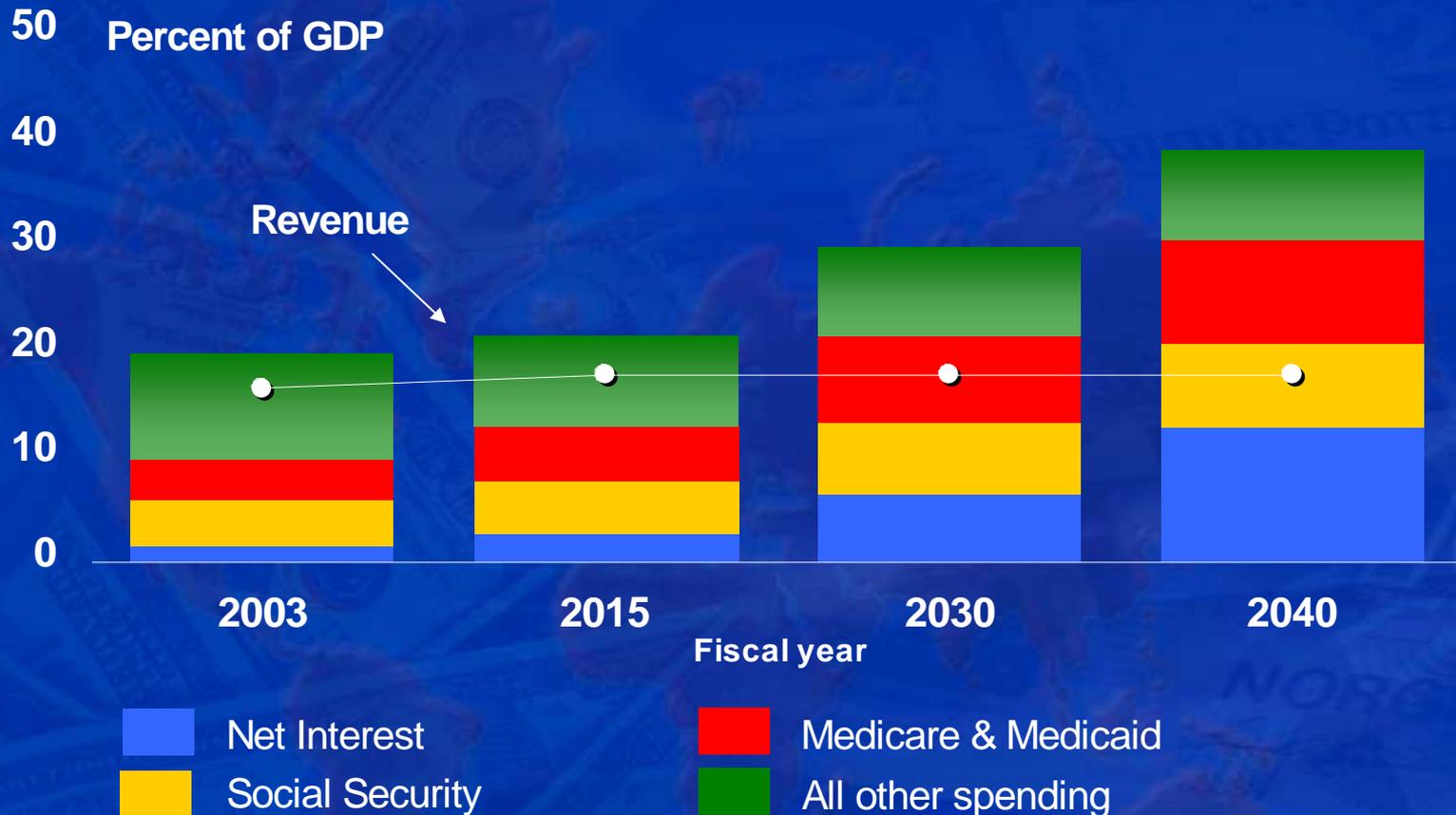


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Source: GAO's March 2004 analysis.

# Composition of Spending as a Share of GDP

Assuming All Expiring Tax Provisions are Extended

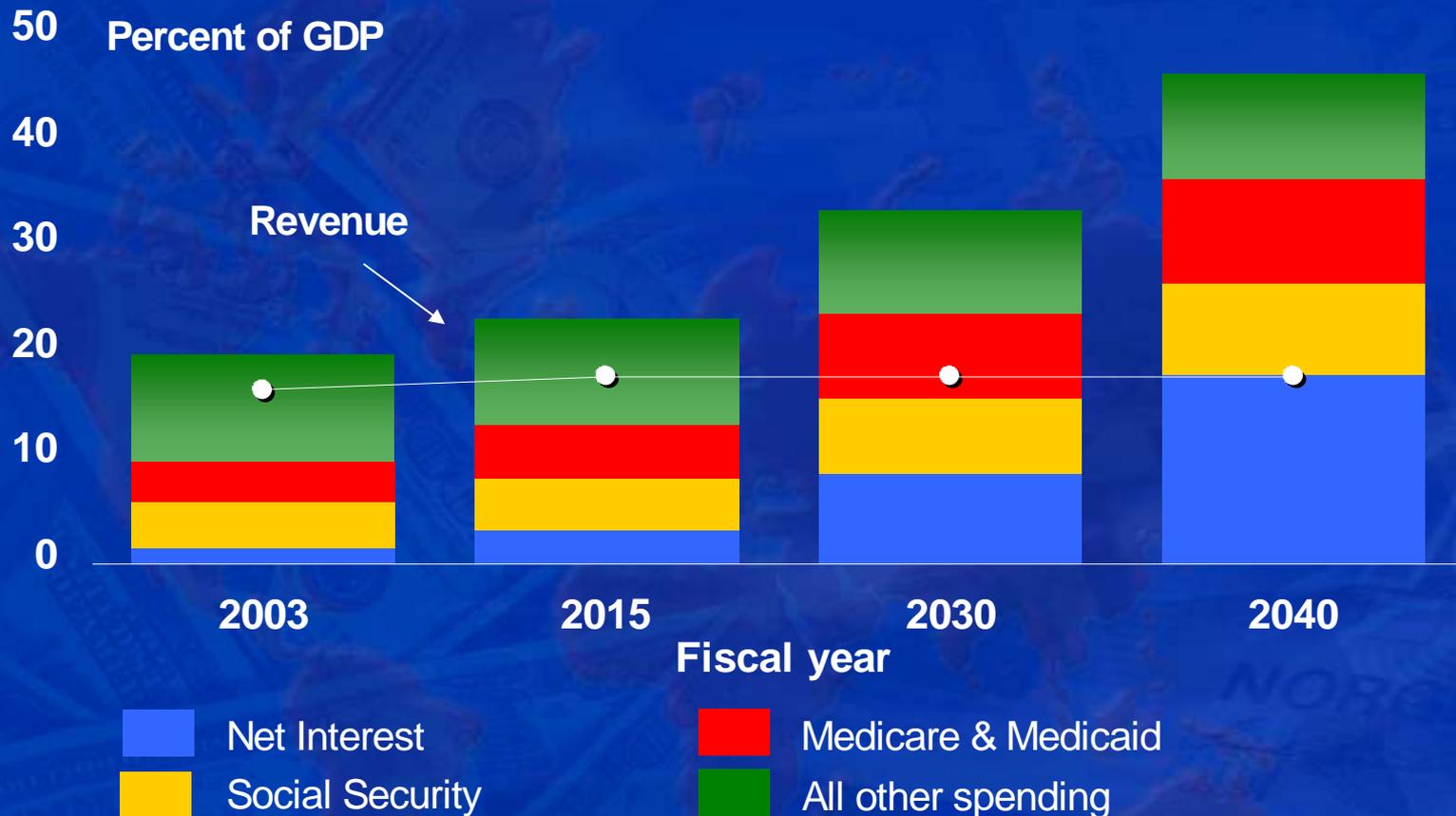


Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant.

Source: GAO's March 2004 analysis.

# Composition of Spending as a Share of GDP

Assuming Discretionary Spending Grows with GDP After 2004 and All Expiring Tax Provisions Are Extended



Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant.

Source: GAO's March 2004 analysis.

# Current Fiscal Policy Is Unsustainable

- **The “Status Quo” Is Not an Option**
  - We face large and growing structural deficits largely due to known demographic trends and rising health care costs.
  - GAO’s simulations show that balancing the budget in 2040 could require actions as large as
    - Cutting total federal spending by about 60 percent or
    - Raising taxes to about 2.5 times today’s level
- **Faster Economic Growth Can Help, but It Cannot Solve the Problem**
  - Closing the current long-term fiscal gap based on responsible assumptions would require real average annual economic growth in the double digit range every year for the next 75 years.
  - During the 1990s, the economy grew at an average 3.2 percent per year.
  - As a result, we cannot simply grow our way out of this problem. Tough choices will be required.
- **The Sooner We Get Started, the Better**
  - Less change would be needed, and there would be more time to make adjustments.
  - The miracle of compounding would work with us rather than against us.
  - Our demographic changes will serve to make reform more difficult over time.

# The Way Forward

- Implement new accounting and reporting approaches and new budget control mechanisms for considering the impact of spending and tax policies and decisions over the long term
- Develop new metrics for measuring the impact of policies and decisions over the long term (e.g., key national indicators to measure our Nation's position and progress over time and in relation to other countries)
- Reexamine the base—question existing programs, policies and activities

# We Need a 3-Pronged Approach

- Restructure existing entitlement programs
- Reexamine the base of discretionary and other spending
- Review and revise our tax policy and enforcement programs

# Rebuilding Public Trust

For any system to work, it must address three fundamental issues.

- First, provide incentives for people to do the right thing.
- Second, provide transparency to help assure that people do the right thing.
- Finally, have effective accountability mechanisms if people don't do the right thing.

Restoring public trust will require that every participant in the corporate reporting supply chain embrace and live by the following core concepts\*

1. A spirit of transparency—stop playing games with financial and performance data. Use full disclosure.
2. A culture of accountability—management, staff, boards, auditors, and stakeholders. High quality, unbiased information to support decision-making.
3. People of integrity—commitment to individual integrity.

\* Excerpts from Building Public Trust: The Future of Corporate Reporting,  
Samuel DiPiazza, Jr. and Robert G. Eccles, 2002

# Key Concepts in the Accountability Profession

- Public vs. personal interests
- Recognizing the difference between the floor (e.g., law, accounting standards) and the ceiling (e.g., principles, values)
- Doing what is right vs. what is acceptable
- Economic substance vs. legal form
- Being concerned with both fact and appearance (e.g., independence)
- Using judgment vs. completing checklists
- Recognizing that continuing improvement in today's rapidly changing world is essential
- Trust is hard to earn, but easy to lose

# Three Key Personal Attributes Needed for These Challenging and Changing Times

- *Leadership*
- *Integrity*
- *Innovation*



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