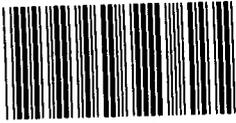


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United States General Accounting Office
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STATEMENT OF
ELMER B. STAATS
COMPTROLLER GENERAL OF THE UNITED STATES
BEFORE THE
TASK FORCE ON GOVERNMENT EFFICIENCY OF THE
HOUSE BUDGET COMMITTEE

HSE 00804

ON

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

Mr. Chairman and Members of the Task Force we appreciate the opportunity to appear here today to discuss GAO's efforts to prevent fraud in Government programs.

GAO has long emphasized fraud prevention and fraud detection in its audit work. Our current efforts in combating fraud began in mid-1976 when we initiated exploratory work to ascertain whether Federal agencies had instituted effective policies and procedures for combating fraud. We believe that the essential elements of such an effort should include:

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- 1 --procedures to assess the vulnerability of the programs in question to see if the agencies were aware of the susceptibility of their programs to fraudulent schemes.
- 2 --the comprehensive collection and analysis of information on known incidents of fraud to determine patterns and trends, and
- 3 --an aggressive effort to follow-up on instances of fraud which would involve not only reactions, but active policing to seek out fraudulent schemes.

Although our review indicated that bright spots existed here and there with respect to individual agency's anti-fraud activities, overall the existence of a serious problem was confirmed.

It is important to stress that while stronger internal audit, inspection and criminal investigation capability is mandatory, it alone is not sufficient to solve the problems. A systematic approach to fraud prevention requires evaluation of the adequacy of management's internal control systems. Close coordination between investigators, auditors and those responsible for program design and execution is required if potentially fraudulent situations are to be examined in any systematic manner.

Each group has an important role to play, but not to the exclusion of the other.

As you know, GAO issued a report in September 1978, 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.

In January 1979 as a response to the problem, I established a Special Task Force for the Prevention of Fraud. This Task Force was asked to perform a three-fold mission. First it was to 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 which I will discuss later in my statement. The second area of Task Force responsibility is what we have labeled "vulnerability assessments." This portion of the effort involves development, on an individual agency by agency basis, of a risk profile of the susceptibility of agency programs to fraud and other illegal activities. Initially we plan to cover

the Department of Labor's Comprehensive Employment and Training Act programs, the Naval Material Command, Small Business Administration, and Community Services Administration. I will also discuss this aspect of our Task Force effort in more detail later in my testimony. The third area of emphasis by the Task Force is the operation of a nationwide toll-free hotline which can be used by citizens anywhere in the country to report instances of fraud in Federal programs. Since the inception of the hotline on January 18, 1979, the Task Force has received 12,000 calls from concerned citizens nationwide.

Based on initial screening, over 6,500 of these allegations warrant further evaluation as to substance for investigation or audit, and have been selected by the Task Force staff for further analysis. To date we have referred over 2,000 of these cases to agency Inspectors General, and 37 cases directly to the Department of Justice. We are monitoring the results of their investigations. From this information we are establishing a computer data base which will be helpful to GAO in its audit of the programs in question. If you will refer to page 3 of the appendix to my statement you will see that the largest number of allegations received relate to social services, and are generally what we characterize as

recipient fraud, i.e., individuals falsifying entitlement to various types of health or welfare benefits.

The other large categories are the Department of Defense-- primarily, alleged irregularities in the procurement of goods and services; and, finally those agencies such as HUD and Labor having large grant programs.

At this point I would like to go into more detail on the initiatives which the Task Force has underway.

OVERVIEW OF FRAUD AND ITS CAUSES

Our overview of fraud and its causes deals with known instances of fraud, its causes, and actions taken by management to prevent its recurrence. In this review we are tracking known fraud back through management and internal control systems and 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, and at what cost. We want to know what control systems have failed thus allowing the fraud to occur. We also want to know what legal and administrative remedies were taken and, conversely if none were taken, why they were not. Finally, we plan to review our traditional concepts of internal control to determine whether the generally accepted controls are valid in today's environment or whether new concepts

and controls are needed. We are working with a universe of more than 130,000 cases of fraud and other illegal activities in 21 departments and agencies. We have taken a statistical sample of some 4,000 cases and are tracking them through systems in each selected agency and in most major programs within each agency.

We encountered a major problem in identifying the universe of cases because Federal agencies do not all define fraud the same way. In order to be consistent in our statistical analysis, we have used a standard working definition of fraud and other illegal activities in requesting data from each department and agency. Our working definition was developed by DOD for its use in responding to the reporting requirements of the Inspector General legislation enacted last year. The definition includes such illegal activities as falsification of documents, submission of false claims, bribery, theft of Government property, and conflict of interest. We are currently working with the Justice Department to come up with a standard definition of fraud that could be used by all Federal agencies in the future.

We have reached the half-way mark in our overview of fraud cases and while it is too soon to draw specific conclusions, it is obvious that most Federal departments and

and agencies have serious management and internal control problems that need correction. Preliminary information indicates that for every proven case of fraud that we have evaluated, at least one basic management or internal control has been violated. In at least one significant case, one of the most valuable and basic of all internal controls-- internal audit, was not being utilized. In other cases control problems have been reported to management with little apparent success.

We are still in the process of precisely defining the problems and it is too soon to tell what remedies are needed. We do know, however, that the problems are many, that too little attention has been paid to them in the past, and, in some cases, a great deal of effort is going to be required to solve them. Because of this, we expect to be making substantive recommendations to the heads of departments and agencies on administrative actions that can be taken to minimize these problems in the future. We also expect to recommend legislative actions needed to improve the fraud prevention capabilities of Federal departments and agencies.

VULNERABILITY ASSESSMENTS

Our second effort, vulnerability assessments, is designed to assess the vulnerability of agencies and their

programs to fraud and other illegal activities. The objective of these assessments is to determine whether agencies selected for audit by the Task Force have adequate systems of internal control to prevent or discourage individuals from intentionally or accidentally misusing Federal assets. Pursuant to the Budget and Accounting Act of 1950, the head of each agency is responsible for establishing and maintaining such systems of control.

According to plan, the Task Force has begun its assessments at all four of the agencies which I mentioned. These agencies were selected for assessment after considering several factors, such as the volume and types of allegations and complaints received over the hotline, audits currently underway, and the results of completed audits of these agencies.

Work at each of the agencies is in different stages. However, it is becoming quite apparent that all of them, to varying degrees, lack necessary controls to minimize the risk of intentional or unintentional misuse of Federal assets. To date, we have observed inadequate internal controls over both administrative and program functions performed by these agencies. Generally, weaknesses relate to inadequate controls over payrolls, procurements, imprest funds,

travel funds, office equipment purchases, computer centers that are processing management information and accounting records, and program funds provided to grantees.

For example, at one agency the payroll system is in the process of being audited by a CPA firm. This is the first audit of the system since it was approved by GAO in 1972. We learned that several employees recently had been caught after defrauding the supplemental manual payroll system of about \$13,000. This happened because there was no supervisory review of work. Our assessment of the regular automated payroll system revealed that many changes had been made to the payroll system computer program; however, none of these changes had been documented as required. Consequently, it was virtually impossible to find out how well the system was controlled.

At the same agency we found inadequate internal controls over travel advances. Over \$4 million of advances were outstanding at the time of our visit. No controls were in place to periodically review the employees' need for these advances. Furthermore, controls were sufficiently loose that employees could receive duplicate advances. Also employees could quit without their advances being reviewed and the amounts deducted from their last payroll check. In fact, this was happening.

In another instance the imprest fund (which is like a petty cash fund) operated by one agency was not adequately controlled. In essence, we found no accountability for receipts and disbursements into and from the fund. As a result, disbursements were being made from the fund based on signatures of unauthorized individuals. Practically anybody could have obtained money illegally from the fund.

At one office in an agency we observed inadequate internal control over procurements and management of property after purchase. For example, individuals had complete control of the total process of ordering merchandise, supplies or equipment; receiving them; and putting them into the property management system. We found 10 of 23 accountable assets that had been purchased were never recorded in the property management system. In addition, the accountable property officer is totally responsible for taking his own physical inventory to verify that all property for which he is responsible is still in the office. Some of the items could not be found by us when we took a physical inventory.

At the completion of our work at each agency, we plan to report the results of our assessments to the Congress, and make recommendations for improving internal controls to the agency head.

Many of the agencies have similar internal control deficiencies. We believe this may be indicative of the seriousness of the lack of internal controls Government-wide. Because of this, 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.

After the Task Force completes its assigned work, we will not drop this work. We plan to continue making reviews of agencies' internal control systems to ensure that they are doing an adequate job of assessing the systems. We will report periodically to the Congress on how well the agencies are doing in this regard.

NATIONWIDE HOTLINE

The last area undertaken by the Task Force is the operation of a nationwide hotline. At Senator Sasser's suggestion, we announced the hotline telephone number on January 18th, and after the first 9 months of operation,

(October 15), had written up over 6,800 allegations which were classified as to materiality, agency and program involved, and geographic location. (Complete details are included as an appendix to my statement). In addition, we have received numerous calls that were more appropriately the concern of other Federal agencies or State or local officials that 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 the first group of calls is complete and the follow-up process on these hot-line leads has begun. Additional calls are being received daily, and will be handled by the same process.

Thus far calls have been received from all 50 States, the District of Columbia and a few overseas locations.

A geographic breakdown based on the 4,408 allegations believed to be substantive in our initial screening of 6,751 cases shows some interesting figures. For example, California had the highest rate of substantive allegations with 469, while Vermont and Wyoming had only 2 each. Washington, D.C., (second highest) had 294 followed by Ohio with 202, New York and Pennsylvania with 210 and 199,

and Florida with 196. 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.

More significant is that almost all Government entities are effected. The Department of Health, Education and Welfare (HEW) is high with 993 substantive allegations including the Social Security Administration (Welfare and SSI) with 590 allegations. HEW is followed by the Department of Defense with 760. The next highest are the Department of Labor with 369 and the Department of Housing and Urban Development with 335.

Substantive hotline calls show that allegations were made against Federal employees in 885 cases or 30.5 percent. Federal contractors or grantee organizations were second highest with 655 allegations or 22.5 percent followed by individual recipients of Federal financial assistance with 649 allegations or 22.3 percent.

We also broke down each category by type of incident. For the category Federal employees only, for example, there were 108 allegations of theft, 107 allegations of private use of Government property, 241 reports of working hour abuses, and 224 reports of improper financial transactions.

In 64 percent of the cases, the informant wanted to be anonymous. Only 28 percent of the informants were Federal employees.

I 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 are not interested in developing an investigative capability but would prefer to work with agency Inspectors General to get individual cases investigated. As of September 26, we had referred over 2,000 cases to the Inspectors General for investigation or audit.

In conclusion, I would like to read a quote from our September 19, 1978, report on Fraud in the Government, which I think portrays rather vividly the taxpayer's frustration with the Government's inability to prevent fraud.

"During a recent prosecution of fraud in VA programs in Chicago, the jurors took the unusual step of writing the following letter to the U.S. District Court Judge who presided over the trial. It suggests something about the intangible costs of fraud in Government programs:

Although we the jury realize that the evidence testimony presented in this trial fully supports the guilt of (the defendant) on all counts in this indictment beyond a reasonable doubt, we would like to take this opportunity to express our strong concern about another matter--the obvious ineffectiveness of VA to help prevent fraud crime with respect to utilization of agency benefit funds due to a lack of an adequate audit system. The Government as well as the private sector has a responsibility to eliminate and/or minimize these temptations via effective systems and adequate audits thereof. When we pay our taxes, we, in effect, give the Government a fiduciary trust and they should handle it accordingly."

This concludes my prepared remarks. I will be happy to answer any questions you or other members of the Task Force may have.

FRAUD TASK FORCE
HOTLINE SUMMARY (10/15/79)

Volume of Calls and
Geographic Area - First 9 Months of Operation

We announced the hotline telephone number on January 18th and after the first 9 months of operation, (October 15), had written up over 6,800 allegations which require classification as to materiality, agency and program involved, and geographic location. In addition to the above, we have received numerous calls that were more appropriately the concern of other Federal agencies or State or local officials that were referred but not written up. Computer analysis of the first group of calls written up is complete and the follow-up process on these hotline leads has begun. Additional calls are being received daily, and will be handled by the same process.

Calls have been received from all 50 States, the District of Columbia and overseas locations.

A geographic breakdown based on the 4,408 allegations believed to be substantive in our initial screening of 6,751 cases is as follows:

Location of Reported Activities

294	Washington, D.C.	31	Minnesota
75	Alabama	61	Mississippi
16	Alaska	137	Missouri
49	Arizona	24	Montana
50	Arkansas	22	Nebraska
469	California	15	Nevada
78	Colorado	17	New Hampshire
22	Connecticut	88	New Jersey
7	Delaware	31	New Mexico
196	Florida	210	New York
150	Georgia	83	North Carolina
8	Hawaii	16	North Dakota
22	Idaho	202	Ohio
103	Illinois	66	Oklahoma
62	Indiana	40	Oregon
32	Iowa	199	Pennsylvania
28	Kansas	14	Rhode Island
78	Kentucky	28	South Carolina
68	Louisiana	19	South Dakota
19	Maine	169	Tennessee
118	Maryland	195	Texas
77	Massachusetts	21	Utah
150	Michigan	2	Vermont

224 Virginia
140 Washington
38 West Virginia
42 Wisconsin
2 Wyoming
25 Overseas
76 Missing Codes

Affected Government Entity

Executive Branch

167 Department of Agriculture
54 Department of Commerce
118 Department of Defense (other than Air Force,
Army, Navy)
151 Department of the Air Force
239 Department of the Army
252 Department of the Navy
45 Department of Energy
359 Department of Health, Education and Welfare
(other than SSA, OE, NIH, FDA)
590 Social Security Administration (Welfare, SSI)
44 Office of Education
15 National Institutes of Health
335 Department of Housing and Urban Development
133 Department of the Interior
104 Department of Justice (other than FBI)

7 Federal Bureau of Investigation
 369 Department of Labor
 22 Department of State
 105 Department of Transportation
 57 Department of the Treasury (other than IRS)
 360 Internal Revenue Service
 8 ACTION
 2 Civil Aeronautics Board
 45 Community Services Administration
 4 CONRAIL
 1 Consumer Product Safety Commission
 68 Environmental Protection Agency
 17 Equal Employment Opportunity Commission
 1 Export-Import Bank of the United States
 6 Farm Credit Administration
 12 Federal Communications Commission
 2 Federal Deposit Insurance Corporation
 2 Federal Election Commission
 2 Federal Home Loan Bank Board
 8 Federal Trade Commission
 122 General Services Administration
 3 Interstate Commerce Commission
 21 National Aeronautics and Space Administration
 3 National Science Foundation
 2 Securities and Exchange Commission

36 Small Business Administration
26 Tennessee Valley Authority
26 United States Civil Service Commission
153 United States Postal Service
200 Veterans Administration
1 The President of the United States
1 The White House Office
1 National Security Council
3 Central Intelligence Agency

Legislative Branch

8 Congress
9 General Accounting Office
5 Government Printing Office
7 Library of Congress

Other

10 D.C. Government
51 Other Federal Agencies
16 Missing Agency Codes

Mix of Calls -- Substantive vs. Non-substantive

Approximately 40 percent of all calls received appear to have some substance and are written up for further evaluation. After additional screening approximately 65 percent of those written up appear to have some substance for investigation or audit. For example, of 6,751 allegations

that have received an initial screening, 4,408 appear to have some substance for investigation or audit. Of the 4,408, about 34 percent are in the "mismanagement" category, while the remaining 66 percent (2,906 allegations) appear to involve intentional wrongdoing.

Types of Allegations Received

Other than those of a non-substantive nature and those that did not appear to involve the expenditure of Federal funds, hotline allegations fell into one of two categories:

- instances of apparent mismanagement, and
- instances of intentional wrongdoing.

In summarizing the allegations of wrongdoing, we found it useful to categorize them according to the participants in the alleged improper activity. We established the following six activity participant categories:

1. Federal employees only
2. Federal employees in conjunction with others
3. Federal contractors or grantee organizations
4. Corporate recipients of Federal financial assistance
5. Individual recipients of Federal financial assistance
6. Other individuals or corporate entities.

Of the 2,906 allegations of wrongdoing, the highest proportion, 31 percent, was in the participant category "Federal employees only." The table below shows the number and proportion of total wrongdoing allegations falling in each of the six participant categories.

<u>Participating Category</u>	<u>No. of Allegations</u>	<u>Percent of Total</u>
1. Federal Employees only	885	30.5
2. Federal employees in conjunction with others	249	8.6
3. Federal contractors or grantee organizations	655	22.5
4. Corporate recipients of Federal financial assistance	14	.5
5. Individual recipients of Federal financial assistance	649	22.3
6. Other individuals or corporate entities	<u>454</u>	<u>15.6</u>
	<u>2,906</u>	<u>100.0</u>

Looking first at the "Federal employees only" category we found that there were 108 allegations of theft, 107 allegations of private use of Government property, 241 reports of employee working hour abuses, 224 reports of improper financial transactions, and 205 reports of other improper activities.

In the second category, that of "Federal employees in conjunction with others" there were 141 allegations of a bribe or kickback having been paid, 5 allegations of extortion and 103 miscellaneous other allegations.

In the "Federal contractor/grantee" category there were 281 allegations of improper expenditure of Government grant funds, 57 allegations of contract non-performance, 64 reports of the theft of Government funds or property and 253 other allegations of various natures.

The 14 allegations that fell into the category "Corporate recipients of Federal financial assistance" generally involved the improper receipt of subsidy funds.

The fifth category, "Individual recipients of Government financial assistance" included 182 allegations of welfare cheating, 114 of cheating on social security benefit eligibility, 141 on collecting inappropriate disability benefits, 43 of cheating on veterans benefits, 33 instances of food stamp cheating, 41 of medicare/medicaid cheating and 95 miscellaneous allegations.

The sixth and final category, "Other individuals or corporate entities" included 298 allegations of personal and corporate income tax cheating, and 156 other allegations of improper activity.

The allegations of wrongdoing that were received to date involve the funds of every one of the 12 cabinet departments of the Federal Government and involve activity in Washington, D.C., and all 50 States.

In 64 percent of the cases, the informant was anonymous. Twenty-eight percent of the informants were Federal employees.

REFERRALS MADE AS OF 10/19/79

HEW	577	DOT	76
DOL	225	DOE	30
HUD	204	Commerce	25
DOD	332	Justice	37
IRS	161	Treasury	31
VA	117	SBA	21
GSA	93	NASA	10
USDA	134	LEAA	17
Post Office	86	GAO	24
Interior	88	CSA	37
EPA	56	OMB	3
NRC	2	Merit System	3
		TVA	17

D.C. Government 4

TOTAL REFERRALS 2,410