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UNITED STATES GENERAL ACCOUNTING OFFICE

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STATEMENT OF
ELMER B. STAATS, COMPTROLLER GENERAL
UNITED STATES GENERAL ACCOUNTING OFFICE
BEFORE THE
SUBCOMMITTEE ON LEGISLATION AND NATIONAL SECURITY
COMMITTEE ON GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES
CONCERNING [FEDERAL AGENCIES' ACTIONS
TO IMPROVE AUDIT RESOLUTION SYSTEMS]

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Mr. Chairman and subcommittee members:

We are pleased to be with you today to discuss the results of our Government-wide review of Federal agencies' actions to strengthen systems for resolving findings in agency audit reports. With me are Mr. Donald L. Scantlebury, Director of our Accounting and Financial Management Division, and Mr. William J. Schad, Assistant Manager of our Chicago regional office.

My testimony today will summarize the major issues addressed in the report "Disappointing Progress in Improving Systems for Resolving Billions in Audit Findings," issued to you, Mr. Chairman, on January 23, 1981. The report follows up on our October 1978 report on this subject which resulted in subcommittee hearings and a committee report in 1979.

Last June you asked us to determine whether departments and agencies have systems in place that conform with the Office of Management and Budget (OMB) policy guidance on audit resolution contained in Circular A-73 and the recommendations of the GAO and House Committee reports. Your subcommittee believed agency management had sufficient time to take necessary actions.

Our review shows that improper and delayed audit resolution is widespread and worsening and is generally caused by agencies' failure to comply with OMB's policy guidance in Circular A-73. The Government is losing billions of dollars because agencies are not acting on audit recommendations to recover funds, avoid cost, and improve operations. Although many of the 71 agencies we

studied have taken some action since 1978 to improve their systems, progress overall has been disappointing.

MAGNITUDE OF THE AUDIT RESOLUTION PROBLEM

In our 1978 report we identified over 14,000 audit reports in 34 agencies containing unresolved findings involving potential recoveries, rebates, revenues, or savings of more than \$4.3 billion. This time we identified nearly 11,000 audit reports at the same agencies containing unresolved monetary findings of \$14.3 billion. These reports also contained thousands of procedural recommendations that would improve Government operations and have a substantial dollar impact as well.

Of the \$10 billion increased in unresolved findings, \$7.6 billion were regulatory audit findings of the Department of Energy. These do not represent potential budgetary savings. Rather, the findings represent potential rebates to customers from oil refiners and other firms that violated energy regulations.

The remaining \$2.4 billion increase is in unresolved non-regulatory audit findings. Among the agencies that reported large increases in this category were the Environmental Protection Agency, Community Services Administration, and the Departments of Agriculture, Air Force, Commerce, Interior, and Labor. Part of the \$2.4 billion increase occurred because some agencies installed tracking systems or improved existing ones. For example, the Air Force figure rose dramatically because monetary findings are now tracked, as they should be, until agency auditors verify that corrective action has been taken.

Our current report also identifies \$170 million in unresolved findings at agencies not in our 1978 report and \$10.5 billion in nearly 17,000 unresolved contract proposal audits. Contract proposal audits, as the name suggests, examine estimated labor, material, overhead, subcontract and general administrative costs of contract price proposals to determine if the contractor's estimates are reasonable and proper.

We consider the preceding numbers to be conservative and believe they would be even higher if agencies kept better records of audit findings. For instance, the Departments of the Army and Navy, which together reported over \$1 billion in monetary findings in fiscal 1979, were unable to provide the amount of unresolved findings. The figures for many other agencies, including most of the large ones, are understated because findings are not tracked until final disposition.

Whatever the true figure, we caution the subcommittee not to assume that all dollars associated with unresolved audit findings are potentially returnable to the Treasury. As already discussed, regulatory and contract proposal findings represent potential rebates to the public and cost avoidance by the Government. Additionally, findings are sometimes settled without a return of funds or program officials reject them for valid reasons.

IMPROVEMENTS NEEDED IN AUDIT RESOLUTION SYSTEMS

Much more needs to be done to ensure prompt and proper audit resolution. Most agencies' audit resolution processes

are deficient in one or more respects. We identified eight needed improvements.

- First. Audit resolution systems must be established and maintained for an accurate and complete record of audit findings until final disposition. When audit findings are not tracked or are prematurely dropped from the tracking system, administrators often overlook final settlement, or assume that findings are completely resolved when they are not.
- Second. Accounting and collection controls must be instituted to ensure that all amounts determined to be due the Government as a result of audit are established as receivables and recovered in accordance with the Federal Claims Collection Standards.
- Third. Decisions to act on audit findings must be made within 6 months and final disposition should proceed rapidly. Audit findings are seldom so complex that program officials need more than 6 months to determine a course of action. Once officials agree to the corrective action needed, they should proceed quickly. For each day a needed improvement is delayed, the Government incurs unnecessary cost.
- Fourth. Findings must be resolved according to laws and regulations, including written justification and the legal basis for decisions not to act on both monetary and procedural findings. The OMB guidance on this matter does not

mention procedural findings, but we believe it should since these findings often result in improved Government operations.

- Fifth. Procedures must be established and followed for elevating to agency heads, or their designees, disagreements between program managers and auditors and reports on which responsible officials have not provided a written determination within 6 months. This will increase auditors' and manager's accountability for prompt and proper action on findings.
- Sixth. Reports must be made to the agency head, at least semiannually, on the age and amounts of unresolved findings and results of findings closed during the period. Few agencies are able to report the ultimate disposition of audit findings because of inadequate tracking and control systems.
- Seventh. Systems must cover findings in all audits of agency activities, including but not limited to those in audits of contractors, subgrantees, and regulated activities. These findings amount to billions of dollars and deserve the same careful consideration as other audit findings.
- Eighth. Procedures must be established for coordinating corrective actions with other affected organizations. Many audit findings involve more than one program, agency, or level of government and require coordination to eliminate the associated deficiencies.

Appendix I of this testimony specifies the agencies at which each of these improvements are needed and Appendix II illustrates the need for each improvement.

Our detailed review at 10 agencies demonstrates how these 8 system deficiencies have resulted in delayed or improper audit resolution. For 193 of 249 audit findings our staff examined, officials failed to act promptly or properly to correct problems or improve operations. Problems exist to some degree at all 10 agencies and involved audits of grants, contracts, subsidies, and agency operations. A number of recent agencies' own audit reports also describe similar faulty resolution systems, particularly regarding long delays and improper management resolution action.

The impact of the system deficiencies at the Department of Defense seem to be the most significant. In fiscal 1981, \$142.7 billion, almost 25 percent of the national budget, went to defense. The new administration is expected to increase this outlay.

In 1979 the full committee recommended that the Secretary of Defense review its audit resolution system and report the result to the committee by December 31, 1979. The review was to have specifically evaluated the propriety of actions taken by procurement officials on audit reports. This was not done. In late 1979, however, DOD did draft a directive for audit resolution. Issuance was delayed until January 1981 because of management's objections to including contract audit findings in the audit resolution system.

The final DOD directive, issued a few days before the date of our report, applies only to internal audits of department operations. That is, contract audit findings are still not subject to Circular A-73 requirements. The directive states that another directive will be developed addressing appropriate followup procedures on recommendations in contract audit reports.

We can only partially illustrate the magnitude of excluding contract audits from Circular A-73 guidance. For contract proposal audits alone, we identified \$10 billion of unresolved findings at the Defense Contract Audit Agency. Within that Agency, there is an additional \$1.9 billion of unresolved contract audit findings generally involving incurred cost and defective pricing.

FACTORS IMPEDING PROMPT AND EFFECTIVE AUDIT RESOLUTION

You asked that we determine why agencies have not corrected deficiencies in their audit resolution systems. I believe that deficiencies will remain until: (1) OMB provides stronger leadership to agencies for improving their systems; (2) Federal executives and managers are held more accountable for this essential management responsibility; (3) and agency auditors appropriately develop and report audit findings and question the adequacy of managers' resolution proposals and actions.

To OMB's credit, it made audit resolution one of nine issues in the former administration's financial priorities program, stressed its importance at meetings with agency heads, and revised Circular A-73. These were important actions, but OMB could have

done more. In 1979 testimony before this subcommittee, the former OMB Director said that the agency needed to extend its oversight beyond issuing guidelines. He said OMB would review audit resolution systems as part of the budget process, but we understand this has not occurred.

Had OMB reviewed agencies' audit resolution systems, it would have learned as we did, that agencies are not complying with Circular A-73 and that clarification is needed in its provisions to ensure: complete reporting to agency heads, applicability of the Circular to all findings, and conformity with laws and regulations of all decisions not to act on findings.

We expected that OMB's review of agencies' resolution systems would have meant that an agency's budget would be adjusted if OMB concluded that the agency's progress in improving its system was unsatisfactory. Such action would be a strong incentive for managers and administrators to properly resolve audit findings.

The lack of individual accountability at the program level prompted your full committee to recommend that the Director of the Office of Personnel Management require executive agencies to include the timeliness and adequacy of audit resolution in the performance criteria of Senior Executive Service officials. We believe this standard should also be in the performance criteria of merit pay staff. Nonetheless, as we reported in 1978, Senior Executive Service and other management officials are still not sufficiently accountable for their actions in resolving findings.

Few agencies include audit resolution in the performance standards of those responsible for resolving audit findings. In some cases responsibility rests with officials who have inappropriate backgrounds or have conflicting duties. Regarding the latter, we have illustrations where the officials responsible for inappropriate expenditures of Federal funds were permitted to reject findings that recommended the funds be recovered. Agency officials have promised to correct these problems by strengthening audit resolution systems, but have not done so.

Accountability must be strengthened now. Bonuses and merit pay should, in part, be based on officials' effectiveness in resolving audits quickly and appropriately. In strengthening accountability, agencies need to take legal or administrative action against grantees and other funding recipients who do not account for expenditures or otherwise do not comply with the conditions under which they receive Federal funds.

Finally, auditors can do more to encourage prompt and proper resolution by reporting accurate and complete findings. Doing so will increase the likelihood that management will take appropriate resolution action. In the cases we reviewed, the cause and effect of discrepant conditions were not always developed fully and clearly. The benefits of auditing are lost and the credibility of auditors is

damaged when findings are poorly developed. Also, satisfactory corrective action becomes more difficult.

RECOMMENDATIONS

Mr. Chairman, our report sets forth recommendations to the Director of OMB, the heads of Federal agencies, and the directors of agency audit organizations. Specifically, we recommend that the Director, OMB:

--Include oversight of agency audit resolution practices in the budget review process to provide (1) an assessment of progress in establishing, revising, and implementing resolution systems, (2) an adjustment of agency budget allowances where appropriate, and (3) a report to the Chairpersons of the House and Senate Committees on Appropriations on progress and action plans.

We also recommend that OMB:

--Clarify Circular A-73 so that (1) it provides that periodic reports to agency heads include complete details on the resolution of findings and on the age and amounts of unresolved findings, (2) it applies to all audit reports, including but not limited to contract, subgrantee, and regulatory audits, and (3) it requires written determinations and the legal basis for decisions not to act on both procedural and monetary findings.

We recommend that agencies:

--Further improve audit resolution policies, procedures, and practices to comply strictly with the intent and spirit of

OMB guidelines, designating a top level manager to coordinate these efforts and prepare progress reports for OMB.

--Take legal or administrative actions against the parties involved whenever audit findings concern fraud, waste, or abuse of Federal funds.

--Make the timeliness and quality of audit resolution a written performance standard and a factor in determining bonuses for Senior Executive Service members and merit pay for supervisors.

We also recommend that the inspectors general and directors of audit agencies develop internal organizational procedures and controls for efficient and effective planning, coordinating, reviewing, and reporting of audit work and audit follow up activities in accordance with GAO and other professional standards.

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This concludes my prepared statement. My colleagues and I will be pleased to respond to any questions you or other members of the subcommittee may have.