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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

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October 18, 1982

The Honorable Jack Brooks
Chairman, Legislation and
National Security Subcommittee
Committee on Government Operations
House of Representatives



119805

The Honorable John D. Dingell
Chairman, Subcommittee on
Oversight and Investigations
Committee on Energy and Commerce
House of Representatives

Subject: Budget Implications of Savings Reported in the
Third Summary Report Issued by the President's
Council on Integrity and Efficiency (GAO/AFMD-83-14)

This report is in response to your August 17, 1982, requests (encls. I and II) for a review of the President's Council on Integrity and Efficiency's third "Summary Report of Inspector General Activities." The summary report covers the 6-month period ending March 31, 1982, and was intended to highlight the significant impact--measured in terms of savings, improved use of funds, and increased effectiveness of Federal programs--which the Inspectors General (IG's), the Council, and the administration have had in combating fraud, waste, and mismanagement in Government. The numerical data in this and the two earlier Council reports have been widely publicized by the President and the news media. A portion of the second report was also included in the Office of Management and Budget's (OMB's) "Major Themes and Additional Budget Details, Fiscal Year 1983."

The President's Council on Integrity and Efficiency was established by Executive order in March 1981 to strengthen the IG program and spearhead the administration's campaign to reduce fraud and waste in Federal programs and operations. Council membership consists of the statutory IG's; representatives of the Departments of Defense (DOD), Justice, and the Treasury; the Federal Bureau of Investigation; and the Office of Personnel Management. The Council is chaired by the Deputy Director of the Office of Management and Budget.

In summary, we found that the Council's third report is an improvement over its two previous reports. It provides clearer definitions and more explanatory information on the statistics contained in its data tables. However, better disclosure in the areas of budgetary savings, preaward contract audit results,

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and actual recoveries would improve future Council reports. More specifically we found that

- the \$5.8 billion represents management commitments that may result in savings, but not necessarily budgetary savings,
- Defense Contract Audit Agency (DCAA) preaward audits differ from IG audits and should be reported separately, and
- management commitments to act on recommendations only partially measure IG and agency effectiveness and do not ensure recovery or other action.

OBJECTIVES, SCOPE, AND METHODOLOGY

Because of the similarity of the audit work desired and the time constraints imposed, your offices agreed that a single, joint addressee report be issued. Based on the issues raised in your request letters and subsequent discussions with your offices, we agreed to review

- the propriety of relying on the \$5.8 billion reported as direct savings and improved use of funds in preparing the Federal budget,
- the propriety of including DCAA preaward audit findings as savings, and
- the implications of and Council member reactions to the change in the audit recoveries definition from the second to the third report.

Our audit work consisted of a review and followup of (1) IG, DOD, DCAA, and OMB responses to a GAO questionnaire that requested concerns or comments on including preaward audit findings as savings, and on the change in the audit recoveries definition, (2) OMB data collection sheets and other related correspondence used in preparing the third report, and (3) Council minutes for all meetings held since the second summary report was issued. We also obtained and reviewed copies of DCAA preaward audit reports.

We conducted most of our work at OMB, DOD, and DCAA. The audit was performed from September 2 through October 1, 1982, and was conducted in accordance with generally accepted government auditing standards. Because of the tight time constraints imposed by the Subcommittees, we did only limited work on the issues addressed in this report.

AUDIT FINDINGS DO NOT NECESSARILY RESULT IN BUDGETARY SAVINGS

The Council's reported savings of \$5.8 billion result from audit recommendations to recover funds, improve system controls,

or otherwise make Government programs and operations more efficient, effective, and economical. These recommendations provide useful input for budgetary decisionmaking, even though they frequently do not result in budgetary savings.

GAO defines a budgetary savings recommendation as a

"* * * recommendation requiring a decision which if implemented would result in an increase in revenue or a decrease in spending for a specific budget function and appropriation, or receipt account."

Budgetary savings are not realized until a recommendation is implemented, and an actual increase in revenue or decrease in spending is achieved.

The majority of the \$5.8 billion savings reported by the Council represents costs avoided and management commitments to seek recoveries, and do not necessarily represent budgetary savings. The Council defines costs avoided as

"* * * estimated amounts that will be avoided as a result of management's commitment to implement auditors' recommendations. The funds which will be saved as a result of this commitment may be made available for other, more effective and efficient use by agency management."

Management commitments to seek recoveries represent "funds questioned by the IG which management has agreed are owed the Government."

For summary report purposes, Council members record monetary savings when management agrees to the merits of an audit finding and makes a commitment to take the action necessary to correct the problem noted. For these commitments to have a budgetary effect, agency officials must act upon them and the actions must result in an increase in revenue or a decrease in spending for a specific budget function and appropriation or receipt account. The Council report does not identify these amounts for either costs avoided or management commitments to seek recoveries or claim that its savings figures are budgetary savings. However, the use of these savings in budget documents and in Presidential speeches implies they are budgetary savings. We believe that the Council report should clearly state that these savings do not necessarily represent budgetary savings.

DCAA PREAWARD AUDIT FINDINGS GENERALLY
RESULT IN IMPROVED USES OF FUNDS

DCAA provides advisory financial services to Federal procurement organizations by performing preaward, incurred costs, cost accounting standards, defective pricing, and other contract related audits. It does 90 to 95 percent of the Federal Government's contract audit work at commercial companies and performs audits for all of the agencies included in the Council's reports. Most of DCAA's monetary findings result from preaward audits. These are evaluations of the reasonableness, allowability, and allocability of costs included in contractors' bid proposals. Amounts questioned in these audits normally do not represent monies due the Government. These amounts are reported to the contracting officer who uses the audit results in negotiating a contract price. Also, depending on the type of contract involved, preaward audit monetary findings will not result in dollar-for-dollar savings, even when the full amount questioned is sustained by contracting officers.

Costs avoided, as reported in the first two Council summary reports, did not include preaward contract audit findings. In preparing the third report, the Council redefined costs avoided to include preaward contract audit findings that were sustained. This change is significant because costs avoided represent \$4.9 billion of the \$5.8 billion savings reported by the Council. Further, DCAA's sustained preaward contract audit findings account for \$3.3 billion of the \$4.9 billion costs avoided total.

On one preaward audit report we reviewed, DCAA auditors examined a \$1.2 billion proposal for supplying cruise missile integration kits for various military aircraft. DCAA questioned a total of \$342 million in contractor forecasted direct labor rates and indirect expense costs. During subsequent contract negotiations, \$308 million of the questioned costs were sustained and the proposed contract price was reduced accordingly. The Council reports the questioned costs that were sustained, \$308 million, as savings attributed to the IG's.

GAO sent a questionnaire to 17 IG's and to officials at DOD, DCAA, and OMB to obtain concerns or comments on the propriety of including preaward contract audit results in the savings figures. We received 19 written responses and obtained oral comments from one agency, the Department of Energy. Although DCAA did return the questionnaire, it withheld comment stating that since DOD is responsible for accumulating and reporting DCAA data to the Council, DOD should respond. It did say that it coordinated a response with DOD officials.

Analysis of the responses showed that:

--15 agencies generally agreed that sustained preaward audit findings should be reported as costs avoided and

--5 agencies disagreed or had mixed feelings about including sustained preaward audit findings as costs avoided.

Selected agency arguments for and against including these findings as costs avoided are presented in enclosure III.

The DOD response stated that

"* * * the inclusion of preaward (forward pricing proposals) contract audit results, under the heading 'costs avoided,' in the President's Council on Integrity and Efficiency's third Summary Report of Inspector General Activities appears to be proper."

However, on several previous occasions DOD and DCAA suggested that the Council separate the results of contract audits from IG internal audits. DOD reports this information separately in its semiannual report to the Congress. DCAA contends that the Council's third report format

"* * * does not provide sufficient differentiation between the staff activities of the statutory IG and the operational functions of the contract audit organization in the Department of Defense."

It also believes that presenting this information in two separate and distinct parts would help avoid criticism on duplication of reported savings and provide meaningful data on contract audit savings. The first part would concentrate on the results of IG activities and the second on the results of contract audit operations. The latter section would include contract audits performed by both the IG's and DCAA.

We agree with DOD and DCAA that contract audits are different from other IG audits. Contract audits are mainly advisory and are a part of the procurement function. Further, we believe that contract audit results should be reported separately and fully explained.

MANAGEMENT COMMITMENTS DO NOT ENSURE
RECOVERY OR OTHER ACTION

The Council changed the audit recoveries definition used in the second summary report when it prepared the third report. It made the change to clarify the meaning of the figures reported

and to reduce or eliminate possible misunderstanding or misuse of the figures. A GAO report issued on May 18, 1982, concluded that the comparability and validity of data in the first two Council summary reports were compromised by definitional and other problems. ^{1/} Most Council members generally agreed with the reporting change made.

The second Council report defined audit recoveries as

" * * * amounts recovered through management actions to collect on questioned costs sustained. Recoveries include money or property originally lost through mismanagement, noncompliance with applicable laws and regulations, or malfeasance. This category also includes amounts to be collected as offsets against future awards." (emphasis added)

For the third report, the Council dropped the term "audit recoveries" and substituted "management commitments to seek recoveries" and defined it as "funds questioned by the IG which management has agreed are owed the Government." The report also states that agency management, not the IG, is responsible for the actual recovery of these funds. The new definition emphasizes the process of obtaining management's commitment to take collection actions on amounts considered due the Government, and deemphasizes the actual collection function.

Most Council members agree with the change. Our questionnaire to 17 statutory IG's, OMB, DCAA, and DOD requested comments or concerns on the definition change. Eighteen responses generally supported the change. These responses were very similar to OMB's, which stated that the new definition is not so much a change as a clarification of the amounts which the IG's are responsible for reporting. OMB said it is more appropriate for the IG's to report the financial impact of their work at the point when management has made a commitment to implement auditors' recommendations than to delay reporting the impact of their work until final collection actions have been taken.

Two IG's expressed concerns about the change. The IG at the Department of Housing and Urban Development stated that amounts sustained in one period could be "not sustained" in the next period because the agency determines that the amounts involved are valid expenses and should not be recovered. The Department of Labor IG stated that actual recoveries would be a better indicator of IG results than management commitments to seek recoveries.

^{1/}"Validity and Comparability of Quantitative Data Presented by the President's Council on Integrity and Efficiency on Inspectors General (IG's) Activities," (GAO/AFMD-82-78, May 18, 1982).

We have no major problems with the Council's reporting management commitments to seek recoveries. It is, in fact, an indicator of IG effectiveness. However, we also believe that the Council should report actual recoveries because audit findings are not resolved until sustained questioned costs are actually recovered.

The Council report emphasizes the fact that management is committed to and responsible for recovering monies owed the Government. In a recent report, we concluded that management has been negligent in collecting debts arising from audits. ^{2/} For fiscal 1978 through 1980, 36 Federal agencies recovered only \$278 million (43 percent) of the \$652 million total questioned costs sustained. We concluded that agencies

- are slow to determine the amount of the debt so it can be pursued,
- do not promptly bring debts under accounting control,
- do not effectively monitor collections, and
- rarely pursue debt collection at subrecipient levels.

We also noted a number of poor management practices which, in our opinion, significantly contributed to agencies' inability to collect audit-related debts promptly and effectively. Specifically, we noted that

- agencies are inappropriately "forgiving" debts without a reasonable collection effort,
- the appeals process provides incentives to grantees to delay payment, and
- interest is not charged on delinquent debts.

OMB and the administration are aware of these problems and are working to correct them. OMB has established a special debt collection project under the sponsorship of the President's Management Improvement Council to review the Government's credit management and debt collection policies and practices. In addition, each agency has made a senior management official responsible for audit resolution and followup. These officials track agency action on audit recommendations and provide the Council with figures on unresolved audits and questioned costs sustained.

^{2/} "Federal Agencies Negligent in Collecting Debts Arising from Audits," (AFMD-82-32, Jan. 22, 1982).

The Council presents the figures obtained from the agency followup officials in the Designated Agency Followup Officials section of its summary report.

More recently, on September 29, 1982, OMB issued its revised Circular A-50, "Audit Followup," which provides policies and procedures to executive agencies for following up on reports issued by IG's, other audit organizations, and GAO. It also makes the agency followup officials responsible for developing and implementing systems to track collections, offsets, writeoffs, demands for payment, and other monetary benefits resulting from audits.

CONCLUSIONS AND RECOMMENDATIONS

The Council's third summary report is an improvement over its two previous reports. In general, the information in the various data tables is better defined and the additional footnote disclosures provide meaningful information that was generally not provided in the earlier reports. However, we believe additional changes would further strengthen the report.

The report should clearly state that the \$5.8 billion savings and improved use of funds must not be interpreted as budgetary savings. This would help ensure that the Congress and others do not misinterpret and misuse the figures for costs avoided and management commitments to seek recoveries. Although audit findings may save money and result in more efficient, effective, and economical program management, they do not necessarily result in budgetary savings. Budgetary savings only occur when audit recommendations are implemented and result in an increase in revenue or a decrease in spending for a specific budget function and appropriation or receipt account. We believe that budgetary savings should be reported separately. By providing this information in its report, the Council would improve the report's usefulness to the Congress in general, and to the Congressional budget, authorization, and appropriation committees in particular.

DCAA is an integral part of the day-to-day operation of the procurement function. It conducts preaward and other contract audits for all Council agencies. Since DCAA performs an advisory service and acts as part of a technical advisory team for the contracting officer, we believe that its contract audit results should be reported separately from the internal audit results of the Council members.

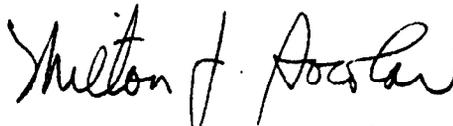
Although IG's are not responsible for the collection function, we believe actual collections measure IG and management impact on Government operations, and that they should be reported in the Council's summary reports. Agency followup officials are responsible for tracking collections and offsets resulting from audits and could provide this data.

We recommend that the President's Council on Integrity and Efficiency

- clearly state that the savings reported do not necessarily represent budgetary savings,
- report separately the budgetary savings that have resulted from IG recommendations,
- report separately and fully explain contract audit results, and
- report actual recoveries (collections and offsets against future awards) in the Designated Agency Followup Officials section of its reports.

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We have not obtained official agency comments on this report. As arranged with your offices, we plan no further distribution of this report until 30 days from its date unless you publicly announce its contents earlier. At that time, we will send copies to interested parties and make copies available to others on request.



Acting Comptroller General
of the United States

Enclosures

JACK BROOKS, TEX., CHAIRMAN
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 222-0147

NINETY-SEVENTH CONGRESS
Congress of the United States
House of Representatives
 LEGISLATION AND NATIONAL SECURITY SUBCOMMITTEE
 OF THE
 COMMITTEE ON GOVERNMENT OPERATIONS
 RAYBURN HOUSE OFFICE BUILDING, ROOM B-373
 WASHINGTON, D.C. 20515
 August 17, 1982

Honorable Charles A. Bowsher
 Comptroller General
 U.S. General Accounting Office
 441 G Street, N.W.
 Washington, D.C. 20548

Dear General:

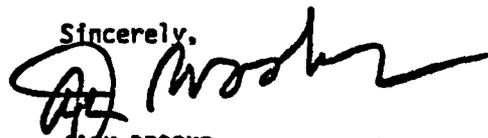
During the last several years, this Subcommittee has monitored the progress of the Inspectors General in their fight against fraud, waste, and abuse. We have read with great interest the three "Summary Reports of Inspectors General Activities" issued by the President's Council on Integrity and Efficiency. These semi-annual reports highlight the government-wide activities of the Offices of Inspector General and were intended to provide a basis for assessing the impact and effectiveness of these organizations. However, in May 1982, your office issued a report (GAO/AFMD-82-78) which disclosed significant problems that affect the validity and comparability of the Council's first and second summary reports. The report also raised concerns about the Council's claim of taxpayer savings of \$2.1 billion resulting from Inspector General activities for the six-month period ending September 30, 1981.

In June 1982, the Council issued its third summary report. Because of the seriousness of the deficiencies you noted in the previous reports, this Subcommittee is concerned about the \$5.8 billion in direct savings in improved use of funds reported as resulting from Inspector General activities. I am interested in an examination of the major components of the \$5.8 billion and your assessment of the actual "hard dollar" savings to the Federal Government. This effort should include determining the types of findings included as cost avoided and management's commitment to seek recoveries. Further, I am concerned about the propriety of including over \$3 billion of Defense Contract Audit Agency pre-award findings in the savings figures.

It would be of great assistance if GAO could review these issues and make recommendations for improving future Council reports on Inspector General activities. It would be helpful if the GAO staff assigned to this effort could meet with my staff as soon as possible to discuss other details about this review. I would appreciate receiving your response by October 15, 1982.

Thank you for your cooperation.

Sincerely,



JACK BROOKS
 Chairman

recovered through management actions to collect on questioned costs sustained" and defined litigation recoveries as "judgments, restitutions, and settlements rendered." The President's Council estimated that audit and litigation recoveries totaled \$406 million for the six-month period ending September 30, 1981.

In comparison, the Third Summary Report does not define recoveries as funds actually collected. Rather, the Council based its \$900 million recovery estimate on commitments of Federal managers to seek recovery of funds.

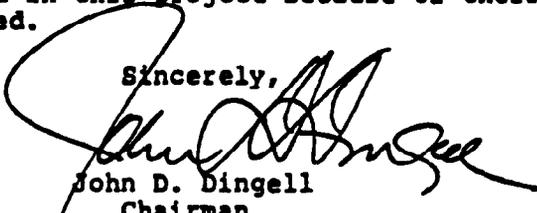
The savings estimates of the First and Second Summary Reports on Inspectors General Activities were relied upon in the preparation of the President's Budget for Fiscal Year 1983 and the Congressional budget resolution for Fiscal Year 1983. It is anticipated that the Third Report on Inspectors General Activities will be considered during the preparation of the President's Budget for Fiscal Year 1984 and the Congressional budget resolution for Fiscal Year 1984. Therefore, I believe that it is extremely important for the General Accounting Office to provide answers to the following questions:

1. Defense Contract Audit Agency pre-award audits.
 - a. Provide examples of typical DCAA pre-award audits.
 - b. Summarize the arguments for and against the inclusion of DCAA pre-award audits in "costs avoided".
 - c. Would pre-award audits be appropriately considered by the President and Congressional committees in calculating reductions in baseline spending?
 - d. Identify any objections raised by representatives of the Defense Department or other agencies to the inclusion of pre-award audits in "costs avoided" by the President's Council on Integrity and Efficiency.
2. Recoveries
 - a. Compare the definitions of recoveries contained in the Second and Third Summary Reports of Inspectors General Activities.
 - b. What definition of recoveries should the President's Council rely upon in preparing the Summary Reports of Inspectors General Activities?

- c. What definition of recoveries could be appropriately considered by the President and Congressional committees in calculating reductions in baseline spending?
- d. Identify any objections raised by the Offices of Inspector General to the redefinition of recoveries contained in the Third Summary Report.

The Subcommittee requests that you provide a letter report in response to this request by October 15, 1982 so that the requested information is available at a timely stage during the preparation of the Fiscal Year 1984 budget. In an effort to expedite your response, we request that David Zylks, Charles Coleman, Thomas Broderick, and Harvey Gold be involved in this project because of their familiarity with the issues involved.

Sincerely,



John D. Dingell
Chairman
Subcommittee on
Oversight and Investigations

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EXAMPLES OF AGENCY CONCERNS AND COMMENTS ON
INCLUDING PREAWARD AUDIT FINDINGS AS SAVINGS

Agency justifications for including preaward audit findings as costs avoided:

- Prevention arises not only from audits of management systems and processes where an IG recommends nonquantifiable improvements but also from audits of contracts, grants, and benefits before they are awarded when an IG recommends reductions in those awards, changed pricing structures, or that the awards not be made. In instances when management accepts the recommendations of the IG, and acts based on these recommendations, it is appropriate to calculate the impact of the IG audit as a "cost avoided." The Council has included the results of preaward audits in the calculation of "costs avoided" with the explicit understanding that "the funds which will be saved as a result of this commitment may be made available for other, more effective and efficient use by agency management." (Office of Management and Budget)
- Preaward audits provide a tangible return to the Government when they result in reducing the cost of a contract or in a decision not to award a contract. Funds saved resulting from preaward audits are often used to award other contracts. The actual return to the Government is the economical and effective use of Federal funds. (Department of Education)
- The preaward audit results represent costs that will not be incurred by the Government as a result of audit recommendations sustained by contracting officers. As such, they are properly classified and reported as costs avoided. The audit results will measure the financial benefits of the IG preaward audit activity. (Veterans Administration)

The arguments against reporting preaward findings:

- The preaward audit results are advisory and are a tool for use by contracting officers in negotiating the final contract. Since cost proposals relate to an intent by the Government to procure services and are not commitments to spend, there is not sufficient justification to consider management concurrences with an audit recommendation as a cost avoided. (Department of Health and Human Services)
- Recoveries resulting from preaward audits are not recoveries in classic audit terms. Audit recoveries usually result from management agreeing to take actions recommended by the auditor to eliminate or reduce significant problems (that is, the payment of unallowable costs or operating deficiencies). (Department of Transportation)

- Preaward findings are difficult to track and subject to interpretation. (Agency for International Development)
- Preaward audits are made of a contractor's proposal and are provided to the contracting officer to assist in the negotiation of the contract. Determinations of cost savings are difficult since both the scope of work and cost are subject to change during negotiations. (Department of Interior)
- The amounts questioned in preaward audits cannot always be compared with negotiated amounts and cannot be reliably determined. Contracts and grant agreements are subject to change and no assurance exists that amounts questioned in preaward audits would not be added after negotiation and award. (Department of Housing and Urban Development)