

GAO

Report to the Chairman, Subcommittee
on Commerce, Consumer Protection,
and Competitiveness, Committee on
Energy and Commerce, House of
Representatives

July 1989

FINANCIAL DISCLOSURE

Navy's Public Disclosure System Generally Works Well but Can Be Improved



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United States
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National Security and
International Affairs Division

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The Honorable James J. Florio
Chairman, Subcommittee on Commerce,
Consumer Protection, and Competitiveness
Committee on Energy and Commerce
House of Representatives

Dear Mr. Chairman:

This report responds to your request that we review the Department of the Navy's implementation of the executive personnel financial disclosure system. Requirements for the system are contained in the Ethics in Government Act of 1978 (P.L. 95-521, Oct. 26, 1978, as amended) and regulations are contained in 5 C.F.R. part 734. The financial disclosure reporting provisions attempt to discourage, identify, and remove conflicts of interest between officials' federal duties and responsibilities and their personal financial interests and activities. Our objectives were to determine whether disclosure reports were filed on time and adequately reviewed; however, as your office requested, we did not include in our review financial disclosure reports for presidential appointees who require Senate confirmation. Appendix I provides details on the objectives, scope, and methodology of our review.

Results in Brief

With minor exceptions the Navy and Marine Corps executive financial disclosure reporting program is working well. We did not find evidence of any conflicts of interest. However, we reviewed a sample of disclosure reports and found that some potential conflicts of interest were not being identified and evaluated because some disclosure report reviewers did not check on whether filers had a financial involvement with affiliates of Department of Defense contractors. We estimate that this resulted in not identifying potential conflicts on about 11 percent of the reports filed for 1987. We reviewed a sample of the potential conflicts which we had identified and found no real conflicts of interest. Two of the three offices involved in implementing the program need to evaluate management controls over the program as required by the Federal Managers' Financial Integrity Act.

Executive Personnel Financial Disclosure Requirements

Title II of the Ethics in Government Act of 1978 requires high level federal executives to publicly disclose their personal financial interests. Regulations promulgated by the Office of Personnel Management at 5 C.F.R. part 734, the Department of Defense Directive 5500.7, and Navy Instruction SECNAVINST 5370.2J prescribe requirements for implementation of the reporting program by the Navy and Marine Corps.

Included among the high level Navy and Marine Corps officials required to submit disclosure reports are (1) presidential appointees, (2) admirals and generals, (3) members of the Senior Executive Service, (4) civil service and special government employees paid at or above the minimum GS-16 pay rate, and (5) employees excepted from the competitive service because their position is of a confidential or policy-making character (schedule C employees). The reports are required to be submitted by (1) incumbent officials by May 15 for the preceding year, (2) new entrants within 30 days of assuming a new position, unless a report which the regulations specify meets this requirement was previously filed, (3) nominees of the President to a position that requires the advice and consent of the Senate within 5 days after transmitting the nomination, and (4) those terminating employment within 30 days after termination, unless they assume certain other federal positions within 30 days of the termination.

Reporting individuals are required to disclose certain assets; income sources; transactions such as purchases, sales, and exchanges of real property or securities; gifts; liabilities; agreements or arrangements with former employers or for future employment; and positions held outside the U.S. government. The reports are to be reviewed by the appropriate Navy or Marine Corps official within 60 days of the date filed. Reviewing officials determine to their satisfaction that each item in the report has been completed and that no interest or position disclosed violates or appears to violate applicable laws and regulations.

Reviewing officials are not required to audit the reports to ensure that all interests have been disclosed. If a reviewing official determines that a conflict of interest or the appearance of a conflict of interest exists, remedial action is required and usually must be completed within 90 days. Remedial actions include divestiture of the conflicting interest, disqualification from particular matters or official actions, restitution, establishment of a qualified trust, request for an exemption or waiver, and transfer, reassignment, limitation of duties, or resignation.

Navy and Marine Corps Program Is Generally Working Well

With minor exceptions the Navy and Marine Corps executive financial disclosure reporting program is working well. The Navy's Office of the General Counsel operates the program for Navy and Marine Corps civilian officials; the Office of the Navy Judge Advocate General operates it for Navy admirals; and the Office of the Marine Corps Judge Advocate Division operates it for Marine Corps generals.

Lists of personnel who are required to file are maintained and updated so that new entrant, incumbent, and termination filers can be notified of the reporting requirement and sent the forms and related information. Officials who make the initial review of the forms—local ethics counselors at various Navy and Marine Corps locations—receive information regarding how to review the reports and some receive specific training. All three offices follow up when a required report is not filed on time, and all said that they have never had an official required to report who failed to comply. All three offices also perform a headquarters level review of reports to, among other things, identify any potential conflicts of interest not identified in the initial local review.

As of late September and October 1988, reports were on file for 828 or 97 percent of the 856 officials on the Navy and Marine Corps master lists of required filers. For 815 of the 828 reports, we were able to determine the required filing deadline and found that 86 percent were filed on time; an additional 7 percent were filed within 30 days of the required filing date; and 7 percent were filed more than 30 days late. Navy and Marine Corps officials informed us in June 1989 that the reports which were not in the files at the time of our check had been located or received. We checked in July 1989 and found that 5 of the 28 missed in our first check of the files were individuals who were not required to file a public disclosure form. One report had been filed with the Office of the General Counsel of the Office of the Secretary of Defense, 9 had been filed on time, 3 had been filed within 30 days of the required filing date, and 10 were filed more than 30 days late. While some reports were filed late, Navy and Marine Corps officials followed up with late filers and were successful in achieving total compliance with the reporting requirement.

As of early October 1988, 89 percent of the 828 reports had been reviewed, 11 percent had been partially reviewed, and less than 1 percent had not yet been reviewed. The Navy and Marine Corps had identified potential conflicts¹ for 323 or 40 percent of the 809 reports for which they had completed determining whether any potential conflicts of interest existed. Table 1 shows the actions that were taken.

Table 1: Types of Actions Taken for Filers With Potential Conflicts

Actions	Number	Percent
Remedial actions (real or apparent conflicts)		
Formal disqualification	10	3
Divestiture	2	a
Exemption	1	a
Cautionary letter (potential conflicts)	318	98

^aLess than 1 percent.

Note: More than one action can be taken for an individual. As a result, there are more actions than reports with potential conflicts.

Although regulations require only real and apparent conflicts to be addressed, it is Navy and Marine Corps policy to send letters cautioning report filers about their involvement with a Department of Defense contractor and about holding any outside position. The purpose of these letters is to alert the filer to the fact that the holding or position is with a concern that could, under other circumstances or if the individuals duties change, give rise to a conflict of interest. For example, the Commanding General of a Marine Base was sent a letter about his stock holdings in AT&T and Bell Atlantic even though his current duties did not bring him into contact with those companies. In another case, a high level official was cautioned about stock holdings in an airline company and two gas and electric companies although his current position did not involve contracting or arranging for travel or gas and electric services. Navy and Marine Corps officials believe cautionary letters reduce the possibility of a conflict occurring in cases where the individuals' duties and responsibilities change.

To identify such potential conflicts, the Navy's Office of the General Counsel and the Office of the Marine Corps Judge Advocate Division compare reported involvements with a Department of Defense list of

¹We consider a conflict of interest to exist whenever a private interest might cause an employee to perform their official duties in a way other than if they did not have the private interest. An appearance of a conflict of interest exists whenever a reasonable person might suspect that the private interest would affect the employee's performance of his or her duties. The Navy considers any financial interest in any company doing business with the Department of Defense as a potential conflict of interest. These interests do not necessarily represent a real or apparent conflict of interest.

contractors with contracts over \$25,000. In addition to this check, the Office of the Navy Judge Advocate General also searches the Directory of Corporate Affiliations² to determine if a corporate affiliate is a defense contractor and thus if a potential conflict exists.

By using a procedure similar to that used by the Office of the Navy Judge Advocate General, we found that 47 of a sample of 108 disclosure reports we reviewed showed 173 financial interests with defense contractors or their affiliates and that 17 of these financial interests had not been identified by the Navy and Marine Corps. We found 12 of the 17 interests using the Directory of Corporate Affiliations. Reviewers had missed the other five on the list of defense contractors. We estimate that the Navy and Marine Corps missed identifying potential conflicts on 11 percent³ of the 1987 reports. As previously noted, the Navy considers any financial interest in a company doing business with the Department of Defense as a potential conflict of interest; however, these interests do not necessarily represent a real or apparent conflict of interest.

We reviewed 26 of the 47 sample reports disclosing a potential conflict of interest in detail and found that 7 reports did not contain all the required information about some reported interests or activities. However, in five of these cases the local ethics counselor either knew or had obtained the additional information from the report filer but had failed to properly record the information on the disclosure form, or the omitted detail was not sufficient to prevent the local ethics counselor from making an informed decision about whether a conflict of interest existed. In the remaining two cases, the local ethics counselor did not obtain sufficient additional information to make an informed decision about whether a conflict of interest existed. In one of these, the underlying assets in an individual retirement account were not disclosed and the local ethics counselor did not find out what they were. In the other, the full names of holdings in mutual funds were not reported and the local ethics counselor did not find out the full names, or whether the funds were diversified and widely held which may mitigate a potential conflict of interest.

²This is a reference volume published by the National Register Publishing Company that lists subsidiaries and affiliates of major U.S. corporations. It covers companies listed on the New York and American Stock Exchanges, those whose stock is traded over the counter, and many privately owned companies.

³We estimate with 95-percent confidence that the Navy and Marine Corps missed identifying interests on between 6 and 18 percent of the 1987 reports.

In two cases where sufficient information had been reported by the filer, the local ethics counselor did not detect that the filer had a reported financial interest in a defense contractor or the affiliate of a defense contractor and, therefore, did not make an informed decision about whether a conflict of interest existed. However, based on our review of the cases and discussions with the officials responsible for reviewing the reports, we did not find evidence that these cases presented a real or apparent conflict of interest.

We also found that the Navy's Office of the General Counsel and the Office of the Marine Corps Judge Advocate Division were not evaluating management controls for executive financial disclosure reporting as part of the Department of Defense's implementation of the Federal Managers' Financial Integrity Act.⁴ Such evaluations were performed by the Office of the Navy Judge Advocate General.

Officials in the Navy's Office of the General Counsel and the Office of the Marine Corps Judge Advocate Division said that they plan to begin using the Directory of Corporate Affiliations in at least the headquarters review of the disclosure reports. In addition, officials of both offices said they plan to begin evaluating management controls for the system as part of their implementation of the Federal Managers' Financial Integrity Act. They also said they plan to emphasize to local ethics counselors the need to obtain and record on the form additional information needed to determine whether a conflict of interest exists.

Conclusions

With minor exceptions the Navy and Marine Corps executive financial disclosure program was working well. However, because the procedures used for identifying potential conflicts were not as thorough for the Navy's Office of the General Counsel, the Office of the Marine Corps Judge Advocate Division, and local ethics counselors as they were for the Office of the Navy Judge Advocate General, some potential conflicts were not detected. We believe all the reviewers should use the Directory of Corporate Affiliations.

Also, local ethics counselors did not always add to the disclosure forms all the information they knew or obtained from individuals about

⁴The Federal Managers' Financial Integrity Act of 1982 requires heads of executive agencies to evaluate their internal control systems against specified standards and report annually to the President and the Congress. If the agency head decides that the agency's systems do not comply with the standards, the report is to identify any material control weaknesses and the agency's plans for correcting them.

reported interests. In addition, reviewers sometimes did not obtain the additional needed detail. We believe all reviewers should obtain and record additional required data on the report forms. Additionally, management controls over the program were not being evaluated by two offices as part of the Navy and Marine Corps Federal Managers' Financial Integrity Act program.

Recommendations

We recommend that the Secretary of the Navy

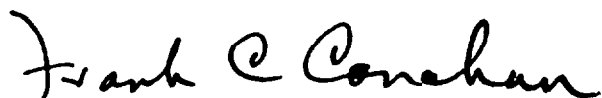
- standardize the use of the Directory of Corporate Affiliations by all Navy and Marine Corps reviewers as an additional means of detecting potential conflicts of interest and
- review management controls over the Navy and Marine Corps executive financial disclosure reporting program in the Navy and Marine Corps implementation of the Federal Managers' Financial Integrity Act.

As your office requested, we did not obtain official comments on this report. However, we discussed the report with officials responsible for the Navy and Marine Corps executive financial disclosure reporting program, and we have incorporated their comments as appropriate.

Unless you publicly announce its contents earlier, we plan no further distribution of this report until 15 days from the date of this letter. At that time, we will send copies to the Chairmen, House and Senate Committees on Armed Services; the Secretary of the Navy; the Director, Office of Government Ethics; and other interested parties. We will also make copies available to others upon request.

This report was prepared under the direction of Harold J. Johnson, Director, Manpower Issues. Other major contributors are listed in appendix II.

Sincerely yours,



Frank C. Conahan
Assistant Comptroller General

Objectives, Scope, and Methodology

The Chairman, Subcommittee on Commerce, Consumer Protection, and Competitiveness, House Committee on Energy and Commerce, requested that we review the Department of Defense's executive personnel financial disclosure system. The Subcommittee subsequently limited the scope of our review to Department of Navy financial disclosure reports requiring review by the Navy without transmitting copies to the Office of Government Ethics. (Copy transmission is required for presidential appointees who require Senate confirmation.) Our objectives were to determine whether officials required to file disclosure reports did so in a timely manner and whether the Navy's review of the reports was adequate.

To evaluate the Navy's system, we obtained the Navy's listing of 856 officials required to file reports for 1987 and reviewed the Navy's files to determine if required filers had submitted reports and had done so within the required time frames. We drew a random sample of 108 reports from the 804 reports on file as of October 24, 1988, in which officials had reported financial interests or activities in organizations other than the federal government and determined if these interests and activities posed potential conflicts of interest. We found 47 of the 108 had interests in Department of Defense contractors which the Navy considered as potential conflicts of interest.

We then reviewed 26 of the 47 reports to determine if (1) the financial interests and activities were reported in sufficient detail to provide full disclosure, (2) the report reviewer had sufficient knowledge of the reporter's personal financial interests, activities, and job responsibilities to make an informed judgment about whether a conflict of interest existed, and (3) the available evidence supported the decision made by the reviewing official. We also discussed the reporting and review process and procedures and internal controls over the process with Navy and Marine Corps officials.

We performed our work at Navy and Marine Corps headquarters and visited or contacted financial disclosure report reviewers at various locations throughout the United States. We conducted our review from August 1988 through June 1989 in accordance with generally accepted government auditing standards.

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